ICEWEB INC
Form 10QSB
August 21, 2006

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED JUNE 30, 2006

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 0-27865

ICEWEB INCORPORATED
(Exact name of small business issuer as specified in its charter)

DELAWARE	13-2640971
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

205 VAN BUREN STREET, SUITE 150, HERNDON, VA 20170
(Address of principal executive offices)

(703) 964-8000
(Issuer's telephone number)

NOT APPLICABLE
(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Check whether the issuer is a shell company as defined by paragraph 12b-2 of the Exchange Act. Yes [ ] No [X]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 8,393,319 shares of common stock issued and outstanding at August 15, 2006.

Transitional Small Business Disclosure Format: Yes [ ] No [X]

IceWeb, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEET

ASSETS	June 30, 2006 (Unaudited)
Current Assets:	
Cash	$ 129,911
Accounts receivable, net of allowance for doubtful accounts of $2,271 at June 30, 2006	504,382
Other receivables	58,838
Prepaid expense	31,591
Other current assets	64,227
Total current assets	788,949
Property and equipment, net of accumulated depreciation of $200,055 at June 30, 2006	117,018
Software development costs, net of accumulated amortization of $206,143 at June 30, 2006	248,194
Goodwill	41,800
Depostis	16,170
Intangibles, net	624,863
Deferred financing cots, net of accumulated amortization	165,000
Total assets	$ 2,001,994
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Accounts payable	$ 988,825
Accrued expenses	146,030
Note payable	471,243
Advances from related party	1,391
Deferred revenues	81,512
Total current liabilities	1,689,001
Notes payable-related parties	229,688
Stockholders' Equity:	
Preferred Stock, $.001 par value; 10,000,000 shares authorized; Series A and B Convertible Preferred stock, par value .001, 3,090,000 shares issued and outstanding	3,090
Common stock; $.001 par value; 25,000,000,000 shares authorized; 8,393,319 issued, and 7,862,711 outstanding	8,393
Treasury stock, at cost, 162,500 shares	(13,000)
Subscription receivable	(50,000)
Additional paid-in capital	9,611,277
Deferred compensation	(417,836)
Accumulated deficit	(9,058,619)
Total stockholders' equity	83,305

Total liabilities and stockholders' equity	$ 2,001,994

See Notes to Unaudited Consolidated Financial Statements.

IceWeb, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three months ended June 30,		Nine months ende June 30,	
	2006	2005	2006	20
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaud
Net sales	$ 835,555	$ 2,049,483	$ 2,970,046	$ 4,9
Cost of goods sold	683,799	1,464,673	2,401,566	3,7
Gross profit	151,756	584,810	568,480	1,1
Operating expenses:				
Research and development	17,936	-	17,936	
Gerneral and administrative expenses	1,012,618	673,465	2,375,639	1,9
	1,030,554	673,465	2,393,575	1,9
Loss from operations	(878,798)	(88,655)	(1,825,095)	(7
Interest expense	(161,403)	(13,424)	(232,869)	(
Other income	-	-	-	
Loss before income taxes	(1,040,201)	(102,079)	(2,057,964)	(8
Net loss	$ (1,040,201)	$ (102,079)	$ (2,057,964)	$ (8
Preferred stock dividend	-	-	(500,000)	(1,0
Loss imputed to shareholders	$ (1,040,201)	$ (102,079)	$ (2,557,964)	$ (1,8
Basic earnings per common share	$ (0.14)	$ (0.02)	$ (0.39)	$
Diluted earnings per common share	$ (0.14)	$ (0.01)	$ (0.39)	$
Basic weighted average common shares outstanding	7,226,854	5,962,657	6,506,433	5,7
Diluted weighted average common shares outstanding	7,226,854	5,962,657	6,506,433	5,7

See Notes to Unaudited Consolidated Financial Statements.

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IceWeb, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine months ended June 30, 2006 (Unaudited)	Nine months ended June 30, 2005 (Unaudited)
Cash flows from operating activities:		
Net loss	$(2,057,964)	$ (813,868)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	648,323	180,807
Allowance for doubtful accounts	(3,575)	(7,600)
Fair value of options issued to employees and consultants	127,976	-
Fair value of shares issued to employees and consultants for services	196,536	-
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	1,076,653	(487,770)
Decrease in other receivables	(58,838)	-
(Increase) decrease in prepaid expenses	(5,612)	(7,400)
(Increase) decrease in intangible assets	(332,874)	572,073
Increase in other assets	(26,657)	(40,437)
Decrease in employee advances	61,302	-
(Decrease) increase in accrued expenses	108,542	(67,002)
Increase in capitalized software development	(454,337)	(129,000)
Increase in deferred revenue	(1,075)	-
Increase (decrease) in accounts payable	177,393	(126,245)
Net cash used in operating activities	(544,207)	(926,442)
Cash flows used in investing activity:		
Purchases of property and equipment	(143,657)	(132,373)
Cash paid in acquisition	(185,247)	-
Net cash used in investing activity	(328,904)	(132,373)
Cash flows from financing activities:		
Payments from (to) related parties	(84,610)	(73,357)
Increase in line of credit	136,780	461,269
Proceeds/Repayments-note payable	14,062	(581,129)
Proceeds for subscription receivable	-	1,700
Payment of financing costs	(52,385)	-
Proceeds from exercise of warrants	400,000	-
Common stock issued for cash	-	468,375
Net preferred stock issued for cash	-	845,836
Proceeds from the exercise of options	32,000	27,300
Net cash provided by financing activities	445,847	1,149,994

Net increase (decrease) in cash	(427,264)	91,179
Cash, beginning of year	557,175	178,781
Cash, end of year	$ 129,911	$ 269,960
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ -	$ -
Cash paid for taxes	$ -	$ -
Non-cash transactions affecting investing and financing actvities:		
Fair value of shares of common stock in consideration for nonmonetary assets and liabilities	$ 100,000	$ -
Fair value of shares issued for services from a retailer and an investor relations firm	$ 456,000	$ -
Conversion of 410,000 shares of Preferred stock to 410,000 shares of common stock	$ 410	$ -
Fair value of shares in partial satsifaction of debt to related parties	$ 126,806	$ -

See Notes to Unaudited Consolidated Financial Statements.

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ICEWEB, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 - ORGANIZATION, BASIS OF PRESENTATION AND GOING CONCERN

IceWEB, Inc., a Delaware corporation ("IWEB" or the "Company") is a diversified technology company headquartered in Herndon, Virginia which was founded in April 2000, became public in April 2002 through a reverse merger, and began trading publicly on the OTCBB under the Trading Symbol "IWEB". The Company is a provider of hosted web-based collaboration solutions that enable organizations to establish Internet, Intranet, and email/collaboration services with little or no up-front capital investment. These enterprise software applications are normally cost prohibitive for Small businesses to deploy so IceWEB's targets these customers with a "Software as a Service" (Saas) recurring monthly service fee. IceWEB has brought these services to market using a "Software as a Service" (Saas) business model. The Company also provides consulting services to our larger enterprise and government customers including network infrastructure, enterprise email/collaboration, and Internet/Intranet portal implementation and support services. IceWEB also markets an array of information technology services and third party computer network hardware and software to large enterprise and government clients.

The financial statements included in this report have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting and include all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation. These financial statements have not been audited.

Certain amounts in the 2005 consolidated financial statements have been reclassified to conform to the 2006 consolidated financial statement presentation. These reclassifications had no impact on previously reported net results of operations or stockholders' equity.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations for interim reporting. The Company believes that the disclosures contained herein are adequate to make the information presented not misleading. However, these financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual Report for the year ended September 30, 2005, which is included in the Company's Form 10-KSB for the year ended September 30, 2005. The financial data for the interim periods presented may not necessarily reflect the results to be anticipated for the year ended September 30, 2006.

The Company's auditor stated in their reports on the financial statements of the Company for the years ended September 30, 2005 and 2004 that the Company is dependent on outside financing and has incurred losses since inception. These factors raise substantial doubt about our ability to continue as a going concern.

For the nine months ended June 30, 2006, the Company incurred net losses of approximately $2.1 million and used cash in operations of approximately $545,000. The accompanying unaudited financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

Management has established plans intended to increase the sales of the Company's products and services. Management intends to seek new capital from new equity securities offerings to provide funds needed to increase liquidity, fund growth and implement its business plan; however, no assurance can be given that the Company will be able to raise any additional capital.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

USE OF ESTIMATES

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates made by management include, but are not limited to, the valuation of derivative liabilities and share-based payments. Actual results will differ from these estimates.

EARNINGS PER SHARE

Basic earnings per share are calculated by dividing income available to stockholders by the weighted-average number of common shares outstanding during each period. Diluted earnings per share are computed using the weighted average number of common and dilutive common share equivalents outstanding during the period. Dilutive common share equivalents consist of shares issuable upon the exercise of stock options and warrants (calculated using the modified treasury stock method). The outstanding options and warrants issuable amounted to 8,033,075 and 7,181,835 at June 30, 2006 and 2005, respectively. The outstanding options, warrants and shares equivalent issuable pursuant to embedded conversion features and warrants at June 30, 2006 and 2005 are excluded from the loss per share computation for that period due to their anti-dilutive effect.

RISKS AND UNCERTAINTIES

The Company maintains its cash and cash equivalent accounts in financial institutions. Accounts at these institutions are insured by the Federal Deposit Insurance Corporation ("FDIC") up to $100,000. During the six-month period ended June 30, 2006, the Company has reached bank balances exceeding the FDIC insurance limit. To reduce its risk associated with the failure of such financial institutions, the Company evaluates at least annually the rating of the financial institutions in which it holds deposits.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of the Company's cash and cash equivalents, accounts payable and accrued expenses and due to stockholder approximate their estimated fair values due to the short-term maturities of those financial instruments. The carrying amount of the derivative liability is based on its fair value. The carrying amount of the convertible notes and bridge notes approximates the estimated fair value for these financial instruments as management believes that such convertible notes constitute substantially all of the Company's debt and the interest payable on the convertible notes approximates the Company's incremental borrowing rate.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY AND EQUIPMENT

Property and equipment, which primarily consists of office equipment and computer software, are recorded at cost and are depreciated on a straight-line basis over their estimated useful lives of three to five years. Maintenance and repairs are charged to expense as incurred. Significant renewals and betterments are capitalized. At the retirement or other disposition of property and equipment, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in other income (expense) in the accompanying statements of operations.

DEFERRED FINANCING COSTS

Deferred financing costs represent costs incurred in connection with the issuance of certain loans. Deferred financing costs are being amortized over the terms of the related debt agreements, which is ten years.

SHARE-BASED PAYMENTS

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which replaces SFAS No. 123 and supersedes APB Opinion No. 25. Under SFAS No. 123(R), companies are required to measure the compensation costs of share-based compensation arrangements based on the grant-date fair value and recognize the costs in the financial statements over the period during which employees are required to provide services. Share-based compensation arrangements include stock options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, or "SAB 107". SAB 107 expresses views of the staff regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods. On April 14, 2005, the SEC adopted a new rule amending the compliance dates for SFAS 123(R). Companies may elect to apply this statement either prospectively, or on a modified version of retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures required for those periods under SFAS 123. Effective January 1, 2006, the Company has fully adopted the provisions of SFAS No. 123(R) and related interpretations as provided by SAB 107. As such, compensation cost is measured on the date of grant as the fair value of the share-based payments. Such compensation amounts, if any, are amortized over the respective vesting periods of the option grant. The Company applies this statement prospectively.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

We previously accounted for stock-based compensation issued to our employees using the intrinsic value method. Accordingly, compensation cost for stock options issued was measured as the excess, if any, of the fair value of our common stock at the date of grant over the exercise price of the options. The pro forma net earnings per share amounts as if the fair value method had been used are presented below for the three months and the six months ended March 31, 2005 and the actual net earnings per share are presented below for the three months and six months ended June 30, 2006 in accordance with the Company's adoption of SFAS 123 (R) effective January 1, 2006.

For purposes of the following disclosures during the transition period of adoption of SFAS 123 (R), the weighted-average fair value of option has been estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used for grants for the three months ended June 30, 2006: no dividend yield; expected volatility 110%; risk-free interest rate of 5.1%; and a expected five-year term for options granted. Had the compensation cost for the nine-months ended June 30, 2005 been determined based of the fair value at the grant, our net income(loss) and basic and diluted earnings(loss) per share would have been reduced to the pro forma amount for that period indicated below. For the quarter ending June 30, 2006, the net income and earnings per share reflect the actual deduction for option expense as compensation. Compensation recorded for stock options is a non-cash expense item.

The following pro forma information is to reflect the change from applying the provisions of FAS 123 and APB 25:

	Nine-months ended June 30, 2006	Nine-months ended June 30, 2005
Net loss	$(2,057,964)	$ (813,868)
Add: Stock-based compensation expense included in reported net (loss) income, net of related tax effects	-	-
Deduct: Total stock-base employee compensation expense determined under fair value based method for all awards, net of related tax effects excluded from net (loss) income:	(-)	(-)
Net loss pro forma	$(2,057,964)	$ (813,868)
Proforma earnings per share:		
Basic	$ (0.30)	$ (0.31)
Diluted	$ (0.30)	$ (0.31)

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ICEWEB, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The fair value of the options granted during the nine-month period ended June 30, 2005 was determined using the Black-Scholes option-pricing model with the following assumptions: risk-free interest of 5.1%; stock volatility of 110%; no dividends; and estimated life of 5 months.

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2005, the Financial Accounting Standard Board ("FASB") issued Statement No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements" (SFAS 154). SFAS 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. We do not believe adoption of SFAS 154 will have a material effect on our financial position, results of operations or cash flows.

In July 2005, the FASB issued FASB Staff Position ("FSP") 150-5, "Accounting Under SFAS 150 for Freestanding Warrants and Other Similar Instruments on Redeemable Shares". FSP 150-5 clarifies that warrants on shares that are redeemable or puttable immediately upon exercise and warrants on shares that are redeemable or puttable in the future qualify as liabilities under SFAS 150, regardless of the redemption feature or redemption price. The FSP is effective for the first reporting period beginning after June 30, 2005, with resulting changes to prior period statements reported as the cumulative effect of an accounting change in accordance with the transition provisions of SFAS 150. We adopted the provisions of FSP 150-5 on July 1, 2005, which did not have a material effect on our financial statements.

In July 2005, the FASB issued EITF 05-6, "Determining the Amortization period for Leasehold Improvements Purchased After Lease Inception or Acquired in a Business Combination", which addressed the amortization period for leasehold improvements made on operating leases acquired significantly after the beginning of the lease. The EITF is effective for leasehold improvements made in periods beginning after June 29, 2005. We adopted the provisions of EITF 05-6 on July 1, 2005, which did not have a material impact to the Company's financial position, results of operations and cash flows.

NOTE 3 - RELATED PARTIES

Stockholders have loans amounting to $25,000 at June 30, 2006, which are non-interest bearing. During the nine months ended June 30, 2006, the Company has issued the note holder 125,000 shares of common stock in exchange for the individual to extend the maturity date of the note by 10 years. The cost associated with these shares has been accounted for as deferred finance charges, and are being amortized over the life of the deferral period. The shares were valued at $200,000 the fair value at the date of issuance. During the nine-month ended June 30, 2006, the Company issued 176,150 shares of common stock to the note holders in partial satisfaction of the notes payable. Such shares were valued at approximately $125,000 based on the quoted market price of the the Company's share of common stock.

The amortization of the deferred financing costs amounted to $35,000 for the nine month period ended June 30, 2006.

The Chief Executive Officer of the Company, from time to time, provides advances to the Company for operating expenses. These advances are short-term in nature and non-interest bearing.

NOTE 4 - STOCKHOLDERS' EQUITY

The Company is authorized to issue 10,000,000 shares of Preferred Stock, par value $.001, with such designations, rights and preferences as may be determined from time to time by the Board of Directors. During the nine-month period ended June 30, 2005, the Company issued 1,666,667 shares of preferred stock for $845,836. There are currently 1,256,667 shares of Series A Preferred Stock issued and outstanding at June 30, 2006.

On December 28, 2005, the Company consummated the sale of 1,833,333 shares of Series B Convertible Preferred Stock to Barron Partners, L.P. and issued the purchaser common stock purchase warrants to purchase an aggregate of 2,250,000 shares of the Company's common stock for an aggregate purchase price of $500,000. The purchase price was paid through the satisfaction of a liability to Barron Partners, L.P. for funds advanced to the Company in September 2005. The Company incurred a "beneficial conversion feature" dividend related to the above transaction in the amount of $500,000.

In the event the Company sells, grants or issues any shares, options, warrants, or any instrument convertible into shares or equity in any form below $2.00 per share the warrant exercise price shall be reduced proportionately at a 20% discount rate of the effective price of such convertible instruments.

Such reduction shall be made at the time such transaction is made, and shall be cumulative upon any other changes to the exercise of the warrants that may already have been made.

No exercise of any warrant can occur if the exercise would result in the holder, Barron Partners LP, and any of its affiliates beneficially owning more than 4.9% of our outstanding common shares following such conversion. Barron Partners LP may waive this provision only with the consent of all of the Series B Preferred Stock Holders and the consent of the holders of a majority of the shares of outstanding Common Stock of the Company who are not affiliates.

NOTE 4 - STOCKHOLDERS' EQUITY (continued)

All of these five-year warrants are exercisable on a cashless basis.

On April 27, 2005, the Company effected a 1 for 80 reverse split of its issued and outstanding common stock. All amounts have been retroactively adjusted to reflect this split.

During the nine-month period ended June 30, 2006, Barron Partners, LP exercised 500,000 warrants at $0.80 per share. The Company received $400,000 in proceeds from the exercise of these warrants.

During the nine-month period ended June 30, 2006, the Company issued 213,877 shares to certain employees, consultants and a US retailer for services. The fair value of the shares amounted to approximately $197,000, based on the quoted price of the Company's share of common stock on the date of issuance. The fair value of such shares has been recognized as sales, general, and administrative expenses.

During the nine-month period ended June 30, 2006, the Company issued 176,120 shares of its common stock to two note holders in partial satisfaction of debt. The fair value of the shares at the date of the partial satisfaction amounted to approximately $127,000 and has reduced the debt by a corresponding amount.

NOTE 5 - STOCK OPTIONS AND COMMON STOCK PURCHASE WARRANTS

During the nine-month period ended June 30, 2006, the Company issued 453,535 shares of common stock to a consultant and a US retailer for services to be rendered. The fair value of the shares amounted to approximately $456,000, based on the quoted price of the Company's share of common stock on the date of issuance. The fair value of such shares has been recognized as deferred compensation and is recognized as a sales, general, and administrative expense over the terms of the agreements, which are one year. The amortization of the deferred compensation amounted to approximately $38,000 during the nine-month period ended June 30, 2006.

During March 2002, the Company adopted the "Management and Director Equity Incentive and Compensation Plan." The maximum number of shares authorized and available under the plan is 1,250,000 shares. Under the terms of the plan, the options expire after 5 years, as long as the employees remain employed with the Company.

Stock Options

During the nine-months ended June 30, 2006 and 2005, the Company had issued 47,500 shares pursuant to the exercise of stock options which generated proceeds of $32,000.

NOTE 5 - STOCK OPTIONS AND COMMON STOCK PURCHASE WARRANTS (continued)

During the nine-month period ended June 30, 2006, the Company issued 500,000 options to employees. Such options were valued at approximately $370,000 at their date of grant. The options were valued based on the Black-Scholes model using the following assumptions: volatility 110%, risk-free interest rate 5%, dividend rate:0%, term 5 years. The fair value of the options was amortized over their vesting terms, which was up to one year. The amortization of the fair value of the options amounted to approximately $128,000 for the nine-month period ended June 30, 2006.

NOTE 6 - ACCOUNTS RECEIVABLE

Accounts receivable consist of normal trade receivables. The Company assesses the collectability of its accounts receivable regularly. During December 2005, the Company entered into a financing agreement with Sand Hill Finance. This agreement gives Sand Hill a security interest in all accounts receivable. The agreement allows the Company to finance up to 80% of receivables under 90 days old.

NOTE 7 - OTHER RECEIVABLES

Other receivables consists of trade receivables for the company PartiotNet, which was acquired in March 22, 2006.

NOTE 8 - SOFTWARE DEVELOPMENT AND SYSTEM DEVELOPMENT COSTS

Under the criteria set forth in SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," capitalization of software development costs begins upon the establishment of technological feasibility of the software. The establishment of technological feasibility and the ongoing assessment of the recoverability of these costs require considerable judgment by management with respect to certain external factors, including, but not limited to, anticipated future gross product revenues, estimated economic life, and changes in software and hardware technology. Capitalized software development costs are amortized utilizing the straight-line method over the estimated economic life of the software not to exceed three years.

As of June 30, 2006, such capitalizable software development costs were approximately $454,337. The amortization of the software development costs amounted to $206,143 during the nine-month period ended June 30, 2006. These costs will be amortized over a period of three years. The Company regularly reviews the value of software development assets and a loss is recognized when the unamortized costs are deemed unrecoverable based on the estimated cash flows to be generated from the applicable software.

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ICEWEB, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 9 - SIGNIFICANT CUMSTOMER INFORMATION AND SEGMENT REPORTING

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, establishes standards for the reporting by business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method for determining what information to report is based on the way that management organizes the operating segments with IceWEB for making operational decisions and assessments of financial performance.

Iceweb's chief operating decision-maker is considered to be the chief executive officer (CEO). The CEO reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. The financial information reviewed by the CEO is identical to the information presented in the accompanying consolidated statements of operations. Therefore, IceWEB has determined that it operates in a single operating segment, specifically, web communications services. For the period ended June 30, 2006 all material assets and revenues of IceWEB were in the United States.

NOTE 10 - CONTINGENCIES

From time to time the Company faces litigation in the ordinary course of business. Currently, we are not involved in any significant litigations.

NOTE 11 - ACQUISITION

PatriotNet, Inc. is a professional Internet Service Provider (ISP) servicing over 3,500 customers with T-1, DSL, dial up lines and email services. In consideration for the purchase of the assets and liabilities including accounts receivable, equipment and intangibles for customer contracts in the amount of $392,325, the Company paid to PatriotNet (a non-related party to Iceweb) of (a) the payment of cash consideration by IOI to PatriotNet of $190,000 at Closing; (b) the issuance by IceWEB of 100,000 shares of IceWEB common stock at Closing, valued at $1.00 dollar per share.

The excess value recorded for the acquisition of PatriotNet over the value of assets received less liabilities assumed has been recorded as customer relationships. Amortization expense for this intangible is provided by using the expected cash flow method for customer relationship capitalized from the date of acquisitions. The acquisition of PatriotNet occurred on March 22, 2006 and the Company has included PatriotNet operations in it's financials from that date.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Part 1

OVERVIEW

The following Management's Discussion and Analysis ("MD&A"), is intended to help the reader understand the results of operations and financial condition of IceWEB. This MD&A is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying notes to the financial statements.

The Company provides hosted web-based collaboration solutions that enable organizations to establish Internet, Intranet, and email/collaboration services with little or no up-front capital investment. These enterprise software applications are normally cost prohibitive for Small businesses to deploy so IceWEB's targets these customers with a "Software as a Service" (Saas) recurring monthly service fee. IceWEB has brought these services to market using a "Software as a Service" (Saas) business model. The Company also provides consulting services to our larger enterprise and government customers including network infrastructure, enterprise email/collaboration, and Internet/Intranet portal implementation and support services. IceWEB also markets an array of information technology services and third party computer network hardware and software to large enterprise and government clients.

The majority of revenue historically has come from professional services, consulting, and hardware/software sales while IceWEB performed the necessary R&D and implementation of our hosted messaging, collaboration, Internet, and other hosted subscription services. Going forward, we will continue to engage in consulting and hardware/software sales; however, the majority of growth is anticipated to be in our "IceWEB Online" services area with products such as IceMAIL, IceVISTA, IcePORTAL, and IceCONNECT.

We intend to sustain the long-term growth of our business through technological innovation, engineering excellence, and a commitment to delivery high-quality product and services to our customers. We are pursuing new customers and revenue sources through our partners and affiliates as well as direct sales to commercial and government customers. We are increasing our use of partners to leverage their existing client base and our combined talents to pursue more online recurring subscription-based services. We are experiencing a greater than 95% retention rate among our subscription-based monthly services such as IceMAIL, IceVISTA, IcePORTAL, and IceCONNECT so every new customer brings us long-term recurring revenue with no recurring cost of sale. Our traditional hardware/software sales and consulting services does, however, continue to be our primary source of revenue at this time and for the next two to three fiscal quarters.

IceWEB has completed several acquisitions over the past five years in an effort to gain technology strength and additional customers. These acquisition have brought computer networking, software development, and Internet-based software service capabilities to the company that were required to expand into the relatively young but prosperous SaaS market.

- In June 2001, IceWEB acquired the assets of Learning Stream, Inc. provider of digital content streaming services. Online educational courses are still available for purchase on the Internet through www.learningstream.com. It is our intention to improve this web site and increate the selection of online courses for sale within the next 3-6 months. One method of accomplishing this is our recent agreement with MindLeaders which will enable IceWEB to greatly expand our available course offerings on the web.

- In June 2003, IceWEB acquired all of the outstanding stock of Interlan Communications, Inc., a provider of data communications and networking solutions for business, government, and education. Interlan provided technical services including presales design and consulting, installation, troubleshooting, and long term maintenance and support contracts. Hardware/software sales and integration services continue to generate revenues for IceWEB based on vendor partners and customer relationships from this acquisition.

- o In June 2003, IceWEB acquired all of the outstanding stock of The Seven Corporation, a provider of network engineering services to commercial and government customers throughout the United States. IceWEB continues to generate revenue from this practice and the customers gained by this acquisition.

- o In October 2003, IceWEB acquired the software ownership rights and customers of Iplicity, Inc. of Virginia. Iplicity had developed a complete content management software platform based on open source architecture to run in any operating environment. In this transaction we acquired software licenses, source code, potential patents and trademarks that were utilizing in developing the current IceVISTA product line.

- o In May 2004 IceWEB acquired substantially all of the assets of DevElements, Inc. of Virginia, a professional IT consultancy firm that designs, develops and implements web-based portal solutions. In this transaction we acquired software licenses, source code, potential patents and trademarks, as well as some cash and tangible assets. Engineering skills, programming code, and revenue from this acquisition are still being leveraged in IceWEB's IceVISTA product.

- o In March 2006, the Company, through its wholly-owned subsidiary, IceWEB Online, Inc., completed the acquisition of substantially all of the assets and some liabilities of PatriotNet, Inc. This brought over 3000 customers with recurring subscription-based services into IceWEB. IceWEB has consolidated customer service and technical personnel to improve overall operational efficiencies within the company. PatriotNet customers and our service offerings continue to generate revenue for the Company and will be sold under the IceCONNECT product/service going forward.

The Company generates revenues from sales of software licenses, hosting of software applications over the Internet, application development, and network management/integration products and services. During fiscal 2005 we have performed a substantial amount of R&D and implementation to introduce new products and services to the market. The combined skills and technology gained from our strategic acquisitions over the past five years has allowed us to bring leading edge enterprise technologies to small and medium sized businesses. We anticipate that our revenues for SaaS subscriptions will exceed our legacy hardware/software sales and integration in fiscal 2007.

We believe that the key factors to our continued growth and profitability include the following:

- o The introduction of our IceWEB Vista portal software which was released June 2005 combined with web portal systems and customers from PatriotNet.

- o The launch of IceMAIL in December metricconverterProductID2005, a2005, a packaged service that provides a network-hosted groupware, email, calendaring, and collaboration solution utilizing Microsoft Exchange, the most widely used enterprise messaging system available.

- o The introduction of the IcePORTAL service in Q4 of FY2005 based on Microsoft SharePoint which will integrate with IceMAIL and provide small business customers with a complete collaboration solution when combined with IceMAIL.

- o Continued focus on developing strategic partnerships with key retail and small business solution providers such as CompUSA, Simply Wireless, and

Intelligent Office--all of which entered into sales and marketing agreements with IceWEB in July 2006 to sell IceMAIL, IcePORTAL, and IceVISTA.

- Raising approximately $4 million of additional working capital to expand our marketing, support our growth and for an acquisition of an additional company in the software services group.

- Hiring additional qualified technical employees

RESULTS OF OPERATIONS

NINE MONTHS ENDED JUNE 30, 2006 AS COMPARED TO NINE MONTHS ENDED JUNE 30, 2005

	For the Nine Months Ended June 30, 2006	2005	Increase/ (Decrease) in $ 2006 vs 2005	Increase/ (Decrease) in % 2006 vs 2005
Net Sales	2,970,046	4,987,776	$(2,017,730)	-40.5%
Cost of goods sold	2,401,566	3,789,535	(1,387,969)	-36.6%
Gross Profit	568,480	1,198,241	(629,761)	-52.6%
Operating expenses:				
Research and development	17,936	-	17,936	NM
General and administrative expenses	2,375,639	1,987,031	388,608	19.6%
Loss from operations	(1,825,095)	(788,790)	1,036,305	131.4%
Interest expense	232,869	44,361	188,508	NM
Other incomes	-	19,283	(19,283)	NM
Net loss	(2,057,964)	(813,868)	$(1,244,096)	152.9%

NM: Not meaningful

Revenues

The decrease in the revenues during the nine-month period ended June 30, 2006 when compared to the prior year period is due to a number of factors. The business of two divisions, integration and critical power which resell third party equipment, represents approximately 55% of top line revenue, is very cyclical. Both divisions experienced higher then usual customer delays on forecasted business for this period. The company is in the process of restructuring its business in order to limit and/or remove the impact of these third party influenced scenarios by shifting focus to internally developed products and services. The company expects revenues to grow from internally developed products and services, despite the restructuring away from third party product sales. The company also continues to target strategic acquisitions to assist in this growth, as well as continued marketing for its products and services.

Cost of Sales

The decrease in cost of sales during the nine-month period ended June 30, 2006 when compared to the prior period is commensurate with our decrease in revenues.

Research and development expenses
The increase in research and development expenses is primarily due to our amortization of research and development expenses, which up to March 31, 2006, were capitalized. No such expenses were amortized during the ine-month period ended June 30, 2005.

Sales, general and administrative expenses

Our sales, general and administrative expenses consists of personnel costs, including commissions, public relations, advertising, marketing programs, lead generation, travel and trade shows as well as rent, legal, accounting, human resources, telecommunications, office supplies and other costs related to our corporate governance and compliance with the reporting requirements of publicly held companies.

The increase in sales, general, and administrative expenses is primarily due to the following:

Issuance of shares to employees and third parties amounting to approximately $197,000 as well as the amortization of the fair value of the stock options issued to employees amounting to approximately $128,000. No such expenses occurred during the nine-months ended June 30, 2005.

We anticipate that general and administrative expenses will continue to remain flat or decline during the balance of fiscal 2006, with the exception of share-based paymentsthat the Company may incur from time to time. The acquisition of PatriotNet should not increase the sales, general and administrative cost of the Company. The Company has already made adjustments to operations of PatriotNet to eliminate redundant overhead.

Amortization expense for intangibles will continue to be substantially lower due to the expensing of approximately all of the $1,800,000 previously recorded goodwill in the prior periods. Amortization expense is provided by use of the straight-line method over five years for IceMail software development costs and the remaining customer relationships capitalized during acquisitions.

Interest Expense

Interest expense consists primarily of the amounts accrued on our revolving credit line with Comerica Bank and notes payable to related parties. The decrease in interest expense for the nine-month period ended June 30, 2006 is primarily due to having a lower weighted-average debt during the nine-month period ended June 30, 2006 when compared to the prior year period.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is the ability of a company to generate funds to support its current and future operations, satisfy its obligations and otherwise operate on an ongoing basis.

Net cash used in operating activities amounted to approximately $545,000 during the nine-month period ended June 30, 2006.

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The net cash used in operating activities consist of our net loss, which amounted to approximately $2.1 million adjusted for the following:

- Depreciation and amortization of approximately $649,000
- Fair value of options issued to employees and consultants of approximately $128,000
- Fair value of shares issued to employees and consultants for services rendered of approximately $197,000
- Decrease in accounts receivable of $1.1 million resulting from lower revenues
- Acquisition of intangible assets of approximately $332,000
- Capitalization of research and development expenses of approximately $454,000 resulting from greater resources allocated to research and development to develop internally new products
- A decrease in accounts payable of approximately $177,000 due to a better cash flow position than in the prior periods.

Net cash used in investing activities for the nine months ended June 30, 2006 was $328,904 and is primarily due to a cash outlay to acquire Patriot for approximately $185,000 and incurring capital expenditures of approximately $144,000.

Net cash provided by financing activities amounted to approximately $446,000 during the nine-month period ended June 30, 2006 and is primarily due to the generation of proceeds of $400,000 from the exercise of warrants, and increase in the line of credit of approximately $137,000, offset by payments made to related parties of approximately $84,000.

At June 30, 2006 we had an accumulated deficit of approximately $9.0 million and the report from our independent registered public accounting firm on our audited financial statements at September 30, 2005 contained an explanatory paragraph regarding doubt as to our ability to continue as a going concern as a result of our net losses and cash used in operations. There are no assurances that we will report net income in any future periods.

Historically, our revenues have not been sufficient to fund our operations and we have relied on capital provided through the sale of equity securities, a bank line of credit and loans from related parties. While we do not have any working capital commitments, we do not presently have any external sources of working capital. Our working capital needs in future periods depend primarily on the rate at which we can increase our revenues while controlling our expenses and decreasing the use of cash to fund operations. Additional capital may be needed to fund acquisitions of additional companies or assets, although we are not a party to any pending agreements at this time and, accordingly, cannot estimate the amount of capital which may be necessary, if any, for acquisitions.

As long as our cash flow from operations remains insufficient to completely fund operations, we will continue depleting our financial resources and seeking additional capital through equity and/or debt financing. In March 2005 we sold shares of our Series A Convertible Preferred Stock and in December 2005 we sold shares of our Series B Convertible Preferred Stock to the same purchaser. The designations of these shares included a restriction that so long as the shares are outstanding, we cannot sell or issue any common stock, rights to subscribe for shares of common stock or securities which are convertible or exercisable into shares of common stock at an effective purchase price of less than the then conversion value which is presently $0.60 per share for the Series A Convertible Preferred Stock and $0.2727 for the Series B Convertible Preferred Stock. Under the terms of the Series B Convertible Preferred Stock transaction we also agreed not to issue any convertible debt or preferred stock. Finally, under the terms of the financing agreement with Sand Hill Finance, LLC we agreed not to incur any additional indebtedness other than trade credit in the ordinary course of business. These covenants may limit our ability to raise capital in future periods. There can be no assurance that acceptable financing can be obtained on suitable terms, if at all. Our ability to continue our existing operations and to continue growth strategy could suffer if we are unable to raise the additional funds on acceptable terms which will have the effect of adversely affecting our ongoing operations and limiting our ability to increase our revenues and maintain profitable operations in the future. If we are unable to secure the necessary additional working capital as needed, we may be forced to curtail some or all of our operations.

CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, which was released by the U.S. Securities and Exchange Commission, encourages all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Our consolidated financial statements include a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. Management believes the following critical accounting policies affect the significant judgments and estimates used in the preparation of the financial statements.

Revenue Recognition - revenues are recognized at the time of shipment of the respective products and/or services. Our Company includes shipping and handling fees billed to customers as revenues. Costs of sales include outbound freight. Licenses and software are billed as services are rendered on a biweekly schedule.

Use of Estimates - Management's discussion and analysis of financial condition and results of operations is based upon our unaudited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates, including those related to allowances for doubtful accounts receivable and the carrying value of intangibles and long-lived assets. Management bases these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

ITEM 3. CONTROLS AND PROCEDURES

Our management, which includes our Chief Executive Officer and Chief Financial Officer have conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-14(c) promulgated under the Securities and Exchange Act of 1934, as amended) as of a date (the "Evaluation Date") as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective for timely gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Securities Exchange Act of 1934, as amended. There have been no changes made in our internal controls that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting based on such evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During March 2006, we issued 10,031 shares to an employee for services rendered. The fair value of the shares amounted to $11,536.

During March 2006, we issued 100,000 shares to a consultant for investor relations services. The fair value of the shares amounted to $100,000.

During April 2006, we issued 150,000 shares to two employees for services rendered. The fair value of the shares amounted to $111,536.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER EVENTS

On August 16th G. Tony Munno, the President of the company and Brian Crooks, The Chief Financial Officer of the company resigned effective immediately.

ITEM 6. EXHIBITS

Exhibit No.	Description
Exhibit 31.1	Certification of Principal Executive Officer pursuant to Section 302
Exhibit 31.2	Certification of Principal Financial Officer pursuant to Section 302
Exhibit 32.1	Certification of Principal Executive Officer pursuant to Section 906
Exhibit 32.2	Certification of Principal Financial Officer pursuant to Section 906

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

IceWEB, Inc.

Dated: August 21, 2006

By: /s/ John R. Signorello

John R. Signorello,
Chairman and CEO,
Principal Executive Officer