VOIP INC
Form 10QSB/A
June 23, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB/A

(Amendment No. 2)

(Mark one)

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

For the quarterly period ended June 30, 2005

Or

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

For the transition period from _________ to ________

Commission File Number: 000-28985

VoIP, Inc.
(Exact name of small business issuer as specified in its charter)

Texas	75-2785941
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

151 So. Wymore Rd, Suite 3000, Altamonte Springs, FL 32714
(Address of principal executive offices)

(407) 389-3232
(Issuer's telephone number)

12330 SW 53rd Street, Suite 712, Ft. Lauderdale, FL 33330
(Former address)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: August 2, 2005: 47,750,975.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one):
Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

1

Explanatory Note

VoIP, Inc. (the "Company") is filing this Amendment No. 2 to its Quarterly Report on Form 10-QSB for the quarterly period ended June 30, 2005 (the "June 30, 2005 10-QSB"), which was originally filed on August 19, 2005, and amended on October 11, 2005. This Amendment No. 2 is being filed to restate the Company's financial statements for the three and six months ended June 30, 2005, which were misstated, resulting in overstated revenues, expenses, receivables and inventory, and understated net loss.

These misstatements were discovered by senior financial management personnel that commenced their employment with the Company in the fourth quarter of 2005, during their review and analysis in connection with the preparation of the Company’s 2005 annual consolidated financial statements. These misstatements occurred in the financial statements of the Company's consolidated subsidiary, VCG Technologies, Inc., doing business as DTNet Technologies (“DTNet”), which was acquired in June 2004. The Company has therefore decided to restate its consolidated financial statements for the three and six months ended June 30, 2005 to correct these misstatements.

In addition, this Amendment No. 2 restates the Company's consolidated balance sheet as of December 31, 2004, to reflect the Company’s Amendment No. 2 to its Annual Report on Form 10-KSB/A, filed on May 11, 2006.

This Amendment No.2 revises (i) Part I, Item 1. Financial Statements to provide the restated financial statements and notes thereto for the three and six months ended June 30, 2005; (ii) Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations to reflect the restated results of operations for this same period; (iii) Part I, Item 3. Controls and Procedures to report management's assessment of the Company's disclosure controls as of the date of the filing of this Amendment No. 2; and (iv) the certifications required under Rules 13a-15 and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") so that they be dated as of a current date as required by Rule 12b-15 of the Exchange Act.

This Amendment No. 2 does not reflect events occurring after the original filing of the Company’s June 30, 2005 10-QSB, and does not update or modify the disclosures therein in any way other than as required to reflect the amendments described above.

VoIP, Inc.

Form 10-QSB/A for the Quarter Ended June 30, 2005

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

VoIP, Inc.
Consolidated Balance Sheets

		June 30, 2005 (Unaudited and Restated)		December 31, 2004 (As Restated)
ASSETS				
Current assets				
Cash and cash equivalents	$	1,068,514	$	1,141,137
Accounts receivable, net of allowance of $99,047 and $136,795, respectively		932,575		166,239
Due from related parties		-		245,402
Inventory		628,878		324,185
Assets from discontinued operations		192,000		412,419
Other current assets		209,884		-
Total current assets		3,031,851		2,289,382
Property and equipment, net		8,637,267		419,868
Goodwill and other intangibles		30,765,594		6,923,854
Other assets		294,884		23,580
TOTAL ASSETS	$	42,729,596	$	9,656,684
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Accounts payable and accrued expenses	$	10,472,720	$	1,148,833
Loans payable		5,130,818		200,000
Convertible notes payable		1,552,925		-
Notes payable to related parties		1,053,186		560,000
Other current liabilities		2,333,343		103,031
Total liabilities		20,542,992		2,011,864
Shareholders' equity				
Common stock - $0.001 par value; 100,000,000 shares authorized; 47,166,380 and 24,258,982 issued and outstanding, respectively		47,167		24,259
Additional paid in capital		33,717,706		14,107,328
Accumulated deficit		(11,578,269)		(6,486,767)
Total shareholders' equity		22,186,604		7,644,820

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	42,729,596	$	9,656,684

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

4

VoIP, Inc.
Consolidated Statements of Operations (Unaudited)

	Six Months Ended June 30		Three Months Ended June 30	
	2005 (As Restated)	2004	2005 (As Restated)	2004
Revenues	$ 3,312,242	$ 85,298	$ 1,909,773	$ 85,298
Cost of sales	2,605,006	58,923	1,303,911	58,923
Gross profit	707,236	26,375	605,862	26,375
Operating expenses:				
Employee compensation	1,734,750	97,700	822,078	97,700
General and administrative expenses	4,063,988	359,656	3,319,888	337,333
Loss from operations, before income taxes	(5,091,502)	(430,981)	(3,536,104)	(408,658)
Provision for income taxes	-	-	-	-
Net loss	$ (5,091,502)	$ (430,981)	$ (3,536,104)	$ (408,658)
Loss per weighted average share of common stock outstanding - basic and fully diluted	$ (0.19)	$ (0.05)	$ (0.12)	$ (0.03)
Weighted average number of shares of common stock outstanding - basic and fully diluted	26,940,458	8,255,570	30,012,632	16,233,813

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

VoIP, Inc.
Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30	
	2005 (As Restated)	2004
Cash flows from operating activities:		
Net loss	$ (5,091,502)	$ (430,981)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	540,400	293
Provision for bad debt	99,047	-
Provision for assets of discontinued operations	200,000	-
Common shares issued for services	748,325	143,000
Employee stock option expense	127,238	-
Common shares exchanged for warrants	239,500	-
Changes in operating assets and liabilities net of assets and liabilities acquired:		
Accounts receivable	(735,772)	-
Due from related parties	169,537	-
Inventory	(304,693)	(2,460)
Other current assets	298,764	(33,719)
Accounts payable and accrued expenses	(58,315)	83,455
Other current liabilities	(816,109)	-
Net cash used in operating activities	(4,583,580)	(240,412)
Cash flows from investing activities:		
Cash from acquisitions	-	(173,182)
Purchase of property and equipment	(37,779)	(20,231)
Purchase of other assets	-	-
Net cash used in investing activities	(37,779)	(193,413)
Cash flows from financing activities:		
Proceeds from issuance of notes payable	2,615,339	-
Payments of notes payable	(769,228)	-
Proceeds from sales of common stock	2,702,625	591,400
Net cash flow provided by financing activities	4,548,736	591,400
Net increase in cash and cash equivalents	(72,623)	157,575
Cash and cash equivalents at beginning of period	1,141,137	3,499
Cash and cash equivalents at end of period	$ 1,068,514	$ 161,074
Non-cash investing and financing activities:		
Goodwill and intangible assets recorded on acquisition	$ (24,101,000)	$ -
Issuance of common stock and warrants		

on acquisition	$	13,819,119	$	-
Issuance of stock for debt conversion	$	1,996,478	$	-
Net liabilities assumed on acquisition, net of cash	$	8,285,403	$	-

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

VoIP, Inc.
Notes to Consolidated Financial Statements

NOTE A - ORGANIZATION AND DESCRIPTION OF BUSINESS

The Company was incorporated on August 3, 1998 under its original name of Millennia Tea Masters, Inc. under the laws of the State of Texas.

On February 27, 2004 the Company entered into a stock purchase agreement that provided for the sale of 12,500,000 shares of its common stock in exchange for $12,500 and a commitment by the purchaser to contribute the assets of two start-up companies in the telecommunications business, eGlobalphone, Inc. (“eGlobalphone”) and VOIP Solutions, Inc. (“VoIP Solutions”).

On April 13, 2004 the Company changed its name to VoIP, Inc. and began to develop and manufacture internet protocol telephony customer premise equipment, and provide voice over the internet subscriber based telephony services and long range WiFi technology solutions for residential and enterprise customers including multimedia applications.

During December 2004, the Company decided to exit the tea import business in order to focus its efforts and resources in the voice over Internet protocol (“VoIP”) telecommunications industry. In connection with the decision, the Company sold its imported tea inventory and began to wind down its tea import operations. The assets, liabilities, and results of operations of the imported tea business have been classified as discontinued operations on the accompanying consolidated financial statements.

On May 31, 2005 the Company acquired 100% of Caerus, Inc. (“Caerus”) and its wholly-owned subsidiaries Volo Communications, Inc., (“Volo”), Caerus Networks, Inc., and Caerus Billing, Inc. in exchange for 16.9 million of the Company's common shares.

Volo is a licensed facilities-based competitive local exchange carrier and interexchange carrier. Volo markets its network products and services under the VoiceOne brand name, and has network access points operating in Orlando, Atlanta, New York, Dallas and Los Angeles. Caerus Networks, Inc. is a technology research and development subsidiary, and Caerus Billing, Inc. is a billing and mediation subsidiary.

The Company offers quality VoIP-based solutions offering residential and business customers more user friendly and affordable ways to communicate. The Company also manufactures products and provides services to Internet Service Providers, Telecommunication Service Providers and Cable Operators in strategic countries around the world. The Company, through its subsidiaries, provides a comprehensive portfolio of IP multimedia-based solutions ranging from subscriber based voice services, to SIP based infrastructure design and deployment, to broadband customer premise equipment design and implementation services, as well as engineering design, manufacturing and distribution of wireless broadband technology.

The Company's operations consist of one segment.

NOTE B - RESTATEMENT OF FINANCIAL STATEMENTS

On March 22, 2006, the Company concluded that its consolidated financial statements for the three and six months ended June 30, 2005 were misstated, resulting in overstated revenues, expenses, receivables and inventory, and understated net loss. These misstatements were discovered by senior financial management personnel that commenced their employment with the Company in the fourth quarter of 2005, during their review and analysis in connection with the preparation of the Company’s 2005 annual financial statements. The misstatements occurred in the financial statements of the Company's consolidated subsidiary VCG Technologies, Inc., doing business as DTNet Technologies (“DTNet”), which was acquired in June 2004. The Company therefore restated its consolidated financial statements for the three and six months ended June 30, 2005 to correct these misstatements. Adjustments to reduce (i) the overstatement of receivables (including amounts due from related parties); (ii) the overstatement of inventory; (iii) the overstatement of revenues; (iv) the overstatement of cost of sales; and (v) the understatement of net loss, aggregated $260,188, $260,495, $604,678, $499,840, and $58,065, respectively, for the six months ended June 30, 2005.

In addition, during the preparation of the financial statements for the quarter ended September 30, 2005, the Company discovered that it did not recognize in its consolidated financial statements the full amount of compensation expense that should have been recognized on warrants issued to employees, or the compensation expense for the vested portion of approximately 4,000,000 stock options issued to employees during the three months ended September 30, 2004, in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). The compensation expense that was not recognized relating to these options and warrants was $1,384,763 in 2004. The Company therefore restated its consolidated financial statements for the year ended December 31, 2004 to correct these misstatements.

The following table sets forth the impact of these restatements on certain amounts previously reported in our consolidated financial statements for the three and six months ended June 30, 2005.

Balance Sheet Data	**As of June 30, 2005**		**As of December 31, 2004**	
	As Previously Reported	**As Restated**	**As Previously Reported**	**As Restated**
Accounts receivable	$ 1,023,226	$ 932,575	$ 818,071	$ 166,239
Due from related parties	169,537	-	245,402	245,402
Inventory	889,373	628,878	187,451	324,185
Other current assets	209,884	209,884	43,702	-
Accounts payable and accrued expenses	10,472,720	10,472,720	1,224,974	1,148,833
Other current liabilities	2,333,343	2,333,343	123,140	103,031
Additional paid in capital	32,332,943	33,717,706	12,722,565	14,107,328
Accumulated deficit	(9,672,823)	(11,578,269)	(4,639,386)	(6,486,767)

Statement of Operations Data	**Six Months Ended June 30, 2005**		**Three Months Ended June 30, 2005**	
	As Previously Reported	**As Restated**	**As Previously Reported**	**As Restated**
Revenue	$ 3,916,920	$ 3,312,242	$ 1,909,773	$ 1,909,773
Cost of goods sold	3,104,846	2,605,006	1,303,911	1,303,911
Operating expenses	5,845,511	5,798,738	4,132,002	4,141,966
Loss from operations	(5,033,437)	(5,091,502)	(3,526,140)	(3,536,104)

NOTE C - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, eGlobalphone, VoIP Solutions, DTNet, and Vox Consulting Group, Inc., d/b/a VoIP Americas(“VoIP Americas”) from their respective dates of acquisition. All significant intercompany balances and transactions have been eliminated in consolidation.

Unaudited Consolidated Interim Financial Statements

The accompanying consolidated financial statements for the three and six months ended June 30, 2005 and 2004 are unaudited but, in the opinion of management, include all necessary adjustments (consisting of normal, recurring adjustments) for a fair presentation of the Company’s consolidated financial position, results of operations and cash flows for the interim periods presented. Interim results are not necessarily indicative of results for a full year. Therefore, the results of operations for the three and six months months ended June 30, 2005 are not necessarily indicative of operating results to be expected for a full year.

Use of Estimates

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

Cash and cash equivalents

For purposes of reporting cash flows, the Company considers all cash on hand, in banks, including amounts in book overdraft positions, certificates of deposit and other highly liquid debt instruments with a maturity of three months or less at the date of purchase to be cash and cash equivalents. Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies.

Caerus has cash restrictions to support letters of credit which in turn support operating license bonds required by several states' regulatory agencies. The amount of restricted cash as of June 30, 2005 was $60,000.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts based on its assessment of the current status of the individual receivables and after using reasonable collection efforts. As of June 30, 2005 and December 31, 2004, the balance of the allowance for uncollectible accounts amounted to $99,047 and $136,795, respectively.

Inventory

Inventory consists of finished goods and is valued at the lower of cost or market using the first-in, first-out method.

Advertising Expenses

Advertising and marketing expenses are charged to operations as incurred.

Income Taxes

The Company and its subsidiaries file consolidated federal and state income tax returns. The Company has adopted Statement of Financial Accounting Standards No. 109 in the accompanying consolidated financial statements. The only temporary differences included therein are attributable to differing methods of reflecting depreciation for financial statement and income tax purposes.

Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing the net income (loss) for the period by the weighted-average number of shares of common stock outstanding. The calculation of fully diluted earnings (loss) per share assumes the dilutive effect of the exercise of outstanding options and warrants at either the beginning of the respective period presented or the date of issuance, whichever is later. Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method.

Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable and notes payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions.

Revenue Recognition

Revenue from product sales is recognized when persuasive evidence of an arrangement exists, delivery to customer has occurred, the sales price is fixed and determinable, and collectibility of the related receivable is probable. The recognition of revenues from Internet telephony services are deferred for new subscribers of eGlobalphone and VoIP Solutions until it deems that the customer has accepted the service. Subsequent revenues are recognized at the beginning of each customer’s month. The recognition of revenue from Internet telephony services are recorded as rendered. Revenues related to long distance, carrier access service and certain other usage-driven charges are billed monthly in arrears and the associated revenues are recognized during the month of service.

Property, plant, and equipment

Property, plant, and equipment are stated at cost. Depreciation is provided over the estimated useful lives of the related assets using the straight line method. The useful life of assets ranges from three to five years. The leasehold improvements are amortized over the life of the related lease.

Under the Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use," the Company expenses computer software costs related to internal-use software that is incurred in the preliminary project stage. When the capitalization criteria of SOP 98-1 have been met, costs of developing or obtaining internal-use computer software are capitalized. Amortization of internal-use software over a five-year estimated useful life commenced upon the software being placed in service beginning January 1, 2004. Amortization of internal-use software for the period ended June 30, 2005 was approximately $77,000.

Business combinations

The Company accounts for business combinations in accordance with Statement of Financial Accounting Standard No. 141 “Business Combinations” ("SFAS No. 141"). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations. SFAS No. 141 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually by comparing carrying value to the respective fair value in accordance with the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets” (“SFAS No. 142”). This pronouncement also requires that the intangible assets with finite useful lives be amortized over their respective estimated useful lives.

Impairment of long-lived assets

The Company reviews the recoverability of its long-lived assets, such as plant, equipment and intangibles when events or changes in circumstances occur that indicate that the carrying value of the asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets.

Concentration of Credit Risk

Financial instruments that may subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company has investment policies and procedures that are reviewed periodically to minimize credit risk.

One customer represented approximately 98% of our subsidiary Caerus' accounts receivable as of June 30, 2005 and approximately 91% of Caerus' revenues for the six months ended June 30, 2005.

NOTE D - ACQUISITION OF CAERUS, INC.

On May 31, 2005 the Company acquired 100% of Caerus and its wholly owned subsidiaries Volo, Caerus Networks, Inc., and Caerus Billing, Inc. in exchange for 16.9 million of the Company's common shares. The acquisition was accounted for as a business combination in accordance with SFAS No. 141.

The purchase price was allocated to the identifiable net assets acquired including the identifiable intangible assets based on their estimated fair market values at the date of acquisition. The goodwill, intangible assets and property recorded for the acquisition of Caerus represent the fair market value of liabilities as of the date of acquisition, plus $13,819,118, which represents the value of the Company's common stock and options issued pursuant to the acquisition, plus acquisition-related costs. The common stock issued to acquire Caerus was valued at the closing market price of the stock on the date of the acquisition, less a 25% discount due to restrictions on the shares. The amortizable lives of the intangible assets recorded for Caerus range from one to nine years.

The fair market value of the assets acquired on May 31, 2005 is as follows:

	Fair Value of Assets Acquired
Cash	$ 66,485
Accounts receivable	285,578
Deposits	108,500
Other current assets	156,659
Property and equipment, net	8,451,763
Other assets	271,609
Accounts payable	(9,382,323)
Note payable	(6,960,818)
Customer deposits	(1,026,750)
Other current liabilities	(2,252,703)
Sub total	(10,282,000)
Intangible assets	13,800,000

Goodwill		10,301,000
Sub total		24,101,000
Purchase price	$	13,819,000

NOTE E - GOODWILL AND OTHER INTANGIBLE ASSETS

a) As of June 30, 2005 goodwill consisted of the following:

		Amount
Acquisition of Caerus	$	10,301,000
Acquisition of DTNet		5,210,553
Acquisition of VoIP Americas		1,408,30
Sub total		16,919,854

b) As of June 30, 2005 intangible assets consisted of the following:
Ingangibles with finite lives:

	Useful Life Years		Amount
Technology - Caerus	4.0	$	6,000,000
Customer relationships - Caerus	6.0		5,800,000
Trade names - Caerus	9.0		1,300,000
Non-compete agreements - Caerus	1.0		500,000
Carrier licenses - Caerus	Unamortized		200,000
Sub total			13,800,000
Less accumulated amortization			(259,260)
Sub total			13,540,740
Ingangibles with indefinite lives:			
Intellectual property			305,000
Sub total			13,840,740
Total		$	30,765,594

The goodwill on the acquisition of DTNet represents the fair market value of DTNet liabilities as of the date of the acquisition plus $4,750,000, which represents the market value of 2,500,000 shares of Company stock issued pursuant to its acquisition.

The goodwill on the acquisition of VoIP Americas represents the fair market value of VoIP Americas' liabilities as of the date of the acquisition plus $1,100,000, which represents the market value of 1,000,000 shares of the Company's stock pursuant to this acquisition.

Intellectual property is carried at cost which is comprised of $200,000 paid in cash and the value assigned to 100,000 Company common shares and 400,000 warrants issued pursuant to this transaction. The valuation of the shares was $1.05 while the value was $105,000. The value of the warrants was determined using the Black-Scholes model calculated as of October 14, 2004. This model uses the annualized deviation calculation and utilized industry averages as a comparison for adequate statistical results in the valuation. This is a standard financial model that considers the statistical annual volatility of the market changes in a stock price.

Intellectual property consists of the following:

a) all rights of the Company of record in the telephone numbers 1(800)TALKTIME, 1(888)TALKTIME, AND 1(877)TALKTIME.COM;
b) all rights to the URL's (domain names) 800TALKTIME.COM, 1800TALKTIME.COM, and 1-800-TALKTIME.COM; and
c) all rights to U.S. Trademark Registration No. 2,209,316 directed to 1-800-TALKTIME and the goodwill associated therewith.

NOTE F - EXCHANGE OF WARRANTS FOR SHARES

In February, 2005 an executive of the Company and the Company agreed to exchange his 2,200,000 warrants for 750,000 restricted shares of the Company. This created additional compensation of $239,500, shown in the compensation and related expenses in the consolidated statement of operations, which is the difference between the market price on the date of exchange and the value on the date of the issuance of the warrants.

NOTE G - STOCK OPTION PLAN

On January 26, 2005, the Company filed a Form S-8 registration statement in connection with the Company's stock option plan (the “Option Plan”). The Option Plan provides for the grant to eligible employees, consultants, and directors of options for the purchase of the Company’s common stock. The Option Plan covers, in the aggregate, a maximum of 4,000,000 shares of common stock and provides for the granting of both incentive stock options (as defined in Section 422 of the Internal Revenue Code of 1986, as amended) and nonqualified stock options (options which do not meet the requirements of Section 422). Under the Option Plan, the exercise price may not be less than the fair market value of the common stock on the date of the grant of the option.

The Company uses the fair value method of SFAS No. 123 in accounting for its stock options. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. The fair value for each option granted is estimated on the date of the grant using the minimum value method.

The vested options as of June 30, 2005 amounting to $127,238 are shown under the compensation and related expenses on the Consolidated Statement of Operations.

NOTE H - NOTES PAYABLE

As of June 30, 2005, Notes Payable consist of the following:

a. Note Payable to Shareholder	$	1,053,196
b. Note Payable - Convertible		