

WIDEPOINT CORP
Form 10QSB/A
January 19, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB/A No. 1

Amendment No. 1 to Quarterly Report on Form 10-QSB
For the quarter ended September 30, 2005

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

Commission file number 0-23967

WIDEPOINT CORPORATION

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

Delaware
(State or other jurisdiction of
incorporation or organization)

52-2040275
(IRS Employer Identification No.)

One Lincoln Centre, 18W140 Butterfield Road, Suite 1100, Oakbrook Terrace, Ill
Address of principal executive offices)

60181
(Zip Code)

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

Former name, former address and former fiscal year, if changed since last report.

The undersigned registrant hereby amends the following portions of its Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005, as set forth in the pages attached hereto:

- Part I. Item 1. Condensed Consolidated Financial Statements
 Item 2. Management's Discussions and Analysis or Plan of Operation
- 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

January 19, 2006

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

INTRODUCTORY NOTE

Grant Thornton LLP, WidePoint Corporation's independent registered public accounting firm, completed its review of the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005. Accordingly, this Amendment No. 1 to that report has been revised to:

remove the legend at the top of the facing page stating that the outside accountants' review is not complete;

remove the explanatory note above the index on the first page of the report stating that the outside accountants' review is not complete and reporting the Company's plan to amend its Annual Report on Form 10-K for the year ended December 31, 2004 to

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include restated financial statements (such amendment was filed on January 19, 2006); and

revise the fifth paragraph under Restatement in Note 1 of the Notes to Condensed Consolidated Financial Statements, which appeared on page 6 of the original filing, stating that this amendment to the Form 10-QSB will be filed and that amendments to certain other prior periodic reports with restated financial statements will be filed (such amendments were filed on January 19, 2006).

In addition, the financial information under Item 1 of Part 1 of the 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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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of WidePoint Corporation:

We have reviewed the accompanying interim consolidated financial statements of WidePoint Corporation and subsidiaries as of September 30, 2005 and 2004, and for the three-month and nine-month periods then ended. These interim consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the interim consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

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We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year then ended (not presented herein). In our report dated April 14, 2005, except for the footnote titled Basis of Presentation, Organization, Nature of Operations, and Restatement as to the effects of the restatement as discussed in Note 1 as to which the date is January 19, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2004, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ GRANT THORNTON LLP

Chicago, Illinois
January 19, 2006

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

WIDEPOINT CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

| | September 30, 2005 | As Restated December 31, 2004 |
|---|-----------------------|-------------------------------------|
| <i>Assets</i> | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 362,879 | \$ 463,525 |
| Accounts receivable | 2,810,879 | 3,007,590 |
| Income tax receivable | 62,737 | -- |
| Prepaid expenses and other assets | 147,047 | 203,126 |
| | 3,383,542 | 3,674,241 |
| Property and equipment, net | 62,503 | 80,652 |
| Goodwill | 2,513,110 | 2,806,440 |
| Intangibles | 1,863,749 | 1,668,945 |
| Other assets | 230,610 | 161,148 |
| | \$ 8,053,514 | \$ 8,391,426 |
| <i>Liabilities, temporary equity and stockholders' equity</i> | | |
| Current liabilities: | | |
| Short-term borrowings | \$ 98,703 | \$ 1,592,408 |
| Accounts payable | 1,542,945 | 1,342,759 |
| Accrued expenses | 655,939 | 859,345 |
| Deferred revenue | 52,787 | -- |
| Income tax payable | 198,620 | 79,177 |
| Short-term portion of deferred rent | 3,680 | 2,720 |
| Financial instruments | 2,951,933 | 6,648,571 |
| | 5,504,607 | 10,524,980 |
| Long-term portion of deferred rent | 4,084 | 7,058 |
| Deferred income tax liability | 110,979 | 221,959 |
| | | |

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| | <u>September 30,</u> | <u>As Restated December 31,</u> |
|-------------------|----------------------|-------------------------------------|
| Total liabilities | 5,619,670 | 10,753,997 |

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

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Temporary equity:

| | | |
|---|----------|----------|
| Preferred stock, \$0.001 par value; 10,000,000 shares authorized: 1,315,714 and 2,045,714 issued and outstanding, respectively | \$ 1,316 | \$ 2,046 |
|---|----------|----------|

Stockholders' equity (deficit):

| | | |
|--|--------------|--------------|
| Common stock, \$0.001 par value; 110,000,000 shares authorized; 30,328,407 and 17,859,009 shares issued and outstanding, respectively | \$ 30,328 | \$ 17,859 |
| Common stock issuable, \$0.001 par value; 1,633,191 and 544,398 shares, respectively | \$ 1,634 | \$ 544 |
| Stock warrants | 14,291 | 14,291 |
| Related party notes receivable | (61,100) | (81,100) |
| Additional paid-in capital | 47,888,006 | 42,788,612 |
| Accumulated deficit | (45,440,631) | (45,104,823) |

| | | |
|--------------------------------------|-----------|-------------|
| Total stockholders' equity (deficit) | 2,432,528 | (2,364,617) |
|--------------------------------------|-----------|-------------|

| | | |
|--|--------------|--------------|
| Total liabilities, temporary equity and stockholders' equity (deficit) | \$ 8,053,514 | \$ 8,391,426 |
|--|--------------|--------------|

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

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WIDEPOINT CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

| | <u>Three Months Ended September 30,</u> | | <u>Nine Months Ended September 30,</u> | |
|--|---|-----------------------------|--|-----------------------------|
| | <u>As Restated 2005</u> | <u>As Restated 2004</u> | <u>As Restated 2005</u> | <u>As Restated 2004</u> |
| Revenues, net | \$ 3,645,237 | \$ 906,685 | \$ 9,235,904 | \$ 2,470,992 |
| Cost of sales (including amortization & depreciation of \$80,980, \$0, \$222,080, and \$0, respectively, and stock compensation expense of \$446,406, \$0, \$1,268,445 and \$0, respectively) | 3,277,871 | 666,544 | 8,155,735 | 1,850,528 |
| Gross profit | 367,366 | 240,141 | 1,080,169 | 620,464 |
| Sales and marketing | 138,493 | 147,068 | 478,807 | 377,238 |
| General & administrative | 682,867 | 197,877 | 2,056,233 | 1,055,922 |
| Depreciation expense | 6,364 | 883 | 18,809 | 3,322 |
| Loss from operations | (460,358) | (105,687) | (1,473,680) | (816,018) |
| Interest income | 2,312 | 1,307 | 4,831 | 5,006 |
| Interest expenses | (48,484) | (493) | (151,181) | (608) |
| Gain from financial instruments | 701,995 | -- | 1,228,038 | -- |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------------|------------------------------------|--------------|
| | | | | |
| Other income | -- | -- | 1,910 | -- |
| Net earnings (loss) before income tax benefit | 195,465 | (104,873) | (390,082) | (811,620) |
| Income tax benefit, net | (54,274) | -- | (54,274) | -- |
| Net earnings (loss) | \$ 249,739 | \$ (104,873) | \$ (335,808) | \$ (811,620) |
| Basic net earnings (loss) per share | \$ 0.01 | \$ (0.01) | \$ (0.01) | \$ (0.05) |
| Basic weighted average shares outstanding | 26,456,542 | 16,896,509 | 22,593,946 | 16,336,990 |
| Diluted net earnings (loss) per share | \$ 0.00 | \$ (0.01) | \$ (0.01) | \$ (0.05) |
| Diluted weighted average shares outstanding | 49,940,870 | 16,896,509 | 22,593,946 | 16,336,990 |

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

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WIDEPOINT CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders Equity

| | Temporary Equity Preferred Stock | | Permanent Equity Common Stock | | Common Stock Issuable | Stock Warrants | Related Party Notes Receivable | Additional Paid-In Capital | Restated Accumulated Deficit | Permanent Equity 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) |
| 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) |
| Issuance of common stock | -- | -- | 2,100,000 | 2,100 | -- | -- | -- | 808,150 | -- | 810,250 |
| Conversion of preferred stock | (300,000) | (300) | 3,000,000 | 3,000 | -- | -- | -- | (2,700) | -- | 300 |
| April 26, 2005 Warrants valuation adjustment | -- | -- | -- | -- | -- | -- | -- | 537,000 | -- | 537,000 |
| May 2, 2005 Warrants | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- |

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| | Temporary Equity Preferred Stock | | Permanent Equity Common Stock | | | | | | | |
|--|-------------------------------------|----------|----------------------------------|-----------|-------|-----------|-------------|---------------|-----------------|--------------|
| valuation adjustment June 30, 2005 | -- | -- | -- | -- | -- | -- | -- | 566,100 | -- | 566,100 |
| Issuance of common stock - Chesapeake June 30, 2005 | -- | -- | -- | -- | 544 | -- | -- | 451,305 | -- | 451,849 |
| Issuance of common stock issuable - Chesapeake | -- | -- | 544,398 | 544 | (544) | -- | -- | -- | -- | -- |
| Expenses associated from registration statement | -- | -- | -- | -- | -- | -- | -- | (151,914) | -- | (151,914) |
| Expenses associated from warrant exercise | -- | -- | -- | -- | -- | -- | -- | (90,980) | -- | (90,980) |
| Net loss | -- | -- | -- | -- | -- | -- | -- | -- | (1,018,509) | (1,018,509) |
| Balance, June 30, 2005 | 1,745,714 | \$ 1,746 | 23,503,407 | \$ 23,503 | 1,089 | \$ 14,291 | \$ (61,100) | \$ 45,244,833 | \$ (45,690,370) | \$ (467,754) |
| Issuance of common stock | -- | -- | 2,525,000 | 2,525 | -- | -- | -- | 999,725 | -- | 1,002,250 |
| Conversion of preferred stock August 24, 2005 | (430,000) | (430) | 4,300,000 | 4,300 | -- | -- | -- | (3,870) | -- | 430 |
| Warrants valuation adjustment September 22, 2005 | -- | -- | -- | -- | -- | -- | -- | 554,900 | -- | 554,900 |
| Warrants valuation adjustment September 30, 2005 | -- | -- | -- | -- | -- | -- | -- | 810,600 | -- | 810,600 |
| Issuance of common stock - Chesapeake | -- | -- | -- | -- | 545 | -- | -- | 445,861 | -- | 446,406 |
| Expenses associated from registration statement | -- | -- | -- | -- | -- | -- | -- | (84,043) | -- | (84,043) |
| Expenses associated from warrant exercise | -- | -- | -- | -- | -- | -- | -- | (80,000) | -- | (80,000) |
| Net loss | -- | -- | -- | -- | -- | -- | -- | -- | 249,739 | 249,739 |
| Balance, September 30, 2005 | 1,315,714 | \$ 1,316 | 30,328,407 | \$ 30,328 | 1,634 | \$ 14,291 | \$ (61,100) | \$ 47,888,006 | \$ (45,440,631) | \$ 2,432,528 |

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

WIDEPOINT CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

| Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|---------------------|------------------------------------|---------------------|
| As Restated 2005 | As Restated 2004 | As Restated 2005 | As Restated 2004 |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------------|------------------------------------|--------------|
| | | | | |
| Cash flows from operating activities: | | | | |
| Net earnings (loss) | \$ 249,739 | \$ (104,873) | \$ (335,808) | \$ (811,620) |
| Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities | | | | |
| Depreciation expense | 7,094 | 883 | 20,999 | 3,322 |
| Amortization expense | 80,250 | -- | 219,890 | -- |
| Deferred income taxes | -- | -- | (110,980) | -- |
| Amortization of deferred financing costs | 3,573 | -- | 10,718 | -- |
| Gain from financial instruments | (701,995) | -- | (1,228,038) | -- |
| Stock compensation expense | 446,406 | -- | 1,268,445 | 501,749 |
| Changes in assets and liabilities | | | | |
| Accounts receivable | (236,812) | (55,166) | 196,711 | (105,865) |
| Income tax receivable | (62,737) | -- | (62,737) | -- |
| Prepaid expenses and other current assets | 131,895 | (6,062) | 191,080 | 21,926 |
| Other assets | 37,198 | (5,423) | 54,820 | (55,334) |
| Accounts payable and accrued expenses | 223,438 | (7,082) | (82,303) | 98,511 |
| Net cash provided by (used in) operating activities | \$ 178,049 | \$ (177,723) | \$ 142,797 | \$ (347,311) |
| Cashflows from investing activities: | | | | |
| Purchase of property and equipment | (1,588) | (4,190) | (2,849) | (4,190) |
| Software development costs | (63,563) | -- | (414,694) | -- |
| Net cash used in investing activities | \$ (65,151) | \$ (4,190) | \$ (417,543) | \$ (4,190) |
| Cashflows from financing activities: | | | | |
| Borrowings on notes payable | 185,967 | -- | 488,566 | -- |
| Payments on notes payable | (1,116,990) | -- | (1,982,271) | -- |
| Collections on related party notes | -- | -- | 20,000 | -- |
| Expenses related to registration statement | -- | -- | (34,495) | -- |
| Proceeds from exercise of stock options | 2,250 | -- | 12,500 | -- |
| Proceeds from exercise of warrants | 1,000,000 | -- | 1,800,000 | -- |
| Expenses related to warrant exercise | (62,000) | -- | (130,200) | -- |
| Net cash provided by financing activities | \$ 9,227 | \$ -- | \$ 174,100 | \$ -- |
| Net increase (decrease) in cash | \$ 122,125 | \$ (181,913) | \$ (100,646) | \$ (351,501) |
| Cash and cash equivalents, beginning of period | \$ 240,754 | \$ 780,024 | \$ 463,525 | \$ 949,612 |
| Cash and cash equivalents, end of period | \$ 362,879 | \$ 598,111 | \$ 362,879 | \$ 598,111 |

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

Supplementary Information:

| | | | | |
|--|-------|-------|------------|-------|
| Notes receivable issued to former ORC shareholders for purchase price adjustment | \$ -- | \$ -- | \$ 270,000 | \$ -- |
| Liabilities incurred but not yet paid | | | | |

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| | | | | |
|--|-----------|-------|------------|-------|
| relating to warrant exercise | \$ 18,000 | \$ -- | \$ 40,780 | \$ -- |
| Liabilities incurred but not yet paid relating to registration statement | \$ 84,043 | \$ -- | \$ 231,847 | \$ -- |
| Cash paid for interest | \$ 17,210 | \$ -- | \$ 57,986 | \$ -- |

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

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**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.

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 and 2006.

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, June 30, 2005, and September 30, 2005, of the common shares earned and the pending released of those common 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 those shares as common stock, but recorded those shares as common stock issuable.

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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 for the year ended December 31, 2004, 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, June 30, 2005, and September 30, 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 for the year ended December 31, 2005, 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:

| | <u>Previously Reported</u> <u>September 30, 2005</u> | <u>As Restated</u> <u>September 30, 2005</u> | <u>Previously Reported</u> <u>December 31, 2004</u> | <u>As Restated</u> <u>December 31, 2004</u> |
|----------------------------|---|---|--|--|
| Common stock | 33,050 | 30,328 | 21,125 | 17,859 |
| Common stock issuable | n/a | 1,634 | n/a | 544 |
| Additional paid-in capital | 48,850,502 | 47,888,006 | 44,691,280 | 42,788,612 |
| Accumulated deficit | (46,404,215) | (45,440,631) | (47,010,213) | (45,104,823) |

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Statement of Operations:

| | <u>Previously Reported</u> | | <u>As Restated</u> | |
|---|--|---|--|---|
| | <u>Three Months Ended</u> <u>September 30, 2004</u> | <u>Nine Months Ended</u> <u>September 30, 2004</u> | <u>Three Months Ended</u> <u>September 30, 2004</u> | <u>Nine Months Ended</u> <u>September 30, 2004</u> |
| Basic and diluted net loss per share | \$ (0.01) | \$ (0.04) | \$ (0.01) | \$ (0.05) |
| Basic and diluted weighted average shares outstanding | 20,162,893 | 18,160,920 | 16,896,509 | 16,336,990 |

| | <u>Previously Reported</u> | | <u>As Restated</u> | |
|--|--|---|--|---|
| | <u>Three Months Ended</u> <u>September 30, 2005</u> | <u>Nine Months Ended</u> <u>September 30, 2005</u> | <u>Three Months Ended</u> <u>September 30, 2005</u> | <u>Nine Months Ended</u> <u>September 30, 2005</u> |
| | | | | |

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| | Previously Reported | | As Restated | |
|---|---------------------|--------------|--------------|----------------|
| | | | | |
| Cost of sales | \$ 2,831,465 | \$ 6,887,290 | \$ 3,277,871 | \$ 8,155,735 |
| Gross profit | \$ 813,772 | \$ 2,348,614 | \$ 367,366 | \$ 1,080,169 |
| General & administrative | \$ 655,648 | \$ 2,382,872 | \$ 682,867 | \$ 2,056,233 |
| Earnings (loss) from operations | \$ 13,267 | \$ (531,874) | \$ (460,358) | \$ (1,473,680) |
| Net earnings (loss) before income tax benefit | \$ 669,090 | \$ 551,724 | \$ 195,465 | \$ (390,082) |
| Net earnings (loss) | \$ 723,364 | \$ 605,998 | \$ 249,739 | \$ (335,808) |
| Basic net earnings (loss) per share | \$ 0.03 | \$ 0.02 | \$ 0.01 | \$ (0.01) |
| Basic weighted average shares outstanding | 28,083,817 | 24,761,565 | 26,456,542 | 22,593,946 |
| Diluted net earnings (loss) per share | \$ 0.01 | \$ 0.01 | \$ 0.00 | \$ (0.01) |
| Diluted weighted average shares outstanding | 53,740,657 | 52,654,102 | 49,940,870 | 22,593,946 |

Statement of Cash Flows:

| | Previously Reported | | As Restated | |
|---------------------------------------|---------------------|--------------------|--------------------|--------------------|
| | Three Months Ended | Nine Months Ended | Three Months Ended | Nine Months Ended |
| | September 30, 2004 | September 30, 2004 | September 30, 2004 | September 30, 2004 |
| Stock compensation expense | -- | \$ 72,000 | -- | \$ 501,749 |
| Accounts payable and accrued expenses | \$ (7,082) | \$ 528,260 | \$ (7,082) | \$ 98,511 |

| | Previously Reported | | As Restated | |
|---------------------------------------|---------------------|--------------------|--------------------|--------------------|
| | Three Months Ended | Nine Months Ended | Three Months Ended | Nine Months Ended |
| | September 30, 2005 | September 30, 2005 | September 30, 2005 | September 30, 2005 |
| Net earnings (loss) | 723,364 | 605,998 | 249,739 | (335,808) |
| Stock compensation expense | -- | -- | 446,406 | 1,268,445 |
| Accounts payable and accrued expenses | 196,219 | 244,336 | 223,438 | (83,303) |

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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 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 September 30, 2005 there were no material cash and cash equivalents of investments in money market and overnight sweep accounts. At December 31, 2004, cash and cash equivalents of investments in money market and overnight sweep accounts were \$46,065. 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

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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: government contracting, 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 Beginning of Period | Additions Charged to Costs and Expenses | Deductions | Balance at End of Period |
|--|--------------------------------------|--|------------|--------------------------------|
| For the year ended December 31, 2004, Allowance for doubtful accounts | \$ 18,819 | 14 | \$ 18,833 | \$ -- |
| For the quarter ended September 30, 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 September 30, 2005 and December 31, 2004, unbilled accounts receivable totaled \$14,204 and \$138,529, 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.

The Company's other revenues are derived from the delivery of a non-customized software offering. 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 offering is fixed or determinable, and collectibility is probable.

Further, the Company has had no history of losses nor has it identified any specific risk of loss at September 30, 2005 due to termination provisions and thus has not recorded a provision for such events.

Significant Customers

For both the three-month and the nine-month periods ended September 30, 2005, one customer, The Department of Homeland Security, individually represented approximately 18% of revenues, and we therefore are materially dependent upon such customer. Due to the nature of our business and the relative size of certain contracts, which are entered into in the ordinary course of business, the loss of any single significant customer, including the above customer, would have a material adverse effect on results. For the quarter ended September 30, 2004, three customers, Abbott Laboratories, Consec, and Manpower, individually represented 19%, 18%, and 13% of revenue, respectively.

Fair value of financial instruments

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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 include a financial instrument in which a valuation for the warrants issued by the Company under the Barron Partners, LP financing agreement contained a registration rights agreement which contains a liquidated 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 has been marked to market at December 31, 2004 and September 30, 2005.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist of cash and cash equivalents and accounts receivable. As of September 30, 2005, one customer, The Department of Homeland Security, accounted for approximately 24% of accounts receivable, and we therefore are materially dependent upon such customer. Due to the nature of our business and the relative size of certain contracts, which are entered into in the ordinary course of business, the loss of any single significant customer, including the above customer, would have a material adverse effect on results. As of December 31, 2004, two customers, The Department of Homeland Security and Tangible Software, individually represented 24% and 13% of accounts receivable, respectively.

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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.

Property and Equipment

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

| | <u>September 30,</u> 2005 | <u>December 31,</u> 2004 |
|---|------------------------------|-----------------------------|
| Computers, equipment and software | \$ 92,878 | \$ 90,029 |
| Less- Accumulated depreciation and amortization | (30,375) | (9,377) |
| | <u>\$ 62,503</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 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 PKI-I for the three month period ending September 30, 2005. WidePoint recorded approximately \$9,700 of amortization expense for PKI-I for the year ended December 31, 2004. Capitalized software costs included in Other Intangibles at September 30, 2005 and December 31, 2004 were approximately \$0.9 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 an annual review is required to determine any 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 31st.

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.

Basic and Diluted Net Earnings/Loss Per Share

Basic earnings 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 rights to the conversion of the preferred stock to common stock and the conversion of options and warrants to purchase common stock added the equivalent of 22,945,848 shares for the three months ended September 30, 2005 and as such has been included in the calculation of the net income per share as such effect would have been dilutive.

The treasury stock effect of options, and warrants to purchase common stock would have added the equivalent of 2,112,000 shares of common stock for the three months ended September 30, 2004 has not been included in the calculation of the net loss per shares as such effect would have been anti-dilutive and are presented as identical.

The treasury stock effect of the rights to the conversion of the preferred stock to common stock and the conversion of options and warrants to purchase common stock would have added the equivalent of 25,374,739 shares for the nine months ended September 30, 2005 but has not been included in the calculation of the net income per share as such effect would have been anti-dilutive.

The treasury stock effect of options, and warrants to purchase common stock would have added the equivalent of 2,112,000 shares of common stock for the nine months ended September 30, 2004 has not been included in the calculation of the net loss per shares as such effect would have been anti-dilutive and are presented as identical.

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 September 30, | | Nine Months ended September 30, | |
|--|-------------------------------------|---------------------|------------------------------------|---------------------|
| | As Restated 2005 | As Restated 2004 | As Restated 2005 | As Restated 2004 |
| Net earnings (loss), as reported | \$ 249,739 | \$ (104,873) | \$ (335,808) | \$ (811,620) |
| Subtract: Total stock-based employee compensation expense determined under fair value based method for awards granted, modified, or settled, net of related tax effects | (209,376) | (87,712) | (787,686) | (263,136) |
| Pro forma net earnings (loss) | \$ 40,363 | \$ (192,585) | \$ (1,123,494) | \$ (1,074,755) |
| Earnings (loss) per share: | | | | |
| Basic - as reported | \$ 0.01 | \$ (0.01) | \$ (0.01) | \$ (0.05) |
| Diluted - as reported | \$ 0.00 | \$ (0.01) | \$ (0.01) | \$ (0.05) |
| Basic - pro forma | \$ 0.00 | \$ (0.01) | \$ (0.05) | \$ (0.07) |
| Diluted - pro forma | \$ 0.00 | \$ (0.01) | \$ (0.05) | \$ (0.07) |

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. There were 500,000 additional options granted during the quarter and nine months ending September 30, 2005.

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 September 30, 2005:

| | |
|----------------------------------|------------|
| Dividend yield | -- |
| Risk-free interest rate (%) | 2.70-4.13% |
| Volatility factor (%) | 65% - 156% |
| Expected life in years | 5 - 6 |
| 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*.

New Accounting Pronouncements

In April 2005, the SEC announced the adoption of a new rule that amends the compliance dates for SFAS No. 123 (revised 2004), *Share-Based Payment* (Statement No. 123(R)). Under Statement No. 123, the Company would have been required to implement the standard as of the beginning of the first interim or annual period that begins after June 15, 2005, or in the interim reporting period ending September 30, 2005. The SEC's new rule allows the Company to implement Statement No. 123(R) at the beginning of its next fiscal year, and accordingly, the Company will begin to reflect the adjustment to earnings for the impact of this accounting pronouncement in the interim reporting period ending March 31, 2006.

In May 2005, SFAS No. 154, *Accounting Changes and Error Corrections* (a replacement of APB Opinion No. 20 and SFAS No. 3) was issued. Statement 154 requires that all voluntary changes in accounting principles and changes required by a new accounting pronouncement that do not include specific transition provisions be applied retrospectively to prior periods' financial statements, unless it is impracticable to do so. Opinion 20 required that most voluntary changes in accounting principle be recognized by including the cumulative effect of changing to the new accounting principle as a component of net income in the period of change. Statement 154 is effective prospectively for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005, with earlier application encouraged. Earlier application is

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permitted for accounting changes and corrections of errors made in fiscal years beginning after the date the Statement was issued (May 2005). Statement 154 does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of the Statement. Accordingly, the Company will implement the provisions of this accounting pronouncement in the fiscal reporting period ending December 31, 2006.

3. Debt

| | September 30, 2005 | December 31, 2004 |
|--|-------------------------------|------------------------------|
| <i>Borrowings under WidePoint's Senior Debt Agreement:</i> | \$ 98,703 | \$ 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. Subsequently, on November 1, 2005, the Company entered into an extension with RBC-Centura through March 1, 2006 of the revolving credit facility. The only modification of the terms of the agreement was for an increase in the borrowing rate from prime to prime plus 1% during the period of the extension. All other terms remained the same. A pro rata administrative fee of 1/2 of 1% of the \$2.5 million revolving credit base of approximately \$4,000 was charged for the issuance of the extension.

The maximum available borrowing under revolving credit facility at September 30, 2005 and December 31, 2004 was \$2.3 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 6% and 5% on September 30, 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 September 30, 2005 and during the year ended December 31, 2004, were \$1.0 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. No interest and finder's fees were paid from January 2004 through October 2004 as the Company had not entered into a credit facility until the end of October 2004. The total interest fees paid for the quarter ended September 30, 2005 was approximately \$17,000.

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 annually on December 31st of each calendar year. These reviews have resulted in no adjustments in goodwill.

During 2004, WidePoint completed the acquisitions of Chesapeake Government Technologies, Inc. and Operational Research Consultants, Inc. Chesapeake Government Technologies, Inc. was a development stage business and therefore was not considered to be a business. The Company has also capitalized software development cost associated with its PKI initiative and has estimated the purchase price allocation of the assets acquired and pursuant to a valuation have allocated estimated purchase price of the components and software capitalization of goodwill and other intangibles as follows:

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| Amortized Intangible Assets | | As of September 30, 2005 | |
|------------------------------------|--|----------------------------------|-------------------------------------|
| | | Gross Carrying Amount | Accumulated Amortization |
| (1) | ORC Intangible (Includes customer relationships and PKI business opportunity purchase accounting preliminary valuations) | \$ 1,145,523 | \$ (202,655) |
| (2) | PKI-I Intangible (Related to internally generated software) | 334,672 | (53,353) |

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| | Amortized Intangible Assets | As of September 30, 2005 | |
|-----|--|---------------------------------|--------------|
| (3) | PKI-II Intangible (Related to internally generated software) | \$ 649,991 | (10,429) |
| | Total | \$ 2,130,186 | \$ (266,437) |
| | <u>Aggregate Amortization Expense:</u> | | |
| | For quarter ended 9/30/05 | \$ 80,250 | |
| | For nine months ended 9/30/05 | \$ 219,890 | |
| | <u>Estimated Amortization Expense:</u> | | |
| | 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 intangible life 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 intangible 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 approximately 5 years.
- (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 approximately 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. ORC commenced sales of its PKI-II service in September of 2005. It has a weighted average life of approximately 5 years and is based upon the contractual life assigned to the authority to issue PKI certificates by the federal government.

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

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.

During the six month ended June 30, 2005, Barron Partners converted 300,000 share of Series A Convertible Preferred Stock into 3,000,000 common shares and subsequently sold 3,000,000 common shares in private transactions to 3 institutional investors.

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During the quarter ended September 30, 2005, Barron Partners LP converted 430,000 shares of Series A Convertible Preferred Stock into 4,300,000 common shares and subsequently sold 3,900,000 common shares in private transactions to 7 institutional investors. Accordingly, 1,315,714 shares of Series A Convertible Preferred Stock were outstanding at September 30, 2005.

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 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 7). 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).

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 September 30, 2005 and December 31, 2004, respectively, there were 31,961,598 and 18,403,407 shares of common stock outstanding. The shares of common stock outstanding as of September 30, 2005 does not include escrowed common stock for 5,555,556 and 1,088,796 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 September 30, 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 September 30, 2005, 2,721,987 common shares have been issued and placed into escrow with 633,191 of those escrowed common shares having met certain performance measures as of September 30, 2005 that will allow for their release after the pending 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 September 30, 2005, no common shares were released from escrow.

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

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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 until June 30, 2005, when per an agreement between the Company and the original shareholders of Chesapeake, the shares were released from escrow and subsequently recorded as common stock. 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 after the filing of the Company's financial statements on Form 10-K in 2006, 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. As a result of meeting certain performance measures by June 30, 2005, the Company recorded in equity the pending release of 544,397 additional common shares on June 30, 2005, which will also continue to be held in escrow until after the filing of the Company's financial statements on Form 10-K in 2006, per an escrow agreement between the Company and the original shareholders of Chesapeake. These shares have not been recorded as common stock but as common stock issuable. As a result of meeting certain performance measures by September 30, 2005, the Company recorded in equity the pending release of 544,397 additional common shares on September 30, 2005, which will also continue to be held in escrow until after the filing of the Company's financial statements on Form 10-K for the year ended December 31, 2005, per an escrow agreement between the Company and the original shareholders of Chesapeake. These shares have not been recorded as common stock but as common stock issuable. The remaining unearned Chesapeake common shares held in escrow that have not met certain performance measures as of September 30, 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.

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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 that 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, which have been earned per 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 common shares, which were released from escrow on June 30, 2005. These common shares were recorded as common stock issuable as of December 31, 2004 and reclassified as common stock on June 30, 2005. On March 31, 2005, June 30, 2005, and September 30, 2005, the original shareholders of Chesapeake earned 544,397 common shares in each quarter, respectively, which totaled 1,633,191 common shares earned during the nine months ended September 30, 2005. These common shares, which will not be released from escrow until after the filing of the Company's financial statements on Form 10-K for the year ended December 31, 2005, have therefore been recorded as common stock issuable.

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.

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, or \$181,650 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. Subsequent to September 30, 2005, the amounts outstanding under these notes have been extinguished by the noteholders.

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 Company used a fair-value option pricing model to value these stock warrants. 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 September 30, 2005. The Company has recorded a gain on the financial instrument of approximately \$702,000 for the three month period ended September 30, 2005, to adjust the difference between the fair-value of these warrants at the end of the three month periods ended June 30, 2005 and September 30, 2005. The Company has recorded a gain on the financial instrument of approximately \$1,228,000 for the nine month period ended September 30, 2005, to adjust the difference between the fair-value of these warrants at December 31, 2004 and September 30, 2005.

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The fair value of the financial instrument as shown on the balance sheet assumes that the shares will be registered. The fair value under the alternative of not registering the shares and paying the full cash liquidated damages would be approximately \$323,000 higher than recorded under the current assumption.

The financial instrument, a derivative, has not been designated as a hedge. The purpose of its issuance was to raise additional capital in a more advantageous fashion than could be done without the use of such an instrument. In addition to expecting the overall cost of capital to be less, the use of the derivative instrument reduces the cost to the common shareholders when the value of their shares declines in exchange for increasing the cost to the common shareholders when the value of their shares increases, all of which should tend to reduce the volatility of the value of the Company's common shares.

If the Company's registration rights agreement with Barron is amended to provide for a liquidated damages provision providing for the non-cash payment of damages in equity of the Company, it would not be necessary to account for the warrants as a liability under EITF 00-19 or to continue to recognize a related financial instrument.

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 had 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 December of 2005, Barron Partners LP exercised its remaining warrants to purchase 5,728,572 common shares and subsequently sold the 5,728,572 common shares in private transactions to several institutional investors. As a result of the exercise of the 5,728,572 warrants, the Company realized gross proceeds of \$2,291,429.

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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 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 to 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 WidePoint's reach into markets that previously were not accessible to the Company. 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.

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As a result of these actions, WidePoint's revenues for the three month period ended September 30, 2005 increased by approximately 302% from approximately \$0.9 million from the comparable three month period ended September 30, 2004 to \$3.6 million. This increase was materially due to the additional revenues generated by WidePoint's acquisition of ORC in October 2004. As a function of the ORC acquisition, 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.

With our recent acquisition of ORC we rely upon a larger portion of our revenues from the Federal Government, either directly or as a subcontractor. The Federal Government's fiscal year ends September 30th. 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 that we offer.

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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, June 30, 2005, and September 30, 2005, of the common shares earned and the pending release of those common 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 those shares as common stock, but recorded those shares as common stock issuable.

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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 for the year ended December 31, 2004, 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, June 30, 2005, and September 30, 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 for the year ended December 31, 2005, 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 OperationsThree Months Ended September 30, 2005 as Compared to Three Months Ended September 30, 2004

Revenue. Revenue for the three month period ended September 30, 2005 was approximately \$3,645,000 as compared to approximately \$907,000 for the three month period ended September 30, 2004. The increase in revenue was primarily attributable to the full quarter impact of revenues derived from our acquisition of ORC in October 2004.

Cost of sales. Cost of sales for the three month period ended September 30, 2005, was approximately \$3,278,000, or 90% of revenues, an increase of approximately \$2,611,000 over cost of sales of approximately \$667,000, or 74% of revenues, in the three month period ended September 30, 2004. The percentage increase in cost of sales was primarily attributable to higher cost of sales related to the revenues at ORC and the quarter's stock issuance expense of approximately \$446,000 for the pending release of common shares to the former Chesapeake shareholders as a result of revenues earned by ORC. 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 September 30, 2005, was approximately \$367,000, or 10% of revenues, an increase of approximately \$127,000 over gross profit of approximately \$240,000, or 26% of revenues, for the three month period ended September 30, 2004.

Sales and marketing. Sales and marketing expense for the three month period ended September 30, 2005, was approximately \$138,000, or 4% of revenues, a decrease of approximately \$9,000, as compared to approximately \$147,000, or 16% of revenues, for the three month period ended September 30, 2004. The percentage decrease in sales and marketing expense was the result of lesser relative sales and marketing expense attributable to the acquisition of ORC in October 2004. The absolute decrease was materially attributable to a decrease in sales consulting expenses.

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General and administrative. General and administrative expenses for the three month period ended September 30, 2005, were approximately \$683,000, or 19% of revenues, an increase of approximately \$485,000, as compared to approximately \$198,000, or 22% of revenues, incurred by the Company for the three month period ended September 30, 2004. The percentage decrease in general and administrative expense was attributable to lesser relative general administrative expense in relation to the increased revenue base as a result of our acquisition of ORC in October 2004. The absolute increase in general and administrative expenses for the three months ended September 30, 2005, was primarily attributable to an increase of approximately \$198,000 in additional general and administrative expenses associated with our acquisition of ORC in October 2004, as well as other general and administrative costs associated with the integration of ORC with WidePoint, and increases in our accounting and legal fees associated with our requisite filings with the Securities and Exchange Commission.

Depreciation expense. Depreciation expense for the three month period ended September 30, 2005, was approximately \$6,000, or less than 1% of revenues; an increase of \$5,000, as compared to approximately \$1,000 of such expenses, or less than 1% of revenues, recorded by the Company for the three month period ended September 30, 2004. The increase in depreciation and amortization expenses for the three month period ended September 30, 2005, was primarily attributable to a larger pool of depreciable assets resulting from the acquisition of ORC in October 2004, and an increase in amortization expense associated with the preliminary purchase accounting related to the purchase of ORC during October 2004.

Interest income. Interest income for the three month period ended September 30, 2005, was \$2,312, or less than 1% of revenues, an increase of \$1,005 as compared to \$1,307, or less than 1% of revenues, for the three month period ended September 30, 2004. The increase in interest income for the three month period ended September 30, 2005, was primarily attributable to interest income provided by the notes issued to the former shareholders of ORC.

Interest expense. Interest expense for the three month period ended September 30, 2005, was \$48,484, or 1% of revenues as compared to \$493, or less than 1% of revenues, for the three month period ended September 30, 2004. The increase in interest expense for the three month period ended September 30, 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 from financial instrument for the three month period ended September 30, 2005, was approximately \$702,000. The gain on financial instrument represents the decrease during the three months ended September 30, 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 of a stabilization in the value of the Company stock underlying the warrants, as well as the leveling of market interest rates during the quarter which had a downward effect in the volatility of the Company's stock and therefore a downward effect on the warrant value.

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Other Income (Expense). There was no other income or expenses for the three month periods ended September 30, 2005, and September 30, 2004.

Net earnings (loss). As a result of the above, the net earnings for the three month period ended September 30, 2005, was approximately \$250,000 as compared to the net loss of approximately \$105,000 for the three months ended September 30, 2004.

Nine Months Ended September 30, 2005 as Compared to Nine Months Ended September 30, 2004

Revenue. Revenue for the nine month period ended September 30, 2005 was approximately \$9,236,000 as compared to approximately \$2,471,000 for the nine month period ended September 30, 2004. The increase in revenue was primarily attributable to the full nine month effect of revenues realized from our acquisition of ORC in October 2004.

Cost of sales. Cost of sales for the nine month period ended September 30, 2005, was approximately \$8,156,000, or 88% of revenues, an increase of approximately \$6,305,000 over cost of sales of approximately \$1,851,000, or 75% of revenues, for the nine month period ended September 30, 2004. The absolute increase in cost of sales was materially attributable to higher revenues and cost of sales resulting from our acquisition of ORC in October 2004 and the nine month stock issuance expense of approximately \$1,268,000 for the pending release of common shares to the former Chesapeake shareholders as a result of revenues earned by ORC.

Gross profit. As a result of the above, gross profit for the nine month period ended September 30, 2005, was approximately \$1,080,000, or 12% of revenues, an increase of approximately \$460,000 over gross profit of approximately \$620,000, or 25% of revenues, for the nine month period ended September 30, 2004.

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Sales and marketing. Sales and marketing expense for the nine month period ended September 30, 2005, was approximately \$479,000, or 5% of revenues, an increase of approximately \$102,000, as compared to approximately \$377,000, or 15% of revenues, for the nine month period ended September 30, 2004. The absolute increase was materially attributable to the increase in sales and marketing expenses resulting from our acquisition of ORC in October 2004.

General and administrative. General and administrative expenses for the nine month period ended September 30, 2005, were approximately \$2,056,000, or 22% of revenues, an increase of approximately \$1,000,000, as compared to approximately \$1,056,000, or 43% of revenues, incurred by the Company for the nine month period ended September 30, 2004. The absolute increase in general and administrative expenses for the nine months ended September 30, 2005, was primarily attributable to an increase of approximately \$1,000,000 in additional general and administrative expenses associated with our acquisition of ORC in October 2004, as well as other general and administrative costs associated with the integration of ORC with WidePoint, and increases in our professional fees associated with our requisite filings with the Securities and Exchange Commission.

Depreciation expense. Depreciation expense for the nine month period ended September 30, 2005, was approximately \$19,000, or less than 1% of revenues, an increase of \$16,000, as compared to approximately \$3,000 of such expenses, or less than 1% of revenues, recorded by the Company for the nine month period ended September 30, 2004. The increase in depreciation and amortization expenses for the nine month period ended September 30, 2005, was primarily attributable to the increased pool of depreciable assets resulting from the acquisition of ORC in October 2004, as well as an increase in amortization expense associated with the purchase accounting related to the purchase of ORC.

Interest income. Interest income for the nine month period ended September 30, 2005, was \$4,831, or less than 1% of revenues, a decrease of \$175 as compared to \$5,006, or less than 1% of revenues, for the nine month period ended September 30, 2004. The slight decrease in interest income for the nine month period ended September 30, 2005, was primarily attributable to an increase in interest income from the notes outstanding to the former ORC shareholders offset by lesser amounts of interest income realized from the daily investment of cash and cash equivalents available to the company over this time period.

Interest expense. Interest expense for the nine month period ended September 30, 2005, was approximately \$152,000, or 2% of revenues, an increase of approximately \$151,000 as compared to \$608, or less than 1% of revenues, for the nine month period ended September 30, 2004. The increase in interest expense for the nine month period ended September 30, 2005 was primarily attributable to WidePoint's increased utilization of 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 from financial instrument for the nine month period ended September 30, 2005, was approximately \$1,228,000. The gain on financial instrument represents a decrease during the nine months ended September 30, 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. Some of the decrease was also attributable to the passage of time resulting in a decrease in the remaining term of the option. This decline in turn resulted from the relatively narrow trading

range of the Company's stock in the nine months 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 nine months which had an upward effect on the warrant value.

Other income (expense). Other income for the nine month period ended September 30, 2005, was \$1,910, or less than 1% of revenues, as compared to \$0 for the nine month period ended September 30, 2004.

Net loss. As a result of the above, the net loss for the nine month period ended September 30, 2005, was approximately \$336,000 as compared to the net loss of approximately \$812,000 for the nine months ended September 30, 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 nine months ended September 30, 2005, operations were materially financed with working capital, senior debt and the proceeds from a convertible preferred stock issuance and warrant exercise.

Cash provided by operating activities for the quarter ended September 30, 2005, was approximately \$178,000 as compared to cash used in operating activities of approximately \$178,000 for the quarter ended September 30, 2004. The increase in cash balances available for operating activities for the quarters ended September 30, 2005 were primarily the result of a decrease in prepaid expenses and other assets.

Capital expenditures in property and equipment for the quarters ended September 30, 2005 and September 30, 2004 were approximately \$2,000 and \$4,000, respectively.

As of September 30, 2005, the Company had a net working capital deficit of approximately \$2.1 million. WidePoint's primary source of liquidity consists of approximately \$0.4 million in cash and cash equivalents and approximately \$2.8 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's historical client base. Current liabilities include approximately \$2.2 million in accounts payable and accrued expenses; \$0.1 million in a line of credit with RBC-Centura Bank; and approximately \$3.0 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 maximum amount of cash that the Company will have to pay pursuant to the financial instrument is \$260,000, the rest will, under any circumstances, be either expire unused or will be settled with common stock. 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 September 30, 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 material 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. In August and September, 2005, Barron exercised warrants for 2,500,000 shares of common stock providing \$1,000,000 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 September 30, 2005 and thereafter kept effective through October 20, 2007, subject to permissible blackout periods and registration maintenance periods, then WidePoint will be required to pay Barron liquidated damages of up to \$20,000 for each month the registration statement is not effective. Barron has waived this penalty through September 30, 2005.

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 \$2.1 million will improve, 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 are expected to 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 our 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. 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. As of September 30, 2005, the Company was compliant with our revolving credit facilities. 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. Subsequently, on November 1, 2005 the Company entered into an extension with RBC-Centura through March 1, 2006 of the revolving credit facility. The only modification of the terms of the agreement was for an increase in the borrowing rate from prime to prime plus 1% during the period of the extension. All other terms remained the same. A pro rata administrative fee of 1/2 of 1 % of the \$2.5 million revolving credit base of approximately \$4,000 was charged by RBC-Centura for the issuance of the extension.

Approximately \$1.2 million of the senior line of credit was utilized in the acquisition of ORC. In addition, the Company raised approximately \$3.6 million 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.

The Company's valuation of the PKI intangible recorded in connection with the acquisition of ORC in October 2004 was estimated based on projections of income from the two PKI software versions. A revised valuation to be performed by independent appraisers will be used to finalize the valuation for the year ended December 31, 2005. There were no pre-acquisition contingencies under SFAS No. 141 relating to the ORC acquisition and the Company does not expect that the final valuation will materially differ from the preliminary valuation.

Off-Balance Sheet Arrangements

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

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PART II.

OTHER INFORMATION

ITEM 6. EXHIBITS.

(a) Exhibits

15 Letter Regarding Unaudited Interim Financial Information

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

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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.