ICEWEB INC
Form 10KSB
December 29, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-KSB

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2008

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

For the transition period from _____ to _____

Commission file number: 0-27865

ICEWEB, INC.
(Name of small business issuer in its charter)

Delaware	13-2640971
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
45925 Maries Road, Dulles, VA	20166
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number: (703) 964-8000

Securities registered under Section 12(b) of the Exchange Act:

None	None
(Title of each class)	(Name of each exchange on which registered

Securities registered under Section 12(g) of the Exchange Act:

Common stock, par value $0.001 per share
(Title of class)

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act o

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-KSB. o

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

State issuer's revenues for its most recent fiscal year. $16,294,423 for the 12 months ended September 30, 2008.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity, as of a specified date within the past 60 days. As of December 28, 2008 the aggregate market value of the common stock held by non-affiliates at the closing price of the registrant's common stock is approximately $994,000.

State the number of shares outstanding of each of the issuer's class of common equity. As of December 28, 2008, 30,379,369 shares of common stock are outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

If the following documents are incorporated by reference, briefly describe them and identify the part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) any annual report to security holders; (2) any proxy or information statement; and (3) any prospectus filed pursuant to Rule 424(b) or (c) of the Securities Act of 1933 ("Securities Act"). None.

Transitional Small Business Disclosure Form (check one): Yes o No x

When used in this annual report, the terms "IceWEB,", the "Company", "we," "our," and "us" refers to IceWEB, Inc. Delaware corporation, and our subsidiaries. The information which appears on our web site at www.iceweb.com is not part of this annual report.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements in this annual report contain or may contain forward-looking statements that are subject to known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements were based on various factors and were derived utilizing numerous assumptions and other factors that could cause our actual results to differ materially from those in the forward-looking statements. Potential risks and uncertainties include, among other things, such factors as: our high level of indebtedness and ability to satisfy the same, our history of unprofitable operations, the continued availability of financing in the amounts, at the times and on the terms required, to support our future business and capital projects, the extent to which we are successful in developing, acquiring, licensing or securing patents for proprietary products, changes in economic conditions specific to any one or more of our markets, changes in general economic conditions, our ability to produce and install product that conforms to contract specifications and in a time frame that meets the contract requirements, and the other factors and information disclosed and discussed in other sections of this report.

You should consider the areas of risk described in connection with any forward-looking statements that may be made in this annual report. Readers are cautioned not to place undue reliance on these forward-looking statements and readers should carefully review this annual report in its entirety, including the risks described in Part I - Item 1. Description of Business - Risk Factors. Except for our ongoing obligations to disclose material information under the Federal securities laws, we undertake no obligation to release publicly any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events.

2

CONTENTS

PART I	Item 1.	Description of Business	4
	Item 2.	Description of Property	12
	Item 3.	Legal Proceedings	12
	Item 4.	Submission of Matters to a Vote of Security Holders	12
PART II	Item 5.	Market for Common Equity, and Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities	12
	Item 6.	Management's Discussion and Analysis or Plan of Operations	13
	Item 7.	Financial Statements	F-1
	Item 8.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	23
	Item 8A.	Controls and Procedures	23
	Item 8A(T)	Controls and Procedures	23
	Item 8B.	Other Information	23
PART III	Item 9.	Directors, Executives Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act	24
	Item 10.	Executive Compensation	29
	Item 11.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	34
	Item 12.	Certain Relationships and Related Transactions, and Director Independence	36
	Item 13.	Exhibits	37
	Item 14.	Principal Accounting Fees and Services	38

PART I

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

IceWEB, Inc., a Delaware corporation (IWEB or the Company) is a storage technology company headquartered in Sterling, Virginia.

BUSINESS OF ICEWEB

The Company was originally founded to serve the commercial and federal markets with network security products and proprietary on-line software solutions. In 2008, the Company narrowed its focus and expanded its capabilities by acquiring INLINE Corporation, a data storage company specializing in custom designed, short-production run storage solutions for the Geospatial Information Systems (GIS) market.

Therefore, for 2009, the Company has three lines of business: Storage & GIS products, IT solutions and Online services. The Company plans to grow its revenues and profits in both the Storage and solutions businesses while maintaining its position in the online market.

Storage & GIS Products. These products simplify how enterprises retain, access, manage and protect their data. Demand for data storage is ever-growing and ubiquitous as data files in all market sectors have become larger and richer with video and multimedia content. This growth is particularly strong in the already billion dollar GIS market that is projected to grow ten-fold over the next decade. Therefore, IceWEB's strategic direction is to grow its share and profits in this market based upon its own proprietary designs and its strategic relationships with its GIS software OEMs such as ESRI, the world-wide leader in GIS application software.

IceWEB and ESRI have collaborated to create ultra-high performance INLINE/ESRI GIS systems that allow customers to analyze data in ways never before possible. IceWEB designs, manufactures and, in concert with its OEM partners, markets these systems to organizations all over the world.

In addition to the Company's line of hardware/software storage products, customers can choose from a broad range of warranty and service programs. INLINE products range from storage servers, to NAS (Network Attached Storage) and SAN (Storage Area Network) solutions. OEM/Custom products are focused on the GIS markets.

Core Products	Models	GIS
Servers	Enterprise & Workgroup	GIS Server, GIS Workgroup Server GIS MLP
SAN	Fibre Channel and IP	
NAS	Engines – Gateways into storage subsystems.	GIS Data Appliance MLP Data Appliance
	Appliances – Fully	GIS Appliance

bundled NAS with GIS Database storage

GIS products utilize the latest storage server, SAN and NAS technology

IT Solutions. IceWEB provides IT network infrastructure security solutions to government and commercial organizations. The products come from the Company's strategic partners which include RSA Security, ISS, Blue Coat, F5 Networks, McAfee and Cisco. IceWEB will continue to invest in this business in 2009. Solutions include:

Security information management, firewall implementation, management and monitoring
Intrusion detection, intrusion, prevention, anti-virus, anti-spam
Wide area network optimization, user authentication, remote access control

Online Services. In December 2005, IceWEB launched IceMAILTM a packaged software service that provides network –hosted groupware, email, calendaring and collaboration functionality. Customers are organizations wishing to use Microsoft Exchange and Outlook without having to procure, maintain and manage their own equipment and software. Online services were subsequently expanded to include IcePORTALTM which provides customers with a complete Intranet portal and IceSECURETM a hosted email encryption service. These products continue to provide predictable monthly revenues for the Company; however the Company has no plans to make new investments in this business in 2009.

Customers. GIS applications allow customers to acquire, view, understand, interpret and visualize data in ways that reveal relationships, patterns and trends in the form of maps, globes, reports and charts. IceWEB's core GIS focus is complimented by its network infrastructure security solutions which are offered in partnership with a wide range of OEM technology leaders. OEM customers include ESRI, Highwinds Solutions, Stryker Imaging and SAIC.

Commercial customers include enterprise companies, small to medium sized businesses (SMB) and OEM partners. IceWEB serves Federal Government markets through GSA, GWAC and BPA agreements with customers in the US Departments of Defense (DOD), Homeland Security (DoHS), the National Aeronautics and Space Administration (NASA) and the National Science Foundation (NSF).

Customer Support and Service. Quality and responsive customer support services can turn first-time customers into perpetual customers. These services can also provide the Company with an ever-growing, predictable revenue stream.

All INLINE products are sold with the Company's 'Bronze' warranty which includes telephone technical support during normal business hours and parts repair or replacement when returned to factory. 'Silver' coverage supplements 'Bronze' by providing next business day shipment for any user replaceable parts falling under warranty.

'Gold' coverage provides U.S. customers with a special toll-free number for technical support. In addition these customers receive, when necessary, on-site assistance during 9 to 5 during the normal work week. 'Platinum' services receive all other services plus the added protection of on-site service with 4 hour response.

In addition, the Company provides factory-authorized services for ESRI customers. For customers with sensitive or classified data such as the Department of Defense, the Company keeps magnetic hard drive platters ready for mailing in event of failure in the field (these customers cannot return defective hard drives due to security reasons).

Sales & Marketing. IceWEB storage and GIS products are sold to end users via the Company's own direct sales force and by its OEM partner sales organization. These OEMs help market and sell our products with the assistance of our sales force. Our marketing efforts increase brand awareness and uncover qualified prospects for our direct sales force. Marketing includes tradeshows, advertising, public relations and Internet.

Research and Development. Continued investment in product research and development is critical to the Company's business. The Company has skilled engineers with extensive experience in the fields of computing, storage, distributed systems, network system design, and GIS applications. R&D is conducted at the Company's headquarters in Dulles, VA.

Manufacturing is conducted at Company headquarters in Dulles, VA. In addition the Company utilizes Xyratex Technology Limited for the assembly, quality control, packaging and shipping for some of its products. Xyratex procures the majority of the components for suppliers pre-qualified by IceWEB. Xyratex and IceWEB collaborate to ensure that third-party suppliers can provide sufficient components to satisfy product delivery schedules. All final test procedures conducted by Xyratex are approved by IceWEB and finished products samples are inspected and tested by IceWEB to ensure that all finished goods meet IceWEB's rigorous quality standards.

Competition. The market for IceWEB storage is highly competitive and likely to become even more competitive in the future. Established companies have historically dominated the storage market, including EMC, Network Appliance, Dell, Hewlett-Packard, Sun Microsystems, Hitachi Data Systems and IBM.

In addition there is additional competition from smaller companies such as Compellent Technologies and LeftHand Networks. In the future, new competitors will emerge as well as increased competition, both domestically and internationally, from other established storage companies. The principal competitive market factors are:

- Industry credibility.
- Product scalability, performance and reliability
- Ease of installation and management;
- Software functionality;
- Total cost of ownership;
- Customer support
- Market presence

IceWEB competes effectively across all of these factors. In particular, the Company's product architecture provides significant competitive advantages in terms of performance, scalability, ease of management and low total cost of ownership. OEM partners provide the Company with a significant number of reference accounts which address credibility and helps marketing to new customers.

Many of the competitors have longer operating histories, better name recognition, larger customer bases and significantly greater financial, technical, sales and marketing resources than we have. Competitors may also be able to devote greater resources to the development, promotion, sale and support of their products. Competitors may also have more extensive customer bases and broader customer relationships than the Company including relationships with potential IceWEB customers.

Intellectual Property

Success in the Company’s technological markets depends, in part, upon the Company’s ability to obtain and maintain proprietary protection for its products, technology and know-how. This must be accomplished without infringing the proprietary rights of others and while simultaneously preventing others from infringing upon the Company’s own proprietary rights.

IceWEB seeks to protect its proprietary positions by, among other methods, filing patent applications. Patent efforts are focused in the United States and, when justified by cost and strategic importance, we file related foreign patent applications in jurisdictions such as the European Union and Japan. As of September 30, 2008, we had applied for three provisional U.S. patents.

Pending patent applications relate to the rapid ingestion of massive amounts of video and other data and other network storage concepts. It is unknown if any of the patent applications will issue as patents. The patent applications may be opposed, contested, circumvented, designed around by a third party, or found to be invalid or unenforceable.

Copyright law, trademarks and trade secret agreements are also used to protect and maintain proprietary positions. The Company’s proprietary information is protected by internal and external controls, including contractual agreements with employees, end-users and channel partners. There is no assurance that these parties will abide by the terms of their agreements.

Trademarks are used on some of the IceWEB products and these distinctive marks may be an important factor in marketing the products. Inline® and Inline logo trademarks have been registered in the United States.

Our History

We were originally formed under the laws of the State of Delaware in February 1969. For many years, we were a wholesaler of custom one, two, three and four-color processed commercial printing, as well as disposable and durable office equipment including stock paper, fax paper, fax and copy machines, computers, file cabinets and safes. We conducted our business throughout the United States of America and Puerto Rico from our headquarters in New York.

In March 1999, we changed the focus of our business and closed a transaction by which we acquired 100% of the outstanding capital stock of North Orlando Sports Promotions, Inc., a privately held Florida corporation. From 1999 until July 2001, we operated a variety of Internet-related services, however, we were unable to generate positive cash flow from these Internet-related businesses.

In May 2001, we executed an Agreement and Plan of Reorganization and Stock Purchase Agreement with Disease S.I., Inc. Under the terms of the agreement, we acquired 100% of the issued and outstanding stock of Disease S.I., Inc. in exchange for 750,000 shares of our common stock. The transaction was accounted for as a reverse acquisition under the purchase method for business combinations. Accordingly, the combination of the two companies was recorded as a recapitalization of Disease S.I., Inc., pursuant to which Disease S.I., Inc. was treated as the continuing entity. Disease S.I., Inc. was a developmental stage biopharmaceutical clinical diagnostics company planning to employ a broad array of technologies to detect, identify and quantify substances in blood or other bodily fluids and tissues. It intended to derive revenues from patent sub-licensing fees, royalties from pharmaceutical sales, appropriate milestone payments and research and development contracts.

Following completion of the acquisition of Disease S.I., Inc., it became apparent to us that it would be in our best long-term interest that the Internet operations be conducted apart from the biopharmaceutical clinical diagnostics operations. On July 24, 2001, we sold a former officer and director 100% of our subsidiary North Orlando Sports

Promotions, Inc., in exchange for the assumption of all liabilities related to North Orlando Sports Promotions, Inc. and its operations estimated at approximately $112,000, and which included the forgiveness of $91,500 in accrued compensation. Included in the sale along with the capital stock of North Orlando Sports Promotions, Inc. were fixed assets, rights to several domain names and various contractual rights and obligations.

On November 27, 2001, we acquired 9,050,833 shares of the common stock of Healthspan Sciences, Inc., a privately held California corporation in exchange for 5,000 shares of our common stock in a private transaction exempt from registration under the Securities Act of 1933 in reliance on Section 4(2) of that act. This agreement was rescinded on March 21, 2002. Pursuant to the rescission, Healthspan Sciences, Inc. returned all 5,000 shares of our common stock issued in the exchange and we returned all 9,050,833 shares of Healthspan Sciences, Inc. which we had received.

On March 21, 2002, we executed an Agreement and Plan of Merger with IceWEB Communications, Inc., a Delaware corporation and its stockholders. Founded in 2000, IceWEB Communications, Inc. enabled interactive communications and education on the web. In June 2001, it had acquired the assets in bankruptcy of Learning Stream, Inc., a provider of streaming services. Pursuant to the agreement, each of the 22,720,500 shares of common stock of IceWEB Communications, Inc. issued and outstanding immediately prior to the merger were converted into the right to receive 0.13375 shares of our common stock, for an aggregate of 303,888 shares of common stock. Each of the warrants to purchase an aggregate of 680,125 shares of IceWEB Communications, Inc. common stock issued and outstanding immediately prior to the merger were converted into the right to receive one warrant to purchase 0.13375 shares of our common stock upon exercise of said warrant.

In June 2003, we acquired 100% of the capital stock of Interlan Communications, Inc., a privately held corporation, in exchange for 25,000 shares of our common stock. In June 2003, we also acquired 100% of the capital stock of Seven Corporation in exchange for 37,500 shares of our common stock and cash consideration of $123,000. As described later in this section, we sold Seven Corporation company in February 2007.

In October 2003, we acquired 19% of the capital stock of Iplicity, Inc. of Virginia, together with substantially all of its assets including software licenses, source code, potential patents and trademarks for a combined stock and cash value of approximately $632,000 which included the issuance of 191,381 shares of our common stock and cash consideration of $65,500.

In May 2004, we acquired substantially all of the assets of DevElements, Inc. of Virginia, including software licenses, source code, potential patents and trademarks, cash, hardware, and equipment. As consideration for the purchase of the assets, we paid DevElements $100,000 and agreed to the assumption of liabilities up to an aggregate of $150,000. In exchange for the 19% interest in DevElements, we issued to the stockholders of DevElements 187,500 shares of our common stock and options to purchase 187,500 shares of common stock exercisable at a price of $27.20 per share and expiring May 13, 2009. We issued to the stockholders options to purchase 6,250 shares, which were contingently exercisable upon the satisfaction of certain performance criteria. The performance criteria, which required contracts, task orders and other work assignments involving billing of at least $840,000 during the six-month period ending November 13, 2004, was not met and the options were cancelled.

On October 18, 2004, we entered into a non-binding letter of intent to acquire 100% of the issued and outstanding stock of Plan Graphics, Inc. The transaction was subject to approval by the Plan Graphics, Inc. stockholders, and certain terms and conditions, including terms and conditions which are customary to this type of transaction. On April 29, 2005 the letter of intent expired without a definitive agreement having been executed or all conditions precedent to the closing having been completed.

In March 2006 we acquired PatriotNet, Inc., an Internet service provider, for total consideration of $290,000 of which $190,000 was paid in cash and $100,000 was paid through the issuance of 100,000 shares of our common stock. We granted Patriot Computer Group, Inc., the seller in the transaction, certain piggyback registration rights for the 100,000 shares of our common stock issued as partial consideration in the transaction. At the time of the acquisition, the purchase price exceeded the fair value of the assets acquired by $390,600 which we treated as goodwill for accounting purposes. From the date of acquisition through September 30, 2007 revenues from PatriotNet were approximately $316,000 and represented approximately 6% of our consolidated revenues. On December 1, 2006 we sold PatriotNet to Leros Online, Inc., a third party, for $150,000 in cash and the assumption of $60,000 in liabilities. At September 30, 2007 we recorded goodwill impairment of $180,000 related to this transaction.

On December 1, 2006 we sold 100% of the capital stock of our wholly-owned subsidiary, Integrated Power Solutions, Inc. to Mr. John Younts, our Vice President of Integrated Power Solutions and a key employee, for the assumption of approximately $180,000 in liabilities and the payment of $12,000 we owed him. For the fiscal year ended September 30, 2006, revenues for Integrated Power Solutions were approximately $457,000, or approximately, 9.5%, of our total sales.

On November 15, 2006, we acquired certain of the assets of True North Solutions related to its governmental customer business for $350,000 of which $250,000 was paid in cash and the balance was paid through the delivery of a $100,000 principal amount promissory note secured by collateral pledge of the assets, payable immediately upon accomplishment of the novation of the GSA Schedule. Under the terms of the agreement, we acquired the customers, forecast, contract renewals, and GSA schedule of True North Solutions. We permitted True North Solutions to use the purchased assets until December 31, 2006 pursuant to which we acted as the seller’s subcontractor until the novation of the GSA Schedule was complete. The novation of the GSA schedule was completed in March, 2008.

On February 16, 2007 we sold 100% of the outstanding stock of our subsidiary, The Seven Corporation of Virginia, Inc., to PC NET in exchange for the waiver of approximately $11,000 we owed PC NET. Under the terms of the agreement we may not engage in any staffing services businesses as The Seven Corporation had conducted for a period of at least two years. For the fiscal year ended September 30, 2006 revenues from The Seven Corporation were $360,000 or approximately 7.5%, of our total sales.

On December 22, 2007, we acquired 100% of the outstanding stock of Inline for $1,925,128 in cash, plus 503,356 shares of IceWEB common stock valued at $276,846, the fair market value on the date of acquisition. The acquisition was accounted for using the purchase method of accounting. The results of operations are included in the financial statements of operations from the date of acquisition. Inline is a leading provider of intelligent enterprise data storage solutions and services for the geospatial intelligence marketplace. Inline's proprietary products include reliable, high performance Storage Area Network Solutions, Network Attached Storage, and Direct Attached Storage and the rapidly expanding OEM Storage Centric Appliances. Today, Inline has developed its fifth generation of advanced data storage solutions, marketed under the brands TruEnterprise and FileStorm. All Inline systems function in a heterogeneous operating system environment, including Windows, UNIX and Linux. The purchase of Inline Corporation included the acquisition of assets of $2,688,795, and liabilities of $614,668.

RISK FACTORS

WE HAVE AN ACCUMULATED DEFICIT AND WE ANTICIPATE CONTINUING LOSSES THAT WILL RESULT IN SIGNIFICANT LIQUIDITY AND CASH FLOW PROBLEMS ABSENT A MATERIAL INCREASE IN OUR REVENUES.

We have an accumulated deficit of $20,131,957 at September 30, 2008. For the years ended September 30, 2008 and 2007, we had a net loss attributable to common stockholders of approximately $6,410,793 and approximately $2,850,123, respectively, and cash provided by/(used) in operations was approximately $862,691 and ($1,245,512), respectively. The report of our independent registered public accounting firm on our consolidated financial statements for the fiscal year ended September 30, 2008 contains a qualification expressing substantial doubt as to our ability to continue as a going concern as a result of our net losses and cash used in operations. We reported a decrease in our revenues for fiscal 2008 as compared to fiscal 2007 of approximately 13% which is primarily related to a drop in our IceWEB Solutions Group. We cannot assure you that our revenues will increase in future periods, nor can we assure you that they will not decrease. As long as our cash flow from operations remains insufficient to fund our operations, we will continue depleting our cash and other financial resources. Our failure to achieve profitable operations in future periods will adversely affect our ability to continue as a going concern. In this event, you could lose all of your investment in our company.

WE WILL NEED ADDITIONAL FINANCING WHICH WE MAY NOT BE ABLE TO OBTAIN ON ACCEPTABLE TERMS. IF WE CANNOT RAISE ADDITIONAL CAPITAL AS NEEDED, OUR ABILITY TO EXECUTE OUR GROWTH STRATEGY AND FUND OUR ONGOING OPERATIONS WILL BE IN JEOPARDY.

Historically, our operations have been financed primarily through the issuance of equity and short-term loans. Capital is typically needed not only to fund our ongoing operations and to pay our existing obligations, but capital is also necessary if we wish to acquire additional assets or companies and for the effective integration, operation and expansion of these businesses. Our future capital requirements, however, depend on a number of factors, including our ability to internally grow our revenues, manage our business and control our expenses. At September 30, 2008, we had a working capital deficit of $5,572,671 as compared to a working capital deficit of $1,981,325 at September 30, 2007. This change is primarily attributable to the acquisition of Inline Corporation and our financing arrangement with Sand Hill Finance to factor accounts receivable. We will need to raise additional capital to fund our ongoing operations, pay our existing obligations and for future growth of our company. We cannot assure you that additional working capital is available to us in the future upon terms acceptable to us. If we do not raise funds as needed, our ability to provide for current working capital needs, make additional acquisitions, grow our company, and continue our existing business and operations is in jeopardy. In this event, you could lose all of your investment in our company.

FROM TIME TO TIME WE ENTER INTO RELATED PARTY TRANSACTIONS, THE TERMS OF WHICH MAY NOT BE AS ADVANTAGEOUS AS WE COULD OBTAIN FROM UNRELATED THIRD PARTIES.

From time to time we have borrowed operating funds from related parties, including from Bluepoint Financial, LLC, a company of which Mr. John Signorello, our Chief Executive Officer, is a 50% owner. In lieu of interest we agreed to issue 1.54 shares of common stock for each dollar lent under the loan. During fiscal 2006 we borrowed approximately $335,000 under this loan agreement, repaid approximately $157,000 and issued shares valued at $296,608 as interest. During fiscal 2007, we borrowed approximately $30,000 under this loan agreement, repaid approximately $308,080 and issued shares valued at $169,803 as interest. The value of the securities we have issued as interest far exceeds generally available commercial interest rates. While the transaction was approved by our Board of Directors, of which Mr. Signorello is a member, there are no assurances that we could not have obtained more favorable terms from third party lenders.

WHILE THE SHARES OF OUR SERIES B CONVERTIBLE PREFERRED STOCK IS OUTSTANDING WE ARE PROHIBITED FROM ENTERING INTO CERTAIN TYPES OF EQUITY AND DEBT TRANSACTIONS WHICH MAY ADVERSELY AFFECT OUR ABILITY TO RAISE WORKING CAPITAL AS NEEDED.

Under the terms of our sale of Series B Convertible Preferred Stock in December 2005, we agreed to a number of limitations on our future capital raising activities, including:

- for a period of three years we will not issue any convertible debt or preferred stock, for a period of two years we will not enter into any new borrowings of more than twice as much as the sum of EBITDA (earnings before income taxes, depreciation and amortization) from recurring operations over the past four quarters,

- for so long as the shares are outstanding we will not issue any debt or equity securities with a floating conversion price or reset feature, and

- for so long as the shares are outstanding we cannot issue any common stock or securities which are convertible into common stock at an effective price per share less than the conversion value of the Series B Convertible Preferred Stock which is initially $0.2727 per share.

These restrictions are likely to adversely affect our ability to raise working capital as needed in future periods as the types of financing transactions generally available to us and other comparably-sized public companies often involve the sale of a convertible security with a reset feature, or the sale of common stock at a discount to market.

OUR FACTORING AGREEMENT WITH SAND HILL FINANCE, LLC CONTAINS CERTAIN TERMS WHICH MAY ADVERSELY AFFECT OUR ABILITY TO RAISE CAPITAL IN FUTURE PERIODS.

In December 2005 and as amended during fiscal 2006 and fiscal 2008, we entered into a Finance Agreement with Sand Hill Finance, LLC for a $2.75 million accounts receivable factoring line. Under the terms of this agreement we agreed not to take certain actions including undertaking a transaction which would result in a change of control of our company or the transfer of more than 20% of our securities and incurring any indebtedness other than trade credit in the ordinary course of business. These restrictions may limit our ability to raise working capital as needed.

OUR PRIMARY ASSETS SERVE AS COLLATERAL UNDER OUR ACCOUNTS RECEIVABLE FACTORING LINE. IF WE WERE TO DEFAULT ON THIS AGREEMENT, THE LENDER COULD FORECLOSE ON OUR ASSETS.

The revolving line with Sand Hill Finance, LLC is collateralized by a blanket security interest in our assets. If we should default under the terms of this agreement, the lender could seek to foreclose on our primary assets. If the lender was successful, we would be unable to conduct our business as it is presently conducted and our ability to generate revenues and fund our ongoing operations would be materially adversely affected.

WE ARE A PARTY TO A SALES/LEASBACK AGREEMENT. IF THE LESSOR SHOULD DECLARE US IN DEFAULT UNDER THE AGREEMENT, WE COULD BE FORCED TO PAY ALL AMOUNTS OWED THEREUNDER OR LOSE THE BENEFIT OF THE EQUIPMENT.

In July 2006, we entered into what is in essence a sale and leaseback agreement with respect to certain computer and office equipment. We received gross proceeds of $300,000 from the sale of the equipment to a third party. As part of the same transaction, we entered into a 36 month agreement to lease the equipment back from the third party for monthly rent payments of $10,398. Imputed interest on this financing is 20% per annum. At September 30, 2008, the amount due under this equipment financing arrangement amounted to $91,807. The equipment which is subject to this

arrangement is material in the operation of our business. From time to time we have failed to make the monthly payments due under this agreement on a timely basis. Should the lessor declare us in default, it would be entitled to accelerate all amounts due under the agreement which is approximately $100,000 at September 30, 2008. If we were unable to satisfy such amount, the lessor could retake the equipment thereby depriving us of its use which could materially affect our business and operations.

WE DO NOT HAVE A DISASTER RECOVERY PLAN AND WE DO NOT CARRY BUSINESS INTERRUPTION INSURANCE.

Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, break-ins and similar events. Our headquarters are physically located in Fairfax County, Virginia, a Washington, DC suburb, in close proximity to the US Capitol, White House, Pentagon, CIA, and numerous other agencies within the intelligence community. All these government installations are considered potential targets of any future terrorist attacks. We do not currently have a disaster recovery plan, nor do we carry business interruption insurance to compensate our company for losses that may occur. We are also vulnerable to computer viruses and/or physical disruptions, which could lead to interruptions, delays, loss of data or the inability to accept orders. The occurrence of any of the foregoing events could have a material adverse effect on our business, prospects, financial condition and results of operations.

OUR MANAGEMENT MAY BE UNABLE TO EFFECTIVELY INTEGRATE OUR ACQUISITIONS AND TO MANAGE OUR GROWTH AND WE MAY BE UNABLE TO FULLY REALIZE ANY ANTICIPATED BENEFITS OF THESE ACQUISITIONS.

Our business strategy includes growth through acquisition and internal development. We are subject to various risks associated with our growth strategy, including the risk that we will be unable to identify and recruit suitable acquisition candidates in the future or to integrate and manage the acquired companies. Acquired companies' histories, geographical locations, business models and business cultures can be different from ours in many respects. Our directors and senior management face a significant challenge in their efforts to integrate our businesses and the business of the acquired companies or assets, and to effectively manage our continued growth. There can be no assurance that our efforts to integrate the operations of any acquired assets or companies acquired in the future will be successful, that we can manage our growth or that the anticipated benefits of these proposed acquisitions will be fully realized. The dedication of management resources to these efforts may detract attention from our day-to-day business. There can be no assurance that there will not be substantial costs associated with these activities or of the success of our integration efforts, either of which could have a material adverse effect on our operating results.

WE HAVE NOT VOLUNTARILY IMPLEMENTED VARIOUS CORPORATE GOVERNANCE MEASURES, IN THE ABSENCE OF WHICH, STOCKHOLDERS MAY HAVE MORE LIMITED PROTECTIONS AGAINST INTERESTED DIRECTOR TRANSACTIONS, CONFLICTS OF INTEREST AND SIMILAR MATTERS.

Recent Federal legislation, including the Sarbanes-Oxley Act of 2002, has resulted in the adoption of various corporate governance measures designed to promote the integrity of the corporate management and the securities markets. Some of these measures have been adopted in response to legal requirements. Others have been adopted by companies in response to the requirements of national securities exchanges, such as the NYSE or The Nasdaq Stock Market, on which their securities are listed. Among the corporate governance measures that are required under the rules of national securities exchanges are those that address board of directors' independence, audit committee oversight, and the adoption of a code of ethics. Because our stock is not listed on an exchange we are not required to adopt these corporate governance standards. While our board of directors has adopted a Code of Ethics and Business Conduct and our Board has established Audit and Compensation Committees, we have not adopted all of the corporate governance measures which we might otherwise have been required to adopt if our securities were listed on a national securities exchange. It is possible that if we were to adopt all of these corporate governance measures, stockholders would benefit from somewhat greater assurances that internal corporate decisions were being made by disinterested directors and that policies had been implemented to define responsible conduct. Prospective investors should bear in mind our current lack of corporate governance measures in formulating their investment decisions.

THE EXERCISE OF WARRANTS AND OPTIONS AND THE CONVERSION OF SHARES OF OUR SERIES B CONVERTIBLE PREFERRED STOCK WILL BE DILUTIVE TO OUR EXISTING STOCKHOLDERS.

At September 30, 2008 we had outstanding:

- 24,688,088 shares of our common stock,
- 1,253,334 shares of Series B Convertible Preferred Stock which is convertible into 1,253,334 shares of our common stock,
- common stock purchase warrants to purchase a total of 300,000 shares of our common stock with exercise prices ranging from $0.65 to $8.00 per share, and
- options granted under our 2000 Management and Director Equity Incentive and Compensation Plan which are exercisable into 6,583,827 shares of our common stock with a weighted average exercise price of $0.44 per share.

10

The conversion of the Series B Convertible Preferred Stock and/or the exercise of outstanding options and warrants may materially adversely affect the market price of our common stock and will have a dilutive effect on our existing stockholders.

CERTAIN OF OUR OUTSTANDING WARRANTS CONTAIN CASHLESS EXERCISE PROVISIONS WHICH MEANS WE WILL NOT RECEIVE ANY CASH PROCEEDS UPON THEIR EXERCISE.

In March 2005 and December 2005, we issued common stock purchase warrants to purchase an aggregate of 6,925,000 shares of our common stock with exercise prices ranging from $2.00 to $9.60 per share in connection with the sales of shares of our Series A Convertible Preferred Stock and Series B Convertible Preferred Stock. The exercise price of each these warrants was subsequently amended to be $1.00 per share. In April, 2008, 5,150,000 of these warrants were converted into 2,525,000 shares of common stock on a cashless basis. At September 30, 2008, none of these warrants remain outstanding. In December 2005, we also issued a seven year common stock purchase warrant to purchase 25,000 shares of our common stock with an exercise price of $1.00 per share in connection with our accounts receivable financing agreement with Sand Hill Finance, LLC.

All of these five-year warrants were exercisable on a cashless basis which means that the holders, rather than paying the exercise price in cash, may surrender a number of warrants equal to the exercise price of the warrants being exercised. The utilization of this cashless exercise feature deprived us of additional capital which might otherwise be obtained if the warrants did not contain a cashless feature.

PROVISIONS OF OUR CERTIFICATE OF INCORPORATION AND BYLAWS MAY DELAY OR PREVENT A TAKE-OVER WHICH MAY NOT BE IN THE BEST INTERESTS OF OUR STOCKHOLDERS.

Provisions of our certificate of incorporation and bylaws may be deemed to have anti-takeover effects, which include when and by whom special meetings of our stockholders may be called, and may delay, defer or prevent a takeover attempt. In addition, certain provisions of the Delaware General Corporations Law also may be deemed to have certain anti-takeover effects which include that control of shares acquired in excess of certain specified thresholds will not possess any voting rights unless these voting rights are approved by a majority of a corporation's disinterested stockholders.

In addition, our certificate of incorporation authorizes the issuance of up to 10,000,000 shares of preferred stock with such rights and preferences as may be determined from time to time by our Board of Directors. We presently have outstanding 1,253,334 shares of Series B Convertible Preferred Stock. Our Board of Directors may, without stockholder approval, issue additional series of preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of our common stock.

OUR COMMON STOCK COULD BE REMOVED FROM QUOTATION ON THE OTCBB IF WE FAIL TO TIMELY FILE OUR ANNUAL OR QUARTERLY REPORTS. IF OUR COMMON STOCK WAS NO LONGER ELIGIBLE FOR QUOTATION ON THE OTCBB, THE LIQUIDITY OF OUR STOCK MAY BE FURTHER ADVERSELY IMPACTED.

Under the rules of the Securities and Exchange Commission we are required to file our quarterly reports within 45 days from the end of the fiscal quarter and our annual report within 90 days from the end of our fiscal year. Under rules adopted by the Financial Industry Regulatory Authority (FINRA) in 2005 which is informally known as the "Three Strikes Rule", a FINRA member is prohibited from quoting securities of an OTCBB issuer such as our company if the issuer either fails to timely file these reports or is otherwise delinquent in the filing requirements three times in the prior two year period or if the issuer's common stock has been removed from quotation on the OTCBB twice in that two year period. We failed to file this annual report on a timely basis. If we were to fail to file two additional

reports on a timely basis our stock would be removed from quotation on the OTCBB and would in all likelihood then be quoted on the Pink Sheets Electronic Quotation Service. Pink Sheets offers a quotation service to companies that are unable to list their securities on the OTCBB or an exchange. The requirements for listing on the Pink Sheets are considerably lower and less regulated than those of the OTCBB an exchange. If our common stock were to be quoted on the Pink Sheets, it is possible that even fewer brokers or dealers would be interested in making a market in our common stock which would further adversely impact its liquidity.

ITEM 2. DESCRIPTION OF PROPERTY

In December 2007, we entered into a seven year lease for approximately 9,000 square feet of office space located in the same building in which our principal executive offices are located. This new lease provides for annual base rental of approximately $148,000. We are also responsible for our pro rata share of certain pass through costs. We have the option to renew this lease for one additional five year term and we have a right of first refusal to lease as additional approximately 7,200 square feet of adjoining office space should it become available.

ITEM 3. LEGAL PROCEEDINGS

The Company is a party to litigation which arises primarily in the ordinary course of business. In the opinion of management, the ultimate disposition of such litigation should not have a material adverse effect on the financial position or results of operations of the Company.

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

None.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is quoted on the OTCBB under the symbol IWEB. The reported high and low bid prices for the common stock as reported on the OTCBB are shown below for the periods indicated. The quotations reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

	High	Low
Fiscal 2007		
First quarter ended December 31, 2006	$ 0.75	$ 0.35
Second quarter ended March 31, 2007	$ 0.85	$ 0.51
Third quarter ended June 30, 2007	$ 0.90	$ 0.50
Fourth quarter ended September 30, 2007	$ 0.85	$ 0.53
Fiscal 2008		
First quarter ended December 31, 2007	$ 0.65	$ 0.45
Second quarter ended March 31, 2008	$ 0.59	$ 0.28
Third quarter ended June 30, 2008	$ 0.62	$ 0.29
Fourth quarter ended September 30, 2008	$ 0.35	$ 0.11

As of December 26, 2008 the last sale price of our common shares as reported on the OTC Bulletin Board was $0.09 per share. As of December 28, 2008, there were approximately 561 record owners of our common stock.

Dividend Policy

We have never paid cash dividends on our common stock. Under Delaware law, we may declare and pay dividends on our capital stock either out of our surplus, as defined in the relevant Delaware statutes, or if there is no such surplus, out of our net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. If, however, the capital of our company, computed in accordance with the relevant Delaware statutes, has been diminished by depreciation in the value of our property, or by losses, or otherwise, to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets, we are prohibited from declaring and paying out of such net profits any dividends upon any shares of our capital stock until the deficiency in the amount of capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets shall have been repaired.

We do not anticipate that any cash dividends will be declared or paid on our common stock in the foreseeable future.

RECENT SALES OF UNREGISTERED SECURITIES

On June 6, 2008 we sold 400,000 shares of common stock at a per share price of $0.20, valued at $80,000 to an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 4(2) of that act.

Small Business Issuer Purchases of Equity Securities

None.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

OVERVIEW

IceWEB, through our Inline Corporation subsidiary is a leading provider of high-performance storage products that simplify the way enterprises retain, access, manage and protect their data. Our products are designed specifically for mid-sized enterprises that have complex storage needs but cannot justify the high procurement and ongoing management costs of other storage area network, or SAN, alternatives. Our products are offered in an integrated, all-inclusive package that combines resilient disk storage with a comprehensive suite of intelligent storage management software.

In addition, IceWEB's Solutions Group specializes in network infrastructure security solutions. Through our team of engineers and our partners, including RSA Security, ISS, F5 Networks, Blue Coat, and Cisco, we provide firewall, authentication, PKI, encryption, and traffic filtering products and services to protect network infrastructure. Our customers are primarily Federal, State, and Local government entities. We believe that the combination of our vendor partners/manufacturers, customers, and government contracting vehicles enables our company to be successful in providing the industry's best network security solutions to government clients and those commercial integrators who service the government. We further believe that we can, through IceWEB Solutions group, position, market, and sell our high margin hosted online subscription services to that constituency enabling us to attain a larger subscriber base for those services.

Also, we offer small and medium sized businesses ("SMBs") hosted access to enterprise-class applications delivered via the Internet for a reasonable monthly fee. These rapidly growing SaaS offerings include such hosted applications as Microsoft Exchange Server, Sharepoint, BlackBerry Enterprise Server, Good Messaging Server, SPAM and Virus protection, and advanced Email Encryption services. Our current customer base consists of nearly 900 organizations

worldwide in both the public and private sectors.

Our storage product architecture employs innovative, proprietary virtualization software that severs the traditional tie between stored data and disk drive hardware. This virtualization software masks the complexity of the underlying storage configuration and enables our storage arrays to cooperate with one another to automatically share resources and balance workloads. Our products are based on the iSCSI network protocol, which utilizes widely-deployed Internet Protocol, or IP, networks. As a result, our customers can cost-effectively install, expand and modify their data storage resources.

Beginning in 2001, we began a series of strategic acquisitions and divestitures which have resulted in our current business and operations and impacted our financial statements for fiscal 2008 and 2007, including:

- in June 2001, we acquired the assets of Learning Stream, Inc., a provider of digital content streaming services, which coincided with the transition of our business model to a focus on e-learning. Learning Stream had developed custom streaming solutions which we believed were more efficient and effective than the solutions we had implemented at that time. We considered the software we acquired to be competitive because it helped remove the complexity and unnecessary cost from the implementation of the streaming technology,

- in June 2003, we acquired all of the outstanding stock of Interlan Corporation, a provider of data communications and networking solutions for business, government, and education. Interlan provided technical services including presales design and consulting, installation, troubleshooting, and long term maintenance and support contracts,

- in June 2003, we also acquired all of the outstanding stock of The Seven Corporation, a provider of network engineering services to commercial and government customers throughout the United States,

- in October 2003, we acquired the software ownership rights and customers of Iplicity, Inc. of Virginia. Iplicity had developed a complete content management software platform based on open source architecture to run in any operating environment. In this transaction we acquired software licenses, source code, potential patents and trademarks,

- in May 2004 we acquired substantially all of the assets of DevElements, Inc. of Virginia, a professional IT consultancy firm that designs, develops and implements web-based productivity solutions for its customers. In this transaction we acquired software licenses, source code, potential patents and trademarks, as well as some cash and tangible assets, and

- in March 2006, the Company, through its wholly-owned subsidiary, IceWEB Online, Inc., completed the acquisition of substantially all of the assets and some liabilities of PatriotNet, Inc.

In August 2006, after multiple quarters of collapsing revenue and higher than anticipated losses in fiscal 2006, our Board of Directors and senior management implemented a strategy of re-focusing the Company on hosted software services and network security sales. The Company determined, through a detailed analysis of operations, that the PatriotNet and Integrated Power Solutions activities were not profitable or in line with the company’s core focus and competencies. In addition, the Company believes we can focus our limited sales and marketing budgets on the remaining core business activities to achieve more success.

- On November 15, 2006, the Company acquired the assets of True North Federal Solutions Group for $350,000 of which $250,000 was paid in cash and $100,000 due upon future terms of the agreement. Under the terms of the agreement, IceWEB acquired the customer database, forecast, contract renewals, and GSA schedule of True North Federal. The revenue generated to IceWEB from this division since the acquisition, exceeded the revenue from the discontinued PatriotNet and IPS operations.

- On December 1, 2006, we sold the assets of PatriotNet to Leros Technologies, a third party, for $150,000 in cash and the assumption of $60,000 in liabilities. On September 30, 2007 we recorded goodwill impairment of $180,000 related to this transaction. The PatriotNet services constituted 9.5% of revenue in fiscal 2006.

- On December 1, 2006, we sold 100% of the capital stock of our wholly-owned subsidiary, Integrated Power Solutions, Inc. to John Younts, a related party, for the assumption of approximately $200,000 in liabilities. In fiscal 2006, revenues for Integrated Power Solutions accounted for approximately $400,000 or 7% of our total IceWEB revenues.

- On December 22, 2007, we acquired 100% of the outstanding stock of Inline Corporation for $1,925,128 in cash, plus 503,356 shares of IceWEB common stock valued at $276,846, the fair market value on the date of acquisition. The acquisition was accounted for using the purchase method of accounting. The results of operations are included in the financial statements of operations from the date of acquisition. Inline is a leading provider of intelligent enterprise data storage solutions and services for the geospatial intelligence marketplace. Inline's proprietary products include reliable, high performance Storage Area Network Solutions, Network Attached Storage, and Direct Attached Storage and the rapidly expanding OEM Storage Centric Appliances. Today, Inline has developed its fifth generation of advanced data storage solutions, marketed under the brands TruEnterprise and FileStorm. All Inline systems function in a heterogeneous operating system environment, including Windows, UNIX and Linux. The purchase of Inline Corporation included the acquisition of assets of $2,688,795, and liabilities of $614,668.

We generate revenues from the manufacture and sale of data storage appliances and servers, the sale of software services, application development, network integrated technology, and third party hardware sales. We believe that the key factors to our continued growth and profitability include the following:

- Continued focus on the GIS market and expanding our channels of distribution with OEM partners
- Continued investment in product development and research efforts
- Raising approximately $3 million of additional working capital to expand our marketing, research and development, and restructure our debt.
- Hiring additional qualified, technical employees, and
- Improving our internal financial reporting systems and processes.

GOING CONCERN

We have a history of losses and have incurred net losses of approximately $20.1 million since inception through September 30, 2008. Our current operations are not an adequate source of cash to fund future operations. The report of our independent registered public accounting firm on our consolidated financial statements for the year ended September 30, 2008 contains an explanatory paragraph regarding our ability to continue as a going concern based upon our net losses. Our ability to continue as a going concern is dependent upon our ability to obtain the necessary financing to meet our obligations and repay our liabilities when they become due and to generate profitable operations in the future. We plan to continue to provide for our capital requirements through the sale of equity securities and debt, however, we have no firm commitments from any third party to provide this financing and we cannot assure you we will be successful in raising working capital as needed. There are no assurances that we will have sufficient funds to execute our business plan, pay our operating expenses and obligations as they become due or generate positive operating results.

RESULTS OF OPERATIONS

FISCAL YEAR ENDED SEPTEMBER 30, 2008 (“fiscal 2008”) AS COMPARED TO FISCAL YEAR ENDED SEPTEMBER 30, 2007 (“fiscal 2007”)

The following table provides an overview of certain key factors of our results of operations for fiscal year 2008 as compared to fiscal year 2007:

	Fiscal Year Ended September 30,		$	%
	2008	2007	Change	Change
Sales	$ 16,294,423	$ 18,732,069	$ (2,437,646)	(13%)
Cost of sales	14,067,630	16,811,274	(2,743,644)	(16%)
Operating Expenses:				
Marketing and selling	192,595	192,816	(222)	(0%)
Depreciation and amortization	575,499	351,400	224,099	(64%)
Research and development	303,526	-	303,526	100%
General and administrative	6,910,659	3,834,829	3,075,210	80%
Total operating expenses	7,981,659	4,379,045	3,602,614	82%
Loss from operations	(5,754,865)	(2,458,250)	(3,296,615)	(134%)
Total other income (expense)	(655,928)	(391,873)	(264,055)	(67%)
Net loss	$ (6,410,793)	$ (2,850,123)	$ (3,560,670)	(125%)

Other Key Indicators:

	Fiscal 2008	Fiscal 2007	% Change
Cost of sales as a percentage of revenues	86.3%	89.75%	(3.4%)
Gross profit margin	13.7%	10.25%	3.4%
General and administrative expenses as a percentage of revenues	39.8%	20.47%	(19.4%)
Total operating expenses as a percentage of revenues	46.2%	23.37%	(22.8%)

Sales

For fiscal 2008, we reported sales of $16,294,423 as compared to net revenues of $18,732,069 for fiscal 2007, a decrease of $2,437,646 or approximately 13%. Of our total net revenues for fiscal 2008, approximately $14,886,699 is attributable to third party product sales by our IceWEB Solutions Group, approximately $982,049 is attributable to our sale of storage products, and approximately $425,676 is attributable to revenues from our online products and services. For fiscal 2007, approximately $16,921,721 is attributable to third party product sales by our IceWEB Solutions Group and approximately $186,625 is attributable to revenues from our online products and services.

The decrease in fiscal 2008 net revenues from fiscal 2007 is primarily due to a decrease in our third party product sales through our IceWEB Solutions Group.

Cost of Sales and Gross Profit

Our cost of sales consists primarily of products purchased for resale by our IceWEB Solutions Group, and the cost of goods to manufacture our storage products. For fiscal 2008, cost of sales was $14,067,630, or approximately 86.3% of revenues, as compared to $16,811,274, or approximately 89.75% of revenues, for fiscal 2007. The decrease in costs of sales as a percentage of revenue and the corresponding increase in our gross profit margin for fiscal 2008 as compared to fiscal 2007 was the result of an increase in higher margin storage sales in fiscal 2008, and improved margins attributable to our Solutions Group revenues.

Total Operating Expenses

Our total operating expenses increased approximately 82% to $7,981,659 for fiscal 2008 as compared to $4,379,045 for fiscal 2007. The increase is primarily due to our acquisition of Inline Corporation in December, 2007. This increase includes:

Marketing and Selling. For the year ended September 30, 2008, marketing and selling costs were $192,595 as compared to $192,816 for the year ended September 30, 2007, a decrease of $222 or approximately 0.1%. This decrease was primarily due to a decrease in online web marketing, advertising and print advertising during fiscal 2008, offset by increased marketing costs related to our storage products and the acquisition of Inline Corporation. We anticipate that our marketing and selling expenses will increase in fiscal 2009 as we execute on our plan to increase our storage sales.

Depreciation and amortization expense. For fiscal 2008, depreciation and amortization expense amounted to $575,499 as compared to $351,400 for fiscal 2007, an increase of 224,099 or 63.8%. Depreciation expense is provided by use of the straight-line method over the estimated useful lives of the assets. For fiscal 2008, depreciation expense was $281,355 as compared to $247,226 for fiscal 2007. The increase in depreciation was attributable to the acquisition in December 2007 of Inline Corporation.

Amortization expense is related to the customer relationships and software library which are intangible assets that we generated through our acquisitions Inline Corporation, DevElements, Inc. and Iplicity, Inc. It also includes the amortization of the value of the manufacturing GSA schedule which was acquired as part of the Inline Corporation acquisition and the GSA schedule which was acquired as part of the True North Solutions Group acquisition. These GSA schedules are being amortized on a straight-line basis over three years. For fiscal 2008, amortization expense was $294,144 as compared to $104,174 for fiscal 2007. The increase in amortization expense of $189,970 is due to the amortization of the intangible assets acquired as part of the Inline Corporation acquisition.

Research and development expense. For fiscal 2008, research and development expenses were $303,526 as compared to $0 for fiscal 2007. The increase in research and development expense is related to the acquisition of Inline Corporation. We anticipate the spending on research and development in fiscal 2009 will be approximately $100,000 per quarter.

General and administrative expense. For fiscal 2008, general and administrative expenses were $6,745,039 as compared to $3,834,829 for fiscal 2007, an increase of $2,910,210 or approximately 76%. This increase is primarily attributable to the acquisition of Inline Corporation in December 2007, which contributed general and administrative expense of $1,096,655. For each of fiscal 2008 and 2007, general and administrative expenses consisted of the following:

	2008	2007
Salaries/benefits	$ 4,544,682	$ 2,561,932
Occupancy	301,313	219,015
Professional fees	93,365	195,491
Other	524,935	256,098
Consulting	197,082	172,041
Investor Relations	904,537	161,505
Travel/Entertainment	125,729	105,097
Internet/Phone	93,638	75,150
Leased Equipment	66,424	48,547
Insurance	48,768	23,607
Licenses	9,566	16,346
	$ 6,910,039	$ 3,834,829

The principal changes in fiscal 2008 as compared to fiscal 2007 include:

- For fiscal 2008, salaries and related taxes and benefits increased $1,982,750 or 77.4% from fiscal 2007. The increase was primarily attributable to the acquisition of Inline Corporation, which contributed $440,437 in salary and related expense. In addition, the increase was due to an increase in the granting of stock options in fiscal 2008 to members of the board of directors, executive officers, and employees which was valued using FASB 123R and resulted in stock-based compensation of $1,988,358 versus the same expense in the prior year of $650,555, an increase of $1,337,803. Excluding the impact of FASB 123R expense and the acquisition of Inline Corporation, salaries and related taxes and benefits increased $204,511.

- For fiscal 2008, occupancy expense increased $82,298 or 37.6% from fiscal 2007. The increase was due to the acquisition of Inline Corporation, and the rent expense associated with their office location. We expect occupancy expense in fiscal 2009 to be substantially reduced as a result of consolidating our office locations in August, 2008.

- For fiscal 2008, professional fees decreased $102,126 or approximately 52.2% from fiscal 2007. The decrease was primarily attributable to a decrease in legal fees incurred to settle lawsuits against the Company, which occurred in fiscal 2007.

- For fiscal 2008, other expense increased $268,837 or approximately 105% from fiscal 2007. The increase is primarily due to the accrued costs to settle potential litigation of $165,000, an increase in hosting fees of $29,270, an increase in web development expense of $52,125, and property taxes related to the Inline office space of $18,169.

- For fiscal 2008, consulting expense increased by $25,041 or approximately 14.6% from fiscal 2007. The increase was primarily due to higher consulting fees related to the acquisition of Inline Corporation in December, 2007.

- For fiscal 2008, investor relations expense increased $743,032 or approximately 460.1% from fiscal 2007. The increase was attributable to an increase in general investor relations activity as we seek to build awareness of our company with financial professionals and individual investors. $493,850 of this expense of the investor relations expense in fiscal 2008 was non-cash. We expect that in fiscal 2009 our investor relations activity and related expense will be substantially reduced.

- For fiscal 2008, travel and entertainment expense increased $20,632 or approximately 19.6%. The increase was attributable to an increase in general business, sales, and travel-related investor relations activity.

- For fiscal 2008, insurance expense increased $25,161 or approximately 106.6%.from fiscal 2007. The increase was attributable to higher premiums paid for general business and D&O insurance, related primarily to the acquisition of Inline Corporation.

LOSS FROM OPERATIONS

We reported a loss from operations of $5,754,865 for fiscal 2008 as compared to a loss from operations of $2,458,250 for fiscal 2007, an increase of $3,296,615 or approximately 134%. This increase is primarily the result of decreased net revenues in the fiscal 2008 period, losses incurred related to the acquisition of Inline Corporation, and non-cash expenses related to FAS123R compensation expense.

TOTAL OTHER INCOME (EXPENSES)

Gain (loss) from sale of assets. During fiscal 2007 we recorded a gain of $153,319 on the sale of our Integrated Power Solutions and The Seven Corporation subsidiaries. We did not have comparable transactions in fiscal 2008.

Interest Expense. For fiscal 2008, interest expense increased $110,778 or approximately 20%. The increase in interest expense is primarily attributable to higher average outstanding note balances during fiscal 2008, offset by lower deferred loan fee amortization in fiscal 2008 of $16,251, as compared to deferred loan fee amortization of $160,000 in fiscal 2007.

NET LOSS

Our net loss was $6,410,793 for fiscal 2008 compared to $2,850,123 for fiscal 2007, a decrease of $3,560,670 or approximately 125%.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is the ability of a company to generate funds to support its current and future operations, satisfy its obligations and otherwise operate on an ongoing basis. The following table provides certain selected balance sheet comparisons between September 30, 2008 and September 30, 2007:

	September 30, 2008	September 30, 2007	$ Change	% Change
Working Capital	(5,572,671)	(1,981,325)	(3,591,346)	181.3%
Cash	4,780	1,092,470	(1,087,690)	(99.6%)
Accounts receivable, net	3,094,110	5,115,428	(2,021,318)	(39.5%)
Inventory	400,312	8,097	392,216	4,844.2%
Total current assets	3,575,930	6,243,714	(2,667,784)	(42.7%)
Property and equipment, net	1,169,369	344,728	824,641	239.2%
Intangibles, net	1,132,612	211,305	921,307	436.0%
Total assets	5,939,327	6,853,703	(914,376)	(13.3%)
Accounts payable and accrued liabilities	7,762,872	5,805,256	1,957,616	33.7%
Notes payable-current	1,372,565	2,293,560	(920,995)	(40.2%)
Deferred revenue	13,164	10,456	2,709	25.9%
Total current liabilities	9,148,601	8,225,039	923,562	11.2%
Notes payable-long term	956,519	98,716	857,803	869.0%
Total liabilities	10,105,120	8,323,755	1,781,365	21.4%
Accumulated deficit	(20,131,957)	(13,721,164)	(6,410,793)	46.7%
Stockholders' deficit	(4,165,793)	(1,470,053)	(2,695,740)	183.4%

At September 30, 2008, we had a working capital deficit of $(5,572,671) compared to a working capital deficit of $(1,981,325) at September 30, 2007, an increase of $3,591,346. The increase is primarily attributable to activity related to our acquisition of Inline Corporation. These changes are primarily attributable to the decreases in accounts receivable of $2,021,318 and cash of $1,100,220, along with the increase in accounts payable and accrued expenses of $1,945,086, offset by the decrease in current notes payable of $920,995, the decrease in notes payable- related party of $115,767, and the increase in inventory of $392,216.

Net cash provided by operating activities was $862,691 for fiscal 2008 as compared to net cash used in operating activities of $1,245,512 for fiscal 2007, an increase of $2,108,203. For fiscal 2008, our cash provided by operations of $862,691 consisted of a net loss of $6,245,793, offset by non-cash items totaling $7,058,551 including items such as depreciation and amortization of $575,499, stock based compensation of $1,573,363, the amortization of deferred compensation of $910,930, and other non-cash items of $16,196. Additionally, during fiscal 2008 we had an increase in operating liabilities and a decrease in operating assets which offset our net loss. This change in operating assets and liabilities primarily consisted of a decrease in accounts receivable of $2,887,773 attributable to a decrease in fourth quarter sales, an increase in accounts payable and accrued liabilities of $1,342,947, offset by an increase in inventory of $2,647.

For fiscal 2007, our cash used in operations of $1,245,512 consisted of a net loss of $2,850,123, offset by non-cash items totaling $1,149,544 including items such as depreciation and amortization of $351,400, stock based compensation of $697,000, the amortization of deferred compensation of $150,666, and other non-cash items of $79,000. Additionally, during fiscal 2007 we had an increase in operating liabilities and an increase in operating assets which offset our net loss. This change in operating assets and liabilities primarily consisted of an increase in accounts receivable of $3,946,058 attributable to an increase in fourth quarter sales, offset by an increase in accounts payable and accrued expenses of $4,559,078 attributable to the increase in fourth quarter 2007 sales.

Net cash used in investing activities for fiscal 2008 was $2,111,749 as compared to net cash used in investing activities of $130,873 for fiscal 2007. During fiscal 2008, we acquired Inline Corporation and in connection therewith used net cash of $1,925,128. Additionally, we used cash of $186,621 for property and equipment purchases. During fiscal 2007, we acquired certain assets and in connection therewith used cash of $247,000. Additionally, we used cash of $21,873 for property and equipment purchases.

Net cash provided by financing activities for fiscal 2008 was $161,367 as compared to $2,035,975 for fiscal 2007, a decrease of $1,874,603. The primary reason for the decrease was a decrease of $858,158 in net proceeds from the sale of equity securities and exercise of warrants and options during fiscal 2008 as compared to fiscal 2007, as well as the net proceeds from notes payable of $1,275,218.

At September 30, 2008 we had an accumulated deficit of $20,131,957 and the report from our independent registered public accounting firm on our audited financial statements at September 30, 2008 contained an explanatory paragraph regarding doubt as to our ability to continue as a going concern as a result of our net losses in operations. In spite of our revenues, there is no assurance that we will be able to maintain or increase our revenues in fiscal 2009 or that we will report net income in any future periods.

We do not have any working capital commitments nor do we not presently have any external sources of working capital. Historically, our revenues have not been sufficient to fund our operations and we have relied on capital provided through the sale of equity securities, and various financing arrangements and loans from related parties. At September 30, 2008 we had cash on hand of $4,780. In addition to the cash necessary to fund our operating losses, research and development, marketing and general growth, we will need cash to satisfy certain obligations. In fiscal 2006, we entered into a receivable factoring agreement with Sand Hill Finance, LLC under which we can sell certain accounts receivable to the lender on a full recourse basis at 80% of the face amount of the receivable up to an aggregate of $1.8 million. We agreed to pay Sand Hill Finance, LLC an annual commitment fee of $10,000 and a monthly finance fee of 2% of the average daily balance under the line. We granted Sand Hill Finance, LLC a blanket security interest in our assets and agreed to refrain from certain actions while the line is outstanding. This financing agreement was amended in fiscal 2008 to increase the line amount to $2,750,000, and to add an eighteen month term loan of $1,000,000 with an interest rate of 24% per annum. As of September 30, 2008, we had $1,581,148 available under the line of credit facility. Also, in July 2006, we entered into what is in essence a sale and leaseback agreement with respect to certain computer and office equipment. At September 30, 2008, amount due under this equipment financing arrangement amounted to $91,807.

Our working capital needs in future periods depend primarily on the rate at which we can increase our revenues while controlling our expenses and decreasing the use of cash to fund operations. Additional capital may be needed to fund acquisitions of additional companies or assets, although we are not a party to any pending agreements at this time and, accordingly, cannot estimate the amount of capital which may be necessary, if any, for acquisitions.

As long as our cash flow from operations remains insufficient to completely fund operations, we will continue depleting our financial resources and seeking additional capital through equity and/or debt financing. In March 2005 we sold shares of our Series A Convertible Preferred Stock and in December 2005 we sold shares of our Series B Convertible Preferred Stock to the same purchaser. The series A Convertible Preferred Stock has been converted into Common Stock, and there are no remaining outstanding shares of Series A Preferred Stock. The designation of the Series B Preferred Stock included a restriction that so long as the shares are outstanding, we cannot sell or issue any common stock, rights to subscribe for shares of common stock or securities which are convertible or exercisable into shares of common stock at an effective purchase price of less than the then conversion value which is presently $0.2727 for the Series B Convertible Preferred Stock. Under the terms of the Series B Convertible Preferred Stock transaction, we also agreed not to issue any convertible debt or preferred stock. The terms of our sales of our Series B Convertible Preferred Stock to Barron Partners contain restrictions on the types of financing transactions we can enter into while those securities are outstanding which may adversely affect our ability to raise capital in equity or debt transactions. In addition, under the terms of the financing agreement with Sand Hill Finance, LLC we agreed not to incur any additional indebtedness other than trade credit in the ordinary course of business. These covenants may also limit our ability to raise capital in future periods. There can be no assurance that acceptable financing can be obtained on suitable terms, if at all. Our ability to continue our existing operations and to fund our working capital needs will suffer if we are unable to raise the additional funds on acceptable terms which will have the effect of adversely affecting our ongoing operations and limiting our ability to increase our revenues and maintain profitable operations in the future. If we are unable to secure the necessary additional working capital as needed, we may be forced to curtail some or all of our operations.

CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, which was released by the U.S. Securities and Exchange Commission, encourages all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Our consolidated financial statements include a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. Management believes the following critical accounting policies affect the significant judgments and estimates used in the preparation of the financial statements.

Use of Estimates - Management's Discussion and Analysis or Plan of Operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates, including those related to allowances for doubtful accounts receivable, the carrying value of property and equipment, intangible assets, and long-lived assets, and the value of stock-option based compensation. Management bases these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Revenue Recognition - We follow the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin 104 for revenue recognition. In general, we record revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. The following policies reflect specific criteria for the various revenues streams of the Company:

Revenues from sales of products are generally recognized when products are shipped unless we have obligations remaining under sales or licensing agreements, in which case revenue is either deferred until all obligations are satisfied or recognized ratably over the term of the contract.

Revenue from services is recorded as it is earned. Commissions earned on third party sales are recorded in the month in which contracts are awarded. Customers are generally billed every two weeks based on the units of production for the project. Each project has an estimated total which is based on the estimated units of production and agreed upon billing rates. Amounts billed in advance of services being provided are recorded as deferred revenues and recognized in the consolidated statement of operations as services are provided.

Accounting for Stock Based Compensation - Effective October 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment ("SFAS No. 123R"). SFAS No. 123R establishes the financial accounting and reporting standards for stock-based compensation plans. As required by SFAS No. 123R, we recognize the cost resulting from all stock-based payment transactions including shares issued under our stock option plans in the financial statements.

RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board has recently issued several new accounting pronouncements:

In July 2006, the FASB issued FASB Interpretation No. 48 – Accounting for Uncertainty in Income Taxes– an interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on accounting for de-recognition, interest, penalties, accounting in interim periods, disclosure and classification of matters related to uncertainty in income taxes, and transitional requirements upon adoption of FIN 48. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is in the process of evaluating the impact of FIN 48 on its Condensed Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, with unrealized gains and losses related to these financial instruments reported in earnings at each subsequent reporting date. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is in the process of evaluating the impact of SFAS No. 159 on its Condensed Consolidated Financial Statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, Financial Statements — Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB No. 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB No. 108 requires registrants to quantify misstatements using both the income statement and balance sheet approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 is effective for years ending after November 15, 2006, and the impact of adoption had no effect on the Company's consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

ITEM 7. FINANCIAL STATEMENTS

IceWEB, Inc. and Subsidiaries

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

CONTENTS

Report of Independent Registered Public Accounting Firm	F-2
Consolidated Financial Statements:	
Consolidated Balance Sheet	F-3
Consolidated Statements of Operations	F-4
Consolidated Statement of Changes in Stockholders' Deficit	F-5
Consolidated Statements of Cash Flows	F-6
Notes to Consolidated Financial Statements	F-7 to F-28

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
IceWEB, Inc.

We have audited the accompanying consolidated balance sheet of IceWEB, Inc. and Subsidiaries as of September 30, 2008 and the related consolidated statements of operations, changes in stockholders' deficit and cash flows for the years ended September 30, 2008 and 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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 consolidated 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 purposes of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 consolidated financial position of IceWEB, Inc. and Subsidiaries, as of September 30, 2008 and the consolidated results of their operations and their cash flows for the years ended September 30, 2008 and 2007, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company had net losses of $6,245,793 and $2,850,123 respectively, for the years ended September 30, 2008 and 2007. These matters raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Sherb & Co., LLP
Certified Public Accountants

Boca Raton, Florida
December 26, 2008

IceWEB, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEET
September 30, 2008

CURRENT ASSETS:	
Cash	$ 4,780
Accounts receivable, net of allowance for doubtful accounts of $9,000	3,094,110
Inventory, net	400,312
Other current assets	21,572
Prepaid expenses	55,155
	3,575,929
OTHER ASSETS:	
Property and equipment, net	1,169,369
Deposits	61,418
Intangible assets, net of accumulated amortization of $458,318	1,132,612
Total Assets	$ 5,939,328
CURRENT LIABILITIES:	
Accounts payable and accrued liabilities	$ 7,762,872
Notes payable	1,372,565
Deferred revenue	13,164
	9,148,601
Long-Term Liabilities	
Notes Payable	956,520
Total Liabilities	10,105,121
Stockholders’ Deficit	
Preferred stock ($.001 par value; 10,000,000 shares authorized) Series A convertible preferred stock ($.001 par value; 0 shares issued and outstanding)	-
Series B convertible preferred stock ($.001 par value; 1,253,334 shares issued and outstanding)	1,253
Common stock ($.001 par value; 1,000,000,000 shares authorized; 24,688,088 shares issued and 24,425,588 shares outstanding)	24,690
Additional paid in capital	15,953,221
Accumulated deficit	(20,131,957)
Treasury stock, at cost, (162,500 shares)	(13,000)
Total stockholders’ deficit	(4,165,793)
Total Liabilities and stockholders’ deficit	$ 5,939,328

See accompanying notes to consolidated financial statements

IceWEB, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Year Ended September 30,	
	2008	2007
Sales	$ 16,294,423	$ 18,732,069
Cost of sales	14,067,629	16,811,274
Gross profit	2,226,794	1,920,795
Operating expenses:		
Marketing and selling	192,595	192,816
Depreciation and amortization expense	575,499	351,400
Research and development	303,526	-
General and administrative	6,910,039	3,834,829
Total operating expenses	7,981,659	4,379,045
Loss from operations	(5,754,865)	(2,458,250)
Other income (expenses):		
Gain/(loss) from sale of assets	-	153,319
Interest income	3,444	3,402
Interest expense	(659,372)	(548,594)
Total other income (expenses)	(655,928)	(391,873)
Net loss	$ (6,410,793)	$ (2,850,123)
Basic and diluted loss per common share	$ (0.35)	$ (0.27)
Weighted average common shares outstanding basic and diluted	18,321,369	10,393,830

See accompanying notes to consolidated financial statements

IceWEB, Inc. and Subsidiaries
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIT
For the years ended September 30, 2008 and 2007

	Series A Preferred Stock		Series B Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Treasury Stock		T
	Shares	Amount	Shares	Amount	Shares	Amount			Share	Amount	
at per 30,	1,256,667	1,257	1,833,334	1,833	8,857,909	8,859	9,801,411	(10,871,041)	(162,500)	(13,000)	(1,0
ation of sation	—	—	—	—	—	—	347,585	—	—	—	3
ation of g nt	—	—	—	—	(350,000)	(350)	(349,650)	—	—	—	(3
of stock	—	—	—	—	350,000	350	174,650	—	—	—	1
n stock or of	—	—	—	—	967,800	968	490,390	—	—	—	4
n stock or of .	—	—	—	—	1,350,000	1,350	489,650	—	—	—	4
n stock n on with yable	—	—	—	—	339,606	340	169,463	—	—	—	1
ion of d to n stock	(800,000)	(800)	—	—	800,000	800	—	—	—	—	
n stock or	—	—	—	—	25,000	25	15,475	—	—	—	

stock to ees	—	—	—	—	—	—	650,555	—	—	—	6
of stock nge for shment	—	—	—	—	700,000	700	428,300	—	—	—	4
of	—	—	—	—	—	—	30,950	—	—	—	
for the	—	—	—	—	—	—	—	(2,850,123)	—	—	(2,8
at per 30,	456,667	$ 457	1,833,334	$ 1,833	13,040,315	$ 13,042	$ 12,248,779	$ (13,721,164)	(162,500)	$ (13,000)	$ (1,4
ation of sation	—	—	—	—	—	—	910,930	—	—	—	9
of stock	—	—	—	—	400,000	400	79,600	—	—	—	
stock or of	—	—	—	—	1,780,000	1,780	217,420	—	—	—	2
stock or of	—	—	—	—	2,625,000	2,625	(2,625)	—	—	—	
stock on with yable	—	—	—	—	266,500	267	40,860	—	—	—	
ion of d to stock	(456,667)	(457)	—	—	456,667	457	—	—	—	—	

ion of d to n stock			(580,000)	(580)	580,000	580	—	—	—	—	
n stock or	—	—	—	—	1,086,250	1,086	495,577	—	—	—	4
n stock o ees	—	—	—	—	2,950,000	2,950	1,073,750	—	—	—	1,0
n stock n on with on	—	—	—	—	1,503,356	1,503	875,343	—	—	—	8
e of .	—	—	—	—	—	—	13,587	—	—	—	
for the	—	—	—	—	—	—	—	(6,410,793)	—	—	(6,4
at per 30,	—	$ —	1,253,334	$ 1,253	24,688,088	$ 24,690	$ 15,953,221	$ (20,131,957)	(162,500)	$ (13,000)	$ (4,1

See accompanying notes to consolidated financial statements

IceWEB, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended September 30,	
	2008	2007
Net loss	$ (6,410,793)	$ (2,850,123)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	575,498	351,400
Share-based compensation	1,573,363	697,005
Gain on conversion of note payable to equity	—	(17,875)
Amortization of deferred compensation	910,930	150,666
Interest expense from stock issued for note payable	—	96,875
Gain on sales of net assets	—	(153,319)
Cancellation of marketing agreement	—	(153,082)
Amortization of deferred finance costs	16,196	159,999
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	2,887,773	(3,946,058)
Prepaid expense	(27,436)	(18,048)
Inventory	2,647	(8,096)
Deposits	(11,143)	(860)
Increase (decrease) in:		
Accounts payable and accrued liabilities	1,342,947	4,559,079
Accrued interest payable	—	(84,375)
Deferred revenue	2,709	(28,700)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	862,691	(1,245,512)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(186,621)	(21,873)
Net cash received from sale of net assets	—	138,000
Cash used in acquisitions, net	(1,925,128)	(247,000)
NET CASH USED IN INVESTING ACTIVITIES	(2,111,749)	(130,873)

(continued)

IceWEB, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(continued)

	For the Year Ended September 30, 2008	For the Year Ended September 30, 2007
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of equipment financing	(98,887)	(77,251)
Proceeds from notes payable - related party	157,425	(23,039)
Repayment of notes payable - related party	(124,109)	(235,791)
Net proceeds from related party advances	—	11,737
Proceeds from notes payable	6,519,365	2,247,477
Payments on notes payable	(6,591,626)	(1,044,521)
Proceeds from common stock issued for cash	80,000	175,000
Proceeds from exercise of common stock options	219,200	491,358
Proceeds from exercise of common stock warrants	—	491,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	161,368	2,035,970
NET INCREASE/(DECREASE) IN CASH	(1,087,690)	659,585
CASH - beginning of period	1,092,470	432,885
CASH - end of period	$ 4,780	$ 1,092,470
Supplemental disclosure of cash flow information:		
Cash paid for :		
Interest	$ 659,372	$ 376,095
Income taxes	$ —	$ —
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Common stock issued for debt and interest	$ 41,127	$ 616,678
Warrant granted for debt discount and debt issuance costs	$ 13,587	$ —
Preferred stock issued for liability	$ —	$ —
Common stock issued in connection with acquisition	$ 876,846	$ —
Acquisition details:		
Fair value of assets acquired	$ 2,688,795	$ 154,521
Intangible assets	$ 1,215,450	$ 275,479
Liabilities assumed	$ (614,668)	$ —
Common stock issued in connection with acquisition	$ 876,846	$ —

See accompanying notes to consolidated financial statements

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

NOTE 1 - ORGANIZATION

IceWEB, Inc. (the “Company”) began trading publicly in April 2002. Utilizing resources gained through acquisitions, the Company has developed two applications that are now available to the general public, IceWEB Vista which is a website portal development and management application, and IceMAIL which is a hosted Microsoft Exchange application service. In addition to the new application services, the Company also continues to provide customers with systems integration, network consulting, and customized software application services.

Complementing the online service offerings is the Company’s IceWEB Solutions Group. The IceWEB Solutions Group focuses on providing computer network security products such as access control, content filtering, email security, intrusion detection, and the latest layer 7 firewall technology. IceWEB has certified technical and sales personnel who continuously build and maintain excellent relationships with key manufacturers of network security solutions. The combination of its vendor partners/manufacturers, customers, and Government contracting vehicles enables IceWEB to be successful in providing the industry’s best network security solutions to the Federal Government and commercial integrators who service the Government.

NOTE 2 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles and include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Reclassifications

Certain reclassifications have been made to previously reported amounts to conform to 2007 amounts. The reclassifications had no impact on previously reported results of operations or shareholders’ deficit.

Going Concern

The Company’s auditors stated in their report on the consolidated financial statements of the Company for the years ended September 30, 2008 and 2007 that the Company is dependent on outside financing and has had losses since inception that raise doubt about its ability to continue as a going concern. In addition and as discussed further in Note 6, the Company is not in compliance with debt covenants under its Financing Agreements with Sand Hills Finance LLC. For the year ended September 30, 2008, the Company incurred a net loss of $6,410,793. The consolidated financial statements do not include any adjustments related to the recovery and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

Management has established plans intended to increase the sales of the Company’s products and services. Management intends to seek new capital from new equity securities offerings to provide funds needed to increase liquidity, fund growth, and implement its business plan. However, no assurances can be given that the Company will be able to raise any additional funds.

Fair value of financial instruments

The carrying amounts of financial instruments, including cash, accounts receivable, accounts payable and accrued liabilities approximated fair value as of September 30, 2008, because of the relatively short-term maturity of these instruments and their market interest rates.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

Use of Estimates

The preparation of financial statements in accordance 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 balance sheets and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates in 2008 and 2007 include the allowance for doubtful accounts, the valuation of stock-based compensation, and the useful life of property and equipment and intangible assets.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable consists of normal trade receivables. The Company recorded a bad debt allowance of $9,000 as of September 30, 2008. Management performs ongoing evaluations of its accounts receivable. Management believes that all remaining receivables are fully collectable. Bad debt expense amounted to $0 and $0 for the years ended September 30, 2008 and 2007, respectively.

Inventory

Inventory is valued at the lower of cost or market, on a first-in, first-out (FIFO) basis and includes primarily finished goods.

Property and Equipment

Property and equipment is stated at cost, net of accumulated depreciation. Depreciation is provided by using the straight-line method over the estimated useful lives of the related assets.

Property and equipment also includes costs incurred in connection with development on the Company’s software developed for internal use and website costs. The Company capitalized certain costs valued in connection with developing or obtaining internal use software in accordance with American Institute of Certified Public Accountants Statement of Position 98-1, “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use”. These costs, which consist of direct technology labor costs, are capitalized and amortized using the straight-line method over expected useful lives of three years.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

Intangible Assets

Intangible assets, net consists of the cost of acquired customer relationships. The Company capitalizes and amortizes the cost of acquired intangible assets over their estimated useful lives on a straight-line basis. The estimated useful lives of the Company's acquired customer relationships is five years.

Long-lived Assets

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company reviews the carrying value of intangibles and other long-lived assets for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is measured by comparison of its carrying amount to the undiscounted cash flows that the asset or asset group is expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the property, if any, exceeds its fair market value.

Revenue Recognition

The Company follows the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin 104 for revenue recognition. In general, the Company records revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. The following policies reflect specific criteria for the various revenues streams of the Company:

Revenues from sales of products are generally recognized when products are shipped unless the Company has obligations remaining under sales or licensing agreements, in which case revenue is either deferred until all obligations are satisfied or recognized ratably over the term of the contract.

Revenue from services is recorded as it is earned. Commissions earned on third party sales are recorded in the month in which contracts are awarded. Customers are generally billed every two weeks based on the units of production for the project. Each project has an estimated total which is based on the estimated units of production and agreed upon billing rates. Amounts billed in advance of services being provided are recorded as deferred revenues and recognized in the consolidated statement of operations as services are provided.

Earnings per Share

The Company computes earnings per share in accordance with Statement of Accounting Standards No. 128, "Earnings per Share ("SFAS No. 128"). Under the provisions of SFAS No. 128, basic earnings per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing the net income (loss) for the period by the weighted average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of the common shares issuable upon the exercise of stock options and warrants (using the treasury stock method) and upon the conversion of convertible preferred stock (using the if-converted method). Potentially dilutive common shares are excluded from the calculation if their effect is antidilutive. At September 30, 2008, there were options and warrants to purchase 6,883,827 shares of common stock and 1,253,334 shares issuable

upon conversion of Series B preferred stock which could potentially dilute future earnings per share.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

Stock-Based Compensation

As more fully described in Note 12, the Company has a stock option plan that provides for non-qualified and incentive stock options to be issued to directors, officers, employees and consultants (the 2000 Management and Director Equity Incentive and Compensation Plan (the “Plan”).

Prior to October 1, 2005, the Company accounted for stock options issued under the Plan under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by FASB Statement No. 123, Accounting for Stock-Based Compensation. No stock-based compensation cost related to employee stock options was recognized in the Consolidated Statement of Operations for the year ended September 30, 2005 as all options granted under the Plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective October 1, 2005, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), Share-Based Payment, using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the year ended September 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of September 30, 2005, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Financial results for the year ended September 30, 2005 have not been restated.

Recent Accounting Pronouncements

The Financial Accounting Standards Board has recently issued several new accounting pronouncements:

In July 2006, the FASB issued FASB Interpretation No. 48 – Accounting for Uncertainty in Income Taxes– an interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on accounting for de-recognition, interest, penalties, accounting in interim periods, disclosure and classification of matters related to uncertainty in income taxes, and transitional requirements upon adoption of FIN 48. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is in the process of evaluating the impact of FIN 48 on its Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, (“SFAS No. 157”), “Fair Value Measurements.” SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, the FASB did provide a one year deferral for the implementation of SFAS No. 157 for other nonfinancial assets and liabilities. The Company is currently evaluating the impact of this Statement on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, with unrealized gains and losses related to these financial instruments reported in earnings at each subsequent reporting date. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is in the process of evaluating the impact of SFAS No. 159 on its Condensed Consolidated Financial Statements.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, Financial Statements — Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB No. 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB No. 108 requires registrants to quantify misstatements using both the income statement and balance sheet approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 is effective for years ending after November 15, 2006, and the impact of adoption had no effect on the Company's consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

NOTE 3 - PROPERTY AND EQUIPMENT

At September 30, 2008, property and equipment consisted of the following:

	Estimated Life		
Office equipment	5 years	$	628,080
Computer software	3 years		713,876
Vehicles	3 years		17,330
Furniture and fixtures	5 years		261,385
Leasehold improvements	5 years		999,050
			2,619,721
Less: accumulated depreciation			(1,450,352)
		$	1,169,369

Depreciation expense for the years ended September 30, 2008 and 2007 was $281,355 and $247,226 respectively.

NOTE 4 - INTANGIBLE ASSETS

At September 30, 2008, intangible assets consist of the following:

Acquired software library	$	100,000
GSA Schedule		275,479
Manufacturing GSA Schedule		750,000

Customer relationships intangible	465,451
	1,590,930
Less: accumulated amortization	(458,318)
	$ 1,132,612

Amortization expense amounted to $294,144 and $104,174 for the years ended September 30, 2008 and 2007, respectively.

F-11

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

Amortization expense subsequent to the year ended September 30, 2008 is as follows:

Years ending September 30:	
2009	$ 334,917
2010	250,742
2011	243,090
2012	243,090
2013	60,773
	$ 1,132,612

NOTE 5 - RELATED PARTY TRANSACTIONS

Advances from Related Party

The Company’s Chief Executive Officer provides advances to the Company from time-to-time for operating expenses. These advances are short-term in nature and are non-interest bearing. At September 30, 2008, amounts due to this related party amounted to $0.

NOTE 6 - NOTES PAYABLE

Sand Hill Finance, LLC

On December 19, 2005, the Company entered into a Financing Agreement with Sand Hill Finance, LLC pursuant to which, together with related amendments, the Company may borrow up to 80% on the Company’s accounts receivable balances up to a maximum of $1,800,000. In conjunction with the acquisition of Inline Corporation in December, 2007, the lending limit on the credit facility was increased to $2,750,000. In addition, the Company and Sand Hill Finance, LLC entered into a 36 month term note agreement in the amount of $1,000,000. Amounts borrowed under the Financing Agreement are secured by a first security interest in substantially all of the Company’s assets. At September 30, 2008, the principal amount due under the Financing Agreement amounted to $1,168,852. The principal amount due under the term note amounted to $919,340. These amounts are included in the notes payable balance of $2,293,560 on the balance sheet at September 30, 2008.

Interest is payable at a rate of 2% per month on the average loan balance outstanding during the year, equal to an annual interest of approximately 24% per year. The Company also agreed to pay an upfront commitment fee of 1% of the credit line upon signing the Financing Agreement, half of which was due and paid upon signing (amounting to $9,000) and half of which is due on the first anniversary of the Financing Agreement. In addition, the Company is obligated to pay a commitment fee of 1% of the credit limit annually, such amounts are payable on the anniversary of the agreement.

In connection with the Financing Agreement, the Company issued Sand Hill Finance, LLC, a seven-year common stock purchase warrant to purchase 25,000 shares of our common stock at an exercise price of $1.00 per share. The warrant contains a cashless exercise provision which means that at the option of the holder, the warrant is convertible into a number of shares of our common stock as determined by dividing the aggregate fair market value of the Company’s common stock minus the aggregate exercise price of the warrant by the fair market value of one share of

common stock. The number of shares issuable upon the exercise of the warrant and the exercise price are subject to adjustment in the event of stock dividends, stock splits and reclassifications. The fair value of the warrant of $16,250 has been recorded as an addition to paid-in capital and interest expense during the year ended September 30, 2007.

In connection with the term loan, the Company issued Sand Hill Finance, LLC a seven-year common stock purchase warrant to purchase 120,000 shares of our common stock at an exercise prices $1.00 per share. The warrant contains a cashless exercise provision which means that at the option of the holder, the warrant is convertible into a number of shares of our common stock as determined by dividing the aggregate fair market value of the Company's common stock minus the aggregate exercise price of the warrant by the fair market value of one share of common stock. The number of shares issuable upon the exercise of the warrant and the exercise price are subject to adjustment in the event of stock dividends, stock splits and reclassifications. The fair value of the warrant of $13,589 has been recorded as an addition to paid-in capital and deferred finance costs during the year ended September 30, 2008.

The Financing Agreement has a term of one year, subject to mutual extension by both parties. As a result, the balance due to Sand Hill Finance, LLC is classified as a current liability on the accompanying consolidated balance sheet.

The terms of the Financing Agreement also restrict the Company from undertaking certain transactions without the written consent of the creditor including (i) permit or suffer a change in control involving 20% of its securities, (ii) acquire assets, except in the ordinary course of business, involving payment of $100,000 or more, (iii) sell, lease, or transfer any of its property except for sales of inventory and equipment in the ordinary course of business, (iv) transfer, sell or license any intellectual property, (v) declare or pay a dividend on stock, except payable in the form of stock dividends (vi) incur any indebtedness other than trade credit in the ordinary course of business and (vii) permit any lien or security interest to attach to any collateral.

Third party guarantee - In November 2006, the Company sold its interest in one of its subsidiaries (Integrated Power Solutions, Inc. or IPS) to a shareholder of the Company and related party. IPS is a party to the Financing Agreement and can borrow against receivables transferred to Sand Hill Finance, LLC under the terms of the Financing Agreement. The Company remains liable for any such amounts borrowed under the Financing Agreement by IPS which is no longer under the Company's control. To date, IPS has not borrowed any funds under the Financing Agreement.

In August, 2008, the Company borrowed $187,500 from an accredited investor. The note bears interest at 16% and had a term of four months, and can be repaid in either cash or IceWEB common stock. As of September 30, 2008 the Company had repaid $41,126 on the note through the sale of 266,500 shares of Iceweb common stock. At September 30, 2008 the outstanding balance on this note was $149,085.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

NOTE 7 - EQUIPMENT FINANCING PAYABLE

On July 6, 2006, the Company entered into what is in essence a sale and leaseback agreement with respect to certain computer and office equipment. The Company received gross proceeds of $300,000 from the sale of the equipment to a third party. As part of the same transaction, the Company entered into an agreement to lease the equipment back from the third party for 36 monthly rent payments of $10,398 until August 2009. The Company is accounting for this equipment financing arrangement as a capital lease. In connection with the agreement, the Company made an initial security deposit of $30,000 and is included in deposits in the balance sheet at September 30, 2008. The equipment had a net book value of $37,846 on the date of the transaction. In connection with the financing, the Company did not record any gain or loss. Imputed interest on this financing is 20% per annum. At September 30, 2008, the amount due under this equipment financing arrangement amounted to $91,807, which is reflected as a current liability on the accompanying balance sheet.

NOTE 8 - COMMITMENTS

The Company leases office space in Dulles, Virginia under a seven-year operating lease that expires on December 31, 2014. The office lease agreement has certain escalation clauses and renewal options. Additionally, the Company has lease agreements for computer equipment an office copy and fax machine. Future minimum rental payments required under these operating leases are as follows:

Years ending September 30:		
2009	$	147,372
2010		147,372
2011		147,372
2012		147,372
2013 and thereafter		294,744
	$	884,232

Rent expense was $326,932 and $199,054 for the years ended September 30, 2008 and 2007.

NOTE 9 - INCOME TAXES

The Company accounts for income taxes under Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes” “SFAS 109”. SFAS 109 requires the recognition of deferred tax assets and liabilities for both the expected impact of differences between the financial statements and the tax basis of assets and liabilities, and for the expected future tax benefit to be derived from tax losses and tax credit carryforwards. SFAS 109 additionally requires the establishment of a valuation allowance to reflect the likelihood of realization of deferred tax assets.

As of September 30, 2008 the Company had unused net operating loss carry forwards of approximately $12,900,000 available to reduce its future federal taxable income. Net operating loss carryforwards expire between fiscal years ending 2021 and 2028. Internal Revenue Code Section 382 places a limitation on the amount of taxable income that can be offset by carryforwards after a change in control (generally a greater than 50% change in ownership).

Deferred Tax Assets:

Tax benefit of net operating loss carry forward	$ 4,865,000
Grant of stock options/restricted stock to employees	838,000
Unpaid accrued salaries	20,000
Amortization of leasehold improvements	49,000
Amortization of intangibles	97,000
	5,869,000
Less: valuation allowance	(5,869,000)
Net deferred tax assets	$ —

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

The table below summarizes the differences between the Company's effective tax rate and the statutory federal rate as follows for fiscal 2008 and 2007. The effective tax rate is 34% Federal and 3.6% State after Federal tax benefit:

	2008	2007
Computed "expected" tax benefit	(34.0)%	(34.0)%
State income taxes	(3.6)%	(3.6)%
Other permanent differences	—	11.6 %
Change in valuation allowance	37.6 %	26.0 %
Effective tax rate	0.0 %	0.0 %

The valuation allowance at September 30, 2008 was $5,869,000. The increase during fiscal 2008 was approximately $2,235,000.

NOTE 10 - CONCENTRATION OF CREDIT RISK

Bank Balances

The Company maintains its cash bank deposits at various financial institutions which, at times, may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. During October 2008, the FDIC increased the insured amounts at participating financial institutions to $250,000 and provided unlimited coverage for non-interest bearing transaction accounts. At September 30, 2008 the Company had no amounts in excess of FDIC insured limits. The Company has not experienced any losses in such accounts.

Major Customers

Sales to ten customers represented approximately 63% of total sales for the year ended September 30, 2008. As of September 30, 2008 approximately 94% of the Company's accounts receivable was due from one customer. Sales to twelve customers represented approximately 50% in 2007.

NOTE 11 - STOCKHOLDERS' DEFICIT

Preferred Stock

The Company's authorized capital includes 10,000,000 shares of blank check preferred stock, par value $0.001 per share, of which 1,666,667 shares have previously been designated as Series A Convertible Preferred Stock. The Company's Board of Directors, without further stockholder approval, may issue our preferred stock in one or more series from time to time and fix or alter the designations, relative rights, priorities, preferences, qualifications,

limitations and restrictions of the shares of each series. In September 2005, the Company's Board of Directors authorized a series of 833,334 shares of blank check preferred stock be designated as Series B Convertible Preferred Stock and on September 28, 2005, the Company filed a Certificate of Designations of Preferences, Rights and Limitations of Series B Preferred with the Secretary of State of Delaware. On December 29, 2005, the Company filed an Amended and Restated Certificate of Designations of Preferences, Rights and Limitations of Series B Convertible Preferred Stock increasing the number of shares authorized under this series to 1,833,334 shares.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

A) Series A Convertible Preferred Stock

The designations, rights and preferences of the Series A Convertible Preferred Stock provide:

- no dividends are payable on the Series A Convertible Preferred Stock. So long as these shares are outstanding, the Company cannot pay dividends on its common stock nor can it redeem any shares of its common stock,

- the shares of Series A Convertible Preferred Stock do not have any voting rights, except as may be provided under Delaware law,

- so long as the shares are outstanding, the Company cannot change the designations of the Series A Convertible Preferred Stock, create a class of securities that in the instance of payment of dividends or distribution of assets upon the Company's liquidation ranks senior to or equal with the Series A Convertible Preferred Stock or increase the number of authorized shares of Series A Convertible Preferred Stock,

- the shares carry a liquidation preference of $0.60 per share,

- each share of Series A Convertible Preferred Stock is convertible at the option of the holder into shares of our common stock, subject to adjustment in the event of stock splits and stock dividends, based upon a conversion value of $0.60 per share, and

- so long as the shares of Series A Convertible Preferred Stock are outstanding, the Company cannot sell or issue any common stock, rights to subscribe for shares of common stock or securities which are convertible or exercisable into shares of common stock at an effective purchase price of less than the then conversion value.

No conversion of the Series A Convertible Preferred Stock may occur if a conversion would result in the holder, Barron Partners LP, and any of its affiliates beneficially owning more than 4.99% of our outstanding common shares following such conversion.

On March 30, 2005, the Company entered into a Preferred Stock Purchase Agreement and related agreements with Barron Partners LP. Under the terms of this agreement, the Company sold Barron Partners LP, an accredited investor, 1,666,667 shares of our Series A Convertible Preferred Stock and issued the purchaser the Common Stock Purchase Warrants “A”, “B” and “C” to purchase an aggregate of 4,500,000 shares of our common stock at exercise prices ranging from $2.00 to $9.60 per share for an aggregate purchase price of $1,000,000. The Company received net proceeds of $900,000 after payment of expenses of $35,000 and a finder's fee to Liberty Company LLC of $65,000. The Company also issued Liberty Company LLC, a broker-dealer, a Common Stock Purchase Warrant “A” exercisable into 175,000 shares of our common stock with an exercise price of $0.70 per share as additional compensation for its services. The Company used these proceeds for general working capital and acquisitions. The transaction was exempt from registration under the Securities Act in reliance on an exemption provided by Section 4(2) of that act.

During fiscal 2008, Series A Preferred stockholders' converted 456,667 share of Series A Preferred Stock into 456,667 shares of common stock.

During fiscal 2007, Series A Preferred stockholders' converted 800,000 share of Series A Preferred Stock into 800,000 shares of common stock.

F-15

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

The Preferred Stock Purchase Agreement provides:

- The Company was required to appoint or elect four additional directors, of whom three directors are required to be independent. In addition, the audit and compensation committees of its Board of Directors are to be comprised solely of independent directors. If at any time after the closing its Board of Directors is not comprised of a majority of qualified independent directors, these independent directors do not make up a majority of the members of the audit and compensation committees of the Board of Directors the Company is required to pay Barron Partners LP liquidated damages of 24% of the purchase price per annum, payable monthly,

- Messrs. John R. Signorello and James Bond, executive officers of the Company at the time, agreed to exchange indebtedness in the principal amount of $325,000, of which approximately $170,000 principal amount was then outstanding, into an aggregate of 541,667 shares of the Company's common stock,

- For a period of three years the Company agreed not to issue any preferred stock, convertible debt or other equity instruments containing reset features. In addition, while the securities issued in the transaction are outstanding, the Company is prohibited from entering into any financing involving a variable rate feature,

- Barron Partners LP was given the right of first refusal to participate in any funding transaction by the Company on a pro rata basis at 94% of the offering price or funding amount received in the transaction,

- If the Company sells notes, shares of its common stock or shares of any class of preferred stock within 24 months from the closing of the offering at an effective price per share of common stock less than the conversion price of the Series A Convertible Preferred Stock then in effect the Company is required to reduce the conversion price of the Series A Convertible Preferred Stock to this lower price,

- Mr. Signorello agreed not to sell any shares of the Company's common stock in excess of 1% of its outstanding shares per quarter or at a price less than $1.50 per share during the two-year period following the closing date. In addition, the remaining officers and directors of our company cannot sell any shares of common stock owned by them for the two year period following the closing date,

- that for a period of three years all employment and consulting agreements must have the unanimous consent of the compensation committee of its Board, and any awards other than salary are usual and appropriate for other officers, directors, employees or consultants holding similar positions in similar publicly held-companies,

- For a period of three years from the closing date the Company agreed not to enter into any new borrowings of more than twice the sum of its EBITDA (earnings before income taxes, depreciation and amortization) from recurring operations over the past four quarters, other than short-term borrowings to purchase products to be resold by us.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

Warrants Issued In the Series A Convertible Preferred Stock Transaction

In connection with the sale of shares of our Series A Convertible Preferred Stock in March 2005, we issued the purchaser the following five-year common stock purchase warrants:

- Common Stock Purchase Warrants "A" to purchase an aggregate of 2,000,000 shares of our common stock at an exercise price of $2.00 per share,

- Common Stock Purchase Warrants "B" to purchase an aggregate of 1,250,000 shares of our common stock at an exercise price of $4.80 per share, and

- Common Stock Purchase Warrants "C" to purchase an aggregate of 1,250,000 shares of our common stock at an exercise price of $9.60 per share.

We also issued Liberty Company LLC, a broker dealer which served as finder for us in the transaction, a Common Stock Purchase Warrant "A" to purchase 175,000 shares of our common stock at an exercise price of $0.70 per share. Other than the exercise price, all other terms of the warrant issued to Liberty Company LLC are identical to the Common Stock Purchase Warrant "A" issued to the purchaser.

The warrants contain a cashless exercise provision which permits the holder, rather than paying the exercise price in cash, to surrender a number of warrants equal to the exercise price of the warrants being exercised. The exercise price of the warrants and the number of shares issuable upon the exercise of the warrants is subject to adjustment in the event of stock splits, stock dividends and reorganizations.

Series A Convertible Preferred Stock and Related Warrants Registration Rights

The Company agreed to file a registration statement within 30 days of the closing for the common shares underlying the securities sold in this offering and to use its best efforts to cause the registration statement to be declared effective by the SEC within 120 days of the closing date of the transaction. The Company agreed to pay Barron Partners liquidated damages of 36% per annum for each day it did not file this registration statement after the initial 30 day period. As the Company did not file the registration statement within 30 days from the closing date of the offering, at June 30, 2005, the Company owed Barron Partners $36,000 representing the failure to file penalty. In addition, the Company agreed to pay Barron Partners liquidated damages of 36% per annum for each day the registration statement was not effective beginning on July 30, 2005 through the earlier of the effective date of the registration statement or March 30, 2007. The Company received a waiver from Barron, whereby Barron waived any penalties due pursuant to the Registration Rights Agreement.

B) Series B Convertible Preferred Stock

The designations, rights and preferences of the Series B Convertible Preferred Stock provide:

- no dividends are payable on the Series B Convertible Preferred Stock. So long as these shares are outstanding, the Company cannot pay dividends on our common stock nor can it redeem any shares of its common stock, the shares of Series B Convertible Preferred Stock do not have any voting rights, except as may be provided under Delaware law,

- so long as the shares are outstanding, the Company cannot change the designations of the Series B Convertible Preferred Stock, create a class of securities that in the instance of payment of dividends or distribution of assets upon our liquidation ranks senior to or pari passu with the Series B Convertible Preferred Stock or increase the number of authorized shares of Series B Convertible Preferred Stock, the shares carry a liquidation preference of $0.2727 per share,

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

- each share of Series B Convertible Preferred Stock is convertible at the option of the holder into one share of the Company's common stock based upon an initial conversion value of $0.2727 per share. The conversation ratio is subject to adjustment in the event of stock dividends, stock splits or reclassification of the Company's common stock. The conversion ratio is also subject to adjustment in the event the Company should sell any shares of its common stock or securities convertible into common stock at an effective price less than the conversion ratio then in effect, in which case the conversion ratio would be reduced to the lesser price. No conversion of the Series B Convertible Preferred Stock may occur if a conversion would result in the holder, Barron Partners LP, and any of its affiliates beneficially owning more than 4.9% of our outstanding common shares following such conversion,

- so long as the Series B Convertible Preferred Stock is outstanding, the Company has agreed not to issue any rights, options or warrants to holders of its common stock entitling the holders to purchase shares of its common stock at less than the conversion ratio without the consent of the holders of a majority of the outstanding shares of Series B Convertible Preferred Stock. If the Company should elect to undertake such an issuance and the Series B holders consent, the conversion ratio would be reduced. Further, if the Company should make a distribution of any evidence of indebtedness or assets or rights or warrants to subscribe for any security to our common stockholders, the conversion value would be readjusted,

- the shares of Series B Convertible Preferred Stock automatically convert into shares of the Company's common stock in the event of change of control of the Company, and

- so long as the shares of Series B Convertible Preferred Stock are outstanding, the Company cannot sell or issue any common stock, rights to subscribe for shares of common stock or securities which are convertible or exercisable into shares of common stock at an effective purchase price of less than the then conversion value of the Series B Convertible Preferred Stock.

During fiscal 2008, Series B Preferred stockholders' converted 580,000 share of Series B Preferred Stock into 580,000 shares of common stock.

On December 28, 2005, the Company consummated a Preferred Stock Purchase Agreement and related agreements with Barron Partners LP. Under the terms of these agreements, the Company issued Barron Partners LP, an accredited investor, 1,833,334 shares of its Series B Convertible Preferred Stock and Common Stock Purchase Warrants "D", "E" and "F" to purchase an aggregate of 2,250,000 shares of its common stock at exercise prices ranging from $2.00 to $9.60 per share, for an aggregate purchase price of $500,000. The Company received net proceeds of $475,000 after payment of commissions of $25,000 (before placement expenses). The Company used these proceeds for general working capital. The transaction was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 4(2) of that act.

On the date of issuance of the Series B Preferred Stock, the effective conversion price was at a discount to the price of the common stock into which it was convertible. In fiscal 2006, the Company recorded a $500,000 preferred stock dividend related to the beneficial conversion feature and the fair value of the warrants granted in connection with the preferred stock.

Under the terms of the Preferred Stock Purchase Agreement, the Company agreed:

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that all convertible debt in the Company would be cancelled and that for a period of three years from the closing date the Company will not issue any convertible debt or preferred stock. In addition, the Company agreed to cause all reset features related to any shares of its outstanding common stock to be cancelled and for a period of three years from the closing date to refrain from entering into any transactions that have reset features,

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

- to maintain a majority of independent directors on its Board of Directors, and that these independent directors will make up a majority of the audit and compensation committees of its Board. If at any time the Company should fail to maintain these independent majority requirements, the Company is required to pay Barron Partners LP liquidated damages of 24% of the purchase price of the securities ($120,000) per annum, payable monthly in kind,

- that if within 24 months from the closing date the Company consummates the sale of debt or equity securities with a conversion price less than the then effective conversion price of the Series B Convertible Preferred Stock, the Company will make a post-closing adjustment in the conversion price of the Series B Convertible Preferred Stock to such lower conversion price,

- that for a period of three years all employment and consulting agreements must have the unanimous consent of the compensation committee of its Board, and any awards other than salary are usual and appropriate for other officers, directors, employees or consultants holding similar positions in similar publicly held-companies,

- that for a period of two years from the closing the Company will not enter into any new borrowings of more than twice as much as the sum of EBITDA from recurring operations over the past four quarters, subject to certain exceptions,

- that for long as Barron Partners LP holds any of the securities, the Company will not enter into any subsequent financing in which we issue or sell any debt or equity securities with a floating conversion price or containing a reset feature, and

- that the Company will submit a proposal at its next annual meeting of stockholders to amend our Certificate of Incorporation to require the consent of the holders of a designated percentage of a designated class of its securities to waive or amend the terms of any rights, options and warrants approved by its Board.

Mr. John R. Signorello, the Company's CEO, agreed not to sell any shares of the Company's common stock that he may own in excess of 1% per quarter or at a price of less than $1.50 per share for a period ending August 30, 2007, and that the earliest any other insiders could sell their shares would be beginning two years from the closing date.

The Company granted Barron Partners LP a right of first refusal to participate in any subsequent funding the Company may undertake on a pro rata basis at 94% of the offering price.

Warrants Issued In the Series B Convertible Preferred Stock Transaction

In connection with the sale of shares of the Company's Series B Convertible Preferred Stock, the Company issued the purchaser the following common stock purchase warrants:

- Common Stock Purchase Warrants "D" to purchase an aggregate of 1,000,000 shares of our common stock at an exercise price of $2.00 per share,

- Common Stock Purchase Warrants "E" to purchase an aggregate of 625,000 shares of our common stock at an exercise price of $4.80 per share, and

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Common Stock Purchase Warrants “F” to purchase an aggregate of 625,000 shares of our common stock at an exercise price of $9.60 per share.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

The Company also issued Liberty Company LLC, a broker dealer which served as finder for the Company in the transaction, a Common Stock Purchase Warrant “G” to purchase 25,000 shares of its common stock at an exercise price of $1.00 per share. Other than the exercise price, all other terms of the warrant issued to Liberty Company LLC are identical to the Common Stock Purchase Warrants “E” and “F” issued to the purchaser.

The expiration date of the warrants is five years, or 18 months after effectiveness of a registration statement subsequent to the issuance hereof with such 18 months to be extended by one month for each month or portion of a month during which such registration statement’s effectiveness has lapsed or been suspended, whichever is longer. The warrants contain a cashless exercise provision which permits the holder, rather than paying the exercise price in cash, to surrender a number of warrants equal to the exercise price of the warrants being exercised. The holder cannot utilize the cashless exercise feature during the first six months of the term or so long as there is an effective registration statement covering the shares of common stock underlying the warrants. The exercise price of the warrants and the number of shares issuable upon the exercise of the warrants is subject to adjustment in the event of stock splits, stock dividends and reorganizations, as well as if we issue common stock or securities convertible into common stock at an effective price less than the then current exercise price of the warrant.

As with the shares of Series B Convertible Preferred Stock, no exercise of these warrants may occur if a conversion would result in the holder, Barron Partners LP, and any of its affiliates beneficially owning more than 4.9% of the Company’s outstanding common shares following such exercise. This limitation, however, immediately terminates as to the warrants in the event of the sale of all or substantially all of the Company’s assets or a merger or consolidation in which the Company is not the surviving entity.

If the Company’s common stock trades at or above $2.85 per share for 20 consecutive trading days, upon notice from the Company the holder must exercise the Common Stock Purchase Warrant “D” within 45 days, or transfer the warrant to a third party. If the holder elects to so transfer the warrant, the new holder then has an additional 45 days to exercise the Common Stock Purchase Warrant “D”. If the Company called the warrants and all or any portion of the warrants are not exercised within these respective periods, the unexercised Common Stock Purchase Warrants “D” will terminate.

Series B Convertible Preferred Stock and Related Warrants Registration Rights

The Company agreed to file a registration statement with the Securities and Exchange Commission within 30 days to register for resale the shares of common stock issuable upon the possible conversion of the Series B Convertible Preferred Stock and the exercise of the warrants, and to use our best efforts to cause such registration statement to be declared effective within 120 days from the closing date. The Company has also granted Barron Partners LP demand registration rights covering these securities, as well as piggy-back registration rights for a period of two years from the closing date. The Company paid all costs associated with these registration statements and have indemnified Barron Partners LP with respect thereto for any losses or claims related to material misstatements or material omissions by the Company in the registration statement(s). The Company received a waiver from Barron, whereby Barron waived any penalties due pursuant to the Registration Rights Agreement.

Common Stock

Fiscal 2007 Transactions

During fiscal 2007, Series A preferred stockholders' converted 800,000 shares of Series A Preferred Stock into 800,000 shares of common stock.

On March 9, 2007, we issued 339,606 shares of our common stock in satisfaction of accrued interest in the amount of $169,803, the fair market value on that day related to a promissory note. The recipient was an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 3(a)(9) of that act.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

On June 5, 2007 we issued 25,000 shares of common stock valued at $15,500, the fair market value on that day to Harold Compton, a member of our Board of Directors, as additional compensation for his having the role as lead director. The recipient was an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 4(2) of that act.

On June 29, 2007, we issued 200,000 shares of our common stock in satisfaction of a promissory note in the amount of $150,000, plus accrued interest of $96,875. The recipient was an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 3(a)(9) of that act. The fair market value of the shares on the date of the transaction was $114,000, and this transaction resulted in a gain on the extinguishment of debt of $132,875, which is included in general and administrative expense in the statement of operations.

On July 5, 2007, we issued 500,000 shares of our common stock in satisfaction a debt in the amount of $200,000. The recipient was an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 3(a)(9) of that act. The fair market value of the shares on the date of the transaction was $335,000, and this transaction resulted in a loss on the extinguishment of debt of $115,000, which is included in general and administrative expense in the statement of operations.

On August 28, 2007 we sold 350,000 shares of common stock at a per share price of $0.50, valued at $175,000 to Harold Compton, a member of our Board of Directors. The acquirer was an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 4(2) of that act.

In fiscal 2007, in connection with the exercise of 1,167,800 stock options, the Company issued 1,167,800 shares of common stock for cash proceeds of $491,358.

During fiscal 2007, in connection with the exercise of 1,200,000 stock warrants, the Company issued 1,200,000 shares of common stock for cash proceeds of $491,000.

Fiscal 2008 Transactions

During fiscal 2008, Series A preferred stockholders' converted 456,667 shares of Series A Preferred Stock into 456,667 shares of common stock.

During fiscal 2008, Series B preferred stockholders' converted 580,000 shares of Series B Preferred Stock into 580,000 shares of common stock.

On August 28, 2007 we sold 400,000 shares of common stock at a per share price of $0.20, valued at $80,000 to an accredited investor, and the issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 4(2) of that act.

In fiscal 2008, in connection with the exercise of 1,780,000 stock options, the Company issued 1,780,000 shares of common stock for cash proceeds of $219,200.

During fiscal 2008, in connection with the cashless exercise of 5,250,000 stock warrants, the Company issued 2,525,000 shares of common stock.

During fiscal 2008, in connection with the payment on a note payable discussed in Note 6, the Company issued 266,500 shares of common stock. The shares were valued at $41,126, the fair market value in the date of issuance.

During fiscal 2008, in connection with the payment for consulting services rendered, the Company issued 2,086,250 shares of common stock. The services were valued at $1,096,663, the fair market value on the date of issuance.

During fiscal 2008, in connection with the acquisition of Inline Corporation, the Company issued 503,356 shares of common stock. The shares were valued at $276,846, the fair market value on the date of issuance.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

During fiscal 2008 the Company issued 2,950,000 shares of common stock to employees, valued at $1,076,700, the fair market value at the time of issuance, as additional compensation.

Common Stock Warrants

In February 2006, the Company reduced the exercise price of common stock purchase warrants to purchase 4,500,000 shares of common stock, all of which are held by Barron Partners LP, to $1.00 per share through December 31, 2006. On March 17, 2006, the Company further reduced the exercise price of 500,000 warrants to purchase 500,000 shares of common stock to $.80 during the period from March 17, 2006 through March 31, 2006. On October 20, 2006, the Company further reduced the exercise price of warrants to purchase 1,000,000 shares of common stock to $.35 during the period from October 17, 2006 through November 10, 2006. To the extent that those warrants were not exercised by 5:30 PM Eastern time, on November 10, 2006, the exercise price of those warrants reverted to $1.00 per share through December 31, 2006 and at that time the warrants reverted back to the original exercise price.

On February 24, 2007 the Company agreed to amend the common stock purchase warrant agreements to purchase 4,500,000 shares of common stock, all of which were held by Barron Partners LP, to $1.00 per share. These common stock purchase warrants were previously priced from $2.00 to $9.60. On April 25, 2007, the Company further reduced the exercise price of 1,000,000 warrants to purchase 1,000,000 shares of common stock to $.60 during the period from April 25 through April 30, 2007. To the extent that those warrants were not exercised by 5:30 PM Eastern time, on April 30, 2007, the exercise price of those warrants reverted to $1.00 per share. On July 12, 2007, the Company reduced the exercise price of warrants to purchase 100,000 shares of common stock to $.50 during the period from July 13, 2007 through July 15, 2007. To the extent that those warrants were not exercised by 5:30 PM Eastern time, on July 15, 2007, the exercise price of those warrants reverted to $1.00 per share. On July 23, 2007, the Company reduced the exercise price of warrants to purchase 100,000 shares of common stock to $.50 during the period from July 23, 2007 through July 23, 2007. To the extent that those warrants were not exercised by 5:30 PM Eastern time, on July 23, 2007, the exercise price of those warrants reverted to $1.00 per share. On August 13, 2007, the Company reduced the exercise price of warrants to purchase 80,000 shares of common stock to $.55 during the period from August 13, 2007 through August 14, 2007. To the extent that those warrants were not exercised by 5:30 PM Eastern time, on August 14, 2007, the exercise price of those warrants reverted to $1.00 per share.

In April, 2008 5,250,000 common stock purchase warrants were converted on a cashless basis into 2,525,000 shares of common stock.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

A summary of the status of the Company's outstanding common stock warrants as of September 30, 2008 and changes during the period ending on that date is as follows:

	Year Ended September 30, 2008			Year Ended September 30, 2007		
	Number of Warrants		Weighted Average Exercise Price	Number of Warrants		Weighted Average Exercise Price
Common Stock Warrants						
Balance at beginning of year	5,955,000	$	1.25	7,055,000	$	4.88
Granted	120,000		1.00	250,000		0.59
Exercised	(5,150,000)		0.28	(1,350,000)		0.80
Forfeited	(625,000)		2.79	—		0.00
Balance at end of year	300,000	$	1.25	5,955,000	$	1.25
Warrants exercisable at end of year	300,000	$	2.18			
Weighted average fair value of warrants granted or re-priced during the year		$	1.00			

The following table summarizes information about common stock warrants outstanding at September 30, 2008:

	Warrants Outstanding			Warrants Exercisable	
Range of Exercise Price	Number Outstanding at September 30, 2008	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at September 30, 2008	Weighted Average Exercise Price
0.65	75,000	0.92 Years	0.65	75,000	0.65
1.00	145,000	5.34 Years	1.00	145,000	1.00
2.00	5,000	2.81 Years	2.00	5,000	2.00
4.00	37,500	1.25 Years	4.00	37,500	4.00
8.00	37,500	1.25 Years	8.00	37,500	8.00
	300,000		$ 2.18	300,000	$ 2.18

NOTE 12 - STOCK OPTION PLAN

In August 2000, the Board of Directors adopted the 2000 Management and Director Equity Incentive and Compensation Plan the "Plan") for directors, officers and employees that provides for non-qualified and incentive stock options to be issued enabling holders thereof to purchase common shares of the Company at exercise prices determined by the Company's Board of Directors. The Plan was approved by the Company's stockholders in August 2001.

The purpose of the Plan is to advance the Company’s interests and those of its stockholders by providing a means of attracting and retaining key employees, directors and consultants. In order to serve this purpose, the Company believes the Plan encourages and enables key employees, directors and consultants to participate in its future prosperity and growth by providing them with incentives and compensation based on its performance, development and financial success. Participants in the Plan may include the Company’s officers, directors, other key employees and consultants who have responsibilities affecting our management, development or financial success.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

Awards may be made under the Plan in the form of Plan options, shares of the Company's common stock subject to a vesting schedule based upon certain performance objectives ("Performance Shares") and shares subject to a vesting schedule based on the recipient's continued employment ("restricted shares"). Plan options may either be options qualifying as incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended or options that do not so qualify. Any incentive stock option granted under the Plan must provide for an exercise price of not less than 100% of the fair market value of the underlying shares on the date of such grant, but the exercise price of any incentive option granted to an eligible employee owning more than 10% of our common stock must be at least 110% of such fair market value as determined on the date of the grant. Only persons who are officers or other key employees are eligible to receive incentive stock options and performance share grants. Any non-qualified stock option granted under the Plan must provide for an exercise price of not less than 50% of the fair market value of the underlying shares on the date of such grant.

As amended in fiscal 2007, the Plan permits the grant of options and shares for up to 10,000,000 shares of the Company's common stock. The Plan terminates 10 years from the date of the Plan's adoption by the Company's stockholders.

The term of each Plan option and the manner in which it may be exercised is determined by the Board of Directors, provided that no Plan option may be exercisable more than three years after the date of its grant and, in the case of an incentive option granted to an eligible employee owning more than 10% of the Company's common stock, no more than five years after the date of the grant. The exercise price of the stock options may be paid in either cash, or delivery of unrestricted shares of common stock having a fair market value on the date of delivery equal to the exercise price, or surrender of shares of common stock subject to the stock option which has a fair market value equal to the total exercise price at the time of exercise, or a combination of the foregoing methods.

The fair value of stock options granted was estimated at the date of grant using the Black-Scholes options pricing model. The Company used the following assumptions for determining the fair value of options granted under the Black-Scholes option pricing model:

	Year Ended September 30,	
	2008	2007
Expected volatility	51% - 62%	76% - 107%
Expected term	1 - 5 Years	3 - 5 Years
Risk-free interest rate	2.34% - 4.38%	4.39% - 4.96%
Forfeiture Rate	0% - 45%	0% - 35%
Expected dividend yield	0%	0%

The expected volatility was determined with reference to the historical volatility of the Company's stock. The Company uses historical data to estimate option exercise, employee termination, and forfeiture rate within the valuation model. The expected term of options granted represents the period of time that options granted are expected

to be outstanding. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury rate in effect at the time of grant.

For the year ended September 30, 2008, total stock-based compensation charged to operations for option-based arrangements amounted to $910,930. At September 30, 2008, there was approximately $820,470 of total unrecognized compensation expense related to non-vested option-based compensation arrangements under the Plan.

IceWEB, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended September 30, 2008 and 2007

A summary of the status of the Company's outstanding stock options as of September 30, 2008 and changes during the period ending on that date is as follows:

	Year Ended September 30, 2008			Year Ended September 30, 2007		
	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value
Stock options						
Balance at beginning of year	5,212,219	$ 0.61	$	1,493,806	$ 1.00	$
Granted	7,310,000	0.27		6,225,000	0.55	
Exercised	(1,765,000)	0.12		(967,800)	0.51	
Forfeited	(4,173,392)	0.49		(1,538,787)	0.76	
Balance at end of year	6,583,827	$ 0.45	$ 92,650	5,212,219	$ 0.61	$285,570
Options exercisable at end of year	4,123,134	$ 0.48	$ 10,560	2,295,527	$ 0.63	$236,766
Weighted average fair value of options granted during the year		$ 0.27			$ 0.55	

The following table summarizes information about employee stock options outstanding at September 30, 2007:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number Outstanding at September 30, 2008	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at September 30, 2008	Weighted Average Exercise Price
$ 0.001-0.25	1,850,000	3.44 Years	$ 0.11	1,096,000	$ 0.18
0.30-0.48	1,045,000	3.20 Years	0.41	784,050	0.40
0.54-0.60	2,531,608	3.81 Years	0.58	1,236,873	0.58
0.61-0.80	1,137,500				