Sugarmade, Inc.
Form 10-Q
May 15, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
þ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 2013

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from N/A to N/A

Commission file number: 000-23446

SUGARMADE, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or jurisdiction of incorporation or organization)	94-3008888 (I.R.S. Employer Identification No.)
2280 Lincoln Avenue, Suite 200, San Jose CA (Address and of principal executive offices)	95125 (Zip Code)

888-747-6233
(Registrant's telephone number, including area code)

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

At May 13, 2013 there were 9,238,526 shares outstanding of the issuer's common, the only class of common equity.

Transitional Small Business Disclosure Format (Check one): Yes o No þ

SUGARMADE, INC.
FORM 10-Q
FOR THE PERIOD ENDED MARCH 31, 2013

TABLE OF CONTENTS

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q includes forward-looking statements. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words "believe," "expect," "will," "anticipate," "intend," "estimate," "project," "plan," "assume" or other similar expressions, or negatives of those expressions, although not all forward-looking statements contain these identifying words. All statements contained or incorporated by reference in this quarterly report regarding our future strategy, future operations, projected financial position, estimated future revenues, projected costs, future prospects, the future of our industry and results that might be obtained by pursuing management's current plans and objectives are forward-looking statements.

You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Our forward-looking statements are based on the information currently available to us and speak only as of the date on the cover of this quarterly report, or, in the case of forward-looking statements in documents incorporated by reference, as of the date of the date of the filing of the document that includes the statement. New risks and uncertainties arise from time to time, and it is impossible for us to predict these matters or how they may affect us. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such difference might be significant and materially adverse to our security holders. We do not undertake and specifically decline any obligation to update any forward-looking statements or to publicly announce the results of any revisions to any statements to reflect new information or future events or developments.

We have identified some of the important factors that could cause future events to differ from our current expectations and they are described in this quarterly report under the caption "Risk Factors," below, and elsewhere in this quarterly report which you should review carefully. Please consider our forward-looking statements in light of those risks as you read this quarterly report.

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary
Condensed Consolidated Balance Sheets

	March 31, 2013 (Unaudited)	June 30, 2012
Assets		
Current assets:		
Cash	$158,335	$192,100
Accounts receivable, net	28,820	18,700
Inventory, net	262,432	88,798
Other current assets	19,130	45,125
Total current assets	468,717	344,723
Equipment, net	3,788	5,257
Other assets	3,994	3,994
Total assets	$476,499	$353,974
Liabilities and Stockholders' Deficit		
Current liabilities:		
Note payable due to bank	$150,000	$150,000
Accounts payable and accrued liabilities	361,798	221,020
Accrued interest, including amounts due to related parties of $29,195	55,892	-
Notes payable due to shareholder	86,000	-
Accrued compensation and personnel related payables	343,339	43,722
Production line of credit	284,000	-
Total current liabilities	1,281,029	414,742
Convertible notes payable, net	363,413	-
Convertible notes payable to related parties, net	118,621	-
Total liabilities	1,763,063	414,742
Stockholders' deficit:		
Preferred stock ($0.001 par value, 10,000,000 shares authorized, none issued and outstanding)	-	-
Common stock ($0.001 par value, 300,000,000 shares authorized, 10,538,526 and 10,288,526 shares issued and outstanding at March 31, 2013 and June 30, 2012, respectively)	10,539	10,289
Additional paid-in capital	8,406,610	8,069,581
Accumulated deficit	(9,703,713)	(8,140,638)
Total stockholders' deficit	(1,286,564)	(60,768)

Total liabilities and stockholders' deficit	$476,499	$353,974

The accompanying notes are an integral part of these condensed consolidated financial statements

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary
Condensed Consolidated Statements of Operations (Unaudited)

	For the three months ended March 31, 2013	For the three months ended March 31, 2012	For the nine months ended March 31, 2013	For the nine months ended March 31, 2012
Revenues, net	$51,645	$84,498	$165,569	$123,996
Cost of goods sold:				
Materials and freight costs	36,161	69,207	111,162	82,589
Provision for inventory obsolescence	-	-	40,851	-
Total cost of goods sold	36,161	69,207	152,013	82,589
Gross margin	15,484	15,291	13,556	41,407
Operating expenses:				
Selling, general and administrative expenses	327,870	634,962	1,442,549	3,246,786
Amortization	-	4,601	-	13,802
Total operating expenses	327,870	639,563	1,442,549	3,260,588
Loss from operations	(312,386)	(624,272)	(1,428,993)	(3,219,181)
Non-operating income (expense):				
Interest expense:				
Related parties	(35,349)	-	(53,004)	-
Other	(44,684)	(1,146)	(81,468)	(1,146)
Total Interest Expense	(80,033)	(1,146)	(134,472)	(1,146)
Interest income:				
Other	124	-	390	1,222
Total non-operating income (expense)	(79,909)	(1,146)	(134,082)	76
Net loss	$(392,295)	$(625,418)	$(1,563,075)	$(3,219,105)
Basic and diluted net loss per share	$(0.04)	$(0.06)	$(0.15)	$(0.31)
Basic and diluted weighted average common shares outstanding used in computing net loss per share	10,538,526	10,372,000	10,492,906	10,294,385

The accompanying notes are an integral part of these condensed consolidated financial statements

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)
For the nine months ended March 31, 2013 and 2012

	2013	2012
Operating activities:		
Net loss	$(1,563,075)	$(3,219,105)
Adjustments to reconcile net loss to cash flows from operating activities:		
Amortization	-	13,802
Depreciation	1,469	1,122
Share based compensation	142,191	184,177
Issuance of common stock for services	98,545	1,590,950
Issuance of warrants with convertible notes	96,543	-
Changes in operating assets and liabilities:		
Accounts receivable	(10,120)	(48,250)
Inventory	(173,634)	(121,751)
Other assets	25,995	(255,367)
Accounts payable and accrued liabilities	140,778	92,296
Accrued interest	55,892	-
Accrued compensation and personnel related payables	299,617	1,301
Net cash used in operating activities	(885,799)	(1,760,825)
Investing activities:		
Purchase of equipment	-	(27,143)
Net cash flows used in investing activities	-	(27,143)
Financing activities:		
Proceeds from issuances of common stock and warrants	-	609,260
Borrowings from note payable to bank	-	50,000
Borrowings from production line of credit	284,000	-
Proceeds from issuance of convertible notes payable	363,413	-
Proceeds from issuance of convertible notes payable to related parties	118,621	-
Issuance of notes payable	86,000	-
Net cash provided by financing activities	852,034	659,260
Net decrease in cash	(33,765)	(1,128,708)
Cash, beginning of period	192,100	1,606,764
Cash, end of period	$158,335	$478,056
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$25,003	$1,146

The accompanying notes are an integral part of these condensed consolidated financial statements

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

1. Summary of significant accounting policies

Nature of business

Sugarmade, Inc. (hereinafter referred to as “we”, “us” or “the/our Company”) is a publicly traded company incorporated in the state of Delaware. Our previous legal name was Diversified Opportunities, Inc. Our Company, Sugarmade, Inc. operates through our subsidiary, Sugarmade, Inc., a California corporation (“Sugarmade-CA”). Our Company is principally engaged in the business of marketing and distributing environmentally friendly non-tree-based paper products. We are parties to an Exclusive License and Supply Agreement (“LSA”) with Sugar Cane Paper Company (“SCPC”), a company located in the People’s Republic of China. SCPC is one of Sugarmade’s original contract manufacturers and SCPC is a holder of intellectual property rights and patents in the area of developing and manufacturing paper from non-wood sources. We also obtained the rights (within the designated territories) to the Sugarmade™ brand name and trademarks. Historically, Sugarmade has leveraged this relationship and corresponding agreement to initially insure production and management of its products. Presently, Sugarmade has been able to diversify its manufacturing and process management options to include other third party contract manufacturers. Sugarmade-CA’s primary product is 100% tree-free copy paper in various sizes, however our Company plans to offer other tree-free paper products in the future.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the United States Securities and Exchange Commission for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes necessary for a comprehensive presentation of financial position, results of operations, or cash flows. It is management's opinion however, that all material adjustments (consisting of normal recurring adjustments) have been made which are necessary for a fair financial statement presentation. The results for the interim period are not necessarily indicative of the results to be expected for the full year.

These condensed consolidated financial statements should be read in conjunction with our Company’s Annual Report on Form 10-K for the year ended June 30, 2012, which contains our audited consolidated financial statements and notes thereto, together with the Management’s Discussion and Analysis of Financial Condition and Results of Operation, for the period ended June 30, 2012. The interim results for the period ended March 31, 2013 are not necessarily indicative of the results for the full fiscal year.

Principles of consolidation

The condensed consolidated unaudited financial statements include the accounts of our Company and its wholly-owned subsidiary, Sugarmade-CA. All significant intercompany transactions and balances have been eliminated in consolidation.

Going concern

The Company sustained continued operating losses during the nine months ended March 31, 2013 and for the year ended June 30, 2012. The Company’s continuation as a going concern is dependent on its ability to generate sufficient cash flows from operations to meet its obligations, in which it has not been successful, and/or obtaining additional financing from its shareholders or other sources, as may be required.

Our condensed consolidated financial statements have been prepared assuming that we will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, our auditors raised concerns about our ability to continue as a going concern in their opinion on our financial statements at and for the year ended June 30, 2012. These condensed consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result should the Company be unable to continue as a going concern.

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

Management is endeavoring to increase revenue generating operations. While priority is on generating cash from operations through the sale of the Company's products, management is also seeking to raise additional working capital through various financing sources, including the sale of the Company's equity and/or debt securities, which may not be available on commercially reasonable terms to our Company, or which may not be available at all. If such financing is not available on satisfactory terms, we may be unable to continue our business as desired and our operating results will be adversely affected. In addition, any financing arrangement may have potentially adverse effects on us and/or our stockholders. Debt financing (if available and undertaken) will increase expenses, must be repaid regardless of operating results and may involve restrictions limiting our operating flexibility. If we issue equity securities to raise additional funds, the percentage ownership of our existing stockholders will be reduced and the new equity securities may have rights, preferences or privileges senior to those of the current holders of our common stock.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires our 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 period. Actual results could differ significantly from those estimates.

Revenue recognition

We recognize revenue in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") No. 605, Revenue Recognition. Revenue is recognized when we have evidence of an arrangement, a determinable fee, and when collection is considered to be probable and products are delivered. This generally occurs upon shipment of the merchandise, which is when legal transfer of title occurs. In the event that final acceptance of our product by the customer is uncertain, revenue is deferred until all acceptance criteria have been met. We currently have a consignment arrangement with two of our customers. We record revenue on consignment goods when the consigned goods are sold by the consignee and all other above mentioned revenue recognition criteria have been satisfied. Cash deposits received in connection with the sales of our products prior to their being delivered is recorded as deferred revenue.

During the year ended June 30, 2012, we became aware of quality issues surrounding our copy paper products. We were able to trace the reported problems with paper quality back to manufacturing issues with our third party contract manufacturer. Our Company has since implemented additional quality assurance procedures both during and at the completion of the production processes. During the nine months ended March 31, 2013, our Company had limited sales as we continued producing and delivering replacement product, in addition to disposing of the product containing the quality issues. For the three months ended March 31, 2013, we sold the remaining sub-quality paper to a third party wholesaler specializing in the liquidation of excess inventory. This sale represented approximately 18% of our revenue for the quarter. As we had recorded an inventory reserve for this product, we recognized revenue with no corresponding cost of goods sold.

Cash

From time to time, we may maintain bank balances in interest bearing accounts in excess of the $250,000 currently insured by the Federal Deposit Insurance Corporation for interest bearing accounts (there is currently no insurance limit for deposits in noninterest bearing accounts). We have not experienced any losses with respect to cash. Management believes our Company is not exposed to any significant credit risk with respect to its cash.

Accounts receivable

Accounts receivable are carried at their estimated collectible amounts, net of any estimated allowances for doubtful accounts. We grant unsecured credit to our customers deemed credit worthy. Ongoing credit evaluations are performed and potential credit losses estimated by management are charged to operations on a regular basis. At the time any particular account receivable is deemed uncollectible, the balance is charged to the allowance for doubtful accounts. Since we cannot necessarily predict future changes in the financial stability of our customers, we cannot guarantee that our allowance for doubtful accounts will be adequate.

From time to time, we may have a limited number of customers with individually large amounts due. Any unanticipated change in a customer's creditworthiness could have a material effect on our results of operations in the period in which such changes or events occurred. Accounts receivable at March 31, 2013 and June 30, 2012 was $28,820 and $18,700 (net of allowance for doubtful accounts of $1,220), respectively, all of which we expect to be collectible.

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

Inventory

Inventory consists of finished goods paper and paper-based products ready for sale and is stated at the lower of cost or market. We value our inventory using the weighted average costing method. Our Company's policy is to include as a part of inventory any freight incurred to ship the product from our contract manufactures to our warehouses. Outbound freights costs related to shipping costs to our customers are considered period costs and reflected in selling, general and administrative expenses. Outbound freight costs to customers totaled $16,019 and $50,628 for the three and nine months ended March 31, 2013, respectively, and $26,888 and $39,288 for the three and nine months ended March 31, 2012. We regularly review inventory and consider forecasts of future demand, market conditions and product obsolescence. If the estimated realizable value of our inventory is less than cost, we make provisions in order to reduce its carrying value to its estimated market value. During the fourth quarter of fiscal 2012, our Company became aware of quality issues surrounding its copy paper products. As a result of these quality issues, we determined that the historical inventory values were not realizable and we recorded a reserve for inventory obsolescence. We completed our review of impacted inventory during the second quarter of fiscal 2013, and recorded additional reserves at that time. For the three months ended March 31, 2013, we continued to dispose of reserved inventory either through sales to a third party liquidator or where it was impractical to sell the inventory, we donated the product to third party charitable organizations. There were no additional reserves recorded during the third quarter ended March 31, 2013. As of March 31, 2013 and June 30, 2012, the balance for the inventory obsolescence reserve totaled $37,708 and $195,880, respectively.

Other current assets

Other current assets consist mainly of prepaid insurance, deposits and other related expenses.

Equipment

Equipment is stated at cost, less accumulated depreciation. Expenditures for maintenance and repairs are charged to expense as incurred. Items of equipment with costs greater than $1,500 are capitalized and depreciated on a straight-line basis over their estimated useful lives ranging from 3-7 years.

Intangible assets

We had intangible assets related to the exclusive license and supply agreement ("LSA") with Sugar Cane Paper Company. During the year ended June 30, 2012, we performed a review of the LSA including estimations of the likely future cash flows to be derived from the LSA. Upon completing the review, it was management's assessment that due to changes in our Company's manufacturing process, enhancements to the product formulation and the limitations on the credit facility, the fair value of the intangible asset had been impaired to the level that the asset has negligible remaining value. As such, our Company recorded an impairment charge totaling $318,983 for the remaining value of the license and supply agreement as of June 30, 2012.

Valuation of long-lived assets

We evaluate long-lived assets for impairment whenever events or changes in circumstances indicate their net book value may not be recoverable. When such factors and circumstances exist, we compare the projected undiscounted future cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amount. Impairment, if any, is based on the excess of the carrying amount over the fair value, based on market value when available, or discounted expected cash flows, of those assets and is recorded in the period in which the determination is made. As noted above, for the year ended June 30, 2012, it was determined that the carrying value of our intangible assets should be zero and we recorded an impairment charge for the full carrying value.

Income taxes

We provide for federal and state income taxes currently payable, as well as for those deferred due to timing differences between reporting income and expenses for financial statement purposes versus tax purposes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in income tax rates is recognized as income or expense in the period that includes the enactment date.

The accounting guidance for uncertainties in income tax prescribes a comprehensive model for the financial statement recognition, measurement, presentation, and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The Company recognizes a tax benefit from an uncertain tax position in the financial statements only when it is more likely than not that the position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits and a consideration of the relevant taxing authority's widely understood administrative practices and precedents.

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

Stock based compensation

Stock based compensation cost is measured at the date of grant, based on the calculated fair value of the stock-based award, and will be recognized as expense over the employee's requisite service period (generally the vesting period of the award). We estimate the fair value of employee stock options granted using the Black-Scholes-Merton Option Pricing Model. Key assumptions used to estimate the fair value of stock options will include the exercise price of the award, the fair value of our common stock on the date of grant, the expected option term, the risk free interest rate at the date of grant, the expected volatility and the expected annual dividend yield on our common stock. We use comparable public company data among other information to estimate the expected price volatility and the expected forfeiture rate. Non-employee stock grant costs are measured and recognized upon completion of performance and tied to the contractual obligations of the parties we transact with.

Loss per share

We calculate basic loss per share ("EPS") by dividing our net loss by the weighted average number of common shares outstanding for the period, without considering common stock equivalents. Diluted EPS is computed by dividing net loss by the weighted average number of common shares outstanding for the period and the weighted average number of dilutive common stock equivalents, such as options and warrants. Options and warrants are only included in the calculation of diluted EPS when their effect is dilutive.

Fair value of financial instruments

The Company follows guidance for accounting for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. Additionally, the Company adopted guidance for fair value measurement related to nonfinancial items that are recognized and disclosed at fair value in the financial statements on a nonrecurring basis. The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

Advertising

We expense advertising costs as incurred. Advertising and promotion totaled $2,292 and $9,001 during the three and nine months ended March 31, 2013. For the three and nine months ended March 31, 2012, advertising and promotions totaled $17,253 and $26,692, respectively. We have no existing arrangements under which we provide or receive advertising services from others for any consideration other than cash.

Concentration

Customers

For the three and nine months ended March 31, 2013, our Company earned net revenues of $51,645 and $165,569, respectively. A significant portion of our Company's revenue is derived from a small number of customers. For the three and nine months ended March 31, 2013, sales to three of our Company's customers accounted for 73% and 84% of net sales, respectively.

Suppliers

For the three and nine months ended March 31, 2013, all of our tree free paper products were purchased from SCPC and their contract manufacturers.

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

Litigation

From time to time, we may become involved in disputes, litigation and other legal actions. We estimate the range of liability related to any pending litigation where the amount and range of loss can be estimated. We record our best estimate of a loss when the loss is considered probable. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, we record a charge equal to at least the minimum estimated liability for a loss contingency when both of the following conditions are met: (i) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements and (ii) the range of loss can be reasonably estimated.

Recent Developed Accounting Pronouncements

Effective January 2013, we adopted FASB ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). The amendments in ASU 2011-11 require the disclosure of information on offsetting and related arrangements for financial and derivative instruments to enable users of its financial statements to understand the effect of those arrangements on its financial position. Amendments under ASU 2011-11 will be applied retrospectively for fiscal years, and interim periods within those years, beginning after January 1, 2013. The adoption of this update did not have a material impact on the consolidated financial statements.

Effective January 2013, we adopted FASB ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive (ASU 2013-02). This guidance is the culmination of the FASB's deliberation on reporting reclassification adjustments from accumulated other comprehensive income (AOCI). The amendments in ASU 2013-02 do not change the current requirements for reporting net income or other comprehensive income. However, the amendments require disclosure of amounts reclassified out of AOCI in its entirety, by component, on the face of the statement of operations or in the notes thereto. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This standard is effective prospectively for annual and interim reporting periods beginning after December 15, 2012. The adoption of this update did not have a material impact on the consolidated financial statements.

New Accounting Pronouncements Not Yet Adopted

In February 2013, the FASB issued ASU No. 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. The amendments in ASU 2013-04 provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this Update is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this Update also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this standard are effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. We are evaluating the effect, if any, adoption of ASU No. 2013-04 will have on our consolidated financial statements.

In March 2013, the FASB issued ASU No. 2013-05, Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a

Foreign Entity or of an Investment in a Foreign Entity. The amendments in ASU No. 2013-05 resolve the diversity in practice about whether Subtopic 810-10, Consolidation—Overall, or Subtopic 830-30, Foreign Currency Matters—Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity. In addition, the amendments in this Update resolve the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. The amendments in this standard are effective prospectively for fiscal years, and interim reporting periods within those years, beginning December 15, 2013. We are evaluating the effect, if any, adoption of ASU No. 2013-05 will have on our consolidated financial statements.

In April 2013, the FASB issued ASU No. 2013-07, Presentation of Financial Statements (Top 205): Liquidation Basis of Accounting. The objective of ASU No. 2013-07 is to clarify when an entity should apply the liquidation basis of accounting and to provide principles for the measurement of assets and liabilities under the liquidation basis of accounting, as well as any required disclosures. The amendments in this standard is effective prospectively for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. We are evaluating the effect, if any, adoption of ASU No. 2013-07 will have on our consolidated financial statements.

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

2. Acquisition of Sugarmade-CA and related financing activities

On April 23, 2011, we entered into the Exchange Agreement with Sugarmade-CA. Under the terms of the Exchange Agreement, we acquired all of the outstanding stock of Sugarmade-CA (the "Exchange"). Upon the closing of the Exchange on May 9, 2011, Sugarmade-CA became a wholly-owned subsidiary of our Company.

Under the terms of the Exchange Agreement, Sugarmade-CA's shareholders exchanged all of their shares of stock on a one-for-one basis for a total of 8,864,108 shares of our common stock. In connection with the Exchange Agreement and effective at the closing of the Exchange transaction, our previous three principal shareholders agreed to enter into a Share Cancellation Agreement pursuant to which 8,762,500 shares held by them were canceled or redeemed in exchange for our Company's payment of $210,000, the issuance of 200,000 two-year warrants to purchase our common stock at $1.25 per share, and certain registration rights.

Prior to the closing of the Exchange, our Company had no operations and was a "shell" company. Accordingly, the transaction was accounted as a reverse-merger and our financial statements reflect the financial position and operations of Sugarmade-CA for all periods presented as if it was the acquiring entity in the Exchange.

3. Note payable due to bank

During October 2011, we entered into a revolving demand note (line of credit) arrangement with HSBC Bank USA, with a revolving borrowing limit of $150,000. The line of credit bears a variable interest rate of one quarter percent (0.25%) above the prime rate (3.25% as of March 31, 2013). This borrowing facility is renewed annually and our Company is required to maintain a separate demand deposit account with HSBC with a minimum balance equal to the outstanding borrowing. In the event the deposit account is not established or minimum balance maintained, HSBC can charge a higher rate of interest of up to 4.0% above prime rate. As of March 31, 2013, the loan's interest rate was three and one half percent (3.5%) and HSBC has advanced $150,000. The note is payable on demand.

4. Production Line of Credit

As part of our agreement with SCPC for a production line of credit, SCPC has provided our Company with access to a portion of the overall credit line to allow us to purchase product for inventory purposes, without the need for customer purchase orders as a requirement to order product from its contract manufacturer. This portion production line of credit will initially be set at $300,000, bear interest at 5% interest per quarter and a 4% usage charge, and require payment 30 days after receipt of funds from our customer. The same repayment terms will remain in effect. As of March 31, 2013, the balance on the credit line totaled $284,000.

5. Convertible note payables, net

Between August 17, 2012 and March 31, 2013, our Company issued a total of $525,000 in convertible promissory notes to eleven accredited investors, one of which is a member of our Board of Directors and another was a former member of our Board of Directors. The convertible promissory notes must be repaid by our Company within 9 months from the date of issuance; accrue interest at the rate of 14%; and are subject to conversion at the election of the investors at such time as our Company has raised a minimum of $500,000 in a subsequent equity financing. The conversion price will be the lower of 80% of the per share purchase price paid for by the new investors in the subsequent financing, or $0.50 per share. Unless these promissory notes are converted or repaid earlier, our Company must pay the noteholders the amount of the then accrued interest on the three, nine, and nine month anniversaries of the issue date.

In connection with the issuance of the promissory notes, the investors in the aggregate received two-year warrants to purchase up to a total of 78,750 shares of common stock at $0.50 per share, and two-year warrants to purchase up to a total of 131,250 shares of common stock at $0.01 per share. For purposes of accounting for the detachable warrants issued in connection with the convertible notes, the fair value of the warrants was estimated using the Black-Scholes-Merton option pricing formula. The value of all warrants granted at the date of issuance totaled $96,543 and was recorded as a discount to the notes payable. The amount will be amortized over the nine month term of the respective convertible note as additional interest expense.

For the three and nine month periods ended March 31, 2013, the Company recorded interest expense related to convertible notes payable (including discount amortization) of $50,024, and $85,111, respectively.

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

6. Related party transactions

On January 19, 2012, our Board of Directors approved a grant of 36,000 shares of our Company's common stock (subject to a 1 year repurchase option by our Company) to Ed Roffman, a former director, for the provision of services to our Company in the areas of finance and public reporting. During the year ended June 30, 2012, our company recorded share based consulting expense totaling $66,900. The monthly expense was based on exercise prices ranging from $1.90 per share to $4.25 per share. The shares were issued in reliance upon the exemption from registration afforded by Section 4(2) of the Securities Act as transactions by an issuer not involving any public offering.

Effective May 11, 2012, our Company entered into a Share Cancellation Agreement with Clifton Leung, a director and shareholder of our Company, pursuant to which Mr. Leung agreed to the cancellation of 500,000 shares of Company common stock held by him. In consideration for the cancellation, our Company agreed to pay Mr. Leung $5,000 representing a price of $0.01 per share of common stock. Our Company accounted for this transaction as a purchase and immediate retirement of treasury shares. Effective June 30, 2012, Mr. Leung forgave the amount owed to him from the share cancellation agreement.

On August 17, 2012, the company issued a convertible note with warrants to Jim Jensen, a former director, in exchange for $25,000 short term loan to our Company. In connection with the issuance of the promissory note, Mr. Jensen received two-year warrants to purchase up to a total of 3,750 shares of common stock at $0.50 per share, and two-year warrants to purchase up to a total of 6,250 shares of common stock at $0.01 per share. The convertible promissory note must be repaid by our Company within 9 months from the date of issuance; accrues interest at the rate of 14%; and is subject to conversion at the election of the noteholder at such time as our Company has raised a minimum of $500,000 in a subsequent equity financing. The conversion price will be the lower of 80% of the per share purchase price paid for by the new investors in the subsequent financing, or $0.50 per share. Unless these promissory notes are converted or repaid earlier, our Company must pay the noteholder the amount of the then accrued interest on the three, nine, and nine month anniversaries of the issue date.

On September 6, 2012, our Company's Board of Directors approved the repricing of options and warrants granted to employees, consultants and board members. The repriced options and warrants had exercise prices ranging from $1.25 to $3.73. A total of 1,245,000 vested and unvested options and warrants were amended to reduce the exercise price to $0.52 per share, based on the most recent closing price for our Company's common stock prior to the approval of the re-pricing, which was deemed to be the fair market value as of that date. One current and two former members of our board had a total of 325,000 options repriced to the lower exercise price. The Company incurred additional share based compensation costs totaling $6,250 related to the repriced options and will recognized over the options vesting period.

On November 29, 2012, the Company entered into a Share Cancellation Agreement with Scott Lantz pursuant to which Mr. Lantz agreed to the cancellation of 354,722 of his shares of Company common stock. Mr. Lantz is the Chief Executive Officer, Chief Financial Officer and a Director of the Company.

On November 30, 2012, our Company issued a convertible promissory note in the amount of $100,000 to Jonathan Leong, one of our directors, as part of a financing involving eleven accredited investors. The convertible promissory note must be repaid by our Company within 9 months from the date of issuance; accrues interest at the rate of 14%; and is convertible at the election of the note holder at such time as our Company has raised a minimum of $500,000 in equity in a subsequent equity financing, at the conversion price which is the lower of 80% of the per share purchase price paid for the securities by the investors in the subsequent financing, or $.50 per share. Unless this promissory note is converted or repaid earlier, our Company must pay the note holder the amount of the then accrued interest on the three month anniversary, nine month anniversary, and nine month anniversary of the issue date. In connection with the issuance of the promissory notes, Mr. Leong received two-year warrants to purchase 15,000 shares of common stock at $.50 per share, and two-year warrants to purchase 25,000 shares of common stock at $.01 per share.

On February 22, 2013, our Company issued a promissory note in the amount of $25,000 to Sandy Salzberg, one of our directors, for short term financing. The note has a term of 30 days and bears interest at a rate of 25% per annum. As of March 31, 2013, the note remained outstanding and had accrued interest totaling $660.

7. Stockholders’ Deficit

Issuance of common stock and warrants for cash

On March 7, 2012, our Company’s Board of Directors approved the sale of our Company’s common stock and warrants to purchase common stock at $2.25 per unit. Each unit consisted of (i) one share of our Company's common stock; and (ii) two-year term warrants to purchase the amount of shares of common stock equal to 80% of the number of units purchased. Each warrant was issued with a fixed exercise price of $0.01 per share. As of June 30, 2012, our Company raised $657,500 through the sale of 292,222 units and the commensurate exercise of 193,778 warrants for additional cash proceeds totaling $1,938. For the nine months ended March 31, 2013, there were no additional stock issuances for cash.

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

Issuance of common stock for services

In May 2011, we issued 500,000 shares of common stock subject to repurchase provisions to an individual as consideration for consulting services. We recorded a prepaid stock compensation in connection with the shares granted totaling $400,000 based on the estimated value of the underlying shares of stock at the time of their issuance to the consultant. The grant was originally scheduled to vest evenly on a monthly basis over two years through May 2013, however our Company vested all of the remaining unvested shares in December 2011. The prepaid stock compensation from the grant was charged to operations at the fair market value of the vesting shares at the time of their vesting since the consultant's performance was tied to the contractual vesting terms. Prepaid stock compensation was originally amortized proportionally over the expected vesting term of the shares at the time the shares were vested, with the difference being recorded as additional paid-in capital. For the year ended June 30, 2012, we recorded noncash charges totaling $1,547,000 in connection with this stock issuance.

On January 19, 2012, our Company issued 36,000 shares of restricted common stock to one of its former board members in exchange for additional advisory services in the area of finance and financial reporting. The shares vest over one year and any unvested shares are subject to repurchase by our Company should the recipient cease to provide for the contracted services. For the nine months ended March 31, 2013, our Company incurred a charge totaling $13,545 related to this issuance.

On May 31, 2012, we issued 10,526 shares of restricted common stock to a public relations firm as part of their compensation for services in the area of public relations related strategy, processes and tactics. For the year ended June 30, 2012, our Company recorded noncash charges totaling $20,000 related to this issuance.

On September 20, 2012, our Company issued 250,000 shares to a third party consultant in consideration for its services under the terms of a consulting agreement for investor relations and public communications services. For the three months ended March 31, 2013, we recorded noncash charges totaling $85,000 in connection with this stock issuance based on previous day's closing price for our common stock, which is deemed the fair market value as of that date.

Share surrender and cancellation

Effective May 11, 2012, our Company entered into a Share Cancellation Agreement with Clifton Leung, a director and shareholder of our Company, pursuant to which Mr. Leung agreed to surrender 500,000 shares of Company common stock held by him. In consideration for the surrender, our Company agreed to pay Mr. Leung $5,000 representing a price of $0.01 per share of common stock. Our Company accounted for this transaction as a repurchase and cancellation of common stock. Effective June 30, 2012, Mr. Leung forgave the amount owed to him from the share cancellation agreement.

On November 29, 2012, the Company entered into a Share Cancellation Agreement with Scott Lantz pursuant to which Mr. Lantz agreed to the cancellation of 354,722 of his shares of Company common stock. Mr. Lantz is the Chief Executive Officer, Chief Financial Officer and a Director of the Company. In consideration for the surrender, our Company agreed to pay Mr. Lantz $10. Our Company accounted for this transaction as a repurchase of common stock previously issued to Mr. Lantz and recorded treasury stock on the date of the agreement. The shares were concurrently issued to certain third party investors who previously participated in the Company's sale of common stock and warrants during the March-May 2012 fundraising. The Company measured the issuance based on the previous day's closing market price of the common stock of $0.3210 per share and recorded $113,866 as contributed shares with a corresponding entry to additional paid in capital.

Stock options

On April 27, 2011, our Company's Board of Directors approved the adoption of the 2011 Stock Option/Stock Issuance Plan (the "2011 Plan") and reserved 1,500,000 shares of common stock for issuance under the 2011 Plan. The 2011 Plan provides for the issuance of both non-qualified stock options and incentive stock options ("ISOs"), and permitted grants to employees, non-employee directors and consultants of our Company. Generally, stock option grants under the 2011 Plan will vest over a period of up to four years and have a term not to exceed 10 years, although the Plan Administrator has the discretion to issue option grants with varying terms and vesting periods.

As of March 31, 2013, we have a total of 1,133,462 incentive and nonqualified stock options granted and outstanding under the Plan. All of our outstanding options have terms of between five and ten years. During the three and nine months ended March 31, 2013, we recognized share based compensation expense totaling $32,105– and $105,797, respectively, related to stock options granted through that date.

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

Other outstanding warrants

We issued warrants to purchase up to 2,185,600 of our common stock in connection with the sale of our common stock during the year ended June 30, 2011 and issued warrants to purchase up to 40,000 shares of our common stock in connection with the sale of our common stock during the year ended June 30, 2012. We also have warrants to purchase 921,500 of our common stock outstanding as of March 31, 2013, issued to individuals providing consulting and advisory services to our Company. During the three and nine months ended March 31, 2013, we recognized share based compensation expense related to these warrants totaling $5,056 and $36,395, respectively.

Between August 17, 2012 and March 31, 2013, our Company issued a total of 210,000 warrants in conjunction with $525,000 in convertible promissory notes to eleven accredited investors, one of which was a member of our Board of Directors and another who is a former member of our Board of Directors. In connection with the issuance of the promissory notes, the investors in the aggregate received two-year warrants to purchase up to a total of 78,750 shares of common stock at $0.50 per share, and two-year warrants to purchase up to a total of 131,250 shares of common stock at $0.01 per share. The value of all warrants granted at the date of issuance totaled $96,543 and was recorded as a discount to the notes payable. The amount will be amortized over the nine month term of the respective convertible note as additional interest expense. For the three and nine months ended March 31, 2013, we amortized $31,661 and $53,577, respectively, of discounts on note payable as interest expense.

Outstanding warrants from all sources have terms ranging from two to five years with certain of the warrants carrying registration rights of the underlying shares of common stock. The number of shares of common stock subject to exercise and the exercise price of all options and warrants outstanding at March 31, 2013 is as follows:

Shares Outstanding	Weighted Average Exercise Price		Shares Vested	Expiration Fiscal Period
2,805,600	$	1.45	2,805,600	4th Qtr, 2013
40,000		0.01	40,000	3rd Qtr, 2014
200,000		1.25	200,000	4th Qtr, 2014
108,500		0.40	108,500	1st Qtr, 2015
104,000		0.19	104,000	2nd Qtr. 2015
10,000		0.19	10,000	3rd Qtr. 2015
30,000		0.53	30,000	4th Qtr, 2016
50,000		0.50	50,000	1st Qtr, 2017
50,000		0.50	50,000	2nd Qtr. 2017
1,079,000		0.55	803,265	4th Qtr, 2021
125,000		0.53	46,872	1st Qtr, 2022
35,000		0.53	12,395	2nd Qtr, 2022
1,462		3.25	1,462	3rd Qtr, 2022
52,000		0.75	-	1st Qtr, 2023
4,690,562			4,262,094	

Stock based compensation

Results of operations for the three and nine months ended March 31, 2013 include share based compensation costs totaling $37,161 and $142,191, respectively, charged to selling, general and administrative expenses. For purposes of accounting for stock based compensation, the fair value of each option and warrant award is estimated on the date of grant using the Black-Scholes-Merton option pricing formula. The following weighted average assumptions were used for the calculations during the three months ended March 31, 2013:

Expected life (in years)	3.74 years	
Weighted average volatility	135.89	%
Forfeiture rate	20.00	%
Risk-free interest rate	1.06	%
Expected dividend rate	-	%

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

The weighted average expected option and warrant term for director and employee stock options granted reflects the application of the simplified method set out in SEC Staff Accounting Bulletin No. 110. The simplified method defines the life as the average of the contractual term of the options and the weighted average vesting period for all options. We utilized this approach as our historical share option exercise experience does not provide a reasonable basis upon which to estimate an expected term. Expected volatilities are based on the historical volatility of our stock as well as those of a peer group. We estimated the forfeiture rate based on our expectation for future forfeitures and we currently expect substantially all options and warrants to vest. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield in effect at or near the time of grant. We have never declared or paid dividends and have no plans to do so in the foreseeable future.

As of March 31, 2013, $297,822 of unrecognized compensation cost related to unvested stock based compensation arrangements is expected to be recognized over a weighted-average remaining period of 4.36 months. The following is required disclosure in connection with stock options and warrants (which resulted in share based compensation charges) as of March 31, 2013: 1) weighted average exercise price - $0.77; 2) weighted average remaining contractual term vested and outstanding options – 55.5 and 63.3 months, respectively; 3) aggregate intrinsic value of outstanding and exercisable options and warrants - $––––––298,900 and $216,079, respectively; 4) weighted average grant date fair value of options and warrants granted - $0.26 per share; and 5) weighted average fair value of options and warrants vested - $0.26 per share.

On September 6, 2012, our Company's Board of Directors approved the repricing of options and warrants granted to employees, active consultants and board members. The repriced options and warrants had exercise prices ranging from $1.25 to $3.73. A total of 1,245,000 options and warrants were amended to reduce the exercise price to $0.52 per share, based on the most recent closing price for our Company's common stock, which is deemed the fair market value as of that date. As a result of the repriced options and warrants, our company will be incurring additional stock based compensation totaling $31,450, recognized in the current and future periods over the remaining vesting periods related to the respective securities. For the three and nine months ended March 31, 2013, we recorded additional stock based compensation expense totaling $2,245 and $18,348, respectively, related to the repriced options and warrants.

The exercise prices for options and warrants granted and outstanding which resulted in stock based compensation charges was as follows at March 31, 2013:

	Exercise Price Range	Number of options or warrants
$	0.25 - $0.50	100,000
$	0.51 – $0.75	1,297,000
$	0.76 - $1.00	-
$	1.01 - $1.25	624,000
$	1.26 - $2.00	32,500
$		-

	2.01 - $3.00	
$	3.01 - $4.00	1,462
		2,054,962

A summary of the status of our non-vested options and warrants as of March 31, 2013 and changes during the three months then ended is as follows:

	Shares
Non-vested outstanding, December 31, 2012	498,675
Granted	152,000
Vested	(222,207)
Cancelled	-
Non-vested outstanding, March 31, 2013	428,468

TABLE OF CONTENTS

Sugarmade, Inc. and Subsidiary
Notes to Unaudited Condensed Consolidated Financial Statements
March 31, 2013

Common Shares Reserved for Future Issuance

The following table summarizes shares of our common stock reserved for future issuance at March 31, 2013:

Stock options outstanding	1,133,462
Stock options available for future grant under the 2011 Plan	366,538
Warrants	3,557,100
Total common shares reserved for future issuance	5,057,100

8. Income taxes

We currently estimate our Company's book net operating loss carryforwards ("NOL") and deferred tax asset balance to total approximately $9,257,000 and $3,731,000, respectively, as of March 31, 2013. Internal Revenue Code Section 382 and similar California rules place a limitation on the amount of taxable income that can be offset by NOL's after a change in control (generally greater than a 50% change in ownership). Transactions such as planned future sales of our common stock may be included in determining such a change in control. These factors give rise to uncertainty as to whether the net deferred tax assets are realizable. Our in NOL will begin to expire in 2024 for federal and state purposes and could be limited for use under IRC Section 382. We have recorded a valuation allowance against the entire net deferred tax asset balance due because we believe there exists a substantial doubt that we will be able to realize the benefits due to our lack of a history of earnings and due to possible limitations under IRC Section 382.

We file income tax returns in the U.S. and in the state of California with varying statutes of limitations. Our policy is to recognize interest expense and penalties related to income tax matters as a component of our provision for income taxes. There were no accrued interest and penalties associated with uncertain tax positions as of March 31, 2013. All operations are in California and the Company believes it has no tax positions which could more-likely-than not be challenged by tax authorities. We have no unrecognized tax benefits and thus no interest or penalties included in the financial statements.

9. Subsequent events

On April 22, 2013, our Company issued a convertible promissory note to an accredited investor totaling $100,000. The note has a term of 2 years, and bears interest at a rate of 15% per annum, with 5% payable in cash and the remaining 10% per annum payable in stock at the conversion rate of seventy cents per share; both on a quarterly basis. The note holder will also have the option to convert the outstanding balance into stock at any time during the term of the Note at an exercise price of seventy cents per share.

Effective April 29, 2013, our Company has appointed Clifton Leung as the Chief Executive Officer of the Company. Mr. Leung is also currently a member of the Board of Directors of the Company. In addition, Mr. Leung was the original President and CEO of the Company's wholly-owned subsidiary, Sugarmade, Inc., as a private company in 2009, prior to when the Company acquired it on May 9, 2011. Also effective April 29, 2013, Scott Lantz resigned as the Chief Executive Officer. Mr. Lantz continues in his roles as President, Chief Financial Officer and a member of the Board of Directors.

On May 9, 2013, the Company entered into a Share Cancellation Agreement with Scott Lantz pursuant to which Mr. Lantz agreed to the cancellation of 1,300,000 of his shares of Company common stock. Mr. Lantz is the President, Chief Financial Officer and a Director of the Company. In consideration for the surrender, our Company agreed to pay Mr. Lantz $130.

TABLE OF CONTENTS

ITEM 2 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis may include statements regarding our expectations with respect to our future performance, liquidity, and capital resources. Such statements, along with any other non-historical statements in the discussion, are forward-looking. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described below in Part II, Item 1A and in our June 30, 2012 Annual Report on Form 10-K/A, amendment number 2, as well as those factors listed in other documents we file with the Securities and Exchange Commission (SEC). We do not assume an obligation to update any forward-looking statement. Our actual results may differ materially from those contained in or implied by any of the forward-looking statements in this Form 10-Q. See "SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS" above.

Overview and Financial Condition

Discussions with respect to our Company's operations included herein refer to our operating subsidiary, Sugarmade-CA. Our Company purchased Sugarmade-CA on May 9, 2011. We have no operations other than those of Sugarmade-CA. Information with respect to our Company's nominal operations prior to the Sugarmade Acquisition is not included herein.

Results of Operations

Revenues

Our Company had revenues totaling $51,645 and $165,569 for the three and nine months ended March 31, 2013, respectively, compared to $84,498 and $123,996, respectively, for the three and nine months ended March 31, 2012. The comparative periods in the prior year reflected sales to customers that later received credits in the fourth quarter of 2012 as a result of quality issues with our paper. The first three quarters of fiscal 2013 reflected building sales as new and replacement product was received into the U.S. During the fourth quarter of fiscal 2012, we became aware of quality issues surrounding our copy paper products. We were able to trace the reported problems with paper quality back to manufacturing issues with our third party contract manufacturer. Our Company has since implemented additional quality assurance procedures both during and at the completion of the production processes and believes that all known issues have been addressed. As a result of the production difficulties, we issued full refunds to our customers during the prior year and have replaced our customer's product supplies. For the three months ended March 31, 2013, we sold the remaining sub-quality paper to a third party wholesaler specializing in the liquidation of excess inventory. This sale represented approximately 18% of our revenue for the quarter.

Cost of goods sold

For the three and nine months ended March 31, 2013, our Company reported cost of goods sold totaling $36,161 and $152,013, respectively, inclusive of a provision for inventory obsolescence of $40,851 for the nine months ended March 31, 2013. The provision was recorded after we completed our full assessment of all remaining product with our customers. This process was completed in the second quarter of fiscal 2013. Cost of goods sold for material and freight costs reflect sub-quality product sold to a third party wholesaler which was fully reserved, resulting in a zero cost of goods sold for this product. Excluding the effects of the fully reserved product, cost of goods sold reflected higher than normal freight charges due to industry surcharges assessed by the shipping carriers to companies using their ocean freight services. As we ship our product from China, these surcharges negatively impact our profit margins. We are managing our freight costs closely in an attempt mitigate some of these costs by using pre-purchased freight, alternative routes and /or longer lead times. Cost of goods sold for the three and nine months ended March 31, 2012 totaled $69,207 and $82,589, reflecting costs correlating to the increasing sales during the period.

Gross margin (loss)

Gross margin was $15,484 and $13,556 for the three and nine months ended March 31, 2013, respectively. For the third quarter of fiscal 2013, gross margin included the positive impact of sales of fully reserved product to a third party wholesaler. Without the benefit of these sales, gross margin as a percentage of sales would have been 14.6% as compared to the current margins of 29.9%. For the nine months ended March 31, 2013, the margin was impacted negatively due to the provision for inventory obsolesces on the remaining inventory from the sub-quality production in fiscal 2012. Higher margins for the nine months ended March 31, 2012 related to the sales of previously written off inventory.

TABLE OF CONTENTS

Selling, general and administrative expenses

For the three and nine months ended March 31, 2013, selling, general and administrative expenses totaled $327,870 and $1,442,549 respectively, compared to $634,962 and $3,246,786 for the three and nine months ended March 31, 2012. The third fiscal quarter and year-to-date ending March 31, 2013 included non-cash related charges for stock compensation and consulting expenses of $37,161 and $240,736 respectively, compared of $115,426 and $1,775,127, respectively, for the same periods in the prior fiscal year. Payroll and related expenses including noncash items totaled $37,161 and $142,191 during the three and nine months ended March 31, 2013, respectively, compared to $328,976 and $908,677 for the three and nine months ended March 31, 2012, respectively. Consulting expenses including noncash items totaled none and $98,545 during the three and nine months ended March 31, 2013, respectively, compared to $119,135 and $1,879,680 for the three and nine months ended March 31, 2012, respectively. Legal and auditing expenses totaled $19,573 and $74,663 during the three and nine months ended March 31, 2013, respectively while legal and auditing expenses for the three and nine months ended March 31, 2012 totaled $23,263 and $97,858, respectively. In an effort to further lower our expenses, during the third quarter of fiscal 2013 we reduced our headcount by 2 more people (in addition to the 5 people in the second quarter of Fiscal 2013), resulting in a 63% headcount reduction.. For the 9 months ended March 31, 2013, we cut costs in many areas as we continued to bring down our overhead operating expenses.

Interest expense and interest income

Interest expense totaled $80,033 and $134,472, respectively, for the three and nine months ended March 31, 2013 compared to negligible amounts for the same period in 2012. The increase in interest expense resulted from the increase in our debt in the form of convertible notes and our Production line of credit. Interest expense related to the convertible notes includes the amortization of discount on the note payable, which totaled $31,661 and $53,577 for the three and nine months ended March 31, 2013, respectively. The remaining accrued interest related to the note payable for the three and nine months ended March 31, 2013 totaled $18,363 and $31,884, respectively. Interest expense related to the SCPC Production line of credit for the third quarter of Fiscal 2013 and the nine months ended March 31, 2013 totaled $25,502and $37,299, respectively.

Net loss

Net loss totaled $392,295 and $1,563,075, respectively, for the three and nine months ended March 31, 2013, compared to $625,418 and $3,219,105 respectively, for the three and nine months ended March 31, 2012. The higher losses in the prior fiscal periods related to the non-cash charges discussed above.

Liquidity and Capital Resources

We have primarily financed our operations through the sale of unregistered equity, warrants and convertible notes payable. As of March 31, 2013, our Company had cash totaling $158,335, current assets totaling $468,717 and total assets of $476,499. We had current liabilities totaling $1,281,029 and total liabilities of $1,763,063, with a negative working capital of $812,312. The increase in negative working capital resulted from the increased debt burden the company has incurred during the three quarters of fiscal 2013. Stockholders' equity reflected a deficit of $1,286,564.

Net cash used by operating activities was $885,799 for the nine months ended March 31, 2013, a decrease of $875,026 from the comparable figure of $1,760,825 for the nine months ended March 31, 2012. The decrease of net cash flows used in operating activities resulted from our decreased net loss and the increase in our liabilities and accrued compensation costs.

For the nine months ended March 31, 2013, we did not have cash flows from investing activities, and only uses of cash activities totaling $27,143 related to furniture and equipment purchases for the nine months ended March 31, 2012l.

Net cash provided by financing activities totaled $852,034 for nine months ended March 31, 2013 as compared to $659,260 for the first nine months of fiscal 2012. The net cash provided by financing activities for the period was mainly attributable to proceeds from the issuances of notes payable and convertible notes payables, as well as the funds provided by the SCPC production line of credit.

On October 1, 2012, our Company obtained a production line of credit line from Norco Sourcing (Hong Kong) Company Ltd ("Norco") that allows our Company to draw up to $3 million dollars on the line. One of our directors, Clifton Leung, has a forty-five percent (45%) ownership interest in Norco. The line of credit will bear interest at 9% per annum. If we were to draw the maximum amount on the line, our Company would have to issue 300,000 shares of Common stock and warrants to purchase 300,000 shares of the Company's common stock at an exercise price of $0.01 per share. The line of credit constitutes an oral agreement between Norco and the Company and has not been memorialized in a written agreement executed between the parties. The Company has not received any funds under the line of credit as of the date of this report.

TABLE OF CONTENTS

Our capital requirements going forward will consist of financing our operations until we are able to reach a level of revenues and gross margins adequate to equal or exceed our ongoing operating expenses. Other than the notes payable discussed above, borrowings from our bank and the production credit facility with our suppliers, we do not have any credit agreement or source of liquidity immediately available to us.

Given estimates of our Company's future operating results and our credit arrangements with our suppliers, we are currently forecasting that we will need to secure additional financing to obtain adequate financial resources to reach profitability. As of the date of this report, we estimate that the cash necessary to implement our current business plan for the next twelve months is approximately $1,500,000. This amount does not include funds for the production of our paper products which we expect to be satisfied by our production line of credit. Similarly, the funds from the production line of credit cannot be used for operational needs. As of March 31, 2013, we had a cash balance of approximately $158,335. However, we cannot provide any assurances that we will be able to raise additional funds to meet our cash needs; that the cash required to implement our current plan will not exceed our estimated amount of $1,500,000; or that we can achieve profitability with the estimated amounts we determined above, or that we will ever achieve profitability. We also cannot provide any assurances that we will be able to receive additional funds under our production line of credit.

Based on our need to raise additional funds to implement our business plans for the next twelve months, we have included a discussion concerning the presentation of our financial statements on a going concern basis in the notes to our financial statements and our independent public accountants have included a similar discussion in their opinion on our financial statements through June 30, 2012. We will be required in the near future to issue debt or sell our Company's equity securities in order to raise additional cash, although there are no firm arrangements in place for any such financing at this time. We cannot provide any assurances as to whether we will be able to secure the necessary financing, or the terms of any such financing transaction if one were to occur. The failure to secure such financing could severely curtail our plans for future growth or in more severe scenarios, the continued operations of our Company.

Capital Expenditures

Our current plans do not call for our Company to expend significant amounts for capital expenditures for the foreseeable future beyond relatively insignificant expenditures for office furniture and information technology related equipment as we add employees to our Company. We are however continually evaluating the production processes of our third party contract manufacturers to determine if there are investments we could make in their processes to achieve manufacturing improvements and significant cost savings. Any such desired investments would require additional cash above our current forecast requirements.

Critical Accounting Policies Involving Management Estimates and Assumptions

Please see the notes to our financial statements.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Intentionally omitted pursuant to Item 305(e) of Regulation S-K.

TABLE OF CONTENTS

ITEM 4 – CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures and internal controls that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures and internal controls, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance of achieving the desired control objectives. In reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures and internal controls. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

As required by the Securities and Exchange Commission Rule 13a-15(e) and Rule 15d-15(e), we carried out an evaluation, under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Controls over Financial Reporting

There have not been any changes in our internal controls over financial reporting during the quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

TABLE OF CONTENTS

PART II

ITEM 1 – LEGAL PROCEEDINGS

From time to time and in the course of business, we may become involved in various legal proceedings seeking monetary damages and other relief. The amount of the ultimate liability, if any, from such claims cannot be determined. However, in the opinion of our management, there are no legal claims currently pending or threatened against us that would be likely to have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 1A – RISK FACTORS

Investment in our common stock involves a high degree of risk. You should carefully consider the risks described below together with all of the other information included in this herein before making an investment decision. If any of the following risks actually occur, our business, financial condition or results of operations could suffer. In that case, the market price of our common stock could decline, and you may lose all or part of your investment. You should also read the section entitled "Special Notes Regarding Forward-Looking Statements" below for a discussion of what types of statements are forward-looking statements as well as the significance of such statements in the context of this report.

RISKS RELATED TO OUR BUSINESS

We have a very limited operating history. Prior to the Sugarmade Acquisition, our Company was a “shell” company with no or nominal operations. Sugarmade-CA recently completed its funding and the related acquisition with our Company. Sugarmade-CA was formed in 2009 to market paper products manufactured from tree-free materials. Sugarmade-CA does not currently have significant operating revenues and has a very limited operating history. Because Sugarmade-CA has a limited operating history, we do not have any historical financial data upon which to base planned operations.

The segments of the paper industry in which we operate are highly competitive and increased competition could affect our sales and profitability. We compete in different markets within the paper industry on the basis of the uniqueness of our products, the quality of our products, customer service, price and distribution. All of our markets are highly competitive. Our competitors vary in size and many have greater financial and marketing resources than we do. While we believe that our products offer unique advantages because of their tree-free composition, if we cannot maintain quality and pricing that are comparable to traditional products we may not be able to develop, or may lose, market share. In some of our markets, the industry’s capacity to make products exceeds current demand levels. Competitive conditions in some of our segments may cause us to incur lower net selling prices, reduced gross margins and net earnings.

Our tree-free products could encounter low consumer acceptance in our primary target markets, including our initial target market of North America. The tree-free paper market in North America is relatively young with little publically available data on the size of the market in relation to the overall paper industry. There is only anecdotal data referencing the growing demand in the United States and abroad for paper products from tree-free sources. Our product is relatively new to consumers and does not have a significant sales history in many of our target markets. Should our tree-free products not be accepted by consumers in these markets, particularly in the markets of our initial focus in North America, we could experience sales and operating results substantially less than we expect to achieve. Such results could jeopardize our Company’s financial well-being and subject an investor to the loss of all or a portion of his investment in our Company.

Our business and financial performance may be adversely affected by downturns in the target markets that we serve or reduced demand for the types of products we sell. Demand for our products is often affected by general economic conditions as well as product-use trends in our target markets. These changes may result in decreased demand for our products. The occurrence of these conditions is beyond our ability to control and, when they occur, they may have a significant impact on our sales and results of operations. Our products are comparably priced with paper products comprised of 30% recycled materials. Both our products and paper products comprised of 30% recycled materials are typically higher in cost than paper products made from virgin pulp wood. The inability or unwillingness of our customers to pay a premium for our products due to general economic conditions or a downturn in the economy may have a significant adverse impact on our sales and results of operations.

Changes within the paper industry may adversely affect our financial performance. Changes in the identity, ownership structure and strategic goals of our competitors and the emergence of new competitors in our target markets may harm our financial performance. New competitors may include foreign-based companies and commodity-based domestic producers who could enter our specialty markets if they are unable to compete in their traditional markets. The paper industry has also experienced consolidation of producers and distribution channels. Further consolidation could unite other producers with distribution channels through which we intend to sell our products, thereby limiting access to our target markets.

TABLE OF CONTENTS

Any interruption in delivery from our suppliers will impair our ability to distribute our products and generate revenues. We are dependent on third party contract manufacturers for the production of our products. We have no manufacturing facilities and we rely on third party contract manufacturers to provide us with an adequate and reliable supply of products on a timely basis. Any interruption in the distribution from these suppliers could affect our ability to distribute our products. Additionally, our suppliers are located in the People's Republic of China ("PRC"). Any legislation or consumer preferences in the United States or other countries requiring products which are made in the United States or such other countries may have a material adverse impact on our sales and results of operations.

Uncertainties with respect to the PRC legal system could limit the legal protections available for us to pursue any claim against our third party contract manufacturers, and therefore our ability to protect our contract rights. We rely on third party contract manufacturers for our supply of products. These third party suppliers operate entirely within the PRC. The PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit legal protections available to us in the event that we needed to bring a claim against our suppliers. Courts in the PRC may recognize and enforce foreign judgments in accordance with the requirements of the PRC Civil Procedures Law based on treaties between China and the country where the judgment is made or on reciprocity between jurisdictions. The PRC does not have any treaties or other arrangements that provide for the reciprocal recognition and enforcement of foreign judgments with the United States. So it is uncertain whether a PRC court would enforce a judgment rendered by a court in the United States. Any litigation we may try to bring in the PRC may be protracted and result in substantial costs and diversion of resources and management attention.

If we fail to maintain satisfactory relationships with our larger customers, our business may be harmed. We do not have and are unlikely to enter into long-term fixed quantity supply agreements with our customers. Due to competition or other factors, we could lose future business from our customers, either partially or completely. Additionally, during our last fiscal year we produced certain batches of paper which did not meet the quality standards required by our customers which resulted in dissatisfaction by those customers. This dissatisfaction may have also harmed our reputation and ability to sell our products to those customers and other customers in the future. The future loss of one or more of our significant customers or a substantial future reduction of orders by any of our significant customers, or the unwillingness of a customer to purchase our products again due to concerns over the quality of the paper they previously purchased could harm our business and results of operations. Moreover, our customers may vary their order levels significantly from period to period and customers may not continue to place orders with us in the future at the same levels as in prior periods. In the event that in the future we lose any of our larger customers, we may not be able to replace that revenue source. This could harm our financial results.

The costs of complying with environmental regulations may increase substantially and adversely affect our consolidated financial condition, liquidity or results of operations. Our Company's third party contract manufacturers are subject to various environmental laws and regulations that govern discharges into the environment and the handling and disposal of hazardous substances and wastes. Environmental laws impose liabilities and clean-up responsibilities for releases of hazardous substances into the environment. However, many PRC laws and regulations are uncertain in their scope, and the implementation of such laws and regulations in different localities could have significant differences. In certain instances, local implementation rules and/or the actual implementation are not necessarily consistent with the regulations at the national level. We cannot assure you that the relevant PRC government authorities will not determine that our suppliers have failed to comply with certain laws or regulations. Our Company's suppliers will likely continue to incur substantial capital and operating expenses in order to comply with current laws. Any future changes in these laws or their interpretation by government agencies or the courts may significantly increase our suppliers' capital expenditures and operating expenses and decrease the amount of funds available for investment in other areas of their operations. In addition, our Company's suppliers may be required to eliminate or mitigate any adverse effects on the environment caused by the release of hazardous materials, whether or not SCPC's suppliers had knowledge of or were responsible for such release. Our suppliers may also incur liabilities for personal injury and property damages as a result of discharges into the environment. If costs or liabilities related to environmental compliance increase significantly for our suppliers, such costs could be passed along to us in the form of higher prices paid for supplied materials. Our consolidated financial condition, liquidity or results of operations may be adversely affected in the event that we were forced to absorb such costs.

TABLE OF CONTENTS

If our third party contract manufacturers were to suffer a catastrophic loss, unforeseen or recurring operational problems at any of its facilities, we could suffer significant product shortages, sales declines and/or cost increases. The paper making and converting facilities of our third party suppliers as well as their distribution warehouses could suffer catastrophic loss due to fire, flood, terrorism, mechanical failure or other natural or human caused events. If any of these facilities were to experience a catastrophic loss, it could disrupt our supply of products for sale, delay or reduce shipments and reduce our revenues. These expenses and losses may not be adequately covered by property or business interruption insurance. Even if covered by insurance, our inability to deliver our products to customers, even on a short-term basis, may cause us to lose market share on a more permanent basis.

Our ability to protect the intellectual property and proprietary technology related to the production of our products is uncertain. Our future success may depend on our ability to protect the proprietary rights and the intellectual property upon which our tree-free products are based. SCPC holds several patents in the People’s Republic of China related to the production of tree-free paper, and under the terms of our supply agreement with SCPC, we have the right to request SCPC to file for counterpart patent protection in Sugarmade’s territories and for copyright protection for the name “Sugarmade,” but we have not yet made such requests. Should we make such a request to SCPC, any patent applications may not be issued as patents, or may not be issued in a form that will be advantageous to us, or we may not be able to obtain copyright protection for the name “Sugarmade”. Additionally, our Company is in the process of applying for a provisional patent in the US to protect its new formulation and process for its most recent tree free pulp and paper product. The provisional patent application which the Company plans to file is intended to allow us to establish an early effective filing date with the United States Patent and Trademark Office (USPTO) for the filing of the planned final non-provisional patent for our paper product. However, we may not be able to file the provisional patent application or the planned final non-provisional patent for our paper product. Additionally, any patents obtained in the future may be challenged by re-examination or otherwise invalidated or eventually be found unenforceable. Both the patent application process and the process of managing patent disputes can be time consuming and expensive. Even if any patents were to be granted, competitors may attempt to challenge or invalidate the patents, or may be able to design alternative techniques or devices that avoid infringement of the patents, or develop products with functionalities that are comparable to the tree-free products which we sell. In the event a competitor infringes upon our intellectual property rights, litigation to enforce such rights or to defend patents granted (or to be granted) against challenge, even if successful, could be expensive and time consuming and could require significant time and attention from our management. We may not have sufficient resources to enforce our intellectual property rights.

We may become involved in claims concerning intellectual property rights, and we could suffer significant litigation or related expenses in defending our or SCPC’s intellectual property rights or defending claims that we infringed the rights of others. We consider our licensed intellectual property to be a material asset. We may lose market share and suffer a decline in our revenue and net earnings if we cannot successfully defend one or more trademarks or patents we have secured or licensed. We do not believe that any of our products infringe the valid intellectual property rights of third parties. However, we may be unaware of intellectual property rights of others that may cover some of our products or services. In that event, we may be subject to significant future claims for damages. Any litigation regarding patents or other intellectual property could be costly and time-consuming and could divert our management and key personnel from our business operations. Claims of intellectual property infringement might also require us to enter into licensing agreements which would reduce our operating margins, or in some cases, we may not be able to obtain license agreements on terms acceptable to us.

FINANCIAL RISKS

Our current business plan requires that our Company raise additional equity by the end of fiscal year 2013. We do not currently have sufficient revenues to cover our operating expenses and have never been profitable. We cannot be certain that our Company will ever generate sufficient revenues and gross margin to achieve profitability in the future. Our business plan requires that our Company needs to raise additional equity by the end of our 2013 fiscal year end.

However, there are no arrangements in place for any such financing at this time. We cannot provide any assurances as to whether we will be able to secure any necessary financing, or the terms of any such financing transaction if one were to occur. Our failure to raise additional capital would seriously harm our business and operating results. If we fail to raise additional capital by the end of fiscal 2013, our business will be materially and adversely affected and an investor could suffer the loss of a significant portion or all of his investment in our Company.

If we cannot establish profitable operations, we will need to raise additional capital to continue our operations, which may not be available on commercially reasonable terms, or at all, and which may dilute your investment. We incurred a net loss for the nine months ended March 31, 2013 in excess of $1,563,000 and had negative cash flows from operations of nearly of $886,000. For the nine months ended March 31, 2012 we incurred a net loss in excess of $3,219,000 and had negative cash flows from operations of nearly $1,761,000. Achieving and sustaining profitability will require us to increase our revenues and manage our product, operating and administrative expenses. We cannot guarantee that we will be successful in achieving profitability. If we are unable to generate sufficient revenues to pay our expenses and our existing sources of cash and cash flows are otherwise insufficient to fund our activities, we will need to raise additional funds to continue our operations. We do not have any arrangements in place for additional funds. If needed, those funds may not be available on favorable terms, or at all. Furthermore, if we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. If we are unsuccessful in achieving profitability and we cannot obtain additional funds on commercially reasonable terms or at all, we may be required to curtail significantly or cease our operations, which could result in the loss of all of your investment in our stock.

TABLE OF CONTENTS

We are dependent upon our production credit borrowing arrangement with SCPC and Norco Sourcing (Hong Kong) Co. Ltd in order to fund our working capital and liquidity requirements. We have signed an agreement with SCPC, and have secured a verbal agreement for a line of credit with Norco Sourcing (Hong Kong) Co. Ltd (“Norco”), to provide our Company with credit facilities to fund the production of our paper products. Our plans going forward are dependent upon SCPC and Norco in providing such financing upon the terms we have agreed to and there are currently no other alternate financing plans in place. Should there be an interruption in either SCPC’s or Norco willingness or ability to provide such financing per the terms of the agreements, we could face a severe liquidity shortfall that could cause our Company’s operations to fail and which could consequently result in the loss of an investor’s investment with our Company.

We may not have the ability to pay our convertible notes when due. Between August 17, 2012 and March 31, 2013, our Company has issued convertible promissory notes totaling $525,000 which must be repaid by our Company within 9 months after their date of issuance. Our Company does not have sufficient capital to repay the notes as of the date of this report, and may not have sufficient capital to repay the notes when due. Our Company is in discussions with several of the note holders to obtain an extension on the due date, or to have the note holders convert their balances into shares of Company common stock. Our Company’s inability to obtain an extension on the due date from the note holders, or our inability to repay the notes when due, would permit the noteholders to exercise their default remedies against our Company which could have a material adverse effect on our Company.

Conversion of our convertible notes into common stock could result in additional dilution to our stockholders. Upon satisfaction of certain conversion conditions (including conditions outside of our control, such as the closing of a financing), the notes may be converted into shares of Company common stock by the noteholders. If shares of our common stock are issued due to conversion of some or all of the convertible notes, the ownership interests of existing stockholders would be diluted.

Our financial statements have been prepared assuming that our Company will continue as a going concern. We have generated losses to date and have limited working capital. These factors raise substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments that might result from this uncertainty. The report of our independent registered public accounting firm included an explanatory paragraph expressing substantial doubt about our ability to continue as a going concern in their recent audit report for the fiscal year ended June 30, 2012. If we cannot generate the required revenues and gross margin to achieve profitability or obtain additional capital on acceptable terms, we will need to substantially revise our business plan or cease operations and an investor could suffer the loss of a significant portion or all of his investment in our Company.

Fluctuations in exchange rates could adversely affect our cost of goods sold and consequently our profit margins. The olid">

Option Awards

Stock Awards

Name

Number of
Securities
Underlying
Unexercised
Options (#)
Exercisable

Number of
Securities
Underlying
Unexercised
Options (#)
Unexercisable

Equity
Incentive Plan
Awards:
Number of
Securities
Underlying
Unexercised
Unearned
Options (#)

Option
Exercise
Price
($)

Option
Expiration
Date

Unvested
Shares of
Stock (#)

Market
Value of
Unvested
Shares of
Stock ($)

Equity
Incentive
Plan
Awards:
Unearned
Shares or
other
Rights that
have not
Vested (#)

Equity
Incentive
Plan
Awards:

	Market or Payout Value of Unearned Shares or Rights that have not Vested ($)								
Daniel Turissini, Chief Technology Officer and Chief Executive Officer of ORC	470,000	-	-	$0.76	9/14/2015	-	-	-	-
Jin Kang President iSYS, LLC	315,000	-	-	$0.54	1/4/2013	-	-	-	-

450,000 options were exercised in 2010 by James T. McCubbin and no options were exercised by the remaining named executive officers in 2010.

On May 11, 2009, the Company's Compensation Committee of the Board of Directors voted to cancel 950,000 options held by management and other employees (the "Cancelled Options") and issue replacement options to such individuals (the "Replacement Options"). The optionees all concurred with such action by the Compensation Committee. The Cancelled Options had varying exercise prices ranging from $0.85 to $2.80 with a weighted average exercise price of $1.06 per share. The exercise price of the Replacement Options was set at $0.54 per share. Other than the exercise price per share, there are no differences in the terms between the Cancelled Options and the Replacement Options. The incremental additional fair value of the Replacement Options was calculated to be approximately $64,000, which was determined by calculating the fair value of the Cancelled Options as they existed on May 11, 2009 immediately prior to cancellation as compared to the fair value on the same date of the exercise price of the Replacement Options. This amount of additional fair value of the Replacement Options will be recognized over the vesting period of the Replacement Options. Since some of the Replacement Options were fully vested at May 11, 2009, there was an expense of approximately $45,000 recognized in the three months ended June 30, 2009 as a result of the cancellation of the Cancelled Options and the issuance of the Replacement Options.

Employment Agreements and Compensation Arrangements; Termination and Change in Control Provisions

The following describes the terms of employment agreements between the Company and the named executive officers and sets forth information regarding potential payments upon termination of employment or a change in control of the Company.

Mr. Komar. On August 13, 2010, we entered into an employment agreement with Steve Komar, our Chief Executive Officer and President, effective as of July 1, 2010, which replaced Mr. Komar's prior employment agreement, dated July 1, 2002, which expired by its terms on June 30, 2010. The new employment agreement has an initial term expiring on June 30, 2012 with one twelve-month renewal option period. The agreement provides for (1) a base salary of $205,000 for the first year of the term, $230,000 for the second year of the term, and $255,000 for the optional third year of the term, (2) a home office/automobile expense allowance of $500 per month to cover such expenses incurred in the pursuit of our business; (3) a phone allowance of $100 per month to cover such expenses incurred in the pursuit of our business; (4) reimbursement for additional actual business expenses consistent with our existing policies that have been incurred for our benefit; (5) paid medical and other benefits consistent with our existing policies with respect to our key executives, as such policies may be amended from time to time in the future; and (6) performance incentive bonuses as may be granted annually at the discretion of the Compensation Committee of the Board.

The employment agreement contains a severance provision which provides that upon the termination of his employment without Cause (as described below) or his voluntary resignation for a Good Reason (as described below), Mr. Komar will receive severance compensation equal to the greater of (a) an amount equal to twelve (12) months of his base salary then in effect, or (b) an amount equal to Mr. Komar's base salary for the remainder of the term of the employment agreement. The employment agreement further provides that if within two years after a change in control of the Company there occurs any termination of Mr. Komar for any reason other than for Cause or a voluntary resignation without a Good Reason, then the Company will be required to pay to Mr. Komar a one time severance payment equal to the greater of (a) an amount equal to eighteen (18) months of his base salary then in effect, or (b) an amount equal to Mr. Komar's base salary for the remainder of the term of the employment agreement. If Mr. Komar's employment terminates for any reason other than for Cause or a voluntary retirement without Good Reason, Mr. Komar will be eligible to participate, at the Company's expense, in all executive medical and dental plans provided by the Company for the remainder of the term of the employment agreement. Mr. Komar will receive a payment equal to any excise, income and other taxes resulting from the imposition of parachute penalties of the Internal Revenue Code or applicable state tax law.

Termination of Mr. Komar's employment by the Company shall be deemed for "Cause" if, and only if, it is based upon (i) conviction of a felony by a federal or state court of competent jurisdiction; (ii) material disloyalty to the Company such as embezzlement or misappropriation of corporate assets; or (iii) engaging in unethical or illegal behavior which is of a public nature, brings the Company into disrepute, and results in material damage to the Company. A resignation by Mr. Komar shall not be deemed to be voluntary and shall be deemed to be a resignation with "Good Reason" if it is based upon (i) a diminution in Mr. Komar's title, duties, or salary; (ii) a material reduction in benefits; (iii) a direction by the Board of Directors that Mr. Komar report to any person or group other than the Board of Directors, or (iv) a geographic relocation of the Company's primary business operations outside of the Washington Metropolitan Area.

In the event of the death or permanent disability of Mr. Komar, Mr. Komar or his estate will receive a one time payment equal to the amount of base salary owed to Mr. Komar for the remainder of the term as if the employment agreement had not been terminated by Mr. Komar's disability or death and all granted but unvested stock options shall be immediately vested and the period of exercise extended for an additional 2 years

Mr. McCubbin. On August 13, 2010, we entered into an employment agreement with James T. McCubbin, our Executive Vice President, Chief Financial Officer, Secretary and Treasurer, effective as of July 1, 2010, which replaced Mr. McCubbin's prior employment agreement, dated July 1, 2002, which expired by its terms on June 30, 2010. The new employment agreement has an initial term expiring on June 30, 2012 with one twelve-month renewal option period. The agreement provides for (1) a base salary of $205,000 for the first year of the term, $230,000 for the second year of the term, and $255,000 for the optional third year of the term, (2) a home office/automobile expense allowance of $500 per month to cover such expenses incurred in the pursuit of our business; (3) a phone allowance of $100 per month to cover such expenses incurred in the pursuit of our business; (4) reimbursement for additional actual business expenses consistent with our existing policies that have been incurred for our benefit; (5) paid medical and other benefits consistent with our existing policies with respect to our key executives, as such policies may be amended from time to time in the future; and (6) performance incentive bonuses as may be granted annually at the discretion of the Compensation Committee of the Board of Directors.

The employment agreement contains a severance provision which provides that upon the termination of his employment without Cause (as described below) or his voluntary resignation for a Good Reason (as described below), Mr. McCubbin will receive severance compensation equal to the greater of (a) an amount equal to twelve (12) months of his base salary then in effect, or (b) an amount equal to Mr. McCubbin's base salary for the remainder of the term of the employment agreement. The employment agreement further provides that if within two years after a change in control of the Company there occurs any termination of Mr. McCubbin for any reason other than for Cause or a voluntary resignation without a Good Reason, then the Company will be required to pay to Mr. McCubbin a one time severance payment equal to the greater of (a) an amount equal to eighteen (18) months of his base salary then in effect, or (b) an amount equal to Mr. McCubbin's base salary for the remainder of the term of the employment agreement. If Mr. McCubbin's employment terminates for any reason other than for Cause or a voluntary retirement without Good Reason, Mr. McCubbin will be eligible to participate, at the Company's expense, in all executive medical and dental plans provided by the Company for the remainder of the term of the employment agreement. Mr. McCubbin will receive a payment equal to any excise, income and other taxes resulting from the imposition of parachute penalties of the Internal Revenue Code or applicable state tax law.

Termination of Mr. McCubbin's employment by the Company shall be deemed for "Cause" if, and only if, it is based upon (i) conviction of a felony by a federal or state court of competent jurisdiction; (ii) material disloyalty to the Company such as embezzlement or misappropriation of corporate assets; or (iii) engaging in unethical or illegal behavior which is of a public nature, brings the Company into disrepute, and results in material damage to the Company. A resignation by Mr. McCubbin shall not be deemed to be voluntary and shall be deemed to be a resignation with "Good Reason" if it is based upon (i) a diminution in Mr. McCubbin's title, duties, or salary; (ii) a material reduction in benefits; (iii) a direction by the Board of Directors that Mr. McCubbin report to any person or group other than the Board of Directors, or (iv) a geographic relocation of the Company's primary business operations outside of the Washington Metropolitan Area.

In the event of the death or permanent disability of Mr. McCubbin, Mr. McCubbin or his estate will receive a one time payment equal to the amount of base salary owed to Mr. McCubbin for the remainder of the term as of the employment agreement had not been terminated by Mr. McCubbin's disability or death and all granted but unvested stock options shall be immediately vested and the period of exercise extended for an additional 2 years.

Mr. Oxley. In May 2008, the Company entered into an employment agreement with Ronald Oxley, our Executive Vice President of Sales, Marketing and Business Strategy. The agreement provides for: (1) a base salary of $180,000 per year; (2) reimbursement for pre-approved business expenses consistent with our existing policies that have been incurred for our benefit; (3) paid medical and other benefits consistent with our existing policies with respect to our key executives, as such policies may be amended from time to time in the future; and (4) performance incentive bonuses as may be granted at the discretion of the Compensation Committee of the Board.

The agreement also contains a termination provision. His employment period will continue from the date of his agreement unless terminated earlier by (a) Mr. Oxley's death or permanent disability which renders him unable to perform his duties hereunder (as determined by WidePoint in its good faith judgment), (b) Mr. Oxley's resignation, commencing from and after the second anniversary date of his agreement, upon prior written notice to WidePoint of 90 days before the annual anniversary date of this Agreement, or (c) WidePoint for Cause. Mr. Oxley's employment agreement defines "Cause" as (i) the repeated failure or refusal of Mr. Oxley to follow the lawful directives of WidePoint or its designee (except due to sickness, injury or disabilities), after prior notice to Mr. Oxley and a reasonable opportunity to cure by Mr. Oxley of up to 30 days, (ii) gross inattention to duty or any other willful, reckless or grossly negligent act (or omission to act) by Mr. Oxley, which, in the good faith judgment of WidePoint, materially injures WidePoint, including the repeated failure to follow the policies and procedures of WidePoint, after prior notice to Mr. Oxley and a reasonable opportunity to cure by Mr. Oxley of up to 30 days, (iii) a material breach of the employment agreement by Mr. Oxley, after prior notice to Mr. Oxley and a reasonable opportunity to cure by Mr. Oxley of up to 30 days, (iv) the commission by Mr. Oxley of a felony or other crime involving moral turpitude or the commission by Mr. Oxley of an act of financial dishonesty against WidePoint or (v) a proper business purpose of WidePoint, which shall be limited only to a decrease in the staffing of the corporate headquarters staff or the elimination of the position filled by Mr. Oxley as a result of a material decrease in revenues and/or profits of WidePoint, but with other cost cutting measures and the termination of other employees at such office being first considered and instituted as determined in the sole judgment of WidePoint prior to the termination of Mr. Oxley; provided, however, that in the event WidePoint terminates Mr. Oxley for a "proper business purpose," then (I) the scope of the non-compete set forth in the employment agreement shall be limited to the products and services offered by WidePoint as of the termination of Mr. Oxley and (II) WidePoint shall pay to Mr. Oxley the lesser of (A) Mr. Oxley's salary and benefits each month for the 6 month period immediately following such termination or (B) in the event less than 6 months remains in the then current term of Mr. Oxley's employment with WidePoint, then Mr. Oxley shall receive his salary and benefits each month for such lesser remaining period of time.

Mr. Oxley's employment agreement further provides that during the employment period and for one year following the termination of Mr. Oxley's agreement as a result of his resignation or a termination by WidePoint for Cause, Mr. Oxley will not own, manage, control, participate in, consult with, advertise on behalf of, render services for or in any manner engage in any competitive business of soliciting or providing any computer, technology, information technology, consulting or any other services and/or products of any type whatsoever to any federal, state and/or local governments and/or to any existing or targeted customers or clients of WidePoint; nor shall Mr. Oxley attempt to influence any then existing or targeted customers, clients or suppliers of WidePoint to curtail any business they are currently, or in the last 24 months have been, transacting with WidePoint. Furthermore, during such period, Mr. Oxley shall not, without WidePoint's prior written consent, knowingly solicit or encourage any existing employee or recruit to leave or discourage their employment with WidePoint.

Mr. Turissini. On October 24, 2004, the Company entered into an employment agreement with Daniel Turissini, our Chief Technology Officer and the Chief Executive Officer of our wholly owned subsidiary, Operational Research Consultants, Inc. ("ORC"). The employment agreement had an initial term expiring on October 25, 2006. On July 25, 2007, the Company entered into an addendum to the employment agreement that provided that Mr. Turissini's employment agreement shall be annually renewable through October 24, 2009. On July 15, 2009, the Company entered into an addendum to the employment agreement that provided that the term of Mr. Turissini's employment agreement shall extend through October 31, 2011. The agreement, as amended pursuant to the July 15, 2009 addendum, provides for: (1) a base salary of $250,000 per year; (2) reimbursement for additional actual business expenses consistent with our existing policies that have been incurred for our benefit; (3) paid medical and other benefits consistent with our existing policies with respect to our key executives, as such policies may be amended from time to time in the future; and (4) performance incentive bonuses as may be granted annually at the discretion of the Compensation Committee of the Board of Directors.

The employment agreement also contains a termination provision. Mr. Turissini's employment period will continue from the date of his agreement on October 24, 2004 until October 31, 2011 unless terminated earlier by (a) Mr. Turissini's death or permanent disability which renders him unable to perform his duties hereunder (as determined by ORC and WidePoint in their good faith judgment), (b) Mr. Turissini's resignation, commencing from and after the third anniversary date of his employment agreement, upon prior written notice to ORC and WidePoint of 90 days before the annual anniversary date of his employment agreement, or (c) ORC and/or WidePoint for Cause. Mr. Turissini's employment agreement defines "Cause" as (i) the repeated failure or refusal of Mr. Turissini to follow the lawful directives of ORC, WidePoint or their designee (except due to sickness, injury or disabilities), after prior notice to Mr. Turissini and a reasonable opportunity to cure by Mr. Turissini of up to 30 days, (ii) gross inattention to duty or any other willful, reckless or grossly negligent act (or omission to act) by Mr. Turissini, which, in the good faith judgment of ORC and WidePoint, materially injures ORC or WidePoint, including the repeated failure to follow the policies and procedures of ORC or WidePoint, after prior notice to Mr. Turissini and a reasonable opportunity to cure by Mr. Turissini of up to 30 days, (iii) a material breach of the employment agreement by Mr. Turissini, after prior notice to Mr. Turissini and a reasonable opportunity to cure by Mr. Turissini of up to 30 days, (iv) the commission by Mr. Turissini of a felony or other crime involving moral turpitude or the commission by Mr. Turissini of an act of financial dishonesty against ORC or WidePoint or (v) a proper business purpose of ORC or WidePoint, which shall be limited only to a decrease in the staffing of the office in which Mr. Turissini is working or the elimination of the position filled by Mr. Turissini as a result of a material decrease in revenues and/or profits at the office in which Mr. Turissini is working, but with other cost cutting measures and the termination of other employees at such office being first considered and instituted as determined in the sole judgment of ORC and WidePoint prior to the termination of Mr. Turissini; provided, however, that in the event ORC terminates Mr. Turissini under subparagraph (v), then (I) the scope of the non-compete under Paragraph 5 of the employment agreement shall be limited to the products and services offered by ORC as of the termination of Mr. Turissini under subparagraph (v), and (II) ORC shall pay to Mr. Turissini his salary and benefits each month for the six month period immediately following such termination..

Mr. Turissini's employment agreement further provides that for one year following the termination of Mr. Turissini's employment agreement as a result of his resignation or a termination by ORC or WidePoint for Cause, Mr. Turissini will not own, manage, control, participate in, consult with, advertise on behalf of, render services for or in any manner engage in any competitive business of soliciting or providing any computer, technology, information technology, consulting or any other services and/or products of any type whatsoever to any federal, state and/or local governments and/or to any existing or targeted customers or clients of ORC and/or WidePoint; nor shall Mr. Turissini attempt to influence any then existing or targeted customers, clients or suppliers of ORC or WidePoint to curtail any business they are currently, or in the last 36 months have been, transacting with ORC or WidePoint. Furthermore, during such period, Mr. Turissini shall not, without ORC's or WidePoint's prior written consent, knowingly solicit or encourage any existing employee or recruit to leave or discourage their employment with ORC or WidePoint.

Mr. Kang. In January 2008, Jin Kang entered into an Employment and Non-Compete Agreement with iSYS, LLC and WidePoint, pursuant to which Mr. Kang serves as the President of iSYS. The agreement provides for (1) a base salary of $225,000 per year, which may be increased by the Company on an annual basis to reflect merit increases and which was increased in July 2009 to a base salary of $250,000, (2) reimbursement for business expenses consistent with our existing policies that have been incurred for our benefit, (3) paid medical and other benefits consistent with our existing policies with respect to our key executives, as such policies may be amended from time to time in the future, and (4) performance incentive bonuses as may be granted at the discretion of the Compensation Committee of the Board of Directors.

The agreement also contains a termination provision. His employment period will continue from the date of his agreement, January 4, 2008 until he is terminated either by (a) Mr. Kang's death or permanent disability, (b) Mr. Kang's resignation (other than for Good Reason), upon prior written notice to WidePoint and iSYS of 90 days, or (c) iSYS or WidePoint for Cause. Mr. Kang's employment agreement defines "Cause" as (i) the repeated failure or refusal of Mr. Kang to follow the lawful directives of iSYS, WidePoint or their designee (except due to sickness, injury or disabilities), after prior notice to Mr. Kang and a reasonable opportunity to cure by Mr. Kang of up to 30 days, (ii) gross inattention to duty or any other willful, reckless or grossly negligent act (or omission to act) by Mr. Kang, which, in the good faith judgment of WidePoint or iSYS, materially injures WidePoint or iSYS, including the repeated failure to follow the policies and procedures of WidePoint or iSYS, after prior notice to Mr. Kang and a reasonable opportunity to cure by Mr. Kang of up to 30 days, (iii) a material breach of his employment agreement by Mr. Kang, after prior notice to Mr. Kang and a reasonable opportunity to cure by Mr. Kang of up to 30 days or (iv) the conviction by Mr. Kang of a felony or other crime involving moral turpitude or the commission by Mr. Kang of an act of financial dishonesty against WidePoint or iSYS. Good Reason shall mean (i) a material breach of the employment agreement by WidePoint or iSYS, subject to written notice and an opportunity to cure of up to 30 days, (ii) any material adverse alteration or diminution of Mr. Kang's duties, subject to written notice and an opportunity to cure of up to 30 days, and (iii) the relocation of iSYS' principal executive offices to a location more than 50 miles from its present location.

Upon termination of Mr. Kang's employment without Cause or by Mr. Kang for Good Reason (as defined in Mr. Kang's employment agreement), iSYS shall pay to Mr. Kang (i) any unpaid base salary as of the date of termination, (ii) in the event that the termination occurs prior to the third anniversary of WidePoint's acquisition of iSYS, base salary from the date of termination until the third anniversary of WidePoint's acquisition of iSYS, (iii) a pro rata portion of any bonus payable to Mr. Kang in respect of the year in which the termination occurs and (iv) reimbursement of outstanding business expenses.

Mr. Kang's employment agreement further provides that during the employment period and for two years following the termination of Mr. Kang's employment as a result of his resignation other than for Good Reason or a termination by WidePoint or iSYS for Cause, Mr. Kang will not own, manage, control, participate in, consult with, advertise on behalf of, render services for or in any manner engage in any competitive business of soliciting or providing any computer, technology, information technology, consulting or any other services and/or products of any type whatsoever to any federal, state and/or local governments and/or to any existing or targeted customers or clients of WidePoint and iSYS; nor shall Mr. Kang attempt to influence any then existing or targeted customers, clients, consultants or suppliers of WidePoint or iSYS to curtail any business they are currently, or in the last 36 months have been, transacting with WidePoint or iSYS. Furthermore, during such period, Mr. Kang shall not, without the prior written consent of WidePoint and iSYS, knowingly solicit or encourage any existing employee, consultant or recruit to leave or discourage their employment with WidePoint or iSYS.

Director Compensation

Directors who are not also officers or employees receive an annual fee of $12,000. The following table sets forth director compensation for fees paid and stock option compensation expense recognized by the Company in 2010:

Director Name	Fees Earned or Paid in Cash ($)	Option Awards ($)(1)	All Other Compensation ($)	Total ($)
James Ritter	12,000	13,500	-	25,500
Morton Taubman	12,000	8,870	-	20,870
George Norwood	12,000	3,790	-	15,790
Otto Guenther	12,000	3,790	-	15,790

(1) The amounts set forth in this column represent compensation expense as determined by the Black-Scholes calculation recognized by the Company in 2008 with respect to options grants, if any, in 2010. Reference is made to Note 2 to our financial statements contained herein with respect to the calculation of such expense. The aggregate number of shares subject to outstanding options held by each director as of December 31, 2010 is as follows: Mr. Ritter, 75,000; Mr. Taubman, 62,000; General Norwood, 62,000; and General Guenther, 62,000.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The following table sets forth information as to those holders (other than officers and directors) known to WidePoint to be the beneficial owners of more than 5% of the outstanding shares of Common Stock as of March 22, 2011.

Security Ownership of Certain Beneficial Owners (Greater than 5% Holders)

Names and Complete Mailing Address	Number of Shares of Common Stock	Percent of Common Stock Outstanding	
Citigroup Inc., Citigroup Global Markets, Inc., Citigroup Financial Products Inc and Citigroup Global Markets Holdings Inc. 388 Greenwich Street New York, NY 10013	3,495,921	5.6	%(1)
Samuel Andrew Donaldson and Janice Smith Donaldson 1121 Crest Lane McLean, Virginia, 22101	3,545,799	5.7	%(2)
Ilex Partners, L.L.C., Steinhardt Overseas Management, L.P., and Michael H. Steinhardt 650 Madison Avenue, 17th Floor New York, New York 10022	3,486,868	5.6	%(3)
Ewing & Partners, Timothy G. Ewing, Ewing Asset Management, LLC and Endurance General Partners, L.P. 4515 Cole Avenue Suite 808 Dallas, TX 75205	3,280,500	5.2	%(4)

(1) Citigroup Inc, Citigroup Global Markets, Citigroup Financial Products Inc., and Citigroup Global Markets Holdings Inc. have no sole voting power in respect of the shares listed above; shared voting power in respect of all shares listed above; no sole dispositive power in respect of the shares listed above; and shared dispositive power in respect of all the shares listed above. Information based solely on a Schedule 13G/A filed with the SEC on February 4, 2011.

(2) Samuel Andrew Donaldson and Janice Smith Donaldson have no sole voting power in respect of the shares listed above; shared voting power in respect of all shares listed above; no sole dispositive power in respect of the shares listed above; and shared dispositive power in respect of all the shares listed above.
Information based solely on a Schedule 13G/A filed with the SEC on March 15, 2011.

(3) Ilex Partners, L.L.C., Steinhardt Overseas Management, L.P., and Michael H. Steinhardt have no sole voting power in respect of the shares listed above; shared voting power in respect of the shares listed above; no sole dispositive power in respect of the shares listed above; and shared dispositive power in respect of all the shares listed above. Information based solely on a Schedule 13G/A filed with the SEC on February 9, 2011.

(4) Ewing & Partners is deemed a beneficial owner of the shares listed above and each of the other listed persons or entities is deemed a beneficial owner of 3,240,500 of the shares listed above, which includes 2,312,260 shares owned by Endurance Partners (Q.P.), L.P. and 928,240 shares owned by Endurance Partners, L.P. Information based solely on a Schedule 13G/A filed with the SEC on February 13, 2009.

The following table sets forth the number of shares of our Common Stock beneficially owned as of March 22, 2011 with respect to the beneficial ownership of Common Stock by each director, director nominee, and each executive officer named in the Summary Compensation Table herein. In general, "beneficial ownership" includes those shares a director or executive officer has the power to vote or transfer, except as otherwise noted, and shares underlying warrants and stock options that are exercisable currently or within 60 days. The calculation of the percentage of outstanding shares is based on 62,674,271 shares outstanding as of March 22, 2011.

Security Ownership of Directors and Executive Officers

Directors, Nominees and Executive Officers	Number of Shares of Common Stock (1)	Percent of Outstanding Common Stock (1)	
Steve Komar (2)	1,959,203	3.13	%
Morton Taubman (3)	62,000	0.99	%
James McCubbin (4)	1,600,203	2.55	%
James Ritter (5)	140,500	0.22	%
Daniel Turissini (6)	1,192,471	1.90	%
Ronald Oxley (7)	133,000	0.21	%
Jin Kang (8)	2,522,794	4.03	%
Otto Guenther (9)	62,000	0.09	%
George Norwood (10)	62,000	0.09	%
All directors and officers as a group (9 persons) (11)	7,734,171	12.34	%

(1) Assumes in the case of each shareholder listed above that all warrants or options held by such shareholder that are exercisable currently or within 60 days were fully exercised by such shareholder, without the exercise of any warrants or options held by any other shareholders.

(2) Includes (i) 641,100 shares owned directly by Mr. Komar, (ii) 525,000 shares subject to exercisable options to purchase shares from the Company, and (iii) 793,103 shares held by SLK Diversified L.P., a limited partnership controlled by Mr. Komar, as a result of which such shares are held by Mr. Komar indirectly. Does not include 250,000 unvested shares owned directly by Mr. Komar.

(3) Includes 62,000 shares subject to exercisable options to purchase shares from the Company.

(4) Includes 1,600,203 shares owned directly by Mr. McCubbin. Does not include 250,000 unvested shares owned directly by Mr. McCubbin.

(5) Includes (i) 65,500 shares owned directly by Mr. Ritter, (ii) 50,000 shares of Common Stock that may be purchased by him at a price of $0.13 per share through December 31, 2013, under an option granted on December 31, 2003, and (iii) 25,000 shares of Common Stock that may be purchased by him at a price of $0.54 per share through May 11, 2019, under an option granted on May 11, 2009.

(6) Includes (i) 722,471 shares owned directly by Mr. Turissini, and (ii) 470,000 shares subject to exercisable options to purchase shares from the Company.

(7) Includes (i) 71,000 shares owned directly by Mr. Oxley, and (ii) 62,000 shares subject to exercisable options to purchase shares from the Company. Does not include 250,000 shares that may be purchased by Mr. Oxley at a price of $0.83 per share until July 25, 2018, pursuant to a stock option granted to him on May 11, 2009.

(8) Includes (i) 2,207,794 shares owned directly by Mr. Kang, and (ii) 315,000 shares subject to exercisable options to purchase shares from the Company.

(9) Includes 62,000 shares subject to exercisable options to purchase shares from the Company.

(10) Includes 62,000 shares subject to exercisable options to purchase shares from the Company.

(11) Includes the shares referred to as included in notes (2), (3), (4), (5), (6), (7), (8), (9), and (10), above.

Equity Compensation Plan Information:

The following table sets forth information as of December 31, 2010, with respect to the Company's compensation plans under which its Common Stock is authorized for issuance:

	(a) Number of securities to be issued upon exercise of outstanding options, warrants, and rights	(b) Weighted average exercise price of outstanding options, warrants, and rights	(c) Number of securities remaining available for future issuance (excluding securities reflected in column (a))
Equity Compensation Plans:			
Approved by security holders	3,587,000	$ 0.62	4,071,049
Not approved by security holders	—	—	—
Total	3,587,000	$ 0.62	4,071,049

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

A related person transaction is a consummated or currently proposed transaction in which the Company has been, is or will be a participant and the amount involved exceeds $120,000, and in which a related person (i.e., any director or executive officer or nominee for director, or any member of the immediate family of such person) has or will have a direct or indirect material interest.

The Company was not a participant in any related person transactions since the beginning of the Company's last fiscal year and no such transactions are currently proposed, with the exception that on October 6, 2010 and November 18, 2010, James T. McCubbin, presently an officer and director of the Company, exercised, in the form of a cashless exercise, his warrant to purchase an aggregate of 450,000 shares of Common Stock of the Company, which warrant was previously issued to such individual pursuant to a Warrant Purchase Agreement, dated January 2, 2001, by and between the Company and each such individual. As a result of his exercise of such warrant, James T. McCubbin, was issued 450,000 shares of common stock of the Company.

Under the Company's corporate governance principles (the "Corporate Governance Principles"), a majority of the Company's Board will consist of independent directors. An "independent" director is a director who meets the NYSE Amex definition of independence and other applicable independence standards under SEC guidelines, as determined by the Board. The Company's Corporate Governance and Nominating Committee conducts an annual review of the independence of the members of the Board and its Committees and reports its findings to the full Board of Directors. Based on the report and recommendation of the Corporate Governance Committee, the Board has determined that each of the Company's non-employee directors—Messrs. Taubman, Ritter, Guenther, and Norwood—satisfies the independence criteria (including the enhanced criteria with respect to members of the Audit Committee) set forth in the applicable NYSE Amex listing standards and SEC rules. Each Board Committee consists entirely of independent, non-employee directors.

For a director to be considered independent, the Board of Directors must determine that the director does not have any direct or indirect material relationships (including vendor, supplier, consulting, legal, banking, accounting, charitable and family relationships) with WidePoint, other than as a director and shareholder. NYSE Amex listing standards also impose certain per se bars to independence, which are based upon a director's relationships with WidePoint currently and during the three years preceding the Board's determination of independence.

The Board considered all relevant facts and circumstances in making its determinations, including the following:

• No non-employee director receives any direct compensation from WidePoint other than under the director compensation program described in this proxy statement.

• No immediate family member (within the meaning of the NYSE Amex listing standards) of any non-employee director is an employee of WidePoint or otherwise receives direct compensation from WidePoint.

• No non-employee director (or any of their respective immediate family members) is affiliated with or employed in a professional capacity by WidePoint's independent accountants.

• No non-employee director is a member, partner, or principal of any law firm, accounting firm or investment banking firm that receives any consulting, advisory or other fees from WidePoint.

• No WidePoint executive officer is on the compensation committee of the board of directors of a company that employs any of our non-employee directors (or any of their respective immediate family members) as an executive officer.

• No non-employee director (or any of their respective immediate family members) is indebted to WidePoint, nor is WidePoint indebted to any non-employee director (or any of their respective immediate family members).

• No non-employee director serves as an executive officer of a charitable or other tax-exempt organization that received contributions from WidePoint.

Non-management members of the Board of Directors conduct at least two regularly-scheduled meetings per year without members of management being present. Mr. Ritter serves as the presiding director of such meetings. Following an executive session of non-employee directors, the presiding director may act as a liaison between the non-employee directors and the Chairman, provide the Chairman with input regarding agenda items for Board of Directors and Committee meetings, and coordinate with the Chairman regarding information to be provided to the non-employee directors in performing their duties.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

Audit Fees

The Company paid Moss Adams approximately $30,400 in fees for audit and review work for fiscal year 2009 that was paid in fiscal year 2009 and an additional $18,100 in fees for audit and review work for fiscal year 2009 that was paid in fiscal year 2010. The Company paid Moss Adams approximately $32,200 in fees for audit and review work for fiscal year 2010 that was paid in fiscal year 2010 and an additional $20,000 in fees for audit and review work for fiscal year 2010 that was paid in fiscal year 2011. The Company will pay Moss Adams in 2011 approximately $81,800 in audit and review fees for work associated with the Company's fiscal year 2010 audit.

Audit-Related Fees

The Company did not pay Moss Adams LLP any audit-related fees for fiscal year 2009 or 2010.

Tax Fees

The Company did not pay Moss Adams any tax fees in 2009. The Company paid Moss Adams in 2010 approximately \$9,300 in tax fees for work associated with the Company's fiscal year 2009 Internal Revenue Code Section 382 tax analysis.

All Other Fees

The Company did not pay Moss Adams any nonaudit fees for fiscal year 2009. The company did pay Moss Adams approximately \$3,200 in nonaudit fees for fiscal year 2010 in fiscal year 2011 and will pay Moss Adams in 2011 approximately \$10,000 in additional nonaudit fees.

Audit Committee Policies and Procedures For Pre-Approval of Independent Auditor Services

The following describes the Audit Committee's policies and procedures regarding pre-approval of the engagement of the Company's independent auditor to perform audit as well as permissible non-audit services for the Company.

For audit services, the independent auditor will provide the Committee with an engagement letter during the March-May quarter of each year outlining the scope of the audit services proposed to be performed in connection with the audit of the current fiscal year. If agreed to by the Committee, the engagement letter will be formally accepted by the Committee at an Audit Committee meeting held as soon as practicable following receipt of the engagement letter. The independent auditor will submit to the Committee for approval an audit services fee proposal after acceptance of the engagement letter.

For non-audit services, Company management may submit to the Committee for approval (during May through September of each fiscal year) the list of non-audit services that it recommends the Committee engage the independent auditor to provide for the fiscal year. The list of services must be detailed as to the particular service and may not call for broad categorical approvals. Company management and the independent auditor will each confirm to the Audit Committee that each non-audit service on the list is permissible under all applicable legal requirements. In addition to the list of planned non-audit services, a budget estimating non-audit service spending for the fiscal year may be provided. The Committee will consider for approval both the list of permissible non-audit services and the budget for such services. The Committee will be informed routinely as to the non-audit services actually provided by the independent auditor pursuant to this pre-approval process.

To ensure prompt handling of unexpected matters, the Audit Committee delegates to its Chairman the authority to amend or modify the list of approved permissible non-audit services and fees. The Chairman will report any action taken pursuant to this delegation to the Committee at its next meeting.

All audit and non-audit services provided to the Company are required to be pre-approved by the Committee. The Chief Financial Officer of the Company will be responsible for tracking all independent auditor fees against the budget for such services and report at least annually to the Audit Committee.

Part IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) Financial Statements and Financial Statement Schedule

(1) Financial Statements:

Report of Moss Adams LLP, Independent Registered Public Accounting Firm.

Consolidated Balance Sheets as of December 31, 2010 and 2009.

Consolidated Statements of Operations for the Years Ended December 31, 2010 and 2009.

Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 2010 and 2009.

Consolidated Statements of Cash Flow for the Years Ended December 31, 2010 and 2009.

Notes to Consolidated Financial Statements.

All other schedules are omitted either because they are not applicable or not required, or because the required information is included in the financial statements or notes thereto.

(b) Exhibits: The following exhibits are filed herewith or incorporated herein by reference:

EXHIBIT NO	
2.1	Membership Interest Purchase Agreement, dated as of January 2, 2008, between the Company, iSYS LLC, and Jin Kang. (Incorporated herein by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)
3.1	Amended and Restated Certificate of Incorporation of WidePoint Corporation. (Incorporated herein by reference to Exhibit A to the Registrant's Definitive Proxy Statement, as filed on December 27, 2004.)
3.2	Bylaws of ZMAX Corporation. (Incorporated herein by reference to Exhibit 3.6 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833))
4.1	Certificate Of Designations, Rights And Preferences Of The Series A Convertible Preferred Stock between WidePoint Corporation and Barron Partners LP (Incorporated herein by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K/A filed on November 2, 2004.))
10.1	Employment and Non-Compete Agreement between WidePoint Corporation, Operational Research Consultants, Inc and Daniel Turissini.* (Incorporated herein by reference to Exhibit 10.15 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2006.)
10.2	Addendum to Employment and Non-Compete Agreement between the Registrant and Daniel E. Turissini, effective as of July 25, 2007. *(Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 30, 2007.)
10.3	$2,000,000 Installment Cash Promissory Note, dated January 4, 2008, issued by the Company in favor of Jin Kang. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)
10.4	Employment and Non-Compete Agreement, dated as of January 4, 2008, between the Company, iSYS LLC and Jin Kang. * (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)
10.5	Commercial Loan Agreement, dated January 2, 2008, between the Company and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)

* Management contract or compensatory plan.

10.6 Security Agreement, dated January 2, 2008, between the Company and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)

10.7 $5,000,000 Promissory Note, dated January 2, 2008, issued by the Company in favor of Cardinal Bank. (Incorporated herein by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)

10.8 Security Agreement, dated January 2, 2008, between the Company and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)

10.9 $2,000,000 Promissory Note, dated January 2, 2008, issued by the Company in favor of Cardinal Bank. (Incorporated herein by reference to Exhibit 10.7 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)

10.10 Debt Subordination Agreement, dated January 2, 2008, between the Company and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.8 to the Registrant's Current Report on Form 8-K filed on January 8, 2008.)

10.11 Common Stock Purchase Agreement, dated April 29, 2008, between the Company and Deutsche Bank AG, London Branch. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on May 5, 2008.)

10.12 Escrow Agreement, dated April 29, 2008, between the Company, Deutsche Bank AG, London Branch and Foley & Lardner LLP as Escrow Agent. (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on May 5, 2008.)

10.13 Common Stock Purchase Agreement, dated May 16, 2008, between the Company and Endurance Partners, L.P. (Incorporated herein by reference to Exhibit 10.11 to the Registrant's Quarterly Report on Form 10-Q filed on May 20, 2008.)

10.14 Escrow Agreement, dated May 16, 2008, between the Company, Endurance Partners, L.P. and Foley & Lardner LLP as Escrow Agent. (Incorporated herein by reference to Exhibit 10.12 to the Registrant's Quarterly Report on Form 10-Q filed on May 20, 2008).

10.15 Common Stock Purchase Agreement, dated May 16, 2008, between the Company and Endurance Partners (Q.P.), L.P. (Incorporated herein by reference to Exhibit 10.13 to the Registrant's Quarterly Report on Form 10-Q filed on May 20, 2008).

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* Management contract or compensatory plan.

10.16 Escrow Agreement, dated May 16, 2008, between the Company, Endurance Partners (Q.P.), L.P. and Foley & Lardner LLP as Escrow Agent. (Incorporated herein by reference to Exhibit 10.14 to the Registrant's Quarterly Report on Form 10-Q filed on May 20, 2008).

10.17 Amendment, dated as of July 25, 2008, between the Registrant and Steven L. Komar.* (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 31, 2008).

10.18 Amendment, dated as of July 25, 2008, between the Registrant and James T. McCubbin.* (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on July 31, 2008).

10.19 Asset Purchase Agreement, dated July 31, 2008, by and among the Registrant, Protexx Acquisition Corporation, Protexx Incorporated, Peter Letizia, Charles B. Manuel, Jr. and William Tabor. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 6, 2008).

10.20 Debt Modification Agreement, dated as of March 17, 2009, between the Registrant and its subsidiaries and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 23, 2009)

10.21 Commercial Loan Agreement, dated as of March 17, 2009, between the Registrant and its subsidiaries and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on March 23, 2009)

10.22 Employment and Non-Compete Agreement, dated May 2008, between the Registrant and Ronald Oxley* (Incorporated herein by reference to Exhibit 10.33 to the Registrant's Annual Report on Form 10-K/A filed on April 30, 2009.)

10.23 Addendum Employment and Non-Compete Agreement*, dated July 15, 2009, by and between Registrant and Daniel E. Turissini (Incorporated herein by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed on July 21, 2009)

10.24 Supplement to Exhibit A to the Membership Interest Purchase Agreement, dated as of August 14, 2009 (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Annual Report on Form 10-K/A filed on August 18, 2009)

10.25 Debt Modification Agreement, dated as of May 25, 2010, between the Registrant and its subsidiaries and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on June 1, 2010)

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* Management contract or compensatory plan.

10.26	Debt Modification Agreement, dated as of August 26, 2010, between the Registrant and its subsidiaries and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 27, 2010)
10.27	Commercial Loan Agreement, dated as of August 26, 2010, between the Registrant and its subsidiaries and Cardinal Bank. (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on August 27, 2010)
10.28	Employment Agreement between WidePoint Corporation and Steve L. Komar, dated August 13, 2010.* (Incorporated herein by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q, as filed on August 16, 2010)
10.29	Employment Agreement between WidePoint Corporation and James McCubbin, dated August 13, 2010.* (Incorporated herein by reference to Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q, as filed on August 16, 2010)
21	Subsidiaries of WidePoint Corporation (Filed herewith).
23.1	Consent of Moss Adams LLP (Filed herewith).
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith).
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith).
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	WidePoint Corporation
Date: March 29, 2011	s/ STEVE L. KOMAR Steve L. Komar Chief Executive Officer
Date: March 29, 2011	/s/ JAMES T. MCCUBBIN James T. McCubbin Executive Vice President – Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, on behalf of the registrant and in the capacities and on the dates indicated.

Dated: March 29, 2011	/s/STEVE L. KOMAR Steve L. Komar Director and Chief Executive Officer (Principal Executive Officer)
Dated: March 29, 2011	/s/JAMES T. MCCUBBIN James T. McCubbin Director, Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)
Dated: March 29, 2011	/s/JAMES M. RITTER James M. Ritter Director
Dated: March 29, 2011	/s/MORTON S. TAUBMAN Morton S. Taubman Director
Dated: March 29, 2011	/s/RON S. OXLEY Ron Oxley Director
Dated: March 29, 2011	/s/OTTO GUENTHER Otto Guenther Director
Dated: March 29, 2011	/s/GEORGE NORWOOD George Norwood Director

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of WidePoint Corporation:

We have audited the accompanying consolidated balance sheets of WidePoint Corporation and subsidiaries as of December 31, 2010 and 2009 and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion of these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of WidePoint Corporation and subsidiaries as of December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/Moss Adams LLP
Scottsdale, Arizona
March 29, 2011

WIDEPOINT CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31, 2010	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$5,816,303	$6,238,788
Accounts receivable, net of allowance of $0 and $52,650, respectively	7,794,913	7,055,525
Unbilled accounts receivable	3,059,665	1,334,455
Prepaid expenses and other assets	473,320	359,563
Current deferred income tax asset	412,801	—
Total current assets	17,557,002	14,988,331
Property and equipment, net	1,241,510	538,811
Goodwill	11,329,917	9,770,647
Other Intangibles, net	1,104,551	1,381,580
Noncurrent deferred income tax asset, net	3,116,705	—
Other assets	46,455	75,718
Total assets	$34,396,140	$26,755,087
Liabilities and stockholders' equity		
Current liabilities:		
Short term note payable	$94,809	$102,074
Accounts payable	7,725,727	7,120,168
Accrued expenses	2,643,613	2,304,995
Income taxes payable	143,450	—
Deferred revenue	294,541	768,504
Current portion of long-term debt	572,943	520,855
Current portion of deferred rent	20,835	54,497
Current portion of capital lease obligation	44,724	112,576
Total current liabilities	11,540,642	10,983,669
Deferred income tax liability, net	—	313,782
Long-term debt, net of current portion	564,490	604,048
Fair value of earnout liability	153,000	—
Deferred rent, net of current portion	98,702	7,312
Capital lease obligation, net of current portion	22,908	67,632
Total liabilities	12,379,742	11,976,443
Stockholders' equity:		
Common stock, $0.001 par value; 110,000,000 shares authorized; 62,690,873 and 61,375,333 shares issued and outstanding, respectively	62,691	61,375
Stock warrants	—	24,375
Additional paid-in capital	68,754,353	67,874,394
Accumulated deficit	(46,800,646)	(53,181,500)
Total stockholders' equity	22,016,398	14,778,644
Total liabilities and stockholders' equity	$34,396,140	$26,755,087

F-2

WIDEPOINT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations

	For the Years Ended December 31, 2010	2009
Revenues, net	$50,812,776	$43,344,053
Cost of revenues (including depreciation and amortization of $807,603 and 950,947, respectively)	37,548,018	33,845,685
Gross profit	13,264,758	9,498,368
Sales and marketing	1,811,305	1,145,955
General and administrative (including stock compensation expense of $110,398 and $146,782, respectively)	8,447,897	6,456,870
Depreciation expense	201,236	179,413
Income from operations	2,804,320	1,716,130
Other income (expenses):		
Interest income	18,440	27,690
Interest expense	(90,052)	(176,424)
Other expense	—	(49)
Total other income (expense)	(71,612)	(148,783)
Net income before provision for income taxes	2,732,708	1,567,347
Income tax (benefit) expense	(3,648,146)	156,891
Net income	$6,380,854	$1,410,456
Basic earnings per share	$0.10	$0.02
Basic weighted-average shares outstanding	61,555,664	59,419,383
Diluted earnings per share	$0.10	$0.02
Diluted weighted-average shares outstanding	62,862,978	60,608,984

WIDEPOINT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity

	Common Stock Shares	Common Stock Amount	Stock Warrants	Additional Paid-In Capital	Accumulated Deficit	Equity Total
Balance, December 31, 2008	58,275,514	$ 58,276	$ 38,666	$ 67,194,788	$ (54,591,956)	$ 12,699,774
Issuance of common stock — options exercises	30,000	30		3,720		3,750
Issuance of common stock — iSYS earnout	690,510	690		517,192		517,882
Issuance of common stock — warrants exercises	2,379,309	2,379		(2,379)		—
Expiration of common stock warrants			(14,291)	14,291		—
Stock options expense				146,782		146,782
Net income					1,410,456	1,410,456
Balance, December 31, 2009	61,375,333	$ 61,375	$ 24,375	$ 67,874,394	$ (53,181,500)	$ 14,778,644
Issuance of common stock — options exercises	869,800	870		148,340		149,210
Issuance of common stock — iSYS earnout	445,740	446		596,846		597,292
Issuance of common stock — restricted	—	—		10,167		10,167
Expiration of common stock warrants			(24,375)	24,375		—
Stock options expense				100,231		100,231
Net income					6,380,854	6,380,854
Balance, December 31, 2010	62,690,873	$ 62,691	$ —	$ 68,754,353	$ (46,800,646)	$ 22,016,398

WIDEPOINT CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	For the Years Ended December 31,	
	2010	2009
Cash flows from operating activities:		
Net income	$6,380,854	$1,410,456
Adjustments to reconcile net income to net cash provided by operating activities		
Deferred income tax (benefit) expense	(3,843,288)	156,891
Depreciation expense	302,754	244,980
Amortization of intangibles	706,085	885,380
Amortization of deferred financing costs	5,852	9,576
Share-based compensation expense	110,398	146,782
Loss on disposal of equipment	8,559	49
Changes in assets and liabilities, net of business combination –		
Accounts receivable and unbilled accounts receivable	(2,464,598)	(805,895)
Prepaid expenses and other assets	(71,757)	135,673
Accounts payable and accrued expenses	851,067	3,803,828
Income taxes payable	143,450	—
Deferred revenue	(473,963)	(899,465)
Net cash provided by operating activities	1,655,413	5,088,255
Cash flows from investing activities:		
Purchase of assets/subsidiaries, net of cash acquired	(383,701)	—
Earnout consideration paid as additional consideration in the acquisition of iSYS	(690,510)	(184,817)
Software development costs	(74,056)	(30,397)
Purchases of property and equipment	(970,337)	(258,249)
Net cash used in investing activities	(2,118,604)	(473,463)
Cash flows from financing activities:		
Borrowings on notes payable	668,653	400,737
Principal payments on notes payable	(664,581)	(3,027,334)
Principal payments under capital lease obligation	(112,576)	(116,583)
Costs related to renewal fee for line of credit	—	(12,000)
Proceeds from exercise of stock options	149,210	3,750
Net cash provided by (used in) financing activities	40,706	(2,751,430)
Net (decrease) increase in cash	(422,485)	1,863,362
Cash and cash equivalents, beginning of period	6,238,788	4,375,426
Cash and cash equivalents, ending of period	$5,816,303	$6,238,788
Supplementary cash flow information:		
Cash paid for–		
Interest	$81,674	$321,780
Income taxes	51,776	$—
Supplementary Disclosure of non-cash Investing and Financing Activities:		
	$597,292	$517,882

Fair value of 445,740 and 690,510 earnout shares issued as additional consideration in the acquisition of iSYS		
Insurance policies financed by short term notes payable	$140,653	$152,479
Capital leases for acquisition of property and equipment	$—	$94,402

Notes to Consolidated Financial Statements

1. Organization and Nature of Operations

Organization

WidePoint was incorporated in Delaware on May 30, 1997. WidePoint Corporation ("WidePoint" or the "Company") is a provider of advanced, federally certified and other customized technology-based products and service solutions to both the government sector and commercial markets. Our advanced technology-based solutions enable organizations to deploy fully compliant IT services in accordance with government requirements and the demands of the commercial marketplace. We have grown through the merger with and acquisition of highly specialized regional IT consulting companies.

Our staff consists of business process and computer specialists who help our government and civilian customers augment and expand their resident technologic skills and competencies, drive technical innovation, and help develop and maintain a competitive edge in today's rapidly changing technological environment in business. Our organization emphasizes an intense commitment to our people, our customers, and the quality of our solutions offerings. As a services organization, our customers are our primary focus.

Nature of Operations

We provide our advanced technology-based products and solutions through three business segments. Our three business segments include: Wireless Mobility Management, Cybersecurity Solutions, and Consulting Services and Products. These segments offer unique solutions and proprietary IP in mobile and wireless full life cycle management solutions; cybersecurity solutions with an expertise in identity management services utilizing certificate-based security solutions; and other associated IT consulting services and products in which we provide specific subject matter expertise in IT Architecture and Planning, Software Implementation Services, IT Outsourcing, and Forensic Informatics. Our three business segments are operated through six wholly-owned operational entities and their principal operations are described as follows:

§ iSYS, LLC ("iSYS"): iSYS specializes in providing the U.S. government and its agencies mobile telecommunications expense management (MTEM) services and forensic informatics, and information assurance services. Operates in our Wireless Mobility Management and Consulting Services and Products segments.

§ Operational Research Consultants, Inc. ("ORC"): ORC specializes in providing the U.S. government and its agencies, as well as commercial businesses, with compliant information and identity assurance management solutions consisting of identity proofing and credentialing through its internally-developed proprietary Public Key Infrastructure (PKI) technologies. Operates in our Cybersecurity Solutions and Consulting Services and Products segments.

- § Advanced Research Concepts Corporation ("ARCC"): ARCC was formed in January 2010 and acquired certain assets of Vuance, Inc. (see Note 4 for additional information regarding this transaction). ARCC provides state governments and commercial businesses with secure critical response management solutions designed to improve coordination within emergency services and critical infrastructure agencies. Operates in our Cybersecurity Solutions segment.

- § WidePoint IL, Inc. and WP NBIL, Inc.: WPNBIL operates in conjunction with WidePoint IL and provides IT architecture and planning, software implementation and IT outsourcing services to the U.S. government or as a subcontractor through large commercial businesses. Operates in our Consulting Services and Products segment.

- § Protexx Acquisition Corporation d/b/a Protexx: Protexx was formed in July 2008 and acquired certain assets of Protexx Inc. Protexx specializes in identity assurance and mobile and wireless data protection services. Protexx is a development stage company. Operates in our Cybersecurity Solutions segment.

2. Significant Accounting Policies

Basis of Presentation

The accompanying Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the financial statement rules and regulations of the Securities and Exchange Commission.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company amounts have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the U.S. 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 period. The more significant areas requiring use of estimates and judgment relate to revenue recognition, accounts receivable valuation reserves, realizability of intangible assets, realizability of deferred income tax assets and the evaluation of contingencies and litigation. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

Significant Customers

For the years ended December 31, 2010 and 2009, respectively, three iSYS customers represented individually the respective percentages of our consolidated revenues set forth in the table below.

Customer Name	2010 (%) Revenue		2009 (%) Revenue	
Transportation Security Administration (“TSA”)	21	%	22	%
Department of Homeland Security (“DHS”)	19	%	22	%
Washington Headquarters Services (“WHS”)	11	%	18	%

WHS revenues as a percentage of consolidated revenues declined to 11% in 2010 from 18% in 2009, which is due to a decision by WHS in the second quarter of 2010 to no longer purchase billable minutes along with the wireless management services.

Due to the nature of our business and the relative size of certain contracts, which are entered into in the ordinary course of business, the loss of any single significant customer could have a material adverse effect on our results of operations.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist of cash and cash equivalents and accounts receivable. As of December 31, 2010, two iSYS customers, TSA and DHS, accounted for approximately 30% and 24%, respectively, of accounts receivable and unbilled accounts receivable. As of December 31, 2009, three clients, DHS, TSA, and WHS, accounted for approximately 30%, 26%, and 20%, respectively, of accounts receivable and unbilled accounts receivable.

Fair value of financial instruments

The consolidated financial statements include financial instruments for which the fair market value may differ from amounts reflected on a historical basis. The Company’s financial instruments include cash equivalents, accounts receivable, notes receivable, accounts payable, short-term debt and other financial instruments associated with the issuance of the common stock. The carrying values of cash equivalents, accounts receivable, notes receivable, and accounts payable approximate their fair value because of the short maturity of these instruments and past evidence that these instruments settle for their carrying value. The carrying amounts of the Company’s bank borrowings under its credit facility approximate fair value because the interest rates are reset periodically to reflect current market rates.

Cash and Cash Equivalents

The Company maintains interest-bearing cash deposits and short-term overnight investments with a large financial institution. The Company considers all highly liquid investments with original maturities of three months or less are considered to be cash equivalents for purposes of these consolidated financial statements. Interest-bearing cash deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to a maximum of $250,000. At December 31, 2010 and 2009, the Company had interest-bearing deposits with a large financial institution in excess of FDIC limits of approximately $4,192,000 and $5,712,000, respectively.

Accounts Receivable

The majority of the Company's accounts receivable is due from the federal government and established private sector companies in the following industries: manufacturing, customer product goods, direct marketing, healthcare, and financial services. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are usually due within 30 to 60 days and are stated at amounts due from customers net of an allowance for doubtful accounts if deemed necessary. Customer account balances outstanding longer than the contractual payment terms are reviewed for collectability and after 90 days are considered past due unless arrangements were made at the time of the transaction that specified different payment terms.

The Company determines its allowance by considering a number of factors, including the length of time accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

The Company has not historically maintained a bad debt reserve for our federal government or commercial customers as we have not witnessed any material or recurring bad debt charges and the nature and size of the contracts has not necessitated the Company's establishment of such a bad debt reserve. Upon specific review and our determination that a bad debt reserve may be required, we will reserve such amount if we view the account as potentially uncollectable.

Unbilled Accounts Receivable

Unbilled accounts receivable on time-and-materials contracts represent costs incurred and gross profit recognized near the period-end but not billed until the following period. Unbilled accounts receivable on fixed-price contracts predominantly consist of third party VAR hardware and software products delivered and MTEM services provided that are not yet billable under the contract terms. At December 31, 2010 and December 31, 2009, unbilled accounts receivable totaled approximately $3,060,000 and $1,334,000, respectively.

Revenue Recognition

A material portion of the Company's revenue arrangements are derived from cost-plus-fixed-fee, cost-plus-award-fee, firm-fixed-price or time-and-materials contracts with federal and state governments and their agencies. Customer orders are generally submitted through task orders or purchase requisitions under a master contract or under an individual purchase requisition. Tangible goods and services provided under customer contracts are generally not interdependent. The Company's revenue streams and related revenue recognition are as follows:

- § Wireless Mobility Management includes mobile telecommunications expense management services and device management that are billed under a time and materials contract. Revenue is recognized when persuasive evidence of an arrangement exists, services have been rendered, the contract price is fixed or determinable and collectability is reasonably assured. The Company has a standard internal process that is used to determine whether all required criteria for revenue recognition have been met. Revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred to manage telecommunications carrier air and data services. The Company also charges a monthly user access and device management fee. The Company acquires telecommunication devices for the customer and recognizes revenue upon receipt of inventory and bills for services at cost plus applicable contractual fees earned. The Company also offers billing management services, which may subject the Company to credit risk as we are responsible for the payment of multiple billable arrangement by and between our customer and various carriers. The Company recognizes revenues and related costs on a gross basis as we have discretion in choosing providers, rate plans, and devices in providing the services to our customers. Certain federal and state governments and their agencies may pay for services and/or devices in advance. These advance payments are recorded as deferred revenue and recognized as services are performed and/or devices delivered.

- § Cyber security solutions consist of Public Key Infrastructure (PKI) identity credentialing software certificates and identity credentialing software certificate consoles and other software. PKI credentialing is usually controlled by the Company and revenue is recognized upon issuance and there are no undelivered elements. Pricing for certificates issued by the Company are based on third party evidence of value. Revenue is recognized from the sales of credentials upon issuance. For PKI credentialing that is controlled by the customer, Revenue is recognized upon delivery of the credentials and/or consols when there are no other additional deliverables. These certificates are delivered electronically to the end user. There is no obligation to provide post contract services in relation to certificates issued and consoles delivered. Cost of Revenues include general infrastructure support costs to maintain the continue issuance of credentials. For other software, which is part of an integrated solution, revenue is recognized using percentage of completion as the individual component parts have no value until the solution has been delivered.

§ Consulting Services and Products include the purchase and sale of third party hardware/software and maintenance services are billed under cost-reimbursable contracts. Revenue is recognized when persuasive evidence of an arrangement exists, services have been rendered, the contract price is fixed or determinable and collectability is reasonably assured. The Company has a standard internal process that is used to determine whether all required criteria for revenue recognition have been met. Revenue is recognized for the re-sale of hardware equipment and software support and maintenance upon delivery to the customer, including applicable contractual fees earned. The Company bears credit risk associated with purchases made on behalf of customers. The Company recognizes revenues and related costs on a gross basis as we have discretion in choosing providers and equipment for our customers. Further our information technology and assurance consulting services are billed under a time and materials contract. Revenue is recognized when persuasive evidence of an arrangement exists, services have been rendered, the contract price is fixed or determinable and collectability is reasonably assured. The Company has a standard internal process that is used to determine whether all required criteria for revenue recognition has been met. Revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred to provide services. Hardware elements are separately procured and priced through third party vendors who deal in such equipment. Our pricing is based on Third Party Evidence of Value ("TPE") with either handling charges or additional fees included in our General Services Adminstration ('GSA") schedule which is similar to those offered by other hardware vendors for similar products and/or services as well as charges for handling and additional fees. The hardware elements under this arrangement procured for the solution was purchased through third party vendors. The hardware elements are recognized at the time of delivery and/or integration into the solutions.

Income Taxes

The Company accounts for income taxes in accordance with authoritative guidance which requires that deferred tax assets and liabilities be computed based on the difference between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. The guidance requires that the net deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the net deferred tax asset will not be realized. The Company recognizes the impact of an uncertain tax position taken or expected to be taken on an income tax return in the financial statements at the amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized in the financial statements unless it is more likely than not of being sustained upon audit by the relevant taxing authority.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Property and equipment consisted of the following:

	Estimated Useful Life		December 31, 2010		December 31, 2009
Land and building	20 yrs	$	677,054	$	—
Computer hardware and software	3 yrs		1,355,661		1,074,495
Furniture and fixtures	5 yrs		126,595		110,459
Automobiles	5 yrs		—		9,880
Gross property and equipment		$	2,159,300	$	1,194,831
Less– Accumulated depreciation and amortization			(917,790)		(656,020)
		$	1,241,510	$	538,811

Depreciation expense is computed using the straight-line method over the estimated useful lives based upon the classification of the property and/or equipment.

The Company assesses the recoverability of property and equipment by determining whether the depreciation of property and equipment over its remaining life can be recovered through projected undiscounted future cash flows. The amount of property and equipment impairment if any, is measured based on fair value and is charged to operations in the period in which property and equipment impairment is determined by management. As of December 31, 2010 and 2009, the Company's management has not identified any material impairment of its property and equipment.

Software Development Costs

The Company capitalizes costs related to software and implementation in connection with its internal use software systems. For software development costs (or "internally developed intangible assets") related to software products for sale, lease or otherwise marketed, significant development costs are capitalized from the point of demonstrated technological feasibility until the point in time that the product is available for general release to customers. Once the product is available for general release, capitalized costs are amortized based on units sold, or on a straight-line basis over a six-year period or such other such shorter period as may be required.
WidePoint capitalized approximately $74,000 for the year ended December 31, 2010, as compared to approximately $30,000 in capitalized costs for the year ended December 31, 2009. WidePoint recorded approximately $251,000 of amortization expense for the year ended December 31, 2010, as compared to approximately $268,000 for the year ended December 31, 2009.

Capitalized software development costs, net, included in Intangibles, net, on the Company's condensed consolidated balance sheets at December 31, 2010 were approximately $0.2 million, compared to approximately $0.4 million at December 31, 2009.

Goodwill and Other Intangible Assets

The Company accounts for goodwill and other indefinite-lived intangible assets in accordance with ASC Topic 350 "Intangibles". Under ASC Topic 350, goodwill and certain indefinite-lived intangible assets are not amortized but are subject to an annual impairment test during the fourth quarter of each year, and between annual tests if indicators of potential impairment exist. The Company has elected to perform this review annually on December 31st of each calendar year. The Company's ORC and iSYS subsidiaries have significant goodwill recorded which relates to the Wireless Mobility Management and Cybersecurity Solutions segments. We have not identified any impairment of goodwill as of December 31, 2010.

Basic and Diluted Earnings Per Share (EPS)

Basic EPS includes no dilution and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted EPS includes the potential dilution that could occur if securities or other contracts to issue common and restricted stock were exercised or converted into common and restricted stock. The number of incremental shares from assumed conversions of stock options, stock warrants and unvested restricted stock awards included in the calculation of diluted EPS was calculated using the treasury stock method. See Note 8 for computation of EPS.

Stock-Based Compensation

The Company previously adopted the provisions of ASC 718-10, "Stock Compensation" (formerly known as SFAS No. 123R), using the modified prospective application transition method. Under this method, compensation cost for the portion of awards for which the requisite service has not yet been rendered that are outstanding as of the adoption date is recognized over the remaining service period. The compensation cost for that portion of awards is based on the grant-date fair value of those awards as calculated for pro forma disclosures under ASC 718-10, as originally issued. All new awards that are modified, repurchased, or cancelled after the adoption date are accounted for under provisions of ASC 718-10. The Company recognizes share-based compensation ratably using the straight-line attribution method over the requisite service period. In addition, pursuant to ASC 718-10, the Company is required to estimate the amount of expected forfeitures when calculating share-based compensation, instead of accounting for forfeitures as they occur, which was the Company's practice prior to the adoption of ASC 718-10. See note 7.

Non-Employee Stock-Based Compensation:

The Company accounts for stock-based non-employee compensation arrangements using the fair value recognition provisions of ASC 505-50, "Equity-Based Payments to Non-Employees" (formerly known as FASB Statement 123, Accounting for Stock-Based Compensation and "Emerging Issues Task Force" EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services).

Accounting Standards Updates

Revenue Recognition – ASU 2009-13, "Revenue Recognition (Topic 605) – Multiple-Deliverable Revenue Arrangements – a Consensus of the FASB Emerging Issues Task Force"
In October 2009 the FASB issued Accounting Standards Update (ASU) 2009-13, "Revenue Recognition (Topic 605) – Multiple-Deliverable Revenue Arrangements – a Consensus of the FASB Emerging Issues Task Force." This update provides amendments to the criteria in ASC Topic 605, "Revenue Recognition," for separating consideration in multiple-deliverable arrangements by establishing a selling price hierarchy. The selling price used for each deliverable will be based on vendor-specific objective evidence (VSOE) if available, third-party evidence if VSOE is not available, or estimated selling price if neither VSOE nor third-party evidence is available. ASU 2009-13 also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. ASU 2009-13 is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, which means that it will be effective for our fiscal year beginning January 1, 2011. This update will not have a material impact on our financial statements.

Supplementary Pro Forma Information for Business Combinations – In December 2010, the FASB issued ASU 2010-29, Disclosure of Supplementary Pro Forma Information for Business Combinations. The update requires that the pro forma information for business combinations to be presented as if the business combination occurred at the beginning of the prior annual reporting period when calculating both the current reporting period and the prior reporting period pro forma financial information. The update also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination. The amended guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The Company adopted this update in the fourth quarter of 2010. Adoption did not have a material impact on our financial statements.

Fair Value Disclosures – In January 2010, the FASB issued Accounting Standards Update No. 2010-06, "Improving Disclosures about Fair Value Measurements" (an update to ASC Topic 820 "Fair Value Measurements and Disclosures"). ASU 2010-06 requires additional disclosures about fair value measurements including transfers in and out of Levels 1 and 2 and a higher level of disaggregation for the different types of financial instruments. For the reconciliation of Level 3 fair value measurements, information about purchases, sales, issuances and settlements should be presented separately. This ASU is effective for annual and interim reporting periods beginning after December 15, 2009 for most of the new disclosures and for periods beginning after December 15, 2010 for the new Level 3 disclosures. Comparative disclosures are not required in the first year the disclosures are required. As of January 1, 2010, the Company adopted this accounting standard update, which did not result in a material impact on our financial statements.

Goodwill Impairment Testing – In December 2010, the FASB issued ASU 2010-28, Intangibles - Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (“ASU 2010-28”). ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. ASU 2010-28 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Company will adopt this standard on January 1, 2011 and believes this standard will not result in a material impact on our financial statements.

3. Long-Term Debt

Revolving Credit Facility

On January 2, 2008, the Company entered into a Commercial Loan Agreement with Cardinal Bank relating to a $5,000,000 revolving credit facility, which agreement was amended pursuant to that certain Amended Commercial Loan Agreement by and between the Company and Cardinal Bank, dated as of March 17, 2009 and that certain Debt Modification Agreement by and between the Company and Cardinal Bank, dated as of May 25, 2010 (as so amended, the “2009 Commercial Loan Agreement”). The 2009 Commercial Loan Agreement provided for a repayment date of September 1, 2010.

On August 26, 2010, the Company entered into a new Debt Modification Agreement with Cardinal Bank (the “2010 Debt Modification Agreement”). The 2010 Debt Modification Agreement sets forth the agreement of the Company and Cardinal Bank to amend the 2009 Commercial Loan Agreement to extend the repayment date of the Company’s revolving credit facility with Cardinal Bank from September 1, 2010 to September 30, 2011.

On August 26, 2010, the Company also entered into a new Commercial Loan Agreement with Cardinal Bank (the “2010 Commercial Loan Agreement”), which agreement replaces the 2009 Commercial Loan Agreement. The 2010 Commercial Loan Agreement provides for a $5,000,000 revolving credit facility from Cardinal Bank to the Company. Advances under the new revolving credit facility will bear interest at a variable rate equal to the Wall Street Journal prime rate plus 0.5%. The Company is required to maintain certain financial covenants quarterly on materially the same terms and conditions as the 2009 Commercial Loan Agreement. As of December 31, 2010, there is no borrowing on the revolving credit facility and the Company was in full compliance with these financial covenants on December 31, 2010.

Long-Term Debt

Long-term debt consisted of the following at December 31:

	2010	2009
Cardinal Bank Term Note (1)	$ 608,241	$ 1,124,903
Cardinal Bank Mortgage (2)	529,192	—
Total	$ 1,137,433	$ 1,125,137
Less current portion	(572,943)	(520,855)
Long-term debt, net of current portion	$ 564,490	$ 604,048

(1) On January 2, 2008, the Company entered into a $2 million four-year term note with Cardinal Bank to fund the unpaid portion of the iSYS purchase price. The term note bears interest at 7.5% with monthly principal and interest payments of approximately $48,000, and matures on January 1, 2012. The term note is secured under a corporate security agreement. At December 31, 2010 and 2009, the Company owed approximately $608,000 and $1.1 million, respectively.

(2) On December 17, 2010, the Company entered into a real estate purchase agreement to acquire iSYS's call center facility in Columbus, Ohio for approximately $677,000. In connection with the real estate purchase agreement the Company entered into a $528,000 ten-year mortgage with Cardinal Bank to fund the unpaid portion of the purchase price. The mortgage loan bears interest at 6.0% with monthly principal and interest payments of approximately $3,800, and matures on December 17, 2020. The mortgage loan principal and interest payments are based on a twenty-year amortization with the unpaid balance due at maturity. At December 31, 2010, the Company owed approximately $529,000 under this mortgage loan. The mortgage loan is secured by the real estate.

Capital Lease Obligations

The Company has leased certain equipment under capital lease arrangements which expire in 2012. Future minimum payments required under the leases are as follows:

For Fiscal Years Ending December 31	Lease Payments
2011	$ 48,316
2012	23,579
Total	$ 71,895
Less portion representing interest	(4,263)
Present value of minimum lease payments under capital leases	67,632
Less current portion	(44,724)
Capital lease obligation, net of current portion	$ 22,908

Total net book value of assets under capital leases at December 31, 2010 and 2009 was $61,344 and $180,209, respectively. Depreciation expense for leased equipment for the year ended December 31, 2010 and 2009 was $96,738 and $90,466, respectively, and accumulated depreciation at December 31, 2010 and 2009 was $378,877 and $269,028, respectively.

4. Goodwill and Intangible Assets

Goodwill

The changes in the carrying amount of goodwill for the years ended December 31, 2009 and 2010, respectively, are as follows:

		2010		2009
Beginning Balance	$	9,770,647	$	8,575,881
Additions:				
Additional earnout purchase consideration in connection with iSYS Membership Interest Purchase Agreement dated January 2, 2008 (see Note 6 for additional information) (1)		1,043,032		1,194,766
Acquisition of Vuance business through ARCC (2)		516,238		—
Ending Balance	$	11,329,917	$	9,770,647

(1) In connection with the Membership Interest Purchase Agreement (the “Membership Agreement”) between the Company, iSYS, LLC and Jin Kang, dated January 4, 2008, the Company delivered 3,000,000 shares of Company’s common stock valued at $1.00 per common share into escrow on January 8, 2008, subject to the satisfaction of certain earnout provisions under the Membership Agreement. Under the Membership Agreement the initial $1.4 million in earnings before interest, taxes, depreciation and amortization (“EBITDA”) from iSYS is excluded from the earnout for the initial 3 years, with 66% of the value in excess of such initial $1.4 million being paid to the former owner of iSYS, with 50% of the amount being paid in cash and 50% being valued and released in escrow shares. In the fourth year the value in excess of 50% is used instead of 66%, with the total earnout capped at $6 million, with $3 million payable in cash and $3 million payable in the release of earnout shares. Performance of the earnout is measured annually and awarded within 30 days following the end of the Company’s fiscal year and filing of the Company’s Form 10-K for that year.

For the years ended December 31, 2010 and 2009, the Company issued common shares of 445,740 and 690,510, respectively, which were earned in accordance with the terms of the Membership Agreement. For the years ended December 31, 2010 and 2009, the Company accrued the cash portion payable in connection with the earnout achieved of $445,740 and $690,510, respectively. For the years ended December 31, 2010 and 2009, the Company paid $690,510 and 184,817, respectively. As of December 31, 2010, the Company issued 1,321,067 common shares in connection with this earnout arrangement, with 1,678,933 common shares remaining in escrow and available to be attained assuming the performance requirement is achieved.

(2) On January 29, 2010, the Company, together with its wholly-owned subsidiary, ARCC, a Delaware corporation, entered into an Asset Purchase Agreement with Vuance, Inc. ("Vuance"), a Delaware corporation, and Vuance's sole shareholder, Vuance, Ltd., a public company organized in the State of Israel under the Israeli Companies Law (the "Vuance Agreement"), pursuant to which ARCC acquired certain assets and assumed certain liabilities of Vuance as further specified in the Vuance Agreement. ARCC acquired all assets of the collective business of Vuance relating to its Government Services Division. The purchased assets include, but are not limited to, the operation by Vuance of identity assurance and priority resource management solutions; crime scene management and information protection, and other activities related or incidental thereto; and the development, maintenance, enhancement and provision of software, services, products and operations for identity management and information protection, which are offered primarily to state and local government agency markets.

The operations of ARCC have been included in the Company's results of operations beginning on January 29, 2010, the acquisition date. The earnout provision of the Vuance Agreement provides for additional consideration of up to $1,500,000 during the earnout period of the calendar years 2010 - 2012, subject to ARCC receiving minimum qualified revenues of at least $4,000,000 per year. In the event ARCC receives at least $4,000,000 in qualified revenues in an earnout year, then Vuance will have the right to receive an earnout payment equal to twenty percent (20%) of the amount by which such qualified revenues for that earnout year exceed $4,000,000; provided, however, that the first $270,000 of any such earnout payment will be retained by the Company for its sole account as reimbursement for certain accounts payable and deferred revenue liabilities assumed by ARCC in connection with the Vuance Agreement.

The following table summarizes the final fair values of the assets acquired and liabilities assumed in this business combination as of December 31, 2010:

Consideration:	
Cash	$383,701
Cash to be paid	10,000
Contingent consideration arrangement	153,000
Fair value of total consideration transferred	$546,701
Fair value of identifiable assets acquired and liabilities acquired:	
Current assets	$42,000
Property and equipment, net	43,675
Trade name and developed software	355,000
Current liabilities assumed	(410,212)
Total identifiable net assets and liabilities assumed	30,463
Goodwill	516,238
Total	$546,701
Approximate acquisition related costs expensed in connection with the Vuance transaction and included in general and administrative for the year ended December 31, 2010	$70,000

Purchased and Internally Developed Intangible Assets

The following table summarizes purchased and internally developed intangible assets subject to amortization:

	As of December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Weighted Average Amortization Period (in years)
Purchased Intangible Assets			
ORC Intangible (Includes customer relationships and PKI business opportunity purchase accounting valuations)	$ 1,145,523	$ (1,145,523)	5
iSYS (includes customer relationships, internal use software and trade name)	$ 1,230,000	$ (703,001)	5
Protexx (Identity Security Software)	$ 506,463	$ (407,984)	3
Advanced Response Concepts Corporation (includes preliminary values for customer relationships and first responder security software)	$ 355,000	$ (65,083)	4
	$ 3,236,986	$ (2,321,591)	4
Internally Developed Intangible Assets			
ORC PKI-I Intangible (Related to internally generated software)	$ 334,672	$ (334,672)	6
ORC PKI-II Intangible (Related to internally generated software)	$ 649,991	$ (633,886)	6

ORC PKI-III Intangible (Related to internally generated software)	$211,680	$(188,160)	3
ORC PKI-IV Intangible (Related to internally generated software)	$42,182	$(37,496)	3
ORC PKI-V Intangible (Related to internally generated software)	$147,298	(40,916)	3
ORC PKI-VI Intangible (Related to internally generated software)	$38,463	—	3
	1,424,286	$(1,235,130)	5
Total	$4,661,272	$(3,556,721)	5
Aggregate Amortization Expense:			
For the year ended 12/31/10	$706,085		
Estimated Future Amortization Expense:			
For the year ended 12/31/11	$456,968		
12/31/12	$320,587		
12/31/13	$243,669		
12/31/14	$77,410		
12/31/15	$5,917		
Total	$1,104,551		

The total weighted average life of all of the intangibles is approximately 4 years.

5. Income Taxes

The Company has adopted the provisions of ASC 740-10-15. The Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. The Company does not have any unrecognized tax benefits at December 31, 2010, including interest and penalties. In the future, any interest and penalties related to uncertain tax positions will be recognized in income tax expense.

The Company files U.S. federal income tax returns and various states income tax returns. The Company may be subject to examination by the IRS for tax years 1995 forward. Additionally, the Company may be subject to examinations by various state taxing jurisdictions for tax years 2000 forward. The Company is currently not under examination by the IRS or any state tax jurisdiction with the exception that we have been notified that the State of Illinois will examine our filings in the second quarter of 2011.

As of December 31, 2010, the Company had net operating loss (NOL) carry forwards of approximately $10,275,000 to offset future taxable income for federal income tax purposes, which is net of the potential limitation discussed below. The Company has state NOLs carry forwards of $10,163,000. These carry forwards expire between 2011 and 2029. In assessing the ability to realize deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon the realization of our recent historical profitability and our outlook for the continued positive prospects for these profits to continue in the future, in the fourth quarter management determined that it was more likely than not most of these net deferred tax assets will be utilized in future periods. We continue to place a full valuation allowance on our state NOLs and some federal NOLs the Company determined will expire prior to utilization. The Company's NOLs are subject to limitations within the meaning of Internal Revenue Code Section 382 when there has been a change in an entity's ownership of 50 percent or greater. As a result of WidePoint's equity transactions, the Company's net operating losses are subject to such limitations.

No tax benefit has been associated with the exercise of stock options for the years ended December 31, 2010 and 2009, respectively, because of the existence of net operating loss carry forwards. There will be no credit to additional paid in capital for such until the associated benefit is realized through a reduction of income taxes payable.

The provision for income taxes consisted of the following for the years ended December 31, 2010 and 2009:

	2010	2009
Current provision (benefit)		
Federal	$ 21,250	$ -
State	127,569	-
	148,819	-
Deferred provision (benefit)		
Federal	(3,767,180)	156,891
State	(29,785)	-
	(3,796,965)	156,891
Total provision for income taxes	$ (3,648,146)	$ 156,891

The provision (benefit) for income taxes results in effective rates, which differs from the federal and state statutory rate as follows:

	2010		2009	
Statutory Federal income tax rate	34.0	%	34.0	%
State Income tax (net of federal benefit)	4.9	%	4.9	%
Non-deductible expenses	0.73	%	1.1	%
Change in valuation allowance	-173.4	%	-101.9	%
Stock Compensation Tax deduction over book	-		-34.5	%
Change in Expiration of Federal NOL Section 382 Limitation	-		106.8	%
Change in prior year State Loss carryforwards	-		-4.1	%
Other	0.1	%	3.7	%
	-133.7	%	10.0	%

The deferred tax assets (liabilities) consisted of the following as of December 31, 2010 and 2009:

	2010	2009
Deferred tax assets:		
Net operating loss carryforwards	$4,227,087	$5,858,547
AMT credit	73,241	13,420
Stock based compensation	543,824	500,449
Advanced payments	1,617	271,813
Intangibles	55,864	-
Other assets	135,276	124,862
Total deferred tax assets	5,036,909	6,769,091
Deferred tax liabilities:		
Intangibles	-	476,604
Goodwill amortization	514,362	313,782
Depreciation and amortization	30,631	—
Capitalized software costs	30,744	159,038
Total deferred tax liabilities	575,737	949,424
Net deferred tax asset	4,461,172	5,819,667
Less– Valuation allowance	(931,666)	(6,133,449)
Net deferred income tax asset/(liability)	$3,529,506	$(313,782)

Changes in the valuation allowance for the years ended December 31, are as follows:

	2010	2009
Opening balance	$ (6,133,449)	$ (7,725,968)
Decrease (Increase)	5,201,783	1,592,519
Ending balance	$ (931,666)	$ (6,133,449)

6.Stockholders' Equity

Common Shares

The Company is authorized to issue 110,000,000 shares of common stock, $.001 par value per share. As of December 31, 2010, there were 62,690,873 shares of common stock outstanding. For the year ended December 31, 2010, the Company issued 869,800 common shares in connection with stock option exercises. See Note 7 for additional information regarding stock option plans. For the year ended December 31, 2010, the Company issued 445,740 and 690,510 common shares in connection with amounts earned as part of an earnout agreement pursuant to the Membership Agreement. See Note 3 for additional information regarding earnout consideration recorded.

Executive Restricted Stock Awards

On November 18, 2010, the Company's Compensation Committee granted Steve L. Komar and James T. McCubbin each an award of 250,000 shares of restricted stock of the Company. Each of the foregoing awards of restricted stock vest upon the earlier to occur of (a) the seventh anniversary date of the grant, or (b) an acceleration event as determined on the date of grant by the Compensation Committee and set forth in the award agreement with respect to such grant. Acceleration events include change of control, termination by the Company without Cause (as defined in the applicable award agreement) or by the individual for Good Reason (as defined in the applicable award agreement), non-renewal of the employment contract for the respective individual on substantially similar terms, death or disability of the individual, as the Company's achievement of certain levels of revenue, and the Company's achievement of certain earnings before interest, taxes, amortization targets.

Executive Stock Warrants

On July 8, 2009, each of Steve L. Komar, James T. McCubbin and Mark F. Mirabile exercised, in the form of a cashless exercise, his respective warrant to purchase 1,333,333 shares of common stock of the Company, which warrant was previously issued to such individual pursuant to a Warrant Purchase Agreement, dated July 14, 2004, by and between the Company and each such individual. As a result of his respective cashless exercise of such warrant, each of Steve L. Komar, James T. McCubbin and Mark F. Mirabile, as applicable, was issued 793,103 shares of common stock of the Company, with 540,230 shares of common stock of the Company being withheld by the Company from each such warrant as payment of the respective exercise price of each such warrant. Accordingly, for the year ended December 31, 2009, the Company issued 2,379,309 shares of common stock in connection with this cashless exercise. The shares issued pursuant to the exercise of these warrants have not been registered under the Securities Act of 1933, as amended (the "Securities Act"). Such shares are exempt from the registration requirements under the Securities Act pursuant to the "private offering" exemption under Section 4(2) of the Securities Act.

Non-Employee Stock Warrants

On November 1, 2005, the Company issued a warrant to purchase 54,878 shares of common stock at a price of $0.80 per share to Hawk Associates as part of a consulting agreement in which Hawk Associates agreed to act as the Company's investor relations representative. The warrant had a term of 5 years. We are accounting for this award in accordance with ASC 505-50, "Equity-Based Payments to Non-Employees" (formerly known as EITF 96-18). This warrant expired at the end of its term without having been exercised.

On October 27, 2004 and November 22, 2004, the Company issued two warrants to purchase 30,612 shares and 5,556 shares of common stock at a price of $0.49 and $0.45 per share, respectively, to Liberty Capitol as part of a consulting agreement in which Liberty Capitol assisted the Company in arranging its senior debt financing with RBC-Centura Bank. The warrants have a term of 5 years. The Company used a fair-value option pricing model to value these stock warrants at approximately $14,291. This value had been reflected as part of stock warrants in the stockholders' equity section of the consolidated balance sheet but the warrants expired unexercised. Therefore the fair-value reflected as part of stock warrants has been reduced and reflected in Additional Paid in Capital in the stockholders' equity section as of December 31, 2009. The warrant expired at the end of its term without having been exercised.

7. Stock Options and Award Programs:

The Company's stock incentive plan is administered by the Compensation Committee and authorizes the grant or award of incentive stock options, non-qualified stock options, restricted stock awards, stock appreciation rights, dividend equivalent rights, performance unit awards and phantom shares. The Company issues new shares of common stock upon the exercise of stock options. Any shares associated with forfeited options were added back to the number of shares that underlie stock options to be granted under the stock incentive plan.

2008 Stock Incentive Plan

Under the Company's 1997 Stock Incentive Plan (the "1997 Plan"), as amended, 10 million shares were reserved for issuance under equity incentive awards issued pursuant to the 1997 Plan. The 1997 Plan expired by its terms on April 17, 2007.

The Company adopted the 2008 Stock Incentive Plan (the "2008 Plan") on December 18, 2008. Under the 2008 Plan, 6,015,438 shares were reserved for issuance under equity incentive awards to be issued pursuant to the 2008 Plan. The 2008 Plan was amended and restated on December 15, 2009. The 2008 Plan will terminate on December 17, 2017. The 2008 Plan was enacted to (a) provide incentive to officers and key employees of the Company and its affiliates to stimulate their efforts toward the continued success of the Company and to operate and manage the business in a manner that will provide for the long-term growth and profitability of the Company; (b) encourage stock ownership by directors, officers and key employees by providing them with a means to acquire a proprietary interest in the Company, acquire shares of the Company's common stock, or to receive compensation which is based upon appreciation in the value of the Company's common stock; and (c) provide a means of obtaining, rewarding and retaining key personnel and consultants.

On May 11, 2009, the Company's Compensation Committee of the Board voted to cancel 950,000 options held by management and other employees (the "Cancelled Options") and issue replacement options to such individuals (the "Replacement Options"). The optionees all concurred with such action by the Compensation Committee. The Cancelled Options had varying exercise prices ranging from $0.85 to $2.80 with a weighted average exercise price of $1.06. The exercise price of the Replacement Options was set at $0.54. Other than the exercise price, there are no differences in the terms between the Cancelled Options and the Replacement Options. The incremental additional fair value of the Replacement Options was calculated to be approximately $64,000, which was determined by calculating the fair value of the Cancelled Options as they existed on May 11, 2009 immediately prior to cancellation as compared to the fair value on the same date of the exercise price of the Replacement Options. This amount of additional fair value of the Replacement Options will be recognized over the vesting period of the Replacement Options. There is approximately $123,000 in remaining unrecognized compensation costs to recognize on these options. Since some of the Replacement Options were fully vested at May 11, 2009, there was an expense of approximately $45,000 recognized in the three months ended September 30, 2009 as a result of the cancellation of the Cancelled Options and the issuance of the Replacement Options.

For the years ended December 31, 2010 and 2009, the Company issued common shares of 865,000 and 30,000, respectively. For the Company's stock incentive plans there were of 6,015,438 and 4,510,438 shares of Common Stock unissued and available for possible issuance as of December 31, 2010 and 2009, respectively.

1997 Director's Formula Stock Option Plan

Under the 1997 Director's Formula Stock Option Plan (the "1997 Director Plan"), as amended, 120 thousand shares were reserved for issuance under the plan. The 1997 Director Plan provided for option grants to purchase 12,000 shares of common stock upon a non-employee director's initial appointment to the Board of Directors. Options granted under the Director Plan vest immediately to 8,000 shares of common stock underlying such options, vest to an additional 2,000 shares after the director's completion of the first year of continued service to the Company, and vest to the remaining 2,000 shares after the completion of the second year of continued service to the Company. Each option granted pursuant to the Director Plan was evidenced by an agreement and is subject to additional terms as set forth in the agreement. Options become exercisable when vested and expire ten years after the date of grant, subject to any shorter period that may be provided in the agreement.

For the Company's stock incentive plans there were of 4,071,049 and 4,571,049 shares of Common Stock unissued and available for possible issuance as of December 31, 2010 and 2009, respectively.

A summary of the stock option and restricted stock award activity under our plans during the years ended December 31, 2010 and 2009 is presented below:

NON-VESTED

	# of Shares	Weighted average grant date fair value per share
Granted	25,000	$ 0.54
Vested	(123,996)	$ 0.79
Forfeited	—	—
Non-vested at December 31, 2009	1,215,004	$ 0.39
Granted	75,000	$ 0.41
Vested	(188,751)	$ .018
Forfeited	(125,000)	$ 0.38
Non-vested at December 31, 2010	976,253	$ 0.43

F-26

OUTSTANDING AND EXERCISABLE

	# of Shares	Weighted average exercise price per share
Total outstanding at January 1, 2009	8,523,411	$ 0.45
Granted	25,000	$ 0.54
Cancelled	(1,001)	$ 1.35
Exercised	(4,029,999)	$ 0.23
Total outstanding at December 31, 2009	4,517,411	$ 0.54
Total exercisable at December 31, 2009	3,302,407	$ 0.43
Granted	75,000	$ 0.65
Cancelled	(133,611)	$ 0.81
Expired	(2,000)	$ 1.35
Exercised	(869,800)	$ 0.17
Total outstanding at December 31, 2010	3,587,000	$ 0.62
Total exercisable at December 31, 2010	2,610,747	$ 0.43

The aggregate remaining contractual lives in years for the options outstanding and exercisable on December 31, 2010 were 3.88 and 3.14, respectively. In comparison, the aggregate remaining contractual lives in years for the options outstanding and exercisable on December 31, 2009 were 4.70 and 3.95, respectively.

Aggregate intrinsic value represents total pretax intrinsic value (the difference between WidePoint’s closing stock price on December 31, 2010 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2010. The intrinsic value will change based on the fair market value of WidePoint’s stock. The total intrinsic value of options outstanding as of December 31, 2010 and 2009 were $ 2,613,900 and $1,233,873, respectively. The total intrinsic value of options exercisable on December 31, 2010 and 2009, respectively, were $2,149,010 and $1,178,222. The total intrinsic value of options exercised during the year ended December 31, 2010 and 2009, respectively, were $931,808 and $1,384,000, respectively.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option pricing model (“Black-Scholes model”), which uses the assumptions of no dividend yield, risk free interest rates and expected life in years of approximately 3 years. The option awards are for the period from 1999 through 2010. Expected volatilities are based on the historical volatility of our common stock. The expected term of options granted is based on analyses of historical employee termination rates and option exercises. The risk-free interest rates are based on the U.S. Treasury yield for a period consistent with the expected term of the option in effect at the time of the grant.

	2010		2009	
Expected dividend yield	0		0	
Expected volatility	102	%	98	%
Risk-free interest rate	0.40-2.38	%	2.04	%
Expected life – Employees options	3 years		3.5 years	
Expected life – Board of directors options	n/a		3.5-10 years	

The amount of compensation expense recognized under ASC 718-10 during the years ended December 31, 2010 and 2009, respectively, under our plans was comprised of the following:

	Years ended December 31			
	2010		2009	
General and administrative expense	$	110,398	$	146,782
Share-based compensation before taxes	$	110,398	$	146,782
Total net share-based compensation expense	$	110,398	$	146,782
Net share-based compensation expenses per basic and diluted common share	nil		nil	

No tax benefit has been associated with the exercise of stock options for the years ended December 31, 2010 and 2009, respectively, because of the existence of net operating loss carryforwards. There will be no credit to additional paid in capital for such until the associated benefit is realized through a reduction of income taxes payable.

At December 31, 2010, the Company had approximately $194,122 of total unamortized compensation expense, net of estimated forfeitures, related to stock option plans that will be recognized over the weighted average period of 3.14 years. At December 31, 2009, the Company had approximately $312,000 of total unamortized compensation expense, net of estimated forfeitures, related to stock option plans that will be recognized over the weighted average period of 3.84 years.

8. Earnings Per Common Share (EPS):

The computations of basic and diluted EPS for the year ended December 31 were as follows:

		2010		2009
Basic EPS computation:				
Net income	$	6,380,854	$	1,410,456
Weighted average number of common shares		61,555,664		59,419,383
Basic EPS	$	0.10	$	0.02
Diluted EPS				
Net income	$	6,380,854	$	1,410,456
Weighted average number of common shares		61,555,664		59,419,383
Incremental shares from assumed conversions of stock options		1,307,314		1,189,601
Adjusted weighted average number of common shares		62,862,978		60,608,984
Diluted EPS	$	0.10	$	0.02

F-28

9.Commitments and Contingencies:

Operating Lease Commitments

The Company has entered into leasing arrangements with unrelated entities for its corporate and subsidiary companies executive and administrative offices, a call center, and a secured data facility. There are three leases that are on a month-to-month basis with monthly rent ranging from $1,300 to $2,500. The remaining leases expire at various times from August 2011 through December 2015 with monthly rent ranging from $2,800 to $26,000 per month, and most include renewal options for additional periods. Many leases provide that the Company pay taxes, maintenance, insurance and other expenses. Rents are generally increased annually by fixed amounts, subject to certain maximum amounts defined within individual agreements. The Company's commitments and contingencies are as follows for its operating leases, which include those leases, and other operating leases. Rent expenses under these operating leases for 2010 and 2009 were approximately $469,000 and $517,000, respectively.

Future minimum payments by year required under lease obligations consist of the following for fiscal years ending December 31:

Year		Operating Leases
2011	$	441,556
2012		423,275
2013		428,951
2014		121,232
2015		27,533
Total	$	1,442,547

Employment Agreements

The Company has employment agreements with certain executives that set forth compensation levels and provide for severance payments in certain instances.

Litigation

The Company is not involved in any material legal proceedings.

10. Segment reporting

Segments are defined by authoritative guidance as components of a company in which separate financial information is available and is evaluated by the chief operating decision maker, or a decision making group, in deciding how to allocate resources and in assessing performance. Management evaluates segment performance primarily based on revenue and segment operating income.

The Company operates as three segments, which includes Wireless Mobility Management, Cybersecurity Solutions, and Consulting Services and Products.

Segment operating income consists of the revenues generated by a segment, less the direct costs of revenue and selling, general and administrative costs that are incurred directly by the segment. Unallocated corporate costs include costs related to administrative functions that are performed in a centralized manner that are not attributable to a particular segment. These administrative function costs include costs for corporate office support, all office facility costs, costs relating to accounting and finance, human resources, legal, marketing, information technology and company-wide business development functions, as well as costs related to overall corporate management.

The following table sets forth selected segment and consolidated operating results and other operating data for the periods indicated. Segment operating income consists of the revenues generated by a segment, less the direct costs of revenue and selling, general and administrative costs that are incurred directly by the segment. Unallocated corporate costs include costs related to administrative functions that are performed in a centralized manner that are not attributable to a particular segment. Management does not analyze assets for decision making purposes as it relates to the segments below. Accordingly, information is not available for long-lived assets or total assets.

	2010				
	Wireless	Cyber	Consulting	Corp	Consol
Revenue	$ 26,553,703	$ 10,645,918	$ 13,613,155	$ -	$ 50,812,776
Operating income including amortization and depreciation expense	2,139,613	3,599,177	19,659	(2,954,129)	2,804,320
Interest Income (expense), net				(71,612)	(71,612)
Pretax income					2,732,708
Income tax benefit				3,648,146	3,648,146
Net income					6,380,854

F-30

	2009				
	Wireless	Cyber	Consulting	Corp	Consol
Revenue	$ 27,305,834	$ 5,675,467	$ 10,362,752	$ -	$ 43,344,053
Operating income including amortization and depreciation expense	3,047,541	1,030,700	289,780	(2,651,891)	1,716,130
Interest Income (expense), net				(148,734)	(148,734)
Other income (expense), net			(49)		(49)
Pretax income					1,567,347
Income tax expense				(156,891)	(156,891)
Net income					1,410,456