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WIDEPOINT CORP  
Form 10QSB/A  
January 19, 2006

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-QSB/A No. 3**

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Amendment No. 3 to Quarterly Report on Form 10-QSB for the quarter ended March 31, 2005

WIDEPOINT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

000-23967

52-2040275

(State or other jurisdiction of  
incorporation or organization)

(Commission File Number)

(IRS Employer Identification No.)

One Lincoln Centre, 18W140 Butterfield Road, Suite 1100, Oakbrook Terrace, Ill

60181

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (630) 629-0003

The undersigned registrant hereby amends the following items, financial statements, exhibits or other portions of its Quarterly Report on Form 10-QSB for the quarter ended March 31, 2005, as previously amended by Amendment No. 2 filed on August 17, 2005, as set forth in the pages attached hereto:

|         |        |   |
|---------|--------|---|
| Part I  | Item 1 | Condensed Consolidated Financial Statements               |
|         | Item 2 | Management's Discussion and Analysis or Plan of Operation |
|         | Item 3 | Controls and Procedures                                   |
| Part II | Item 6 | Exhibits  |

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

WidePoint Corporation

Date: January 19, 2006

By: /s/ James T. McCubbin  
James T. McCubbin  
Vice President and Chief Financial Officer

INTRODUCTORY NOTE

This Amendment No. 3 of the Company's Quarterly Report on Form 10-QSB has been revised as a result of certain Restatements made by the Company, which are further described in the Financial Statements, note No. 1.

WIDEPOINT CORPORATION

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**Part I. FINANCIAL INFORMATION**

## Item 1. Condensed Consolidated Financial Statements

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**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.****WIDEPOINT CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS**

|                                   | <b>March 31,</b> | <b>Restated</b>     |
|-----------------------------------|------------------|---------------------|
|                                   | <b>2005</b>      | <b>December 31,</b> |
|                                   | (unaudited)      | (unaudited)         |
| <i>Assets</i>                     |                  |                     |
| Current assets:                   |                  |                     |
| Cash and cash equivalents         | \$ 255,506       | \$ 463,525          |
| Accounts receivable               | 2,279,506        | 3,007,590           |
| Prepaid expenses and other assets | 157,528          | 203,126             |
|                                   | <hr/>            | <hr/>               |
| Total current assets              | 2,692,540        | 3,674,241           |
|                                   | <hr/>            | <hr/>               |
| Property and equipment, net       | 75,013           | 80,652              |
| Goodwill                          | 2,806,440        | 2,806,440           |
| Intangibles                       | 1,766,459        | 1,668,945           |
| Other assets                      | 212,400          | 161,148             |
|                                   | <hr/>            | <hr/>               |
| Total assets                      | \$ 7,552,852     | \$ 8,391,426        |
|                                   | <hr/>            | <hr/>               |

|   | <u>March 31,</u> | <u>Restated<br/>December 31,</u> |
|---|------------------|----------------------------------|
| <i>Liabilities and stockholders' equity</i>   |                  |                                  |
| Current liabilities:  |                  |                                  |
| Short-term borrowings   | 1,383,493        | 1,592,408                        |
| Accounts payable  | \$ 995,822       | \$ 1,342,759                     |
| Accrued expenses  | 780,169          | 859,345                          |
| Income taxes payable  | 190,709          | 79,177                           |
| Short-term portion of deferred rent   | 3,038            | 2,720                            |
| Financial instruments   | 5,652,308        | 6,648,571                        |
|   | <hr/>            | <hr/>                            |
| Total current liabilities   | 9,005,539        | 10,524,980                       |
| Long-term portion of deferred rent  | 6,138            | 7,058                            |
| Deferred income tax liability   | 110,979          | 221,959                          |
|   | <hr/>            | <hr/>                            |
| Total liabilities   | 9,122,656        | 10,753,997                       |
| Temporary equity:   |                  |                                  |
| Preferred stock, \$0.001 par value; 10,000,000 shares authorized; 2,045,714 shares issued and outstanding, respectively | \$ 2,046         | \$ 2,046                         |
| Stockholders' (deficit) equity:   |                  |                                  |
| Common stock, \$0.001 par value; 110,000,000 shares authorized; 17,859,009 shares issued and outstanding, respectively  | \$ 17,859        | \$ 17,859                        |
| Common stock issuable, \$0.001 par value; 1,088,795 and 544,398 shares, respectively                                    | \$ 1,089         | \$ 544                           |
| Stock warrants  | 14,291           | 14,291                           |
| Related party notes receivable  | (61,100)         | (81,100)                         |
| Additional paid-in capital  | 43,127,872       | 42,788,612                       |
| Accumulated deficit   | (44,671,861)     | (45,104,823)                     |
|   | <hr/>            | <hr/>                            |
| Total stockholders' deficit   | (1,571,850)      | (2,364,617)                      |
|   | <hr/>            | <hr/>                            |
| Total liabilities, temporary equity and stockholders' deficit   | \$ 7,552,852     | \$ 8,391,426                     |
|   | <hr/>            | <hr/>                            |

The accompanying notes are an integral part of these consolidated statements.

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**WIDEPOINT CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <hr/>                                   |             |
|  | <b>As Restated<br/>2005</b>             | <b>2004</b> |
|  | <hr/>                                   |             |
|  | <b>(unaudited)</b>                      |             |
| Revenues, net  | \$ 2,669,532                            | \$ 723,083  |
| Cost of sales (including depreciation and amortization of \$70,550, and \$0, | 2,272,808                               | 565,766     |

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|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
| respectively, and stock compensation expense of \$370,190 and \$0, respectively) |   |             |
| Gross profit   | 396,910                                 | 157,317     |
| Sales and marketing  | 176,370                                 | 101,881     |
| General & administrative   | 727,808                                 | 150,063     |
| Depreciation expense   | 6,170                                   | 1,789       |
| Loss from operations   | (513,438)                               | (96,416)    |
| Other income, net:   |   |             |
| Interest income  | 770                                     | 1,862       |
| Interest expense   | (52,783)                                | (115)       |
| Gain from financial instrument   | 996,263                                 | --          |
| Other  | 2,150                                   | --          |
| Net earnings/(loss)  | \$ 432,962                              | \$ (94,669) |
| Basic net earnings/(loss) per share  | \$ 0.02                                 | \$ (0.01)   |
| Basic weighted average shares outstanding  | 18,409,455                              | 15,579,913  |
| Diluted net earnings/(loss) per share  | \$ 0.01                                 | \$ (0.01)   |
| Diluted weighted average shares outstanding                                      | 46,774,960                              | 15,579,913  |

The accompanying notes are an integral part of these consolidated statements.

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

|                            | Temporary Equity |          | Permanent Equity |           |                             |                                      | Restated                         |                        |                              |                |
|----------------------------|------------------|----------|------------------|-----------|-----------------------------|--------------------------------------|----------------------------------|------------------------|------------------------------|----------------|
|                            | Preferred Stock  |          | Common Stock     |           | Common<br>Stock<br>Issuable | Related<br>Party Notes<br>Receivable | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Permanent<br>Equity<br>Total |                |
|                            | Shares           | Amount   | Shares           | Amount    |                             |                                      |                                  |                        |                              |                |
| Balance, December 31, 2004 | 2,045,714        | \$ 2,046 | 17,859,009       | \$ 17,859 | 544                         | \$ 14,291                            | \$ (81,100)                      | \$ 42,788,612          | \$ (45,104,823)              | \$ (2,364,617) |

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|   | Temporary Equity |          | Permanent Equity |           |       |           | Restated    |               |                 |                |
|---|------------------|----------|------------------|-----------|-------|-----------|-------------|---------------|-----------------|----------------|
| Collections on related party notes receivable   | --               | --       | --               | --        | --    | --        | 20,000      | --            | --              | 20,000         |
| March 31, 2005                                  |                  |          |                  |           |       |           |             |               |                 |                |
| Issuance of common stock Chesapeake             | --               | --       | --               | --        | 545   | --        | --          | 369,645       | --              | 370,190        |
| Expenses associated from registration statement | --               | --       | --               | --        | --    | --        | --          | (30,385)      | --              | (30,385)       |
| Net gain  | --               | --       | --               | --        | --    | --        | --          | --            | 432,962         | 432,962        |
| Balance, March 31, 2005                         | 2,045,714        | \$ 2,046 | 17,859,009       | \$ 17,859 | 1,089 | \$ 14,291 | \$ (61,100) | \$ 43,127,872 | \$ (44,671,861) | \$ (1,571,850) |

The accompanying notes are an integral part of these consolidated statements.

**WIDEPOINT CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | Three Months Ended March 31, |             |
|--|------------------------------|-------------|
|  | As Restated 2005             | 2004        |
|  | (unaudited)                  |             |
| Cash flows from operating activities:  |                              |             |
| Net earnings (loss)  | \$ 432,962                   | \$ (94,669) |
| Adjustments to reconcile net earnings/(loss) to net cash provided by operating activities: |                              |             |
| Depreciation expense   | 6,900                        | 1,789       |
| Amortization expense   | 69,820                       | --          |
| Stock compensation expense   | 370,190                      | --          |
| Deferred income taxes  | (110,980)                    | --          |
| Deferred financing costs   | 3,573                        | --          |
| Gain from financial instrument   | (996,263)                    | --          |
| Changes in assets and liabilities  |                              |             |
| Accounts receivable  | 728,084                      | 91,543      |
| Prepaid expenses and other assets  | 45,598                       | 15,234      |
| Other assets   | (54,825)                     | 3,748       |
| Accounts payable and accrued expenses  | (325,434)                    | (7,256)     |
| Net cash provided by operating activities  | \$ 169,625                   | \$ 10,389   |
| Net cash flows from investing activities:  |                              |             |
| Purchase of property and equipment   | (1,261)                      | --          |

|  | <b>Three Months<br/>Ended March 31,</b> |            |
|--|---|------------|
| Intangible development costs                   | (167,333)                               | --         |
| Net cash flows used in investing activities    | \$ (168,594)                            | \$ --      |
| Net cash used in financing activities          |   |            |
| Borrowings on notes payable                    | 158,866                                 | --         |
| Payments on notes payable                      | (367,781)                               | --         |
| Collections on related party notes             | 20,000                                  | --         |
| Expenses related to registration statement     | (30,385)                                | --         |
| Proceeds from exercise of stock options        | 10,250                                  | --         |
| Net cash used in financing activities          | \$ (209,050)                            | \$ --      |
| Net (decrease) increase in cash                | \$ (208,019)                            | \$ 10,389  |
| Cash and cash equivalents, beginning of period | \$ 463,525                              | \$ 949,612 |
| Cash and cash equivalents, end of period       | \$ 255,506                              | \$ 960,001 |
| Supplementary information:                     |   |            |
| Cash paid for interest                         | \$ 26,723                               | \$ --      |

The accompanying notes are an integral part of these consolidated statements.

**WIDEPOINT CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation, Organization and Nature of Operations:**

WidePoint Corporation ( WidePoint or the Company ) is an information technology ( IT ) services firm with established competencies in federal government and commercial sector IT consulting services, including planning, managing and implementing IT solutions, software and secure authentication processes, and specialized outsourcing arrangements. Our staff consists of business and computer specialists who help customers augment and expand their resident technologic skills and competencies, drive technical innovation, and help develop and maintain a competitive edge in today s rapidly changing technological environment in business.

In 2004, WidePoint acquired Chesapeake Government Technologies, Inc. ( Chesapeake ) and Operational Research Consultants, Inc. ( ORC ) as part of WidePoint s strategy to refocus our business development initiatives toward the substantial increase in government spending on infrastructure and automation that has been accelerated by recent geopolitical events that have created an unprecedented need for systems and process expertise across most government markets, federal, state and local. WidePoint intends to capitalize on the expected growth in its target markets through strategic acquisitions, continue rollout of ORC s Public Key Infrastructure ( PKI ) initiative, and continue to implement our project based enterprise strategy emphasizing industry-wide best practices disciplines. The Company intends to continue to leverage the synergies between its newly acquired operating subsidiaries and cross sell its technical capabilities into each separate marketplace serviced by its respective subsidiaries.

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The Company has physical locations in Oakbrook Terrace, Illinois, Fairfax, Virginia, Alexandria, Virginia, and Chesapeake, Virginia. The Company employees work at various client locations throughout the upper Midwest, Texas, and Mid Atlantic areas of the United States.

In addition, most of the Company's current costs consist primarily of the salaries and benefits paid to the Company's technical, marketing and administrative personnel and as a result of its plan to expand its operations through a combination of internal growth initiatives and merger and acquisition opportunities, the Company expects such costs to increase. The Company's profitability also depends upon both the volume of services performed and the Company's ability to manage costs. As a significant portion of the Company's costs is labor related, the Company must effectively manage these costs to achieve and grow its profitability. To date, the Company has attempted to maximize its operating margins through efficiencies achieved by the use of the Company's proprietary methodologies, and by offsetting increases in consultant salaries with increases in consultant fees received from its clients. The uncertainties relating to its ability to achieve and maintain profitability, obtain additional funding to fund its growth strategy and provide the necessary investment to continue to upgrade its management reporting systems to meet the continuing demands of the present regulatory changes affect the comparability of the information reflected in the selected consolidated financial information presented above. The Company believes that its cash on hand, and available senior lending facility are adequate to finance operations through 2005.

### *Restatement*

Management of the Company determined that we had not correctly accounted for the Chesapeake acquisition as 1) it should not have resulted in the recognition of an intangible asset, 2) Company shares that were placed in escrow for release only upon the achievement of certain future revenue should not have been recognized immediately, but instead, only upon the achievement of certain contingencies, 3) as a result of timing differences between the actual release from escrow on June 30, 2005 of the shares earned as of December 31, 2004, the Company should not have recorded the shares earned as of December 31, 2004 as common stock but recorded the shares as common stock issuable until the shares were released from escrow by the Company's transfer agent, which occurred on June 30, 2005, and 4) as a result of timing differences between the recording as of March 31, 2005 of the shares earned and the release of the shares from escrow, which will not occur until after the filing of the Company's financial statements on Form 10-K in 2006, the Company should not have recorded the shares as common stock, but recorded the shares as common stock issuable as of March 31, 2005.

While the Company's management believes that the Company did acquire assets in a business sense when it acquired the stock of Chesapeake, these assets, consisting primarily of Chesapeake's relationships with various sources of potential business opportunities, did not meet the criteria for recognition as assets under Statement of Financial Accounting Standards No. 141 (SFAS 141). Additionally, the acquisition could not, alternatively, give rise to goodwill because Chesapeake was in the development stage at the time of acquisition and therefore not considered a business.

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Management has acquiesced to the use of the ORC revenue as a basis for release of the escrowed shares under the belief that the revenue of ORC, which management believes was acquired as a result of Chesapeake relationships, qualifies as revenue for determination of the release of escrowed shares. For financial reporting purposes, however, the text of the Chesapeake agreement does not provide sufficient objective evidence of linkage between release of the shares and ORC revenue to allow for capitalizing the cost of the release as additional acquisition cost of ORC. A portion of the shares escrowed in the Chesapeake transaction were earned by the former shareholders of Chesapeake as of December 31, 2004 as a result of revenues realized by ORC since its acquisition by the Company. The shares were subsequently released from escrow after the filing of the Company's financial statements on Form 10-K in 2005, per the conditions of an escrow agreement between the Company and the former shareholders of Chesapeake.

As a consequence of these determinations, previously issued financial statements have been restated to eliminate the intangible asset associated with the Chesapeake acquisition, reverse the related amortization expense, expense as consulting fees the cost of the transaction attributable to the cost of issuance of the non-escrowed shares and other related direct costs at the time of acquisition, to record and expense as consulting fees in cost of sales the release of the shares from escrow at December 31, 2004, and to expense in cost of sales and record the value of those shares in equity that met as of March 31, 2005 the performance measures which would result in the release of those shares from escrow after the filing of the Company's financial statements on Form 10-K in 2006, per the conditions of an escrow agreement between the Company and the former shareholders of Chesapeake, and to record the shares in equity as common stock issuable until such time as they could be reclassified as common stock upon the release of the shares earned from escrow.

We also determined that certain amortization costs related to the ORC acquisition should have been recorded in cost of sales and not in amortization and depreciation; and we determined that under our October and November 2004 Barron financing agreements, preferred stock recorded should have been classified as temporary preferred equity and not permanent preferred equity. As such, we have restated our financial statements with a summary of the effects of the restatements to properly reflect the appropriate accounting treatment as follows:

Balance Sheet:

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|   | Previously<br>Reported | As Restated    | Previously<br>Reported | As Restated       |
|---|------------------------|----------------|------------------------|-------------------|
|   | March 31, 2005         | March 31, 2005 | December 31, 2004      | December 31, 2004 |
| Intangibles   | 3,260,935              | 1,766,459      | 3,190,927              | 1,668,945         |
| Total assets  | \$ 9,047,328           | \$ 7,552,852   | \$ 9,913,408           | \$ 8,391,426      |
| Preferred stock<br>(temporary equity)                             | n/a                    | 2,046          | n/a                    | 2,046             |
| Common stock  | 21,125                 | 17,859         | 21,125                 | 17,859            |
| Common stock issuable   | n/a                    | 1,089          | n/a                    | 544               |
| Preferred stock<br>(stockholders' equity)                         | 2,046                  | n/a            | 2,046                  | n/a               |
| Additional paid-in<br>capital                                     | 43,484,997             | 43,127,872     | 43,515,382             | 42,788,612        |
| Accumulated deficit   | (43,536,687)           | (44,671,861)   | (44,312,333)           | (45,104,823)      |
| Total permanent<br>shareholders' deficit                          | (75,328)               | (1,571,850)    | (840,589)              | (2,364,617)       |
| Total liabilities,<br>temporary equity &<br>shareholders' deficit | \$ 9,047,328           | \$ 7,552,852   | \$ 9,913,408           | \$ 8,391,426      |

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Statement of Operations:

|                                | Previously<br>Reported<br>Three Months<br>Ended | As Restated<br>Three Months<br>Ended |
|--------------------------------|---|--------------------------------------|
|                                | March 31, 2005                                  | March 31, 2005                       |
| Cost of sales                  | 1,847,163                                       | 2,272,622                            |
| Gross profit                   | 822,369   | 396,910                              |
| Depreciation &<br>Amortization | 88,945  | 6,170                                |



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|   |            |            |
|---|------------|------------|
| Loss from operations                        | (170,754)  | (513,438)  |
| Net (loss) earnings                         | 775,646    | 432,962    |
| Basic net (loss) earnings per share         | \$ 0.04    | \$ 0.02    |
| Basic weighted average shares outstanding   | 21,125,393 | 18,409,455 |
| Diluted net (loss) earnings per share       | \$ 0.01    | \$ 0.01    |
| Diluted weighted average shares outstanding | 51,983,931 | 46,774,960 |

Statement of Cash Flows:

|                            | Previously Reported | As Restated        |
|----------------------------|---------------------|--------------------|
|                            | Three Months Ended  | Three Months Ended |
|                            | March 31, 2005      | March 31, 2005     |
| Net (loss) earnings        | 775,646             | 432,962            |
| Amortization expense       | 97,326              | 69,820             |
| Stock compensation expense | n/a                 | 370,190            |

**2. Significant Accounting Policies**

*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of acquired entities since their respective dates of acquisition. All significant intercompany amounts have been eliminated.

*Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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

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period. Actual results could differ from those estimates.

### *Cash and Cash Equivalents*

Investments purchased with original maturities of three months or less are considered cash equivalents for purposes of these consolidated financial statements. The Company maintains cash and cash equivalents with various major financial institutions. At times, cash balances held at financial institutions were in excess of federally insured limits. The Company places its temporary cash investments with high-credit, quality financial institutions, and as a result, the Company believes that no significant concentration of credit risk exists with respect to these cash investments.

### *Accounts Receivable*

The majority of the Company's accounts receivable are due from either United States federal agencies or established companies in the following industries: manufacturing, consumer product goods, direct marketing, healthcare and financial services. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are due within 30 to 60 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due.

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

| Description                           | Balance at<br>Beginning of<br>Period | Additions<br>Charged to<br>Costs and<br>Expenses | Deductions | Balance at<br>End of<br>Period |
|---------------------------------------|--------------------------------------|--|------------|--------------------------------|
| For the quarter ended March 31, 2004, |                                      |  |            |                                |
| Allowance for doubtful accounts       | \$ 18,819                            | \$ 14  | \$ 14      | \$ 18,819                      |

For the quarter ended March 31, 2005,

|                                 |       |       |       |       |
|---------------------------------|-------|-------|-------|-------|
| Allowance for doubtful accounts | \$ -- | \$ -- | \$ -- | \$ -- |
|---------------------------------|-------|-------|-------|-------|

Unbilled accounts receivable on time-and-materials contracts represent costs incurred and gross profit recognized near the period-end but not billed until the following period. Unbilled accounts receivable on fixed-price contracts consist of amounts incurred that are not yet billable under contract terms. At March 31, 2005 and December 31, 2004, unbilled accounts receivable totaled \$12,869 and \$0, respectively.

### *Revenue Recognition*

The majority of the Company's revenues are derived from cost-plus, or time-and-materials contracts. Under cost-plus contracts, revenues are recognized as costs are incurred and include an estimate of applicable fees earned. For time-and-material contracts, revenues are computed by multiplying the number of direct labor-hours expended in the performance of the contract by the contract billing rates and adding other billable direct costs. In the event of a termination of a contract, all billed and unbilled amounts associated with those task orders where work has been performed would be billed and collected. The termination provisions of the contract would be accounted for at the time of termination. Any deferred and/or amortization cost would either be billed or expensed depending upon the termination provisions of the contract. Further, the Company has had no history of losses nor has it identified any specific risk of loss at March 31, 2005 or on December 31, 2004 due to termination provisions and thus has not recorded provisions for such events.

The Company's other revenues are derived from the delivery of non-customized software. In such cases revenue is recognized when there is persuasive evidence that an arrangement exists (generally a purchase order has been received or contract signed), delivery has occurred, the charge for the software is fixed or determinable, and collectibility is probable.

### *Significant Customers*

For the quarter ended March 31, 2005, two customers, Tangible Software and The Department of Homeland Security, individually represented approximately 15% and 14% of revenues, respectively, and we therefore are materially dependent upon such customers. Due to the nature of our business and the relative size of certain contracts which are entered into in the ordinary course of business, the loss of any single significant

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customer, including the above customers, would have a material adverse effect on results. For the quarter ended March 31, 2004, four customers, Abbot Laboratories, Spencer Stuart, Manpower, and Baxter Healthcare, individually represented 18%, 14%, 13%, and 13% of revenue, respectively.

### *Fair value of financial instruments*

The Company's financial instruments include cash equivalents, accounts receivable, accounts payable, short-term debt and other financial instruments associated with the issuance of the common stock warrants attributable to the preferred stock capital investment in the Company in October of 2004. The carrying values of cash equivalents, accounts receivable and accounts payable approximate their fair value because of the short maturity of these instruments. The carrying amounts of the Company's bank borrowings under its credit facility approximate fair value because the interest rates are reset periodically to reflect current market rates.

The Company's financial instruments also include a financial instrument in which a valuation for the warrants issued by the Company under the Barron Partners, LP preferred financing agreement contained a registration rights agreement which contained a liquidating damages provision. Accordingly, a Black Scholes calculation was used to determine the fair value of those warrants which are classified as a financial instrument. The Financial Instrument was marked to market at March 31, 2005.

### *Concentrations of Credit Risk*

Financial instruments that potentially subject the Company to credit risk, which consist of cash and cash equivalents and accounts receivable. As of March 31, 2005, two customers, Tangible Software and The Department of Homeland Security accounted for approximately 25% and 18%, respectively of accounts receivable. As of December 31, 2004, two customers, The Department of Homeland Security and Tangible Software, individually represented 24% and 13% of accounts receivable, respectively.

### *Income Taxes*

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. Under SFAS No.109, deferred tax assets and liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. SFAS No. 109 requires that the net deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the net deferred tax asset will not be realized.

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### *Property and Equipment*

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

|   | <u>March 31,</u> | <u>December 31,</u> |
|---|------------------|---------------------|
|   | <u>2005</u>      | <u>2004</u>         |
| Computers, equipment and software               | \$ 91,290        | \$ 90,029           |
| Less- Accumulated depreciation and amortization | (16,277)         | (9,377)             |
|   | <u>\$ 75,013</u> | <u>\$ 80,652</u>    |

Depreciation expense is computed using the straight-line method over the estimated useful lives of three years.

In accordance with the American Institute of Certified Public Accountants Statement of Position 98-1 Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, the Company capitalizes costs related to software and implementation in connection with its internal use software systems.

### *Software Development Costs*

WidePoint accounts for software development costs related to software products for sale, lease or otherwise marketed in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise

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Marketed. For projects fully funded by the Company, significant development costs are capitalized from the point of demonstrated technological feasibility until the point in time that the product is available for general release to customers. Once the product is available for general release, capitalized costs are amortized based on units sold, or on a straight-line basis over a six-year period or other such shorter period as may be required. WidePoint recorded approximately \$14,000 of amortization expense for the period ending March 31, 2005. WidePoint recorded approximately \$9,700 of amortization expense for the year ended December 31, 2004. Capitalized software costs included in Other Intangibles at March 31, 2005 and December 31, 2004 were approximately \$0.7 and \$0.6 million, respectively.

### *Goodwill, Intangibles, and Long-Lived Assets*

Goodwill represents costs in excess of fair values assigned to the underlying net assets acquired. The Company has adopted the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. These standards require the use of the purchase method of accounting for business combinations, set forth the accounting for the initial recognition of acquired intangible assets and goodwill and describe the accounting for intangible assets and goodwill subsequent to initial recognition. Under the provisions of these standards, goodwill is not subject to amortization and annual review is required for impairment. The impairment test under SFAS No. 142 is based on a two-step process involving (i) comparing the estimated fair value of the related reporting unit to its net book value and (ii) comparing the estimated implied fair value of goodwill to its carrying value. Impairment losses are recognized whenever the implied fair value of goodwill is less than its carrying value. The Company's annual impairment testing date is December 31.

The Company recognizes an acquired intangible apart from goodwill whenever the intangible arises from contractual or other legal rights, or when it can be separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged, either individually or in combination with a related contract, asset or liability. Such intangibles are amortized over their useful lives. Impairment losses are recognized if the carrying amount of an intangible subject to amortization is not recoverable from expected future cash flows and its carrying amount exceeds its fair value.

The Company reviews its long-lived assets, including property and equipment, identifiable intangibles, and goodwill annually or whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of its long-lived assets, the Company evaluates the probability that future undiscounted net cash flows will be less than the carrying amount of the assets.

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### *Basic and Diluted Net Loss Per Share*

Basic income or loss per share includes no dilution and is computed by dividing net income or loss by the weighted-average number of common shares outstanding for the period. Diluted income or loss per share includes the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The treasury stock effect of the conversion of preferred stock to common stock, options, and warrants to purchase 27,827,156 shares of common stock outstanding at March 31, 2005 has been included in the calculation of the fully diluted net income per share as such effect would have been dilutive. The treasury stock effect of the options and warrants to purchase 2,112,000 shares of common stock outstanding at March 31, 2004 has not been included in the calculation of the net loss per share as such effect would have been anti-dilutive.

### *Stock-based compensation*

#### Employee Compensation:

The Company accounts for stock-based employee compensation arrangements using the intrinsic value method in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and complies with the disclosure provisions of SFAS No. 123 *Accounting for Stock-Based Compensation*. Under APB Opinion No. 25, compensation cost is generally recognized based on the difference, if any, on the date of grant between the fair value of the Company's common stock and the amount an employee must pay to acquire the stock. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement 123, *Accounting for Stock-Based Compensation*, using the assumptions described in Note 8, to its stock-based employee plans.

|                                  | Three Months ended<br>March 31, |             |
|----------------------------------|---------------------------------|-------------|
|                                  | <b>As Restated</b>              |             |
|                                  | <b>2005</b>                     | <b>2004</b> |
| Net earnings (loss), as reported | \$ 432,962                      | \$ (94,669) |
| Add: Total stock-based employee  |                                 |             |

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|   | Three Months ended<br>March 31, |              |
|---|---------------------------------|--------------|
| compensation expense determined under fair value method, net of related effects | (250,813)                       | (87,712)     |
| Pro forma net earnings (loss)   | \$ 182,149                      | \$ (182,381) |
| Net earnings (loss) per share:  |                                 |              |
| Basic - as reported   | \$ 0.02                         | \$ (0.01)    |
| Diluted - as reported   | \$ 0.01                         | \$ (0.01)    |
| Basic - pro forma   | \$ 0.01                         | \$ (0.01)    |
| Diluted - pro forma   | \$ 0.00                         | \$ (0.01)    |

The pro forma disclosure is not likely to be indicative of pro forma results which may be expected in future years because of the fact that options vest over several years, pro forma compensation expense is recognized as the options vest and additional awards may also be granted.

For purposes of determining the effect of these options, the fair value of each option is estimated on the date of grant based on the Black-Scholes single-option pricing model assuming the following for the three months ended March 31, 2005:

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|                             |            |
|-----------------------------|------------|
| Dividend yield              | --         |
| Risk-free interest rate (%) | 2.70-4.13% |
| Volatility factor (%)       | 156%       |
| Expected life in years      | 5          |

Non-employee based compensation:

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

**3. Debt**

|  | March 31,<br>2005 | December 31,<br>2004 |
|--|-------------------|----------------------|
| <i>Borrowings under WidePoint's Senior Debt Agreement:</i> | \$ 1,383,493      | \$ 1,592,408         |

On October 25, 2004, the Company executed a senior lending agreement with RBC-Centura. The Agreement initially provides for a \$2.5 million revolving credit facility. The maturity date of the credit facility is October 25, 2005.

The maximum available borrowing under revolving credit facility at March 31, 2005 and December 31, 2004 was \$1.8 million and \$2.2 million, respectively. Borrowings under the Agreement are collateralized by the Company's eligible contract receivables, inventory, all of its stock in certain of our subsidiaries and certain property and equipment, and bear interest at the Prime Rate which was 5.75% and 5% on March 31, 2005 and December 31, 2004, respectively.

WidePoint's credit facility requires that the Company maintain specified financial covenants relating to fixed charge coverage, interest coverage, and debt coverage, and maintain a certain level of consolidated net worth. The weighted average borrowings under the revolving portion of the facility and the prior agreement for the quarter ended March 31, 2005 and during the year ended December 31, 2004, were \$1.5 and \$1.5 million, respectively. In conjunction with the execution of the credit facility, the Company recorded \$0.1 million in loan origination costs, included in other assets, which have been amortized ratably over the term of the credit facility which commenced in October of 2004 and will expire in October of 2005.

The total interest and finders' fees paid were approximately \$34,000 for the year ended December 31, 2004. The total interest fees paid for the quarter ended March 31, 2005 was approximately \$20,000.

#### 4. Goodwill and Intangibles

Effective January 1, 2002, WidePoint adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. Under SFAS 142, goodwill is to be reviewed at least annually for impairment. The Company has elected to perform this review on December 31<sup>st</sup> of each calendar year. These reviews have resulted in no adjustments in goodwill.

During 2004, WidePoint completed the acquisition of Operational Research Consultants, Inc. As a result of this acquisition the Company has acquired goodwill and intangibles. The following details the components of goodwill and intangibles:

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|  | As of March 31, 2005             |                                     |
|--|----------------------------------|-------------------------------------|
|  | <u>Gross Carrying<br/>Amount</u> | <u>Accumulated<br/>Amortization</u> |
| Amortized intangible assets  |                                  |                                     |
| (1) ORC Intangible (Includes customer relationships and PKI business opportunity purchase accounting preliminary valuations) | \$ 1,145,523                     | \$ (92,116)                         |
| (2) PKI-I Intangible (Related to internally generated software)  | 334,672                          | (24,251)                            |
| Total  | <u>\$ 1,480,195</u>              | <u>\$ (116,367)</u>                 |
| Unamortized intangible assets  |                                  |                                     |
| (3) Other (PKI-II Intangible)  | <u>\$ 402,630</u>                |                                     |
| Total  | \$ 402,630                       |                                     |
| <b><u>Aggregate Amortization Expense:</u></b>  |                                  |                                     |
| For quarter ended 3/31/05  | \$ 69,820                        |                                     |
| <b><u>Estimated Amortization Expense:</u></b>  |                                  |                                     |
| For year ended 12/31/05  | \$ 300,140                       |                                     |
| For year ended 12/31/06  | \$ 321,000                       |                                     |
| For year ended 12/31/07  | \$ 321,000                       |                                     |
| For year ended 12/31/08  | \$ 321,000                       |                                     |
| For year ended 12/31/09  | \$ 321,000                       |                                     |

- (1) The ORC intangible is made up of the estimated preliminary purchase accounting associated with the valuation assigned by the Company to ORC's customer relationships and PKI business opportunity. The PKI business opportunity intangible has an estimated life of 6 years and ORC's customer relationships have an estimated life of 5 years. The PKI business opportunity was estimated based upon the contractual life assigned to the authority to issue PKI certificates by the federal government. The fair value of the PKI business opportunity was estimated using the expected present value of future cash flows estimated by the Company for ORC's PKI business opportunity. ORC's customer relationship intangible was estimated based upon an analysis of the historic life of ORC's present customer relationships and their present contract opportunities. A fair value was estimated using the expected present value of the estimated future cash flows generated from those relationships. The weighted average life of this intangible asset class is 5.5 years.

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- (2) The PKI-I intangible is related to internally generated software that was associated with ORC's PKI-I development of its phase 1 software offerings. ORC commenced sales of its PKI-I service in August of 2004. It has a weighted average life of 5 years and is based upon the contractual life assigned to the authority to issue PKI certificates by the federal government.
- (3) The PKI-II intangible is related to a secondary PKI software development effort by ORC which is still ongoing. Therefore, no amortization expense has been incurred.

The total weighted average life of all of the intangibles is approximately 5 years.

There were no amounts of research and development assets acquired during the quarter ending March 31, 2005, nor any written off in the period.

There were no changes in the carrying amount of goodwill for the quarter ended March 31, 2005.

The goodwill acquired is associated with the acquisition of ORC in October of 2004. No impairment was required as of March 31, 2005.

## 5. Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. Under SFAS No. 109, deferred tax assets and liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. SFAS No. 109 requires that the net deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the net deferred tax asset will not be realized.

The Company has determined that its net deferred tax asset did not satisfy the recognition criteria set forth in SFAS No. 109 and, accordingly, established a valuation allowance for 100 percent of the net deferred tax asset, less the deferred liability related to the Section 481(a) adjustment.

As of December 31, 2004 the Company had net operating loss carry forwards of approximately \$20,628,000 to offset future taxable income. These carry forwards expire between 2010 and 2024. Under the provision of the Tax Reform Act of 1986, when there has been a change in an entity's ownership of 50 percent or greater, utilization of net operating loss carry forwards may be limited. As a result of WidePoint's equity transactions, the Company's net operating losses will be subject to such limitations and may not be available to offset future income for tax purposes.

## 6. Temporary Preferred Stock

### *Temporary Preferred Stock*

Our certificate of incorporation authorizes the Company to issue up to 10,000,000 shares of preferred stock, \$0.001 par value per share, of which 2,045,714 shares were outstanding at December 31, 2004.

Pursuant to the Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock, filed with the Secretary of State of the State of Delaware on November 9, 2004, 2,045,714 shares of the Company's preferred stock are designated as Series A Convertible Preferred Stock having the following rights:

Each share of Series A Convertible Preferred Stock has a conversion rate equal to \$0.175 per share and is convertible at the option of the holder into ten shares of common stock.

The conversion of the Series A Convertible Preferred Stock is subject to the following conditions:

Subject to waiver, holders of Series A Convertible Preferred Stock do not have the right to convert any portion of the preferred stock to the extent that after giving effect to such conversion, the holder (together with any affiliates of the holder), would beneficially own in excess of 4.99% of the number of shares of the common stock outstanding immediately after giving effect to such conversion. In the event the converted shares when issued and combined with all other shares of

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common stock beneficially owned by the holder and its affiliates equals, at any time, more than 4.99% of the total number of then outstanding shares of common stock, then for so long as such holder and its affiliates beneficially owns more than 4.99% of the total number of then outstanding shares of common stock, the holder of the converted shares and its affiliates shall have no more than 22% of the total voting power of all outstanding shares of common stock at any time.

Holders of WidePoint's Series A Convertible Preferred Stock are entitled to receive a liquidation preference equal to \$1.75 per share in the event of the liquidation, dissolution, or winding up of the Company's business.

Holders of Series A Convertible Preferred Stock are not entitled to voting rights. However, unless approved by the holders of the outstanding Series A Convertible Preferred Stock, the Company cannot: (a) alter or change adversely the powers, preferences or rights given to the Series A Convertible Preferred Stock or alter or amend the certificate of designation relating to the Series A Convertible Preferred Stock, (b) authorize or create any class of stock ranking as to dividends or distribution of assets upon a liquidation senior to or otherwise pari passu with the Series A Convertible Preferred Stock, (c) amend the certificate of incorporation or other charter documents in breach of the certificate of designations, or (d) increase the authorized number of shares of Series A Convertible Preferred Stock.

Dividends are not payable with respect to the Series A Convertible Preferred Stock.

Shares of Series A Convertible Preferred Stock are subject to automatic conversion generally under the following circumstances: (i) a change in control of WidePoint, (ii) the consummation of a public offering (with a value of at least \$5 million or more) of our common stock, (iii) upon receipt of the consent of all holders of the Series A Convertible Preferred Stock, or (iv) in the event that the fair market value of the outstanding shares of our common stock exceeds \$100 million.

As a result of the issuance of a registration rights agreement that contained a liquidated damages clause, the Company is required to follow the Emerging Issues Task Force EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock by the Company (see footnote 8). In light of the required accounting treatment under EITF 00-19, the entire proceeds of the issuance were allocated to warrants and as such no proceeds have been allocated to the preferred stock issuance.

### *Registration Rights Agreement*

The shares of common stock issuable by WidePoint to Barron upon a conversion of shares of the Series A Convertible Preferred Stock or an election to exercise all or a portion of the warrants will not be registered under the Securities Act of 1933. To provide for the registration of such underlying shares, Barron and WidePoint entered into a registration rights agreement, dated October 20, 2004, requiring WidePoint to prepare and file a registration statement covering the resale of the shares of common stock underlying the Series A Convertible Preferred Stock and warrants. The registration statement was filed on January 5, 2005. The registration rights agreement further required WidePoint to use its best efforts to cause such registration statement to be declared effective by February 22, 2005 (i.e., 120 days following the closing of the sale of the Series A Convertible Preferred Stock).

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The registration rights agreement also contains a liquidated damages provision which calls for Barron to receive from WidePoint a specified amount if: (i) WidePoint fails to file a registration statement covering the underlying shares of common stock; (ii) the registration statement is not declared effective by February 22, 2005; or (iii) the registration statement is not effective in the period from April 23, 2005 (i.e., 180 days following the October 25, 2004 closing of the preferred financing) through the two years following the date of the registration rights agreement, subject to permissible blackout periods and registration maintenance periods. In the event that one of the aforementioned events occurs, the registration rights agreement calls for WidePoint to pay Barron a cash amount equal to the lesser of \$20,000 or 1% of the purchase price of that portion of the Series A Convertible Preferred Stock which has not been converted into common stock as of the occurrence of such event, with such amount to be paid by WidePoint to Barron on a monthly basis after the occurrence of such event. Barron is entitled to receive the aforementioned damages until such time as the registration statement is declared effective. Since the registration statement registering the underlying shares of common stock has not yet been declared effective, Barron is currently entitled to receive such damages. However, WidePoint has received a waiver from Barron for all damages accrued under this provision through September 30, 2005. As such, WidePoint has paid no damages under this provision to date. If the registration statement is not declared effective by the SEC and does not remain effective during the above two-year period, the maximum amount of damages payable pursuant to this provision would be \$260,000.

## **7. Stockholders Equity**

The Company is authorized to issue 110,000,000 shares of common stock, \$.001 par value per share. As of March 31, 2005 and December 31, 2004, respectively, there were 18,947,804 and 18,403,407 shares of common stock outstanding. The shares of common stock outstanding as of



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March 31, 2005 does not include escrowed common stock for 5,555,556 and 2,177,590 shares that are associated with shares issued and held in escrow pending contingent release. The shares of common stock outstanding as of December 31, 2004 does not include escrowed common stock for 5,555,556 and 2,721,987 shares that are associated with shares issued and held in escrow pending contingent release. As of March 31, 2005, 5,555,556 common shares have been issued and placed into escrow with none of those shares yet having been earned under a purchase agreement between WidePoint and ORC. As of March 31, 2005, 2,721,987 common shares have been issued and placed into escrow with 544,397 of those escrowed common shares having met certain performance measures as of March 31, 2005 that will allow for their release pending the completion of the Company's audited financial statements for the period ending December 31, 2005, as further described under a purchase agreement between WidePoint and Chesapeake. The rights, preferences and privileges of holders of common stock are subject to, and may be adversely affected by the rights of the holders of shares Series A Convertible Preferred Stock and of any additional series of preferred stock that may be designated and issued in the future.

### Common Stock

On October 25, 2004, WidePoint completed the acquisition of Operational Research Consultants, Inc., or ORC, a privately held IT and engineering firm providing mission-critical sensitive and strategic information security solutions to the United States Government. Pursuant to the terms of a Purchase Agreement entered into on October 25, 2004, between the Company and the ORC shareholders, the Company issued 5,555,556 common shares of the Company's common stock and placed it into an escrow to be released to the ORC shareholders in the event they attain certain performance parameters in 2004 and 2005. As of March 31, 2005, no common shares were released from escrow.

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On April 30, 2004, the Company closed upon the acquisition of all the issued and outstanding shares of Chesapeake, pursuant to the terms of an Agreement and Plan of Merger, dated as of March 24, 2004. WidePoint issued 4,082,980 shares of its common stock to stockholders of Chesapeake in consideration for all of the issued and outstanding shares of Chesapeake owned by them. In conjunction with this closing, the sole stockholders also entered into an escrow agreement and deposited 3,266,384 shares of the 4,082,980 newly issued shares of WidePoint common stock into escrow. The 3,266,384 shares of common stock placed into escrow have not been recorded in equity and will be released to the Chesapeake Shareholders in the event of the satisfaction of certain conditions set forth in the merger agreement, which provides that during the period commencing after the closing of the merger and ending on December 31, 2005, the 3,266,384 shares of common stock will be released to the Chesapeake Shareholders in a ratio based on the amount of revenues actually received by the Company from the business acquired from Chesapeake. The December 31, 2005 escrow expiration date may be extended for one additional year in the event it is determined that Chesapeake has achieved certain performance levels in the latter part of 2005. In the event that WidePoint does not receive certain levels of revenues from the business acquired from Chesapeake, then any of the 3,266,384 shares of common stock to which the Chesapeake Shareholders have not become entitled to receive will be returned to the Company. The Company recorded in equity and issued 816,596 of the common shares out of 4,082,980 common shares issued to the Chesapeake Shareholders at the time of the acquisition of Chesapeake. The Company recorded the shares in common stock issuable at the time of the acquisition and subsequently recorded the shares in common stock after the shares were issued by the Company's transfer agent on July 13, 2004. As a result of meeting certain performance measures by December 31, 2004 the Company recorded in equity 544,398 common shares, which were held in escrow by the Company. The shares were recorded as common stock issuable. Per an agreement between the Company and the original shareholders of Chesapeake, the shares will be released from escrow and subsequently recorded as common stock after the filings of the Company's financial statements on Form 10-K for the period ending December 31, 2004. As a result of meeting certain performance measures by March 31, 2005, the Company recorded in equity the pending release of 544,397 additional common shares on March 31, 2005, which will continue to be held in escrow until the after the filing of the Company's financial statements on Form 10-K for the year ended December 31, 2005 per an agreement between the Company and the original shareholders of Chesapeake. These shares have not been recorded in common stock but in common stock issuable. The remaining unearned Chesapeake common shares held in escrow that have not met certain performance measures as of March 31, 2005 have not been expensed or recorded within equity.

Pursuant to an agreement on April 30, 2004 between the Company and Tripoint Capital Advisors, LLP, the company issued 500,000 shares of its common stock without registration under the Securities Act of 1933 for services rendered in association with the Chesapeake acquisition. These shares were reported at the fair value at the date of issuance.

Pursuant to stock purchase agreements entered into on July 8, 2002, between the Company and each of Steve L. Komar, James T. McCubbin and Mark M. Mirabile, the Company privately sold 865,000 shares of its common stock to each such person without registration under the Securities Act of 1933, pursuant to the private offering exemption under Section 4(2) thereof, in consideration of a three-year full-recourse note.

### *Common Stock Issuable*

The Company entered into an escrow agreement with the original Chesapeake shareholders, which required certain performance measures to be achieved to cause the shares to be earned and subsequently released. The difference between the dates the shares were earned and subsequently released from escrow resulted in a timing difference, which required the Company to record the shares when they were earned as common stock issuable and subsequently reclassified as common stock upon the release of the shares from escrow. The Company recorded the shares that have

been earned per certain performance measures at each recording date, while the escrow agreement only allowed for the release of the shares earned after the Company's fiscal year filings of its financial statements on Form 10-K, for each respective period, per the terms of the escrow agreement.

On December 31, 2004 the original shareholders of Chesapeake earned 544,398 shares, which will be released from escrow after the filing of the Company's financial statements on Form 10-K for the period ending December 31, 2004, per an escrow agreement between the Company and the original Chesapeake shareholders. As such, the shares were recorded as Common Stock Issuable as of December 31, 2004. Upon the filing of the Company's financial statements on Form 10-K for the period ending December 31, 2004, the shares will be released from escrow and at that time reclassified as Common Stock. On March 31, 2005, the original shareholders of Chesapeake earned 544,397 shares, which will not be released from escrow until after the filing of the Company's financial statements on Form 10-K for the period ending December 31, 2005, per an agreement between the Company and the original Chesapeake shareholders. Therefore, the Company has recorded the shares as Common Stock Issuable as of March 31, 2005. The remaining unearned Chesapeake common shares held in escrow that have not met certain performance measures as of March 31, 2005 have not been expensed or recorded within equity.

#### *Stock Warrants*

On October 27, 2004 and November 22, 2004, the Company issued warrants to purchase 30,612 and 5,556 shares of common stock, respectively to Liberty Capitol as part of a consulting agreement in which Liberty Capitol assisted the Company in arranging its senior debt financing with RBC-Centura. The warrants have a term of 5 years. The Company used a fair-value option pricing model to value these stock warrants at approximately \$14,291. This value has been reflected as part of stock warrants in the stockholders' equity section of the consolidated balance sheet and is being amortized over the life of the debt as interest expense.

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#### *Related Party Notes*

Pursuant to stock purchase agreements entered into on July 8, 2002, between the Company and each of Steve L. Komar, James T. McCubbin and Mark M. Mirabile, the Company privately sold 865,000 shares of its common stock to each such person without registration under the Securities Act of 1933, pursuant to the private offering exemption under Section 4(2) thereof, in consideration of a three-year full-recourse, 5% interest bearing promissory note with equal annual principal payments due, issued by each such person to the Company in the principal amount of \$60,550.00, or \$181,650.00 in the aggregate (which equals \$0.07 per share, being the closing price of the Company's common stock on July 8, 2002). Amounts outstanding under these notes are reflected as a reduction to stockholders' equity until paid.

#### **8. Financial Instrument**

In October of 2004, the Company issued warrants to purchase 10,228,571 shares of common stock to Barron Partners, LP as part of a preferred stock financing. The warrants have a term of 5 years. The value of these warrants has been reflected as a financial instrument in the short-term liabilities section of the consolidated balance sheet as a result of the issuance of a registration rights agreement that included a liquidated damages clause, which is linked to an effective registration of such securities. Accordingly, the Company applied EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* and accounted for the warrants as a liability. In light of the required accounting treatment under EITF 00-19, the Company is also required to value the fair market price of the financial instrument as of March 31, 2005. The Company utilized a Black-Scholes calculation to determine the fair valuation of the financial instrument on March 31, 2005. We used a volatility input of 101% and a risk free interest rate of 4.18% and a warrant exercise price of \$0.40 per common share. The fair value utilizing this calculation produced a computed result for the financial instrument of \$5,652,308. As of December 31, 2004, the value of the financial instrument was \$6,648,571. The difference between the measured fair value marked to market at December 31, 2004 and March 31, 2005 resulted in the gain from financial instrument of \$996,263.

#### **9. Litigation**

As of December 31, 2004, ORC was the defendant in a lawsuit entitled Fleurette v. ORC, C.A. No. 1:04-cv-1054, in the Eastern District of Virginia, in which Renee Fleurette Gallagher, a former employee of ORC, alleged that ORC wrongfully terminated her employment with ORC. The plaintiff sought an unspecified amount of damages from ORC. Prior administrative and judicial proceedings instituted by Ms. Gallagher against ORC have been dismissed or found to be without merit. ORC did not believe that it had committed any wrong against Ms. Gallagher and therefore vigorously defended itself in the lawsuit filed by Ms. Gallagher. As part of the agreements entered into between WidePoint, ORC and the former stockholders of ORC at the time of WidePoint's acquisition of ORC, the former stockholders of ORC agreed to indemnify WidePoint and ORC from any liability involving the claims by Ms. Gallagher against ORC, including the above-captioned lawsuit. In February of 2005, a settlement was reached between the parties and the complaints were dismissed.

Other than as described above, the Company is not involved in any material legal proceedings.

## 10. Subsequent events

In April and May of 2005, Barron Partners LP converted 300,000 preferred shares into 3,000,000 common shares and subsequently sold the 3,000,000 common shares in private transactions to three institutional investors. Barron Partners LP also exercised warrants purchasing 2,000,000 common shares and subsequently sold the 2,000,000 common shares in private transactions to two institutional investors. As a result of the exercise of the 2,000,000 warrants, the Company realized gross proceeds of \$800,000.

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

The following discussion and analysis of the financial condition and results of operations of the Company should be read in conjunction with the financial statements and the notes thereto which appear elsewhere in this quarterly report and the Company's Annual Report on Amended Form 10-K for the year ended December 31, 2004.

The information set forth below includes forward-looking statements. Certain factors that could cause results to differ materially from those projected in the forward-looking statements are set forth below. Readers are cautioned not to put undue reliance on forward-looking statements. The Company disclaims any intent or obligation to update publicly these forward-looking statements, whether as a result of new information, future events or otherwise.

### **Restatement and Overview**

WidePoint is an information technology (IT) services firm with established competencies in federal government and commercial sector IT consulting services, including planning, managing and implementing IT solutions, software and secure authentication processes, and specialized outsourcing arrangements. Our staff consists of business and computer specialists who help customers augment and expand their resident technologic skills and competencies, drive technical innovation, and help develop and maintain a competitive edge in today's rapidly changing technological environment in business.

In 2004, WidePoint acquired Chesapeake Government Technologies, Inc. (Chesapeake) and Operational Research Consultants, Inc. (ORC) as part of WidePoint's strategy to refocus the Company's business development initiatives toward the substantial increase in government spending on infrastructure and automation that has been accelerated by recent geopolitical events that have created an unprecedented need for systems and process expertise across most government markets, federal, state and local. This market is also growing due to the fact that many government legacy systems and processes are approaching the end of their technologically useful lives, indicating the need for significant upgrade and enhancement. WidePoint intends to capitalize on the expected growth in its target markets through its strategic acquisitions, continuing rollout of the ORC Public Key Infrastructure (PKI) initiative, and by continuing to implement our project based enterprise strategy emphasizing industry-wide best practices disciplines.

With the addition of the customer base and the increase in revenues attributable from the ORC acquisition, WidePoint's opportunity to leverage and expand further into the federal marketplace has improved dramatically. ORC's past client successes, top security clearances in their facilities and with their personnel, and additional breadth of management talent have expanded the Company's reach into markets that previously were not accessible to WidePoint. WidePoint intends to continue to leverage the synergies between the newly acquired operating subsidiaries and cross sell those technical capabilities into each separate marketplace serviced by its respective subsidiaries. Further, WidePoint is continuing to actively search out new synergistic acquisitions that we believe will further enhance the present base of business, which has been augmented by our recent acquisitions and internal growth initiatives.

As a result of these actions WidePoint's revenues for the period ending March 31, 2005 increased by approximately 285% from approximately \$0.7 million for the period ending March 31, 2004 to \$2.7 million for the period ending March 31, 2005. This increase was materially due to the additional revenues generated by WidePoint's acquisition of ORC in October 2004. Due to our recent acquisition of ORC we presently derive a relatively larger base of revenue from contracts with U.S. government agencies and U.S. government contractors that are focused on national security. Funding for these programs and services are generally linked to trends in U.S. government spending in the areas of defense, intelligence and homeland security. Leading up to and following the terrorist events of September 11, 2001, the U.S. government substantially increased its overall defense, intelligence and homeland security budgets. Because of the increasing focus on national security, ORC's client relationships in this sector, and ORC's PKI initiative we anticipate that quarterly revenues will continue at these levels or higher levels in future quarters.

A number of factors, including the progress of contracts, revenues earned on contracts, the number of billable days in a quarter, the timing of the pass-through of other direct costs, the commencement and completion of contracts during any particular quarter, the schedule of the government agencies for awarding contracts, the term of each contract that we have been awarded and general economic conditions may subject our revenues and operating results to significant variation from quarter to quarter. Because a significant portion of our expenses, such as personnel and facilities costs, are fixed in the short term, successful contract performance and variation in the volume of activity as well as in the number of contracts commenced or completed during any quarter may cause significant variations in operating results from quarter to quarter.

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With our recent acquisition of ORC we rely upon a larger portion of our revenues from the Federal Government directly or as a subcontractor. The Federal Government's fiscal year ends September 30. If a budget for the next fiscal year has not been approved by that date, our clients may have to suspend engagements that we are working on until a budget has been approved. Such suspensions may cause us to realize lower revenues in the fourth quarter and/or first quarter of the year. Further, a change in presidential administrations and in senior government officials may negatively affect the rate at which the Federal Government purchases the services which we offer.

As a result of the factors above, period-to-period comparisons of our revenues and operating results may not be meaningful. You should not rely on these comparisons as indicators of future performance as no assurances can be given that quarterly results will not fluctuate, causing a possible material adverse effect on our operating results and financial condition.

In addition, most of WidePoint's current costs consist primarily of the salaries and benefits paid to WidePoint's technical, marketing and administrative personnel. As a result of our plan to expand WidePoint's operations through a combination of internal growth initiatives and merger and acquisition opportunities, WidePoint expects such costs to increase. WidePoint's profitability also depends upon both the volume of services performed and the Company's ability to manage costs. As a significant portion of the Company's cost is labor related, WidePoint must effectively manage these costs to achieve and grow its profitability. To date, the Company has attempted to maximize its operating margins through efficiencies achieved by the use of its proprietary methodologies, and by offsetting increases in consultant salaries with increases in consultant fees received from its clients. The uncertainties relating to the ability to achieve and maintain profitability, obtain additional funding to partially fund the Company's growth strategy and provide the necessary investment to continue to upgrade its management reporting systems to meet the continuing demands of the present regulatory changes affect the comparability of the information reflected in the selected consolidated financial information presented above.

Management of the Company determined that we had not correctly accounted for the Chesapeake acquisition as 1) it should not have resulted in the recognition of an intangible asset, 2) Company shares that were placed in escrow for release only upon the achievement of certain future revenue should not have been recognized immediately, but instead, only upon the achievement of certain contingencies, 3) as a result of timing differences between the actual release from escrow on June 30, 2005 of the shares earned as of December 31, 2004, the Company should not have recorded the shares earned as of December 31, 2004 as common stock but recorded the shares as common stock issuable until the shares were released from escrow by the Company's transfer agent, which occurred on June 30, 2005, and 4) as a result of timing differences between the recording as of March 31, 2005 of the shares earned and the release of the shares from escrow, which will not occur until after the filing of the Company's financial statements on Form 10-K for the year ended December 31, 2005, the Company should not have recorded the shares as common stock, but recorded the shares as common stock issuable as of March 31, 2005.

While the Company's management believes that the Company did acquire assets in a business sense when it acquired the stock of Chesapeake, these assets, consisting primarily of Chesapeake's relationships with various sources of potential business opportunities, did not meet the criteria for recognition as assets under Statement of Financial Accounting Standards No. 141 (SFAS 141). Additionally, the acquisition could not, alternatively, give rise to goodwill because Chesapeake was in the development stage at the time of acquisition and therefore not considered a business.

Management has acquiesced to the use of the ORC revenue as a basis for release of the escrowed shares under the belief that the revenue of ORC, which management believes was acquired as a result of Chesapeake relationships, qualifies as revenue for determination of the release of escrowed shares. For financial reporting purposes, however, the text of the Chesapeake agreement does not provide sufficient objective evidence of linkage between release of the shares and ORC revenue to allow for capitalizing the cost of the release as additional acquisition cost of ORC. A portion of the shares escrowed in the Chesapeake transaction were earned by the former shareholders of Chesapeake as of December 31, 2004 as a result of revenues realized by ORC since its acquisition by the Company. The shares were subsequently released from escrow after the filing of the Company's financial statements on Form 10-K in 2005, per the conditions of an escrow agreement between the Company and the former shareholders of Chesapeake.

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As a consequence of these determinations, previously issued financial statements have been restated to eliminate the intangible asset associated with the Chesapeake acquisition, reverse the related amortization expense, expense as consulting fees the cost of the transaction attributable to

the cost of issuance of the non-escrowed shares and other related direct costs at the time of acquisition, to record and expense as consulting fees in cost of sales the release of the shares from escrow at December 31, 2004, and to expense in cost of sales and record the value of those shares in equity that met as of March 31, 2005 the performance measures which would result in the release of those shares from escrow after the filing of the Company's financial statements on Form 10-K in 2006, per the conditions of an escrow agreement between the Company and the former shareholders of Chesapeake, and to record the shares in equity as common stock issuable until such time as they could be reclassified as common stock upon the release of the shares earned from escrow.

We also determined that certain amortization costs related to the ORC acquisition should have been recorded in cost of sales and not in amortization and depreciation; and we determined that under our October and November 2004 Barron financing agreements, preferred stock recorded should have been classified as temporary preferred equity and not permanent preferred equity. For further information related to the quantitative effects of the restatement, see note 1 of the Company's financial statements.

## Results of Operations

### Three Months Ended March 31, 2005 as Compared to Three Months Ended March 31, 2004

*Revenue.* Revenue for the three month period ended March 31, 2005 was approximately \$2,670,000 as compared to approximately \$723,000 for the three month period ended March 31, 2004. The increase in revenue was primarily attributable to a full quarter of revenues from our acquisition of ORC in October 2004.

*Cost of sales.* Cost of sales for the three month period ended March 31, 2005, was approximately \$2,273,000, or 85% of revenues, an increase of approximately \$1,707,000 over cost of sales of approximately \$566,000, or 78% of revenues, for the three month period ended March 31, 2004. The percentage increase in cost of sales was primarily attributable to the amortization expense of intangible assets associated with the purchase price allocation from the Company's acquisition of ORC and the compensation expense of approximately \$370,000 that resulted from an earnout of 544,397 escrowed shares that were derived by ORC revenues during the three month period ending March 31, 2005, that triggered the recording in equity of the 544,397 escrowed shares. The absolute increase in cost of sales was materially attributable to higher revenues and cost of sales as a direct result of our acquisition of ORC in October 2004.

*Gross profit.* As a result of the above, gross profit for the three month period ended March 31, 2005, was approximately \$397,000, or 15% of revenues, an increase of approximately \$240,000 over gross profit of approximately \$157,000, or 22% of revenues, for the three month period ended March 31, 2004.

*Sales and marketing.* Sales and marketing expense for the three month period ended March 31, 2005, was approximately \$176,000, or 7% of revenues, an increase of approximately \$74,000, as compared to approximately \$102,000, or 14% of revenues, for the three month period ended March 31, 2004. The increase was materially attributable to the increase in sales and marketing expenses from our acquisition of ORC in October 2004.

*General and administrative.* General and administrative expenses for the three month period ended March 31, 2005, were approximately \$728,000, or 27% of revenues, an increase of approximately \$578,000, as compared to approximately \$150,000, or 21% of revenues, incurred by the Company for the three month period ended March 31, 2004. The increase in general and administrative expenses for the three months ended March 31, 2005, was primarily attributable to an increase of approximately \$578,000 in additional general and administrative expenses associated with our acquisition of ORC in October 2004, other general and administrative costs associated with the integration of ORC with WidePoint, increases in our accounting and legal fees associated with our requisite filings with the Securities and Exchange Commission, and WidePoint's mergers and acquisitions efforts currently underway.

*Depreciation.* Depreciation expense for the three month period ended March 31, 2005, was approximately \$6,200, or less than 1% of revenues, an increase of approximately \$4,400, as compared to approximately \$1,800 of such expenses, or less than 1% of revenues, recorded by the Company for the three month period ended March 31, 2004. The increase in depreciation expense for the three month period ended March 31, 2005, was primarily attributable to greater amounts of depreciable assets as a result of the acquisition of ORC in October 2004 and an increase in amortization expense associated with the purchase accounting related to the purchase of ORC in October 2004.

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*Interest income.* Interest income for the three month period ended March 31, 2005, was \$770, or less than 1% of revenues, a decrease of \$1,092 as compared to \$1,862, or less than 1% of revenues, for the three month period ended March 31, 2004. The decrease in interest income for the three month period ended March 31, 2005, was primarily attributable to lesser amounts of cash and cash equivalents along with lower short term interest rates that were available to the Company on investments in overnight sweep accounts.

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*Interest expense.* Interest expense for the three month period ended March 31, 2005, was \$52,783, or 2% of revenues, an increase of \$52,668 as compared to \$115, or less than 1% of revenues, for the three month period ended March 31, 2004. The increase in interest expense for the three month period ended March 31, 2005 was primarily attributable to WidePoint's increase in interest expense associated with its recent secured senior lending facility with RBC-Centura which was utilized in association with the purchase of ORC.

*Gain on Financial instrument.* The gain on financial instrument for the three month period ended March 31, 2005, was approximately \$996,000. The gain on financial instrument represents the decrease during the three months ended March 31, 2005 in the estimated fair value of the warrants issued to Barron Partners, L. P. in connection with the preferred stock financing. The estimated fair value of the warrants decreased principally because the estimated volatility of the Company's stock declined. This decline in turn resulted from the relatively narrow trading range of the Company's stock in the quarter as compared to past history. A less volatile stock provides a lower probability that the warrant holder will be able to eventually realize a gain on exercise. The effect of the decreased estimated volatility was partially offset by the increase in the value of the Company stock underlying the warrants, as well as the increased market interest rates during the quarter which have an upward effect on the warrant value.

*Other.* Other income for the three month period ended March 31, 2005, was \$2,150, or less than 1% of revenues. Other income was primarily attributable to finder's fees. There was no other income for the three month period ended March 31, 2004.

*Net income.* As a result of the above, the net income for the three month period ended March 31, 2005, was approximately \$433,000 as compared to the net loss of approximately \$95,000 for the three months ended March 31, 2004.

### Liquidity and Capital Resources

The Company has, since inception, financed its operations and capital expenditures through the sale of preferred and common stock, seller notes, convertible notes, convertible exchangeable debentures, senior secured loans and the proceeds from the exercise of the warrants related to a convertible exchangeable debenture. During 2004 and the quarter ended March 31, 2005, operations were materially financed with working capital, senior debt and the proceeds from a convertible preferred stock issuance.

Cash provided by operating activities for the quarter ended March 31, 2005, was approximately \$169,600 as compared to cash provided by operating activities of approximately \$10,400 for the quarter ended March 31, 2004. The decrease in cash balances available for operating activities for the quarters ended March 31, 2005 and 2004, respectively, were primarily a result of investments in which we expanded our sales and general and administrative cost structure to implement our growth strategy. Capital expenditures in property and equipment were approximately \$1,000 for the quarter ended March 31, 2005, as compared to capital expenditures in property and equipment of no material amount for the quarter ended March 31, 2004.

As of March 31, 2005, the Company had a net working capital deficit of approximately \$6.3 million.

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WidePoint's primary source of liquidity consists of approximately \$0.3 million in cash and cash equivalents and approximately \$2.3 million of accounts receivable. The increase in accounts receivable was primarily the result of the Company's acquisition of ORC and is attributable to slower processing and collection times associated with the normal billing and collecting cycle of ORC as compared to WidePoint. Current liabilities include approximately \$2.0 million in accounts payable and accrued expenses; \$1.4 million in a line of credit with RBC Centura Bank; and \$5.7 million in financial instruments which may be converted to equity upon the extinguishment of the Company's liquidated damages clause within the registration rights agreement entered into with Barron Partners, LP. The material increase in liabilities is predominately the result of the acquisition of ORC and the increase in the computed valuation of the financial instrument as of March 31, 2005.

The Company's business environment is characterized by rapid technological change, experiences times of high growth and contraction and is influenced by material events such as mergers and acquisitions that can substantially change the Company's outlook.

Since 2002, WidePoint has embarked upon several new initiatives to counter the current negative environment within our industry and expand our capacity to restore revenue growth. The Company requires substantial working capital to fund the future growth of its business, particularly to finance accounts receivable, sales and marketing efforts, and capital expenditures. There are currently no commitments for capital expenditures. Future capital requirements will depend on many factors, including the rate of revenue growth, if any, the timing and extent of spending for new product and service development, technological changes and market acceptance of the Company's services.

On October 25 and 29, 2004, WidePoint completed financings with Barron Partners L.P. ( Barron ), a private equity fund that engages in investing primarily in private investments in publicly traded entities, for an aggregate amount of \$3,580,000, under a preferred stock purchase agreement and related agreements. Net proceeds from the financing after costs and expenses, including fees of finders and agents, were approximately \$3,030,000. WidePoint issued an aggregate of 2,045,714 shares of its Series A Convertible Preferred Stock that are convertible

into an aggregate of 20,457,143 shares of its Common Stock at a conversion rate equal to \$0.175 per share. In addition, WidePoint issued to Barron warrants to purchase up to an additional 10,228,571 shares of its Common Stock at an exercise price of \$0.40 per common share. In April and May, 2005, Barron exercised warrants for 2,000,000 shares of common stock, providing \$800,000 in gross proceeds to the Company.

Pursuant to the registration rights agreement, between Barron and WidePoint, related to the stock issuances described in the preceding paragraph, WidePoint filed a registration statement on January 5, 2005, covering the resale of the shares of common stock issuable upon conversion and/or exercise of the Series A Convertible Preferred Stock and the warrants issued to Barron. If our registration statement is not declared effective by the Securities and Exchange Commission by April 23, 2005 and thereafter kept effective through October 20, 2007, subject to permissible blackout periods and registration maintenance periods, then WidePoint may be required to pay Barron a maximum penalty of up to \$20,000 for each month the registration statement is not effective. As of May 16, 2005, the registration statement has not been made effective.

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WidePoint believes that its current cash position and line of credit is sufficient to meet capital expenditure and working capital requirements for the near term. From a current trend perspective, WidePoint believes that the net working capital deficit of \$6.3 Million will improve modestly, as the investment costs of software development programs are substantially reduced and additional proceeds are realized from the exercise of Warrants by investors; both of which will be partially offset by incremental working capital needs associated with the projected Revenue growth of the business. WidePoint is unaware of any additional known trends or uncertainties not described herein that are reasonably likely to result in liquidity increasing or decreasing in any material way. However, the growth and technological change of the market make it difficult to predict future liquidity requirements with certainty. Over the longer term, the Company must successfully execute its plans to increase revenue and income streams that will generate significant positive cash flows if it is to sustain adequate liquidity without impairing growth or requiring the infusion of additional funds from external sources. Further, our failure to comply with the restrictive covenants under our revolving credit facilities could result in an event of default, which, if not cured, amended, or waived, could result in us being required to repay these borrowings before their due date. To date any covenants that we have not been compliant with have either been amended or waived and we continue to work with RBC-Centura to structure appropriate covenants that match our present business condition and environment. Although we currently are not in compliance with two of our covenants, which includes our ebitda to debt ratio covenant and our net income covenant, RBC-Centura has waived such violations until such time as the Company delivers to RBC-Centura the Company's financial statements for the quarter ended June 30, 2005 evidencing that the Company is in compliance with the above covenants. If we are forced to refinance these borrowings on less favorable terms, our results of operations and financial condition could be adversely affected due to the increased cost and interest rate. Additionally, a major expansion, such as occurred with the acquisition of ORC or any other major new subsidiaries, might require external financing that could include additional debt or equity capital. The Company obtained a one year senior line of credit from RBC-Centura Bank in October 2004 for up to \$2.5 million dollars, collateralized against accounts receivables, that also allows for the expansion of this line of credit up to \$5.0 million upon the successful completion of an additional acquisition. The interest rate on the line of credit is variable, and is based upon the prime lending rate. Approximately \$1.2 million dollars of the senior line of credit was utilized in the acquisition of ORC. In addition, the Company raised approximately \$3.6 million dollars in connection with the aforementioned equity investments by Barron Partners, LP, that were used in the acquisition of ORC. There can be no assurance that additional financing, if required, will be available on acceptable terms, if at all, for future acquisitions and/or growth initiatives.

#### **Off-Balance Sheet Arrangements**

The Company has no existing off-balance sheet arrangements as defined under SEC regulations.

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### **ITEM 3. CONTROLS AND PROCEDURES.**

#### **Disclosure Controls and Procedures**

The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and include controls and procedures designed to ensure that such

information is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, to allow timely decisions regarding required disclosure. Based on the evaluation of the effectiveness of the Company's disclosure controls and procedures as of March 31, 2005 required by Rule 13a-15(b) under the Securities Exchange Act of 1934 and conducted by the Company's principal executive and principal financial officers, such officers concluded that the Company's disclosure controls and procedures were not effective as of March 31, 2005. That conclusion was based on the existence of the material weakness in our internal control over financial reporting discussed below.

#### **Changes in Internal Control Over Financial Reporting**

In connection with the evaluation by the Company's principal executive and principal financial officers required by Rule 13a-15(d) under the Securities Exchange Act of 1934, such officers determined that the following change in the Company's internal control over financial reporting occurred during the quarter ended March 31, 2005, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

We identified a material weakness in our internal control over financial reporting in the first quarter of 2005 that related to insufficient technical accounting expertise within our accounting function to resolve non-routine or complex accounting and tax matters that occurred in connection with (i) our recent material acquisition of Operational Research Consultants, Inc. in October 2004; and (ii) determination of the proper accounting treatment of the financial instrument relating to the warrants issued by the Company in October 2004.

In addition, during the fourth quarter of 2005, as a result of comments raised by the SEC in connection with the Company's pending Registration Statement on Form S-1, the Company determined it would be necessary to restate prior financial statements to (i) reclassify the amortization expense associated with the acquisition of ORC to cost of sales, (ii) reclassify the Company's preferred stock as temporary preferred stock, and (iii) expense certain costs associated with the Company's acquisition of Chesapeake.

The material weakness in internal controls resulted in (i) our late filing on April 19, 2005 (four days after the extended due date) of our Annual Report on Form 10-K for the year ended December 31, 2004, (ii) the need to restate the recorded amount of the financial instrument at December 31, 2004 and March 31, 2005 due to the failure to mark-to-market such instrument at December 31, 2004 and (iii) the need to restate the prior financial statements as set forth in this amendment. In order to remediate that material weakness, we engaged a consulting firm in January 2005 with the requisite accounting expertise, and are continuing to use the services of that firm in connection with such complex accounting matters.

We believe that the material weakness in our internal controls will be remediated during the first quarter of 2006 as we expect the above-referenced complex accounting issues will have been resolved, and further believe that the total costs associated with the remediation will be immaterial.

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## **PART II.**

### **OTHER INFORMATION**

#### **ITEM 6. EXHIBITS.**

(a) Exhibits

31.1A Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2A Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32A Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



