

WIDEPOINT CORP  
Form 10-K/A  
January 19, 2006

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K/A No. 3

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

Amendment No. 3 to Annual Report on Form 10-K for the year ended December 31, 2004

WIDEPOINT CORPORATION

(Exact name of registrant as specified in its charter.)

Delaware

000-23967

52-2040275

(State or other jurisdiction of  
incorporation or organization)

(Commission  
File Number)

(I.R.S. Employer  
Identification No.)

One Lincoln Centre, Oakbrook Terrace, IL

60181

(Address of principal executive offices)

(Zip Code)

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

The undersigned registrant hereby amends the following items, financial statements, exhibits or other portions of its Annual Report on Form 10-K for the year ended December 31, 2004, as previously amended by Amendment No. 2 filed on August 17, 2005, as set forth in the pages attached hereto:

Part II	Item 6	Selected Consolidated Financial Information
	Item 7	Management's Discussion and Analysis of Financial Condition and Results of Operations
	Item 8	Financial Statements
	Item 9A	Controls and Procedures
Part IV	Item 15(a)	Financial Statements and Financial Statement Schedule
	Item 15(b)	Exhibits

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

WidePoint Corporation

Date: January 19, 2006

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

INTRODUCTORY NOTE

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

**Part II.****ITEM 6. SELECTED FINANCIAL DATA.**

The selected financial data presented below for each of the years in the five-year period ended December 31, 2004 is derived from our audited consolidated financial statements. You should read the selected financial data presented below in conjunction with our consolidated financial statements, the notes to our consolidated financial statements and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations.

On October 25, 2004, WidePoint acquired the stock of Operational Research Consultants, Inc. ( ORC ), a Virginia corporation. The accompanying financial data includes the accounts of ORC as of the date of the acquisition. A further description of that purchase is set forth in the Company's Form 8-K/A filed on January 7, 2005 and subsequently amended with the Securities and Exchange Commission on January 19, 2006. On April 30, 2004, WidePoint closed on the acquisition of Chesapeake Government Technologies, Inc. ( Chesapeake ), a Delaware corporation. A further description of that purchase is set forth in the Company's Form 8-K filed on May 14, 2004 and subsequently amended on August 17, 2005. On September 29, 2000, WidePoint sold Parker Management Consultants, Ltd. ( PMC ). The accompanying financial data includes the accounts of PMC through that date of sale. A further description of that sale transaction is set forth in the Company's Form 8-K/A filed on December 13, 2000 with the Securities and Exchange Commission.

The reflected changes as a result of the acquisitions and disposition described above along with the Company's strategy to continue to acquire additional businesses might cause the data described in the tables below not to be indicative of the Company's future financial condition or results of operations.

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**Selected Financial Data**

	As Restated 2004	2003	2002	2001	2000
Statement of Operations Data:					
Revenues	\$ 5,542,118	\$ 3,293,508	\$ 3,495,160	\$ 5,902,728	\$ 12,834,474
Cost of revenues	4,484,469	2,460,281	2,489,983	3,122,061	7,014,045
Gross Profit	1,057,649	833,227	1,005,177	2,780,667	5,820,429
Sales and marketing expense	596,564	430,065	525,322	614,786	1,856,694
General and administrative expense	1,626,454	693,220	643,771	2,549,661	8,535,062
Facilities closing expense	--	--	--	43,500	376,289
Disposition of subsidiary	--	--	--	--	699,203
Impairment of long-term assets	--	--	--	5,853,693	--
Depreciation and amortization	15,713	12,777	51,792	545,290	851,562
Loss from operations	(1,181,082)	(302,835)	(215,708)	(6,826,263)	(6,498,381)
Other income (expense):					
Interest income	5,841	11,551	17,658	44,655	103,351
Interest expense	(38,144)	(1,304)	(1,559)	(5,231)	(198,971)
Loss from financial instruments	(3,070,617)	--	--	--	--
Other	2,118	1,500	140,000	--	--
Net loss before income taxes	(4,281,884)	(291,088)	(59,609)	(6,786,839)	(6,594,001)
Income taxes (benefit)	(816)	--	--	--	--

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	As Restated 2004	2003	2002	2001	2000
Net loss	\$ (4,281,068)	\$ (291,088)	\$ (59,609)	\$ (6,786,839)	\$ (6,594,001)
Basic and diluted loss per share	\$ (0.26)	\$ (0.02)	\$ (0.00)	\$ (0.52)	\$ (0.51)
Basic and diluted weighted average shares outstanding	16,657,947	15,579,913	14,243,310	12,984,913	12,979,055
Dividends	--	--	--	--	--
Total Assets	\$ 8,391,426	\$ 1,465,645	\$ 1,921,868	\$ 2,193,339	\$ 9,690,389
Long-term debt	--	--	--	--	--
Long-term obligations (Capital leases only)	--	--	--	6,421	24,430
Capital leases, current portion	--	--	6,421	18,009	29,830
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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

**Forward Looking Statements**

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 Corporation is a consulting services firm specializing in planning, managing and implementing Information Technology ( IT ) solutions. Its 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.

During 2002 and 2003, WidePoint witnessed a highly competitive economic environment within the commercial IT sector due to a combination of constrained business investment and an excessive supply of IT consultants. As a result of these conditions, the Company experienced both reduced gross margins and decreased demand for the IT services that it provides.

In 2004, WidePoint acquired Chesapeake Government Technologies, Inc. ( Chesapeake ) and Operational Research Consultants, Inc. ( ORC ) as part of WidePoint s strategy to refocus the Company s business development initiatives toward the substantial increase in government spending on infrastructure and automation that has been accelerated by recent geopolitical events that have created an unprecedented need for systems and process expertise across most government markets, federal, state and local. This market is also growing due to the fact that many government legacy systems and processes are approaching the end of their technologically useful lives, indicating the need for significant upgrade and enhancement. WidePoint intends to capitalize on the expected growth in its target markets through its strategic acquisitions, continuing rollout of the ORC Public Key Infrastructure ( PKI ) initiative, and by continuing to implement our project based enterprise strategy emphasizing industry-wide best practices disciplines. With the addition of the customer base and the increase in revenues attributable from the ORC acquisition, WidePoint s opportunity to leverage and expand further into the federal marketplace has improved dramatically. ORC s past client successes, top security clearances in their facilities and with their personnel, and additional breadth of management talent have expanded the Company s reach into markets that previously were not accessible to WidePoint. The Company 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, the Company is continuing to actively search out new synergistic acquisitions that WidePoint believes will further enhance the present base of business which has been augmented by its recent acquisitions and internal growth initiatives.

As a result of these actions in 2004, the Company s revenues for the period ending December 31, 2004 increased by approximately 68% from approximately \$3.3 million in 2003 to \$5.5 million in 2004. This increase was materially due to the additional revenues of approximately \$2.2 million generated by ORC from October 25, 2004 through December 31, 2004. ORC generated approximately \$10.5 million in unaudited

revenues for the year ending December 31, 2004. Taken together with the results of WidePoint's revenues for the same period, the combined total materially affects the comparability of the information reflected in the selected consolidated financial information presented above, and therefore may not be indicative of the Company's future financial condition or results of operations. Further, as the Company attempts to continue to implement its strategy of strategic growth driven both by internal growth and potential merger and acquisition activity, we believe that future performance may continue to affect the comparability of the information reflected in the selected consolidated financial information presented above.

In addition, most of the Company's current costs consist primarily of the salaries and benefits paid to WidePoint'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. 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, and 3) as a result of timing differences between the actual issuance by the Company of shares earned and issued, the Company should have recorded those shares earned as of December 31, 2004 as common stock issuable and not as common stock as those shares were not issued until June 30, 2005. For further information related to the quantitative effects of the restatement, see note 1 of the Company's financial statements.

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 give rise to goodwill because Chesapeake was in the development stage at the time of acquisition and therefore not considered a business.

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Management has acquiesced to the use of the ORC revenue as a basis for release of the escrowed shares under the belief that the revenue of ORC, which management believes was acquired as a result of Chesapeake relationships, qualifies as revenue for determination of the release of escrowed shares. For financial reporting purposes, however, the text of the Chesapeake agreement does not provide sufficient objective evidence of linkage between release of the shares and ORC revenue to allow for capitalizing the cost of the release as additional acquisition cost of ORC. A portion of the shares escrowed in the Chesapeake transaction were released based on ORC's sales in that year.

As a consequence of these determinations, previously issued financial statements are being 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, and to record and expense as consulting fees the release of the shares from escrow at December 31, 2004.

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 for the year ended December 31, 2004. At December 31, 2004, the goodwill, intangibles, preferred stock (temporary equity), additional paid-in capital, and accumulated deficit were adjusted from previously reported amounts to properly reflect the appropriate accounting treatment.

### **Critical Accounting Policies and Estimates**

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. These accounting principles require us to make certain estimates, judgments and assumptions. WidePoint believes that the estimates, judgments and assumptions upon which the Company relies are reasonably based upon information available to it at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. To the extent there are material differences between these estimates, judgments and assumptions and actual results, the Company's financial statements will be affected. The significant accounting policies that WidePoint believes are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

### **Critical Accounting Policies and Estimates**

Revenue recognition;

Allowance for doubtful accounts;

Goodwill;

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Intangibles; and

Accounting for income taxes.

In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result. The Company's senior management has reviewed these critical accounting policies and related disclosures with its Audit Committee. See Notes to Consolidated Financial Statements, which contain additional information regarding accounting policies and other disclosures required by U.S. GAAP.

#### *Revenue Recognition*

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

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

#### *Allowance for Doubtful Accounts*

WidePoint determines its Allowance by considering a number of factors, including the length of time trade accounts receivable are past due, previous loss history, the customer's current ability to pay its obligations, and the condition of the general economy and the industry as a whole. The Company makes judgments as to its ability to collect outstanding receivables based on these factors and provide allowances for these receivables when collections become doubtful. Provisions are made based on specific review of all significant outstanding balances.

#### *Goodwill*

Goodwill represents costs in excess of fair values assigned to the underlying net assets acquired. The Company has adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. These standards require the use of the purchase method of accounting for business combinations, set forth the accounting for the initial recognition of acquired intangible assets and goodwill and describe the accounting for intangible assets and goodwill subsequent to initial recognition. Under the provisions of these standards, goodwill is not subject to amortization and annual review is required for impairment. The impairment test under SFAS No. 142 is based on a two-step process involving (i) comparing the estimated fair value of the related reporting unit to its net book value and (ii) comparing the estimated implied fair value of goodwill to its carrying value. Impairment losses are recognized whenever the implied fair value of goodwill is less than its carrying value. The Company's annual impairment testing date is December 31. Goodwill is a significant item on the Company's balance sheet and represents approximately 33% of our total assets. Goodwill is identified on the face of the Balance Sheet.

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#### *Intangibles*

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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 and identifiable intangibles 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.

As of December 31, 2004, the Company is not aware of any known trends, demands, commitments, events or uncertainties that are reasonably likely to occur and materially affect the methodology or the assumptions the Company has used to value long-lived assets. Long-lived assets are a significant item on the Company's balance sheet and represent approximately 20% of our total assets. Any impairment as a result of the estimate utilizing net cash flows to determine the assumed value of long-lived assets could have a significant impact on the Company's financial condition, changes in financial condition and results of operations. Long-lived assets are identified on the face of the Balance Sheet as Intangibles. Amortization of Intangibles are identified on the face of the Statement of Operations within Cost of Sales.

The Company's senior management has discussed the development and selection of the accounting estimate, and the MD&A disclosure regarding it, with the audit committee of the Company's board of directors.

### *Accounting for Income Taxes*

WidePoint accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. Under the asset and liability method of SFAS No. 109, deferred income taxes are recognized for the expected future tax consequences of temporary differences between financial statement carrying amounts, and the tax bases of existing assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

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The Company has incurred historical net operating losses, or NOLs, for federal income tax purposes. Accordingly, no federal income tax provision has been recorded to date and there are no taxes payable. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which those temporary differences become deductible.

Based upon the level of historical losses that may limit utilization of NOL carry forwards in future periods, management is unable to predict whether these net deferred tax assets will be utilized prior to expiration. The unused NOL carry forwards expire in years 2010 through 2023. As such, the Company has recorded a full valuation allowance against net deferred tax assets. Although WidePoint believes that its estimates are reasonable, no assurance can be given that the final outcome of these matters will not be different than that which is reflected in the historical income tax provisions. Such differences could have a material effect on the income tax provision and net income in the period in which such determination is made.

### *New Accounting Pronouncements*

In December 2004, the Financial Accounting Standards Board issued Statement 123 (revised 2004), *Share-Based Payment* (Statement 123(R)). This Statement requires that the costs of employee share-based payments be measured at fair value on the awards' grant date using an option-pricing model and recognized in the financial statements over the requisite service period. This Statement does not change the accounting for stock ownership plans, which are subject to American Institute of Certified Public Accountants SOP 93-6, *Employer's Accounting for Employee Stock Ownership Plans*. Statement 123(R) supersedes Opinion 25, *Accounting for Stock Issued to Employees* and its related interpretations, and eliminates the alternative to use Opinion 25's intrinsic value method of accounting, which the Company is currently using.

Statement 123(R) allows for two alternative transition methods. The first method is the modified prospective application whereby compensation cost for the portion of awards for which the requisite service has not yet been rendered that are outstanding as of the adoption date will be recognized over the remaining service period. The compensation cost for that portion of awards will be based on the grant-date fair value of those awards as calculated for pro forma disclosures under Statement 123, as originally issued. All new awards and awards that are modified, repurchased, or cancelled after the adoption date will be accounted for under the provisions of Statement 123(R). The second method is the modified retrospective application, which requires that the Company restate prior period financial statements. The modified retrospective application may be applied either to all prior periods or only to prior interim periods in the year of adoption of this statement. The Company is currently determining which transition method it will adopt and is evaluating the impact Statement 123(R) will have on its financial position, results of operations, EPS and cash flows when the Statement is adopted. Upon making its determination of the transition method the Company

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will adopt Statement 123(R). The Company will adopt this Statement on January 1, 2006 in accordance with the requirements.

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In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150), which establishes standards for how companies classify and measure certain financial instruments with characteristics of both liabilities and equity. It requires companies to classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). We believe that the adoption of SFAS 150 will not result in a material change in our financial statements.

### Results of Operations

#### Year Ended December 31, 2004 Compared to the Year ended December 31, 2003

*Revenues.* Revenues for the year ended December 31, 2004, were approximately \$5.5 million, an increase of \$2.2 million, as compared to revenues of approximately \$3.3 million for the year ended December 31, 2003. The 68% increase in revenues in 2004 was primarily attributable to the acquisition of Operational Research Consultants, Inc. ( ORC ). ORC contributed approximately \$2.2 million in revenues subsequent to its acquisition by the Company on October 25, 2004.

*Gross profit.* Gross profit for the year ended December 31, 2004, was approximately \$1.1 million, or 19% of revenues, an increase of \$0.3 million as compared to gross profit of approximately \$0.8 million, or 25% of revenues, for the year ended December 31, 2003.

The increase in the amount of gross profit was primarily attributable to higher billing rates as a result of the greater demand for the IT security skill sets of the consultants at ORC, partially offset by the recording of the issuance of 544,398 shares of the Company's common stock to the former Chesapeake shareholders as a result of meeting performance measures related to the realization of revenues by ORC during the fourth quarter ended December 31, 2004. The release of those shares from escrow represented a compensation expense in cost of sales of approximately \$381,000.

The cost elements related to consultant salaries, benefits and expenses at both ORC and WidePoint are substantially similar. ORC's ability to contain its salary, benefit, and other cost elements on both an absolute and per capita basis, while revenue per capita has been increasing, has resulted in WidePoint's realization of an improvement in gross profit for the year ended December 31, 2004 as compared to December 31, 2003.

*Sales and marketing.* Sales and marketing expenses for the year ended December 31, 2004 were approximately \$0.6 million, or 11% of revenues, as compared to \$0.4 million, or 13% of revenues, for the year ended December 31, 2003. The \$0.2 million increase in sales and marketing expenses for the year ended December 31, 2003, was primarily attributable to an increase in the amount of sales and marketing expenditures as a result of the Company's recent acquisition of ORC.

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*General and administrative.* General and administrative expenses for the year ended December 31, 2004 were approximately \$1.6 million, or 29% of revenues, as compared to \$0.7 million, or 21% of revenues, for the year ended December 31, 2003. The \$0.9 million increase in general and administrative expenses in 2004 was primarily attributable to an increase in the amount of general and administrative expenses associated with the acquisitions of both Chesapeake and ORC, the Company's implementation of its federal sector business initiative and the recording of the issuance of 500,000 shares of the Company's common stock to TriPoint Capital Advisors for corporate advisory services that resulted in a compensation expense of approximately \$72,000.

*Interest income (expense).* Interest income for the year ended December 31, 2004 was \$5,841, a decrease of \$5,710, or 51%, as compared to \$11,551 for the year ended December 31, 2003. The decrease in interest income in 2004 was primarily attributable to lesser amounts of available cash and other securities. Interest expense for the year ended December 31, 2004 was \$38,144, an increase of \$36,840, or 2,725%, as compared to \$1,304 in interest expense for the year ended December 31, 2003. The increase in interest expense in 2004 was primarily attributable to the Company'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.

*Loss from Financial Instruments.* The Company recognized a loss from financial instruments of approximately \$3,071,000 in the year ended December 31, 2004 which related to the difference between the fair value of the warrants issued to Barron Partners, LP in connection with the preferred stock financing and the market price of the common stock underlying such warrants at December 31, 2004. No such loss was recognized in the year ended December 31, 2003.

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*Net loss.* As a result of the above, the net loss for the year ended December 31, 2004 was approximately \$4.3 million, an increase of \$4.0 million, as compared to the net loss of approximately \$0.3 million for the year ended December 31, 2003.

### Year Ended December 31, 2003 Compared to the Year ended December 31, 2002

*Revenues.* Revenues for the year ended December 31, 2003, were approximately \$3.3 million, a decrease of \$0.2 million, as compared to revenues of approximately \$3.5 million for the year ended December 31, 2002. The 6% decrease in revenues in 2003 was primarily attributable to negative pricing pressures that resulted from the highly competitive economic environment that reduced average billing rates for the Company's consultants.

*Gross profit.* Gross profit for the year ended December 31, 2003, was \$0.8 million, or 25% of revenues, a decrease of \$0.2 million as compared to gross profit of \$1.0 million, or 29% of revenues, for the year ended December 31, 2002. The decrease in the amount of gross profit was attributable to a reduction in revenues and a decrease in operating margins caused by the inability of the Company to completely offset lower average bill rates with a decrease in corresponding consultant costs.

*Sales and marketing.* Sales and marketing expenses for the year ended December 31, 2003 were \$0.4 million, or 13% of revenues, as compared to \$0.5 million, or 15% of revenues, for the year ended December 31, 2002. The \$0.1 million decrease in sales and marketing expenses for the year ended December 31, 2003, was primarily attributable to the Company's attempt to match the size of the Company's sales force with the operational requirements of the Company's business.

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*General and administrative.* General and administrative expenses for the year ended December 31, 2003 were \$0.7 million, or 21% of revenues, as compared to \$0.6 million, or 18% of revenues, for the year ended December 31, 2002. The \$0.1 million increase in general and administrative expenses in 2003 was primarily attributable to increases in administrative labor cost.

*Interest income (expense).* Interest income for the year ended December 31, 2003 was \$11,551, a decrease of \$6,107, or 35%, as compared to \$17,658 for the year ended December 31, 2002. The decrease in interest income in 2003 was primarily attributable to lower interest rates. Interest expense for the year ended December 31, 2003 was \$1,304, a decrease of \$255, or 16%, as compared to \$1,559 in interest expense for the year ended December 31, 2002. The decrease in interest expense in 2003 was primarily attributable to the elimination of the capital lease obligations.

*Net loss.* As a result of the above, the net loss for the year ended December 31, 2003 was approximately \$0.3 million, an increase of \$0.2 million, as compared to the net loss of approximately \$60,000 for the year ended December 31, 2002.

### **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 2003, operations were materially financed with working capital, senior debt and the proceeds from a convertible preferred stock issuance.

Cash used in operating activities for the year ended December 31, 2004, was approximately \$0.5 million as compared to cash used in operating activities of approximately \$0.3 million for the year ended December 31, 2003. The decrease in cash balances available for operating activities for the years ended December 31, 2004 and 2003, respectively, were primarily a result of investments in which we expanded our sales and general and administrative cost structure to implement our growth strategy. Capital expenditures in property and equipment were approximately \$15,000 for the year ended December 31, 2004, as compared to capital expenditures in property and equipment of approximately \$8,000 for the year ended December 31, 2003.

The Company had material increases in our balance sheet in accounts receivables, prepaid expenses, goodwill, intangibles, accounts payable and accrued expenses as of December 31, 2004 as compared to December 31, 2003. The increases in the assets and liabilities in our balance sheet were primarily due to our recent acquisition of ORC. Accounts receivable increased as a result of the increase in revenues from ORC and prepaid expenses increased as a result of the additional cost associated with operating ORC. The increase in accounts receivable attributable to the ORC acquisition allowed the Company to secure a senior line of credit for up to \$2.5 million dollars. The line of credit allowed the Company to partially finance the purchase of ORC and presently provides additional liquidity and working capital for the Company. As a result of the acquisition of ORC, the Company's accounts receivable aging has declined. This has primarily been as a result of a longer payment cycle at ORC. ORC invoices monthly while WidePoint invoices, weekly and monthly. As a result of the monthly billing cycle at ORC, the Company has experienced a longer average period to collect its accounts receivable from its clients. As of December 31, 2004, the Company has not witnessed any problems associated with collectibility or billing problems with any major customers or any significant changes in credit terms, collection



efforts, credit utilization and/or delinquency policies. Goodwill and intangible assets increased as a result of the purchase accounting related the purchase of ORC. Accounts payable and accrued expenses increased as a result of the increased cost of operating ORC.

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As of December 31, 2004, the Company had a net working capital deficit of approximately \$6.9 million. WidePoint's primary source of liquidity consists of approximately \$0.5 million in cash and cash equivalents and approximately \$3.0 million of accounts receivable. Current liabilities include approximately \$2.2 million in accounts payable and accrued expenses; \$1.6 million in a line of credit with RBC Centura Bank; and \$6.6 million in financial instruments which may be converted to equity upon the extinguishment of the Company's liquidation damages clause within the registration rights agreement entered into with Barron Partners, LP.

The market for the Company's services is experiencing an environment of constrained technology investment resulting from an economic slowdown that has reduced new technology initiatives. As a result of this negative environment, the demand for IT consultants ranging from software programmers to network engineers has been negatively affected. This has reduced demand for consultants, as well as created an increase in competition from both domestic and foreign firms for the diminished amount of new and ongoing IT initiatives. WidePoint anticipates a reversal of these negative events in the future, as economic growth is restored, the constrained environment in new technology initiatives ebb, and the Company executes its current mergers and acquisitions strategy. Therefore, the Company's business environment is characterized by rapid technological change; experiences times of high growth and contraction and is influenced by material events such as mergers and acquisitions that can substantially change the Company's outlook.

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

On October 25 and 29, 2004, WidePoint completed financings with Barron Partners L.P. (Barron), a private equity fund that engages in investing primarily in private investments in publicly traded entities, for an aggregate amount of \$3,580,000, under a preferred stock purchase agreement and related agreements. Net proceeds from the financing after costs and expenses, including fees of finders and agents, were approximately \$3,030,000. WidePoint issued an aggregate of 2,045,714 shares of its Series A Convertible Preferred Stock that are convertible into an aggregate of 20,457,143 shares of its Common Stock at a conversion rate equal to \$0.175 per share. In addition, WidePoint issued to Barron a warrant to purchase up to an additional 10,228,571 shares of its Common Stock at an exercise price of \$0.40 per common share. The shares of Common Stock which may be acquired by Barron upon its conversion of its Series A Convertible Preferred Stock and/or the exercise of its warrant are subject to contractual restrictions which restrict the ability of Barron and its affiliates to acquire shares of Common Stock which equal no more than 4.99% of the outstanding shares of WidePoint's Common Stock at any time. This contractual restriction may be removed upon 61 days notice to WidePoint from Barron, but in the event Barron elects to remove this restriction, then Barron and its affiliates agreed that Barron and its affiliates can only vote the shares of Common Stock held by Barron and its affiliates which result in Barron and its affiliates having no more than 22% of the total voting power of all outstanding shares of WidePoint's Common Stock at any time. As a result of the Barron financing transaction, WidePoint issued warrants to Westcap Securities, Inc., a registered broker-dealer and WidePoint's placement agent in such transaction, to purchase 511,428 shares of Common Stock at an exercise price of \$0.40 per share, which warrants expire in October 2009. On April 8, 2005, Barron converted 100,000 shares of its preferred stock into 1,000,000 shares of Common Stock.

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Pursuant to the registration rights agreement, between Barron and WidePoint, related to the stock issuances described in the preceding paragraph, WidePoint filed a registration statement on January 5, 2005, covering the resale of the shares of Common Stock issuable upon conversion and/or exercise of the Series A Convertible Preferred Stock and the warrants issued to Barron. If our registration statement is not declared effective by the Securities and Exchange Commission by April 23, 2005 and thereafter kept effective through October 20, 2007, subject to permissible blackout periods and registration maintenance periods, then WidePoint will be required to pay Barron a maximum penalty of up to \$20,000 for each month the registration statement is not effective. Barron has waived the penalty provision of up to \$20,000 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. 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. 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. Our failure to comply with the restrictive covenants under our revolving credit facility could result in an event of default, which, if not cured, amended, or waived, could result in us being required to repay these borrowings before their due date. To date any covenants with which we have not been compliant have either been amended or waived and we continue to work with RBC-Centura to structure appropriate covenants that match our present business condition and environment. Although we currently are not in compliance with two of our covenants, which includes our ebitda to debt ratio covenant and our net income covenant, RBC-Centura has waived such violations until such time as the Company delivers to RBC-Centura the Company's financial statements for the quarter ended June 30, 2005 evidencing that the Company is in compliance with the above covenants. If we are forced to refinance these borrowings on less favorable terms, our results of operations and financial condition could be adversely affected by increased cost and rate. Approximately \$1.2 million dollars of the senior line of credit was utilized in the acquisition of ORC. In addition, the Company raised approximately \$3.6 million dollars in connection with the aforementioned equity investments by Barron Partners, LP, that were used in the acquisition of ORC. There can be no assurance that additional financing, if required, will be available on acceptable terms, if at all, for future acquisitions and/or growth initiatives.

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### Off-Balance Sheet Arrangements

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

### Contractual Obligations

The following table summarizes the Company's contractual obligations at December 31, 2004 and the effect such obligations are expected to have on liquidity and cash flow in future periods.

	Payments Due by Period				
	Total	Less than 1 year	1- 2 years	3-4 years	More than 5 years
Contractual Obligations					
Long-Term	\$ --	\$ --	\$ --	\$ --	\$ --
Capital Lease	--	--	--	--	--
Convertible debt	--	--	--	--	--
Operating lease (1)	2,072,877	595,259	525,340	887,928	64,350
Purchase Obligations	--	--	--	--	--
Other Long-Term Liabilities	--	--	--	--	--
Total (2)	\$ 2,072,877	\$ 595,259	\$ 525,340	\$ 887,928	\$ 64,350

(1) WidePoint's office located at One Lincoln Center, Oakbrook Terrace, Illinois 60181 has a lease which runs through July 31, 2007, with payments in 2005 representing an obligation of approximately \$42,800 and payments from 2006 to 2007 representing obligations of approximately \$70,600. The office at 1736 South Park Court, Chesapeake, VA has a lease which runs through April 30, 2006, with payments in 2005 representing an obligation of approximately \$26,700 and payments in 2006 representing obligations of approximately \$9,000. The office at 11250 Waples Mill Rd., Fairfax, VA, has a lease which runs through March 15, 2009, with payments in 2005 representing an obligation of approximately \$341,000 and payments in 2006 through 2009 representing obligations of approximately \$1,188,000. The office at 1625 Prince St., Alexandria, VA, has a lease which runs through January 31, 2008, with payments in 2005 representing an obligation of approximately \$91,700 and payments in 2006 through 2008 representing obligations of approximately \$191,600.

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(2) The above table does not include the financial instrument that is reported as a current liability on the Company's balance sheet at December 31, 2004 and is discussed in Note 10 to the Company's consolidated financial statements contained herein. Such financial instrument (which amounted to \$6,648,571 at December 31, 2004) does not fall within the above five categories of contractual obligations called for by the table. The recordation of that short-term liability resulted from the issuance of warrants by the Company to Barron Partners, LP in October 2004 and the related registration rights agreement that included a liquidated damages clause, requiring the fair value of the warrants to be treated as a derivative financial instrument under EITF 00-19.

**Other**

Inflation has not had a significant effect on the Company's operations, as increased costs to the Company have generally been offset by increased prices of products and services sold, although this has been more recently compromised by some of the competitive pricing pressures referenced under Competition in Item 1 of this document.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

This report contains forward-looking statements setting forth the Company's beliefs or expectations relating to future revenues and profitability. Actual results may differ materially from projected or expected results due to changes in the demand for the Company's products and services, uncertainties relating to the results of operations, dependence on its major customers, risks associated with rapid technological change and the emerging services market, potential fluctuations in quarterly results, and its dependence on key employees and other risks and uncertainties affecting the technology industry generally. 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.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA**

The consolidated financial statements and schedules required hereunder and contained herein are listed under Item 15 below.

**ITEM 9A. CONTROLS AND PROCEDURES.**

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**Disclosure Controls and Procedures**

The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and include controls and procedures designed to ensure that such information is accumulated and communicated to the Company's management, including its principal executive and financial officers, to allow timely decisions regarding required disclosure. Based on the evaluation of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2004 required by Rule 13a-15(b) under the Securities Exchange Act of 1934 and conducted by the Company's chief executive officer and chief financial officer, such officers concluded that the Company's disclosure controls and procedures were not effective as of December 31, 2004. That conclusion was based on the fact that during the first quarter of 2005, the Company identified a material weakness in its internal control over financial reporting due to insufficient technical accounting expertise within the accounting function to resolve non-routine or complex accounting and tax matters such as those that occur in connection with a material acquisition such as the Company's recent acquisition of Operational Research Consultants, Inc. The existence of that weakness was further demonstrated by the subsequent determination during 2005 of the need for certain financial statement corrections and restatements. Additional information regarding those matters is set forth below under "Changes in Internal Control Over Financial Reporting." As a result of that material weakness, the Company failed to timely file its Annual Report on Form 10-K for the year ended December 31, 2004. The Company filed a Form 12b-25 extending the March 31, 2005 filing due date for the report to April 15, 2005, but did not file the report until April 19, 2005.

In November 2004, the Company discovered that its proxy statement, dated November 17, 2003 and used in connection with the Company's annual meeting of shareholders on December 18, 2003, had not been filed with the SEC as required, and its 2002 annual report to shareholders (which consisted of a one-page cover letter attached to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, which had been timely filed) had not been submitted to the SEC as required. On November 12, 2004, the Company filed such proxy material and submitted such annual report to shareholders to the Commission. The late filing resulted from the fact that the service provider that had been engaged by the Company in 2003 to Edgarize and file the proxy statement and submit the annual report to shareholders inadvertently failed to make such filing and submission. The service provider acknowledged responsibility for its failure to make such filings, and the Company engaged another service provider that Edgarized and made the filings. In the fourth quarter of 2004, the Company instituted an additional internal reporting process to track and confirm the timely filing of reports with the SEC whereby confirmations are routed to executive management after each new filing is submitted and accepted to track and confirm the timely filing. That new internal control was instituted during the quarter ended December 31, 2004 and was in place at December 31, 2004.

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## Changes in Internal Control Over Financial Reporting

In connection with the evaluation by the principal executive officer and principal financial officer of the Company required by Rule 13a-15(d) under the Securities Exchange Act of 1934, such officers determined that the following change in the Company's internal control over financial reporting occurred during the quarter ended December 31, 2004, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. As discussed above under "Disclosure Controls and Procedures," that change in internal control over financial reporting was designed to remediate the weakness in the Company's internal control over financial reporting relating to the tracking of the timeliness of its filings and submissions with the SEC. That change implemented an additional internal control that involved an additional reporting process to track and confirm the filing of SEC filings whereby confirmations are routed to executive management after each new filing is submitted and accepted to track and confirm the filing.

During the first quarter of 2005, in connection with the Company's preparation of this Annual Report on Form 10-K, the Company identified a material weakness in the design of its internal control over financial reporting related to insufficient technical accounting expertise within our accounting function to resolve non-routine or complex accounting and tax matters that occurred in connection with (i) our recent material acquisition of Operational Research Consultants, Inc. in October 2004; and (ii) determination of the proper accounting treatment of the financial instrument relating to the warrants issued by the Company in October 2004.

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

The material weakness in internal controls resulted in (i) our late filing on April 19, 2005 (four days after the extended due date) of our Annual Report on Form 10-K for the year ended December 31, 2004, (ii) the need to restate the recorded amount of the financial instrument at December 31, 2004 and March 31, 2005 due to the failure to mark-to-market such instrument at December 31, 2004, and (iii) the need to restate the prior financial statements as set forth in this amendment. In order to remediate that material weakness, we engaged a consulting firm in January 2005 with the requisite accounting expertise, and are continuing to use the services of that firm in connection with such complex accounting matters. That action constituted a change in the Company's internal control over financial reporting that occurred during the first quarter of 2005. To date, the Company has not expended any material costs, nor does it estimate it will expend any material costs associated with engaging the accounting consultancy firm the Company hired to assist it in its technical accounting requirements. The accounting consultancy firm does not have any relationship with our current independent auditors.

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

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## Part IV.

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) Financial Statements and Financial Statement Schedule

(1) Financial Statements:

Report of Grant Thornton LLP, Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2004 and 2003

Consolidated Statements of Operations for the Years Ended December 31, 2004, 2003, and 2002

Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 2004, 2003, and 2002

Consolidated Statements of Cash Flow for the Years Ended December 31, 2004, 2003, and 2002

Notes to Consolidated Financial Statements

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

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

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<u>EXHIBIT NO.</u>	<u>DESCRIPTION</u>
2.1	Stock Purchase Agreement among ZMAX Corporation, Michael C. Higgins and Michael S. Cannon, dated November 6, 1996, for the acquisition of Century Services, Inc. (Incorporated herein by reference to Exhibit 2.1 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
2.2	Agreement and Plan of Merger between ZMAX Corporation and New ZMAX Corporation, dated June 10, 1999. (Incorporated herein by reference to Exhibit 2.2 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
3.1	Amended and Restated Certificate of Incorporation of WidePoint Corporation. (Incorporated herein by reference to Exhibit A to the Registrant's Definitive Proxy Statement, as filed on December 27, 2004.)
3.2	Bylaws of ZMAX Corporation. (Incorporated herein by reference to Exhibit 3.6 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
4.1	Form of Warrant to Purchase Common Stock of ZMAX Corporation. (Incorporated herein by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
10.1	ZMAX Corporation 1999 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)*
10.2	Form of ZMAX Corporation 1999 Non-qualified Stock Option Award (form of grant and vesting schedule). (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)*
10.3	ZMAX Corporation 1999 Directors Formula Stock Option Plan. (Incorporated herein by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)*
10.4	Form of ZMAX Corporation Directors Formula Stock Option Award (form of grant and vesting schedule). (Incorporated herein by reference to Exhibit 10.4 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)*
10.5	Employment Agreement between Century Services, Inc. and Michael C. Higgins, dated November 6, 1996. (Incorporated herein by reference to Exhibit 10.5 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)*

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\* Management contract or compensatory plan

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- 10.6 First Amendment to the Employment Agreement between Century Services, Inc. and Michael C. Higgins, dated May 21, 1999. (Incorporated herein by reference to Exhibit 10.6 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)\*
- 10.7 Employment Agreement between Century Services, Inc. and Joseph Yeh, dated June 18, 1999. (Incorporated herein by reference to Exhibit 10.7 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)\*
- 10.8 Separation Agreement between Century Services, Inc. and Michael S. Cannon, dated April 22, 1999. (Incorporated herein by reference to Exhibit 10.8 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)\*
- 10.9 Consulting Agreement among ZMAX Corporation, MBY, Inc. and Michel Berty, dated April 1, 1999. (Incorporated herein by reference to Exhibit 10.9 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)\*
- 10.10 Consulting Agreement among ZMAX Corporation, Wareham Management Ltd. and G.W. Norman Wareham, dated May 30, 1999. (Incorporated herein by reference to Exhibit 10.10 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)\*
- 10.11 Consulting Agreement between ZMAX Corporation and Shafiq Nazerali, dated May 30, 1999. (Incorporated herein by reference to Exhibit 10.11 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)\*
- 10.12 Earn Out Stock Escrow Agreement among ZMAX Corporation, Michael C. Higgins, Michael S. Cannon and Powell, Goldstein, Frazer & Murphy, dated November 6, 1996. (Incorporated herein by reference to Exhibit 10.12 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.13 ZMAX Corporation Stockholders Agreement among Michael C. Higgins, Michael S. Cannon and ZMAX Corporation, dated November 6, 1996. (Incorporated herein by reference to Exhibit 10.13 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.14 Stock Pledge and Security Agreement from Michael C. Higgins in favor of ZMAX Corporation, dated November 6, 1996. (Incorporated herein by reference to Exhibit 10.14 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)

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\* Management contract or compensatory plan

- 10.15 Letter Agreement among ZMAX Corporation, IMS International, Inc., Wan Hsien Information International Corporation, Ltd., Multi-Dimension International, and Institute for Information Industry Regarding the Purchase by ZMAX Corporation of the "COCACT" Software Program, dated April 30, 1999. (Incorporated herein by reference to Exhibit 10.15 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.16 Letter Agreement between ZMAX Corporation and Institute for Information Industry Regarding the Purchase by ZMAX Corporation of the COCACT Software Program, dated April 30, 1999. (Incorporated herein by reference to Exhibit 10.16 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.17 Letter Agreement between ZMAX Corporation and Wan Hsien Information International Corporation Ltd. Regarding the Purchase by ZMAX Corporation of the COCACT Software Program, dated April 30, 1999, as amended. (Incorporated herein by reference to Exhibit 10.17 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.18 Conversion Agreement between Fiserv Federal Systems, Inc. and ZMAX Corporation, dated April 28, 1999. (Incorporated herein by reference to Exhibit 10.18 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.19 Agreement between ZMAX Corporation and Investor Communications Company, LLC, dated as of May 20, 1999. (Incorporated herein by reference to Exhibit 2.2 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.20 Investor Relations Consulting Agreement between ZMAX Corporation and Investor Communications Company, LLC, dated as of May 20, 1999. (Incorporated herein by reference to Exhibit 10.20 to the Registrant's Registration Statement on Form S-4 (File No. 333-29833).)
- 10.21 Agreement and Plan of Merger, dated as of December 14, 1998, by and among ZMAX Corporation, Eclipse Acquisition Corporation, Eclipse Information Systems, Inc., and Frank Schultz, Mark Mirabile, John Schultz, Scott Shedd, Brad Adams, Ron Hilicki, Fred

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Anderson, Harold Zimmerman, Chris Gildone, Dave Vittitow, Kristina Palmer, Tom Carroll and Gary Singer. (Incorporated herein by reference to Exhibit 2 to the Registrant's Current Report of Form 8-K, as filed on December 29, 1998 (File No. 333-555993).)

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\* Management contract or compensatory plan

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- 10.22 Agreement and Plan of Merger, dated as of October 1, 1999, by and among ZMAX Corporation, Parker Acquisition Corporation, Parker Management Consultants, Ltd., Westmont Non-Grantor Trust, and Kenneth W. Parker and Jennifer L Parker. (Incorporated herein by reference to Exhibit 2 to the Registrant's Current Report of Form 8-K, as filed on October 18, 1999 (File No. 333-55993).)
- 10.23 Employment Agreement between ZMAX Corporation and Michael C. Higgins, dated September 1, 1999.\* (Incorporated herein by reference to Exhibit 10.23 to Registrant's Report of Form 10-K, as filed on March 30, 2000 (File No. 000-23967).)
- 10.24 Employment Agreement between ZMAX Corporation and James T. McCubbin, dated September 1, 1999.\* (Incorporated herein by reference to Exhibit 10.24 to Registrant's Report of Form 10-K, as filed on March 30, 2000 (File No. 000-23967).)
- 10.25 Separation Agreement between WidePoint Corporation and Michael C. Higgins, dated December 31, 2001.\*
- 10.26 Employment Agreement between WidePoint Corporation and Steve Komar, dated July 1, 2002.\* (Incorporated herein by reference to Exhibit 10.26 to Registrant's Report of Form 10Q, as filed on August 15, 2002 (File No. 000-23967))
- 10.27 Employment Agreement between WidePoint Corporation and James McCubbin, dated July 1, 2002.\* (Incorporated herein by reference to Exhibit 10.26 to Registrant's Report of Form 10Q, as filed on August 15, 2002 (File No. 000-23967))
- 10.28 Employment Agreement between WidePoint Corporation and Mark Mirabile, dated July 1, 2002.\* (Incorporated herein by reference to Exhibit 10.26 to Registrant's Report of Form 10Q, as filed on August 15, 2002 (File No. 000-23967))
- 10.29 Agreement and Plan of Merger by and among WidePoint Corporation, Chesapeake Acquisition Corporation, Chesapeake Government Technologies, Inc. and Mark C. Fuller, John D. Crowley and Jay O. Wright. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)
- 10.30 Escrow Agreement by and among WidePoint Corporation, Mark C. Fuller, John D. Crowley, Jay O. Wright and Foley & Lardner LLP. (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)
- 10.31 Stock Pledge Agreement by and among WidePoint Corporation, Mark C. Fuller, John D. Crowley, Jay O. Wright and Foley & Lardner LLP. (Incorporated herein by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)

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\* Management contract or compensatory plan

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- 10.32 Employment and Non-Compete Agreement between WidePoint Corporation and Mark C. Fuller.\* (Incorporated herein by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)
- 10.33 Employment and Non-Compete Agreement between WidePoint Corporation and John D. Crowley.\* (Incorporated herein by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)
- 10.34 Consulting and Non-Compete Agreement between WidePoint Corporation and Jay O. Wright.\* (Incorporated herein by reference to Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)
- 10.35 Warrant Agreement between WidePoint Corporation and Mark C. Fuller. (Incorporated herein by reference to Exhibit 10.7 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)

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- 10.36 Warrant Agreement between WidePoint Corporation and John D. Crowley. (Incorporated herein by reference to Exhibit 10.8 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)
- 10.37 Warrant Agreement between WidePoint Corporation and Jay O. Wright. (Incorporated herein by reference to Exhibit 10.9 to the Registrant's Current Report on Form 8-K filed on May 14, 2004.)
- 10.38 Preferred Stock Purchase Agreement Between WidePoint Corporation and Barron Partners LP. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K/A filed on November 2, 2004.)
- 10.39 Common Stock Purchase Warrant between WidePoint Corporation and Barron Partners LP. (Incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K/A filed on November 2, 2004.)
- 10.40 Registration Rights Agreement between WidePoint Corporation and Barron Partners LP. (Incorporated herein by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K/A filed on November 2, 2004.)
- 10.41 Certificate Of Designations, Rights And Preferences Of The Series A Convertible Preferred Stock between WidePoint Corporation and Barron Partners LP (Incorporated herein by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K/A filed on November 2, 2004.)

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\* Management contract or compensatory plan

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- 10.42 Stock Purchase Agreement between WidePoint Corporation, Operational Research Consultants, Inc. (Incorporated herein by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K/A filed on November 2, 2004.)
  - 10.43 Master Amendment between WidePoint Corporation and Barron Partners L.P. (Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on November 11, 2004.)
  - 10.44 Common Stock Purchase Warrant between WidePoint Corporation and Westcap Securities Inc. (Filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2004).
  - 10.45 Common Stock Purchase Warrant between WidePoint Corporation and Westcap Securities Inc. (Filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2004).
  - 10.46 Loan and Security Agreement, dated as of October 22, 2004, by and between RBC Centura Bank and WidePoint Corporation. (Filed with the Company's Annual Report on Form 10-K/A No. 1 for the year ended December 31, 2004).
  - 10.47 Letter Amendment to Loan and Security Agreement, dated as of February 7, 2005, by and between RBC Centura Bank, WidePoint Corporation and the subsidiaries of WidePoint Corporation. (Filed with the Company's Annual Report on Form 10-K/A No. 1 for the year ended December 31, 2004).
  - 21 Subsidiaries of WidePoint Corporation (Filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2004).
  - 23.1A Consent of Grant Thornton LLP
  - 31.1A Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 31.2A Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 32A Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
WidePoint Corporation:

We have audited the accompanying consolidated balance sheet of WidePoint Corporation and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years ended December 31, 2004, 2003 and 2002. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on the financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of WidePoint Corporation and subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their consolidated cash flows

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for the years ended December 31, 2004, 2003 and 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the Company has restated its consolidated financial statements for the year ended December 31, 2004.

/s/ Grant Thornton LLP

Chicago, Illinois

April 14, 2005,

except for the effects of the restatement as discussed in Note 1, titled

Basis of Presentation, Organization, Nature of Operations, and Restatement as to which the date is January 19, 2006

The accompanying notes are an integral part of these consolidated statements

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### **WIDEPOINT CORPORATION AND SUBSIDIARIES**

	<b>December 31,</b>	
<b>Consolidated Balance Sheets</b>	<b>As Restated 2004</b>	<b>2003</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 463,525	\$ 949,612
Accounts receivable, net of allowance of \$0 and \$18,819 respectively	3,007,590	405,662
Prepaid expenses and other assets	203,126	49,645
Total current assets	3,674,241	1,404,919
Property and equipment, net	80,652	6,990
Goodwill	2,806,440	--
Intangibles	1,668,945	--
Other assets	161,148	53,736
Total assets	\$ 8,391,426	\$ 1,465,645
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 1,342,759	\$ 52,382
Accrued expenses	859,345	238,902
Income taxes payable	79,177	--
Short-term portion of deferred rent	2,720	--
Short-term borrowings	1,592,408	--
Financial instruments	6,648,571	--
Total current liabilities	10,524,980	291,284

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	<b>December 31,</b>	
<b>Consolidated Balance Sheets</b>		
Long-term portion of deferred rent	7,058	--
Deferred income tax liability	221,959	--
	<hr/>	<hr/>
Total liabilities	\$ 10,753,997	\$ 291,284
	<hr/>	<hr/>
Temporary equity:		
Preferred stock, \$0.001 par value; 10,000,000 shares authorized; 2,045,714 shares and no shares issued and outstanding, respectively	\$ 2,046	\$ --
Stockholders' (deficit) equity:		
Common stock, \$0.001 par value; 50,000,000 shares authorized; 17,859,009 shares and 15,579,913 shares issued and outstanding, respectively	\$ 17,859	\$ 15,580
Common stock issuable, \$0.001 par value; 544,398 shares	544	--
Stock warrants	14,291	--
Related party notes receivable	(81,100)	(128,003)
Additional paid-in capital	42,788,612	42,110,539
Accumulated deficit	\$(45,104,823)	\$(40,823,755)
	<hr/>	<hr/>
Total stockholders' (deficit) equity	(2,364,617)	1,174,361
	<hr/>	<hr/>
Total liabilities, temporary equity and stockholders' (deficit) equity	\$ 8,391,426	\$ 1,465,645
	<hr/>	<hr/>

The accompanying notes are an integral part of these consolidated statements

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**WIDEPOINT CORPORATION AND SUBSIDIARIES**

**Consolidated statements of operations**

	<b>For the Years Ended December 31,</b>		
	<b>As Restated 2004</b>	<b>2003</b>	<b>2002</b>
	<hr/>	<hr/>	<hr/>
Revenues, net	\$ 5,542,118	\$ 3,293,508	\$ 3,495,160
Cost of revenues (including depreciation and amortization of \$46,547, \$0, and \$0, respectively, and stock compensation expense of \$381,079, \$0, and \$0, respectively)	4,484,469	2,460,281	2,489,983
	<hr/>	<hr/>	<hr/>
Gross profit	1,057,649	833,227	1,005,177
Sales and marketing	596,564	430,065	525,322
General and administrative	1,626,454	693,220	643,771
Depreciation expense	15,713	12,777	51,792
	<hr/>	<hr/>	<hr/>
Loss from operations	(1,181,082)	(302,835)	(215,708)
Other income (expenses):			
Interest income	5,841	11,551	17,658
Interest expense	(38,144)	(1,304)	(1,559)
Loss from financial instruments	(3,070,617)	--	--

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	<b>For the Years Ended December 31,</b>		
Other	2,118	1,500	140,000
Net loss before provision for income taxes	(4,281,884)	(291,088)	(59,609)
Income tax benefit	(816)	--	--
Net loss	\$ (4,281,068)	\$ (291,088)	\$ (59,609)
Basic and diluted net loss per share	\$ (0.26)	\$ (0.02)	\$ (0.00)
Basic and diluted weighted-average shares outstanding	16,657,947	15,579,913	14,243,310

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**

	<u>Temporary Equity Preferred Stock</u>		<u>Permanent Equity Common Stock</u>		<u>Common Stock Issuable</u>	<u>Stock Warrants</u>	<u>Related Party Notes Receivable</u>	<u>Additional Paid-In Capital</u>	<u>Restated Accumulated Deficit</u>	<u>Permanent Equity Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>						
Balance, January 1, 2002	--	--	12,984,913	12,985	--	140,000	--	41,931,484	(40,473,058)	1,611,411
Adjustment of warrant valuation	--	--	--	--	--	(140,000)	--	--	--	(140,000)
Sale of common stock	--	--	2,595,000	2,595	--	--	--	179,055	--	181,650
Issuance of related party notes receivable	--	--	--	--	--	--	\$ (185,056)	--	--	(185,056)
Net loss	--	--	--	--	--	--	--	--	(59,609)	(59,609)
Balance, December 31, 2002	--	--	15,579,913	15,580	--	--	(185,056)	42,110,539	(40,532,667)	1,408,396
Collections on related party notes receivable	--	--	--	--	--	--	57,053	--	--	57,053
Net loss	--	--	--	--	--	--	--	--	(291,088)	(291,088)
Balance, December 31, 2003	--	\$ --	15,579,913	\$ 15,580	--	\$ --	\$ (128,003)	\$ 42,110,539	\$ (40,823,755)	\$ 1,174,361

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	<u>Temporary Equity Preferred Stock</u>		<u>Permanent Equity Common Stock</u>		<u>Common Stock</u>	<u>Stock</u>	<u>Related Party Notes</u>	<u>Additional Paid-In</u>	<u>Restated Accumulated</u>	<u>Permanent Equity</u>
Collections on related party notes receivable	--	--	--	--	--	--	46,903	--	--	46,903
Issuance of common stock - Tripoint	--	--	500,000	500	--	--	--	71,928	--	72,428
Issuance of common stock issuable - Chesapeake	--	--	--	--	817	--	--	--	--	--
Issuance of common stock - Chesapeake	--	--	816,596	817	(817)	--	--	384,397	--	385,214
December 31, 2004										
Issuance of common stock issuable - Chesapeake	--	--	--	--	544	--	--	380,535	--	381,079
Issuance of common stock - ORC	--	--	962,500	962	--	--	--	384,038	--	385,000
Sale of preferred stock	2,045,714	2,046	--	--	--	--	--	--	--	--
Expenses associated from preferred stock	--	--	--	--	--	--	--	(542,825)	--	(542,825)
Issuance of common stock warrants	--	--	--	--	--	14,291	--	--	--	14,291
Net loss	--	--	--	--	--	--	--	--	(4,281,068)	(4,281,068)
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)

The accompanying notes are an integral part of these consolidated statements

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**WIDEPOINT CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**

	<b>For the Years Ended December 31,</b>		
	<b>Restated 2004</b>	<b>2003</b>	<b>2002</b>
Cash flows from operating activities:			
Net loss	\$ (4,281,068)	\$ (291,088)	\$ (59,609)
Adjustments to reconcile net loss to net cash used in operating activities:			
Deferred tax benefit	110,980	--	--
Depreciation expense	15,713	12,777	51,792
Amortization expense	46,547	--	--

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	For the Years Ended December 31,		
Stock compensation expense	882,828	--	--
Deferred financing costs	11,909	--	--
Loss on sale of property and equipment	(1,500)	(1,500)	(750)
Loss from financial instruments	3,070,617	--	--
Adjustment of warrant valuation	--	--	(140,000)
Changes in assets and liabilities-			
Accounts receivable	(179,376)	(11,435)	65,756
Prepaid expenses and other assets	(250,603)	18,579	(19,312)
Accounts payable and accrued expenses	201,340	(30,711)	(235,502)
Income tax payable	79,177	--	--
Net cash used in operating activities	<u>\$ (515,396)</u>	<u>\$ (303,378)</u>	<u>\$ (337,625)</u>
Cash flows from investing activities:			
Purchase of subsidiaries, net of cash acquired	(4,640,729)	--	--
Purchases of property and equipment	(15,336)	(7,802)	--
Proceeds from sale of property and equipment	1,500	1,500	750
Cashflows (used in) provided by investing activities	<u>\$ (4,654,565)</u>	<u>\$ (6,302)</u>	<u>\$ 750</u>
Cash flows from financing activities:			
Borrowings on notes payable	1,792,408	--	--
Payments on notes payable	(200,000)	--	--
Collections on related party notes	40,000	57,053	--
Net payments on long-term obligations	--	(6,421)	(18,009)
Proceeds from issuance of warrants	14,291	--	--
Net proceeds from issuance of preferred stock	3,037,175	--	--
Cashflows provided by (used in) financing activities	<u>\$ 4,683,874</u>	<u>\$ 50,632</u>	<u>\$ (18,009)</u>
Net decrease in cash	(486,087)	(259,048)	(354,884)
Cash and cash equivalents, beginning of period	<u>\$ 949,612</u>	<u>\$ 1,208,660</u>	<u>\$ 1,563,544</u>
Cash and cash equivalents, ending of period	<u>\$ 463,525</u>	<u>\$ 949,612</u>	<u>\$ 1,208,660</u>
Supplementary cash flow information:			
Cash paid for-			
Interest	<u>\$ 7,125</u>	<u>\$ --</u>	<u>\$ --</u>
Income taxes	<u>\$ --</u>	<u>\$ --</u>	<u>\$ --</u>

The accompanying notes are an integral part of these consolidated statements

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## Notes to Consolidated Financial Statements

### 1. Basis of Presentation, Organization, Nature of Operations, and Restatement:

WidePoint Corporation is a consulting services firm specializing in planning, managing and implementing Information Technology ( IT ) solutions. Its 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.

During 2002 and 2003, WidePoint witnessed a highly competitive economic environment within the commercial IT sector due to a combination of constrained business investment and an excessive supply of IT consultants. As a result of these conditions, the Company experienced both

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reduced gross margins and decreased demand for the IT services that it provides. 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 its strategic acquisitions, continue rollout of ORC's Public Key Infrastructure ( PKI ) initiative, and by continuing 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 respected 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 is adequate to finance operations through 2005.

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### *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, and 3) as a result of timing differences between the actual issuance by the Company of shares earned and released from escrow, the Company should have recorded the shares earned as of December 31, 2004 as common stock issuable and not as common stock as those shares would 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, 2004.

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 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 released based on ORC's sales in that year.

As a consequence of these determinations, previously issued financial statements are being 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, and to record and expense as consulting fees the release of the shares from escrow at December 31, 2004.

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 for the year ended December 31, 2004. At December 31, 2004, the goodwill, intangibles, preferred stock (temporary equity), additional paid-in capital, and accumulated deficit were adjusted from previously reported amounts to properly reflect the appropriate accounting treatment. A summary of the effects of the restatements are as follows:

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## Balance Sheet:

	<b>Previously Reported</b>	<b>As Restated</b>
	<b>December 31, 2004</b>	<b>December 31, 2004</b>
Intangibles	\$ 3,190,927	\$ 1,668,945
Total assets	\$ 9,913,408	\$ 8,391,426
Preferred Stock (temporary equity)	n/a	2,046
Preferred stock (stockholders equity)	2,046	n/a
Common stock	21,125	17,859
Common stock issuable	n/a	544
Additional paid-in capital	43,515,382	42,788,612
Accumulated deficit	(44,312,333)	(45,104,823)
Total shareholders equity(deficit)	840,589	(2,364,617)
Total liabilities, temporary equity & shareholders equity	\$ 9,913,408	\$ 8,391,426

## Statement of Operations:

	<b>Previously Reported</b>	<b>As Restated</b>
	<b>Year Ended</b>	<b>Year Ended</b>
	<b>December 31, 2004</b>	<b>December 31, 2004</b>
Cost of revenues	\$ 4,066,543	\$ 4,484,469
Gross profit	1,475,575	1,057,649
General & administrative	1,196,707	1,626,454
Depreciation and amortization	70,896	n/a



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Depreciation expense	n/a	15,713
Loss from operations	(388,592)	(1,181,082)
Net loss before provision for income taxes	(3,489,394)	(4,281,884)
Net loss	\$ (3,488,578)	\$ (4,281,068)
Basic and diluted net loss per share	\$ (0.19)	\$ (0.26)
Basic and diluted weighted average shares outstanding	18,664,148	16,657,947

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Statement of Cashflows:

	<b>Previously Reported</b>	<b>As Restated</b>
	<b>Year Ended</b>	<b>Year Ended</b>
	<b>December 31, 2004</b>	<b>December 31, 2004</b>
Net loss	\$ (3,488,578)	\$ (4,281,068)
Amortization expense	64,884	46,547
Stock compensation expense	n/a	882,828
Prepaid expenses	(257,505)	250,603
Accounts payable and accrued expenses	273,341	201,340
Net cash (used in) provided by operating activities	(522,299)	(515,396)
Collections on related party notes receivable	46,903	40,000
Net cash (used in) provided by financing activities	\$ 4,690,777	\$ 4,683,874

**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 December 31, 2004 and 2003, cash and cash equivalents of investments in money market and overnight sweep accounts were \$46,065 and \$250,144, respectively. At times, cash balances held at financial institutions were in excess of federally insured limits. The Company places its temporary cash investments with high-credit, quality financial institutions, and as a result, the Company believes that no significant concentration of credit risk exists with respect to these cash investments.

*Accounts Receivable*

The majority of the Company's accounts receivable are due from established companies in the following industries: manufacturing, consumer product goods, direct marketing, healthcare and financial services. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are due within 30 to 60 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are reviewed for collectability and after 90 days are considered past due.

The Company determines its allowance 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, 2002, Allowance for doubtful accounts	\$ 30,000	\$ 3,950	\$ 30,000	\$ 3,950
For the year ended December 31, 2003, Allowance for doubtful accounts	\$ 3,950	\$ 17,864	\$ 2,995	\$ 18,819

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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	\$ --
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 December 31, 2004 and 2003, unbilled accounts receivable totaled \$138,529 and \$6,207, respectively.				

*Revenue Recognition*

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

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

*Significant Customers*

During 2004, two customers, Abbott Laboratories and The Department of Homeland Security, individually represented 12%, and 11% of revenues, respectively, and we therefore are materially dependent upon such customers. Due to the nature of our business and the relative size of certain contracts which are entered into in the ordinary course of business, the loss of any single significant customer, including the above customers, would have a material adverse effect on results. During 2003, four customers, Abbot Laboratories, Spencer Stuart, Manpower, and Baxter Healthcare, individually represented 18%, 14%, 13%, and 13% of revenue, respectively.

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*Fair value of financial instruments*

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

The Company's financial instruments also include a financial instrument in which a valuation for the warrants from the Barron Partners, LP preferred financing agreement contained a registration rights agreement which contained a liquidating damages provision. Accordingly, a Black Scholes calculation was used to determine the fair value of those warrants which are classified as a financial instrument. The Financial Instrument was marked to market at December 31, 2004.

*Concentrations of Credit Risk*

Financial instruments that potentially subject the Company to credit risk consist of cash and cash equivalents and accounts receivable. As of December 31, 2004, two customers, The Department of Homeland Security and Tangible Software, individually represented 24% and 13% of accounts receivable, respectively. As of December 31, 2003, three customers, Abbott Laboratories, Meritage Technologies, and BTE Consulting, Inc., individually represented 26% and 11% and 10% of accounts receivable, respectively.

*Income Taxes*

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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:

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	December 31,	
	2004	2003
Computers, equipment and software	\$ 90,029	\$ 25,535
Less- Accumulated depreciation and amortization	(9,377)	(18,555)
	\$ 80,652	\$ 6,990

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 five-year period or other such shorter period as may be required. WidePoint recorded \$9,700 of amortization expense for the year ended December 31, 2004. The Company recorded no amortization expense for the year ended December 31, 2003 and 2002, respectively. Capitalized software costs included in Other Intangibles at December 31, 2004 were approximately \$0.6 million. WidePoint had no capitalized software costs included in Other Intangibles at December 31, 2003 and 2002, respectively.

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

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

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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.

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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 Loss Per Share*

Basic income or loss per share includes no dilution and is computed by dividing net income or loss by the weighted-average number of common shares outstanding for the period. Diluted income or loss per share includes the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The treasury stock effect of escrowed shares, options and warrants to purchase 20,942,127, 2,112,000, and 1,978,000 shares of common stock outstanding at December 31, 2004, 2003, and 2002, respectively, has not been included in the calculation of the net loss per share as such effect would have been anti-dilutive. As a result of these items, the basic and diluted loss per share for all periods presented are identical.

### *Stock-based compensation*

Employee based 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 below to its stock-based employee plans.

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	<b>Year ended December 31,</b>		
	<b>As Restated 2004</b>	<b>2003</b>	<b>2002</b>
Net loss, as reported	\$ 4,281,068	\$ 291,088	\$ 59,609
Add: Total stock-based employee compensation expense determined under fair value based method for awards granted, modified, or settled, net of related tax effects	\$ 690,503	\$ 615,704	\$ 644,178
Pro forma net loss	\$ 4,941,571	\$ 906,792	\$ 703,787
Loss per share:			
Basic and diluted - as reported	\$ 0.26	\$ 0.02	\$ 0.00
Basic and diluted - pro forma	\$ 0.30	\$ 0.06	\$ 0.05

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

For purposes of determining the effect of these options, the fair value of each option is estimated on the date of grant based on the Black-Scholes single-option pricing model assuming the following for the years ended December 31, 2004, 2003 and 2002:

	2004	2003	2002
Dividend yield	--	--	--
Risk-free interest rate	2.70 - 4.13%	2.70-4.13%	2.70 - 4.13%

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	<u>2004</u>	<u>2003</u>	<u>2002</u>
Volatility factor	156%	156%	156%
Expected life in years	5	5	5

Non-employee based compensation:

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

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*New accounting pronouncements*

In December 2004, the Financial Accounting Standards Board issued Statement 123 (revised 2004), *Share-Based Payment* (Statement 123(R)). This Statement requires that the costs of employee share-based payments be measured at fair value on the awards grant date using an option-pricing model and recognized in the financial statements over the requisite service period. This Statement does not change the accounting for stock ownership plans, which are subject to American Institute of Certified Public Accountants SOP 93-6, *Employer's Accounting for Employee Stock Ownership Plans*. Statement 123(R) supersedes Opinion 25, *Accounting for Stock Issued to Employees* and its related interpretations, and eliminates the alternative to use Opinion 25's intrinsic value method of accounting, which the Company is currently using.

Statement 123(R) allows for two alternative transition methods. The first method is the modified prospective application whereby compensation cost for the portion of awards for which the requisite service has not yet been rendered that are outstanding as of the adoption date will be recognized over the remaining service period. The compensation cost for that portion of awards will be based on the grant-date fair value of those awards as calculated for pro forma disclosures under Statement 123, as originally issued. All new awards and awards that are modified, repurchased, or cancelled after the adoption date will be accounted for under the provisions of Statement 123(R). The second method is the modified retrospective application, which requires that the Company restates prior period financial statements. The modified retrospective application may be applied either to all prior periods or only to prior interim periods in the year of adoption of this statement. The Company is currently determining which transition method it will adopt and is evaluating the impact Statement 123(R) will have on its financial position, results of operations, EPS and cash flows when the Statement is adopted. Upon making its determination of the transition method the Company will adopt Statement 123(R). The Company will adopt this Statement on January 1, 2006 in accordance with the requirements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150), which establishes standards for how companies classify and measure certain financial instruments with characteristics of both liabilities and equity. It requires companies to classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). We believe that the adoption of SFAS 150 will not result in a material change to our financial statements.

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**3. Debt:**

**December  
31,  
2004**

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Borrowings under WidePoint's Senior Debt

Agreement: \$ 1,592,408

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

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

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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. As of and during the year ended December 31, 2004, WidePoint was in compliance with each of these financial covenants. The weighted average borrowings under the revolving portion of the facility and the prior agreement during the year ended December 31, 2004, were \$1.5 million. 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.

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

#### 4. Acquisitions:

On October 25, 2004, WidePoint completed the acquisition of 100 percent of the outstanding common shares of Operational Research Consultants, Inc., or ORC. ORC specializes in information technology, or IT, integration and secure authentication solutions and providing services to the United States Government. The results of operations for ORC have been included in our consolidated financial statements since that date.

In consideration for the ORC stock, the Company paid the ORC shareholders an aggregate of \$5,000,000 payable in a combination of cash of approximately \$4.6 million, approximately \$0.4 million of the Company's common stock, and approximately \$0.1 million in a receivables holdback. In addition an earnout provision worth up to \$5 million in consideration in the form of Company common stock of up to \$2.5 million at \$0.45 per common share and cash consideration up to \$2.5 million may be realized upon performance parameters disclosed within the purchase agreement further described in an 8-K filing on October 29, 2004. The earnout provisions may be realized through December 31, 2005. No earnout provisions have been earned as of December 31, 2004.

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The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

	October 25, 2004
Current assets	\$ 2,446,740
PP&E, net	74,038
Goodwill	2,806,440
Intangible assets <sup>(1)</sup>	1,655,594
Other assets	21,724
Current liabilities	(1,560,422)
Deferred tax liability	(332,939)
	\$ 5,111,175

(1) Intangible assets. As part of the Company's preliminary purchase accounting for ORC, an estimated preliminary intangible valuation amount of \$1,145,523 was allocated to intangibles for ORC's customer relationships and ORC's PKI business opportunity. An intangible asset was also identified as internally generated software that was associated with ORC's PKI-I development of its PKI phase 1 software product application with a valuation amount of \$334,672. Further, ORC subsequently initiated an additional development measure in which ORC was accumulating the costs associated with the further development of an additional software product application, ORC's PKI-II development, with an intangible value of \$175,399, for which ORC continues to accumulate development costs.

The weighted average lives of 6 and 5 years is associated with the estimated preliminary purchase valuation of the intangible value attributed to the ORC purchase accounting that is related to ORC's customer relationships and ORC's PKI business opportunity. The 5 year period was used as the estimate for the intangible asset allocated to ORC's customer relationships, and 6 years was used as the estimate for the PKI business opportunity.

The following table summarizes the pro forma statements of operations of ORC and WidePoint consolidated for the periods ending December 31, 2003 and 2004, respectively:

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	Proforma 2004	Proforma 2003
Revenues	13,853,008	18,250,123
Net Loss	(4,355,527)	(628,140)
Loss per share	(0.25)	(0.04)
Basic common shares outstanding	17,620,447	16,552,413

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**5. Goodwill and Intangible Assets:**

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 31<sup>st</sup> of each calendar year. These reviews have resulted in no adjustments in goodwill.

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

	<b>As of December 31, 2004</b>	
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
Amortized intangible assets		
(1) ORC Intangible (Includes customer relationships and PKI business opportunity purchase accounting preliminary valuations)	\$ 1,145,523	\$ (36,847)
(2) PKI-I Intangible (Related to internally generated software)	334,672	(9,700)
Total	\$ 1,480,195	\$ (46,547)
Unamortized intangible assets		
(3) Other (PKI-II Intangible)	\$ 235,297	
Total	\$ 235,297	
<b><u>Aggregate Amortization Expense:</u></b>		
For year ended 12/31/04	\$ 46,547	
<b><u>Estimated Amortization Expense:</u></b>		
For year ended 12/31/05	\$ 300,140	
For year ended 12/31/06	\$ 321,000	
For year ended 12/31/07	\$ 321,000	
For year ended 12/31/08	\$ 321,000	
For year ended 12/31/09	\$ 321,000	



- (1) The ORC intangible is made up of the estimated preliminary purchase accounting associated with the valuation assigned by the Company to ORC's customer relationships and its PKI business opportunity. The PKI business opportunity intangible has an estimated life of 6 years and ORC's customer relationships has 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 5.5 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 5.5 years and is based upon the contractual life assigned to the authority to issue PKI certificates by the federal government.
- (3) The PKI-II intangible is related to a secondary PKI software development effort by ORC which is still ongoing. Therefore, no amortization expense has been incurred.

The total weighted average life of all of the intangibles is approximately 5.5 years.

There were no amounts of research and development assets acquired in 2004, nor any written off in the period.

The changes in the carrying amount of goodwill for the year ended December 31, 2004 are as follows:

	<u>Total</u>
Balance as of January 1, 2004	\$ 0
Goodwill acquired during year	\$ 2,806,440
Balance as of December 31, 2004	\$ 2,806,440

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

#### 6. Promissory Notes:

#### *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 (3) year full-recourse, five percent (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.

#### 7. Income Taxes:

The income tax benefit of \$816 for the year ended December 31, 2004, consisted of a current expense of \$110,164 and a deferred benefit of \$110,980. The Company had no provision for income taxes for the years ended December 31, 2003 and 2002.

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

	For the Years Ended December 31,		
	As Restated 2004	2003	2002
Statutory federal income tax rate	34.0%	34.0%	34.0%
Non-deductible expenses	(0.2)	(0.2)	(2.1)
Decrease (increase) in valuation allowance	(18.7)	(35.4)	(36.4)
Intangibles	(10.5)	--	--
Capitalized software cost	(5.3)	--	--
Section 481(a) adjustment	(5.3)	--	--
Other	6.0	1.6	4.5
	(0.0)	--	--

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The deferred tax assets (liabilities) consisted of the following as of December 31, 2004 and 2003:

	December 31,	
	As Restated 2004	2003
Deferred tax assets:		
Net operating loss carryforwards	\$ 8,251,149	\$ 6,561,552
AMT credit	13,853	13,853
Capital losses in excess of capital gains	696,215	696,215
Financial instrument	81,999	--
Other assets	95,403	162,189
Total deferred tax assets	9,138,619	7,433,809
Deferred tax liabilities:		
Section 481(a) adjustment	(221,959)	--
Intangibles	443,471	--
Depreciation and amortization	(248,606)	--
Capitalized software costs	(224,108)	--
Total deferred liabilities	1,138,143	--
Net deferred tax asset	8,000,476	--
Less- Valuation allowance	(8,222,435)	(7,433,809)

December 31,

\$ (221,959)	\$ --
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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 \$20,627,872 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. The capital losses in excess of capital gains expire in the year 2005.

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

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	2004	2003
Opening balance	\$ (7,433,809)	\$ (7,471,764)
Current year adjustment	788,626	37,955
Ending balance	\$ (8,222,435)	\$ (7,433,809)

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.

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 2023. 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. The capital losses in excess of capital gains expire in the year 2005.

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

	2004	2003
Opening balance	\$ (7,433,809)	\$ (7,471,764)
Current year adjustment	788,626	37,955
Ending balance	\$ (8,222,435)	\$ (7,433,809)

## 8. Temporary Preferred Equity

### *Temporary Preferred Stock*

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

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

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*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:*

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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 Tax Force EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock by the Company. In light of the required accounting treatment under EITF 00-19, the entire proceeds of the issuance were allocated to warrants and as such no proceeds have been allocated to the preferred stock issuance.

### **Registration Rights Agreement**

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

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The registration rights agreement also contains a liquidated damages provision which calls for Barron to receive from WidePoint a specified amount if: (i) WidePoint fails to file a registration statement covering the underlying shares of common stock; (ii) the registration statement is not declared effective by February 22, 2005; or (iii) the registration statement is not effective in the period from April 23, 2005 (i.e., 180 days following the October 25, 2004 closing of the preferred financing) through the two years following the date of the registration rights agreement, subject to permissible blackout periods and registration maintenance periods. In the event that one of the aforementioned events occurs, the registration rights agreement calls for WidePoint to pay Barron a cash amount equal to the lesser of \$20,000 or 1% of the purchase price of that

portion of the Series A Convertible Preferred Stock which has not been converted into common stock as of the occurrence of such event, with such amount to be paid by WidePoint to Barron on a monthly basis after the occurrence of such event. Barron is entitled to receive the aforementioned damages until such time as the registration statement is declared effective. Since the registration statement registering the underlying shares of common stock has not yet been declared effective, Barron is currently entitled to receive such damages. 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.

## 9. Stockholders Equity:

The Company is authorized to issue 50,000,000 shares of common stock, \$.001 par value per share. At the annual meeting of stockholders that was held on January 27, 2005, stockholders approved a proposal to increase the authorized shares of common stock from 50,000,000 to 110,000,000. As of December 31, 2004, there were 18,403,407 shares of common stock outstanding, which does not include escrowed common stock of 5,555,556 and 2,721,987, respectively, that are associated with shares issued and held in escrow pending contingent release. 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 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 December 31, 2004 no common shares were earned.

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On April 30, 2004, the Company closed upon the acquisition of all the issued and outstanding shares of Chesapeake, pursuant to the terms of an Agreement and Plan of Merger, dated as of March 24, 2004. WidePoint issued 4,082,980 shares of its common stock to stockholders of Chesapeake in consideration for all of the issued and outstanding shares of Chesapeake owned by them. In conjunction with this closing, the sole stockholders also entered into an escrow agreement and deposited 3,266,384 shares of the 4,082,980 newly issued shares of WidePoint common stock into escrow. The 3,266,384 shares of common stock placed into escrow has not been recorded in equity and will be released to the Chesapeake Shareholders in the event of the satisfaction of certain conditions set forth in the merger agreement, which provides that during the period commencing after the closing of the merger and ending on December 31, 2005, the 3,266,384 shares of common stock will be released to the Chesapeake Shareholders in a ratio based on the amount of revenues actually received by the Company from the business acquired from Chesapeake. The December 31, 2005 escrow expiration date may be extended for one additional year in the event it is determined that Chesapeake has achieved certain performance levels in the latter part of 2005. In the event that WidePoint does not receive certain levels of revenues from the business acquired from Chesapeake, then any of the 3,266,384 shares of common stock to which the Chesapeake Shareholders have not become entitled to receive will be returned to the Company. The Company recorded in equity 816,596 of the common shares out of 4,082,980 common shares issued to the Chesapeake Shareholders at the time of the acquisition. The Company recorded the 816,596 common shares at the time of the acquisition as common stock issuable and upon the issuance of the common stock by the Company's transfer agent on July 13, 2004, reclassified the common shares as common stock. Further, for the period ending December 31, 2004, the Company recorded in equity and released 544,398 common shares from the escrow to the Chesapeake Shareholders after the filing of the Company's Form 10-K with the Securities and Exchange Commission with 2,721,987 common shares continuing to be held within escrow and not recorded within equity. The Company recorded as compensation expense the initial 816,596 shares issued at the time of the acquisition of Chesapeake. As a result of meeting certain performance measures, the Company recorded in equity the release of 544,398 additional common shares on December 31, 2004. These shares have been recorded as common stock issuable as they have not been released from escrow as of December 31, 2004, per an escrow agreement between the Company and the original Chesapeake shareholders. The remaining unearned Chesapeake shares that have not met certain performance measures as of December 31, 2004 have not been recorded within equity.

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

Pursuant to stock purchase agreements entered into on July 8, 2002, between the Company and each of Steve L. Komar, James T. McCubbin and Mark M. Mirabile, the Company privately sold 865,000 shares of its common stock to each such person without registration under the Securities Act of 1933, pursuant to the private offering exemption under Section 4(2) thereof, in consideration of a three (3) year full-recourse note. (See note 6)

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*Common stock issuable*

The Company entered into an escrow agreement with the original Chesapeake shareholders, which required certain performance measures to be achieved to cause the shares to be earned and subsequently released. The difference between the dates the shares were earned and subsequently released from escrow resulted in a timing difference, which required the Company to record the shares when they were earned as common stock issuable and subsequently reclassified as common stock upon the release of the shares from escrow. The Company recorded the shares that have been earned per certain performance measures at each recording date, while the escrow agreement only allowed for the release of the shares earned after the Company's fiscal year filings of its financial statements on Form 10-K, for each respective period, per the terms of the escrow agreement.

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

*Stock Warrants*

On October 27, 2004 and November 22, 2004, the Company issued 30,612 and 5,556 warrants, 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 warrant has a term of 5 years. The Company used a fair-value option pricing model to value this stock warrant 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 are being amortized over the life of the debt as interest expense.

On October 1, 1999, the Company issued a stock warrant to purchase 200,000 shares of common stock at \$5.00 per share, an amount that exceeded the stock's trading price on that date, as part of the PMC acquisition. The warrant has a term of 3 years. The Company used a fair-value option pricing model to value this stock warrant at approximately \$140,000. This value has been reflected as part of stock warrants in the stockholders' equity section of the consolidated balance sheet and has been included as part of the Company's purchase accounting for the PMC acquisition. This warrant expired on October 1, 2002 and as such, the Company reversed the expense recognized in 1999 and reduced the amounts allocated to deferred compensation and to the warrant.

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*Related Party Notes*

Pursuant to stock purchase agreements entered into on July 8, 2002, between the Company and each of Steve L. Komar, James T. McCubbin and Mark M. Mirabile, the Company privately sold 865,000 shares of its common stock to each such person without registration under the Securities Act of 1933, pursuant to the private offering exemption under Section 4(2) thereof, in consideration of a three (3) year full-recourse, five percent (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.

**10. Financial Instrument:**

In October of 2004, the Company issued 10,228,571 warrants 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 this stock warrant. 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 December 31, 2004. The Company has recorded a loss on the financial instrument of \$3,070,617 for the period ending December 31, 2004, to adjust the difference between the fair-value of these warrants and the market price.

**11. Stock Options and Stock-Based Compensation:**

*1997 Stock Incentive Plan*

In May 1997, the Company adopted the 1997 Stock Incentive Plan (the *Incentive Plan*). The purpose of the Incentive Plan is to provide additional compensation to employees, officers, directors and consultants of the Company or its affiliates. Under the terms of the Incentive Plan, as amended, 3,000,000 shares of common stock have been reserved for issuance as incentive awards under the Incentive Plan. The number of shares of Company common stock associated with any forfeited stock incentive will be added back to the number of shares that can be issued under the Incentive Plan. Awards under the Incentive Plan and their terms are determined by a committee (the *Committee*) that has been selected by the Board of Directors. The Incentive Plan permits the Committee to make awards of a variety of equity-based incentives (collectively, *Stock Incentives*).

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The Incentive Plan allows for the grant of incentive stock options and nonqualified stock options. The exercise price of the options will be established by the Committee. The term of an option will be specified in the applicable agreement provided, however, that no option can be exercised ten years after the date of grant. In addition to stock options, the Incentive Plan also allows for the grant of other Stock Incentives, including stock appreciation rights, stock awards, phantom shares, performance unit appreciation rights and dividend equivalent rights. These Stock Incentives will be subject to the terms prescribed by the Committee in accordance with the provisions of the Incentive Plan.

In February 1998, the Company amended the Incentive Plan to permit the adjustment of the terms and conditions of outstanding options. On October 25, 2004, the Company issued 1,111,111 options to an employee pool of ORC. On January 27, 2005, the shareholders of the Company approved an amendment to increase the common stock reserved for issuance as incentive awards under the Incentive Plan to 10,000,000.

*1997 Directors Formula Stock Option Plan*

In May 1997, the Company adopted the 1997 Directors Formula Stock Option Plan (the *Director Plan*). The Company has reserved 120,000 shares of common stock to underlie stock options granted under the Director Plan. Any shares associated with forfeited options are added back to the number of shares that underlie stock options to be granted under the Director Plan.

The awards of stock options under the Director Plan are determined by the express terms of the Director Plan. Generally, only non-employee directors of the Company who do not perform services for the Company are eligible to participate in the Director Plan. The Director Plan provides for option grants to purchase 12,000 shares of common stock upon a non employee director's initial appointment to the Board of Directors. The options will vest immediately to 8,000 shares of common stock underlying such options, will vest to an additional 2,000 shares after the director's completion of the first year of continued service to the Company, and will vest to the remaining 2,000 shares after the completion of the second year of continued service to the Company. Each option granted pursuant to the Director Plan will be evidenced by an agreement and will be subject to additional terms as set forth in the agreement. Options become exercisable when vested and expire ten years after the date of grant, subject to any shorter period that may be provided in the agreement.

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The following is a summary of the WidePoint options and management warrant activity:

	<u>Number of Shares</u>	<u>Option Price Range</u>	<u>Weighted-Average Exercise Price</u>
Outstanding, December 31, 2002	1,816,000	0.07 - 1.35	0.15
Granted	400,000	0.07 - 0.13	0.12
Canceled or expired	(104,000)	0.12 - 14.06	0.17
Outstanding, December 31, 2003	2,112,000	0.07 - 1.35	0.14

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	Number of Shares	Option Price Range	Weighted-Average Exercise Price
Granted	5,111,111	0.235 - 0.45	0.28
Canceled or expired	--	--	--
Outstanding, December 31, 2004	7,223,111	.07 - 1.35	0.24

As of December 31, 2004 and 2003, options and management warrants to purchase 7,223,111 and 1,447,340 shares, respectively of common stock were exercisable with a weighted average exercise price of \$0.24 and \$0.14, respectively. The weighted-average remaining contractual life of the options outstanding at December 31, 2004 and December 31, 2003, was 6 and 8 years, respectively. The weighted-average fair value of options and management warrants granted in 2004 and 2003 was \$0.28 and \$0.04, respectively.

Had compensation expense been determined based on the fair value of the options at the grant dates consistent with the method of accounting under SFAS No. 123, the Company's net loss and net loss per share would have been increased to the pro forma amounts indicated below:

	<b>For the Years Ended December 31,</b>		
	<b>As</b>		
	<b>Restated</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Net loss:			
As reported	\$ 4,281,068	\$ 291,088	\$ 59,609
Pro forma	\$ 4,971,571	\$ 906,792	\$ 703,787
Pro forma basic and diluted net loss per share:			
As reported	\$ 0.26	\$ 0.02	\$ 0.00
Pro forma	\$ 0.30	\$ 0.06	\$ 0.05

The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: no dividend yield, expected volatility of 140-166 percent, risk-free interest rates from 2.70 to 4.13 percent and an expected term of five years.

## 12. Commitments and Contingencies:

The Company has entered into a number of leases for its offices location as describe above in Note 1. The Company's commitments and contingencies are as follows for its operating leases which include those leases, and other operating leases. The terms of the operating leases run through 2009 and the total commitments per year are as follows:

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Year Ended December 31,	Operating Leases
2005	\$ 595,259
2006	525,340
2007	499,530
2008	388,398
2009	64,350
Total	\$ 2,072,877

### Employment Agreements

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



*Litigation*

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

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

**13. Segment reporting:**

During 1998, the Company adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS No. 131 requires a business enterprise, based upon a management approach, to disclose financial and descriptive information about its operating segments. Operating segments are components of an enterprise about which separate financial information is available and regularly evaluated by the chief operating decision maker(s) of an enterprise. Under this definition, the Company operated as a single segment for all periods presented. The single segment is comprised of our Consulting services segment within the Commercial and Federal Marketplaces.

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**14. Selected Quarterly Financial Data (Unaudited):**

A summary of selected quarterly information for 2004 and 2003 is as follows:

	As Restated 2004 Quarter Ended (in thousands of U.S. dollars except per share amounts)			
	<u>March 31</u>	<u>June 30</u>	<u>Sep. 30</u>	<u>Dec. 31</u>
Net Sales	\$ 723	\$ 841	\$ 907	\$ 3,071
Gross Profit	157	223	240	438
Net Loss	(95)	(612)	(105)	(3,469)
Loss per Share	\$ (0.01)	\$ (0.04)	\$ (0.01)	\$ (0.20)

	2003 Quarter Ended (in thousands of U.S. dollars except per share amounts)			
	<u>March 31</u>	<u>June 30</u>	<u>Sep. 30</u>	<u>Dec. 31</u>
Net Sales	\$ 923	\$ 815	\$ 759	\$ 796
Gross Profit	246	219	197	171
Net Loss	(64)	(56)	(73)	(98)
Loss per Share	\$ (0.00)	\$ (0.00)	\$ 0.00	\$ (0.01)

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