

MPHASE TECHNOLOGIES INC  
Form 10-K/A  
May 11, 2006

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

Amendment No. 1 to

**FORM 10-K/A**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND  
EXCHANGE ACT OF 1934 (NO FEE REQUIRED) FOR THE YEAR ENDED JUNE 30, 2005**

**COMMISSION FILE NO. 000-24969**

**mPHASE TECHNOLOGIES, INC.**

(Name of issuer in its charter)

**NEW JERSEY**

(State or other jurisdiction of  
incorporation or organization)

**22-2287503**

(I.R.S. Employer  
Identification Number)

**587 CONNECTICUT AVE., NORWALK,**

**CT 06854-1711**

**(Address of principal executive offices)**

**(Zip Code)**

Registrant's telephone number, including area code: (203) 838-2741

**SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:**

**COMMON STOCK, \$.01 PAR VALUE**

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, during the preceding 12 months (or for shorter period that the registrant was required to file such report), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to the Form 10-K.

As of September 26, 2005, there were 154,621,457 shares of common stock, .01 par value, outstanding and the aggregate market price of shares held by non-affiliates was approximately \$30,240,325 (Based upon a closing common stock price of \$.23 on September 26, 2005) (solely for the purpose of calculating the preceding amount, all directors and officers of the registrant are deemed to be affiliates.)

**mPHASE TECHNOLOGIES, INC.**

**ANNUAL REPORT ON FORM 10-K**

FOR THE YEAR ENDED JUNE 30, 2005

**TABLE OF CONTENTS**

|   | PAGE  |
|---|---|
| <b>PART I</b>   |   |
| <u>ITEM 1.</u> <u>Business</u>  | <u>3</u>  |
| <u>ITEM 2.</u> <u>Properties</u>  | <u>17</u>                                       |
| <u>ITEM 3.</u> <u>Legal Proceedings</u>   | <u>17</u>                                       |
| <u>ITEM 4.</u> <u>Submission of Matters to a Vote of Security Holders</u>                                   | <u>17</u>                                       |
| <b>PART II</b>  |   |
| <u>ITEM 5.</u> <u>Market for Registrant's Common Equity and Related Stockholder Matters</u>                 | <u>18</u>                                       |
| <u>ITEM 6.</u> <u>Selected Consolidated Financial Data</u>  | <u>23</u>                                       |
| <u>ITEM 7.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>26</u>                                       |
|   | <u>Data</u>                                     |
| <u>ITEM 8.</u> <u>Financial Statements and Supplementary Data</u>   | <u>41</u>                                       |
| <u>ITEM 9.</u> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>  | <u>41</u>                                       |
| <b>PART III</b>   |   |
| <u>ITEM 10.</u> <u>Directors and Executive Officers</u>   | <u>42</u>                                       |
| <u>ITEM 11.</u> <u>Executive Compensation</u>   | <u>45</u>                                       |
| <u>ITEM 12.</u> <u>Security Ownership of Certain Beneficial Owners and Management</u>                       | <u>48</u>                                       |
| <u>ITEM 13.</u> <u>Certain Relationships and Related Transactions</u>                                       | <u>50</u>                                       |
| <b>PART IV</b>  |   |
| <u>ITEM 14A.</u> <u>Exhibits, Financial Statement Schedules and Reports on Form 8-K</u>                     | <u>55</u>                                       |
|   | <u>Report of Independent Public Accountants</u> |
|   | <u>Report of Certified Public Accountants</u>   |
|   | <u>Financial Statements</u>                     |
|   | <u>Notes to Financial Statements</u>            |
| <u>ITEM 14B.</u> <u>Valuation and Qualifying Accounts</u>   | <u>F-12</u>                                     |
|   | <u>F-31</u>                                     |

## **PART I**

### **FORWARD-LOOKING STATEMENTS**

This report contains "forward-looking statements". In some cases, you can identify forward-looking statements by terms such as "may," "intend," "might," "will," "should," "could," "would," "expect," "believe," "estimate," "predict," "potential," or the negative of these terms and similar expressions intended to identify forward-looking statements. These statements reflect the Company's current views with respect to future events and are based on assumptions and subject to risks and uncertainties. The Company discusses many of these risks and uncertainties in greater detail in Part I, Item 1 of this 10-K under the heading "Risk Factors." These risks and uncertainties may cause the Company's actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements. You should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent the Company's estimates and assumptions as of the date of this report. The Company is under no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

The following discussion should be read in conjunction with mPhase Technologies' financial statements and related notes included elsewhere in this report.

### **ABOUT THIS AMENDMENT**

Management has reevaluated the adequacy clarity and completeness of the Form 10-K and certain disclosures in the accompanying consolidated financial statements. As a result of this reevaluation, management has reissued the Form 10-K/A and the June 30, 2005 consolidated financial statements with expanded and clarified information. The amendment includes expanded and clarified disclosure in the Consolidated Financial Statements, which begin on page F-1 plus certain technical and clerical edits. The aforementioned changes to the consolidated financial statements have no effect on the financial position and results of operations for the year ended June 30, 2005 or the results of operations for the years ended June 30, 2003 and 2004.

### **ITEM 1. BUSINESS**

#### **GENERAL DESCRIPTION OF THE BUSINESS**

mPhase Technologies, Inc. ("mPhase" or the "Company") is a development stage technology company headquartered in Norwalk, Connecticut with offices in Little Falls, New Jersey and New York, New York. The

Company is a developer and seller of broadband communications products, specifically middleware and set top boxes and, in addition, provides systems integration solutions for delivery of broadcast television (IPTV), video on demand, high-speed internet and voice using internet protocol over the existing infrastructure of a telephone service provider. The Company's TV+ solution is carrier class and standards based middleware designed to operate with any IP based network. In fiscal year 2004, the Company entered into the field of nanotechnology research and development of micro power cell batteries of various voltages. In March of 2005, the Company extended its research and development efforts with respect to power cell batteries for another 12 months by renewing its Development Agreement with the Bell Labs division of Lucent Technologies, Inc. In March of 2005 the Company also expanded its product development efforts utilizing the science of nanotechnology by entering into a 12 month Development Agreement with Bell Labs to develop a micro electro mechanical system directional sensor. mPhase shares common office space and common management with Microphase Corporation, a privately-held company. Microphase is a seller of radio frequency and filtering technologies to the defense and telecommunication industries. Microphase has been in operation for 50 years and supports mPhase with engineering, administrative and financial resources, as needed.

Since our inception in 1996, mPhase has been a development-stage company. Our primary activities have consisted of designing, manufacturing and testing innovative products and solutions designed to allow for the delivery of broadcast television by telephone service providers over their existing infrastructure. Such efforts have now evolved into Release 3.0 of our TV+ product that is a carrier class solution designed to allow telecommunications service providers to deliver digital broadcast television, high speed internet and voice over both copper and fiber infrastructure. We have not, as yet, derived significant revenue from such system although we received our first order for 1000 ports of Release 2.0 of our TV+ solution from a major telecommunications provider located in Russia generating approximately \$280,000 in revenue during fiscal year 2005. The Company's entry into the field of nanotechnology began in February of 2004 and initially focused upon exploratory development of batteries with significantly longer shelf lives and enhanced capabilities. In March of 2005, we expanded such efforts in development of innovative products through the science of nanotechnology with the commencement of research to develop ultra sensitive magnetometers or magnetic field sensors with the potential to have significant applications and impact in the field of military electronics. The Company believes that such expansion into nanotechnology product development is consistent with its strategy of being a pioneer of high growth technology products and potentially diversifies its product mix.

mPhase introduced its first TV over DSL platform, the Traverser Digital Video and Data Delivery System ("DVDDS"), in 1998. The DVDDS is a patented end to end system that enables a telecommunications service provider to deliver up to several hundred channels of motion picture experts group two ("MPEG-2") standard broadcast digital television, high speed internet and voice over copper telephone lines between a central office facility of the provider and a customer's premise. mPhase has not, as yet, derived any material revenues from sales of the DVDDS. The DVDDS is a proprietary technology developed in conjunction with Georgia Tech Research Corporation (GTRC) and is one of the first systems of its kind developed.. The system is the only system on the market that utilizes non- Internet Protocol ("IP") transmission over ADSL. The DVDDS was originally installed at Hart Telephone Company in Hartwell, Georgia, as a test system in fiscal year 2002. A DVDDS system is also installed at the BMW manufacturing plant in Spartanburg, South Carolina for use as a television broadcast system in a commercial setting. The Company has discontinued further development of the Traverser DVDDS and replaced it with its TV+ solution.

The Company believes that the demand for the TV+ system will be greatest in markets primarily outside of the United States that do not have a hybrid fiber coaxial cable ("HFC") infrastructure necessary for cable TV or fiber to

the curb.. Release 3.0 of the TV+ solution, expected to occur by December of 2005, will utilize a communications framework based upon Internet Protocol (IP) instead of Asynchronous Transfer Mode (ATM) that was utilized by Releases 1.0 and 2.0 of the TV+ product. ATM is an industry standard for transportation of data based upon a packaging of information into a fixed-size cell format for transportation across networks. Many telecommunications service providers currently deploy equipment that handles this protocol because it can support voice, video, data and multimedia applications simultaneously with a high degree of reliability. IP is another transport protocol that maintains network information and routes packets across networks. IP packets are larger and can hold more data than ATM cells. Historically, there have been concerns that service providers would be unable to provide the same quality of service with IP because it is not optimized for time-sensitive signals such as broadcast television and voice. Nevertheless, there is a greater demand by telecommunication service providers for IP systems for delivery of television, voice and high-speed data because such systems are significantly more cost effective to deploy based upon greater scalability.

Release 3.0 of the TV+ solution consists of middleware/software that will operate with any IP based network including DSL, Ethernet, or fiber or any combination thereof. The solution is transport agnostic and may be deployed with any IP multicast router or DSLAM transportation method used for the delivery of television and high-speed data over an IP network.

In those television markets in the United States that are not served by HFC, we believe that the availability of programming content is essential to facilitate potential sales of our systems enabling delivery of broadcast television over ADSL. In March of 2000, we established mPhase Television net., Inc. (mPhase TV), a joint venture between mPhase and Alphastar International, Inc. in which mPhase owns a 57% interest. Through such joint venture, mPhase has gained significant experience in negotiation of contracts with television programmers for delivery of television over DSL. Such experience should prove useful in providing assistance especially to smaller U.S. telecommunications service providers in obtaining programming content necessary to enter into the delivery of broadcast television over DSL.

mPhase also has designed and markets a line of DSL component products ranging from items such as Plain Old Telephone Service (POTS) splitters to innovative loop management products. From our inception in 1996 to date virtually all of mPhase's revenue has been derived from sales of our DSL products such as POTS splitters and low pass filters.

Our newest innovation in our suite of DSL component products is our *i* POTS or Intelligent POTS splitter product. This product enables telephone service providers comprehensive remote and automated test access to all elements of a DSL network. The *i* POTS, and *i* POTS3 (renamed the Broadband Watch product) allows a telephone service provider to bypass POTS splitters on a DSL network and avoid having to manually intervene and disrupt line usage so a test signal can pass through a DSL network. This product marks an advancement in automating DSL loop

management. As DSL deployments increase, it is becoming more important for telecommunications service providers to streamline the process for rolling-out and troubleshooting DSL services. Additionally, as competition for high speed Internet expands, the market is witnessing a reduction in the price for such service. Therefore, it has become imperative that telecommunications service providers lower the operational costs involved with deploying and supporting DSL services. Currently our *i POTS 1* is designed for use with the Lucent Stinger, whereas, the *iPOTS3* is compatible with DSLAM's manufactured by other vendors.

In November of 2004, the Company announced that Lucent Saudi Arabia's telecommunications deployment selected the Company's Broadband Loop Watch product. The broadband loop management system is designed to reduce the operating and maintenance expenses associated with DSL deployments by telecommunications service providers. The first delivery of such product is expected in the second quarter of fiscal year 2006.

As noted above, mPhase has recently entered the business of nanotechnology that utilizes the latest scientific research in molecular engineering, quantum physics and electrochemistry to create new advances in products. In February of 2004, mPhase entered into a \$1.2 million 12 month Development Agreement with the Bell Labs division of Lucent Technologies, Inc. focusing upon the development of battery and power cell products initially targeted initially for military applications which was extended in March of 2005 for and additional 12 months for another \$1.2 million. In March of 2005, the Company entered into a second Development Agreement for 12 months for \$1.2 million with the Bell Labs division of Lucent Technology to develop ultra sensitive magnetic sensor devices through the science of nanotechnology. The discipline of developing new products utilizing nanotechnology fabrication is in its early stages of exploratory development making it difficult to predict the timing of product releases and future revenues. mPhase believes that these reserve batteries with exceptionally long shelf lives, very small size and high power density as well as electromagnetic sensors may be some of the first products resulting from nanotechnology research and development to achieve commercial viability.

### **Business Development, Organization, and Acquisition Activities**

mPhase was incorporated in New Jersey in 1979 under the name Tecma Laboratory, Inc. In 1987, the Company changed its name to Tecma Laboratories, Inc. As Tecma Laboratories, Inc., the Company was primarily engaged in the research, development and exploitation of products in the skin care field. On February 17, 1997, the Company acquired Lightpaths, Inc., a Delaware corporation, which was engaged in the development of telecommunications products incorporating DSL technology, and the Company changed its name to Lightpaths TP Technologies, Inc.

On January 29, 1997, the Company formed another wholly-owned subsidiary called TLI Industries, Inc. The shares of TLI were spun off to its stockholders on March 31, 1997 after the Company transferred the assets and liabilities,

including primarily fixed assets, patents and shareholder loans related to the prior business of Tecma Laboratories. As a consequence of these transactions, the Company became the holding company of its wholly-owned subsidiary, Lightpaths, Inc. on February 17, 1997.

On May 5, 1997, the Company completed a reverse merger with Lightpaths TP Technologies, Inc. and thereafter changed its name to mPhase Technologies, Inc. on June 2, 1997.

On March 26, 1998 the Company entered into a Licensing Agreement with Georgia Tech Research Corporation ("GTRC") in which mPhase became the exclusive licensee of all patents received by GTRC in connection with development of the legacy Traverser DVDDS. GTRC is entitled to receive a royalty equal to 5% of gross sales of the Traverser DVDDS and 30% of any "lump sum payments" received in connection with revenues received by mPhase from the Traverser DVDDS product the under the terms of its license, as amended. The Traverser DVDDS has been replaced by the Company's IPTV solution.

On June 25, 1998, mPhase acquired Microphase Telecommunications, Inc., a Delaware corporation, from Microphase Corporation by issuing 2,500,000 shares of its common stock. Microphase Telecommunications' principal assets were patents and patent applications utilized in the development of its proprietary Traverser technology.

In March 2000, mPhase entered into a joint venture with AlphaStar International, Inc. to form an entity called mPhaseTelevision.Net, Inc. in which the Company held a 50% interest. On May 1, 2000, the Company acquired an additional 6.5% interest in mPhaseTelevision.Net, Inc. and made it one of its consolidated subsidiaries.

On March 14, 2000, mPhase entered into an agreement with BMW Manufacturing Corp., located in South Carolina. Under the agreement, the Company installed version 1.0 of the Traverser for BMW's telephone transmission network. BMW has agreed that, upon its notice and consent, mPhase will be able to demonstrate to potential customers the functioning system at BMW's facilities. BMW has made two (2) subsequent purchases increasing the size of the deployment to 48 unique units.

Our flagship installation, Hart Telephone, has completed the building and development of its digital headend during the fourth quarter of 2001. Hart currently has approximately 20 customers receiving about 80 channels of television services utilizing such platform.

In May of 2002 mPhase initiated discussion for development of a cost-reduced set top box (INI) with the Bell Laboratories division of Lucent Technologies, Inc.



Effective December 1, 2002, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. for the development of mPhase's broadcast television switch as an integrated platform with the Lucent Stinger

DSL Access Concentrator.

On December 9, 2002, pursuant to a Statement of Work, Lucent commenced development of the Broadcast Television Switch for mPhase.

On December 15, 2002, mPhase engaged Lucent for the cost reduction of its Traverser INI set top box.

On January 21, 2003 mPhase entered into a Co-Branding Agreement with Lucent Technologies under which mPhase's INI set top box would be co-branded with the Lucent Technologies name and logo.

On April 4, 2003, mPhase entered into a Systems Integration Agreement with Lucent Technologies. Under the terms of such an agreement mPhase has been given the exclusive rights to sell worldwide as a 'bundled' solution the Stinger in connection with mPhases' BTS.

Effective September 15, 2003, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. that has been extended through December of 2005 pursuant to additional Statements of Work under such Development Agreement for development of its IPTV solution.

Effective February 3, 2004, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. for the development of micro power source arrays fabricated using nanotextured superhydrophobic materials.

On November 28, 2004, mPhase entered a Software License Agreement with Espial Group, Inc to be used in the set top box of its TV+ solution.

On January 3, 2005, mPhase entered into a work order with Magpie Telecom Insiders, Inc. pursuant to the terms of a Software Development Agreement dated September 2, 2004 for purposes of adding video on demand to its TV+ solution.

Effective March 5, 2005, mPhase extended its Development Agreement with Bell Labs for an additional 12 months for the development of micro power source power arrays.

Effective March 10, 2005, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies Inc. for the development of a new generation of magnetic field sensors using the science of nanotechnology.

Our revenue, historically, has been derived exclusively from sales of DSL component telephone equipment parts, the majority of which has come from our sales of POTS Splitter Shelves. We have derived no material revenue to date with respect to our *iPOTS* and broadband loop products or our nanotechnology products other than \$280,000 of revenue with respect to the sale of 1000 set top boxes together with software for Release 2.0 of our TV+ solution in fiscal year 2005. In our fiscal years ended June 30, 2005 and June 30, 2004 we generated approximately \$1.6 million and \$4.5 million in revenue, respectively, from the commercial sale of our component products and overall losses for such years of \$11,304,036 and \$7,758,586, respectively. These component products, including filters and Central Office POTS Splitter Shelves, marketed to other DSL equipment vendors. We do not believe that our TV+ platform developed by Lucent will be materially impaired by the sale of these component products to these potential competitors.

## **Products & Services**

### **IPTV Solution**

Our primary business is to develop and market our TV+ solution that consists of a middleware/software and a set top box designed for the delivery of television over any IP network. We believe our TV+ system is the most cost-effective, reliable, scalable and easiest to operate platforms for delivery of broadcast television, data and voice over IP networks on the market. mPhase primarily is targeting its marketing of its IPTV product to international telephone companies. Telephone companies around the world are experiencing negative pressures on their wireline calling revenues and need to increase their per subscriber revenue and margins. Outside of the United States, service providers are particularly reliant on their copper infrastructure, as few countries have upgraded their infrastructure to optics. Beyond that, the options for pay-TV services outside the U.S. are, for the most part, limited. Consumers living

abroad have less access to digital television, leaving international telecommunication companies well-positioned to capture a large percentage of the market. Hence, we believe the market conditions that exist abroad are stronger for our products than those that exist domestically. mPhase intends to utilize its own sales force, in addition to strategic partners to distribute its products worldwide.

Our legacy DVDDS is currently deployed with BMW Manufacturing in Spartanburg, South Carolina and was previously deployed as a test system at Hart Telephone in Hartwell Georgia that had up to 80 users. The DVDDS has not, as yet, generated material revenues and has been replaced by our TV+ solution.

Our goal is to achieve wide acceptance of our TV+ solution in developing markets outside of the United States for multi-channel digital broadcast IP television at significant gross margins by creating an extremely cost-effective product. Release 3.0 of our TV+ solution consists primarily of highly scalable system management middleware/software designed to deliver IP television, video on demand, high speed internet and voice over any IP based network. The solution is carrier class and standards based designed to work with hardware of many different vendors that manufacture DSLAM's, IP Multicasters and set top boxes that are key components that form part of a system for the delivery of IPTV.. The Company is also developing its own next generation set top box to work as part of its TV+ solution as well as to sell as a stand alone product. It is important to note that the Company has shifted its focus from a proprietary end to end hardware and software platform for the delivery of broadcast television over DSL to the development of middleware/software for carrier class delivery of IPTV over any IP network infrastructure of a telecommunications service provider. This shift has taken place over the past two years in response to advancements in IP deliver of television and the current requirements of telecommunications service providers for IPTV solutions.

## **Other DSL Products**

### *POTS Splitter Shelves*

A Plain Old Telephone Service ("POTS") Splitter Shelf is a low pass/high pass filter that separates voice and data transmissions. POTS Splitter Shelves are necessary to permit simultaneous voice and data transmissions over the same twisted copper wire pair. POTS splitter shelves and the individual cards that populate the shelf, separate and combine traffic traveling along each twisted pair of wires into the analog voice portion of a transmission and the digital data portion, so that each signal can travel independent of the other. This product allows for increased clarity of both voice and data information and decreased crosstalk or interference.

Our POTS Splitter products are available in a domestic and European version.

*Intelligent POTS Splitter (iPOTS ), iPOTS3 and Universal Bypass*

The mPhase *i* POTS and *i* POTS 3 (recently renamed the Broadband Watch ) are innovative products for the DSL industry that enables remote and cost effective testing of a copper telephone loop for DSL deployment by a telephone service provider. Loop management and maintenance including line testing, qualification and troubleshooting from a telecommunication service providers central office (CO) can be accomplished by use of these products. Prior to the introduction by mPhase of the *i* POTS product line, testing by a telephone company of its copper wires for DSL, qualification and troubleshooting required the dispatching of personnel to the field. Thus the *i* POTS product reduces the cost for a telephone service provider seeking to deploy and maintain DSL services. The (patent pending) *i* POTS and new *i* POTS3 products allow both wideband and narrowband testing of a telephone service provider's copper loop. The *i* POTS is designed for use with the Lucent Stinger digital subscriber line access multiplexer or transport equipment for sending data from a telephone service providers central office to a customer (DSLAM). Our *i* POTS3 product is compatible with the Lucent Stinger as well as DSLAM's of other major vendors.

#### Microfilters

We have developed a complete line of microfilters, including a 2 and 4 pole filter for use in single and multi-phone households, as well as a Network Interface Device Splitter. These products, similar to POTS splitters, ensure clear and reliable service of voice, high-speed data, and television when these two services are transported over the same line.

#### Nanotechnology Products

Effective February 3, 2004, mPhase entered into a Research and Development Agreement with the Bell Labs division of Lucent Technologies, Inc. for exploratory development of micro power cell battery arrays employing nantextured superhydrophobic materials for \$1.2 million. Under the terms of the contract, the Company will share in royalties from any licensing of the products developed with Lucent. In March of 2005 mPhase has extended such contract for an additional 12 months on at a total cost of \$1.2 million. In March of 2005 mPhase also engaged the Bell Labs division of Lucent Technologies, Inc in a second 12 month \$1.2 million contract to develop an ultra sensitive magnetometer designed initially for electronic military applications.

#### Target Market

mPhase's primary target market for its IP TV+ solution (Release 3.0 of its TV+ system) is primarily large international telephone service providers and rural U.S. telephone service providers in areas in which an extensive fiber infrastructure has not been developed. We believe our IPTV solution is most competitive in markets that currently have limited access to multi-channel television services such as many parts of Eastern Europe, Africa, Latin America, Asia and the Middle East, as well as parts of the rural United States.

## **Competitive Business Conditions**

During the past 4 years, the market for the delivery of TV by telephone service providers has been marked by significant technological change. During the robust spending period in the late 1990's into the year 2000, the theme of convergence focused strictly on the last mile to the home in the United States. Telephone service providers were beginning to deliver high-speed internet over digital subscriber lines (DSL) using their copper infrastructure and examining methods to deliver broadcast television together with voice as a triple play to increase revenues and margins as traditional revenues and margins from wire line telephone services declined with the advent of wireless and voice over IP competition from cable providers. The industry has evolved from an initial focus on proprietary end to end systems such as the Traverser DVDDS developed by mPhase to the need for standards-based open architecture with carrier class quality and security which are features of mPhase's Release 3.0 of its TV+ solution for the delivery of IP television. During such period, telephone service providers concluded that in order to achieve minimum cost of delivery and maximum scalability, any solution for delivery of broadcast television and video on demand would need to be based upon a transport mode utilizing the new Internet Protocol as opposed to the services provider's traditional asynchronous transfer mode (ATM protocol). The evolution of mPhase's TV+ solution is targeted to meet the new market realities and requirements of major telecommunications service providers for the delivery of a triple play of converged services.

Despite significant market noise and fanfare about IP TV, major deployments of true broadcast television are few. The complexity of designing the software/middleware solution of low cost, high reliability, scalability, security and open architecture to allow service providers to custom tailor and grow into a system based upon such provider's network topology, take rate among customers and specific feature requirements has proved to be a significant challenge for all of the major players in such market place including Microsoft and Alcatel. The story is still being played out in the market with considerable uncertainty as to who the final dominant players will be on the middleware/software market which is the driving focus of mPhase's Version 3.0 of its TV+ solution. In 2005, the telecommunications sector has continued its slow recovery began in 2004 from the significant downturn and weakness in capital spending by service providers globally that began at the end of calendar year 2000. The dramatic pull back in equipment purchased by service providers from its peak commencing at the end of calendar year 2000, has significantly reduced earnings and resulted in dramatically reduced stock prices of telecommunications equipment vendors. This, together with the tremendous correction of stock prices in general during the past four years, has halted the growth of the sector. The Company remains optimistic about the future of the industry and the potential of its IP TV platform and solutions. The Company has responded to the market challenges in the past several years to reconfigure its video product line from a narrow, proprietary, DSL platform solution to an open systems standard for the delivery of Broadcast Television, high speed internet and voice over a medium agnostic and delivery agnostic solution. The Company's IPTV solution enables telephone service providers to deliver a triple play of services over both a fiber, coaxial or copper transport medium with a transport mode not tied to any particular DSLAM vendor but rather based upon an open standards system delivery and management system software. The Company believes that the market for its intelligent loop

diagnostic systems such as the Broadband Watch product will grow as the rollout of DSL continues globally. We anticipate an eventual upturn in capital spending by telephone service providers even though such upturn may be constrained by the fact that service providers still face significant challenges of overcapacity and declining margins for traditional services globally. Nevertheless, the worldwide rollout of DSL data delivery services should provide a market for the Company's component products such as POTS splitters.

As has been seen during the past several years, in addition to the very volatile economic climate, the telecommunications software and hardware equipment market is also characterized by swift technological change. Currently, communications service providers have the option to offer several broadband solutions for the last mile to the home, including the existing ISDN or T-1 technologies, fiber optics or hybrid coaxial cable and wireless and satellite delivery methods. Communications service providers may use these other technologies instead of DSL to offer their subscribers broadband access. Based upon current telecommunications industry standards and deployment methodologies, mPhase believes that it has broadened its competitive capabilities beyond the traditional DSL and copper market with the development of its IPTV product in Release 3.0 of its TV+ solution that operates over any form of IP network.

Where DLSAM (digital subscriber line access multiplexes) continue to be a key transport instrument for the delivery by telephone service providers of converged services, it should be noted that Alcatel is the leading supplier of DSLAMS (digital subscriber line access multiplexers) around the globe having deployed several video over DSL installations with telephone service providers. Historically, Alcatel has worked with multiple equipment vendors to create a complete, end-to-end video solution, including middleware (i.e., software) and has recently announced a major joint venture with Microsoft to develop middleware for IPTV delivery by telecommunications service providers..

There are a number of middleware providers competing in the IP TV solutions market including a number of competitors that are much larger, better known and with far greater financial resources than mPhase. Such competitors include Minerva, Orca Interactive, Siemens Corporation and VBrick Systems.

With respect to its set top box product, the Company faces strong competition from Advanced Digital Broadcast, Amino Communications, Kraetel, Pace Micro Technology, Samsung Telsey Telecommunications and VBrick Systems. End to end solutions competitors in the IPTV market include UTStarcom, mx Ware and Industria.

Bell South has recently awarded a major contract to the Alcatel/ Microphase joint venture to develop an IP network capable of delivering an IP TV solution with robust features. Next Level Communications (NLC), a division of

Motorola, has secured over 100 customers predominantly in the United States. The majority of their deployments utilize a specific form of DSL known as VDSL (very fast digital subscriber line). VDSL requires that telecommunications service providers install fiber optics into the neighborhood, or close to the customer premises because signals can only travel up to 5,000 feet over copper telephone wires. As a result, relative to the mPhase solutions, the NLC platform is more capital intensive due to the cost of the infrastructure upgrade (i.e., installing fiber optics closer to the customer premises). NLC has also introduced an ADSL version of its equipment, which enables greater serviceable distance radius of approximately 8,000 feet. mPhase believes that with the development of Version 3.0 of its TV+ solution, it can compete in the middleware market for any solution involving an IP network including but not limited to fiber, coaxial cable, Ethernet and both the ADSL and VDSL markets. It should be noted that standards are just beginning to develop for the VDSL market, which previously had significantly constrained the growth of such market.

To date, there are several deployments of IPTV worldwide including a deployment in Italy by Fastweb an Italian corporation. In Spain, Imagenio, operated by Telefonica has completed a significant deployment. Other major deployments of IPTV worldwide also include Yahoo BB/Softbank in Japan, Supersun in Hong Kong and Media on Demand in the Republic of China operated by Chunghwa Telecom.

With respect to video over DSL solutions, there are currently a number of minor deployments by rural teleco's in the United States. In addition there is a VDSL deployment at SasTel in Saskatchewan Canada by a former division of Lucent Technologies, Inc that was divested and is now an independent company in Canada. This solution, similar to NLC's products, offers greater functionality and features, however is more costly in terms of per port equipment cost than the mPhaseTV+ platform. Finally, other smaller vendors are emerging, partnering with other equipment vendors to create a video over DSL platform. Equipment providers such as Net to Net and Paradyne are modifying their data platforms to support the delivery of television services. However, mPhase believes it has certain cost of equipment advantages over other vendors making its system more economically viable for potential customers. The Company believes that the strength of the systems software developed for mPhase coupled with the strength of the data-centric Lucent Stinger make its TV+ system solution competitive in its target markets.

Other vendors that offer complete platforms for delivery of TV over DSL or hardware or software portions of such platforms that incorporate broadband solutions over copper wire include: ADC, Advanced Fiber Communications, Innovia, NEC, Motorola, Huawei Technologies Corporation Limited, Paradyne Networks, Samsung, 2Wire, Siemens, TUT Systems, Motorola, UTSTARCOM and Westell. In addition, we also compete with Minerva and Myrio Corporation, which provide infrastructure software products to deliver multi-channel digital television over telephone networks..

Cable television providers are also competing in the space for converged services using analog and digital cable connections that have been upgraded for digital two-way services. In the United States, the majority of cable connections have already been upgraded and can support the delivery of television and high-speed Internet, and in many cases, cable telephony. In fact, the imposing threat that cable companies present has created a catalyst among telephone companies to expand their service offering to include advanced services such as digital television.

While satellite delivered television services in the U.S. have experienced significant growth over the past several years, the ability for satellite providers to offer reliable, consistent and cost-effective high speed data is still in its infancy and too expensive to commercially deploy. Furthermore, satellite providers are not typically equipped to offer telephony services, unless they were to partner with a telephony provider. Beyond that, particularly outside of the U.S., the direct-to-home satellite options are limited due to either low channel counts or unreliable quality. Satellite signals are often affected by weather events such as severe snow or rain, unlike DSL-delivered services which remain unaffected by weather patterns.

## **Manufacturing**

mPhase subcontracts all of the manufacturing of its products to outside sources including related parties such as Janifast Ltd. and Microphase Corporation. We currently have no contracts in place for the manufacturing of our products with either Microphase Corporation or Janifast Ltd. or any other non-affiliated third party manufacturers. We periodically execute purchase orders for the manufacture of quantities of POTS Splitters that are produced by Janifast Ltd.

## **Outsourcing**

The Company practices an outsourcing model whereby it contracts with third party vendors to perform certain functions rather than performing those functions internally. For instance, mPhase outsourced the digital engineering development for the legacy Traverser DVDDS to GTARC. It also out sources analog engineering development and certain administrative functions to Microphase Corporation. mPhase has outsourced to Lucent Technologies, Inc., as well as Magpie Telecom Insiders, Inc. and Espial significant software development to be used as part of its new IPTV solution. With respect to hardware to be used in its IPTV+-system, mPhase is targeting leading vendors as well as contract manufacturing companies with strategically located facilities globally, with which it can establish long-term relationships. By using contract manufacturers, mPhase will avoid the substantial capital investments required for internal production.

As previously described in detail, the Company has entered into a number of significant agreements with Lucent Technologies, Inc which include a Co-Branding Agreement allowing the Company to add the Lucent name and Logo to its cost-reduced set top box. Such agreement is for an initial period of one year and is subject to renewal on an annual basis by mutual



consent. In addition, the Company has entered into a Systems Integrator Agreement, dated as of April 4, 2003 designating the Company as a reseller of the Lucent Stinger DSL transport product when bundled as part of the mPhase TV+ platform globally. Such agreement gives mPhase the exclusive right to sell the TV+ product worldwide containing the Lucent Stinger as the DSL transport mechanism for delivering broadcast television, high speed data and voice over copper telephone wires. In order to qualify for such status, as an accredited reseller, Lucent Technologies, Inc. determined that the Company's TV+ platform added significant software and hardware value to the Stinger DSL product by enabling such product to deliver broadcast television over ADSL in addition to the Stinger's well known existing world -class capabilities for the delivery of voice and high-speed data over copper telephone lines. Such agreement is for an initial two year term provided that either party may cancel such agreement with 60 days notice to the other party.

As a member of the Lucent Business Partner organization, mPhase may be able to leverage established relationships with an existing Stinger customer base without having to expand its sales force. Although to date mPhase has not upgraded any Stingers with its TV+ solution there are approximately 4 million ports of the Stinger deployed around the world. mPhase and the Lucent Global Business Partners group are also targeting other Business partners in markets where there currently is a lack of cable television infrastructure.

mPhase has also outsourced to the Bell Laboratories Division of Lucent Technologies its research and development efforts in the nanotechnology area aimed at developing power cells and batteries with enhanced shelf lives and other features not currently available in batteries. Such focus is initially upon the development of batteries for military applications using nanotextured materials. In addition, as noted above, mPhase expanded its efforts in product development using the science of nanotechnology in fiscal year 2005 by extending its original Development Agreement with Bell Labs for power cell and battery development for another 12 months as well as entering into a new 12 month agreement with Bell Labs to develop electronic magnetic sensors (the Magnetometer) product line.

## **Patents and Licenses**

We have filed and intend to file United States patent and/or copyright applications relating to some of our proposed products and technologies, either with our collaborators, strategic partners or on our own. There can be no assurance, however, that any of the patents obtained will be adequate to protect our technologies or that we will have sufficient resources to enforce our patents.

Because we may license our technology and products in foreign markets, we may also seek foreign patent protection. With respect to foreign patents, the patent laws of other countries may differ significantly from those of the United States as to the patentability of our products or technology. In addition, it is possible that competitors in both the United States and foreign countries, many of which have substantially greater resources and have made substantial investments in competing technologies, may have applied for, or may in the future apply for and obtain, patents,

which will have an adverse impact on our ability to make and sell our products. There can also be no assurance that competitors will not infringe on our patents or will not claim that we are infringing on their patents. Defense and prosecution of patent suits, even if successful, are both costly and time consuming. An adverse outcome in the defense of a patent suit could subject us to significant liabilities to third parties, require disputed rights to be licensed from third parties or require us to cease our operations.

The intellectual property owned and licensed by the Company falls into two general categories, analog and digital intellectual property.

mPhase owns the analog intellectual property, which can be characterized as filter technology. This intellectual property includes:

- Low pass filter shelves and POTS Splitters, which separate and combine the DSL spectrum from the traditional voice service;

- ADSL filters, which are filters that conform to the worldwide DSL standard and are utilized in the transmission of data and voice service; and

- Bypass for telephone Splitter System, which enables an automated and remote bypass of the POTS Splitter so full metallic testing can be performed.

We have a pending patent application, which was filed in June 1999 claiming priority to three provisional patent applications for the analog portion of our technology.

mPhase exclusively licenses our digital intellectual property from GTRC. We also have an exclusive, worldwide license to manufacture and market products using the technology developed by GTARC under our contract with them. The exclusive license with GTRC is applicable for the duration of their patent protecting the system design and other technology related to the Traverser. The digital intellectual property that we license provides several unique aspects of the Traverser. Among them is the backplane design, which provides every subscriber the ability to view any channel available. All subscribers in a given system could be watching the same channel at the same time. The intellectual property licensed exclusively to mPhase by GTRC includes the below mentioned patents. A patent for the System and Method for the Delivery of Digital Video and Data over a Communications Channel was issued on November 28, 2000 to the Georgia Tech Research Corporation.

A patent was issued on March 27, 2001 to the Georgia Tech Research Corporation for the System and Method for Maintaining

Timing Synchronization in a Digital Video Network. This patent covers the development of the Framer and the Framer chip. The Framer is an Integrated Circuit, which gives the Traverser the capability of allocating both the downstream and upstream bandwidth into virtually any application required. This feature allows the Traverser to deliver both MPEG-2 digital video and Internet data simultaneously and also allows for future applications of the Traverser.

A patent was issued on November 27, 2001 to the Georgia Tech Research Corporation for the Method and Apparatus for Combining a Plurality of 8B/10B Encoded Data Streams addresses video data transport between digital headends and the access network serving subscribers. A further patent is pending covering other methods of video program transport.

Another patent was issued on August 13, 2002 covering what mPhase calls the System Management Workstation (SMW). Specifically, this patent entitled, "Computer System and Method for Providing Digital Video and Data Over a Communication Channel" addresses the means by which the computer system and method manages the already patented bus or broadcast backplane, for the delivery of converged voice, video and data. The management system covered by this patent performs functions such as monitoring the health of the Traverser system, managing a database of user information, as well as linking multiple central offices to a master system control station.

Georgia Tech also has patents pending that protect:

- o apparatus and methods of remote control of the Intelligent Network Interface; and,
  
- o systems and methods to provide subscribers means to playback previously recorded video content.

mPhase is currently reviewing with Georgia Tech Research Corporation the value of the Patents and Patents Pending with respect to the Traverser DVDDS product and the cost of maintaining such Patents in the United States and selected countries outside of the United States. The Company intends to maintain only such Patents relating to the Traverser DVDDS platform that could have future value either with respect to future deployments of its legacy product or which may create legal barriers to entry against potential competitors.

The Company had filed 7 additional patents that consist of a combination of (a) patents granted to mPhase from the bell labs division of Lucent Technologies, Inc. and (b) joint patents development by mPhase and employees of bell labs with respect to the nanotechnology products currently under development by the Company

On July 12, 2005, mPhase announced that it had been granted a U.S. patent that covers a series of techniques for splitting different voice and data signals in DSL access networks that is used in its Broadband Loop Watch product.

We also rely on unpatented proprietary technology, and we can make no assurance that others may not independently develop the same or similar technology to ours or otherwise obtain access to our unpatented technology. If we are unable to maintain the proprietary nature of our TV+ platform, in particular, which is not currently the protected by any patents or the subject of any patents pending, our future operations would likely be adversely affected.

### **Government Regulation**

The Federal Communication Commission, or FCC, and various state public utility and service commissions, regulate most of mPhase's potential domestic customers. Changes to FCC regulatory policies may affect the accessibility of communications services, and otherwise affect how telecommunications providers conduct their business. These regulations may adversely affect the Company's potential penetration into certain markets. In addition, its business and results of operations may also be adversely affected by the imposition of certain tariffs, duties and other import restrictions on components, which mPhase obtains from non-domestic component suppliers. Changes in current or future laws or regulations, in the U.S. or elsewhere, could materially adversely affect the Company's business.

To the best of our knowledge, there are no state or local laws to which we are subject that are relevant to our system from a regulation and certification standpoint. At the Federal level, we are subject to Federal Communications Commission (FCC) Regulations Under the Code of Federal Regulations, Title 47, Chapter 1, Part 15-RADIO FREQUENCY DEVICES, and Part 68-CONNECTION OF TERMINAL EQUIPMENT TO THE TELEPHONE NETWORK. Part 15 sets out the requirements to obtain a license for operating a radiator of electromagnetic energy, and the technical and administrative specifications relating to the marketing of such radiators. Part 68 sets out the rules and regulations to provide for uniform standards for the protection of the telephone network from harms caused by the connection of terminal equipment and associated wiring thereto, and for the compatibility of hearing aids and telephones so as to ensure that persons with hearing aids have reasonable access to the telephone network.

Our products and equipment were designed to comply with the aforementioned rules and regulations. The POTS splitter and filter products were already certified with FCC Part 68. The TV+ is FCC Part 15 compliant.

Compliance with FCC rules and regulations allows our equipment to be marketed and sold in the United States. While the certification process and costs associated have no material effect on mPhase's financial condition, failure to comply with FCC rules and regulations would result in loss of revenue and additional costs on product revision and/or redesign.

## **Research and Development**

mPhase has designed the legacy Traverser DVDDS and its ancillary component parts in conjunction with multiple research and development partners. On March 26, 1998, we entered into a license agreement with GTRC which has the patent on the Digital Video and Data Delivery System technology. GTRC has granted us the exclusive license to use and re-sell this technology in the legacy Traverser DVDDS TV platform. We are required to pay GTRC royalties of 5% on the sales of the legacy Traverser DVDDS platform. The agreement expires automatically when the patents covering the invention expire. GTARC conducts the majority of our digital research and development for the Traverser. Microphase Corporation contributed the analog technology incorporated in the design of the Traverser, as well as providing ongoing development of analog DSL components. As of June 30, 2004, we had been billed a cumulative total of approximately \$13,563,000 for research and development conducted by GTARC.

mPhase originally contracted with Lucent in fiscal year 2002 to reduce the cost of its INI set top box used with the Traverser DVDDS platform. During fiscal year 2003, the Company engaged Lucent to develop an integrated system with the Lucent Stinger DSLAM and mPhase middleware for the delivery of Television, high speed internet and voice on an open standards system to replace the proprietary Traverser product. As previously noted, Releases 1.0 and 2.0 of the TV+ solution are designed to be ATM systems that operate exclusively with the Lucent Stinger DSLAM to enable a telecommunications service provider to deliver broadcast television, voice and high speed internet over DSL.

Version 3.0 of our TV+ system or IPTV product is expected to be completed in the second quarter of fiscal year 2006 by the Bell Labs division of Lucent Technologies, Inc. under a contract entered into August of 2004 and extended in August of 2005, for an aggregate cost of approximately \$1.6 million and we have engaged and expect to continue to engage Lucent for assistance with our development of other product refinements and enhancements on a project by project basis. As of June 30, 2005 we have been billed a cumulative total of approximately \$3,105,545 for research and development conducted by Lucent, of which we have paid approximately \$2,726,117.

In addition, our advanced battery and power cell technology research and development is being performed by the Bell Labs division of Lucent under the terms of a contract for a cost of approximately \$1.2 million with payments over a 12 month period of \$100,000 per months extending through February of 2006. From February of 2004 through February of 2005 the Company had paid a total of \$1.2 million to Bell Labs under at the rate of \$100,000 under its initial contract for development of advanced battery and power cell technology. In March of 2005, the Company further engaged Bell Labs in a separate Development Agreement for the development of a new generation of ultra magnetic sensors using the science of nanotechnology with a total cost of \$1.2 million also payable in monthly installments of \$100,000 for a period of 12 months.

## **Employees**

mPhase presently has 19 full-time employees, two of whom are also employed by Microphase Corporation. See the description in the section entitled "Certain Relationships and Related Transactions."

## **RISK FACTORS**

### **RISKS RELATED TO FINANCIAL ASPECTS OF OUR BUSINESS**

**The Company has entered into the new and emerging business of nanotechnology, which entails significant exploratory development and commercial risk.**

The Company has expended approximately \$1.8 million pursuant to a contract commencing in February of 2004 with Lucent Technologies, Inc. to initially develop longer life battery cells for military applications. The Company expects to continue exploratory research with Lucent Technologies, Inc. and in March of 2005 extended its original Development Agreement with Lucent for an additional 12 months at a cost of \$100,000 per month. Even though a feasibility prototype product has been successfully developed, pure research involves a high degree of risk with significant uncertainty as to whether a commercially viable product will result. On March 10, 2005 the Company

undertook to have Lucent Technologies Inc develop a new product line using the science of nanotechnology that is an uncooled magnetic ultra sensor device or magnetometer. The Company does not expect significant revenues from either of its nanotechnology products for at least 3 years.

**mPhase's stock price has suffered significant declines during the past four years and remains volatile.**

The market price of our common stock closed at \$7.56 on June 30, 2000 and closed at \$.28 and \$.23 on June 30, 2005 and September 26, 2005 respectively. During such period of time the shares of outstanding common stock of the Company increased from approximately 30 million to over 150 million shares (245 shares fully diluted). Such increase of shares was done to finance company operations and were issued at prices that were depressed and substantially diluted shares held by shareholders acquiring shares prior to the second quarter of fiscal year 2002. Stocks in telecommunications equipment providers of DSL products have been very volatile and declined dramatically during such period. Our common stock is a highly speculative investment and is suitable only for such investors with financial resources that enable them to sustain the loss of their entire investment in such stock. Because the price of our common stock is less than \$5.00 per share and is not traded on the NASDAQ National or NASDAQ Small Cap exchanges, it is considered to be a "penny stock" limiting the type of customers that broker/dealers can sell to. Such customers consist only of "established customers" and "Accredited Investors" (within the meaning of Rule 501 of Regulation D of the Securities Act of 1933, as amended-generally individuals and entities of substantial net worth) thereby limiting the liquidity of our common stock.

**We have reported net losses for each of our fiscal years from our inception in 1996 through the fiscal year ended June 30, 2005 and may not be able to operate profitability in the future.**

We have had substantial operating losses since our inception in 1996 (including \$11,234,324 and \$7,758,586 for the fiscal year ended June 30, 2005 and fiscal year ended June 30, 2004, respectively and cannot be certain when or if we will ever be profitable. We expect to continue to have net losses for the foreseeable future and have a need to raise not less than \$5-10 million in additional cash in the next 12 months through further offerings to continue operations. We have never been profitable from our inception in October 1996 through June 30, 2005 and we have incurred (a) accumulated losses of \$127,009,407 and a stockholder's deficit of \$1,617,735 and (b) cumulative negative cash flow from operations of \$55,638,706. As of June 30, 2005 we have negative working capital of \$1,674,419

**Our independent auditor's report expresses doubt about our ability to continue as a going concern.**

The reports of the Company's outside auditors, Rosenberg, Rich, Baker, Berman & Company with respect to its latest audited 10K for the fiscal years ended June 30, 2005, June 30, 2004, June 30, 2003, June 30, 2002 and June 30, 2001 stated that "there is substantial doubt of the Company's ability to continue as a going concern." Such opinion from our outside auditors makes it significantly more difficult and expensive for the Company to raise additional

needed capital necessary to continue our operations.

**Our common stock is subject to significant dilution upon issuance of shares we have reserved for future issuance.**

As of June 30, 2005, we have warrants and options outstanding convertible into approximately 107,000,000 shares of mPhase common stock, which, upon conversion, may adversely affect the future price of our common stock. As of June 30, 2005 we have warrants and options convertible into approximately 70,000,000 shares of our common stock at \$.30 per share or less that, upon exercise will generate proceeds of approximately \$18,200,000, may result in significant dilution to many of our current shareholders and may adversely affect the future price of our common stock. As of June 30, 2005, the Company has approximately 720,000 shares of common stock reserved for the issuance upon the conversion of certain 12% convertible notes to related parties at \$.25 per share, which may adversely affect the future price of our common stock. On June 15, 2004, the Company at a Special Meeting of Shareholders received authorization to increase its authorized shares of common stock from 125 million to 250 million shares and at its fiscal year 2004 annual meeting held on July 20, 2005 received shareholder approval to increase its authorized shares of common stock from 250 million to 500 million shares to enable it to continue to finance development of its products and fund continued operations. We may be forced to raise additional cash for operations by selling additional shares of our common stock at depressed prices causing further dilution to our shareholders. Certain warrants with key vendors are subject to cashless exercise and may be immediately exercised with no resulting proceeds to the Company.

## **RISK FACTORS RELATED TO OUR OPERATIONS**

**We have been a development-stage company since our inception in 1996 and have not to date had a significant deployment of any of our solutions for the delivery of broadcast television, high-speed internet and voice by a major telephone service provider.**

We have had to date no material revenues derived from sales of either our legacy Traverser Digital Video Data Delivery System (DVDDS) or our TV+ solution or our new Broadband Loop Watch product. There has been to date only one sale of our Release 2.0 of our TV+ software and Set Top Boxes for 1000 customers of a telecommunications service provider in Russia that is just commencing deployment of a small group of customers as a trial and no major



deployments of our TV+ Solution by telephone service providers globally of our products and there currently is uncertainty as to the extent, if at all, that deployments will occur in the future.

**We depend upon outsourcing of our research and product development of our TV+ Solution and Nanotechnology products to Lucent Technologies Inc.**

We depend upon Lucent Technologies Inc. for the successful development of our TV+ product, certain design and software used in our Broadband Loop Watch product and our Nanotechnology products and our business would be materially adversely affected if Lucent Technologies Inc. were to terminate our relationship.

**The loss of key personnel could adversely affect our business**

Management and employment contracts with all of our officers have expired and no assurances can be given that such executives will remain with the Company or that the Company will be able to successfully enter into agreements with such key executives. All of our officers have been granted stock options that are intended to represent a key component of their compensation. Such options may not provide the intended incentives to such officers if our stock price declines or experiences significant volatility.

**Economic support from affiliated companies has been significant during the downturn in the telecommunications industry.**

Both Microphase Corporation, and Janifast Ltd. have provided significant financial support to mPhase during fiscal years ended June 30, 2002 and June 30, 2003 in the form of either cash infusions or conversions of related party debt. Such companies, which share common management with mPhase, are under no legal obligation to and may not be able to sustain such economic support of mPhase in the future should such support be necessary.

**Sales and margins from our component DSL products have varied dramatically during the past three years and remain volatile.**

Sales and gross margins from our POTS Splitter and other DSL products have experienced a significant decline during the period from June 30, 2001 through June 30, 2003 as a result of the significant downturn in capital spending by telecommunications service providers. Although there was a recovery in such sales, and to a lesser extent margins, during the fiscal year ending June 30, 2004, there was again a substantial downturn again for the fiscal year ended June 30, 2005. The outlook for a recovery in sales remains uncertain. Failure to achieve significant sales with adequate gross margins with respect to our component DSL products will negatively affect the cash available to the Company

prior to commencement of sales of our TV+ solution thereby having a negative effect upon the overall financial condition of the Company and the price of our common stock.

**We rely on single sources for supply of a certain component for our POTS splitter product that has been the source of all of our revenues to date.**

We purchase the core torroid, which is a key component in our POTS Splitter Product from VAC Corporation. We purchase such component on a purchase order basis and have no long term contract for the supply of such component. The loss of this current source of supply could result in us having to redesign our product at additional cost and result in lost revenues from our main source of sales to date.

**We may incur substantial expenditures in the future in order to protect our intellectual property.**

We do not have currently patents or patents pending for our TV+ product. The telecommunications industry, in general, is characterized by a large number of patents and frequent patent litigation based upon claims of patent infringement when compared to other industries.

## **RISK FACTORS RELATED TO OUR TARGETED MARKETS**

**Historically the sale of infrastructure products to telecommunication providers in international markets has a long lead time and a multiplicity of risks.**

We expect the majority of our future revenues from our TV+ solution to be derived from international emerging markets and our success depends upon our ability to sell our flagship television platform outside of the United States where political, currency and regulatory risks are significantly greater. As a result of their distance from the United States, different time zones, culture, management and language differences, these operations pose greater risk than selling in the United States. Our sales cycle for our IPTV platform is lengthy (since it involves a major strategic

decision by an international telecommunications service provider) and we may incur significant marketing expenses with no guarantee of future sales. A significant market for our IP TV+ solution may never develop if international telephone service providers fail to successfully deploy broadband services including high speed data and television. Telephone service providers worldwide have significantly decreased capital expenditures for broadband and other deployment as a result of the current economic downturn in the industry. Future market demand that will cause telephone service providers to continue to aggressively roll out converged services including television and high-speed internet in particular, is highly unpredictable especially in markets outside of the United States. Certain telephone companies (especially in developing international economies) may have backbone infrastructure that is not of sufficient quality to accommodate the mPhase IPTV+ solution. Currency fluctuations, changes in foreign taxes and import duties and economic and political instability in international markets pose a greater risk to our operations than U.S. markets.

**Our television platform may not achieve compliance with regulatory requirements in foreign countries.**

Our TV+ solution may fail to meet foreign regulatory standards. Since our targeted markets for our IPTV product involves countries outside of the United States, such products are subject to greater regulatory risks since they must comply with different standards of different countries than can vary widely in the telecommunications industry. The failure to meet such regulatory standards would result in potential customers in countries outside of the United States not purchasing our TV+ solution.

**The telecommunications industry is subject to intense competition characterized by swift changes in technology.**

The telecommunications industry is subject to swift and continuing innovation and technological changes that could render our TV+ solution obsolete and intense competition in the industry could prevent us from ever becoming profitable. Our competitors that sell IP TV solutions that compete with our middleware and set top box include much larger, better known companies with significantly greater selling and marketing experiences and financial resources. Such competitors include for middleware a joint venture between Microsoft and Alcatel, as well as Minevera, Orca Interactive, Siemens, VBrick Systems and Video Furnace. Competition in the IP set top box product include Advanced Digital Broadcast Systems, Amino Communications, Kraetel, Pace Micro Technology, Samsung Telsey Telecommunications and VBrick Systems. End to end solutions competitors for IPTV include UTStarcom, mxWare and Industria. Telephone service providers that are our targeted customers face competition from cable-based technologies and satellite technologies that may cause them not to deploy our TV+ solution.

**Deployment of our television platforms requires certain additional investments by telecommunications service providers.**

Our Customers may need to build a digital head-end to download television content from satellites involving a significant additional capital expenditure to utilize the digital television capabilities of our TV+ solution. For

customers seeking to provide feature rich services such as video on demand, the installation of additional routers and servers may be required to upgrade the internet backbone capabilities necessary to deploy our TV+ solution. Such additional capital costs may cause potential customers not to purchase our television platforms.

**We may not be able to evolve our technology, products and services or develop new technology, products and services that are acceptable to our customers.**

The market for our broadcast digital television platform in the form of IPTV is characterized by:

Rapid technology change;

New and improved product introductions;

Changing customer Demands; and

Evolving industry standards and product obsolescence.

Our future success will depend upon our ability to continually enhance our IPTV delivery capabilities with additional features and continued reduce costs in order to meet new and continuing technology evolution and competitive demands of the market place. The development of enhanced and new technology, products and services is a complex and uncertain process requiring high levels of innovation, highly-skilled engineering and development personnel, and the accurate anticipation of technological and market trends. We may not be able to identify, develop, market or support new or enhanced technology, products, or services on a timely basis, if at all owing to our size and limited financial resources.

**Telecommunications Service Providers outside of the United States must be able to access sources for Broadcast Television Content in order to deploy our either of our TV+ solution.**

In order to have an incentive to deploy TV+ solution, an international telecommunications service provider must have access, to multiple channels of Television programming from content providers at prices that enable such provider to earn a profit from the deployment of television programming. In certain of our key target markets, such as Brazil, only cable companies are permitted under current law to provided such content and therefore a local service provider must either establish a working relationship with such a cable provider to have an incentive to utilize our

products.

## **ITEM 2. PROPERTIES**

Our corporate headquarters is located at 587 Connecticut Avenue, Norwalk, CT 06854-1711. The Company leases this office space from Microphase Corporation under a facilities agreement with Microphase that provides that mPhase lease office space, lab facilities and administrative staff on a month-to-month basis for \$10,000/month. The Company also maintains an office in Little Falls, New Jersey and New York, New York with monthly rents of \$11,500 and \$3,000 per month respectively.

## **ITEM 3. LEGAL PROCEEDINGS**

The Company was advised in April of 2002 that, following an investigation by the staff of the Securities and Exchange Commission, the staff intends to recommend that the Commission file a civil injunctive action against Packetport.com, Inc. (hereinafter "Packetport") and its Officers and Directors. Such recommendation relates to alleged civil violations by Packetport and such Officers and Directors of various sections of the Federal Securities Laws. The staff has alleged civil violations of Sections 5 and 17(a) of the Securities Act of 1933 and Sections 10(b) and 13(d) of the Securities Exchange Act of 1934. As noted in other public filings of mPhase, the CEO and COO of mPhase also serve as Directors and Officers of Packetport. Such persons have advised mPhase that they deny any violation of law on their part and intend to vigorously contest such recommendation. To date, no charges have been filed by the SEC or any other government agency.

From time to time we may be involved in various legal proceedings and other matters arising in the normal course of business.

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

On June 6, 2005, the Company filed a preliminary proxy with the SEC relating to its Annual Meeting of Shareholders of the Company for the fiscal year ended June 30, 2004, which was held on July 20, 2005. At such meeting shareholders of the Company approved a proposal by the Company to amend the Company's Certificate of Incorporation under New Jersey law to increase the authorized shares of common stock from 250 million to 500 million shares of \$.01 par stock. There were a total of 65,590,387 votes for the proposal, which included 408,968 broker non votes and abstentions and 3,018,669 votes against the proposal. Our Form of Definitive Proxy covering a detailed description of the proposal was filed with the SEC on June 17, 2005 and is hereby incorporated by reference.

**PART II**

**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

**(A) MARKET PRICES OF COMMON STOCK**

The primary market for mPhase's common stock is the NASDAQ OTC Bulletin Board, where it trades under the symbol "XDSL." The Company became publicly traded through a merger with Lightpaths TP Technologies, formerly known as Tecma Laboratories, Inc. pursuant to an agreement dated February 17, 1997. The following table sets forth the high and low closing prices for the shares for the periods indicated as provided by the NASDAQ's OTCBB System. The quotations shown reflect inter-dealer prices, without retail mark-up, markdown, or commission and may not represent actual transactions. These figures have been adjusted to reflect a 1 for 10 reverse stock split on March 1, 1997.

| YEAR/QUARTER                    | HIGH    | LOW     |
|---------------------------------|---------|---------|
| Fiscal year ended June 30, 2001 |         |         |
| First Quarter                   | \$ 9.25 | \$ 3.00 |

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|                                 |    |      |    |      |
|---------------------------------|----|------|----|------|
| Second Quarter                  |    | 5.94 |    | 1.47 |
| Third Quarter                   |    | 3.38 |    | 1.22 |
| Fourth Quarter                  |    | 2.61 |    | 1.03 |
| Fiscal year ended June 30, 2002 |    |      |    |      |
| First Quarter                   | \$ | 1.67 | \$ | .31  |
| Second Quarter                  |    | .86  |    | .31  |
| Third Quarter                   |    | .62  |    | .27  |
| Fourth Quarter                  |    | .50  |    | .23  |
| Fiscal Year ended June 30, 2003 |    |      |    |      |
| First Quarter                   | \$ | .32  |    | .15  |
| Second Quarter                  |    | .31  |    | .15  |
| Third Quarter                   |    | .36  |    | .19  |
| Fourth Quarter                  |    | .42  |    | .28  |
| Fiscal year ended June 30, 2004 |    |      |    |      |
| First Quarter                   | \$ | .42  | \$ | .29  |
| Second Quarter                  |    | .61  |    | .29  |
| Third Quarter                   |    | .69  |    | .38  |
| Fourth Quarter                  |    | .46  |    | .29  |
| Fiscal year ended June 30, 2005 |    |      |    |      |
| First Quarter                   | \$ | .31  | \$ | .21  |
| Second Quarter                  |    | .35  |    | .23  |
| Third Quarter                   |    | .60  |    | .30  |
| Fourth Quarter                  |    | .41  |    | .25  |

**(B) HOLDERS**

As of June 30, 2005, mPhase had 145,045,832 shares of common stock outstanding and approximately 12,000 stockholders of record. As of June 30, 2005 we have approximately 83,708,760 shares, 24,259,833 shares, and 1,200,000 of stock reserved for issuance upon the conversion of warrants, options, and convertible notes respectively.

## **(C) DIVIDENDS**

mPhase has never declared or paid any cash dividends on its common stock and does not anticipate paying any cash dividends in the foreseeable future. The Company currently intends to retain future earnings, if any, to finance operations and the expansion of its business. Any future determination to pay cash dividends will be at the discretion of the Board of Directors and will be based upon mPhase's financial condition, operating results, capital requirements, plans for expansion, restrictions imposed by any financing arrangements and any other factors that the Board of Directors deems relevant.

### *Issuances of Unregistered Securities*

The following securities were issued by us within the past three years and were not registered under the Securities Act of 1933, as amended (the "Act"). Each of the transactions is claimed to be exempt from registration under the Act.

In September 2001, certain of our officers and directors purchased an aggregate of 2,000,000 shares of common stock for an aggregate investment of \$1,000,000. These issuances included 1,000,000 shares to Mr. L. Barton, a director at that time, for an investment of \$500,000; 400,000 shares to Mr. Ronald A. Durando, the Company's president and a director, for an investment of \$200,000; 400,000 shares to Mr. Gustave Dotoli, the Company's vice-president and a director, for an investment of \$200,000; and; 200,000 shares to Mr. Martin S. Smiley, the Company's vice-president, for an investment of \$100,000; and were exempt pursuant to Section 4(2) and/or Rule 506 of Regulation D of the Act.

In December 2001 and January 2002, we issued 6,797,643 shares of common stock and a like amount of warrants at an exercise price of \$.30 per share for a term of five (5) years pursuant to Rule 506 of Regulation D of the Act for approximately \$2,000,000 in cash. This issuance was exempt pursuant to Section 4(2) and/or Rule 506 of Regulation D of the Act.



During the year ended June 30, 2002 the Company issued 7,492,996 shares of its common stock, and 5,953,490 warrants to related parties and strategic vendors, in connection with the conversion of \$2,738,658 of accounts payable and accrued expenses, of which 6,150,000 shares of common stock and 3,400,000 warrants were issued in settlement of \$1,460,000 of accounts payable to related parties as follows:

- a.) During December 2001, the Company converted \$660,000 of liabilities due to Microphase and \$360,000 of liabilities due to Janifast into 2,200,000 and 1,200,000, respectively, shares of the Company's common stock and a like amount of warrants to purchase one share each of the Company's common stock at an exercise price of \$.30 pursuant to debt conversion agreements pursuant to Section 3(a)(9) of the Act and 320,000 shares of common stock plus warrants to purchase another 320,000 shares of common stock at \$.30 for a term of 5 years, respectively, were issued to strategic vendors pursuant to Section 3(a)(9) of the Act.
- b.) During the quarter ended March 31, 2002 the Company converted \$96,000 of liabilities due to Strategic Vendors into 320,000 shares of the Company's common stock and a like amount of warrants to purchase one share each of the Company's common stock at an exercise price of \$.30 pursuant to debt conversion agreements pursuant to Section 3(a)(9) of the Act.
- c.) Effective March 31, 2002, the Company converted \$420,872 of liabilities due to Piper Rudnick LLP, outside legal counsel to mPhase pursuant to Section 3(a)(9) of the Act into a warrant to purchase up to a total of \$1,683,490 shares of the Company's common stock which pursuant to EITF 96 18, has an approximate value of \$.30 per share and a warrant to purchase 550,000 shares of the Company's common stock at an exercise price of \$.30 per share pursuant to the terms of payment agreement. In addition, Piper agreed to accept a Promissory note for \$420,872 of current payables at an interest rate of 8% with payments of \$5,000 per month commencing June 1, 2002 and continuing through December 1, 2003, with a final payment of principal plus accrued interest due at maturity on December 31, 2003. Additionally, 1,022,996 shares of common stock were issued to strategic vendors, the value of which was based upon the price of the Company's common stock on the effective date of settlement with each strategic vendor, to settle \$761,786 of liabilities pursuant to Section 3(a)(9) of the Act. The conversion of \$1,182,658 of such liabilities which, together with gains from cash settlements of \$27,960 resulted in an aggregate gain on extinguishments of \$142,236.
- d.) Effective for June 30 2002, the Company converted \$360,000 of liabilities due to Microphase and \$80,000 of liabilities due to Janifast into 2,250,000 and 500,000 shares of the Company's common stock, respectively, pursuant to debt conversion agreements pursuant to Section 3(a)(9) of the Act.

From August 2001 to June 2002, we issued an aggregate of 2,976,068 shares of common stock to consultants for an aggregate of \$1,202,997. We also issued an aggregate of 2,675,000 warrants to consultants for an aggregate of \$1,040,000. Each transaction was pursuant to Section 4(2) of the Act.

During the year ended June 30, 2003, we issued 4,296,680 shares of Common Stock at \$.30 per share plus 5 year warrants to purchase 4,296,680 shares of Common Stock at \$.30 per share in a Private Placement pursuant to Rule 506 of Regulation D of the Act, generating net proceeds to the company of approximately \$1,164,000.

During the year ended June 30, 2003, the Company issued 426,000 shares of its common stock valued at \$112,245 and 1,690,000 warrants, valued at \$203,150 based upon the fair market value of the Company's common stock on the date of the grant using the Black-Scholes option pricing model. The Company recorded these charges, totaling \$318,395 to operations for the year ended June 30, 2003. Each transaction was pursuant to Section 4(2) of the Act.

During the fiscal year ended June 30, 2003, the Company converted certain payables and accrued expenses with officers, related parties and strategic vendors pursuant to Section 4(2) and to Section 3(a)(9) of the Act aggregating approximately \$1.9 million into 5,923,333 restricted shares of the Company's common stock and 5 year warrants to purchase an additional 3,706,800 restricted shares of the Company's common stock. Of these, 5,533,333 shares of common stock and 3,491,800 warrants were issued in settlement of \$1,748,756 of debt to related parties as follows:

- a.) The conversion of \$620,000 and \$360,000 of liabilities due to Microphase corporation, and Janifast Ltd into 3,033,000 shares and 1,500,000 shares of stock, respectively. The value attributable to the shares was based upon the market price of the Company's common stock on the measurement date, such date was determined pursuant to EITF00-1, as to when all the contingent terms of the conversion agreements were met, in which no gain or loss was recognized on the conversion of \$980,000 of debt, and;
- b.) Also included in such conversions during the year ended June, 30 2003, were transactions whereby the Company converted \$525,967 of liabilities; \$269,362 due to the Company's president, \$211,605 due to the vice president and \$45,000 due to the a sales manager who is also concurrently employed by Microphase, for unpaid management compensation and sales commissions due from mPhase into warrants to purchase up to a total of 2,656,500 shares of the Company's common stock. The aggregate value of such warrants was estimated using the Black-Scholes options pricing model, pursuant to EITF 96-18, having an approximate value of \$.21 per share, or \$538,173. The Company recorded a settlement expense of approximately \$12,206 with respect to the Company's president and vice president.
- c.) Strategic vendors converted \$117,486 of payables into 340,000 shares of the Company's common stock on the measurement date the value of which was based upon the price of the Company's common stock on the effective date of settlement with each party. This resulted in a gain of \$37,383, which, when combined with all conversions and the gains from cash settlements of \$36,049 for the fiscal year 2003, resulted in a net gain on

extinguishments in the statements of operations of \$61,226 for the year ended June 30, 2003.

In August of 2003, the Company issued 333,334 shares of its common stock together with a like amount of warrants in a private placement pursuant to Rule 506 of Regulation D of the Act, generating net proceeds of \$100,000 which was collected during the three month period ended on September 30, 2003.

During the six months ending December 31, 2003, the Company granted 924,667 shares of its common stock and warrants to purchase 249,667 shares of its common stock to consultants for services performed, valued at \$307,243, and charged to operations during the period. Each transaction was pursuant to Section 4(2) of the Act.

During the three months ended December 31, 2003, the Company issued 500,000 shares of its common stock pursuant to warrants previously issued to purchase said shares pursuant to Rule 506 of Regulation D of the Act for an aggregate of \$150,000 in cash.

In December of 2003, the Company issued to five accredited investors 2,300,000 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of \$.35 per share, in a private placement pursuant to Rule 506 of Regulation D of the Act generating net proceeds of \$805,000, \$175,000 of which was collected in January, 2004. An advisor of the Company was issued 100,000 shares for assisting in this transaction.

In January of 2004, the Company issued to twenty-three accredited investors 7,160,720 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of \$.35 per share, in a private placement pursuant to Rule 506 of Regulation D of the Act generating net proceeds of \$2,506,250, all of which was collected in January, 2004.

In March and April of 2004, the Company issued to six accredited investors 1,811,429 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of \$.35 per share, in a private placement pursuant to Rule 506 of Regulation D of the Act generating net proceeds of \$634,000, all of which was collected in March and April, 2004. Two advisors of the company were issued 128,826 shares of its common stock together with a like amount of 5 year warrants to purchase one share each of the Company's common stock, with an exercise price of \$.35 per share for assisting in this transaction.

In June of 2004, the Company issued to three accredited investors 3,844,000 shares of its common stock together with two warrants each to purchase a like amount of stock at \$.35 and \$.50 respectively at a price of \$.25 per unit. Such warrants are exercisable for a period of 5 years and are callable at \$.10 per \$100,000 of the value of the shares in

which such warrants may be converted if the common stock of the company trades for 20 consecutive days above (i) \$.50 per share in the case of the \$.35 warrant and (ii) \$.75 per share in the case of the \$.50 warrant.

During the year ended June 30, 2004, the Company issued 17,446,441 shares of its common stock valued at \$6,419,545 and 900,000 warrants, valued at \$300,901 based upon the fair market value of the Company's common stock on the date of the grant using the Black-Scholes option pricing model. The Company recorded these charges, totaling \$130,450 to operations for the year ended June 30, 2004. Each transaction was pursuant to Section 4(2) of the Act.

During the fiscal year ended June 30, 2004, the Company converted certain payables and accrued expenses with GTRC, a strategic vendor, pursuant to Section 4(2) and to Section 3(a)(9) of the Act aggregating approximately \$1.8 million into 5 year cashless warrants to purchase an additional 5,039,200 restricted shares of the Company's common stock valued at \$.35 per share plus a \$100,000 term promissory note. The Company is in arrears with respect to the first payment on the note and is currently renegotiating the amount of the note and payment schedule since the note includes past and future royalty payments with respect to the Company's patents covering its Traverser DVDDS, some of which the Company may relinquish going forward.

Effective for the three-month period ended September 30, 2004 the Company issued the following unregistered securities:

A July private placement of 622,000 shares, each with two separate 5 year warrants were sold for \$ 155,000, each warrant specifying the right to purchase one additional share at \$.25 and \$.50, respectively. A September private placement of 1,050,000 shares, each with two separate 5 year warrants was sold for \$ 247,400, each warrant specifying the right to purchase one additional share at \$.25 and \$.35, respectively. A total of 3,344,00 shares has been reserved to provide for conversion in connection with these warrants.

Effective for the three-month period ended December 31, 2004 the Company issued the following unregistered securities:

During the three months ending December 31, 2004, the Company granted 134,500 shares of its common stock to consultants for services performed valued at \$26,900. Additionally, the Company issued 2,817,954 shares of its

common stock pursuant to the exercise of previously outstanding warrants, generating net proceeds intended to be used for general corporate purpose of \$563,590. During the quarter ended December 31 of 2004, the Company issued equity units consisting of 10,717,500 shares of its common stock together with a like amount of warrants, with an exercise price of \$.25, in a private placement generating net proceeds intended to be used for working capital and general corporate purposes, of 2,116,600 of which \$2,066,600 was collected through December 31, 2004 and \$50,000 was collected in January of 2005. A consultant who assisted the Company with this transaction also received 100,000 shares of the Company's common stock.

During January of 2005, the Company issued an additional 3,750,000 shares of equity units as part of the private placement begun in the second quarter of fiscal year 2005, generating additional proceeds of \$750,000. Additionally, 1,000,000 shares of common stock plus a 5 year warrant for a like amount of shares at \$.25 per share were issued to Janifast Ltd. upon conversion of \$200,000 of accounts payable. In addition 424,875 shares of common stock plus a 5 year warrant for a like amount of shares at \$.25 per share were issued to Martin Smiley, CFO and General Counsel of the Company in connection with his conversion of a \$75,000 promissory note plus accrued interest of \$9,975. In addition 65,000 shares of common stock and a 5 year warrant for a like amount of stock at \$.25 per share were issued to Mr. Durando, President and CEO of the Company for conversion of \$13,000 of accrued interest on various promissory notes issued by the Company and also received 1,395,400 shares of common stock of the Company in connection with the exercise of a warrant at \$.01 per share previously awarded for unpaid compensation. A reduction in principal of \$13,954 of a \$75,000 promissory note to Mr. Durando was made for payment of the exercise price of \$.01 per share under the warrant. Mr. Gustave T. Dotoli, Chief Operating Officer of the Company also was issued 375,000 shares of common stock of the Company in connection with the exercise of a portion of a warrant at \$.01 per share. Payment for such exercise was made in exchange for cancellation of \$3,750 of accrued interest on a \$75,000 promissory note. Finally Mr. Souzzo, a consultant, received 100,000 shares of common stock plus a 5 year warrant for a like amount of stock at \$.25 per share in exchange for cancellation of \$20,000 of accounts payable.

Effective for the three-month period ended March 31, 2005 the Company issued the following unregistered securities:

The December 31, 2004 and outstanding subscriptions receivable balance of \$ 50,000 was fully collected in January of 2005. Additionally, the December 2004 private placement was closed out in January of 2005 with the placement of 3,600,000 equity units at \$.20 per unit consisting of one share of common stock plus 5 year warrants for a like amount of shares with a strike price of \$.25 per share generating net proceeds of \$720,000 to the Company.

A January Private Placement realized net proceeds of \$357,250 upon issuance of 1,793,750 shares of Common Stock at \$.20 per share plus 5 year warrants to purchase 1,793,750 shares of Common Stock at \$.25 per share.

A later Private Placement realized net proceeds of \$1,351,000 upon issuance of 4,920,000 shares of Common Stock plus 5 year warrants to purchase 4,920,000 shares of Common Stock at \$.25 per share.

In January of 2005 there were stock option awards issued to two consultants for services performed. The company granted 250,000 options to a consultant for professional services, these options provide for the right of stock purchase at an exercise price of \$.25, these options have a five year life and expire in January of 2010. A second award issued a like number of options to another service provider under similar terms, except that the options associated with this second award offer a call feature, available to the company, for redemption of such options at a call price of \$.45 at any time during their five year life. In aggregate, 400,000 options were issued in connection with these awards and will result in a charge to General and Administrative non-cash expense in the amount of 133,990 in the third quarter of fiscal 2005. The valuation of this charge was made on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option premium model.

In February of 2005, GTARC tendered 5,069,242 of cashless warrants which they held in connection with a previous debt settlement in exchange for 4,949,684 of the company's shares of common stock, the balance of the 119,558 warrants were effectively cancelled as a result of certain warrant exercise exchange provisions adjusting the exchange rate based on specified stock pricing experience as per the original debt settlement agreement.

A March Private Placement resulted in the realization of net proceeds of \$1,217,000 upon issuance of 4,396,667 shares of Common Stock at \$.30 per share plus 5 year warrants to purchase 4,396,667 shares of Common Stock at \$.30 per share.

On February 17 of 2005, the Company granted 2,600,000 warrants and 400,000 options to consultants for services performed valued at \$1,328,600 and \$204,400, respectively. The warrants and options provide the right to purchase a share of mPhase common stock at an exercise price \$.45 and \$.30 per share, respectively, over their 5 year life expiring in February of 2010. These warrant and option awards were valued on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option premium model and the value of the award will be expensed to General and Administrative non-cash expenses in the third quarter of fiscal 2005.

On January 15, 2005, Martin Smiley converted a \$ 100,000 convertible note payable by the Company in exchange for 400,000 shares of common stock and a like number of warrants that were price at \$.25 per unit. General and Administrative non-cash expense in the amount of \$131,750 was recognized in the third quarter of fiscal year 2005 consistent with the market price of the stock of \$.31 on the date of the award.

Also in January of 2005, Martin Smiley was awarded additional compensation of 425,000 shares of common stock. This award resulted in a charge to General and Administrative non-cash expense in the amount of \$ 131,750 in the third quarter of fiscal 2005, representing an expense recognition consistent with the market price of that stock of \$.31 on the date of that award.

In January of 2005 there were stock option awards issued to two consultants for services performed. The company granted 250,000 options to a consultant for professional services, these options provide for the right of stock purchase at an exercise price of \$.25, these options have a five year life and expire in January of 2010. A second award issued a

like number of options to another service provider under similar terms, except that the options associated with this second award offer a call feature, available to the company, for redemption of such options at a call price of \$.45 at any time during their five year life. In aggregate, 400,000 options were issued in connection with these awards and will result in a charge to General and Administrative non-cash expense in the amount of \$ 133,990 in the third quarter of fiscal 2005. The valuation of this charge was made on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option premium model assumptions of a 145% volatility or beta factor and a 2.6% interest rate factor.

In February of 2005, GTARC tendered 5,069,242 of cashless warrants which they held in connection with a previous debt settlement in exchange for 4,949,684 of the company's shares of common stock, the balance of the 119,558 warrants were effectively cancelled as a result of certain warrant exercise exchange provisions adjusting the exchange rate based on specified stock pricing experience as per the original debt settlement agreement.

A March Private Placement resulted in the realization of net proceeds of \$1,217,000 upon issuance of 4,396,667 shares of Common Stock at \$.30 per share plus 5 year warrants to purchase 4,396,667 shares of Common Stock at \$.30 per share.

On February 17 of 2005, the Company granted 2,600,000 warrants and 400,000 options to consultants for services performed valued at \$1,328,600 and \$204,400, respectively. The warrants and options provide the right to purchase a share of mPhase common stock at an exercise price \$.45 and \$.30 per share, respectively, over their 5 year life expiring in February of 2010. These warrant and option awards were valued on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option premium model and the value of the award will be expensed to General and Administrative non-cash expenses in the third quarter of fiscal 2005.

On January 15, 2005, the company converted a \$ 100, 000 convertible note payable to Martin Smiley in exchange for 400,000 shares and a like number of warrants that were price at \$.25 per unit or \$100,000 in aggregate.

Also in January of 2005, Martin Smiley was awarded additional compensation of 425,000 shares of common stock. This award will result in a charge to General and Administrative non-cash expense in the amount of \$ 131,750 in the third quarter of fiscal 2005, representing an expense recognition consistent with the market price of that stock of \$.31 on the date of that award.

In late February and early March of 2005, the Company converted approximately \$173,898 in accounts payable due various vendors into 535,296 shares of common stock aggregating \$183,310 in full settlement of those obligations and pursuant to Section 3(a)(9) of the Act.

During May 2005 the Company adjusted the exercise price of \$.45 per share of an investor's 5 year warrant to purchase 714,296 shares of common stock. The warrant was originally issued in January 2005, to \$.225 in July of 2005. In July of 2005 such investor exercised a portion of such warrant, as adjusted, to purchase 200,000 shares of the Company's common stock generating \$45,000 of net proceeds to the Company.

On July 20, 2005, at the Company's annual meeting of Shareholders, the Shareholders ratified an amendment to its Certificate of Incorporation to increase the number of authorized shares of common stock from 250,000,000 to 500,000,000 shares.

During June and July 2005 the Company completed a private placement of equity units pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended. Each unit consists of one share of the Company's common stock at \$0.20 per share plus a five (5) year warrant to purchase one share of the Company's common stock at \$.25 per share. Such placement generated an aggregate of \$3,488,000 of proceeds to the Company, to be used primarily to pay for research and development expenses and for general corporate purposes. A total of 14,140,000 shares of the Company's common stock together with five (5) year warrants to purchase 14,140,000 shares of the Company's common stock at \$.25 per share were issued in such private placement. In connection with such private placement, consultants and advisors received \$253,500 of fees paid in cash and 476,500 shares of the Company's common stock and five (5) year warrants to purchase 476,500 shares of the Company's commons tock at \$.25 per share.

## **ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

The selected financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the historical financial statements and notes included in this annual report. The statement of operations data from October 2, 1996 (date of inception) to June 30, 1997 and for the year ended June 30, 1998, and the balance sheet data as of June 30, 1997 and 1998, are derived from financial statements that have been audited by Schuhalter, Coughlin & Suozzo, LLC, independent auditors, and are included in this document. The statement of operations data for the years ended June 30, 1999, 2000, and 2001 and the balance sheet data as of June 30, 1999, 2000, and 2001 are derived from financial statements that have been audited by Arthur Andersen LLP., independent auditors. The statement of operations data for the years ended June 30, 2002, June 30, 2003, June 30, 2004 and June 30, 2005 and the balance sheet data as of June 30, 2002, June 30, 2003, June 30, 2004 and June 30, 2005 are derived from financial statements that have been audited by Rosenberg Rich Baker Berman & Company, independent auditors, and are included in this document.



|   | Year Ended June 30,               |             |            |            |             | Cumulative<br>from<br>inception           |
|---|-----------------------------------|-------------|------------|------------|-------------|---|
|   | 2001                              | 2002        | 2003       | 2004       | 2005        | October 2,<br>1996 to<br>June 30,<br>2005 |
|   | (in thousands, except share data) |             |            |            |             |   |
| STATEMENT<br>OF<br>OPERATIONS<br>DATA:                    |                                   |             |            |            |             |   |
| Total revenues  | \$ 10,524                         | \$ 2,582    | \$ 1,582   | \$ 4,641   | \$ 1,711    | \$ 21,320                                 |
| Costs and<br>Expenses:                                    |                                   |             |            |            |             |   |
| Cost of sales   | 5,805                             | 2,415       | 1,493      | 4,270      | 1,446       | 15,359                                    |
| Research and<br>development                               | 10,780                            | 3,820       | 3,538      | 3,928      | 5,127       | 43,544                                    |
| General and<br>administrative                             | 17,322                            | 7,039       | 2,684      | 4,118      | 6,580       | 85,635                                    |
| Depreciation and<br>amortization                          | 660                               | 670         | 515        | 123        | 63          | 2,953                                     |
| Operating loss  | (24,043)                          | (11,361)    | (6,649)    | (7,798)    | (11,505)    | (126,171)                                 |
| Other income<br>(expense), net                            | -                                 | 142         | 50         | 150        | 382         | (722)                                     |
| Interest income<br>(expense)                              | 43                                | (26)        | (51)       | (111)      | (111)       | (116)                                     |
| Net loss  | \$ (24,000)                       | \$ (11,245) | \$ (6,650) | \$ (7,759) | \$ (11,234) | \$ (127,009)                              |
| Basic and diluted<br>net<br>loss per share                | \$ (.72)                          | \$ (.23)    | \$ (.10)   | \$ (.10)   | \$ (.10)    |   |
| Shares used in<br>basic and diluted<br>net loss per share | 33,436,641                        | 49,617,280  | 65,217,088 | 77,677,120 | 108,657,578 |   |

Year Ended June 30,

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|   | <b>2001</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> |
|---|-------------|-------------|-------------|-------------|-------------|
| <b>BALANCE SHEET DATA:</b>                    |             |             |             |             |             |
| Cash and cash equivalents                     | \$ 31       | \$ 47       | \$ 397      | \$ 90       | \$ 351      |
| Working capital (deficit)                     | (1,458)     | (94)        | (1,405)     | (2,112)     | (1,674)     |
| Total assets                                  | 8,997       | 6,942       | 3,782       | 2,591       | 2,232       |
| Long-term obligations, net of current portion | 90          | 2,891       | 2,608       | 1,038       | 315         |
| Total stockholders' equity (deficit)          | \$ 1,865    | \$ (42)     | \$ (3,229)  | \$ (2,918)  | \$ (1,618)  |

The statement of operations data as of the periods indicated below are derived from unaudited financial statements. The operations data for the quarterly periods ended September 30, 2001 and each quarter thereafter to and including the quarter ended December 31, 2001 are derived from unaudited financial statements reviewed by Arthur Andersen LLP and the operations data for the quarterly periods from March 31, 2002 and each quarter thereafter through and including the quarter ended June 30, 2005, have been derived from unaudited financial statements reviewed by Rosenberg, Rich, Baker, Berman & Company, and include all adjustments (consisting of normal recurring items) that management considers necessary for a fair presentation of the financial statements.

|  | <b>Three months ended</b>                   |                    |                 |                |
|--|---|--------------------|-----------------|----------------|
|  | <b>September 30</b>                         | <b>December 31</b> | <b>March 31</b> | <b>June 30</b> |
|  | <b>(in thousands, except share amounts)</b> |                    |                 |                |
| <b>FISCAL 2005 QUARTERLY STATEMENT OF OPERATIONS DATA:</b> |   |                    |                 |                |
| Total revenues   | \$ 179                                      | \$ 296             | \$ 564          | \$ 672         |
| Costs and Expenses:  |   |                    |                 |                |
| Cost of Sales  | 130   | 245                | 448             | 623            |
| Research and development                                   | 1,101                                       | 1,055              | 1,664           | 1,307          |
| General and administrative                                 | 709   | 2,071              | 2,639           | 1,032          |
|  | <u>1</u>                                    | -                  | <u>127</u>      | -              |
|  |   |                    | <u>62</u>       | <u>1</u>       |

|  |                   |                   |                    |                    |            |
|--|-------------------|-------------------|--------------------|--------------------|------------|
| Depreciation and amortization                          |                   |                   |                    |                    |            |
| Operating loss   | (1,762)           | (3,203)           | (4,249)            | (2,291)            |            |
| Interest expense, Net                                  | (29)              | (66)              | (37)               | 21                 |            |
| Gain (loss) on debt extinguishments and investments    | <u>(41)</u>       | <u>-</u>          | <u>-</u>           | <u>(59)</u>        | <u>482</u> |
| Net loss   | \$ <u>(1,832)</u> | \$ <u>(3,269)</u> | \$ <u>(4,345)</u>  | \$ <u>(1,788)</u>  |            |
| Basic and diluted net loss per share                   | \$ <u>(.02)</u>   | \$ <u>(.04)</u>   | \$ <u>(.04)</u>    | \$ <u>(.01)</u>    |            |
| Shares used in basic and diluted net loss per share(1) | <u>89,719,962</u> | <u>93,388,984</u> | <u>120,015,504</u> | <u>137,719,500</u> |            |

|  | <b>Three months ended</b>                   |                    |                   |                   |
|--|---|--------------------|-------------------|-------------------|
|  | <b>September 30</b>                         | <b>December 31</b> | <b>March 31</b>   | <b>June 30</b>    |
|  | <b>(in thousands, except share amounts)</b> |                    |                   |                   |
| <b>FISCAL 2004 QUARTERLY STATEMENT OF OPERATIONS DATA:</b> |   |                    |                   |                   |
| Total revenues   | \$ 2,489                                    | \$ 1,291           | \$ 555            | \$ 306            |
| Costs and Expenses:  |   |                    |                   |                   |
| Cost of Sales  | 2,099                                       | 1,191              | 484               | 294               |
| Research and development                                   | 611   | 843                | 1,404             | 1,212             |
| General and administrative                                 | 605   | 914                | 803               | 1,856             |
| Depreciation and amortization                              | <u>46</u>                                   | <u>28</u>          | <u>27</u>         | <u>22</u>         |
| Operating loss   | (872)                                       | (1,685)            | (2,162)           | (3,078)           |
| Interest expense, Net                                      | (16)  | (16)               | (20)              | (59)              |
| Gain (loss) on debt extinguishment                         | <u>23</u>                                   | <u>=</u>           | <u>(152)</u>      | <u>278</u>        |
| Net loss   | \$ <u>(865)</u>                             | \$ <u>(1,701)</u>  | \$ <u>(2,334)</u> | \$ <u>(2,859)</u> |
| Basic and diluted net loss per share                       | \$ <u>(.01)</u>                             | \$ <u>(.02)</u>    | \$ <u>(.03)</u>   | \$ <u>(.03)</u>   |
| Shares used in basic and diluted net loss per share(1)     | <u>71,725,318</u>                           | <u>72,814,272</u>  | <u>81,564,405</u> | <u>84,885,017</u> |

**Three months ended****September 30****December 31****March 31****June 30**

(In thousands, except share amounts)

## FISCAL 2003 QUARTERLY

STATEMENT OF  
OPERATIONS DATA:

|  |                   |                   |                   |                   |
|--|-------------------|-------------------|-------------------|-------------------|
| Total revenues   | \$ 210            | \$ 562            | \$ 210            | \$ 600            |
| Costs and Expenses:                                    |                   |                   |                   |                   |
| Cost of sales  | 197               | 547               | 205               | 544               |
| Research and development                               | 803               | 753               | 906               | 1,077             |
| General and administrative                             | 893               | 731               | 544               | 516               |
| Depreciation and amortization                          | <u>131</u>        | <u>129</u>        | <u>129</u>        | <u>127</u>        |
| Operating loss   | (1,814)           | (1,598)           | (1,574)           | (1,664)           |
| Interest expense, Net                                  | (18)              | (15)              | (11)              | (6)               |
| Gain on debt extinguishment                            | 41                | -                 | 9                 | 11                |
| Gain (Loss) on investments                             | -                 | <u>(16)</u>       | <u>(12)</u>       | <u>17</u>         |
| Net Loss   | \$ <u>(1,791)</u> | \$ <u>(1,629)</u> | \$ <u>(1,588)</u> | \$ <u>(1,642)</u> |
| Basic and diluted net loss per share                   | \$ <u>(.03)</u>   | \$ <u>(.07)</u>   | \$ <u>(.02)</u>   | \$ <u>(.02)</u>   |
| Shares used in basic and diluted net loss per share(1) | <u>60,881,131</u> | <u>65,914,466</u> | <u>65,956,810</u> | <u>68,164,160</u> |

**Three months ended****September 30****December 31****March 31****June 30**

(in thousands, except share amounts)

## FISCAL 2002 QUARTERLY

STATEMENT OF  
OPERATIONS DATA:

|                                    |                   |                   |                   |                   |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|
| Total revenues                     | \$ 537            | \$ 545            | \$ 866            | \$ 634            |
| Costs and Expenses:                |                   |                   |                   |                   |
| Cost of Sales                      | 457               | 530               | 724               | 704               |
| Research and development           | 1,111             | 1,257             | 539               | 912               |
| General and administrative         | 2,862             | 1,641             | 1,355             | 1,182             |
| Depreciation and amortization      | <u>193</u>        | <u>209</u>        | <u>136</u>        | <u>132</u>        |
| Operating loss                     | (4,086)           | (3,092)           | (1,888)           | (2,296)           |
| Interest expense, Net              | (10)              | (1)               | (5)               | (10)              |
| Gain (Loss) on debt extinguishment | <u>33</u>         | <u>5</u>          | <u>85</u>         | <u>19</u>         |
| Net Loss                           | \$ <u>(4,063)</u> | \$ <u>(3,088)</u> | \$ <u>(1,808)</u> | \$ <u>(2,287)</u> |
|                                    | \$ <u>(.10)</u>   | \$ <u>(.07)</u>   | \$ <u>(.03)</u>   | \$ <u>(.04)</u>   |

Basic and diluted net loss per share

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Shares used in basic and diluted net loss per share(1) | 42,037,506 | 44,645,458 | 55,606,168 | 56,459,167 |
|--|------------|------------|------------|------------|

(1) The quarterly earnings per share data above are computed independently for each of the quarters presented. As such, the sum of the quarterly per common share information may not equal the full year amounts due to rounding differences resulting from changes in the weighted-average number of common shares outstanding.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS AND PLAN OF OPERATIONS**

The following is management's discussion and analysis of certain significant factors, which have affected mPhase's financial position and should be read in conjunction with the accompanying financial statements, financial data and the related notes.

**RESULTS OF OPERATIONS**

***OVERVIEW***

mPhase is a development-stage company that historically develops, markets and sells a line of innovative DSL based broadband communications equipment and IP Television delivery solutions. During fiscal year ended June 30, 2005 the mPhase expanded its efforts in the field of nanotechnology by entering into a new \$1.2 million Development Agreement with the Bell Labs Division of Lucent Technologies, Inc. to develop an ultra sensitive magnetic detection device known as a magnetometer which has significant potential military applications. In March of 2005 the Company extended for an additional 12 months at a cost of \$1.2 million its initial contract with Bell Labs focused upon power

cell and battery development with military applications as an additional business segment. The Bell labs division of Lucent Technologies, Inc. has been engaged by mPhase to perform research and development under a \$1.2 million Development Agreement of a power cell that will have a relatively unlimited shelf life and other advantages for soldiers in the field (such as lack of detection) . Such product is expected to be ready for sale in approximately 18 months.

mPhase is a developer of broadband communications products, specifically, middleware, set top boxes and systems integration solutions for the delivery of broadcast quality television, video on demand, high speed internet and voice utilizing internet protocol. (IPTV) mPhase's believes that Release 3.0 of its TV+ solution, scheduled for September of 2005 is the most cost-effective, standards based, scalable solution with carrier class quality and security available for telecommunications service providers around the world. mPhase believes that telecommunication service providers in countries outside of the United States that generally lack extensive fiber to the home infrastructure will find the Company's TV+ solution as an attractive way to retain traditional telephone customers by offering a full package of services. The TV+ solution is designed to enable telecommunication service providers to solve the "last mile" from a central office location to a customer over any existing infrastructure including copper, fiber or coax. Version 3.0 of the TV+ solution is a culmination of years of development of a world class television delivery solution for telecommunication service providers. The Company also develops and sells DSL products including "intelligent" POTS Splitter DSL loop diagnostic systems and Plain Old Telephone Service (POTS) Splitters necessary to split a telephone signal into a high frequency digital and low digital data component and low frequency analog voice component necessary for a telephone service provider to provide high-speed internet services over copper from its central office to its customer's premises. Since our inception in 1996 we have been a development-stage company.

In February of 2004, the Company entered into the field of Nanotechnology research and development of micro power cell batteries of various voltages. The initial goal is to develop batteries for military applications having significantly longer shelf life prior to activation, instant on capabilities due to their extremely small internal size, and power management capabilities to significantly extend their duty cycle periods than are currently available in the market. The Company believes that such development is consistent with its strategy of being a pioneer in areas of high growth technology and potentially diversifies its mix of products. On March 11, 2005 the Company announced that it had expanded its nanotechnology research and efforts to develop extremely sensitive uncooled magnetic sensors, commonly known as a magnetometer, as a new product line.

Our TV+ platform requires a telecommunications service provider to build a digital video head-end to downlink channels of broadcast television programming from satellites. The cost of building a digital head end has been substantially reduced in the past few years as off the shelf technology has become less expensive. Such equipment includes a satellite receiving dish, video grooming equipment and mPhase's system management software necessary for managing the video content. mPhase does not manufacture such digital head-end equipment.

mPhase also designs and markets a line of DSL component products ranging from commodity items such as POTS splitters to innovative loop management products. To date, all sales revenue has been derived from sales of its POTS splitters and related low-pass filter products. mPhase expects to derive its first material revenues from sales of its TV+ product during fiscal year 2005.

mPhase's suite of DSL products also includes the *i* POTS3 (renamed the Broadband Watch product) or Intelligent POTS Splitter product that marks a significant advancement in automating loop management and is interoperable with the DSLAM's of any vendor. As DSL deployments scale, it is becoming increasingly more important for telecommunications service providers to streamline the process for provisioning and troubleshooting DSL services. Additionally, as competition for high speed Internet expands, the market is witnessing a reduction in price. Therefore, it has become increasingly more important for telecommunications service providers to lower the operational costs involved with supporting DSL services. The *i* POTS3 is a device that allows service providers to perform full loop testing without having to deploy manual assets by allowing service providers to temporarily bypass the POTS Splitter and have a comprehensive view of their DSL networks. Prior to the introduction of this product in order to perform full testing, service providers would have to manually intervene so that test signals could be passed through the network. mPhase has not derived any sales of such product to date but believes that such product could provide an additional revenue stream for mPhase in fiscal year 2005.

mPhase was organized on October 2, 1996. On February 17, 1997, the Company acquired Tecma Laboratories, Inc., a public

corporation in a reverse merger transaction. This resulted in the Company's stock becoming publicly traded on the NASDAQ Over-the-Counter Bulletin Board. On June 25, 1998, the Company acquired Microphase Telecommunications, Inc. in a stock for stock exchange, whose principal assets included patents and patent applications utilized in the Company's legacy Traverser DVDDS product. On August 21, 1998, mPhaseTV.net, Inc. was organized as a wholly-owned subsidiary to market interactive television and e-commerce revenue opportunities. This subsidiary is dissolved. On March 2, 2000, mPhase acquired an interest in mPhaseTelevision.Net, Inc., a joint venture organized to provide digital television programming content to service providers in the United States deploying TV over DSL.

On March 14, 2000, we entered into an agreement with BMW Manufacturing Corp., located in South Carolina. Under the agreement, we installed version 1.0 of the Traverser for BMW's telephone transmission network. BMW has agreed that, upon its notice and consent, we will be able to demonstrate to potential customers the functioning system at BMW's facilities. BMW has made two (2) subsequent purchases increasing the size of its deployment to 62 unique units.

Our flagship installation, Hart Telephone, has completed the build and development of its digital headend during fourth quarter of 2001. The completion of their digital headend marks the move from beta to commercial deployment of the Traverser platform. Hart currently has approximately 70 customers receiving about 80 channels of television services.

Effective December 1, 2002, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. for development of mPhase's broadcast television switch as an integrated platform with the Lucent Stinger DSL Access Concentrator.

On December 9, 2002, pursuant to a Statement of Work, Lucent commenced development of the BTS for mPhase.

On December 15, 2002, mPhase engaged Lucent for the cost reduction of its Traverser INI set top box.

On January 21, 2003 mPhase entered into a Co-Branding Agreement with Lucent Technologies under which mPhase's INI set top box would be co-branded with the Lucent Technologies name and logo.

On April 4, 2003, mPhase entered into a Systems Integration Agreement with Lucent Technologies. Under the terms of such an agreement mPhase has been given the exclusive rights to sell worldwide as a 'bundled' solution the Stinger in connection with mPhases' BTS.

In July of 2003, mPhase successfully deployed for testing the TV+ platform for 3 customers of Hart Telephone Company.

As of September 15, 2003, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc for further development of its TV+ product.

As of February 4, 2004, mPhase entered into a Development Agreement with the Bell Laboratories division of Lucent Technologies, Inc. relating to Micro-Power Source Arrays Fabricated Using Nanotextured Superhydrophobic Materials. Such Agreement was extended in March of 2005 for another 12 months by the parties.

In August of 2004, mPhase extended its contract with the Bell Labs division of Lucent Technologies, Inc. to develop Release 3.0 of its TV+ product as an IP delivery based system. Release 3.0 is expected to be deployed in the second quarter of fiscal year 2005. Releases 1.0 and 2.0 of the TV+ product based upon ATM delivery technology were each



completed in fiscal year 2005.

In March of 2005, Lucent entered into a second Development Agreement in the field of nanotechnology with the Bell Laboratories division of lucent technologies, Inc. to develop an ultra sensitive magnetic sensor device initially targeted for military applications.

The Company has incurred net losses totaling approximately \$ 127 million during the development of its flagship product from inception through June 30, 2005. In fiscal 2001, the Company had anticipated that the sales of its component products would be able to supplement the underwriting of the completion of our flagship product, the Traverser. In fiscal 2002 these sales declined with the overall decline of DSL deployments and spending in the telephonic industry. The Company sales of its POTS splitter product continued to slow during most of fiscal year 2003 with overall revenue decreasing approximately \$1 million as telecommunications spending continued to decline. In the first quarter of fiscal year ended June 30, 2004, the Company experienced a significant increase in revenues from its POTS splitter product which resulted in revenues increasing from approximately \$2.5 million in fiscal year 2003 to approximately \$4.6 million in fiscal year 2004. In fiscal year 2005, revenues from POTS splitter products again decreased to approximately \$1.2 million. The Company did receive its first order for 1000 ports of its TV+ product from a major Russian telecommunications service provider in fiscal year 2005 resulting in approximately \$280,000 of additional revenue.

During fiscal year 2005, the Company shifted its development efforts with respect to its TV+ product from its ATM products characterized by Releases 1.0 and 2.0 of its TV+ product to an IP delivery protocol in Release 3.0 of its TV+ product. Such transformation, to meet a major shift in requirements of telecommunication service providers for delivery of converged services delayed the expected commencement of material revenues from the TV+ product from fiscal year 2005 to fiscal year 2006. The Company believes that it will commence receiving revenues in fiscal year 2006 from initial commercial deployments of its IPTV+ product. Until such time such revenues are realized, the Company intends on maintaining its reduced cost structure to minimize its losses, which management believes will permit the Company to ultimately achieve profitability. The Company believes the initial deployments and the resultant revenues of its flagship Release 3.0 of its TV+ solution are not expected to occur until the second quarter of fiscal year 2006. An upturn of spending in the telephonic industry for DSL component products should increase sales and improve the Company's margins and provide the Company the opportunity to attain profitability.

Revenues. To date, all material revenues have been generated from sales of POTS Splitter Shelves and other DSL component products to a small number of telecommunications companies. mPhase believes that future revenues are

difficult to predict because of the length and variability of the commercial roll-out of the TV+ platform to various telecommunications service providers but does anticipate some sales of its IPTV+ solution in fiscal year 2006. Since the Company believes that there may be a significant international market for the TV+ platform, involving many different countries with different regulations, certifications and commercial practices than the United States, future revenues are highly subject to changing variables and uncertainties. Additionally, the continued instability of the telecommunications market evidenced by reduced in capital spending from its peak in fiscal year 2001 across the whole telecom sector contributes to our difficulty in accurately predicting future revenues.

**Cost of revenues.** The costs necessary to generate revenues from Microphase and the sale of POTS Splitter Shelves and other DSL component products include direct material, labor and manufacturing. mPhase paid these costs to Janifast, Ltd., which has facilities in the People's Republic of China and is owned by and managed by certain senior executives of the Company. The cost of revenues also includes certain royalties paid to Microphase Corporation, a privately held corporation organized in 1955, which shares certain common management with the Company. Costs for future production of the Traverser product will consist primarily of payments to manufacturers to acquire the necessary components and assemble the products and future patent royalties payable to GTRC. Microphase does not share in revenues from sales of the TV+ product.

**Research and development.** Research and development expenses consist principally of payments made to Lucent and for development of the TV+ product and Nanotechnology products. All research and development costs are expensed as incurred.

During the fiscal year ended June 30, 2005, the company incurred non-cash research and development stock based employee compensation of \$0 and an additional \$0 non-cash stock based expense for consultants.

**General and administrative.** Selling, general and administrative expenses consist primarily of salaries and related expenses for personnel engaged in direct marketing of the TV+ platform, the POTS Splitter Shelves and other DSL component products, as well as support functions including executive, legal and accounting personnel. Certain administrative activities are outsourced on a monthly fee basis to Microphase Corporation. Finally, mPhase leases the principal office from Microphase Corporation.

**Litigation.** mPhase has not incurred any material expenses due to litigation since its inception.

**Non-cash administrative stock-based employee compensation charge.** mPhase incurred non-cash administrative stock-based employee compensation charges of \$1,242,793 and \$3,150,343, for the fiscal years ended 2005 and 2004, respectively. The Company has reduced its use of stock options and warrants as a form of compensation to employees, directors and outside consultants as part of its current austerity program.

***TWELVE MONTHS ENDED JUNE 30, 2005 VS. JUNE 30, 2004***

Revenues. Total revenues for the year ended June 30, 2005 decreased to \$1,711,085 from \$4,641,346 for the year ended June 30, 2004. The decrease was primarily attributable to decreased sales of the Company's POTS Splitter product line especially during the first quarter of fiscal year 2004, caused by a downturn of orders from one customer that orders component products from the Company. The Company recognized \$280,000 of revenue in connection with the first sale of 1000 ports of Release 2.0 its TV+ solution to a major telecommunications service provider in Russia. The Company continues to believe that its line of POTS Splitter products is positioned to be competitively priced with high reliability and connectivity, and as such has the potential to be significant part of DSL deployment. The Company cannot predict when the demand for telecommunication equipment will resume, however we do expect certain added revenue in fiscal year 2006 from the completion of Release 3.0 of our TV+ solution and Broadband Loop Watch Products..

Cost of revenues. Cost of sales was \$1,446,151 for the year ended June 30, 2005 as compared to \$4,068,255 in the year ended June

30, 2004. Cost of revenues decreased for the twelve months ended June 30, 2005 compared to the prior period ending June 30, 2004 primarily because of decreased sales. Gross margins for the period ended June 30, 2005 were 15.5%. The gross margins have varied dramatically as spending among telecommunication providers has contracted, coupled with downward pressures related to the supply and demand of telecommunications products. The single most significant reason the margins decreased dramatically was due to the reduced selling price of our POTS Splitter product. Discounts, consisting of a 2% discount from the amount invoiced if paid within 10 days were offered during fiscal year 2005. Such discounts amounted to \$1,447 for the period ended June 30, 2005, and were offered to Covad Communication our leading telecommunications service provider customer. Discounts were offered in fiscal 2004 to Covad Communications amounting to 2% from the amount invoiced if paid within 10 days were offered to Covad Communications and amounted to \$71,425.

Research and Development. Research and development expenses were \$5,127,438 for the year ended June 30, 2005 as compared to \$4,069,721 in the year ended June 30, 2004, an increase of \$1,057,717. Such expenditures included \$3,319,280 incurred with Lucent Technologies, Inc. for the year ended June 30, 2005 as compared to \$2,328,602 during the comparable period in 2004. In addition we incurred \$919,937 with Microphase and other strategic vendors for the year ended June 30, 2005 as compared to \$99,494 during the comparable period in 2004.

The significant increase in research and development expenses with Lucent Technologies, Inc. is due to the continued and accelerated development of the TV+ product together with the extension of the \$1.2 million month Development Agreement for an additional 12 months related to the battery and power pack product development utilizing nanotechnology and the entering into a second one year \$1.2 million Development Agreement with Lucent to develop ultra electronic sensor devices also using nanotechnology. Such expenditures may increase in fiscal year 2006 since the Company's strategy is to further enhance the features and cost reduce its TV+ and expand its product line in the Nanotechnology area.

The elimination in research expenditures incurred with GTRC is due to the Company's refocus in development from its legacy Traverser DVDDS television delivery platform to its TV+ product.

Research expenditures incurred with Microphase were related to the continuing development of the Company's DSL component products, including the Company's line of POTS Splitters and Microfilters and the Company's newest products, the Broadband Watch.

General and Administrative Expenses. Selling, general and administrative expenses were \$6,579,761 for the year ended June 30, 2005 up from \$4,177,961 for the comparable period in 2004, a decrease of \$2,401,800. The increase in the selling, general and administrative costs was primarily the result of the addition of a number of new employees critical to the Company's needs in developing, marketing and selling the TV+ and NanoTechnology product lines with Lucent a respectively.

Included is an increase of non-cash charges relating to the issuance of common stock and options to consultants, which totaled \$3,150,343 for the year ended June 30, 2005 as compared to \$1,242,793 during the comparable period in 2004. Other components of the increase in selling, general and administrative expenses were increases in payroll of approximately \$503,000 to \$1,456,000, offer by a decrease in the use of outside consultants of approximately \$284,000 to \$704,002, marketing expenses such as trade shows of \$118,000 to \$158,000, and advertising expenses of \$68,000 to \$90,000, and a non recurring charge of \$1,85,721 for the value of shares issued to investors to reflect market changes in the common stock of which approximated \$2,498,271 or 100% of the increase in spending.

Net loss. mPhase recorded a net loss of \$11,234,324 for the year ended June 30, 2005 as compared to a loss of \$7,758,586 for the same period ended June 30, 2004. This represents a loss per common share of \$(.10) in 2005 as compared to \$(.10) in 2004, based upon weighted average common shares outstanding of 108,657,578 and 77,677,120 during the periods ending June 30, 2004 and June 30, 2005 respectively.

***TWELVE MONTHS ENDED JUNE 30, 2004 VS. JUNE 30, 2003***

Revenues. Total revenues for the year ended June 30, 2004 increased to \$4,641,346 from \$1,581,639 for the year ended June 30, 2003. The increase was primarily attributable to increased sales of the Company's POTS Splitter product line especially during the first quarter of fiscal year 2004, caused by an upturn in July and August of 2004 of orders from one customer that orders component products from the Company. The Company continues to believe that its line of POTS Splitter products is positioned to be competitively priced with high reliability and connectivity, and as such has the potential to be significant part of DSL deployment. The Company cannot predict when the demand for telecommunication equipment will resume, however we do not expect significant sales in the first two quarters of fiscal 2005.

Cost of revenues. Cost of sales was \$4,068,255 for the year ended June 30, 2004 as compared to \$1,493,394 in the year ended June 30, 2003. Cost of revenues increased for the twelve months ended June 30, 2004 compared to the prior period ending June 30, 2003 primarily because of increased sales. Gross margins for the period ended June 30, 2004 were 12%. The gross margins have varied dramatically as spending among telecommunication providers has contracted, coupled with downward pressures related to the supply and demand of telecommunications products. The single most significant reason the margins decreased dramatically was due to the reduced selling price of our POTS Splitter product. Discounts, consisting of a 2% discount from the amount invoiced if paid within 10 days were offered during fiscal year 2004. Such discounts amounted to \$71,425 for the period ended June 30, 2004, and were offered to Covad Communication our leading telecommunications service provider customer. Discounts were offered in fiscal 2003 to an existing customer to accelerate collections in connection with an order of our POTS Splitter product and was treated as a purchase discount to each our customers, and the reduction to net sales lowered the gross margins in the period.

Research and Development. Research and development expenses were \$4,069,721 for the year ended June 30, 2004 as compared to \$3,538,305 in the year ended June 30, 2003, an increase of \$531,416. Such expenditures included \$2,328,602 incurred with Lucent Technologies, Inc. for the year ended June 30, 2004 as compared to \$1,112,500 during the comparable period in 2003. In addition we incurred \$99,494 with Microphase and other strategic vendors

for the year ended June 30, 2004 as compared to \$528,434 during the comparable period in 2003.

The significant increase in research and development expenses with Lucent Technologies, Inc. is due to the continued and accelerated development of the TV+ product together with the entry into a \$1.2 million 12 month Development Agreement for battery and power pack product development utilizing Nanotechnology. Such expenditures are expected to increase in fiscal year 2005 since the Company's strategy is to further enhance the features and cost reduce its TV+ and expand its product line in the Nanotechnology area.

The elimination in research expenditures incurred with GTRC is due to the Company's refocus in development from its legacy Traverser DVDDS television delivery platform to its TV+ product.

Research expenditures incurred with Microphase were related to the continuing development of the Company's DSL component products, including the Company's line of POTS Splitters and Microfilters and the Company's newest products, the iPOTS.

General and Administrative Expenses. Selling, general and administrative expenses were \$4,177,961 for the year ended June 30, 2004 up from \$2,683,534 for the comparable period in 2003, an increase of \$149,427. The increase in the selling, general and administrative costs was primarily the result of the addition of a number of new employees critical to the Company's needs in developing, marketing and selling the TV+ and NanoTechnology product lines with Lucent a respectively.

Included is an increase of non-cash charges relating to the issuance of common stock and options to consultants, which totaled \$1,010,895 for the year ended June 30, 2004 as compared to \$477,836 during the comparable period in 2003. Other components of the increase in selling, general and administrative expenses were increases in payroll of approximately \$461,226 to \$953,602, increase in the use of outside consultants of approximately \$251,103 to \$987,720, marketing expenses such as trade shows of \$30,148 to \$40,347, and advertising expenses of \$20,439 to \$21,948, all of which approximated \$1,295,975 or 87% of the increase in spending.

Net loss. mPhase recorded a net loss of \$7,758,586 for the year ended June 30, 2004 as compared to a loss of \$6,650,211 for the same period ended June 30, 2003. This represents a loss per common share of \$(.10) in 2004 as compared to \$(.10) in 2003, based upon weighted average common shares outstanding of 77,677,120 and 65,217,088 during the periods ending June 30, 2004 and June 30, 2003 respectively.

## **CURRENT PLAN OF OPERATIONS**

### **RESEARCH AND DEVELOPMENT ACTIVITIES**

mPhase throughout its history has outsourced its research and development activity with respect to both of its TV platforms as well as its POTS splitter products and nanotechnology products. GTARC has conducted a significant amount of research and development for mPhase pursuant to a research agreement comprised of a series of delivery orders, which outline the timing, necessary actions and form of payment for specific tasks related to the completion of certain components of the DVDDS legacy product. Microphase has performed research and development for mPhase with respect to certain component DSL products such as the *i* POTS Splitter products, low pass filters and POTS Splitters and the legacy DVDDS product. Currently mPhase major research and development is performed by the Bell Laboratories division of Lucent Technologies, Inc. in connection with its IPTV solution as well as exploratory development of nanotechnology products.

For the years ended June 30, 2005, and 2004 and for the period since inception (October 2, 1996) to June 30, 2005, approximately \$0 \$0, and \$ 13,524,300, respectively, has been billed to mPhase for research and development conducted by GTARC. With the completion of the DVDDS legacy product, the Company has shifted its research and development from GTARC to Lucent Technologies Inc. in connection with its TV+ product as well as its entry into the nanotechnology product area. Such new research and development during Fiscal Year 2005 was (a) for completion of Versions 2.0 and 3.0 of the TV+ product and (b) entry into the nanotechnology product area focused initially on (a) power cells and batteries and (b) ultra magnetic sensory devices each designed for military applications. The Company incurred research and development expenses with Lucent for fiscal years ended June 30, 2005 and 2004 of \$3,319,280 and \$1,837,044 respectively.

The amount of research and development costs the Company has expended from October 2, 1996, its inception date, through June 30, 2005 is \$43,544,238. During the year ended June 30, 2005, the Company incurred research and

development expenses of \$3,518,238 related to the continued development of its current IPTV solution and other DSL products and services as compared to \$3,669,723 for the same period ended June 30, 2004. In addition the Company incurred research and development expenses for the fiscal year 2005 of \$1,609,200 for its nanotechnology products as compared to \$600,000 for fiscal year ended June 30, 2004..

## **STRATEGIC ALLIANCES IMPLEMENTED**

The Company has entered into a Co-Branding Agreement with Lucent for its redesigned cost reduced set top box portion of its TV+ platform. In addition, pursuant to a Systems Integration Agreement with Lucent, the Company has been designated as the exclusive worldwide reseller of the Lucent Stinger when bundled as part of the mPhase TV+ system. In addition the Company and Lucent share jointly in certain intellectual property being developed with respect to disposable power cells, which is the subject of exploratory development using the science of nanotechnology.

## **CRITICAL ACCOUNTING POLICIES**

### **REVENUE RECOGNITION**

All revenue included in the accompanying consolidated statements of operations for all periods presented relates to sales of mPhase's POTS Splitter Shelves and DSL component products.

As required, mPhase has adopted the Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," which provides guidelines on applying generally accepted accounting principals to revenue recognition based upon the interpretations and practices of the SEC. The Company recognizes revenue for its POTS Splitter Shelf and other DSL component products at the time of shipment, at which time; no other significant obligations of the Company exist, other than normal warranty support.

The deferred revenues balance recorded on the Balance Sheet for the fiscal year ended June 30, 2003 is made up of three customer deposits consisting of \$156,180 in the aggregate for the POTS product and of \$58,000 for final customer acceptance of the Traverser product that will occur upon commercial production of such product.

## **RESEARCH AND DEVELOPMENT**



Research and development costs are charged to operations as incurred in accordance with Statement of Financial Accounting Standards ("SFAS"), No.2, "Accounting for Research and Development Cost."

## **INCOME TAXES**

mPhase accounts for income taxes using the asset and liability method in accordance with SFAS No.109 "Accounting for Income Taxes." Under this method, deferred tax assets and liabilities are measured using currently enacted tax rates. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations in the period that includes the enactment date. Because of the uncertainty as to their future reliability, net deferred tax assets, consisting primarily of net operating loss carryforwards, have been fully reserved for. Accordingly, no income tax benefit for the net operating loss has been recorded in the accompanying financial statements.

Utilization of net operating losses generated through June 30, 2003 may be limited due to "changes in control" of our common stock that occurred.

## **STOCK-BASED COMPENSATION**

Financial Accounting Statement No. 123, Accounting for Stock Based Compensation, encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation for grants to employees using the intrinsic method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. The Company has adopted the "disclosure only" alternative described in SFAS 123 and SFAS 148, which require pro forma disclosures of net income and earnings per share as if the fair value method of accounting had been applied.

The Company accounts for non-employee stock based awards in which goods or services are the consideration received for the equity instruments issued based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more readily determinable.

## **INVENTORY RESERVE AND VALUATION ALLOWANCE**

The Company carries its inventory at the lower of cost, determined on a first-in, first-out basis, or market. Inventory consists mainly of the Company's POTS Splitter Shelf and Filters. In determining the lower of cost or market, the Company periodically reviews and estimates a valuation allowance to reserve for technical obsolescence and marketability. The allowance represents management's assessment and reserve for the technical obsolescence based upon the inter-operability of its component products, primarily filters and splitters, with presently deployed and next generation DSL infrastructures as well as a reserve for marketability based upon current prices and the overall demand for the individual inventory items. Material changes in either the technical standards of future DSL deployments or further erosion in the demand for deployments of DSL infrastructures could affect the estimates and assumptions resulting in the amounts reported. The allowance is estimated as the difference between inventory at historical cost, on a first in first out basis, and market based upon assumptions about future demand, current prices and product liability, and charged to the provision for inventory, which is a component of cost of sales. At the point the historical cost is adjusted, a lower cost-basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

During the fiscal years ended June 30, 2005, 2004 and 2003, the Company declared its net reserve by approximately \$183,000, decreased its net reserve by approximately \$98,000, and increased its net reserve by approximately \$302,000, respectively, for technical obsolescence and marketability based upon current prices and overall demand and charged a like amount to expense, representing a percentage increase in the reserve of 15.3% of average inventory in fiscal 2005, to a current reserve of 23.7% of average inventory, at cost, of approximately \$864,057 on hand during the period in fiscal 2005, an increase in the reserve of 5.9% of average inventory, at cost, of approximately \$1,671,000 on hand during the period in fiscal 2004 and 8.4% of average inventory, at cost, of approximately \$3,588,000 on hand during the period in fiscal 2003. As of June 30, 2005, the Company recorded a cost adjustment against the reserve of approximately \$49,300, recognizing permanent cost reductions due to price adjustments and further reduced the reserve for reductions due to obsolescence resulting from a lack of inter-operability of certain components in inventory with the Company's present product line approximating \$25,000. As a result on June 30, 2005 the Company had a total inventory valuation reserve of \$205,642 against its inventory with a total balance, at cost, of \$695,785, or 29.5%. If there was to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of rapidly changing technology and customer requirements, we could be required to increase our inventory allowances and our gross margins could be adversely affected.

## **MATERIAL RELATED PARTY TRANSACTIONS**

The Company records material related party transactions. The Company incurs costs for engineering, design and production of prototypes and certain administrative functions from Microphase Corporation and the purchase of finished goods, primarily consisting of DSL splitter shelves and filters, from Janifast Limited. The Company has incurred costs for obtaining transmission rights. This enabled the Company to obtain re-transmission accreditation to proprietary television content that the Company plans to provide with its flagship product, the Traverser within its incorporated joint venture mPhase Television.Net, in which the Company owns a 56.5% interest..

Directors that are significant shareholders of Janifast Limited include Messrs Ronald A. Durando, Gustave T. Dotoli, and Necdet F. Ergul.

Mr. Abraham Biderman is a Managing Director of Eagle Advisers, Inc., a firm that performs investment banking services for the Company and was employed until September 30, 2003 by our former investment banking firm Lipper & Company.

Mr. Abraham Bidderman, Biderman, and Mr. Anthony Guerino own a relatively small amount of stock, warrants and options in mPhase Technologies, Inc.

Mr. Durando, the President and CEO of mPhase, owns a controlling interest and is a director of Janifast Limited. Mr. Durando is Chief Operating Officer and Mr. Dotoli is an officer of Microphase Corporation. Mr. Ergul, the chairman of the board of mPhase, owns a controlling interest and is a director of Microphase Corporation. Microphase, Janifast, Hart Telephone and Lintel Corporation are significant shareholders of mPhase. Microphase, Janifast and Hart Telephone have converted significant liabilities to equity in fiscal years June 30, 2001, 2002 and in the current fiscal year. Management believes the amounts charged to the Company by Microphase, Janifast, mPhase Television.Net and Hart Telephone are commensurate to amounts that would be incurred if outside parties were used. The Company believes Microphase, Janifast and Hart Telephone have the ability to fulfill their obligations to the Company without further support from the Company.

Significant charges from related parties are summarized for the periods enumerated as follows:

|  | Year Ended June 30, |             |             |
|--|---------------------|-------------|-------------|
|  | 2003                | 2004        | 2005        |
| <b>Charges and Expenses with Related Parties</b> |                     |             |             |
| <b>Charges incurred with Janifast Ltd.</b>       |                     |             |             |
| <b>included in:</b>                              |                     |             |             |
| Cost of sales and ending inventory               | \$178,959           | \$2,771,925 | \$1,536,494 |

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|  |             |             |             |
|--|-------------|-------------|-------------|
| Total Janifast   | \$178,959   | \$2,771,925 | 1,536,494   |
| <b>Charges incurred with Microphase Corp.</b>  |             |             |             |
| <b>included in:</b>  |             |             |             |
| Cost of sales and ending inventory<br>(Including Royalties)  | \$86,468    | \$140,123   | \$94,740    |
| Research and development   | 428,434     | 84,494      | 60,000      |
| General and administrative   | 133,200     | 231,068     | 304,030     |
| Total Microphase Corp.   | \$648,102   | \$455,685   | \$458,770   |
| <b>Total Charges with Related Parties included in:</b>   |             |             |             |
| Cost of sales and ending inventory   | \$265,427   | \$2,912,048 | \$1,631,234 |
| Research and development   | 428,434     | 84,494      | 60,000      |
| General and administrative   | 133,200     | 231,068     | 304,030     |
| Total Charges with Related Parties   | \$827,061   | \$3,227,610 | \$1,995,264 |
| Included in Cost of Sales in the Consolidated Statements of Operations<br>(including changes in inventory) |             |             |             |
| Janifast   | \$935,137   | \$3,507,476 | \$1,275,960 |
| Microphase (including royalties)   | \$408,918   | \$140,123   | \$94,740    |
|  | \$1,344,055 | \$3,647,599 | \$1,370,700 |
| Total Related Party Expense Included in Cost of Sales  |             |             |             |

## LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2005 mPhase had a working capital deficit of \$1,674,419 as compared to a working capital deficit of \$2,111,452 as of June 30, 2004. The Company believes this will be sufficient for its short-term liquidity. During fiscal year ending June 30, 2006 it is estimated that the Company will need to raise approximately \$5-10 million to meet longer term liquidity needs through June 30, 2006. Such monies would be necessary primarily to fund future capital expenditures for research and development of enhanced features for its TV+ product and the manufacturing of inventory necessary to complete any significant order for DSL component products. Additional capital will need to be raised to build inventory for any significant order of the TV+ platform, the legacy DVDDS platform or the new set top box that might occur in fiscal year 2006. Finally, (depending upon sales and margins in fiscal year 2006) additional capital may be required to fund a portion of any growth necessary in operations.

Included in the Company's working capital position at June 30, 2005, were the conversions of approximately \$1,200,000 of accounts payable and accrued expenses due to related parties and strategic vendors to equity and, \$79,200 of accounts payable and accrued expenses due to a strategic vendor was converted to payment terms whereby 40,480 remains outstanding and is expected to be paid in fiscal 2006.

Through June 30, 2005, the Company has incurred development stage losses totaling approximately \$127,091,407. At June 30, 2005, the Company had cash and cash equivalents of \$351,185 compared to \$90,045 at June 30, 2004. Historically, mPhase had funded its operations and capital expenditures primarily through private placements of common stock. Management expects that its ongoing financial needs will be provided by financing activities and believes that the sales of its line of POTS Splitter products and other related DSL component products as well as its TV+ and Broadband Watch products will provide some offset to cash flow used in operations, although there can be no assurance as to the level and growth rate of such sales in future periods as seen with quarter to quarter fluctuations in component sales. At June 30, 2005, the Company had accounts receivable of \$533,841 and inventory of approximately \$490,000. This compared to \$64,100 of accounts receivable and approximately \$1.2 million of inventory at June 30, 2004.

Cash used in operating activities was \$7,795,964 million during the twelve months ending June 30, 2005. For fiscal 2005 the cash used by operating activities principally consists of the net loss plus the slight increase in accounts receivable, offset by the decrease in inventory and by the increases in accounts payable, accrued expenses and increases in the amounts due to related parties; further offset by non cash expenses for depreciation and amortization, and by non-cash charges for common stock options and warrants issued for services.

In the year ended June 30, 2005, net cash of approximately \$156,000 was used in investing activities for the purchase of fixed assets and patent enhancements.

During the twelve-month period ended June 30, 2005, the Company raised capital through private placements with accredited investors and the exercise of previously outstanding warrants, whereby the Company issued 39,853,661 shares of the Company's common stock pursuant to private placements, generating net proceeds to the Company of \$7,287,088, of which \$460,000 were collected in July 2005, and 3,637,954 shares of the Company's common stock pursuant to the exercise of warrants at exercise prices ranging from \$.25 to \$.35 per share, generating net proceeds of \$680,609. The Company incurred \$633,867 of cash expenses and issued 854,075 shares of common stock and 729,075 warrants, each to purchase one share of its common stock at prices ranging from \$.25 to \$.35 per share to finders, consultants and investment banking firms in connection with these private placements.

During the fiscal year ended June 30, 2005 certain strategic vendors and related parties converted approximately \$1.2 million of accounts payable and accrued expenses into 3,895,171 shares of the Company's common stock and 4,616,571 warrants. Such vendors include the Company's outside counsel, Piper Rudnick LLC.

During the fiscal year ended June 30, 2003, certain strategic vendors and related parties converted approximately \$1.9 million of accounts payable and accrued expenses into 5,923,333 shares of the Company's common stock and 3,706,800 warrants. Such vendors include Microphase Corporation and Janifast Ltd. In addition, Messrs. Durando and Dotoli converted \$468,756 in back salary obligations into warrants to purchase 2,491,800 shares of common stock of the Company. These warrants were exercised in part for 1,770,400 shares of the company's common stock during fiscal 2005 and 721,400 warrants to purchase one share each of the company's common stock remain outstanding as of June 30, 2005, such warrants are held by Mr. Dotoli.

The Company has no commitments from affiliates or related parties to provide additional financing. The Company has, from time to time, been able to obtain financing from affiliates when conditions in the capital markets make third party financing difficult to obtain or when external financing is available only upon very unattractive terms to the Company, and when such capital has been available from the affiliates.

As a result, conversion of debt with related parties and strategic vendors during the periods enumerated is as follows:

| <i>Equity Conversions of Debt With<br/>Related Parties and Strategic<br/>Vendors</i> | <b>For the Years Ended June 30,</b> |              |              |
|--|-------------------------------------|--------------|--------------|
|  | <b>2003</b>                         | <b>2004</b>  | <b>2005</b>  |
| Related Party Conversions  |                                     |              |              |
| Number of shares   | 5,533,333                           | 0            | 3,259,875    |
| Number of warrants   | 3,491,800                           | 0            | 3,259,875    |
| Amount converted to equity   | \$ 1,748,756                        | \$ 0         | \$ 651,975   |
| Strategic Vendor Conversions   |                                     |              |              |
| Number of shares   | 390,000                             | 110,467      | 635,296      |
| Number of warrants   | 205,000                             | 5,069,242    | 1,356,696    |
| Amount converted to equity   | \$ 529,503                          | \$ 1,963,202 | \$ 426,894   |
| Total Related Party and Strategic<br>Party Conversions                               |                                     |              |              |
| Number of shares   | 5,923,333                           | 110,467      | 3,895,171    |
| Number of warrants   | 3,696,800                           | 5,069,242    | 4,616,571    |
| Amount converted to equity   | \$ 1,946,788                        | \$ 1,963,202 | \$ 1,078,869 |

|                                |    |        |    |         |    |         |
|--------------------------------|----|--------|----|---------|----|---------|
| Gain on Extinguishment of Debt | \$ | 61,226 | \$ | 150,058 | \$ | 418,696 |
|--------------------------------|----|--------|----|---------|----|---------|

As of June 30, 2005, mPhase had commitments of approximately \$1,200,000, \$800,000, \$900,000 and \$600,000 respectively for capital expenditures with respect to its TV+, Broadband Watch, Micro Power Cell, and Magnetometer products respectively with Lucent Technologies, Inc.

#### **LOSSES DURING THE DEVELOPMENT STAGE AND MANAGEMENT'S PLANS**

Through June 30, 2005, the Company incurred development stage losses totaling approximately \$127,009,407, and at June 30, 2005 had a working capital deficit of \$1,674,419. The primary reason for the deterioration in the Company's working capital position at June 30, 2005, was the continued weakness in sales necessary to fund continuing expenses of operations as well as difficult capital markets funding conditions and the desire of management of the Company to avoid unnecessary dilution by issuing large amounts of equity at depressed prices to raise larger sums of cash. As noted above, during the fiscal year ended June 30, 2005 the Company's efforts to maintain a manageable working capital position included conversions of (i) approximately \$1,200,000 of accounts payable and accrued expenses due to related parties and strategic vendors to equity, (ii) approximately \$79,200 of accounts payable and accrued expenses due to a strategic vendor into notes payable. At June 30, 2005, the Company had \$351,185 of cash and cash equivalents and \$533,841 of trade receivables to fund short-term working capital requirements. The Company's ability to continue as a going concern and its future success is dependent upon its ability to raise capital in the near term to: (1) satisfy its current obligations, (2) continue its research and development efforts, and (3) the successful market and sell its products.

During the fiscal years ended June 30, 2004 and 2005 the Company was able to negotiate extended payment terms for overdue accounts payable with strategic vendors. These obligations are now classified as notes payable and included in current and long-term portions of notes payable in the accompanying balance sheets, based upon the revised payment terms. The Company believes it can maintain its present repayment schedule, or otherwise renegotiate such terms that are satisfactory to the Company and these vendors.

On August 30, 2004, the Company paid \$100,000 to Piper & Rudnick LLC, its outside counsel in connection with

the renegotiation of a Payment Agreement effective June 30, 2004. Under the terms of the renegotiated Payment Agreement, the Company agreed to payments of \$25,000 each on December 1, 2004, March 1, 2005, June 1, 2005 and September 1, 2005 and a payment of \$50,000 on December 1, 2006 plus \$25,000 payments on March 1, 2006, June 1, 2006, September 1, 2006 and a final payment of \$75,000 on December 1, 2007. In addition, Piper Rudnick agreed to convert an additional \$150,000 of such payable into a 5 year cashless warrant to purchase the Company's common stock at \$.25 per share. This agreement replaced in its entirety a prior agreement effective March 31, 2002 in which the Company was \$473,787 in arrears with respect to a Promissory Note as of June 30, 2004. The Company has made payments on December 1, 2004, March 1, 2005 and June 1, 2005 of \$25,000. As of the date hereof the Company has not made the payment due September 1, 2005.

The Company believes that it will be able to complete the necessary steps in order to meet its cash flow requirements throughout fiscal 2006 and continue its development and commercialization efforts. Management's plans in this regard include, but are not limited to, the following:

We intend to continue to invest in technology and telecommunications hardware and software necessary to keep our products. We continue to operate on an austerity budget with sharply reduced administrative and marketing expenses.

We continue our efforts to raise additional funds through private placements of our common stock, the proceeds of which are required to fund continuing development stage expenditures and the commercial roll-out of our IPTV solution. However, there can be no assurances that we will generate sufficient revenues to provide positive cash flows from operations or that sufficient capital will be available when needed or at terms that we deem to be reasonable.

We have evaluated our cash requirements for fiscal year 2006 based upon certain assumptions, including our ability to raise additional financing and initial expected sales of our TV+ product.. The Company anticipates that it will need to raise approximately \$5-10 million additional monies primarily in private placements of its common stock with accredited investors, or alternatively we will need to curtail certain expenses as incurred at the present levels including marketing and research and development expenses. We have no commitments from affiliated or third parties to provide additional financing. In the event that we do not receive any proceeds from additional financings, we will attempt to further reduce expenditures and continue to operate the Company from sales revenue and any funding that may be available from affiliated companies. Additional investment in technology design to enhance the features and reduce the cost of the TV+ platform will be necessary over the next 12 months. In addition, the Company is currently obligated to pay \$100,000 per month to Lucent for development of its power cell and battery products using nanotechnology and \$100,000 per month to Lucent for development of its magnetometer product, in each case through March of 2006. As of the date hereof, the Company owes Lucent \$179,428 with respect to its TV+ solution as well as an aggregate of approximately \$330,000 to other vendors assisting in the TV+ solution. In addition the Company owes Lucent \$100,000, and \$100,000 with respect to its Nanotechnology and Magnetometer products.

Should these cash flows not be available to us, we believe we would have the ability to revise our operating plan and make certain further reductions in expenses, so that our resources available at June 30, 2004, plus financing to be secured during fiscal year 2005, and expected POTS splitter revenues, will be sufficient to meet our obligations until the end of fiscal year 2004. We have continued to experience operating losses and negative cash flows. To date, we



have funded our operations with a combination of component sales, debt conversions with related parties and strategic vendors and private equity offerings. Management believes that we will be able to secure the necessary financing in the short term to fund our operations into our next fiscal year. However, failure to raise additional

funds, or generate significant cash flows through revenues, could have a material adverse effect on our ability to achieve our intended business objectives.

#### **ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISKS**

The Company is not exposed to changes in interest rates as the Company has no floating rate debt arrangements and no investments in certain held-to-maturity securities. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. A hypothetical 100 basis point adverse move in interest rates along the interest rate yield curve would not materially affect the fair value of any financial instruments at June 30, 2005. We believe that interest rate risks for our accounts receivable are insignificant. Sales to customers are denominated in dollars. Accordingly, we are not directly exposed to market risks from currency fluctuations.

#### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

None.

#### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**PART III****ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS**

Executive officers are selected by the Board of Directors. No family relationships exist between any of the executive officers or directors. The following table sets forth certain information with respect to each person, who is an executive officer or director. mPhase's executive officers and directors as of June 30, 2005 are as follows:

| <u>NAME</u>               | <u>AGE</u> | <u>POSITION(S)</u>                    |
|---------------------------|------------|---------------------------------------|
| Necdet F. Ergul           | 81         | Chairman of the Board and Director    |
| Ronald A. Durando         | 48         | Chief Executive Officer and Director  |
| Gustave T. Dotoli (2)     | 69         | Chief Operating Officer and Director  |
| David Klimek              | 50         | Director and Chief Technical Officer* |
| Martin Smiley             | 57         | Officer                               |
| <b>OUTSIDE DIRECTORS</b>  |            |                                       |
| Anthony H. Guerino (1)(2) | 57         | Director                              |
| Abraham Biderman (1)(2)   | 55         | Director                              |

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

\*All of the directors except Mr. Klimek (who declined to stand for reelection) were elected by the shareholders on July 20, 2005 at the annual meeting for the fiscal year ended June 30, 2004. The current executive officers and directors, along with their backgrounds, are set forth below:

NECDET F. ERGUL has served as mPhase's Chairman of the Board since October 1996 with the exception of a three-month period when he temporarily resigned due to the press of personal business. Mr. Ergul also currently serves as the Chairman of the Board of Directors, President and Chief Executive Officer of Microphase Corporation, a

leading developer of military electronic defense and telecommunications technology, which he founded in 1955. In addition to his management responsibilities at Microphase, he is active in engineering design and related research and development. Mr. Ergul holds a Masters Degree in Electrical Engineering from the Polytechnic Institute of Brooklyn, New York.

RONALD A. DURANDO is a co-founder of mPhase and has served as the Company's President, Chief Executive Officer and Director since its inception in October 1996. Since 1994, Mr. Durando has been an Officer of Microphase Corporation. Mr. Durando is not a Director of Microphase Corporation. >From 1986-1994, Mr. Durando was President and Chief Executive Officer of Nutley Securities, Inc., a registered broker-dealer. In addition, Mr. Durando is also Chairman of the Board of Janifast, Ltd., a Hong Kong company, for operational and manufacturing companies in China. Mr. Durando is also President and a Director of PacketPort.com, Inc. ("Packet Port").

GUSTAVE T. DOTOLI has served as mPhase's Chief Operating Officer since October 1996 and has been a Director since October 1996. Prior to joining the Company, Mr. Dotoli was President and CEO of State Industrial Safety, Inc. from 1986-1996. In addition, Mr. Dotoli currently serves as the Vice President of Corporate Development of Microphase Corporation. Mr. Dotoli is also a Director and Vice President of Packet Port. He is formerly the President and Chief Executive Officer of the following corporations: Imperial Electro- Plating, Inc., World Imports USA, Industrial Chemical Supply, Inc., SISCO Beverage, Inc. and Met Pack, Inc. Mr. Dotoli received a B.S. in Industrial Engineering from Fairleigh Dickenson University in 1959.

DAVID KLIMEK is a co-founder of mPhase and has served as the Company's Chief Technology Officer since June 1997 and as Director of Engineering since its inception in October 1996. Mr. Klimek joined the Board of Directors in October 1996. From 1990-1996, Mr. Klimek owned and operated Mashiyach Design, Inc., an engineering consulting firm. He has more than 18 years of technical engineering and design expertise and presently holds 14 individual or co-authored U.S. patents. From 1982 to 1990, Mr. Klimek was the R&D manager of Digital Controls, Inc. Mr. Klimek holds a B.S. in Electrical Engineering from Milwaukee School of Engineering, Milwaukee, Wisconsin..

ANTHONY H. GUERINO has been a member of the Board since February 23, 2000. Since December 1997, Mr. Guerino has been an attorney in private practice in New Jersey. Prior thereto, Mr. Guerino served as a judge of the Newark Municipal Courts for over twenty (20) years, periodically sitting in the Essex County Central Judicial Processing Court at the Essex County Courthouse. Mr. Guerino has been a chairperson for and member of several judicial committees and associations in New Jersey, and has been an instructor for the Seton Hall School of Law's Trial Moot Court Program.

ABRAHAM BIDERMAN has been a member of the Board since August 3, 2000. He currently is the Managing Director of Eagle Advisers, Inc, a small investment banking firm. From 1990 through September 30, 2003, Mr. Biderman was been employed by Lipper &

Co. as Executive Vice President; Executive Vice President, Secretary and Treasurer of the Lipper Funds; and Co-Manager of Lipper Convertibles, L.P. Prior to joining Lipper & Co. in 1990, Mr. Biderman was Commissioner of the New York City Department of Housing, Preservation and Development from 1988 to 1989 and Commissioner of the New York City Department of Finance from 1986 to 1987. He was Chairman of the New York City Retirement System from 1986 to 1989. Mr. Biderman was Special Advisor to former Mayor Edward I. Koch from 1985 to 1986 and assistant to former Deputy Mayor Kenneth Lipper from 1983 to 1985. Mr. Biderman is a Director of the Municipal Assistance Corporation for the City of New York. Mr. Biderman graduated from Brooklyn College and is a certified public accountant.

MARTIN SMILEY joined mPhase as Executive Vice President, Chief Financial Officer and General Counsel in August 2000. Mr. Smiley has over twenty years experience as a corporate finance and securities attorney and as an investment banker. Prior to joining the company, Mr. Smiley served as a Principal at Morrison & Kibbey, Ltd., a mergers and acquisitions and investment banking firm from 1998 to 2000, and as a Managing Director for CIBC Oppenheimer Securities from 1994 to 1998. He served as a Vice President of Investment Banking at Chase Manhattan Bank from 1989 to 1994, and as a Vice President and Associate General Counsel for Chrysler Capital Corporation from 1984 to 1989. Mr. Smiley graduated with a B.A. in Mathematics from the University of Pennsylvania and earned his law degree from the University of Virginia School of Law.

At each annual meeting of stockholders, the newly elected directors' terms begin on the date of election and qualification, and continue through the next annual meeting following election. Terms may differ in the case where a director resigns, is removed from office, or until the time when a successor director is elected and qualified.

## **SECTION 16 (A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Directors, executive officers, and individual owning more than 10 percent of mPhase common stock are required to file initial reports of ownership and changes in ownership with the SEC under Section 16(a) of the Securities Exchange Act of 1934, as amended. The SEC regulations also require those persons to provide copies of all filed Section 16(a) reports to the Company. mPhase has reviewed the report copies filed in fiscal year 2005, and based also on written representations from those persons, the Company believes that there was compliance with Section 16(a) filing requirements for fiscal year 2004. All the officers and directors filed all of the required forms in a timely manner.

**ITEM 11. EXECUTIVE COMPENSATION**

The following table sets forth, for the fiscal year ended June 30, 2005 and the two previous fiscal years, the compensation earned by mPhase's chief executive officer and the four other executive officers, whose compensation was greater than \$100,000 for services rendered in all capacities to the Company for the year ended June 30, 2005.

## SUMMARY COMPENSATION TABLE

LONG-TERM COMPENSATION

|                                       | <u>YEAR</u> | <u>ANNUAL<br/>COMPENSATION</u> |              | <u>RESTRICTED<br/>STOCK<br/>AWARD(S)</u> | <u>SECURITIES<br/>UNDERLYING<br/>OPTIONS/SARS</u> |
|---------------------------------------|-------------|--------------------------------|--------------|--|---|
|                                       |             | <u>SALARY</u>                  | <u>BONUS</u> |  |   |
| Ronald A. Durando (1)                 |             |                                |              |  |   |
| Chief Executive Officer and President | 2005        | \$305,000                      | -            | -  | 2,500,000   |
|                                       | 2004        | \$285,000                      | -            | -  | 1,500,000   |
|                                       | 2003        | \$234,504                      | -            | -  | 450,000   |
| Gustave Dotoli (1)                    | 2005        | \$215,000                      | -            | -  | 1,500,000   |
| Chief Operating Officer               | 2004        | \$225,000                      | -            | -  | 750,000   |
|                                       | 2003        | \$193,254                      | -            | -  | 350,000   |
| David Klimek                          | 2005        | \$86,950                       | -            | -  | 50,000  |
| Chief Technology Officer              | 2004        | \$ 89,062                      | -            | -  | 100,000   |
|                                       | 2003        | \$ 90,958                      | -            | -  | 75,000  |

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|   |      |           |   |         |         |
|---|------|-----------|---|---------|---------|
| Martin Smiley                               | 2005 | \$125,000 | - | 425,000 | -       |
| Executive Vice President                    | 2004 | \$103,958 | - | -       | -       |
| Chief Financial Officer and General Counsel | 2003 | \$109,583 | - | -       | 200,000 |

(2) Does not include 1,395,400 and 1,096,400 warrants to Messrs. Durando and Dotoli, respectively, to cancel previously unpaid compensation. Such warrants relate \$234,362, \$35,000 and \$1,184,105, \$27,500 respectively for unpaid cash compensation to Mr. Durando and Mr. Dotoli for fiscal years 2002 and 2003, respectively, the amounts of which are included in "Annual Compensation" in the above table.

No individual named above received prerequisites or non-cash compensation during the years indicated which exceeded the lesser of \$50,000 or an amount equal to 10% of such person's salary. No other executive officer received compensation and bonuses that exceeded \$100,000 during any year.

### Compensation of Directors

During fiscal year 2005 mPhase compensated each of the inside directors with Options to purchase 4,000,000 shares of common stock at a price of \$.35 per share for services both as officers and directors. The outside directors were each compensated with Options to purchase 150,000 shares of common stock at \$.35 per share. There was no cash stipend paid to any directors during the fiscal years 2004 and 2003.

### STOCK OPTIONS

The following table contains information regarding options granted in the fiscal year ended June 30, 2005 to the executive officers named in the summary compensation table above. For the fiscal year ended June 30, 2005, mPhase granted options and compensatory warrants to acquire up to an aggregate of 7,775,000 shares to employees and directors.

### OPTION GRANTS IN LAST FISCAL YEAR

#### (INDIVIDUAL GRANTS)

| Name                    | Number of<br>Securities<br>Underlying<br>Option/SARS<br>Granted (#) | %<br>of Total<br>Option/SARS<br>Granted to<br>Employees in<br>Fiscal Year | Exercise<br>or<br>Base<br>Price<br>(\$/Share) | Market<br>Price<br>on<br>Grant<br>Dates | Expiration<br>Dates | Potential Realizable<br>Value<br>of Assumed Annual<br>Rates of Stock Price<br>Appreciation for<br>5 Year Option Term |           |            |
|-------------------------|---|---|---|---|---------------------|--|-----------|------------|
|                         |   |   |   |   |                     | <u>0%</u>  | <u>5%</u> | <u>10%</u> |
| Ronald<br>A.<br>Durando | 2,500,000   | 32%   | \$.35   | \$.31                                   | 2010                | \$0  | \$0       | \$67,750   |
| Gustave<br>T. Dotoli    | 1,500,000   | 19%   | .35   | .31                                     | 2010                | 0  | 0         | \$24,375   |
| David<br>Klimek         | 150,000   | 2%  | .35   | .31                                     | 2010                | 0  | 0         | \$3,750    |

The following table sets forth information with respect to the number and value of outstanding options held by executive officers named in the summary compensation table above at June 30, 2005. During the fiscal year ended June 30, 2004, No options were exercised. The value realized is the difference between the closing price on the date of exercise and the exercise price. The value of unexercised in-the-money options is based upon the difference between the closing price of mPhase's common stock on June 30, 2005, and the exercise price of the options.

### AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND

#### FISCAL YEAR-END OPTION VALUES

| Shares<br>Acquired | Value<br>Realized | NUMBER OF SECURITIES (1)<br>UNDERLYING UNEXERCISED<br>OPTIONS AT YEAR END (#) | VALUE OF UNEXERCISED<br>IN-THE-MONEY OPTIONS AT<br>YEAR END (\$) |
|--------------------|-------------------|---|--|
|--------------------|-------------------|---|--|

|                   | <b>on Exercise</b> | <b>\$</b> | <b>EXERCISABLE</b> | <b>UNEXERCISABLE</b> | <b>EXERCISABLE</b> | <b>UNEXERCISABLE</b> |
|-------------------|--------------------|-----------|--------------------|----------------------|--------------------|----------------------|
| Ronald A. Durando | -                  | -         | 7,230,000          | -                    | \$ -               | -                    |
| Gustave T. Dotoli | -                  | -         | 4,500,000          | -                    | \$ -               | -                    |
| David Klimek      | -                  | -         | 522,500            | -                    | \$ -               | -                    |
| Martin Smiley(2)  | -                  | -         | 1,070,000          | -                    | \$ -               | -                    |

(1) Includes compensatory warrants granted during the year ended June 30, 2005.

(2) In January of 2005, Mr. Smiley received a grant of 450,000 shares of common stock.

#### Employment Agreements

All employment agreements with officers of mPhase have expired and are currently being renegotiated.

#### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The members of the Compensation Committee during fiscal 2005 were Messrs. McInerney (who resigned from the Board of Directors effective April 2005), Biderman and Guerino. Neither Messrs. Biderman, McInerney nor Guerino have been one of mPhase's officers or employees. None of the Company's directors or executive officers served as a member of the Compensation Committee (or other board committee performing equivalent functions or, in the absence of such committee, the entire Board of Directors) of another entity during fiscal 2005 that has a director or executive officer serving also as a director on mPhase's Board of Directors, except that Mr. Dotoli is also a member of the Board of Directors of PacketPort, a company in which Mr. Durando serves as Chief Executive Officer. Mr. Dotoli, together with Mr. Durando and Mr. Ergul, are collectively controlling shareholders of Janifast and Mr. Dotoli and Mr. Ergul are also Directors of Janifast. Janifast has produced components for the TV+ and has and continues to produce the POTS splitter product for mPhase. MPhase plans to use Janifast to produce certain portions of orders for its Television platforms in the future.



**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth as of June 30, 2005 certain information regarding the beneficial ownership of our shares:

1.

by each person who is known by us to be the beneficial owner of more than five percent (5%) of its outstanding common stock;

2.

each of our directors;

3.

by each executive officer named in the Summary Compensation Table; and, by all of our directors and executive officers as a group.

| <b>Name and Address of Beneficial Owner(1)</b> | <b>Number of "Shares" of Common Stock Beneficially Owned</b> | <b>Percentage Ownership of Common Stock(2)</b> |
|--|--|--|
| Necdet F. Ergul(5)(6)                          | 2,616,250  | 1.8%   |
| Ronald A. Durando(3)(5)                        | 11,644,382   | 7.6%   |
| Gustave T. Dotoli(5)(7)                        | 6,021,100  | 4.0%   |
| David Klimek(5)                                | 424,500  | *  |
| Abraham Biderman(4)(5)                         | 1,711,500  | *  |
| Anthony Guerino(5)                             | 657,500  | *  |
| Martin Smiley(8)                               | 6,196,132  | 4.2%   |
| Microphase Corporation (9)                     | 14,224,686   | 9.5%   |
| Janifast(10)                                   | 10,935,000   | 7.4%   |
|  | 54,431,050   | 34.5%  |

All executive Officers Directors, and  
(2)  
beneficial owners

\* Less than 1%

(1) Unless otherwise indicated, the address of each beneficial owner is 587 Connecticut Avenue, Norwalk, Connecticut 06854-1711.

(2) Unless otherwise indicated, mPhase believes that all persons named in the table have sole voting and investment power with respect to all shares of the Company shares beneficially owned by them. The percentage for each beneficial owner listed above is based on 145,048,832 shares outstanding on June 30, 2005, and, with respect to each person holding options or warrants to purchase shares that are exercisable within 60 days after June 30, 2005, the number of options and warrants are deemed to be outstanding and beneficially owned by the person for the purpose of computing such person's percentage ownership, but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person. The number of shares indicated in the table include the following number of shares issuable upon the exercise of warrants or options:

|                        |           |
|------------------------|-----------|
| Necdet F. Ergul        | 1,766,250 |
| Ronald A. Durando      | 8,614,367 |
| Gustave Dotoli         | 4,278,067 |
| <br>                   |           |
| Martin Smiley          | 4,074,543 |
| Abraham Biderman       | 1,017,500 |
| Anthony Guerino        | 552,000   |
| Microphase Corporation | 5,170,000 |
| Janifast Ltd.          | 2,200,000 |

(3) Includes 1,396,148 shares held by Durando Investment LLC, and 8,395,000 shares and 2,200,000 warrants held by Janifast which Mr. Durando controls and 530,000 shares owned by Karen and Ronald Durando Foundation; and 695,000 shares owned by Durando Charitable Remainder Trust.

- (4) Includes 5,233 shares of common stock, options and warrants for 272,500 shares of common stock. Does not include 1,103,225 shares held by Lipper & Co, where Mr. Biderman is a director.
- (5) Includes options for 25,000 and 150,000 shares of common stock received as compensation for participation on the Board of Directors.
- (6) Includes 200,000 shares owned by Berrin Snyder, his daughter and 150,000 owned by Eda Peterson, his daughter. Also includes 8,244,667 shares and 4,450,000 warrants and 720,000 shares and warrants to purchase 720,000 shares issuable pursuant to the terms of a convertible note held by Microphase Corporation, a company in which Mr. Ergul is the President and Chief Executive Officer.
- (7) Includes 277,500 shares owned by Patricia and Gustave Dotoli Foundation; and 195,000 shares owned by Dotoli Charitable Remainder Trust.
- (8) Includes 8,244,667 shares and 4,450,000 warrants and 720,000 shares and warrants to purchase 720,000 shares issuable pursuant to the terms of a convertible note held by Microphase Corporation, the totals of which are included in the total beneficially owned shares of Necdet F. Ergul.
- (9) Includes 7,350,000 shares and 1,200,000 warrants, the totals of which are included in the total beneficially owned shares of Ronald A. Durando.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

## Material Related Party Transactions

The Company records material related party transactions. The Company incurs costs for engineering, design and production of prototypes and certain administrative functions from Microphase Corporation and the purchase of finished goods, primarily consisting of DSL splitter shelves and filters, from Janifast Limited. The Company has incurred costs for obtaining transmission rights. This enabled the Company to obtain re-transmission accreditation to proprietary television content that the Company plans to provide with its flagship product, the TV+ within its incorporated joint venture mPhase Television.Net, in which the Company owns a 56.5% interest.

Mr. Durando, the President and CEO of mPhase, owns a controlling interest and is a director and COB of Janifast Limited. Mr. Durando and Mr. Dotoli are officers of Microphase Corporation. Mr. Dotoli is also a shareholder of Janifast Limited. Mr. Ergul, the chairman of the board of mPhase, owns a controlling interest and is a director of Microphase Corporation and is a director and shareholder of Janifast Limited. Microphase, Janifast, are significant shareholders of mPhase.

Management believes the amounts charged to the Company by Microphase, Janifast, mPhase Television.Net and Hart Telephone are commensurate to amounts that would be incurred if outside parties were used. The Company believes Microphase, and Janifast Limited has the ability to fulfill their obligations to the Company without further support from the Company.

## Transactions with Officers, Directors and their Affiliates

Directors that are significant shareholders of Janifast Limited include Messrs Ronald A. Durando, Gustave T. Dotoli, and Necdet F. Ergul.

During the 12 month period ended June 30, 2005, Eagle Advisers, an investment banking firm founded by Mr. Abraham Biderman, a member of the Board of Directors of the Company, earned fees and reimbursement expenses of approximately \$633,000 in connection with services in connection with private placements of the Company's common stock and warrants and raised a total of \$6,117,000 net of such fees for the Company.

Additionally at June 30, 2004, Mr. Durando was owed \$300,000 and Mr. Smiley was owed \$100,000 by the Company as evidenced by a non-interest bearing promissory note that was repaid in July 2004. As of June 30, 2004 a total of \$55,000 in the aggregate was due to Mr. Durando and Mr. Dotoli for unpaid compensation.

Mr. Durando's June 30, 2004 note payable balance of \$300,00 was repaid by the Company during fiscal year 2005. During the first and second quarters of fiscal year 2005, Mr. Durando made additional bridge loans to the Company evidenced by various 12% demand notes in the aggregate of \$525,000. Mr. Durando was repaid a total of \$450,000 of such loans in January of 2005. In addition, Mr. Durando converted \$13,954 of the principal amount of a \$75,000 promissory note leaving unpaid principal of \$61,046 outstanding. Mr. Durando converted \$13,000 of accrued and unpaid interest on various promissory notes of the Company into 65,000 shares of common stock and a 5 year warrant to purchase a like amount of common stock at \$.25 per share.

During the twelve month period ended June 30, 2005 Mr. Dotoli and Mr. Smiley, the COO, and CFO and General Counsel of the Company respectively, each lent the Company \$75,000. Mr. Dotoli was repaid, the principal amount of such loan, in cash in January, 2005 and Mr. Smiley converted his \$75,000 loan into 375,000 shares of common stock of the Company plus a 5 year warrant to purchase a like amount of shares at \$.25 per share. In addition, Mr. Smiley converted \$9,975 of accrued interest into 49,875 shares of common stock plus a 5 year warrant to purchase a like amount of shares at \$.25 per share. Finally Mr. Smiley received 25,000 additional shares of common stock as a market adjustment to his equity investment of \$25,000 on August 30, 2004. Mr. Dotoli cancelled \$3,750 of accrued and unpaid interest from August 15, 2004 through January 15, 2004 into 375,000 shares of common stock pursuant to the terms of a portion of a warrant that was exercised at \$.01 per share previously given by the Company to Mr. Dotoli in exchange for and cancellation of unpaid compensation. On January 15, 2004, Mr. Smiley was awarded 425,000 shares of common stock as additional compensation.

During the six months ending December 31, 2004, accounts payable in the amount of \$250,000 owed by mPhase to Microphase Corporation was cancelled in exchange for the 1,250,000 shares of common stock and a 5 year warrant to purchase a like amount of shares at \$.25. In addition for such period, Janifast Ltd. cancelled \$200,000 of accounts payable owed by mPhase in exchange for 1,000,000 shares of common stock and a 5 year warrant to purchase a like amount of shares at \$.25 per share.

In late February and early March of 2005, the various vendors converted approximately \$173,898 in accounts payable due from the Company into 535,296 shares of Common stock aggregating \$183,310 in full settlement of those obligations.

Mr. Ronald A. Durando converted \$13,000 of accrued and unpaid interest on various demand notes issued by the Company for loans by Mr. Durando during the six month period ended December 31, 2004 into 65,000 shares of common stock plus a 5 year warrant to purchase a like amount of shares at \$.25 per share. In addition Mr. Durando converted \$13,954 of principal of a \$75,000 promissory note into the exercise, in full, of a warrant to purchase 1,395,400 shares of common stock at \$.01 previously granted to Mr. Durando in exchange for cancellation of unpaid compensation.

Mr. Gustave Dotoli, Chief Operating Officer of the Company converted \$ 3,750 of accrued and unpaid interest on a \$75,000 promissory note into 375,000 shares of common stock at \$.01 pursuant to a portion of a warrant previously granted to Mr. Dotoli for unpaid compensation. A consultant of the Company converted \$20,000 of accounts payable owed by the Company to 100,000 shares of common stock plus a 5 year warrant to purchase 100,000 shares of

common stock at \$.25 per share.

In June of 2005, Mr. Smiley converted the his 12% \$100,000 note converted plus accrued interest thereon to 520,000 shares of common stock of mPhase at the rate of \$.20 cents per share plus a 5 year warrant for an additional 520,000 shares of common stock at \$.25 per share.

In addition a demand note payable to Martin Smiley, CFO and General Counsel of mPhase, in the amount of \$75,000 was converted into 375,000 shares of common stock plus a 5 year warrant to purchase a like amount of shares at \$.25 per share and Mr. Smiley extended from July 25, 2004 to July 25, 2005 a \$100,000 promissory note carrying 12% interest. In addition Mr. Smiley converted accrued and unpaid interest on his various promissory notes of \$ 9,975 through December 31, 2004 into 49,875 shares of common stock plus a 5 year warrant to purchase a like amount of common stock at \$.25 per share. Mr. Smiley's remaining \$100,000 note is convertible into Common Stock of mPhase at the rate of \$.25 cents per share through July 25, 2009. Upon conversion, the note holder will be granted warrants to purchase an equivalent amount of mPhase Common Stock at \$.25 cents per share for a period of five years from the date of conversion plus a 5 year warrant for a like amount of shares at \$.25 per share. Mr. Ronald A. Durando converted \$13,000 of accrued and unpaid interest on various demand notes issued by the Company for loans by Mr. Durando during the six month period ended December 31, 2004 into 65,000 shares of common stock plus a 5 year warrant to purchase a like amount of shares at \$.25 per share. In addition Mr. Durando converted \$13,954 of principal of a \$75,000 promissory note into the exercise, in full, of a warrant to purchase 1,395,400 shares of common stock at \$.01 previously granted to Mr. Durando in exchange for cancellation of unpaid compensation. Finally, Mr. Gustave Dotoli, Chief Operating Officer of the Company converted \$ 3,750 of accrued and unpaid interest on a \$75,000 promissory note into 375,000 shares of common stock at \$.01 pursuant to a portion of a warrant previously granted to Mr. Dotoli for unpaid compensation.

Mr. Edward Suozzo, a consultant of the Company, converted \$20,000 of accounts payable owed by the Company to 100,000 shares of common stock plus a 5 year warrant to purchase 100,000 shares of common stock at \$.25 per share.

During the three months ending September 30, 2004, a note payable in the amount of \$180,000 to Microphase Corporation, a related party, remained outstanding. Such note was extended by Microphase from July 25, 2004 and now matures on July 25, 2005. Additionally, a note payable to Martin Smiley, CFO and General Counsel of mPhase, in the amount of \$100,000 was extended from July 25, 2004 to July 25, 2005. Both liabilities carry an interest rate of 12% payable quarterly in arrears and were extended effective June 30, 2004. Each note is convertible into Common Stock of mPhase at the rate of \$.25 cents per share plus a 5 year warrant for a like amount of common stock at \$.25 per share through July 25, 2005 and a second 5 year warrant at \$.50 per share convertible into a like amount of shares.

On August 30, 2004, the Company paid \$100,000 to Piper&Rudnick, LLP, its outside counsel, in connection with the renegotiation of a Payment Agreement effective June 30, 2004. Under the terms of the renegotiated Payment Agreement, the Company agreed to payments of \$25,000 each on December 1, 2004, March 1, 2005, June 1, 2005 and September 1, 2005 and a payment of \$50,000 on December 1, 2006 plus \$25,000 payments on March 1, 2006, June 1, 2006, September 1, 2006 and a final payment of \$75,000 payment on December 1, 2007. In addition, Piper&Rudnick LLP agreed to convert \$150,000 of such payable into a 5 year cashless warrant to purchase the Company's common

stock at \$.25 per share.

On August 30, 2004 the Company issued two demand promissory notes each in the principal amount of \$75,000 at 12% interest in consideration of loans of \$75,000 to the Company from each of Mr. Dotoli, its COO and Mr. Smiley, its CFO and General Counsel. In addition on September 30, 2004, the Company issued a demand promissory note to Microphase Corporation, a related party, for a loan of \$175,000 to the Company with a 12% interest rate. Finally, the Company issued demand promissory notes with an interest rate of 12% to Mr. Ronald Durando, CEO of the Company for loans made to the Company dated August 30, 2004, as well as demand promissory notes to Mr. Durando, its CEO, for loans to the Company of \$200,000 on August 30, 2004, \$75,000 on September 28, 2004 and \$175,000 on September 30, 2004 respectively.

On July 25, 2004, Mr. Smiley agreed to convert his 12% convertible promissory note for \$100,000 that had matured into a demand promissory at the same interest rate with interest payable quarterly, in arrears.

Necdet F. Ergul, Ronald A. Durando and Gustave T. Dotoli, our Chairman, Chief Executive Officer and Chief Operating Officer, respectively, are executive officers and shareholders of Microphase and Ronald Durando and Gustave T. Dotoli are president and vice- president of PacketPort.com., respectively.

On November 26, 1999, Mr. Durando acquired, via a 100% ownership of PacketPort, Inc., a controlling interest in Linkon Corporation, now known as PacketPort.com, Inc. On November 26, 1999, PacketPort, Inc., a company owned 100% by Mr. Durando, acquired controlling interest in Linkon Corp., which subsequently changed its name to PacketPort.com, Inc. In connection with this transaction, Mr. Durando transferred 350,000 shares of our common stock to PacketPort, Inc.

Mr. Michael McInerney, an outside Director, is employed by Lintel Inc. and Mr. Abraham Biderman was employed until September 30, 2003 by our former investment banking firm Lipper & Company. Mr. Biderman's current firm Eagle Advisers, Inc. has acted as a finder of money in connection with finder's fees of \$30,000 during fiscal year 2004.

Messrs. Biderman, McInerney and Mr. Anthony Guerino, as outside directors of mPhase, own a relatively small amount of stock, warrants and options in the Company.

#### Transactions with Microphase Corporation

mPhase's President and Chairman of the Board of the Company are also employees of Microphase. On May 1, 1997, the Company entered into an agreement with Microphase, whereby it will use office space as well as the administrative services of Microphase, including the use of accounting personnel. This agreement for fiscal year 2004 required mPhase to pay Microphase \$10,000 per month. Microphase also charges fees for specific projects on a project-by-project basis. During the year ended June 30, 2005 and for the period of time from mPhase's inception (October 2, 1996) to June 30, 2005, \$458,770, and \$8,138,956, respectively, have been charged to expense or inventory under these Agreements and is included in operating expenses in the accompanying consolidated statements of operations. Management believes that amounts charged to the Company by Microphase are commensurate to amounts that would be incurred if outside third parties were used.

The Company is obligated to pay a 3% royalty to Microphase on revenues from its proprietary Traverser\_ Digital Video and Data Delivery System and DSL component products.

At June 30, 2005, approximately \$0 of undelivered purchase orders remains outstanding with Microphase.

#### Transactions with Janifast

Janifast Ltd., a Hong Kong corporation manufacturer, which has produced components for our prototype Traverser\_ DVDDS product, and may produce such components for us in the future. Necdet F. Ergul, Ronald A. Durando and Gustave T. Dotoli are controlling shareholders of Janifast Ltd. with an aggregate ownership interest of greater than 75% of Janifast Ltd. Mr. Durando is Chairman of the Board of Directors and Mr. Ergul is a Director of Janifast.

During the years ended June 30, 2005 and the period from inception (October 2, 1996) to June 30, 2005 \$1,536,494 and \$15,117,789 respectively, of invoices for products and services have been charged to inventory or expense- other liabilities-related parties as long term liabilities in the consolidated balance sheet and as of June 30, 2005. Additionally, at June 30, 2005, approximately \$298,000 of undelivered purchase orders remain outstanding with Janifast Limited, and outstanding payables to Janifast Limited are approximately \$491,098.

#### Transactions with Other Related Parties



In March 2000, mPhase acquired a 50% interest in mPhaseTelevision.Net (formerly Telco Television Network, Inc.), an incorporated joint venture. This percentage was increased to approximately 57% in fiscal year 2001. Alpha Star International, Inc currently owns the remaining joint venture interest.

During the fiscal years ended June 30, 2002, June 30, 2003 and June 30,2004, the joint venture was charged \$69,000, \$0 and \$0, for fees and costs by each of its joint venture partners and their affiliates.

#### Transactions with Other Significant Beneficial Owners of mPhase Common Stock and Warrants

Effective June 30, 2004, the Company was \$473,787 in arrears with respect to a Promissory Note issued to Piper Rudnick LLP plus other legal fees of \$118,773.36. It should be noted that Piper & Rudnick received such Promissory Note plus two warrants received in March of 2002 in exchange for cancellation of certain payables. Such warrants have conversion rights into our common stock for a total of 2,233,490 shares that have been registered under a recently effective Form S-1 Registration Statement, and are cashless. On September 3, 2003, the Company paid \$100,000 in cash to Piper in exchange for reducing the total payable to \$550,000 plus the issuance of additional cashless warrant for \$150,000 worth of the Company's common stock valued at \$.25 per share. The remaining \$300,000 payable has the following future payment schedule:

1. Payments of \$25,000 each on December 1, 2004, March 1, 2005, June 1, 2005, September 1, 2005, March 1, 2006, June 1, 2006 and September 1, 2006.
2. A payment of \$50,000 on December 1, 2005
3. A payment of \$75,000 due on December 1, 2006

(a)(1) The following is a list of the financial statements, financial statement schedules and exhibits, which are included in this Annual Report on Form 10-K. Where so indicated by footnote, exhibits, which were previously filed, are incorporated by reference.

**FINANCIAL STATEMENT SCHEDULES:**

**EXHIBITS**

**EXHIBITS**

**NUMBER**

**REFERENCE**

**DESCRIPTION**

|      |   |
|------|---|
| 2.1* | Exchange of Stock Agreement and Plan of Reorganization (incorporated by reference to Exhibit 2(a) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).   |
| 2.2* | Exchange of Stock Agreement and Plan of Reorganization dated June 25, 1998 (incorporated by reference to Exhibit 2(b) to our registration statement on Form 10SB-12G filed on May 6, 1999 (file no. 000-24969)).  |
| 3.1* | Certificate of Incorporation of Tecma Laboratory, Inc. filed December 20, 1979 (incorporated by reference to Exhibit 3(a) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).   |
| 3.2* | Certificate of Correction to Certificate of Incorporation of Tecma Laboratory, Inc. dated June 19, 1987 (incorporated by reference to Exhibit 3(b) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).                                |
| 3.3* | Certificate of Amendment of Certificate of Incorporation of Tecma Laboratory, Inc. filed August 28, 1987 (incorporated by reference to Exhibit 3(c) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).                               |
| 3.4* | Certificate of Amendment of Certificate of Incorporation of Tecma Laboratories, Inc. filed April 7, 1997 (incorporated by reference to Exhibit 3(d) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).                               |
| 3.5* | Certificate of Amendment of Certificate of Incorporation of Lightpaths TP Technologies, Inc. filed June 2, 1997 (incorporated by reference to Exhibit 3(e) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).                        |
| 3.6* | Certificate of Amendment of Certificate of Incorporation of mPhase Technologies, Inc. filed September 15, 2000 (incorporated by reference to Exhibit 3i to our quarterly report on Form 10Q filed on November 13, 2000 (file no. 000-24969)).                                     |
| 3.7* | Bylaws of the Company (incorporated by reference to Exhibit 3(g) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).  |
| 4.1* | Form of Registration Rights Agreement, dated January 26, 2001, by and among the Company and the purchasers listed on Schedule A attached thereto (incorporated by reference to Exhibit 4.1 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)). |
| 4.2* | Form of Registration Rights Agreement, dated February 9, 2001, by and among the Company   |

and the purchasers listed on Schedule A attached thereto (incorporated by reference to Exhibit 4.2 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)).

4.3\* Form of Warrant.

4.4\* Warrant Issued to Piper Rudnick LLP.

10.1\* License Agreement, dated March 26, 1998, between the Company and Georgia Tech Research Corporation (incorporated by reference to Exhibit 10(e) to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000- 24969)).

## EXHIBITS

### NUMBER

### REFERENCE

### DESCRIPTION

- 10.2\* First Amendment to the License Agreement dated January 8, 2001, between the Company and Georgia Tech Research Corporation (incorporated by reference to Exhibit 10.2 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)).
- 10.3\* Employment Agreement between Ronald A. Durando and the Company (incorporated by reference to Exhibit 10.8 to our registration statement on Form SB-2 filed on August 13, 1999 (file no. 333-85147)).
- 10.4\* Employment Agreement between Gustave T. Dotoli and the Company (incorporated by reference to Exhibit 10.9 to our registration statement on Form SB-2 filed on August 13, 1999 (file no. 333-85147)).
- 10.5\* Employment Agreement between Martin S. Smiley and the Company, dated as of August 15, 2000 (incorporated by reference to Exhibit 10.5 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)).
- 10.6\* Employment Agreement between David C. Klimek and the Company, dated as of April 1, 2001 (incorporated by reference to Exhibit 10.6 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)).
- 10.7\* Manufacturing Services Agreement dated March 14, 2001, by and between the Company and Flextronics International USA, Inc (incorporated by reference to Exhibit 10.7 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)).
- 10.8\* Supply Agreement by and between the Company and Hart Telephone Company, Inc., date of August 19, 1998 (incorporated by reference to Exhibit 10.8 to our registration statement on

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Form S-1 filed on June 18, 2001 (file no. 33-63262)).

- 10.9\* Facilities/Services Agreement between the Company and Microphase Corporation, dated as of July 1, 1998. (incorporated by reference to Exhibit 10.9 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)).
- 10.10\* Company's 2001 Stock Incentive (incorporated by reference to Exhibit C to our preliminary proxy statement on Form Pre 14A filed on March 21, 2001 (file no.000-30202)).
- 10.11\* License Agreement, dated July 31, 1996, by and between AT&T Paradyne Corporation and Microphase Corporation. (incorporated by reference to Exhibit 10.11 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33-63262)).
- 10.12(a)\* Assignment Agreement dated February 17, 1997, by and between the Company and Microphase Corporation. (incorporated by reference to Exhibit 10.12 to our registration statement on Form S-1 filed on June 18, 2001 (file no. 33- 63262)).
- 10.12(b)\* Distribution Agreement effective May 15, 2002 by and between Corning Cable System and the Company.
- 10.13.\* Development Agreement between Lucent Technologies, Inc. and mPhase Technologies, Inc., effective as of December 1, 2002, relating to Video Services Switch and Statement of Work, dated December 9, 2002.\*\*

**EXHIBITS**

**NUMBER**

**REFERENCE**

**DESCRIPTION**

- 10.14. \* Purchase Order between the Company and Lucent Technologies, Inc., dated December 15, 2002, for cost reduction of the mPhase Traverser INI set box. \*\*
- 10.15.\* Co-Branding Agreement, dated as of January 21, 2003, between the Company and Lucent Technologies, Inc.\*\*
- 10.16\* Systems Integrator Agreement, dated as of April 4, 2003, between the Company and Lucent Technologies, Inc.\*\*
- 10.17\* Development Agreement between Lucent Technologies, Inc and mPhase technologies, Inc. relating to Broadcast Television Switch (BTS) effective as of September 15, 2003.\*\*
- 10.18\* Development Agreement effective February 3, 2004 between Lucent Technologies, Inc. and mPhase Technologies, Inc for development of micro fuel cell Nano Technology.\*\*
- 10.19\* Software License Agreement between Espial Group, Inc, a Canadian Corporation and mPhase Technologies, Inc. entered into November 28, 2004.
- 10.20\*

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Software Development Agreement between Magpie Telecom Insiders, Inc, and mPhase Technologies, dated September 2, 2004 and Work Order dated January 3, 2005

- 10.21\* Development Agreement effective March 11, 2005 between Lucent Technologies Inc and mPhase Technologies relating to development of Magnetometers.
- 10.22\* Amendment No. 2 to Development Agreement dated as of March 9, 2005 relating to Micro Power Source Cells between mPhase Technologies, Inc and Lucent Technologies, Inc.
- 10.23\* Amendment No. 2 to Development Agreement between Lucent Technologies, Inc.
- 21\* and mPhase Technologies, Inc. dated as September 15, 2003
- 23.1\* Consents of Schuhalter, Coughlin & Suozzo, LLC dated August 31, 1998 and Mauriello, Franklin & LoBrace, P.C. dated August 31, 1998 (incorporated by reference to Exhibit 23 to our registration statement on Form 10SB-12G filed on October 16, 1998 (file no. 000-24969)).
- 23.2\* Consents of Schuhalter, Coughlin & Suozzo, LLC dated April 23, 1999 and Mauriello, Franklin & LoBrace, P.C. dated April 23, 1999 (incorporated by reference to Exhibit 23 to our registration statement on Form 10SB-12G filed on May 6, 1999 (file no. 000-24969)).
- 23.3\* Consent of Schuhalter, Coughlin & Suozzo, LLC dated August 13, 1999 (incorporated by reference to Exhibit 23.1 to our registration statement on Form SB-2 filed on August 13, 1999 (file no. 333-85147)).
- 23.4\* Consent of Arthur Andersen LLP (incorporated by reference to our registration statement, Amendment No. 2 filed on Aug. 15, 2001.)
- 23.5\* Consent of Schuhalter, Coughlin & Suozzo, LLC (incorporated by reference to our registration statement, Amendment No. 2 filed on Aug. 15, 2001.)
- 23.6\* Consent of Piper Marbury Rudnick & Wolfe LLP (incorporated by reference to our registration statement, Amendment No. 2 filed on Aug. 15, 2001.)
- 23.7\* Consent of Rosenberg, Rich, Baker, Berman and Company (incorporated by reference to our registration statement, Amendment No. 1/A filed on August 1 2002.)
- 23.8\* Consent of Schuhalter, Coughlin & Suozzo, LLC (incorporated by reference to our registration statement, Amendment No 1/A filed on August 2, 2002.)
- 23.9\* Consent of Piper&Rudnick LLP. (incorporated by reference to our registration statement, Amendment No. 1/A filed on August 2, 2002)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Incorporated by reference.

\*\* All or portions of such Agreements have been omitted and the Company has requested that the omitted sections be treated as "Confidential Information" pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended and has been filed with the Securities and Exchange Commission separately.

## FINANCIAL STATEMENTS

|   | <u>PAGE</u> |
|---|-------------|
| Report of Rosenberg Rich Baker Berman & Company   | F-1         |
| Report of Arthur Andersen LLP   | F-2         |
| Report of Schuhalter, Coughlin & Suozzo, PC   | F-3         |
| Consolidated Balance Sheets as of June 30, 2004 and 2005  | F-4         |
| Consolidated Statements of Operations for the years ended June 30, 2003, 2004 and 2005 and for the period from inception (October 2, 1996) through June 30, 2005.                                       | F-5         |
| Consolidated Statements of Changes in Stockholders' Equity (Deficit) for the period from inception (October 2, 1996) to June 30, 1997 and for each of the seven years in the period ended June 30, 2005 | F6-12       |
| Consolidated Statements of Cash Flows for the years ended June 30, 2003, 2004 and 2005 and for the period from inception (October 2, 1996) through June 30, 2005.                                       | F-12        |
| Notes to Consolidated Financial Statements  | F-14 F-32   |

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of mPhase Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of mPhase Technologies, Inc. (a New Jersey corporation in the development stage) and subsidiaries as of June 30, 2005 and June 30, 2004, and the related consolidated statements of operations, changes in stockholders' equity (deficit), cash flows and Schedule II (Valuation and Qualifying Accounts, Item 14B) for each of the three years in the period ended June 30, 2005 and for the period

from inception (October 2, 1996) to June 30, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of mPhase Technologies, Inc. for the period from inception to June 30, 2001. Such amounts are included in the cumulative from inception to June 30, 2005 totals of the statements of operations, changes in stockholders' equity and cash flows and reflect total net loss of 80 percent of the related cumulative totals. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to amounts for the period from inception to June 30, 2001, included in the cumulative totals, is based solely upon the report of the other auditors.

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 audits to obtain reasonable assurance about whether the financial statements are free of material accounting misstatement. 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of mPhase Technologies, Inc. and subsidiaries as of June 30, 2005 and 2004 and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2005 and for the period from inception to June 30, 2005, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations and is in a working capital deficit position that raises substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 14 to the consolidated financial statements, management has improved presentation and expanded certain disclosures in the accompanying consolidated financial statements. The resulting changes from these expanded disclosures and additional schedules have no effect on the financial position and results of operations for the year ended June 30, 2005. As a result of these expanded disclosures, management has reissued the June 30, 2005 consolidated financial statements to reflect these expanded disclosures.

Rosenberg Rich Baker Berman & Company Bridgewater, NJ

September 19, 2005, except for Note 14 as to which the date is May 9, 2006.

**REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS**

To the Board of Directors and Stockholders of mPhase Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of mPhase Technologies, Inc. (a New Jersey corporation in the development stage) and subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended June 30, 2001 and for the period from inception (October 2, 1996) to June 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of mPhase Technologies, Inc. for the period from inception to June 30, 2001. Such amounts are included in the cumulative from inception to June 30, 1998 totals of the statements of operations, changes in stockholders' equity and cash flows and reflect total net loss of 6 percent of the related cumulative totals. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to amounts for the period from inception to June 30, 1998, included in the cumulative totals, is based solely upon the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the 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. 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of mPhase Technologies, Inc. and subsidiaries as of June 30, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2001 and for the period from inception to June 30, 2001, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations and is in a working capital deficit position that raises substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Arthur Andersen LLP

Stamford, Connecticut



October 12, 2001

PURSUANT TO SEC RELEASE NO. 33-8070 AND RULE 437A UNDER THE SECURITIES ACT OF 1933, AS AMENDED, mPHASE TECHNOLOGIES, INC. HAS NOT RECEIVED WRITTEN CONSENT AFTER REASONABLE EFFORT TO USE THIS REPORT. THIS REPORT IS A COPY OF A PREVIOUSLY ISSUED ARTHUR ANDERSEN LLP REPORT. THIS REPORT HAS NOT BEEN REISSUED BY ARTHUR ANDERSEN LLP. WITH RESPECT TO THIS INSTANT 10K/A, YOU WILL NOT BE ABLE TO RECOVER AGAINST ARTHUR ANDERSEN LLP UNDER SECTION 11 OF THE SECURITIES ACT FOR ANY UNTRUE STATEMENTS OF A MATERIAL FACT CONTAINED IN THE FINANCIAL STATEMENTS AUDITED BY ARTHUR ANDERSEN LLP OR ANY OMISSIONS TO STATE A MATERIAL FACT REQUIRED TO BE STATED THEREIN.

F-2

## **REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

To the Board of Directors and Stockholders of mPhase Technologies, Inc.:

We have audited the statements of operations, changes in stockholders' equity, and cash flows for the period October 2, 1996 (date of inception) through June 30, 1998 of mPhase Technologies, Inc. (a development stage company). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the results of its operations and its cash flows for the period of October 2, 1996 (date of inception) through June 30, 1998 in conformity with generally accepted accounting principles.

Schuhalter, Coughlin & Suozzo, PC

Raritan, New Jersey

January 28, 1999

F-3

**mPHASE TECHNOLOGIES, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED BALANCE SHEETS**

|  | 2004          | JUNE 30, | 2005          |
|--|---------------|----------|---------------|
| <b>ASSETS</b>  |               |          |               |
| Current assets:  |               |          |               |
| Cash and cash equivalents  | \$ 90,045     | \$       | 351,185       |
| Accounts receivable, net of bad debt reserve of \$0 and \$0 respectively | 64,100        |          | 533,841       |
| Stock subscription receivable  | 886,000       |          | 460,000       |
| Inventory  | 1,237,972     |          | 490,142       |
| Prepaid expenses and other current assets                                | <u>81,061</u> |          | <u>25,622</u> |
| Total current assets   | 2,359,178     |          | 1,860,790     |
| Property and equipment, net  | 52,685        |          | 162,692       |

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|  |    |                    |    |                    |
|--|----|--------------------|----|--------------------|
| Patents and licenses, net                            |    | 161,605            |    | 141,451            |
| Other assets   |    | <u>17,250</u>      |    | <u>67,250</u>      |
| Total assets   | \$ | <u>2,590,718</u>   | \$ | <u>2,232,183</u>   |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)       |    |                    |    |                    |
| Current liabilities:                                 |    |                    |    |                    |
| Accounts payable                                     | \$ | 2,088,658          | \$ | 1,691,338          |
| Accrued expenses                                     |    | 636,033            |    | 431,765            |
| Due to related parties                               |    | 680,956            |    | 721,569            |
| Note payable, related party                          |    | 300,000            |    | 277,000            |
| Current Portion of Long Term debt                    |    | 550,803            |    | 413,537            |
| Deferred revenue                                     |    | <u>214,180</u>     |    | =                  |
| Total current liabilities                            |    | 4,470,630          |    | 3,535,209          |
| Other liabilities                                    |    |                    |    |                    |
| Other liabilities                                    |    | 618,550            |    | 214,709            |
| Notes payable-related parties                        |    | 280,000            |    | -                  |
| Long-term debt, net of current portion               |    | 139,500            |    | 100,000            |
| COMMITMENTS AND CONTINGENCIES (Note 13)              |    |                    |    |                    |
| STOCKHOLDERS' EQUITY (DEFICIT):                      |    |                    |    |                    |
| Common Stock, par value \$.01, 250,000,000           |    |                    |    |                    |
| shares authorized; 88,899,962 and 145,048,832        |    |                    |    |                    |
| outstanding, in 2004 and 2005 respectively           |    |                    |    |                    |
|  |    | 888,999            |    | 1,450,489          |
| Additional paid-in capital                           |    | 111,976,095        |    | 123,949,156        |
| Deficit accumulated during development stage         |    | (115,775,083)      |    | (127,009,407)      |
| Less-treasury stock, 13,750 shares, at cost          |    | <u>(7,973)</u>     |    | <u>(7,973)</u>     |
| Total stockholders' equity (deficit)                 |    | <u>(2,917,962)</u> |    | <u>(1,617,735)</u> |
| Total liabilities and stockholders' equity (deficit) | \$ | <u>2,590,718</u>   | \$ | <u>2,232,183</u>   |

The accompanying notes are an integral part of these consolidated balance sheets.

F-4

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

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|   | For the Years Ended June 30, |                       |                        | From Inception<br>(October 2,<br>1996)<br>to June 30,<br>2005 |
|---|------------------------------|-----------------------|------------------------|---|
|   | 2003                         | 2004                  | 2005                   |   |
| TOTAL NET REVENUES  | \$ 1,581,639                 | \$ 4,641,346          | \$ 1,711,085           | \$ 21,320,125   |
| COSTS AND EXPENSES:   |                              |                       |                        |   |
| Cost of Sales (Including \$1,344,055, \$3,647,599 and \$1,370,700 incurred with related parties in 2003, 2004, and 2005, respectively as discussed in Note 11)                          | 1,493,394                    | 4,068,255             | 1,446,151              | 15,359,358  |
| Research and development (including non-cash stock related charges of \$385,495, \$72,000, \$0 and \$2,117,669 respectively, see also note 11 Related Party Transactions)               | 3,538,305                    | 4,069,721             | 5,127,438              | 43,544,238  |
| General and administrative (including non-cash stock related charges of \$748,840, \$1,242,793, \$2,948,083 and \$50,281,225 respectively, see also note 11 Related Party Transactions) | 2,683,534                    | 4,177,961             | 6,579,761              | 85,634,858  |
| Depreciation and Amortization   | <u>515,417</u>               | <u>122,878</u>        | <u>62,679</u>          | <u>2,952,586</u>  |
| Total costs and expenses  | <u>8,230,650</u>             | <u>12,438,815</u>     | <u>13,216,029</u>      | <u>147,491,040</u>  |
| Loss from operations  | <u>(6,649,011)</u>           | <u>(7,797,469)</u>    | <u>(11,504,944)</u>    | <u>(126,170,915)</u>  |
| OTHER INCOME (EXPENSE):   |                              |                       |                        |   |
| Net Gain (Loss) On Extinguishments and Settlements  | 61,226                       | 150,058               | 418,695                | 772,216   |
| Minority interest loss in consolidated subsidiary   | -                            | -                     | -                      | 20,000  |
| Loss from unconsolidated subsidiary   | -                            | -                     | -                      | (1,466,467)   |
| Loss on sale of securities  | (11,258)                     | -                     | (37,411)               | (48,669)  |
| Interest income (expense), net  | <u>(51,168)</u>              | <u>(111,175)</u>      | <u>(110,469)</u>       | <u>(115,572)</u>  |
| Total other income (expense)  | <u>(1,200)</u>               | <u>38,883</u>         | 270,620                | <u>(838,492)</u>  |
| NET LOSS  | \$ <u>(6,650,211)</u>        | \$ <u>(7,758,586)</u> | \$ <u>(11,234,324)</u> | \$ <u>(127,009,407)</u>                                       |
| Unrealized holding (loss) gain on securities  | 4,026                        | -                     | -                      | -   |
| COMPREHENSIVE LOSS  | \$ <u>(6,646,185)</u>        | \$ <u>(7,758,586)</u> | \$ <u>(11,234,324)</u> | \$ <u>(127,009,407)</u>                                       |
| LOSS PER COMMON SHARE, basic and diluted  | \$ <u>(.10)</u>              | \$ <u>(.10)</u>       | \$ <u>(.10)</u>        |   |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING, basic and diluted   | <u>65,217,088</u>            | <u>77,677,120</u>     | <u>108,657,578</u>     |   |

The accompanying notes are an integral part of these consolidated balance sheets.

**mPHASE TECHNOLOGIES, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF CHANGES IN**  
**STOCKHOLDERS' EQUITY (DEFICIT)**  
**FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)**  
**TO JUNE 30, 1997 AND FOR EACH OF THE EIGHT YEARS**  
**IN THE PERIOD ENDED JUNE 30, 2005**

|  | <b>Common Stock</b> |                            | <b>Additional<br/>Paid-In<br/>Capital</b> |                                       | <b>Accumulated<br/>Deficit</b> |              | <b>TOTAL<br/>STOCKHOLDERS'<br/>EQUITY<br/>(DEFICIT)</b> |
|--|---------------------|----------------------------|---|---------------------------------------|--------------------------------|--------------|---|
|  | <b>Shares</b>       | <b>\$.01<br/>Par Value</b> | <b>Treasury<br/>Stock</b>                 | <b>Deferred<br/>Compensa<br/>tion</b> |                                |              |   |
| BALANCE,<br>OCTOBER 2, 1996<br>(date of inception).  | 1,140,427           | \$ 11,404                  | \$ -                                      | \$ 459,753                            | \$ -                           | \$ (537,707) | \$ (66,550)   |
| Issuance of common<br>stock of<br>Tecma Laboratories,<br>Inc., for<br>100% of the<br>Company.  | 6,600,000           | 66,000                     | -   | (537,157)                             | -                              | 537,707      | 66,550  |
| Issuance of common<br>stock, in<br>private placement, net<br>of offering<br>costs of \$138,931 | 594,270             | 5,943                      | -   | 752,531                               | -                              | -            | 758,474   |
| Net loss   | -                   | -                          | -   | -                                     | -                              | (781,246)    | (781,246)   |
| BALANCE, JUNE<br>30, 1997  | 8,334,697           | 83,347                     | -   | 675,127                               | -                              | (781,246)    | (22,772)  |

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|   |                   |                   |                   |                     |             |                      |                     |
|---|-------------------|-------------------|-------------------|---------------------|-------------|----------------------|---------------------|
| Issuance of common stock with warrants, in private placement, net of offering costs of \$84,065               | 999,502           | 9,995             | -                 | 791,874             | -           | -                    | 801,869             |
| Issuance of common stock for services   | 300,000           | 3,000             | -                 | 147,000             | -           | -                    | 150,000             |
| Issuance of common stock in connection with investment in unconsolidated subsidiary                           | 250,000           | 2,500             | -                 | 122,500             | -           | -                    | 125,000             |
| Repurchase of 13,750 shares of common stock   | -                 | -                 | (7,973)           | -                   | -           | -                    | (7,973)             |
| Issuance of common stock with warrants in private placement, net of offering costs of \$121,138               | 1,095,512         | 10,955            | -                 | 659,191             | -           | -                    | 670,146             |
| Issuance of common stock for financing services   | 100,000           | 1,000             | -                 | (1,000)             | -           | -                    | -                   |
| Issuance of common stock in consideration for 100% of the common stock of Microphase Telecommunications, Inc. | 2,500,000         | 25,000            | -                 | 1,685,000           | -           | -                    | 1,710,000           |
| Net loss  | -                 | -                 | -                 | -                   | -           | (4,341,059)          | (4,341,059)         |
| BALANCE, JUNE 30, 1998  | <u>13,579,711</u> | <u>\$ 135,797</u> | <u>\$ (7,973)</u> | <u>\$ 4,079,692</u> | <u>\$ -</u> | <u>\$(5,122,305)</u> | <u>\$ (914,789)</u> |

The accompanying notes are an integral part of these consolidated balance sheets.

**mPHASE TECHNOLOGIES, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF CHANGES IN**  
**STOCKHOLDERS' EQUITY (DEFICIT)**  
**FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)**  
**TO JUNE 30, 1997 AND FOR EACH OF THE EIGHT YEARS**  
**IN THE PERIOD ENDED JUNE 30, 2005**

|   | <b>Common Stock</b> |                                | <b>Additional<br/>Paid-In<br/>Capital</b> |  |      |                | <b>TOTAL<br/>STOCKHOLDERS'<br/>EQUITY<br/>(DEFICIT)</b> |
|---|---------------------|--------------------------------|---|--|------|----------------|---|
|   | <b>Shares</b>       | <b>\$.01<br/>Par<br/>Value</b> | <b>Treasury<br/>Stock</b>                 | <b>Deferred Accumulated<br/>Compensation Deficit</b> |      |                |   |
| BALANCE,<br>JUNE 30, 1998   | 13,579,711          | \$ 135,797                     | \$ (7,973)                                | \$ 4,079,692   | \$ - | \$ (5,122,305) | \$ (914,789)  |
| Issuance of<br>common stock<br>with warrants in<br>private<br>placements, net<br>of offering<br>costs of<br>\$107,000 | 3,120,000           | 31,200                         | -   | 2,981,800  | -    | -              | 3,013,000   |
| Issuance of<br>common stock<br>for<br>services  | 1,599,332           | 15,993                         | -   | 8,744,873  | -    | -              | 8,760,866   |
| Issuance of<br>common stock   | 642,000             | 6,420                          | -   | 1,553,227  | -    | -              | 1,559,647   |

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|  |                   |                |                   |                      |                     |                        |                     |
|--|-------------------|----------------|-------------------|----------------------|---------------------|------------------------|---------------------|
| with warrants in private placement, net of offering costs of \$45,353                  |                   |                |                   |                      |                     |                        |                     |
| Issuance of common stock in private placement, net of offering costs of \$679,311      | 4,426,698         | 44,267         | -                 | 10,343,167           | -                   | -                      | 10,387,434          |
| Issuance of stock options for services   | -                 | -              | -                 | 7,129,890            | -                   | -                      | 7,129,890           |
| Issuance of warrants for services  | -                 | -              | -                 | 16,302               | -                   | -                      | 16,302              |
| Deferred employee stock option compensation  | -                 | -              | -                 | -                    | (140,000)           | -                      | (140,000)           |
| Net loss   | -                 | -              | -                 | -                    | -                   | (22,838,344)           | (22,838,344)        |
| <b>BALANCE, JUNE 30, 1999</b>  | <b>23,367,741</b> | <b>233,677</b> | <b>\$ (7,973)</b> | <b>\$ 34,848,951</b> | <b>\$ (140,000)</b> | <b>\$ (27,960,649)</b> | <b>\$ 6,974,006</b> |
| Issuance of common stock and options in settlement                                     |                   |                |                   |                      |                     |                        |                     |
| Issuance of common stock upon exercise of warrants and options                         | 75,000            | 750            | -                 | 971,711              | -                   | -                      | 972,461             |
| Issuance of common stock in private placement, net of cash offering costs of \$200,000 |                   |                |                   |                      |                     |                        |                     |
| Issuance of common stock in private placement, net of cash offering costs of \$466,480 | 4,632,084         | 46,321         | -                 | 5,406,938            | -                   | -                      | 5,453,259           |
| Issuance of common stock for   | 1,000,000         | 10,000         | -                 | 3,790,000            | -                   | -                      | 3,800,000           |
| Issuance of common stock in private placement, net of cash offering costs of \$200,000 |                   |                |                   |                      |                     |                        |                     |
| Issuance of common stock in private placement, net of cash offering costs of \$466,480 | 1,165,500         | 11,655         | -                 | 9,654,951            | -                   | -                      | 9,666,606           |
| Issuance of common stock for   |                   |                |                   |                      |                     |                        |                     |
| Issuance of common stock for   | 1,164,215         | 11,642         | -                 | 8,612,265            | -                   | -                      | 8,623,907           |



|   |                   |                   |                   |                      |                       |                        |                     |
|---|-------------------|-------------------|-------------------|----------------------|-----------------------|------------------------|---------------------|
| services  |                   |                   |                   |                      |                       |                        |                     |
| Issuance of options for services                            | -                 | -                 | -                 | 9,448,100            | -                     | -                      | 9,448,100           |
| Deferred employee stock option compensation                 | -                 | -                 | -                 | 1,637,375            | (1,637,375)           | -                      | -                   |
| Amortization of deferred employee stock option compensation | -                 | -                 | -                 | -                    | 551,707               | -                      | 551,707             |
| Net loss  | =                 | =                 | =                 | =                    | =                     | (38,161,542)           | (38,161,542)        |
| BALANCE, JUNE 30, 2000                                      | <u>31,404,540</u> | <u>\$ 314,045</u> | <u>\$ (7,973)</u> | <u>\$ 74,370,291</u> | <u>\$ (1,225,668)</u> | <u>\$ (66,122,191)</u> | <u>\$ 7,328,504</u> |

The accompanying notes are an integral part of these consolidated balance sheets.

F-7

**mPHASE TECHNOLOGIES, INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF CHANGES IN**  
**STOCKHOLDERS' EQUITY (DEFICIT)**  
**FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)**  
**TO JUNE 30, 1997 AND FOR EACH OF THE EIGHT YEARS**

## IN THE PERIOD ENDED JUNE 30, 2005

|  | Common Stock        |                    | Treasury<br>Stock | Additional<br>Paid-In<br>Capital |                | Deferred<br>Compensation | Accumulated<br>Deficit | TOTAL<br>STOCKHOLDERS'<br>EQUITY<br>(DEFICIT) |
|--|---------------------|--------------------|-------------------|----------------------------------|----------------|--------------------------|------------------------|---|
|  | Shares<br>Par Value | \$.01<br>Par Value |                   |                                  |                |                          |                        |   |
| BALANCE,<br>JUNE 30,<br>2000   | 31,404,540          | \$ 314,045         | \$ (7,973)        | \$ 74,370,291                    | \$ (1,225,668) | \$ (66,122,191)          | \$ 7,328,504           |   |
| Issuance of<br>common<br>stock upon<br>exercise of<br>options  | 320,000             | 3,200              | -                 | 324,300                          | -              | -                        | 327,500                |   |
| Issuance of<br>common<br>stock with<br>warrants in<br>private<br>placements, net<br>of<br>cash offering<br>costs of<br>\$512,195 | 4,329,850           | 43,298             | -                 | 7,766,547                        | -              | -                        | 7,809,845              |   |
| Issuance of<br>common<br>stock for<br>services   | 450,000             | 4,500              | -                 | 1,003,125                        | -              | -                        | 1,007,625              |   |
| Issuance of<br>options and<br>warrants for<br>services   | -                   | -                  | -                 | 5,849,585                        | -              | -                        | 5,849,585              |   |
| Deferred<br>employee stock<br>option<br>compensation   | -                   | -                  | -                 | 607,885                          | (607,885)      | -                        | -                      |   |
| Amortization of<br>deferred<br>employee stock<br>option<br>compensation  | -                   | -                  | -                 | -                                | 1,120,278      | -                        | 1,120,278              |   |
| Issuance of<br>common<br>stock in<br>settlement of<br>debt<br>to directors and<br>related<br>parties                             | 4,840,077           | 48,402             | -                 | 2,371,637                        | -              | -                        | 2,420,039              |   |

|                              |                   |                   |                   |                      |                     |                        |                     |
|------------------------------|-------------------|-------------------|-------------------|----------------------|---------------------|------------------------|---------------------|
| Net Loss                     | =                 | =                 | =                 | =                    | =                   | <u>(23,998,734)</u>    | <u>(23,998,734)</u> |
| BALANCE,<br>JUNE 30,<br>2001 | <u>41,344,467</u> | <u>\$ 413,445</u> | <u>\$ (7,973)</u> | <u>\$ 92,293,370</u> | <u>\$ (713,275)</u> | <u>\$ (90,120,925)</u> | <u>\$ 1,864,642</u> |

The accompanying notes are an integral part of these consolidated balance sheets.

F-8

**mPHASE TECHNOLOGIES, INC.**

**CONSOLIDATED STATEMENT OF CHANGES IN**

**SHAREHOLDERS' EQUITY (DEFICIT)**

**FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)**

**TO JUNE 30, 1997 AND FOR EACH OF THE EIGHT YEARS**

**IN THE PERIOD ENDED JUNE 30, 2005**

|   | Shares     | \$.01 Par Value | Treasury Stock | Additional Paid-in Stock | Deferred Compensation | Accumulated Deficit | Comprehensive Loss | Stockholders' Equity (Deficit) | Total |
|---|------------|-----------------|----------------|--------------------------|-----------------------|---------------------|--------------------|--------------------------------|-------|
| Balance June 30, 2001                                       | 41,344,467 | \$413,445       | \$ (7,973)     | \$92,293,370             | \$ (713,275)          | (90,120,925)        | -                  | 1,862,642                      |       |
| Issuance of Common stock with warrants in private placement | 6,980,643  | 69,807          | -              | 1,903,943                | -                     | -                   | -                  | 1,973,750                      |       |
|   | 2,976,068  | 29,760          | -              | 1,169,241                | -                     | -                   | -                  | 1,139,001                      |       |

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|  |                   |                |                   |                      |                    |                      |                   |                    |
|--|-------------------|----------------|-------------------|----------------------|--------------------|----------------------|-------------------|--------------------|
| Issuance of Common stock for services  | -                 | -              | -                 | 1,877,937            | -                  | -                    | -                 | 1,877,937          |
| Issuance of options and warrants for services  | -                 | -              | -                 | 1,877,937            | -                  | -                    | -                 | 1,877,937          |
| Cancellation of unearned options to former employees   | -                 | -              | -                 | (140,802)            | 140,802            | -                    | -                 | -                  |
| Amortization of deferred employee stock option compensation  | -                 | -              | -                 | -                    | 548,550            | -                    | -                 | 548,550            |
| Issuance of common stock and warrants in settlement of debt to related parties and strategic vendors | 7,492,996         | 74,930         | -                 | 2,663,728            | -                  | -                    | -                 | 2,534,558          |
| Sale of Common stock to certain Officers and Directors in private placement                          | 2,000,000         | 20,000         | -                 | 980,000              | -                  | -                    | -                 | 1,900,000          |
| Issuance of Common stock upon exercise of options  | 13,334            | 133            | -                 | 3,867                | -                  | -                    | -                 | 4,060              |
| Net Loss   | -                 | -              | -                 | -                    | -                  | (11,245,361)         | -                 | (11,245,361)       |
| Other comprehensive loss   | -                 | -              | -                 | -                    | -                  | -                    | (4,026)           | (4,026)            |
| Balance, June 30, 2002   | <u>60,807,508</u> | <u>608,075</u> | <u>\$ (7,973)</u> | <u>\$100,751,284</u> | <u>\$ (23,923)</u> | <u>(101,366,286)</u> | <u>\$ (4,026)</u> | <u>\$ (42,489)</u> |
| Issuance of Common stock with warrants in private placement, net of Cash                             | 4,296,680         | 42,967         | -                 | 1,121,351            | -                  | -                    | -                 | 1,160,315          |

|   |                   |                |                   |                    |             |                       |              |                       |
|---|-------------------|----------------|-------------------|--------------------|-------------|-----------------------|--------------|-----------------------|
| offering costs<br>of<br>\$124,687   |                   |                |                   |                    |             |                       |              |                       |
| Issuance of<br>Common stock<br>for services   | 426,000           | 4,260          | -                 | 107,985            | -           | -                     | -            | 112,245               |
| Issuance of<br>options and<br>warrants for<br>services  | -                 | -              | -                 | 274,100            | -           | -                     | -            | 274,100               |
| Amortization<br>of deferred<br>employee stock<br>option<br>compensation   | -                 | -              | -                 | -                  | 23,923      | -                     | -            | 23,923                |
| Issuance of<br>common stock<br>and warrants in<br>settlement of<br>debt to related<br>parties and<br>strategic<br>vendors | 5,923,333         | 59,233         | -                 | 1,826,329          | -           | -                     | -            | 1,885,562             |
| Net Loss  | -                 | -              | -                 | -                  | -           | (6,550,211)           | -            | (6,650,211)           |
| Other<br>comprehensive<br>loss  | =                 | =              | =                 | =                  | =           | =                     | <u>4,026</u> | <u>4,026</u>          |
| Balance, June<br>30, 2003   | <u>71,453,521</u> | <u>714,535</u> | <u>\$ (7,973)</u> | <u>104,081,049</u> | <u>\$ 0</u> | <u>\$ 108,016,295</u> | <u>\$ -</u>  | <u>\$ (3,228,886)</u> |

F-9

|                        |            |             |               |             |      |
|------------------------|------------|-------------|---------------|-------------|------|
| Balance, June 30, 2003 | 71,453,521 | \$ (7,973)  | \$ -          | \$ -        | \$ - |
|                        | 714,535    | 104,081,049 | (108,016,497) | (3,228,886) |      |

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|  |                   |                   |                    |           |                      |                    |                    |                    |
|--|-------------------|-------------------|--------------------|-----------|----------------------|--------------------|--------------------|--------------------|
| Issuance of common stock with warrants in private placement, net of cash offering costs of \$313,200 | 15,177,973        | 151,779           | -                  | 4,322,934 | -                    | -                  | -                  | 4,474,713          |
| Issuance of common stock for services  | 924,667           | 9,247             | -                  | 238,153   | -                    | -                  | -                  | 247,400            |
| Issuance of options and warrants for services  |                   |                   |                    | 1,067,393 | -                    | -                  | -                  | 1,067,393          |
| Issuance of common stock pursuant to exercise of warrants  | 1,233,334         | 12,333            | -                  | 304,467   | -                    | -                  | -                  | 316,800            |
| Issuance of common stock and warrants in settlement of debt to related parties and strategic vendors | 110,467           | 1,105             | -                  | 1,962,099 | -                    | -                  | -                  | 1,963,204          |
| Net Loss   | =                 | =                 | =                  | =         | =                    | <u>(7,758,586)</u> | =                  | <u>(7,758,586)</u> |
| Balance, June 30, 2004   | <u>88,899,962</u> | <u>\$ (7,973)</u> |                    | <u>\$</u> | <u>\$-</u>           | <u>\$</u>          | <u>\$-</u>         | <u>\$</u>          |
|  | <u>888,899</u>    |                   | <u>111,976,095</u> |           | <u>(115,775,083)</u> |                    | <u>(2,917,962)</u> |                    |

F-10

**mPHASE TECHNOLOGIES, INC.**

**CONSOLIDATED STATEMENT OF CHANGES IN****SHAREHOLDERS' EQUITY (DEFICIT)****FOR THE PERIOD FROM INCEPTION (OCTOBER 2, 1996)****TO JUNE 30, 1997 AND FOR EACH OF THE EIGHT YEARS IN THE PERIOD ENDED JUNE 30, 2005**

|  | <b>Shares</b>      | <b>\$.01 stated<br/>Value</b> | <b>Treasury<br/>Stock</b> | <b>Additional<br/>Paid<br/>in Capital</b> | <b>Accumulated<br/>Deficit</b> | <b>Total<br/>Shareholders<br/>Equity</b> |
|--|--------------------|-------------------------------|---------------------------|---|--------------------------------|--|
| Balance, June 30,<br>2004  | <u>88,899,962</u>  | <u>\$ 888,999</u>             | <u>\$ (7,973)</u>         | <u>\$ 111,976,095</u>                     | <u>(115,775,083)</u>           | <u>2,917,962</u>                         |
| Issuance of Shares in<br>Private<br>Placement                        | 39,853,661         | 398,535                       | -                         | 6,888,553                                 | -                              | 7,287,088                                |
| Issuance of in<br>connection with<br>exercise of warrants            | 3,637,954          | 36,380                        | -                         | 644,229                                   |                                | 680,609                                  |
| Conversion of Debt<br>to Common<br>Stock and warrants                | 3,895,171          | 36,952                        | -                         | 1,174,134                                 |                                | 1,213,086                                |
| Options Awarded to<br>Consultants                                    | -                  | -                             | -                         | 2,191,043                                 |                                | 2,191,043                                |
| Options Awarded to<br>Officers                                       | -                  | -                             | -                         | 625,290                                   |                                | 625,290                                  |
| Issuance of shares to<br>Officers and<br>consultants for<br>services | 1,151,000          | 11,510                        |                           | 322,500                                   |                                | 334,010                                  |
| Exercise of cashless<br>warrants                                     | 4,949,684          | 49,499                        | -                         | (49,499)                                  |                                | -  |
| Exercise of warrants<br>by officers                                  | 1,770,400          | 17,704                        | -                         | -   |                                | 17,704                                   |
| Reparation of Private<br>Placement<br>Offering                       | 891,000            | 8,910                         | -                         | 176,811                                   |                                | 185,721                                  |
| Net Loss   | -                  | -                             | -                         |   | (11,234,324)                   | (11,234,324)                             |
| Balance June 30,<br>2005   | <u>145,048,832</u> | <u>\$1,450,489</u>            | <u>\$(7,973)</u>          | <u>\$123,949,156</u>                      | <u>\$(127,009,407)</u>         | <u>\$(1,617,735)</u>                     |

The accompanying notes are an integral part of these consolidated balance sheets.

F-11

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | <b>For the Years<br/>Ended<br/>June 30,</b> |               |                | <b>Inception<br/>(October 2,<br/>1996) to<br/>June 30,<br/>2005</b> |
|---|---|---------------|----------------|---|
|   | <b>2003</b>                                 | <b>2004</b>   | <b>2005</b>    |   |
| <b>CASH FLOWS FROM<br/>OPERATING<br/>ACTIVITIES:</b>                              |   |               |                |   |
| Net loss  | \$(6,650,211)                               | \$(7,758,586) | \$(11,234,324) | \$(127,009,407)   |
| Adjustments to reconcile net loss to<br>net<br>cash used in operating activities: |   |               |                |   |
| Depreciation and amortization   | 1,425,952                                   | 736,099       | 280,590        | 6,610,829   |
| Book value of fixed assets disposed   | -   | -             | -              | 74,272  |
| Loss on unconsolidated subsidiary   | -   | -             | -              | 1,466,467   |
| Provision for doubtful accounts   | -   | -             | -              | 32,124  |
| Impairment of note receivable   | -   | -             | -              | 232,750   |
| Loss on securities  | 11,258                                      | -             | 37,411         | 48,669  |
| Gain on Extinguishments   | (61,226)                                    | (150,058)     | (418,696)      | (772,216)   |
| Common stock and options and<br>warrants for                                      | 1,134,335                                   | 1,314,793     | 3,336,064      | 52,794,954  |



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purchase of common stock granted  
Changes in operating assets and liabilities:

|   |           |          |           |           |
|---|-----------|----------|-----------|-----------|
| Accounts receivable                       | (13,355)  | 223,035  | (469,741) | (565,965) |
| Inventory                                 | 1,449,628 | 865,355  | 533,030   | (494,703) |
| Prepaid expenses and other current assets | (29,652)  | 19,267   | 55,439    | 55,439    |
| Production advances-related parties       |           |          |           |           |
| Other assets                              | 3,580     | -        | (50,000)  | (627,182) |
| Receivables from subsidiary               | -         | -        | -         | (150,000) |
| Due from officer                          | -         | -        | -         | -         |
| Accounts payable                          | 174,939   | 171,712  | (85,579)  | 4,243,528 |
| Accrued expenses                          | 273,986   | (32,702) | (111,589) | 1,668,280 |
| Deferred revenue                          | -         | -        | (214,180) | -         |

Due to related parties:

|                                       |             |             |             |              |
|---------------------------------------|-------------|-------------|-------------|--------------|
| Microphase                            | 721,544     | 83,762      | 257,348     | 2,637,059    |
| Janifast                              | 99,841      | 422,905     | 254,063     | 2,956,968    |
| Officers                              | 246,835     | (90,583)    | 34,200      | 502,956      |
| Lintel                                | -           | -           | -           | 477,000      |
| Due to Others                         | -           | (32,500)    | -           | 179,472      |
| Net cash used in operating activities | (1,212,546) | (4,227,501) | (7,795,964) | (55,638,706) |

CASH FLOWS FROM INVESTING ACTIVITIES:

|  |          |           |           |             |
|--|----------|-----------|-----------|-------------|
| Investment in patents and licensing rights | -        | (40,893)  | (34,167)  | (450,780)   |
| Purchase of property and equipment         | (73,305) | (104,001) | (121,476) | (2,762,582) |
| Net cash used in investing activities      | (73,305) | (144,894) | (155,643) | (3,213,362) |

CASH FLOWS FROM FINANCING ACTIVITIES:

|  |           |           |           |            |
|--|-----------|-----------|-----------|------------|
| Net proceeds from private placement of common stock and exercise of options and warrants | 1,090,474 | 3,964,558 | 8,393,717 | 58,866,193 |
| Repurchase of treasury stock at cost   | -         | -         | -         | (7,973)    |
| Advances from/repayment to Microphase  | 527,840   | (180,000) | -         | 347,840    |
| Proceeds from notes payable officers   | 130,000   | 300,000   | 535,000   | 965,000    |
| Repayment of notes payable - officers  | (30,000)  | -         | (650,000) | (680,000)  |
| Repayment of notes payable   | (82,668)  | (18,978)  | (65,970)  | (287,807)  |
| Net cash (used in)/provided by financing activities                                      | 1,635,646 | 4,065,580 | 8,212,747 | 59,203,253 |

|  |            |           |            |            |
|--|------------|-----------|------------|------------|
| Net increase (decrease) in cash                      | 349,623    | (306,815) | 261,140    | 351,185    |
| CASH AND CASH<br>EQUIVALENTS,<br>beginning of period | 47,065     | 396,860   | 90,145     | -          |
| CASH AND CASH<br>EQUIVALENTS,<br>end of period       | \$ 396,860 | \$ 90,045 | \$ 351,185 | \$ 351,185 |

The accompanying notes are an integral part of these consolidated balance sheets.

F-12

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2005**

**1. ORGANIZATION AND NATURE OF BUSINESS**

mPhase Technologies, Inc. ("mPhase" or the "Company") was organized on October 2, 1996. The primary business of mPhase is to design, develop, manufacture and market high-bandwidth telecommunications products incorporating digital subscriber line ("DSL") technology. The present activities of the Company are focused on the deployment of its TV+ System, which delivers MPEG2 digital television, high-speed Internet and voice over copper wire. Additionally, the Company sells a line of DSL component products. In February of 2004, the Company entered the field of Nanotechnology focused upon the development of batteries and power cells with military applications as an additional

product line.

On February 17, 1997, mPhase acquired Tecma Laboratories, Inc., ("Tecma") in a transaction accounted for as a reverse merger.

On June 25, 1998, the Company acquired Microphase Telecommunications, Inc. ("MicroTel") a Delaware corporation, through the issuance of 2,500,000 shares of its common stock in exchange for all the issued and outstanding shares of MicroTel (Note 4). The assets acquired in this acquisition were patents and patent applications utilized in the Company's proprietary Traverser Digital Video and Data Deliver System ("Traverser").

On August 21, 1998, the Company incorporated a 100% wholly-owned subsidiary called mPhaseTV.net, Inc., a Delaware corporation, to market interactive television and e-commerce revenue opportunities. This subsidiary is dissolved.

On March 2, 2000 the Company acquired a 50% interest in mPhaseTelevision.Net, Inc., an incorporated joint venture with AlphaStar International, Inc. (Note 8) for \$20,000. The Company acquired an additional interest in the joint venture of 6.5% in April of 2000 for \$1.5 million. Based on its controlling interest in mPhaseTelevision.Net, the operating results of mPhaseTelevision.Net are included in the consolidated results of the Company since March 2, 2000.

The Company is in the development stage and its present activities are focused on the commercial deployment of its TV+ products for delivery of broadcast IPTV, Broadband Watch loop diagnostic system and dsl component products which include POTS splitters and a line of intelligent POTS splitter products and a new line of power cell batteries being developed through the use of Nanotechnology. Since mPhase is in the development stage, the accompanying consolidated financial statements should not be regarded as typical for normal operating periods.

## **2. LOSSES DURING THE DEVELOPMENT STAGE AND MANAGEMENT'S PLANS**

Through June 30, 2005, the Company had incurred development stage losses totaling \$127,009,407, and at June 30, 2005 had a stockholders' deficit of \$1,617,735. At June 30, 2005, the Company had \$351,185 of cash and cash equivalents and \$533,841 of trade receivables and \$460,000 of stock subscriptions collected in July 2005 to fund short-term working capital requirements.

The Company's ability to continue as a going concern and its future success is dependent upon its ability to raise capital in the near term to: (1) satisfy its current obligations, (2) continue its research and development efforts, and (3)

the successful wide scale development, deployment and marketing of its products.

The Company believes that it will be able to complete the necessary steps in order to meet its cash flow requirements throughout fiscal 2005 and continue its development and commercialization efforts. Management's plans in this regard include, but are not limited to, the following:

During the fiscal year ended June 30, 2005, the Company converted certain payables and accrued expenses with a strategic vendor aggregating approximately \$1,200,000 into 3,895,171 common stock plus warrants to purchase 4,616,571 shares of common stock at effective strike prices ranging from \$.25 to \$.35.

Management estimates that the Company will need additional minimum capital of \$5.0-\$10.0 million by June 30, 2006 to continue its operations either through revenues from sales, external independent or related party funding further expense reductions some combination thereof. The Company presently has ongoing discussions and negotiations with a number of additional financing alternatives, one or more of which it believes will be able to successfully close to provide necessary working capital, while maintaining sensitivity to shareholder dilution issues. However, the Company has no definitive agreements to provide funding at this time.

In addition to the above financing activities, the following business initiatives are also ongoing and are expected to provide additional working capital to the Company.

The Company received its first order in fiscal year 2005 for 1000 ports of its TV+ solution from a major telecommunications service provider in Russia. In addition the Company is currently negotiating with several organizations for the commencement of field trials that would lead to commercial sales of its broadcast television platform products. The Company has had a downturn in sales of its POTS splitter products for its fiscal year ended June 30, 2005 to \$1,711,084, which included sales to two customers of approximately \$1,095,000 during such period.

Management believes that actions presently being taken to complete the Company's development stage through the commercial roll-out of its broadcast television platforms will be successful. However, there can be no assurance that mPhase will generate sufficient revenues to provide positive cash flows from operations or that sufficient capital will be available, when required, to permit the Company to realize its plans. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2005**

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**PRINCIPLES OF CONSOLIDATION**

The consolidated financial statements include the accounts of mPhase, its wholly-owned and majority owned subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

**USE OF ESTIMATES**

The preparation of financial statements in conformity with generally accepted accounting principles 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. Actual results could differ from those estimates.

**RECLASSIFICATIONS**

Certain reclassifications have been made in the prior period consolidated financial statements to conform to the current period presentation.

## CASH AND CASH EQUIVALENTS

mPhase considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

## STOCK BASED COMPENSATION

Financial Accounting Statement No. 123, Accounting for Stock Based Compensation, encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. The Company has adopted the "disclosure only" alternative described in SFAS 123 and SFAS 148, which require pro forma disclosures of net income and earnings per share as if the fair value method of accounting had been applied.

## PROPERTY AND EQUIPMENT

Property and equipment is recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of three to five years.

## SHORT-TERM INVESTMENTS

Short-term investments principally consist of highly-liquid shares of corporate securities. The Company classifies all these short-term investments as available-for-sale securities. Unrealized gains and losses on these investments are recorded in accumulated other comprehensive income (loss) as a separate component of shareholders' equity. Any decline in market value judged to be other than temporary is recognized in determining net income. Realized gains and losses from the sale of these investments are included in determining net income (loss).

## REVENUE RECOGNITION

All revenue included in the accompanying consolidated statements of operations for all periods presented relates to sales of mPhase's POTS Splitter Shelves and DSL component products.

As required, mPhase has adopted the Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," which provides guidelines on applying generally accepted accounting principles to revenue recognition based on the interpretations and practices of the SEC. The Company recognizes revenue for its POTS Splitter Shelf and other DSL component products at the time of shipment, at which time, no other significant obligations of the Company exist, other than normal warranty support.

#### SHIPPING AND HANDLING CHARGES

The Company includes costs of shipping and handling billed to customers in revenue and the related expense of shipping and handling costs is included in cost of sales.

#### BUSINESS CONCENTRATIONS AND CREDIT RISK

To date the Company's products have been sold to a limited number of customers, primarily in the telecommunications industry.

The Company had revenue from two customers of 35.1% and 28.9% during the fiscal year ended June 30, 2005. The Company had revenue from two customers of 76% and during the fiscal year ended June 30, 2004.

F-15

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(A DEVELOPMENT STAGE COMPANY)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2005

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

ADVERTISING COSTS

Advertising costs are expensed as incurred.

COMPREHENSIVE INCOME (LOSS)

In addition to net loss, comprehensive income (loss) includes all changes in equity during a period, except those resulting from investments by and distributions to owners. Items of comprehensive income include foreign currency exchanges and unrealized gains and losses on investments classified as available for sale.

In 1998, the Company adopted SFAS No. 130, Reporting Comprehensive Income, which establishes rules for the Reporting of Comprehensive Income and its components. For the years ended June 30, 2005, June 30, 2004 and June 30, 2003, the items of comprehensive income include unrealized gains and losses on investments the Company had classified as available for sale.

PATENTS AND LICENSES

Patents and licenses are capitalized when mPhase determines there will be a future benefit derived from such assets, and are stated at cost. Amortization is computed using the straight-line method over the estimated useful life of the asset, generally five years.

Amortization expense was \$468,495, \$86,395 and \$54,321 for the years ended June 30, 2003, 2004, and 2005, respectively.



The impairment test for the Company's patents and license rights resulted in the Company concluding that no impairment in addition to amortization previously recorded was necessary during the year ended June 30, 2004.

## INVENTORIES

Inventory consists mainly of the Company's POTS Splitter Shelf and Filters. Inventory is comprised of the following:

|                                | <b>June 30</b>      |                   |
|--------------------------------|---------------------|-------------------|
|                                | <b>2004</b>         | <b>2005</b>       |
| Raw materials                  | \$ 75,834           | \$ 376,776        |
| Work in Progress               | 525,647             | 77,830            |
| Finished goods                 | <u>1,024,726</u>    | <u>241,178</u>    |
| Total                          | <u>1,626,207</u>    | <u>695,784</u>    |
| Less: Reserve for obsolescence | <u>(388,235)</u>    | <u>(205,642)</u>  |
|                                | \$ <u>1,237,972</u> | \$ <u>490,142</u> |

## LONG-LIVED ASSETS

In August 2001, the FASB issued Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," which became effective for the Company July 1, 2002 for the fiscal years ended June 30, 2003, June 30, 2004 and June 30, 2005. The Company assesses long-term assets for impairment under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Under SFAS No. 144, the Company reviews long-term assets for impairment whenever events or circumstances indicate that the carrying amount of those assets may not be recoverable. The Company also assesses these assets for impairment based on their estimated future cash flows.

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2005**

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

**FAIR VALUE OF FINANCIAL INSTRUMENTS**

The carrying amounts reported in the consolidated balance sheets for mPhase's cash, accounts receivable, accounts payable, and accrued expenses approximate their fair values due to the short maturities of these financial instruments.

The carrying amounts reported in the consolidated balance sheets for mPhase's notes payable, long-term debt, amounts due to related parties approximate their fair values and the amounts recorded as other liabilities and other liabilities - related parties approximate their fair values based on current rates at which the Company could borrow funds with similar maturities.

**LOSS PER COMMON SHARE, BASIC AND DILUTED**

mPhase accounts for net loss per common share in accordance with the provisions of SFAS No. 128, "Earnings per Share" ("EPS"). SFAS No. 128 requires the disclosure of the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Common equivalent shares have been excluded from the computation of diluted EPS since their effect is anti-dilutive.

**WARRANTY RESERVE**

The Company warrants that all equipment manufactured by it will be free from defects in material and workmanship under normal use for a period of one year from the date of shipment. Through June 30, 2005, substantially all sales by the Company have been from component telephone equipment parts, primarily the Company's POTS Splitter Shelves. The Company's actual experience for cost and expenses incurred in connection with such warranties have been insignificant. Warranty expense for the fiscal year ended June 30, 2005 was nominal. Reserve is considered efficient to provide for future warranty costs on fiscal 2005 sales. The company's aggregate accrued liability is \$28,000 at this time.

## RECENT ACCOUNTING PRONOUNCEMENTS

### FASB 150 - Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity

In May 2003, the FASB issues SFAS statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of nonpublic entities, if applicable. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. The adoption of this statement beginning with the quarter commencing August 1, 2003 did not have a significant impact of the Company's results of operations or financial position.

### FASB 151 - Inventory Costs

In November 2004, the FASB issued FASB Statement No. 151, which revised ARB No. 43, relating to inventory costs. This revision is to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). This Statement requires that these items be recognized as a current period charge regardless of whether they meet the criterion specified in ARB 43. In addition, this Statement requires the allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after the date of this Statement is issued. Management believes this Statement will have no impact on the financial statements of the Company once adopted.

### FASB 152 - Accounting for Real Estate Time-Sharing Transactions

In December 2004, the FASB issued FASB Statement No. 152, which amends FASB Statement No. 66, Accounting for Sales of Real Estate, to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position (SOP) 04-2, Accounting for Real Estate Time-Sharing Transactions. This Statement also amends FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, to state that the guidance for (a) incidental operations and (b) costs incurred to sell real estate projects does not apply to real-estate time sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Management believes this Statement will have no impact on the fiscal statements of the Company once adopted.

#### FASB 153 - Exchange of Nonmonetary Assets

In December 2004, the FASB issued FASB Statement No. 153. This Statement addresses the measurement of exchanges of nonmonetary assets. The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges incurred during fiscal years beginning after the date of this Statement is issued. Management believes this Statement will have no impact on the financial statements of the Company once adopted.

#### FASB 123 (revised 2004) - Share-Based Payments

In December, 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123(R), "Share-Based Payment". Among other things, SFAS No. 123 (R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statements based on their fair values. The Company is required to adopt the provisions of Statement No. 123(R) in its interim period beginning February 1, 2006. Adoption of Standard No. 123(R) is not expected to have a material impact on the Company's financial statements.

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2005**

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities"

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The adoption of FIN 46 did not have a significant impact on our consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of nonpublic entities, if applicable. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. The adoption of this statement is not expected to have a significant impact on the Company's results of operations or financial position.

**STATEMENT OF CASH FLOW SUPPLEMENTAL INFORMATION**

|  | <b>JUNE 30<br/>2004</b> | <b>JUNE 30<br/>2005</b> |
|--|-------------------------|-------------------------|
| Interest paid  | \$ 11,175               | \$ 48,090               |
| Taxes paid   | \$ 550                  | \$ 550                  |
| Schedule of Non-Cash<br>Investing and Financing Activities:                          |                         |                         |
| Conversion of accounts payable and accrued expenses<br>to equity                     | \$ 1,963,202            | \$ 1,078,869            |
| Conversion of accounts payable and accrued expenses<br>to notes payable              | \$ -                    | \$ 79,680               |
| Work in process inventory transferred to Research and<br>development fixed<br>assets | \$ -                    | \$ 214,800              |
| Investments in Patents and Licenses paid with equity                                 | \$ 38,750               | \$ -0-                  |

**4. ACQUISITION OF MICROTEL**

In June 1998, mPhase issued 2,500,000 shares of common stock in exchange for all of the issued and outstanding shares of MicroTel, a wholly-owned subsidiary of Microphase, Inc. ("Microphase"). The transaction was accounted for as a purchase pursuant to APB Opinion No. 16 "Accounting for Business Combinations". The total purchase price of approximately \$1,870,000, which was based on the fair market value of the shares issued, was allocated to the patents acquired and is being amortized over an estimated useful life of five years. Pursuant to the agreement of merger, MicroTel has become a wholly-owned subsidiary of mPhase.

**5. NOTE RECEIVABLE**

As consideration for a letter of settlement with a former consultant of mPhase, the Company had loaned the former consultant \$250,000 in the form of a Note (the "Note") secured by 75,000 shares of the former consultants common stock of mPhase. The Note was due April 7, 2001. The Company decreased the Note to \$37,500, representing the estimated value of the underlying stock at June 30, 2001. The Company charged \$212,500 to administrative expense as a result of this impairment. The Company has included the \$37,500, in long-term assets in the accompanying consolidated balance sheet for the year ended June 30, 2001. The Company decreased the Note to \$17,250, representing the estimated value of the underlying stock at June 30, 2002. The Company charged \$20,250 to administrative expenses as a result of the further impairment of the underlying stock value at June 30, 2002 and has maintained the same balance for the Note throughout the fiscal years ended June 30, 2003, June 30, 2004 and June 30, 2005. The Company has included the \$17,250 in long-term assets in the accompanying consolidated balance sheet for the years ended June 30, 2004 and June 30, 2005.

F-18

**mPHASE TECHNOLOGIES, INC.****(A DEVELOPMENT STAGE COMPANY)****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2005****6. PROPERTY AND EQUIPMENT**

Property and equipment, at cost, consist of the following:

|                                |    | <b>2004</b>        | <b>June 30</b> |  | <b>2005</b>        |
|--------------------------------|----|--------------------|----------------|--|--------------------|
| Equipment                      | \$ | 2,676,030          | \$             |  | 2,426,605          |
| Office and marketing equipment |    | <u>482,464</u>     |                |  | <u>514,895</u>     |
|                                |    | <u>3,158,494</u>   |                |  | <u>2,941,500</u>   |
| Less-Accumulated depreciation  |    | <u>(3,105,809)</u> |                |  | <u>(2,778,808)</u> |
|                                | \$ | 52,685             | \$             |  | 162,692            |

Depreciation expense for the years ended June 30, 2003, 2004, and 2005, was \$957,457, \$649,704 and 227,269 respectively, of which \$442,040, \$613,221, and \$218,911 respectively, relates to research laboratory and testing

equipment included in research and development expense.

## 7. ACCRUED EXPENSES

Accrued expenses consist of the following:

|                           |    | <b>2004</b>    | <b>June 30</b> | <b>2005</b>    |
|---------------------------|----|----------------|----------------|----------------|
| Lucent Projects (Note 13) | \$ | 257,800        | \$             | -              |
| Other General Expenses    |    | <u>378,233</u> |                | <u>431,765</u> |
|                           | \$ | 636,033        | \$             | 431,765        |

At June 30, 2005 \$379,428 Payable to Lucent Technologies Inc. was included in Accounts Payable.

## 8. JOINT VENTURE

In March 2000, mPhase acquired a 50% interest in mPhaseTelevision.Net (formerly Telco Television Network, Inc.), an incorporated joint venture, for \$20,000. The agreement provided for the grant of warrants to the joint venture partner in consideration of the execution of the Joint Venture Agreement, to purchase 200,000 shares of the Company's common stock for \$4.00 per share (valued at \$2,633,400). This non-cash charge is included in general and administrative expenses in the accompanying statement of operations for the year ended June 30, 2000. The fair value of the warrants granted to the joint venture partner as of the date of grant was based on the Black-Scholes stock option pricing model, using the following weighted average assumptions: annual expected rate of return of 0%, annual volatility of 115%, risk free interest rate of 5.85% and an expected option life of 3 years.

The agreement stipulates for mPhase's joint venture partner, AlphaStar International, Inc., ("Alphastar"), to provide mPhaseTelevision.Net right of first transmission for its transmissions of MPEG-2 digital satellite television. In addition, in March 2000, mPhase loaned the joint venture \$1,000,000 at 8% interest per annum. The loan is repayable to the Company from equity infusions

to the subsidiary, no later than such time that mPhaseTelevision.Net qualifies for a NASDAQ Small Cap Market Listing. During April 2000, the Company acquired an additional 6.5% interest in mPhaseTelevision.Net for \$1,500,000.



As of June 30, 2005 mPhase owns a 56.5% interest in mPhaseTelevision.net. The Company terminated the lease of the earth station for business reasons, and there was no material impact on mPhaseTelevision.net's operating activities.

Pursuant to an agreement dated as of June 18, 2002, mPhaseTelevision.Net has terminated its lease of the earth station and Alphastar and its affiliated entity have converted certain accounts payable into shares of the Company's common stock. Additionally, under this Agreement, mPhase is obligated to pay Alphastar and its affiliates \$35,000, which is included in amounts due to related parties in the accompanying consolidated balance sheet.

During the fiscal years ended June 30, 2003, June 30, 2004 and ended June 30, 2005, the joint venture was charged \$0, \$0 and \$0, respectively for fees and costs by its joint venture partner and its affiliates.

F-19

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2005**

**9. LONG TERM DEBT**

Long-term debt is comprised of the following:

|   | June 30, |          |
|---|----------|----------|
|   | 2004     | 2005     |
| Settlement Agreements   |          |          |
| Accounts payable originally expected to be converted to a \$150,000 Note payable to GTRC bearing 7% interest, amended in March 2004, and reduced to \$100,000, to be amortized in equal quarterly installments \$16,667 plus interest at 7% through March 2005 (see also-Note 13-Commitments and Contingencies) | \$83,333 | \$50,000 |
| Note payable to law firm bearing 8% interest, originally monthly installments of \$5,000 per month commencing in June 2002 and continuing through December 1, 2003 with a final payment of principal plus accrued interest originally due at maturity on December 31, 2003, this note was                       |          |          |

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in arrears as of June 30, 2004 and the company negotiated a new settlement arrangement as of August 31, 2004. Under such settlement agreement, which the Company made a \$100,000 cash payment and gave a cashless warrant to purchase \$150,000 worth of common stock valued at \$.25 per share. In addition the Company agreed to pay \$25,000 on each of December 1, 2004, March 1, 2005, June 1, 2005, September 1, 2005 and \$50,000 shall be payable on December 1, 2005. Thereafter the Company is obligated to pay \$25,000 on each of March 1, 2006, June 1, 2006, September 1, 2006 with a final payment of \$75,000 on December 1, 2006.

(See also Note 10, Stockholders Equity and Note 11, Related Party Transactions) 289,500 225,000

Note payable to vendor bearing 8% interest due in weekly payments of \$5,000 including accrued interest. These payments commenced in January 2002 and originally were scheduled to continue until June 2004. This note is presently in arrears and is included in current portion of long term debt.

210,558 198,057

Note payable to vendor non interest bearing average monthly payments of \$4,167 in 2003 and \$3,660 in 2004. These payments commenced in April 2002 and originally were scheduled to continue until May 2004. This note and accrued interest there on was settled during the fiscal year ending June 30, 2005 in

79,765

consideration of the issuance of \$212,669 shares of the company's common stock.

Note payable, vendor, interest at 8%, with average monthly payments of \$2,000 originally scheduled to through March, 2004. This note and accrued interest there on was settled during the fiscal year ending June 30, 2005 with a cash

27,147

payment of \$6,000 and are the issuance of 80,000 shares of the company's common stock.

Settlement payable, effective interest rate at 5% with vendor for 12 payments of \$6,640 through December 31, 2005

- 40,480

Total \$690,303 \$513,537

Less: Current portion 550,803 413,537

Long-term Debt, non-current portion \$139,500 100,000

At June 30, 2005 total maturities of long-term debt are as follows:

2006 413,537

2007 100,000

TOTAL \$ 513,537

**mPHASE TECHNOLOGIES, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2005**

**10. STOCKHOLDERS' EQUITY**

mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

1

**10. STOCKHOLDERS' EQUITY**

mPhase initially authorized capital of 50,000,000 shares of common stock with no par value. On February 23, 2000, the Board of Directors proposed and on May 22, 2000 the shareholders approved an increase in the authorized capital to 150,000,000 shares of common stock. On June 15, 2004, a Special Meeting of Shareholders of the Company approved a proposal by the Company to amend the Company's Certificate of Incorporation under New Jersey law to increase the authorized shares of common stock from 150 million to 250 million shares and change the par value of all shares of common stock from no par to \$0.01 par stock.

On January 26, 2000 the Board of Directors of mPhase resolved that the stated value of the common stock was \$.01 for accounting purposes and, as such, the financial statements have been retroactively restated to reflect this change.

Tecma issued 6,600,000 shares of common stock for all of the issued and outstanding shares of the Company in the reverse acquisition (Note 1).

In October 1997, mPhase issued 250,000 shares of its common stock in connection with its investment in Complete Telecommunications Inc.

During the year ended June 30, 1998, mPhase sold, pursuant to private placements, 2,095,014 shares of its common stock together with 1,745,179 warrants for proceeds to the Company of \$1,472,015, net of offering costs of \$205,203. The warrants were issued to purchase one share each of common stock at an exercise price of \$0.75, and exercised during the year ended June 30, 2000 generating proceeds to the Company of \$1,308,884. Included in offering costs are 100,000 shares of common stock issued for services provided by a third party valued at \$0.50 per share, the fair market value on the date of grant.

During the year ended June 30, 1998, mPhase issued 300,000 shares of common stock to consultants for services at \$0.50 per share, its fair market value. The Company recorded a charge to operations of \$150,000 included in cumulative from inception in the accompanying consolidated statement of operations.

On June 25, 1998, mPhase issued 2,500,000 shares of its common stock for all of the outstanding stock of MicroTel (Note 4) for approximately \$1,870,000, the fair market value.

In November 1998, mPhase sold, 3,120,000 shares of its common stock at \$1.00 per share, together with 1,000,000 warrants, with an exercise price of \$1.00 per share, for \$3,013,000 net of offering costs of approximately \$107,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. On June 2, 2000 these warrants were exercised, generating proceeds to the Company of \$1,000,000.

During the year ended June 30, 1999, mPhase issued 1,599,332 shares of common stock to employees and consultants for services performed. The Company recognized a charge to operations of \$8,760,866, based upon the fair market value of the shares.

In April, May and June of 1999, mPhase sold a total of 642,000 shares of common stock at \$2.50 per share, together with 642,000 warrants for \$1,559,647, net of offering costs of \$45,353 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors.

The warrants expire in June 2004. By June 30, 2000, 148,000 of these warrants were exercised, generating proceeds to the Company of \$370,000.

In June 1999, mPhase sold 4,426,698 shares of its common stock at a price of \$2.50 per share for \$10,387,434, net of offering costs of \$679,311, in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors.

In December 1999 and January 2000, mPhase sold, pursuant to private placements, 1,000,000 shares of common stock at a price of \$4.00 per share, net of cash offering costs of \$200,000, generating net proceeds to the Company of \$3,800,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. In connection with the private placements, the Company issued 200,000 and 50,000 warrants to purchase common stock to the respective investors. The warrants had an exercise price of \$4.00 and \$5.00, respectively. During February 2000, these warrants were exercised, generating \$1,050,000 of proceeds to the Company.

In March 2000, mPhase sold 832,500 shares of common stock at a price of \$10.00 per share, net of cash offering costs of \$466,480, and issued 124,875 shares to a transaction advisor for services, generating net proceeds to the Company of \$7,858,520 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. On May 5, 2000 the Company issued an additional 208,125 shares to these investors due to a market value adjustment. These shares were valued at \$1,808,086, which is included in general and administrative expenses in the accompanying statement of operations for the year ended June 30, 2000.

F-25

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

10. STOCKHOLDERS' EQUITY - (Continued)

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During the year ended June 30, 2000, mPhase issued 1,164,215 shares of common stock to employees and consultants for services performed. The Company recognized a charge to operations of \$8,623,907, based upon the fair market value of the common stock on the dates of grant.

In September 2000, mPhase issued 510,000 shares of its common stock, generating net proceeds of \$2,532,120, net of cash offering costs of \$17,880 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors. In connection with the private placement, the Company issued 105,750 shares of its common stock to transaction advisors.

In February 2001, mPhase issued 2,342,500 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock generating gross proceeds of \$4,685,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended with accredited investors. The attached warrants permit the investor to purchase one share each of common stock at an exercise price of \$3.00 per share. The Company incurred cash offering costs of \$425,315 and also issued 284,600 shares of its common stock and 162,600 warrants to purchase one share each at an exercise price of \$3.00 to transaction advisors.

In May and June 2001, mPhase issued 1,087,000 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock generating gross proceeds of \$1,087,000 in private transactions pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended with accredited investors. The attached warrants permit the investor to purchase one share each of common stock at an exercise price of \$3.00. The Company incurred offering costs of \$69,000.

During the year ended June 30, 2001, the Company issued 450,000 shares of common stock to consultants for services performed and to be performed. The Company recognized a charge to operations of \$886,534 and deferred \$121,091 for services to be performed in the fiscal year ending June 30, 2002. Total expense of \$1,007,625, based upon the fair market value of the common stock on the date of the grant and the balance of \$121,091 was charged to operations for the year ended June 30, 2002.

Effective June 30, 2001 the Company issued 4,840,077 shares of the Company's common stock in settlement of debt totaling \$2,420,039 to directors and related parties, based upon the fair market value of the common stock issued which approximated the debt settled on the measurement date on September 6, 2001, such date was determined pursuant to EITF00-19 as to when all contingent terms of the conversion agreement were set. The shares are reflected as outstanding as of June 30, 2001, pursuant to A9566 and SFAS 128.

In July 2001, the Company issued 75,000 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock at an exercise price of \$3.00 generating proceeds of \$75,000 in a private transaction with accredited investors.

In December 2001, the Company issued 3,474,671 shares of its common stock and a like amount of warrants to purchase one share each of the Company's common stock at an exercise price of \$.30 generating gross proceeds of \$1,042,000 in a private transaction pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended with accredited investors, which included a subscription receivable of \$440,200, which was collected in January 2002.

In January 2002, the Company issued 2,754,503 shares of its common stock and a like amount of warrants to purchase one share each at an exercise price of \$.30 generating gross proceeds of \$826,351 and June 2002, the Company issued 100,000 shares of its common stock and a like amount of warrants to purchase one share each at an exercise price of \$.30, generating gross proceeds of \$30,000 in a private placements pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended, with accredited investors.

In connection with the December 2001, January 2002, and June 2002, private placements, the Company issued 576,469 shares of its common stock and a like amount of warrants to purchase one share each at an exercise price of

\$.30 to finders and consultants whom assisted in the transaction.

F-26

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

10. STOCKHOLDERS' EQUITY - (Continued)

During the year ended June 30, 2002 the Company issued 7,492,996 shares of its common stock, and 5,953,490 warrants to related parties and strategic vendors, in connection with the conversion of \$2,738,658 of accounts payable and accrued expenses, of which 6,150,000 shares of common stock and 3,400,000 warrants were issued in settlement of \$1,460,000 of accounts payable to related parties as follows:

Conversions Concurrent with Private Placements

Included in the total for the year ended June 30, 2002, related parties and strategic vendors converted debt aggregating approximately \$1,020,000 and \$96,000 respectively into:

(a) 3,400,000 shares of common stock plus warrants to purchase another 3,400,000 shares of common stock at \$.30 for a term of 5 years (2,200,000 units with Microphase for \$660,000 and 1,200,000 units with Janifast for \$360,000) and;

(b) 320,000 shares of common stock plus warrants to purchase another 320,000 shares of common stock at \$.30 for a term of 5 years, respectively, were issued to strategic vendors.

Such conversions were upon the same terms of a concurrent private placement of common stock by the Company of approximately \$1.8 million in cash received for 6 million shares of common stock plus warrants to purchase another 6 million shares of Company's common stock for 5 years at \$.30 per share. No gain or loss was recognized in connection with conversions by related parties and strategic vendors of the above total of \$1,116,000 of debt.

Conversions, Settlements and Gain on Extinguishments

In addition this total for the year ended June 30, 2002 includes 4,873,333 shares of common stock and warrants to purchase 2,656,800 shares of the Company's common stock which were issued as follows:

(a) 2,750,000 shares of common stock were issued to related parties, the value of which was based upon the price of the Company's common stock on the measurement date, such date was determined pursuant to EITF00-1 as to when all contingent terms of conversion agreements were met, in which no gain or loss was recognized on the conversion of \$440,000 of debt; and

(b) 1,022,996 shares of common stock were issued to strategic vendors, the value of which was based upon the price of the Company's common stock on the effective date of settlement with each party, and, two warrants to purchase 2,233,490 shares of the Company's common stock were issued the Company's outside counsel to settle outstanding indebtedness of approximately \$450,000 as of March 15, 2002. The aggregate value of such warrants was estimated using the Black Scholes options pricing model, assuming an annual expected return of 0%, annual Beta volatility of 125.4 and a risk free interest rate of 5.9% pursuant to EITF 96-18, for the conversion of \$1,182,658 of such liabilities which, together with gains from cash settlements of \$27,860 resulted in an aggregate gain on extinguishments of \$142,236.

During the year ended June 30, 2002, certain officers, directors and related parties were issued 2,000,000 and 6,150,000 shares of mPhase common stock and 3,400,000 warrants in consideration of the investment of \$1,000,000 cash and the conversion of \$1,460,000 accounts payable. (see Note 11).

Also, during the fiscal year ended June 30, 2002, the Company granted 2,923,000 shares of its common stock and 1,675,000 warrants to consultants for services performed valued at \$1,199,001 for common stock and \$504,657 for warrants based upon the fair market value of the Company's common stock on the date of the grant using the Black-Scholes option premium model. These totaled \$1,703,658 and the Company recorded a charge to operations of \$955,668 for the year ended June 30, 2002 and the balance of \$747,990 was charged to operations for the year ended June 30, 2003.

During the year ended June 30, 2003, the Company issued 426,000 shares of its common stock valued at \$112,245 and 1,690,000 warrants, valued at \$203,150 based upon the fair market value of the Company's common stock on the date of the grant using the Black-Scholes option pricing model. The Company recorded these changes, totaling \$318,395 to operations for the year ended June 30, 2003.

F-27

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

During the fiscal year ended June 30, 2003, the Company converted certain payables and accrued expenses with officers, related parties and strategic vendors aggregating approximately \$1.9 million into 5,923,333 restricted shares of the Company's common stock and 5 year warrants to purchase an additional 3,706,800 restricted shares of the Company's common stock, of which 5,533,333 shares of common stock and 3,491,800 warrants were issued in settlement of \$1,748,756 of debt to related parties as follows:

Conversions Concurrent with Private Placements

Included in the total for the year ended June 30, 2003, related parties and strategic vendors converted debt aggregating approximately \$300,000 and \$15,000 respectively into:

- (a) 1,000,000 shares and 5 year warrants to purchase at \$.30 a share 1,000,000 shares of mPhase common stock by Microphase, a related party, which converted \$300,000 of liabilities;
- (b) 50,000 shares and 5 year warrants to purchase at \$.30 a share 50,000 shares of mPhase common stock by a strategic vendor which converted \$15,000 of liabilities.

Such conversions were upon the same terms of a concurrent private placement of common stock by the Company and no gain or loss was recognized in connection with these conversions.

Conversions, Settlements and Gain on Extinguishments

In addition this total for the year ended June 30, 2003 includes 3,772,996 shares of common stock and warrants to purchase 2,233,490 shares of the Company's common stock which were issued as follows:

- (a) During the year ended June 30, 2003, these included transactions with related parties whereby the Company and the counter parties respective board of director's approved, entering into an agreement in principle with the Company's officers and affiliates, including Janifast Ltd. and Microphase Corporation, to convert up to an amount equal to accounts payable through September 30, 2002. Such approval was received by the respective boards of directors authorizing conversions of such payables effective September 30, 2002 resulting in the conversion of \$620,000 on and \$360,000 on of liabilities due to Microphase Corporation, and Janifast Ltd. into 3,033,000 shares and 1,500,000 shares of stock, respectively. The value attributable to the shares was based upon the market price of the Company's common stock on the measurement date, such date was determined pursuant to EITF00-1, as to when all the contingent terms of the conversion agreement were met, in which no gain or loss was recognized on the conversion of \$980,000 of debt and,
- (b) Also included in such conversions during the year ended June 30, 2003, were transactions whereby the Company converted \$525,967 of liabilities due to the Company's president, vice president and a sales manager who is also concurrently employed by Microphase, for unpaid management compensation and sales commissions due from mPhase into warrants to purchase up to a total of 2,656,800 shares of the Company's common stock. The aggregate

value of such warrants was estimated using the Black-Scholes options pricing model, pursuant to EITF 96-18, having an approximate value of \$.21 per share, or \$538,173. The Company recorded a settlement expense of approximately \$12,206 with respect to these three individuals.

(c) Strategic vendors converted \$117,486 of payables into 340,000 shares of the Company's common stock on the measurement date the value of which was based upon the price of the Company's common stock on the effective date of settlement with each party. This resulted in a gain of \$37,383, which, when combined with all the conversions and gains from cash settlements of \$36,049 for the fiscal year 2003, resulted in a net gain on extinguishments in the statements of operations of \$61,226 for the year ended June 30, 2003.

#### Conversions Concurrent with Private Placements

Included in this total for the year ended June 30, 2003, related parties and strategic vendors converted debt aggregating approximately \$300,000 and \$15,000 respectively into:

(a) 1,000,000 shares and 5 year warrants to purchase at \$.30 a share 1,000,000 shares of mPhase common stock by Microphase, a related party, which converted \$300,000 of liabilities;

(b) 50,000 shares and 5 year warrants to purchase at \$.30 a share 50,000 shares of mPhase common stock by a strategic vendor which converted \$15,000 of liabilities.

Such conversions were upon the same terms of a concurrent private placement of common stock by the Company and no gain or loss was recognized in connection with these conversions.

F-28

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

#### 10. STOCKHOLDERS' EQUITY - (Continued)

In August of 2003, the Company issued 333,334 shares of its common stock together with 5 year warrants convertible into a like amount of shares of common stock at \$.30 per share generating net proceeds of \$100,000 in a Private Placement pursuant to Section 506 of Regulation D of the Securities Act of 1933 to 1 Accredited Investors. The proceeds of such placement were used for working capital purposes.

In December of 2003, the Company issued 1,550,000 shares of its common stock together with 5 year warrants convertible into a like amount of shares at \$.35 per share generating net proceeds of \$542,500 in a Private Placement pursuant to Section 506 of Regulation D of the Securities Act of 1933 to 1 Accredited Investor. The proceeds of such placement were used for working capital purposes and to defray a portion of the costs of Research and Development expenses with Lucent Technologies, Inc.

From January through March of 2004, the Company issued 8,509,543 shares of common stock together with 5 year warrants convertible into a like amount of common stock at \$.35 per share generating net proceeds of \$2,729,213 in a Private Placement pursuant to Section 506 of Regulation D of the Securities Act of 1933 to 25 Accredited Investors. The proceeds of such placement were used for working capital purposes and to defray a portion of the costs of Research and Development expenses with Lucent Technologies, Inc.

In March of 2004, the Company issued 691,429 shares of common stock together with 5 year warrants convertible into a like amount of common stock at \$.35 per share generating net proceeds of \$242,000 in a Private Placement pursuant to Section 506 of Regulation D of the Securities Act of 1933 to 2 Accredited Investors. The proceeds of such private placement were used for working capital purposes.

In June of 2004, the Company issued 3,844,000 shares plus 5 year callable warrants to purchase a like amount of shares at \$.35 plus 5 year callable warrants to purchase shares at \$.50 generating net proceeds of \$961,000 in a Private Placement pursuant to Section 506 of Regulation D of the Securities Act of 1933 to 5 Accredited Investors. The proceeds of such private placement were used to pay Research and Development Expenses with Lucent Technologies, Inc and for general corporate working capital. In July of 2004 such placement was completed with the



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issuance by the Company of 620,000 shares of common stock plus a like amount of 5 year callable warrants at \$.35 and \$.50 to 5 Accredited Investors generating net proceeds of \$155,000.

During the fiscal year ended June 30, 2004, the Company converted certain payables and accrued expenses with GTRC aggregating approximately \$1.9 million into a cashless 5 year warrant to purchase 5,069,200, restricted shares of the Company's common stock plus a \$100,000 term promissory note. In addition, the Company converted a total of \$36,890 in payables to other vendors in exchange for 10,467 shares of common stock.

In July of 2004, the Company issued 622,000 shares of its common stock together with a like amount of callable warrants at \$.35 and \$.50 respectively in a private placement. In August and September of 2004, the Company issued 1,050,000 shares of its common stock together with a like amount of callable warrants at \$.25 and \$.50 per share in private placements, which after cash outlays of approximately \$15,900, generated net proceeds of \$247,500. The aggregate net proceeds of such private placements of \$402,100 were collected during the three month period ended September 30, 2004. On December 7, 2004, the Company issued an additional 891,000 shares to the investors in the foregoing private placements due to a market value adjustment. These shares were valued at \$185,721 which is included in general and administrative expenses in the accompanying statement of operations for the period ended December 31, 2004.

During the three months ending December 31, 2004, the Company granted 134,500 shares of its common stock to consultants for services performed valued at \$26,900.

Additionally, the Company issued 2,817,914 shares of its common stock pursuant to the exercise of previously outstanding warrants, generating net proceeds intended to be used for general corporate purpose of \$563,590.

During the quarter ended December 31 of 2004, the Company issued equity units consisting of 10,717,700 shares of its common stock together with a like amount of warrants, with an exercise price of \$.25, in a private placement generating net proceeds intended to be used for working capital and general corporate purposes, of \$2,116,600 of which \$2,066,600 was collected through December 31, 2004 and \$50,000 was collected in January of 2005. A consultant who assisted the Company with this transaction also received 100,000 shares of the Company's common stock.

Additionally, a separate December 2004 private placement was closed out in January of 2005 with the placement of 3,600,000 equity units at \$.20 per unit consisting of one share of common stock plus 5 year warrants for a like amount of shares with a strike price of \$.25 per share generating net proceeds of \$720,000 to the Company. The December 31, 2004 and outstanding subscriptions receivable balance of \$ 50,000 was fully collected in January of 2005.

During January 2005, Private Placement realized net proceeds of \$357,250 upon issuance of 1,793,750 shares of Common Stock at \$.20 per share plus 5 year warrants to purchase 1,793,750 shares of Common Stock at \$.25 per share. A later Private Placement realized net proceeds of \$1,351,000 upon issuance of 4,920,000 shares of Common Stock plus 5 year warrants to purchase 4,920,000 shares of Common Stock at \$.25 per share. A March Private Placement resulted in the realization of net proceeds of \$1,217,000 upon issuance of 4,396,667 shares of Common Stock at \$.30 per share plus 5 year warrants to purchase 4,396,667 shares of Common Stock at \$.30 per share.

F-29

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

### 10. STOCKHOLDERS' EQUITY - (Continued)

In January of 2005 there were stock option awards issued to two consultants for services performed. The company granted 250,000 options to a consultant for professional services, these options provide for the right of stock purchase at an exercise price of \$.25, these options have a five year life and expire in January of 2010. A second award issued a like number of options to another service provider under similar terms, except that the options associated with this second award offer a call feature, available to the company, for redemption of such options at a call price of \$.45 at any time during their five year life. In aggregate, 400,000 options were issued in connection with these awards and will result in a charge to General and Administrative non-cash expense in the amount of \$ 133,990 in the third quarter

of fiscal 2005. The valuation of this charge was made on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option premium model.

In February of 2005, GTARC tendered 5,069,242 of cashless warrants which they held in connection with a previous debt settlement in exchange for 4,949,684 of the company's shares of common stock, the balance of the 119,558 warrants were effectively cancelled as a result of certain warrant exercise exchange provisions adjusting the exchange rate based on specified stock pricing experience as per the original debt settlement agreement.

On February 17 of 2005, the Company granted 2,600,000 warrants and 400,000 options to consultants for services performed valued at \$ 1,328,600 and \$ 204,400, respectively. The warrants and options provide the right to purchase a share of mPhase common stock at an exercise price \$.45 and \$.30 per share, respectively, over their 5 year life expiring in February of 2010. These warrant and option awards were valued on the basis of the fair market value of the Company's common stock on the date of grant using the Black-Scholes option premium model and the value of the award will be expensed to General and Administrative non-cash expenses in the third quarter of fiscal 2005.

On January 15, 2005, the company converted a \$100,000 convertible note payable to Martin Smiley in exchange for 400,000 shares and a like number of warrants that were priced at \$.25 per unit or \$100,000 in aggregate.

Also in January of 2005, Martin Smiley was awarded additional compensation of 425,000 shares of common stock. This award will result in a charge to General and Administrative non-cash expense in the amount of \$ 131,750 in the third quarter of fiscal 2005, representing an expense recognition consistent with the market price of that stock of \$.35 on the date of that award.

In late February and early March of 2005, the Company converted approximately \$173,898 in accounts payable due various vendors into 535,296 shares of common stock aggregating \$183,310 in full settlement of those obligations.

During the nine months ending March 31, 2005, accounts payable in the amount of \$250,000 owed by mPhase to Microphase Corporation was cancelled in exchange for the 1,250,000 shares of common stock and a 5 year warrant to purchase a like amount of shares at \$.25. In addition for such period, Janifast Ltd. cancelled \$200,000 of accounts payable owed by mPhase in exchange for 1,000,000 shares of common stock and a 5 year warrant to purchase a like amount of shares at \$.25 per share.

In late February and early March of 2005, the various vendors converted approximately \$173,898 in accounts payable due from the Company into 535,296 shares of Common stock aggregating \$183,310 in full settlement of those obligations.

Mr. Ronald A. Durando converted \$13,000 of accrued and unpaid interest on various demand notes issued by the Company for loans by Mr. Durando during the nine month period ended March 31, 2005 into 65,000 shares of common stock plus a 5 year warrant to purchase a like amount of shares at \$.25 per share. In addition Mr. Durando converted \$13,954 of principal of a \$75,000 promissory note into the exercise, in full, of a warrant to purchase 1,395,400 shares of common stock at \$.01 previously granted to Mr. Durando in exchange for cancellation of unpaid compensation.

Mr. Gustavo Dotoli, Chief Operating Officer of the Company converted \$ 3,750 of accrued and unpaid interest on a \$75,000 promissory note into 375,000 shares of common stock at \$.01 pursuant to a portion of a warrant previously granted to Mr. Dotoli for unpaid compensation. A consultant of the Company converted \$20,000 of accounts payable owed by the Company to 100,000 shares of common stock plus a 5 year warrant to purchase 100,000 shares of common stock at \$.25 per share.

mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

## 10. STOCKHOLDERS' EQUITY - (Continued)

In addition a demand note payable to Martin Smiley, CFO and General Counsel of mPhase, in the amount of \$75,000 was converted into 375,000 shares of common stock plus a 5 year warrant to purchase a like amount of shares at \$.25 per share and Mr. Smiley extended from July 25, 2004 to July 25, 2005 a \$100,000 promissory note carrying 12% interest. In addition Mr. Smiley converted accrued and unpaid interest on his various promissory notes of \$ 9,975 into 49,875 shares of common stock plus a 5 year warrant to purchase a like amount of common stock at \$.25 per share. Mr. Smiley's remaining \$100,000 note is convertible into Common Stock of mPhase at the rate of \$.25 cents per share through July 25, 2009. Upon conversion, the note holder will be granted warrants to purchase an equivalent amount of mPhase Common Stock at \$.25 cents per share for a period of five years from the date of conversion plus a 5 year warrant for a like amount of shares at \$.25 per share

In July of 2005 a private placement of 622,000 shares, each with two separate 5 year warrants were sold for \$ 155,000, each warrant specifying the right to purchase one additional share at \$.25 and \$.50, respectively. A September private placement of 1,050,000 shares, each with two separate 5 year warrants were sold for \$247,400, each warrant specifying the right to purchase one additional share at \$.25 and \$.35, respectively. A total of 3,344,000 shares have been reserved to provide for conversion in connection with these warrants.

## Conversions, Settlements and Gain on Extinguishments

As a result of the preceding, during the three years ended June 30, 2005, extinguishments, cancellations and conversions of debt for issuance of the Company's common stock to related parties is summarized in Note 11 and amounts relating to strategic investors is summarized as follows:

## Conversions, Settlements and Gain on Extinguishments

As a result of the preceding, during the three years ended June 30, 2005, extinguishments, cancellations and conversions of debt for issuance of the Company's common stock to related parties is summarized in Note 11 and amounts relating to strategic investors is summarized as follows:

| Equity Conversions of Debt with Strategic Vendors | 2003      | For the Years Ended June 30, |           |
|---|-----------|------------------------------|-----------|
|   |           | 2004                         | 2005      |
| Number of Shares                                  | 390,000   | 110,467                      | 635,296   |
| Number of Warrants                                | 215,000   | 5,069,200                    | 1,356,696 |
| Amount Converted to Equity                        | \$198,032 | \$1,963,202                  | \$426,894 |
| Gain on Extinguishments of Debt                   | \$ 61,226 | \$ 150,058                   | \$418,696 |

During the year ended June 30, 2005, the Company recorded non-cash extinguishment loss from settlements of \$134,217 and after adjusting for cash and default settlements, resulted in net gains on extinguishments of \$418,696.

The Company has no commitments from affiliates or related parties to provide additional financings. The Company has, from time to time, been able to obtain financings from affiliates when conditions in the capital markets make third party financing difficult to obtain or when external financing is available only upon very unattractive terms to the

Company, and when such capital has been available from the affiliates. (See also-Note 11-Related Party Transactions)

F-31

mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
June 30, 2005

10. STOCKHOLDERS' EQUITY - (Continued)

STOCK INCENTIVE PLANS

A summary of the stock option activity for the years ended June 30, 2003, 2004, 2005 pursuant to the terms of both plans, which include incentive stock options and non-qualified stock options, is set forth on the below:

|                              | NUMBER OF<br>OPTIONS |    | WEIGHTED<br>AVERAGE<br>EXERCISE PRICE |
|------------------------------|----------------------|----|---------------------------------------|
| Outstanding at June 30, 2003 | 17,167,000           | \$ | 1.24                                  |
| Granted                      | 4,730,000            |    | .42.                                  |
| Exercised                    | -                    |    | -                                     |
| Canceled /Expired            | (4,172,000)          |    | (1.43)                                |
| Outstanding at June 30, 2004 | 17,725,000           |    | .87                                   |
| Granted                      | 7,775,000            |    | .35                                   |
| Exercised                    |                      |    |                                       |
| Canceled/Expired             | 1,240,167            |    | (2.05)                                |
| Outstanding at June 30, 2005 | 24,259,833           | \$ | .78                                   |
| Exercisable at June 30, 2005 | 24,259,833           | \$ | .78                                   |

The fair value of options granted in 2003 and 2004 and options and compensatory warrants granted in 2005 was estimated as of the date of grant using the Black-Scholes stock option pricing model, based on the following weighted average assumptions: annual expected return of 0%, annual volatility of 144.4% in 2003, 145.3% in 2004 and 145.3% in 2005, based upon a risk-free interest rate ranging from 2.1% to 5.8% and expected option life of 4 years.

The per share weighted average fair value of stock options granted during 2003, 2004 and 2005 was \$.21, \$.35 and \$.35 respectively. The per share weighted average remaining life of the options outstanding at June 30, 2003, 2004, and 2005 is 2.80, 2.88 and 3.02 years, respectively.

mPhase has elected to continue to account for stock-based compensation under APB Opinion No. 25, under which no compensation expense has been recognized for stock options and certain compensating warrants granted to employees at fair market value. Had compensation expense for stock options granted under the Plan and certain warrants granted to employees in 2005, been determined based on fair value at the grant dates, mPhase's net loss for 2003, 2004 and 2005 would have been increased to the pro forma amounts shown below.

During the second quarter of fiscal 2006 the Company will adopt the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, for stock-based employee compensation, effective as of the beginning of the fiscal year. Under the modified prospective method of adoption selected by the Company, stock-based employee compensation cost recognized in 2005 is the same as that which would have been recognized had the fair value recognition provisions of Statement 123 been applied to all awards granted after October 1, 1995. The following table illustrates the effect on net income and earnings per share as if the fair value based method has been applied to all outstanding and unvested awards in each period.

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|   | Twelve months ended June 30, |               |                |
|---|------------------------------|---------------|----------------|
|   | 2003                         | 2004          | 2005           |
| Net loss, as reported   | \$(6,650,211)                | \$(7,758,586) | \$(11,234,324) |
| Add: Stock-based employee compensation expense net included in report of net income, net of related tax effects                             | 23,923                       | 72,000        | 131,750        |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (239,983)                    | (810,080)     | (444,396)      |
| Pro forma net loss  | \$(6,866,231)                | \$(8,486,666) | (11,546,970)   |
| Loss per share:   |                              |               |                |
| Basic and diluted-as reported   | \$(.10)                      | \$(.10)       | (.10)          |
| Basic and diluted-pro forma   | \$(.11)                      | \$(.11)       | (.11)          |

F-32

mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

10. STOCKHOLDERS' EQUITY - (Continued)

For the year ended June 30, 2003, the Company recorded non-cash charges and deferred compensation totaling \$70,950 and \$0, respectively, in connection with the grant of 625,000 options to employees and consultants and the Company recorded non-cash charges of \$203,155 in connection with the grant of 1,690,000 compensating warrants to employees and consultants for services rendered or to be rendered. Such charges are the result of the differences between the quoted market value of the Company's common stock on the date of grant and the exercise price for option and warrants issued to employees and Black-Scholes stock option pricing calculations for options and warrants issued to consultants.

For the year ended June 30, 2004 the Company recorded non-cash charges and deferred compensation totaling \$833,100 and \$0 respectively, in connection with the grant of options covering 4,370,000 shares of common stock to employees and consultants and the Company recorded non-cash charges of \$170,451 in connection with the grant of 500,000 compensating warrants to employees and consultants for services rendered or to be rendered. Such charges are the result of the differences between the quoted market value of the Company's common stock on the date of grant and the exercise price for option and warrants issued to employees and Black-Scholes stock option pricing calculations for options and warrants issued to consultants.

For the year ended June 30, 2005, the Company recorded non-cash charges and deferred compensation totaling \$2,816,333 and \$0, respectively, in connection with the grant of 7,775,000 options to employees and options to consultants for services rendered or to be rendered. Such charges are the result of the differences between the quoted market value of the Company's common stock on the date of grant and the exercise price for options issued to employees and Black-Scholes stock option pricing calculations for options issued to consultants

The following summarizes information about stock options outstanding at June 30, 2005:

| RANGE OF EXERCISE PRICE | NUMBER OUTSTANDING | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER EXERCISABLE | WEIGHTED AVERAGE EXERCISE PRICE |
|-------------------------|--------------------|---|---------------------------------|--------------------|---------------------------------|
| \$0 - \$.50             | 19,485,000         | 3.82  | .37                             | 19,480,000         | .37                             |
| \$.51-\$1.50            | 4,603,500          | .85   | .83                             | 4,603,500          | .85                             |

|                |         |     |      |         |      |
|----------------|---------|-----|------|---------|------|
| \$1.50-\$16.38 | 176,333 | .40 | 4.63 | 176,333 | 4.63 |
|----------------|---------|-----|------|---------|------|

WARRANTS

In January and April 1998, mPhase issued 25,000 and 50,000 warrants, respectively, each to purchase one share of common stock at an exercise price of \$1.06 and \$2.44, respectively, for consulting services. The warrants expire five years from the date of issuance. At any time after the date of issuance, the Company may, at its option, elect to redeem all of these warrants at \$0.01, subject to adjustment, as defined, per warrant, provided that the average closing price of the common stock for 20 business days within any period of 30 consecutive business days exceeds \$5.00 per share. As of June 30, 2001, none of these warrants remain outstanding.

In July 1998, in connection with the private placements, mPhase issued 400,000 warrants, each to purchase one share of common stock at an exercise price of \$1.00 per share. The Company allocated the net proceeds from the sale of the common stock to the common stock and the warrants. On July 26, 1999, pursuant to the warrant agreement these 400,000 warrants were converted into 352,239 shares of common stock. In accordance with the warrant agreement, the warrant holder had the right to initiate a cashless exercise to convert the warrants into shares of common stock in lieu of exchanging cash. The number of shares received was determined by dividing the aggregate fair market value of the shares minus the aggregate exercise price of the warrants by the fair market value of one share. In September 1998, mPhase issued 6,666 warrants for services, each to purchase one share of common stock at an exercise price of \$0.75 per share. The warrants expire five years from the date of grant. The Company determined the fair market value of the warrants issued under the Black-Scholes Option Pricing Model to be \$16,302. This amount is included in the Company's general and administrative expenses in the accompanying consolidated statement of operations as of June 30, 1999. These warrants were exercised during the year ended June 30, 2000 generating proceeds to the Company of \$5,000.

In June 1999, in connection with the private placements, mPhase also issued 400,000 warrants each to purchase one share of common stock at an exercise price of \$1.00 per share. The warrants were to expire five years from the date of grant. These warrants were exercised during the year ended June 30, 2000 generating proceeds of to the Company of \$400,000.

In January 2000, in connection with private placements, mPhase issued 200,000 and 50,000 warrants, each to purchase one share of common stock, at an exercise price of \$4.00 and \$5.00, respectively. The net proceeds of the private placement were allocated to the warrants and the common stock based on their respective fair values. The warrants were to expire five years from the date of issuance. These warrants were exercised in February 2000.

F-33

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

10. STOCKHOLDERS' EQUITY - (Continued)

During the year ended June 30, 2001, mPhase issued 4,980,125 warrants to investors including 1,550,625 warrants to existing investors as compensation which resulted in a charge of \$1,249,804 to operations based upon the fair value of the warrants issued as determined under the Black-Scholes option pricing model, and 162,600 to finders, consultants and investment banking firms, each of these warrants to purchase one share each of the Company's common stock at \$3.00, for five years, in connection with private placements.

During the year ended June 30, 2001, mPhase granted 1,180,000 warrants to consultants for services performed and for services to be performed at prices ranging from \$1.25 to \$5.00, which resulted in a charge of \$1,185,874 to

operations and deferred \$457,942 for services to be performed in the fiscal year ended June 30, 2002, totaling \$1,643,816 based upon the fair value of the warrants issued as determined under the Black-Scholes option pricing model.

As of June 30, 2001, 6,816,725 warrants were outstanding with a weighted average exercise price of \$2.93.

During the year ended June 30, 2002, the Company issued 75,000 and 6,797,643 warrants to investors and to finders, consultants and investment banking firms, each of these warrants to purchase one share each of the Company's common stock at \$3.00 and \$.30, for five years, in connection with private placements. The Company also issued 13,334 shares of its common stock following the exercise of warrants resulting in gross proceeds \$4,000. Also, during the year ended June 30, 2002, the Company granted 1,675,000 warrants to consultants for services performed and 6,043,490 warrants to creditors, including related parties, in connection with the conversion of outstanding liabilities.

As of June 30, 2002, 21,965,260 warrants were outstanding with a weighted average exercise price of \$1.05.

During the year ended June 30, 2003, the Company issued 4,701,696 warrants to investors and to finders, consultants and investment banking firms, each of these warrants to purchase one share each of the Company's common stock at \$.30, for five years, in connection with private placements. Also, during the year ended June 30, 2003, the Company granted 1,690,000 5 year warrants to employees and consultants for services performed with an exercise price of \$.40 per share of common stock and 3,706,800 warrants to creditors, including related parties (see Note 11), in connection with the conversion of outstanding liabilities.

As of June 30, 2003, 31,777,735 warrants remain outstanding with a weighted average exercise price of \$.84.

During the year ended June 30, 2004, the Company issued warrants to purchase 18,795,487 shares of common stock to investors and warrants to purchase 628,826 shares of common stock to finders, consultants and investment banking firms. Of such warrants, 11,106,487 shares of the Company's common stock may be purchased at \$.30, for five years, 3,844,000 shares may be purchased at \$.35 and 3,844,000 shares may be purchased at \$.50 in connection with private placements. Also, during the year ended June 30, 2004, the Company granted 5 year warrants to purchase 500,000 shares to consultants for services performed with an exercise price of \$.30 per share of common stock and 5,069,242 warrants to creditors, including related parties (see Note 11), in connection with the conversion of outstanding liabilities. Additionally, warrants cover 1,233,334 of common stock were exercised during the fiscal year ended June 30, 2004, generating net proceeds to the Company of \$316,800. Also during the fiscal year ended June 30, 2004, warrants covering 519,000 shares with a weighted average exercise price of \$2.50 were cancelled or expired.

As of June 30, 2004, 55,017,953 warrants remain outstanding with a weighted average exercise price of \$.55.

During the nine months ended March 31, 2005, in connection with the private placements discussed above the Company issued 27,200,117 of warrants to investors and finders and when combined with warrants previously outstanding and exercised, expired or canceled, during the period result in the Company now having 75,428,473 with a weighted average price of \$.48.

During May 2005 the Company adjusted the exercise price of \$.45 per share of an investor's 5 year warrant to purchase 714,296 shares of common stock. The warrant was originally issued in January 2005, to \$.225 in July of 2005. In July of 2005 such investor exercised a portion of such warrant, as adjusted, to purchase 200,000 shares of the Company's common stock generating \$45,000 of net proceeds to the Company.

On July 20, 2005, at the Company's annual meeting of Shareholders, the Shareholders' ratified an amendment to its Certificate of Incorporation to increase the number of authorized shares of common stock from 250,000,000 to 500,000,000 shares.

During June and July 2005 the Company completed a private placement of equity units pursuant to Rule 506 of Regulation D of the Securities Act of 1933, as amended. Each unit consists of one share of the Company's common stock at \$0.20 per share plus a five (5) year warrant to purchase one share of the Company's common stock at \$.25 per share. Such placement generated an aggregate of \$3,488,000 of proceeds to the Company, to be used primarily to pay for research and development expenses and for general corporate purposes. A total of 14,140,000 shares of the Company's common stock together with five (5) year warrants to purchase 14,140,000

shares of the Company's common stock at \$.25 per share were issued in such private placement. In connection with such private placement, consultants and advisors received \$253,500 of fees paid in cash and 476,500 shares of the Company's common stock and five (5) year warrants to purchase 476,500 shares of the Company's common stock at \$.25 per share.

During the year ended June 30, 2005, the Company issued warrants to purchase 40,609,586 shares of common stock to investors and warrants to purchase 729,075 shares of common stock to finders, consultants and investment banking firms. Of such warrants, 39,124,586 shares of the Company's common stock may be purchased for 5 years at \$.25 shares and may be purchased at \$.35 and 1,485,003 shares may be purchased at \$.50 in connection with private placements. Also, during the year ended June 30, 2005, the Company granted 5 year warrants to purchase 2,600,000 shares to consultants for services performed with an exercise price of \$.25 to \$.35 per share of common stock and warrants to purchase 4,616,571 shares to creditors, including related parties (see Note 11), in connection with the conversion of outstanding liabilities. Additionally, warrants cover 3,637,954 of common stock were exercised during the fiscal year ended June 30, 2005, generating net proceeds to the Company of \$680,609. Also during the fiscal year ended June 30, 2005 a cashless exercise of warrants previously issued resulted in the issuance of 4,949,684 shares of the Company's common stock. Additionally, during the fiscal year ended June 30, 2005, warrants covering 5,331,144 shares were cancelled or expired.

As of June 30, 2005, warrants covering 89,054,406 shares remain outstanding with a weighted average exercise price of \$.36.

#### RESERVED SHARES

The Company has reserved approximately 720,000 shares issuable upon provisions of convertible notes to related parties, which provide for, at the option of the holders of \$180,000 of notes payable, the conversion of unpaid principal and interest into units valued at \$.25 each, unit consisting of one share of the Company's common stock and one warrant each to purchase the Company's common stock at \$.25 per share good for 5 years.

F-34-

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

#### 11. RELATED PARTY TRANSACTIONS

Mr. Durando, the President and CEO of mPhase, and together with Mr. Ergul owns a controlling interest and is a director of Janifast Limited. Mr. Durando and Mr. Dotoli are officers of Microphase Corporation. Mr. Ergul, the chairman of the board of mPhase, owns a controlling interest and is a director of Microphase Corporation. Microphase, Janifast, Hart Telephone and Lintel Corporation are significant shareholders of mPhase. Microphase, Janifast and Hart Telephone have converted significant liabilities to equity in fiscal years June 30, 2001, 2002 and in the current fiscal year. The Company believes Microphase, Janifast and Hart Telephone have the ability to fulfill their obligations to the Company without further support from the Company. mPhase's President, Executive Vice President and Chairman of the Board of the Company are also officers of Microphase (Note 4).

On May 1, 1997, the Company entered into an agreement with Microphase, whereby it will use office space as well as the administrative services of Microphase, including the use of accounting personnel. This agreement was for \$5,000 per month and was on a month-to-month basis. In July 1998, the office space agreement was revised to \$10,000 and in



January 2000 to \$11,050 per month. In July 2001, the agreement was revised to \$11,340 a month. In July, 2002 this was increased to \$12,200 per month and as of January 1, 2003 such rent was reduced to 10,000 per month. Additionally, in July 1998, mPhase entered into an agreement with Microphase, whereby mPhase reimburses Microphase \$40,000 per month for technical research and development assistance. Such agreement was amended as of January 1, 2002 to reduce such payment to \$20,000 per month. Microphase also charges fees for specific projects on a project-by-project basis. During the years ended June 30, 2001, 2002, and 2003 and for the period from inception (October 2, 1996) to June 30, 2003, \$2,128,983, \$1,212,594, \$648,102 and \$7,224,526, respectively, have been charged to expense or inventory under these Agreements and is included in operating expenses in the accompanying consolidated statements of operations.

On February 15, 1997, mPhase entered into a Technology, Patent and Trademark License Agreement (the "Agreement") with

MicroTel (Note 4). The Agreement permits the Company to utilize the patent and trademark technology of MicroTel under a licensing arrangement. The Company made payments of \$37,500 per month, commencing June 1, 1997 for technology development. During the period ended June 30, 1997 and 1998, \$37,500 and \$450,000 has been charged to expense under this Agreement and is included in licensing fees in the accompanying consolidated statement of operations. As of June 25, 1998, the Company acquired MicroTel and as of that date this Agreement is no longer in effect.

Also, during the fiscal year ended June 30, 2000, \$2,600,000 was advanced to Microphase in the form of a note, which was repaid by Microphase during the year. mPhase recorded \$39,000 of interest income on this note for the year ended June 30, 2000. The Company is obligated to pay a 3% royalty to Microphase on revenues from its legacy Traverser" Digital Video and Data Delivery System and its DSL component products. During the years ended June 30, 2001, 2002 and 2003 mPhase recorded royalties to Microphase totaling \$297,793, \$78,762 and \$47,304, respectively.

F-35

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

Pursuant to a debt conversion agreement between the Company and Microphase, for the year ended June 30, 2001, Microphase received 1,278,000 shares of mPhase common stock and for the year ended June 30, 2002, in consideration for a direct investment of \$100,000 and pursuant to debt conversion agreements canceling \$740,000 of liabilities of the Company, Microphase received 2,900,000 shares of mPhase common stock and 2,200,000 warrants to purchase mPhase common stock, as discussed in Note 10. For the fiscal year ended June 30, 2003 Microphase received 4,033,333 shares of common stock, such shares included 3,033,333 shares that the value of which was based upon the price of the Company's common stock on the effective date of settlement, plus 1,000,000 shares and 1,000,000 five year warrants to purchase shares of common stock of mPhase at \$.30 per share whereby such conversions were upon the same terms of a concurrent private placement of common stock by the Company. No gain or loss was recognized in connection with conversions by Microphase for fiscal 2003 in exchange for the cancellation of accounts payable totaling \$920,000. As of June 30, 2004 and 2005, the Company had \$145,550 and \$0 in current accounts payable to Microphase, which are included in amounts due to related parties as current liabilities in the accompanying consolidated balance sheet. As of June 30, 2002, the Company had \$92,405 included in other liabilities- related parties and as of June 30, 2004 and June 2005 and \$180,000 and \$0 respectively in notes payable - related parties as long term liabilities in the accompanying consolidated balance sheet. Additionally, at June 30, 2005, no undelivered purchase orders remain outstanding with Microphase.

In September of 2005, Mr. Durando and Mr. Smiley lent the Company \$50,000 and \$100,000 respectively and such amounts were repaid by the Company, without interest in October of 2005.

Mr. Abraham Biderman was employed until September 30, 2003 by our former investment-banking firm Lipper & Company. During the six months ended December 31, 2005, Mr. Biderman's current firm Eagle Advisers, Inc. has acted as a finder of money in connection with finder's fees of \$312,067 respectively.

During the six month period ended December 31, 2005, Mr. Durando, Mr. Dotoli and Mr. Smiley made bridge loans to the Company in the aggregate amounts of \$50,000, \$100,000 and \$150,000. The loans due Mr. Dotoli and Mr. Smiley are outstanding at December 31, 2005. All of the loans have since been repaid.

## JANIFAST

During the year ended June 30, 2000, mPhase advanced money to Janifast Limited, which is owned by U.S. Janifast Holdings, Ltd, a related party of which three directors of mPhase are significant shareholders, in connection with the manufacturing of POTS Splitter shelves and DSL component products. As of June 30, 2000 the amount advanced to Janifast was approximately \$1,106,000, which is included in production advances-related parties on the accompanying balance sheet. There were no such advances during the years ended June 30, 2002 and 2003. Pursuant to debt conversion agreements between the Company and Janifast, for the year ended June 30, 2001 Janifast received 1,200,000 shares of mPhase common stock canceling liabilities of \$600,000, and for the year ended June 30, 2002 Janifast received 3,450,000 shares of mPhase common stock and 1,200,000 warrants to purchase mPhase common stock for the cancellation of \$720,000 of liabilities, as discussed in Note 10. During the year ended June 30, 2003 Janifast was issued 1,500,000 shares of mPhase common stock in connection with the cancellation of \$360,000 of outstanding liabilities of mPhase, the value of which was based upon the price of the Company's common stock on the effective date of settlement. No gain or loss was recognized in connection with conversions by Janifast for fiscal 2003. During the years ended June 30, 2003, 2004 and 2005 and the period from inception (October 2, 1996) to June 30, 2005, there has been \$174,959, \$2,771,925, 1,536,494 and \$15,001,105, respectively, of invoices for products and services have been charged to inventory or expense and is included in operating expenses in the accompanying statements of operations. Effective December 30, 2004, Janifast Ltd. agreed to convert \$200,000 of accounts payable into common stock of the Company at \$.20 per share plus a 5 year warrant for a like amount of shares at \$.25 per share. At June 30, 2005 the Company had \$491,098 current accounts payable, which are included in due to related parties and additionally, at June 30, 2005, approximately \$298,000 of undelivered purchase orders remain outstanding with Janifast.

|  | Year Ended June 30, |             |             |
|--|---------------------|-------------|-------------|
| <b>Charges and Expenses with Related Parties</b>                   | 2003                | 2004        | 2005        |
| <b>Charges incurred with Janifast Ltd.<br/>included in:</b>        |                     |             |             |
| Cost of sales and ending inventory                                 | \$178,959           | \$2,771,925 | \$1,536,494 |
| Total Janifast   | \$178,959           | \$2,771,925 | 1,536,494   |
| <b>Charges incurred with Microphase<br/>Corp.<br/>included in:</b> |                     |             |             |
| Cost of sales and ending inventory<br>(Including Royalties)        | \$86,468            | \$140,123   | \$94,740    |
| Research and development   | 428,434             | 84,494      | 60,000      |
| General and administrative   | 133,200             | 231,068     | 304,030     |
| Total Microphase Corp.   | \$648,102           | \$455,685   | \$458,770   |

**Total Charges with Related Parties included in:**

|                                    |           |             |             |
|------------------------------------|-----------|-------------|-------------|
| Cost of sales and ending inventory | \$265,427 | \$2,912,048 | \$1,631,234 |
| Research and development           | 428,434   | 84,494      | 60,000      |
| General and administrative         | 133,200   | 231,068     | 304,030     |
| Total Charges with Related Parties | \$827,061 | \$3,227,610 | \$1,995,254 |

Included in Cost of Sales in the Consolidated Statements of Operations  
(including changes in inventory)

|                                  |             |             |             |
|----------------------------------|-------------|-------------|-------------|
| Janifast                         | \$935,137   | \$3,507,476 | \$1,275,960 |
| Microphase (including royalties) | \$408,918   | \$140,123   | \$94,740    |
|                                  | \$1,344,055 | \$3,647,599 | \$1,370,700 |

Total Related Party Expense Included in Cost of Sales

F-36

mPHASE TECHNOLOGIES, INC  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

11. RELATED PARTY TRANSACTIONS - (continued)

OTHER RELATED PARTIES

For consulting services rendered in connection with the joint venture (Note 8), the Company agreed to pay two officers of the Company and a related party \$412,400, which was included on the June 30, 2000 consolidated balance sheet of the Company. This amount was paid by the Company during the year ended June 30, 2001.

In July 2000, mPhase added a member to the Board of Directors who is employed by an investment-banking firm that has assisted and is expected to continue to assist the Company in raising capital through private financing. During the year ended June 30, 2001, the Company issued 140,350 shares of common stock for investment banking services rendered during the period and recorded an additional \$69,000 of fees which is included in accrued expenses at June 30, 2001. The Company has installed its prototype product and commenced beta testing at Hart Telephone. In addition, the Company has entered into a supply agreement with Hart Telephone upon the completion of beta testing and the commencement of production of the Traverser" As consideration for the execution of the agreement with Hart Telephone, in May 2000, mPhase issued Hart Telephone 125,000 options each to purchase one share of common stock at an exercise price of \$1.00 (valued at \$1,010,375), which is included in research and development expenses in the accompanying statement of operations for the year ended June 30, 2000. Mr. J. Lee Baron, the president and chief executive officer of Lintel Inc., (Lintel is the parent of Hart Telephone Company), and at that time a Director of the Company, received a \$285,000 bonus, a stock award of 140,000 shares and 100,000 options in addition to the 125,000 granted to Hart for Beta testing services in the year ended June 30, 2000 and 120,000 options for services as a Director for the year ended June 30, 2001.

F-37

,mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

11. RELATED PARTY TRANSACTIONS - (continued)

A former member of mPhase's Board of Directors (who resigned in March of 2005) is employed by Lintel, Inc, the parent corporation of Hart Telephone. Prior to becoming a director, this individual received 25,000 options during the fiscal year ended June 30, 1999, of which 5,000 options were exercised during the fiscal year ended June 30, 2000; 23,000 options during the fiscal year ended June 30, 2001 and 15,000 options as a consultant for beta testing service during fiscal year ended June 30, 2002. In addition, during the years ended June 30, 2002, 2003 and June 30, 2004 he received options and warrants covering 62,500 shares, 35,000 shares and 100,000 shares of common stock, respectively, for services as a director.

Effective June 30, 2001, the Company converted \$2,420,039 of liabilities due to directors and related parties into 4,840,077 shares of the Company's common stock pursuant to debt conversion agreements.

Effective March 31, 2002, the Company converted \$420,872 of liabilities due to Piper Rudnick LLP, outside legal counsel to mPhase into a warrant to purchase up to a total of 1,683,490 shares of the Company's common stock which pursuant to EITF 96-18, has an approximate value of \$.30 per share; and a warrant to purchase 550,000 shares of the Company's common stock at an exercise price of \$.30 per share pursuant to the terms of payment agreement. In addition, Piper agreed to accept a Promissory note for \$420,872 of current payables at an interest rate of 8% with payments of \$5,000 per month commencing June 1, 2002 and continuing through December 1, 2003, with a final payment of principal plus accrued interest due at maturity on December 31, 2003. As of August 11, 2003 the Company has an arrearage of \$ 35,000 with respect to the payments on the promissory note.

During the year ended June, 30 2003, the Company converted \$525,967 of liabilities due to the Company's president, vice president and a sales manager who is also concurrently employed by Microphase, for unpaid management compensation and sales commissions due from mPhase into warrants to purchase up to a total of shares of the Company's common stock which, pursuant to EITF 96-18, have an approximate value of \$.21 per share or \$538,173. The Company recorded a settlement expense of approximately \$12,206, which is included as a reduction to gain on settlements in the statements of operations for the year ended June 30, 2003.

In March of 2003, Messrs, Durando, Dotoli and Smiley participated in a private placement of the company investing \$20,000, \$20,000 and \$75,000 respectively, receiving common stock of mPhase at \$.30 per share plus 5 year warrants of mPhase to purchase a like amount of common stock at \$.30 per share. In March of 2003, Messrs Durando and Smiley lent to mPhase \$30,000 and \$100,000 respectively at 12% interest pursuant to two promissory notes originally due in September of 2003. In June 2003, Mr. Durando was repaid and Mr. Smiley agreed to extend his note until July, 2004. Also in June, 2003, Microphase agreed to convert \$360,000 of accounts payable to a note payable, interest at 12% due in July, 2004. The notes have provisions for prepayment by the Company and at the option of the holder, provide for the conversion of unpaid principal and interest into units valued at \$.30 each, each unit consisting of one share of the Company's common stock and a one warrant to purchase the Company's common stock at \$.30 per share for a period of 5 years. During the fiscal year ended June 30, 2004 Microphase was repaid \$180,000 and \$180,000 remains outstanding.

As of June 30, 2004, Mr. Smiley and Microphase each agreed to extend to July 25, 2005, the maturity on their 12% convertible promissory notes in the principal amount of \$100,000 and \$180,000 respectively.

Additionally at June 30, 2004, Mr. Durando was owed \$300,000 by the Company as evidenced by a non-interest bearing promissory note that was repaid in July 2004. As of June 30, 2004 a total of \$55,000 in the aggregate was due to Mr. Durando and Mr. Dotoli for unpaid compensation.

Mr. Durando's June 30, 2004 note payable balance of \$300,000 was repaid by the Company during the nine month period ended March 31, 2005. During the first and second quarters of fiscal year 2005, Mr. Durando made additional bridge loans to the Company evidenced by various 12% demand notes in the aggregate of \$525,000. Mr. Durando was repaid a total of \$450,000 of such loans in January of 2005. In addition, Mr. Durando converted \$13,954 of the principal amount of a \$75,000 promissory note leaving unpaid principal of \$61,046 outstanding. Mr. Durando

converted \$13,000 of accrued and unpaid interest on various promissory notes of the Company into 65,000 shares of common stock and a 5 year warrant to purchase a like amount of common stock at \$.25 per share.

During the fiscal year ended June 30, 2005 Mr. Dotoli and Mr. Smiley, the COO, and CFO and General Counsel of the Company respectively, each lent the Company \$75,000. Mr. Dotoli was repaid, the principal amount of such loan, in cash in January, 2005 and Mr. Smiley converted his \$75,000 loan into 375,000 shares of common stock of the Company plus a 5 year warrant to purchase a like amount of shares at \$.25 per share. In addition, Mr. Smiley converted \$9,975 of accrued interest into 49,875 shares of common stock plus a 5 year warrant to purchase a like amount of shares at \$.25 per share. Finally Mr. Smiley received 25,000 additional shares of common stock as a market adjustment to his equity investment of \$25,000 on August 30, 2004. Mr. Dotoli cancelled \$3,750 of accrued and unpaid interest from August 15, 2004 through January 15, 2004 into 375,000 shares of common stock pursuant to the terms of a portion of a warrant that was exercised at \$.01 per share previously given by the Company to Mr. Dotoli in exchange for and cancellation of unpaid compensation. On January 15, 2004, Mr. Smiley was awarded 425,000 shares of common stock as additional compensation.

In July of 2005, Mr. Smiley was repaid a loan of \$35,000, without interest made to the Company in June of 2005. In the three month period ended September 30, 2005, Mr. Durando and Mr. Smiley lent the Company \$50,000 and \$100,000 respectively which was repaid by the Company, without interest in October of 2005.

Generally, as summarized below, the Company has offered conversion of debts to related parties on substantially the same terms as concurrent private placements (typically in \$.30 units, such units including both shares of common stock and warrants to purchase a like amount of common stock) in addition to conversion of debts pursuant to terms of concurrent private placements and financial instruments which, pursuant to EITF 00-19 have been settled with the Company's common stock as conditioned by benchmarks, generally coinciding with the Company's negotiations to settle any and all obligations with Georgia Tech Research and its affiliate (see also Note 13) as follows:

F-38

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mPHASE TECHNOLOGIES, INC.  
(A Development Stage Company)  
Notes to Consolidated Financial Statements  
June 30, 2005

## 11. RELATED PARTY TRANSACTIONS -

*(continued)*

### Equity Conversions of Debt and Other Financial Instruments with Related Parties

|                                      | 2003       | June 30,<br>2004 | 2005       |
|--------------------------------------|------------|------------------|------------|
| <b>Janifast:</b>                     |            |                  |            |
| Number of shares                     | 1,500,000  | 0                | 1,000,000  |
| Number of warrants                   | 0          | 0                | 1,000,000  |
| Amount converted to equity           | \$ 360,000 | \$ 0             | \$ 200,000 |
| <b>Microphase Corporation:</b>       |            |                  |            |
| Number of shares                     | 4,033,333  | 0                | 1,250,000  |
| Number of warrants                   | 1,000,000  | 0                | 1,250,000  |
| Amount converted to equity           | \$ 920,000 | \$ 0             | \$ 250,000 |
| <b>Strategic Vendor Conversions:</b> |            |                  |            |
| Number of shares                     | 390,000    | 110,467          |            |

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|  |              |              |            |
|--|--------------|--------------|------------|
| Number of warrants                           | 215,000      | 5,069,242    |            |
| Amount converted to equity                   | \$ 198,032   | \$ 1,963,202 | \$         |
| <b>Officers</b>                              |              |              |            |
| Number of shares                             | 0            | 0            | 1,009,875  |
| Number of warrants (A)                       | 2,491,800    | 0            | 1,009,875  |
| Amount converted to equity                   | \$ 480,967   | \$ 0         | \$ 201,975 |
| <b>Joint Venture Partners and Affiliates</b> |              |              |            |
| Number of shares                             | 0            | 0            |            |
| Number of warrants                           | 0            | 0            |            |
| Amount converted to equity                   | \$ 0         | \$           | \$         |
| <b>Total Related Party Conversions</b>       |              |              |            |
| Number of shares                             | 5,923,333    | 110,0467     | 3,259,875  |
| Number of warrants                           | 3,706,800    | 5,069,242    | 3,259,875  |
| Amount converted to equity                   | \$ 1,958,999 | \$ 1,963,202 | \$ 651,975 |

(A) Includes \$12,206 settlement expense incurred to the Company's Chief Operating Officer in connection with the exchange of warrants to purchase the Company's common stock to cancel unpaid compensation, which is included as a reduction to gain on settlements in fiscal 2003.

## 12. INCOME TAXES

No provision has been made for corporate income taxes due to cumulative losses incurred. At June 30, 2005, mPhase has operating loss carryforwards of approximately \$71.1million and 70.5 million to offset future federal and state income taxes respectively, which expire at various times from 2016 through 2024. Certain changes in stock ownership can result in a limitation in the amount of net operating loss and tax credit carryovers that can be utilized each year.

At June 30, 2005 the Company has net deferred income tax assets of approximately \$27.25 million comprised principally of the future tax benefit of net operating loss carryforwards, which represents an increase of \$3.05 million for the fiscal year ended June 30, 2005. A full valuation reserve has been recorded against such assets due to the uncertainty as to their future realizability.

## 13. COMMITMENTS AND CONTINGENCIES

### COMMITMENTS

mPhase has entered into various agreements with Georgia Tech Research ("GTRC") and its affiliate, Georgia Tech Applied Research Corporation, ("GTARC"), pursuant to which the Company receives technical assistance in developing the commercialization of its Digital Video and Data Delivery System. The amount incurred by the Company for GTRC technical assistance with respect to its research and development activities during the years

ended, 2003, 2004 and 2005 totaled \$100,000 \$0 and \$0 respectively, and \$13,539,952 from the period from inception through June 30, 2005.

If and when sales commence utilizing its legacy DVDDS digital broadcast television platform, mPhase will be obligated to pay to GTRC a royalty up to 5% of product sales, as defined.

As of June 30, 2005, mPhase is obligated to pay Lucent Technologies, Inc. \$200,000 per month through and including the first of each month from July 1, 2005 through and including March 1, 2006 in connection with the development of its Nanotechnology product line. Additionally, the Company engages Lucent on a project-by-project basis for research and development of technical product related enhancements for its TV+ product. The Company owed Lucent \$379,428 in accounts payable and accrued expenses through June 30, 2005. The amount incurred by the Company with Lucent for assistance with respect to its research and development activities during the years ended 2003, 2004, and 2005 totaled \$1,112,500, \$2,328,602, and 3,424,800 respectively, and \$7,021,902 from the period from inception through June 30, 2005.

From time to time, mPhase may be involved in various legal proceedings and other matters arising in the normal course of business. The Company currently has no material outstanding legal proceedings, nor does it anticipate any actions which would result in liabilities in excess of amounts recorded in these financial statements.

#### 14. REISSUANCE OF FINANCIAL STATEMENTS

Management has reevaluated the adequacy and completeness of presentation and certain disclosures in the accompanying consolidated financial statements. As a result of this reevaluation, management has reissued the June 30, 2005 consolidated financial statements in an effort to clarify and more completely disclose the Company's presentation of the consolidated financial statements at June 30, 2005.

The aforementioned changes to the consolidated financial statements have no effect on the financial position and results of operations for the year ended June 30, 2005.

**Item 14. Controls and Procedures**

Under the supervision and with the participation of management including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14c and of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the fiscal year ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**SCHEDULE II****ITEM 14B. VALUATION AND QUALIFYING ACCOUNTS****mPHASE TECHNOLOGIES, INC.****VALUATION AND QUALIFYING ACCOUNTS**

Years Ended June 30, 20045, 2004 and 2003

(In Thousands)

|  | <b>Balance at<br/>beginning<br/>of year</b> | <b>Charged to<br/>costs and<br/>expenses</b> | <b>Additions<br/>Charged to<br/>other<br/>accounts</b> | <b>Deductions</b> | <b>Balance at<br/>end of year</b> |
|--|---|--|--|-------------------|-----------------------------------|
| Description  |   |  |  |                   |                                   |
| Year ended June 30, 2005                                   |   |  |  |                   |                                   |
| Allowance for doubtful accounts<br>(deducted from accounts | \$ 0  | 0  | 0  | 0                 | \$ 0                              |
| receivable)  |   |  |  |                   |                                   |
| Allowance for obsolescence (deducted<br>from inventory, at |   |  |  |                   |                                   |



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|   |    |       |     |      |         |    |     |
|---|----|-------|-----|------|---------|----|-----|
| cost)   | \$ | 388   | 0   | 0    | (183)   | \$ | 205 |
| Year ended June 30, 2004  |    |       |     |      |         |    |     |
| Allowance for doubtful accounts<br>(deducted from accounts<br>receivable) | \$ | 0     | 0   | 0    | 0       |    | 0   |
| Allowance for obsolescence (deducted<br>from inventory, at<br>cost)       |    |       |     |      |         |    |     |
|   | \$ | 486   | 0   | (87) | (11)    |    | 388 |
| Year ended June 30, 2003  |    |       |     |      |         |    |     |
| Allowance for doubtful accounts<br>(deducted from accounts<br>receivable) | \$ | 3     | 0   | 0    | (3)     |    | 0   |
| Allowance for obsolescence (deducted<br>from inventory, at cost)          | \$ | 1,243 | 302 | 0    | (1,059) |    | 486 |

F-33

**SIGNATURES**

Pursuant to the requirements of the Section 13 or 15(d) 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.

mPHASE TECHNOLOGIES, INC.

Dated: May 10, 2006

By: /s/ RONALD A. DURANDO  
Ronald A. Durando  
President, CEO

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

|  |              |
|--|--------------|
| Necdet F. Ergul, Chairman of the Board               | May 10, 2006 |
| Ronald A. Durando, Chief Executive Officer, Director | May 10, 2006 |
| Gustave T. Dotoli, Chief Operating Officer, Director | May 10, 2006 |
| Martin S. Smiley, Chief Financial Officer            | May 10, 2006 |
| Anthony Guerino, Director                            | May 10, 2006 |
| Abraham Biderman, Director                           | May 10, 2006 |

**CERTIFICATIONS**

I, Ronald A. Durando, certify that:

1.

I have reviewed this annual report on Amendment No. 1 to Form 10-K/A of mPhase Technologies, Inc.;

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant's and have:

a.

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b.

Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c.

Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a.

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b.

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Ronald A. Durando

Ronald A. Durando

Chief Executive Officer

May 10, 2006

**CERTIFICATIONS**

I, Martin S. Smiley, certify that:

1. I have reviewed this annual report on Amendment No. 1 to Form 10-K/A of mPhase Technologies, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant's and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;

and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Martin S. Smiley

Martin S. Smiley

Chief Financial Officer

May 10, 2006

**CERTIFICATIONS PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Annual Report of mPhase Technologies, Inc. a New Jersey corporation (the "Company"), on Amendment No. 1 to Form 10K/A for the fiscal year ended June 30, 2005, as filed with the Securities and Exchange Commission (the "Report"), I, Ronald A. Durando, Chief Executive Officer of the Company certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), that to his knowledge:

1.

The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2.

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

-

/s/ Ronald A. Durando

Ronald A. Durando

Chief Executive Officer

May 10, 2006

**Exhibit 32.2**

**CERTIFICATIONS PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Annual Report of mPhase Technologies, Inc., a New Jersey corporation (the "Company"), on Amendment No. 1 to Form 10K/A for the fiscal year ended June 30, 2005, as filed with the Securities and Exchange Commission (the "Report"), I, Martin S. Smiley, Chief Financial Officer of the Company certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), that to his knowledge:

1.

The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2.

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.



/s/ Martin S. Smiley

Martin S. Smiley

Chief Financial Officer

May 10, 2006