

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2011

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File Number: 001-32421**

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**58-2342021**

(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

**420 Lexington Avenue, Suite 1718, New York, New York 10170**

(Address of principal executive offices) (Zip Code)

**(212) 201-2400**

(Registrants telephone number, including area code)

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: November 9, 2011.

Title Of Each Class	Number of Shares Outstanding
Common Stock, \$0.01 par value	148,254,997

## FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES

### EXPLANATORY NOTE

This Amendment No. 1 to our Form 10-Q for the quarterly period ended September 30, 2011 is filed to provide the interactive data files required by Item 6 of Form 10-Q, as well as an additional exhibit that was not contained in the original Form 10-Q. There is no change to the Company's financial position, results of operations, cash flows or any other information contained in the Company's original Form 10-Q for the quarterly period ended September 30, 2011, which was filed on November 15, 2011. This Amendment No. 1 to the Form 10-Q speaks as of the original filing date of the Form 10-Q, does not reflect events that may have occurred subsequent to the original filing date, and does not modify or update in any way disclosures made in the original Form 10-Q.

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**Condensed Consolidated Interim Statements of Operations**  
(Unaudited)

	<b>Three Months Ended September 30,</b>		<b>Nine Month's Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Income Statement</b>				
<b>Revenue</b>	\$ 9,931,247	\$ 11,149,973	\$ 30,778,563	\$ 30,465,806
<b>Operating expenses:</b>				
Cost of revenues exclusive of depreciation and amortization	8,820,457	10,108,777	27,621,852	27,526,331
Depreciation and amortization	101,137	198,106	418,205	637,891
Selling general and administrative expenses (including \$38,603 and \$101,897 of stock-based compensation for the three months ended September 30, 2011 and 2010, respectively and \$71,991 and \$238,942 for the nine months ended September 30, 2011 and 2010, respectively)	2,051,647	2,202,399	6,218,391	6,594,291
Advertising and marketing	1,613	15,358	6,995	36,554
Total operating expenses	<u>10,974,854</u>	<u>12,524,640</u>	<u>34,265,443</u>	<u>34,795,067</u>
<b>Operating loss</b>	<u>(1,043,607)</u>	<u>(1,374,667)</u>	<u>(3,486,880)</u>	<u>(4,329,261)</u>
<b>Other income (expenses):</b>				
Interest income	4,567	141	4,724	384
Interest expense	(41,999)	(42,662)	(146,168)	(146,969)
Other	(27,101)	160,161	82,728	178,390
Total other income (expenses)	<u>(64,533)</u>	<u>117,640</u>	<u>(58,716)</u>	<u>31,805</u>
Loss from continuing operations	(1,108,140)	(1,257,027)	(3,545,596)	(4,297,456)
<b>Discontinued operations:</b>				
Discontinued operations	(2,833)	6,224	5,531	(82,132)
<b>Net loss</b>	<u>\$ (1,110,973)</u>	<u>\$ (1,250,803)</u>	<u>\$ (3,540,065)</u>	<u>\$ (4,379,588)</u>
<b>Loss applicable to common stockholders:</b>				
Loss from continuing operations	\$ (1,108,140)	\$ (1,257,027)	\$ (3,545,596)	\$ (4,297,456)
Preferred stock dividends in arrears	(101,729)	(147,099)	(368,446)	(436,501)
<b>Net loss from continuing operations applicable to common stockholders:</b>	(1,209,869)	(1,404,126)	(3,914,042)	(4,733,957)
Discontinued operations	(2,833)	6,224	5,531	(82,132)
<b>Net loss applicable to common stockholders:</b>	<u>(1,212,702)</u>	<u>(1,397,902)</u>	<u>(3,908,511)</u>	<u>(4,816,089)</u>
<b>Basic and diluted loss per common share:</b>				
Loss from continuing operations per common share	\$ (\$0.01)	\$ (\$0.01)	\$ (\$0.03)	\$ (\$0.04)
Loss from discontinued operations per common share	(0.00)	0.00	0.00	(0.00)
<b>Loss per common share</b>	<u>\$ (\$0.01)</u>	<u>\$ (\$0.01)</u>	<u>\$ (\$0.03)</u>	<u>\$ (\$0.04)</u>
<b>Weighted average common shares outstanding:</b>				
Basic and diluted	<u>144,588,746</u>	<u>125,861,331</u>	<u>138,994,794</u>	<u>110,401,741</u>

See accompanying notes to the Condensed Consolidated Interim Financial Statements.

## Condensed Consolidated Interim Statements of Cash Flows (Unaudited)

	Nine Months Ended September 30,	
	2011	2010
<b>Statement of Cash Flows</b>		
<b>Cash flows from operating activities:</b>		
Net loss	\$ (3,540,065)	\$ (4,379,588)
Discontinued operations	(5,531)	82,132
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Depreciation and amortization	418,205	637,891
Loss on disposal of fixed assets	24,614	
Bad debt expense	150,407	(17,954)
Stock-based compensation	71,991	238,942
Settlement of vendor liability	(75,000)	(159,500)
<b>Increase (decrease) in cash attributable to changes in operating assets and liabilities:</b>		
Accounts receivable	(59,029)	(478,904)
Prepaid expenses and other current assets	(162,333)	(42,040)
Other assets	10,254	8,109
Payments of security deposits	(1,250)	(10,099)
Accounts payable and accrued expenses	58,338	(165,695)
Other long-term liabilities	(23,134)	107,507
<b>Net cash used in operating activities</b>	<b>(3,132,533)</b>	<b>(4,179,199)</b>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(57,387)	(146,170)
Increase in restricted cash	(4,490)	(285,046)
<b>Net cash used in investing activities</b>	<b>(61,877)</b>	<b>(431,216)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from the sale of common stock, net	681,005	3,582,815
Proceeds from the sale of common stock not yet issued	0	50,000
Proceeds from notes payable - related parties	3,014,740	1,348,000
Proceeds from notes payable - non-related parties	208,382.00	100,000
Payments on capital lease/equipment financing obligations	208,382	(9,373)
Repayments of notes payable - related parties	(277,000)	(245,000)
Repayments of notes payable - non-related parties	(383,870)	(10,155)
<b>Net cash provided by financing activities</b>	<b>3,240,670</b>	<b>4,816,287</b>
<b>Net increase (decrease) in cash and cash equivalents from continuing operations</b>	<b>46,260</b>	<b>205,872</b>
<b>Cash flows from discontinued operations:</b>		
Cash used in provided by operating activities of discontinued operations	(44,755)	(47,403)
<b>Net change in cash and cash equivalents:</b>		
<b>Net change in cash and cash equivalents</b>	1,505	158,469
<b>Cash and cash equivalents - start of period</b>	20,370	99,019
<b>Cash and cash equivalents - end of period</b>	<b>\$ 21,875</b>	<b>\$ 257,488</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	\$ 19,421	\$ 40,247
<b>Supplemental schedule of non-cash investing and financing activities:</b>		
Conversion of notes payable - related parties to common stock	\$ 245,000	\$ 724,800
Conversion of notes payable - non related parties to common stock	\$ 300,000	\$ 200,000
Conversion of interest payable to common stock	\$ 17,809	\$ 19,982
Transfer from escrow payable to common stock	\$ 0	\$ 321,417
Transfer from equity to escrow payable - shares to vendor, not yet issued	\$ 0	\$ 75,000
Transfer from trade payables to escrow payable - shares to vendor, not yet issued	\$ 0	\$ 30,000
Preferred stock converted into common stock	\$ 2,500,000	\$ 0

See accompanying notes to the Condensed Consolidated Interim Financial Statements

## NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

### 1. Basis of Presentation, Consolidation, and Summary of Selected Significant Accounting Policies

The accompanying notes to the condensed consolidated interim financial statements should be read in conjunction with the Annual Report on Form 10-K for the fiscal year ended December 31, 2010 for Fusion Telecommunications International, Inc. and its Subsidiaries (collectively, the "Company"). All material intercompany balances and transactions have been eliminated in consolidation. These condensed consolidated interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 8 of Regulation S-X of the United States Securities and Exchange Commission (the "SEC") and therefore omit or condense certain footnotes and other information normally included in condensed consolidated interim financial statements prepared in accordance with accounting principles generally accepted in the United States of America (the "U.S. GAAP"). In the opinion of the Company's management, all adjustments (consisting of normal recurring accruals) considered necessary for the fair presentation of the condensed consolidated interim financial statements have been made. The results of operations for an interim period are not necessarily indicative of the results for the entire year.

During the three and nine months ended September 30, 2011 and 2010, comprehensive loss was equal to the net loss amounts presented for the respective periods in the accompanying condensed consolidated interim statements of operations. In addition, certain prior year balances have been reclassified to conform to the current presentation.

#### Income taxes

The Company complies with accounting and reporting requirements with respect to accounting for income taxes, which require an asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities that will result in future taxable or deductible amounts, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amount expected to be realized. In accordance with U.S. GAAP, the Company is required to determine whether a tax position of the Company is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. De-recognition of a tax benefit previously recognized could result in the Company recording a tax liability that would reduce net assets. The Company is subject to income tax examinations by major taxing authorities for all tax years since 2008 and may be subject to review and adjustment at a later date based on factors including, but not limited to, on-going analyses of and changes to tax laws, regulations and interpretations thereof. During the three and nine month periods ended September 30, 2011, the Company recognized no adjustments for uncertain tax positions.

#### Loss per share

The Company complies with the accounting and disclosure requirements regarding earnings per share. Basic loss per share excludes dilution and is computed by dividing loss attributable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income of the Company.

Unexercised options to purchase 5,244,761 and 5,917,875 shares of the Company's common stock as of September 30, 2011 and 2010, respectively, and unexercised warrants to purchase 45,452,877 and 42,171,097 shares of the Company's common stock as of September 30, 2011 and 2010, respectively, were not included in the computation of diluted loss per share because the inclusion of these securities would be anti-dilutive. The net loss per common share calculation includes a provision for preferred stock dividends in the approximate amount of \$368,000 and \$437,000 for the nine months ended September 30, 2011 and 2010, respectively. As of September 30, 2011, the Board of Directors had not declared any dividends on the Company's preferred stock. As of September 30, 2011, the Company has accumulated approximately \$2,622,000 of preferred stock dividends.

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES**

**Discontinued operations**

The Company classifies a business component that has either been disposed of or is classified as held for sale as a discontinued operation if the cash flow of the component has been or will be eliminated from ongoing operations and the Company will no longer have any significant continuing involvement in the component. The results of operations of the discontinued component through the date of disposition, including any gains or losses on disposition, are aggregated and presented separately in the condensed consolidated interim statements of operations. See note 5 for additional information regarding discontinued operations.

**Stock-based compensation**

The Company accounts for stock-based compensation by recognizing the fair value of the compensation cost for all stock awards over their respective service periods (generally equal to the vesting period). This compensation cost is determined using option pricing models intended to estimate the fair value of the awards at the date of grant using the Black-Scholes option-pricing model. An offsetting increase to stockholders' equity is recorded equal to the amount of the compensation expense charge.

Stock-based compensation expense recognized in the condensed consolidated interim statements of operations for the three and nine months ended September 30, 2011 and 2010 includes compensation expense for stock-based payment awards granted prior to September 30, 2011 but not yet vested, based on the estimated grant date fair value. As stock-based compensation expense recognized in the condensed consolidated statements of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. When estimating forfeitures, the Company considered historical forfeiture rates as well as ongoing trends for actual option forfeiture.

The impact of stock-based compensation expense on the Company's results of continuing operations was approximately \$39,000 and \$102,000 for the three months ended September 30, 2011 and 2010, respectively, and approximately \$72,000 and \$239,000 for the nine months ended September 30, 2011 and 2010, respectively. These amounts are included in selling, general, and administrative expenses in the condensed consolidated interim statements of operations.

The following table summarizes the stock option activity for the nine months ended September 30, 2011:

Activity	(unaudited) Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2010	5,722,375	\$ 0.96
Granted	121,500	\$ 0.09
Cancelled or expired	(599,114)	\$ 1.15
Outstanding at September 30, 2011	5,244,761	\$ 0.92
Exercisable at September 30, 2011	3,896,975	\$ 1.2

The Company calculated the fair value of each common stock option grant on the date of grant using the Black-Scholes option-pricing model method with the following assumptions:

	(unaudited)	
	Nine Months Ended September 30,	
	2011	2010
Dividend yield	0%	0%
Stock volatility	123.01-179.70%	131.38%
Average Risk-free interest rate	1.45-2.46%	2.4%
Average option term (years)	4	4

As of September 30, 2011, there was approximately \$43,000 of total unrecognized compensation cost, net of estimated forfeitures, related to stock options granted under the Company's Stock Incentive Plans, which is expected to be recognized over a weighted-average period of 1.64 years.

**Fair value of financial instruments**

The carrying amounts of the Company's assets and liabilities approximate the fair value presented in the accompanying Condensed Consolidated Interim Balance Sheets, due to their short-term maturities.

## FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES

### Use of estimates

The preparation of condensed consolidated interim financial statements in conformity with U.S. GAAP 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 condensed consolidated interim financial statements and the reported amounts of revenues and expenses during the period. Actual results could be affected by the accuracy of those estimates.

### Restricted cash

The Company had approximately \$538,000 and \$533,000 of cash restricted from withdrawal and held by banks as certificates of deposit securing letters of credit as of September 30, 2011 and December 31, 2010, respectively. This restricted cash is required as security deposits under the Company's non-cancelable operating leases for office facilities. See note 15, Subsequent Events, regarding the Company's restricted cash.

## 2. Going Concern

At September 30, 2011, the Company had a working capital deficit of \$11.7 million and an accumulated deficit of \$148.5 million. The Company has continued to sustain losses from operations and has not generated positive cash flow from operations since inception. Management is aware that its current cash resources are not adequate to fund its operations for the remainder of the year. During the nine months ended September 30, 2011, the Company raised approximately \$3.4 million, net of expenses, from the issuance of related party promissory notes and the sale of the Company's securities. The Company cannot provide any assurances if and when it will be able to attain profitability. These conditions, among others, raise substantial doubt about the Company's ability to continue operations as a going concern. No adjustment has been made in the condensed consolidated interim financial statements to the amounts and classification of assets and liabilities which could result should the Company be unable to continue as a going concern.

## 3. Sale of Accounts Receivable

On September 12, 2011 the Company entered into a purchase and sale agreement with Prestige Capital Corporation ("Prestige"), whereby the Company can sell certain of its accounts receivable to Prestige at a discount in order to improve the Company's liquidity and cash flow. The initial sale of receivables closed on September 19, 2011 and the Company sold receivables to Prestige with a book value of approximately \$470,000. The Company recognized a loss on the sale of those receivables of approximately \$8,000. In connection with this sale and in accordance with the purchase and sale agreement, Prestige paid the Company 75% of the face amount of the receivables, or approximately \$352,000, on the closing date. The remainder, net of the discount, will be paid to the Company within four business days after Prestige receives payment on the receivables, which generally have 30 day terms. The Company has the option to make additional sales of accounts receivable provided they meet the criteria outlined in the agreement, the term of which is for nine months. The transfer of accounts receivable to Prestige under this agreement meet the criteria for a sale of financial assets. As a result, such receivables have been derecognized from the Company's consolidated balance sheet as of September 30, 2011.

Prestige also provided the Company with a one-time advance of \$208,382 on the closing date. This advance is secured by a priority lien on the Company's accounts receivable; however it is not attributable to a transfer of specific accounts receivable and is therefore reflected as a note payable to non-related parties in the accompanying consolidated balance sheet as of September 30, 2011. The proceeds from the advance were used to pay down other unrelated party indebtedness and for general corporate purposes. The advance is payable in 25 equal weekly installments beginning in October 2011 and an advance fee of approximately \$15,000 is payable 180 days after the closing date. The advance fee is being recognized under the interest method over the term of the advance.

## 4. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following at September 30, 2011 and December 31, 2010:

	<u>September 30, 2011</u> (unaudited)	<u>December 31, 2010</u>
Prepaid insurance	\$ 95,561	\$ 59,805
Due from Prestige (see note 3)	109,822	-
Inventory	-	4,243
Other prepaid expenses	<u>59,958</u>	<u>38,961</u>
<b>Total</b>	<b><u>\$ 265,341</u></b>	<b><u>\$ 103,009</u></b>

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES**

**5. Discontinued Operations**

In 2009, in order to streamline operations, reduce expenses, and focus on the development of the Company's corporate services and carrier services segments, the Company eliminated the consumer services segment and restructured its overall operations. In accordance with requirements under U.S. GAAP, the Company has classified the operating results of its consumer services segment as a discontinued operation in the accompanying condensed consolidated interim financial statements. The September 30, 2011 and 2010 condensed consolidated interim financial statements have been adjusted for the Company's discontinued consumer services segment. The following table represents the assets and liabilities of the discontinued operations as of September 30, 2011 and December 31, 2010:

	<b>September 30, 2011 (Unaudited)</b>	<b>December 31, 2010</b>
Property and equipment, net	\$ <u>8,579</u>	\$ <u>12,449</u>
Total current assets reclassified to discontinued operations	\$ <u>8,579</u>	\$ <u>12,449</u>
Capital lease obligations, current portion	\$ 99,517	\$ 99,517
Accounts payable and accrued expenses	<u>15,028</u>	<u>65,757</u>
Current liabilities reclassified to discontinued operations	\$ <u>114,545</u>	\$ <u>165,274</u>

The operating results of the discontinued operations for the nine months ended September 30, 2011 and 2010 are as follows:

	<b>Nine Months Ended September 30, 2011 (unaudited)</b>	<b>2010 (unaudited)</b>
Revenues	\$ -	\$ 7,617
Cost of Revenues	-	(780)
Depreciation and amortization	3,870	16,835
Selling, general and administrative	(1,426)	73,694
Other income	<u>7,975</u>	-
Net income (loss)	\$ <u>5,531</u>	\$ <u>(82,132)</u>

**6. Intangible Assets**

Identifiable intangible assets as of September 30, 2011 and December 31, 2010 are comprised of:

	<u>September 30, 2011 (unaudited)</u>		<u>December 31, 2010</u>	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Trademarks	\$ 478,871	\$ (194,891)	\$ 478,871	\$ (143,926)
Intellectual Property	<u>86,397</u>	<u>(21,599)</u>	<u>86,397</u>	<u>(12,342)</u>
Total	\$ <u>565,268</u>	\$ <u>(216,490)</u>	\$ <u>565,268</u>	\$ <u>(156,268)</u>

Amortization expense for the three months ended September 30, 2011 and 2010 was \$20,074 and \$16,988, respectively. Amortization expense for the nine months ended September 30, 2011 and 2010 was \$60,222 and \$50,964, respectively. Estimated future aggregate amortization expense is as follows for the periods indicated:

Remaining three months ending December 31,	2011	20,074
Year ending December 31:	2012	79,626
	2013	78,912
	2014	78,912
	2015	78,911
	2016	12,343

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES**

**7. Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses consist of the following at September 30, 2011 and December 31, 2010:

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
	<b>( unaudited )</b>	
Trade accounts payable	\$ 7,405,105	\$ 7,773,241
Accrued expenses	595,216	551,266
Accrued payroll and vacation	100,076	140,341
Cost accrual	74,925	2,752
Interest payable	331,425	291,782
Deferred revenue	172,008	149,545
Other	593,597	269,747
	<u>\$ 9,272,352</u>	<u>\$ 9,178,674</u>

**8. Long-Term Debt and Capital Lease/Equipment Financing Obligations**

At September 30, 2011 and December 31, 2010, components of long-term debt and capital lease/equipment financing obligations of the Company are comprised of the following:

	<b>September 30,</b>	<b>December 31,</b>
	<b>2011</b>	<b>2010</b>
	<b>(unaudited)</b>	
Promissory notes payable - related parties	\$ 4,913,364	\$ 2,420,625
Promissory notes payable - non-related parties	208,382	683,870
Capital lease/equipment financing obligations	1,963	4,550
Total promissory notes payable and capital lease/equipment financing obligations	5,123,709	3,109,045
Less:		
Current portion of capital lease/equipment financing obligations	(1,963)	(4,550)
Current portion of notes payable - related parties	(4,913,364)	(2,420,625)
Current portion of notes payable - non-related parties	(208,382)	(683,870)
Non-current portion of promissory notes payable and capital lease/equipment financing obligations	\$ -	\$ -

**Promissory notes payable – related parties**

From 2007 through 2010, the Company borrowed an aggregate of \$3,415,268 from Marvin Rosen, the Company's Chairman of the Board of Directors. These loans were evidenced by promissory notes bearing interest at rates ranging from 3% to 10% per annum. Principal payments on the indebtedness related to these promissory notes through December 31, 2010 totaled \$394,843. In addition, at various times during 2010, Mr. Rosen converted a total of \$724,800 of indebtedness evidenced by such promissory notes into an aggregate of 5,320,002 shares of the Company's common stock and warrants to purchase a total of 2,360,004 shares of the Company's common stock. The warrants are generally exercisable for a period of five years from the respective dates of debt conversion at exercise prices ranging from 120% to 150% of the closing price of the Company's common stock on the date of the conversion. All of the promissory notes grant the lender a collateralized security interest, pari passu with other lenders, in the Company's accounts receivable and are payable in full upon ten days notice from the lender. To date, the Company has not received a demand for payment. On May 21, 2009, the Company borrowed \$125,000 from Marose, LLC, of which Mr. Rosen is a member. This loan is evidenced by a promissory note, which initially matured on July 20, 2009, and bears an interest rate of 8% per annum. The note also grants the lender a collateralized security interest, pari passu with other lenders, in the Company's accounts receivable. On the July 20, 2009 initial maturity date of the note, the note became a demand note pursuant to its terms, and the entire amount of this note remained outstanding at September 30, 2011 and December 31, 2010. To date the Company has not received a demand for payment.

## FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES

During the first nine months of 2011, the Company borrowed an additional \$2,994,739 from Mr. Rosen, \$277,000 of which was repaid during the period. These loans were evidenced by a series of short-term promissory notes, each of which is payable in full upon ten days notice from the lender and bear interest at the rate of 3.25% per annum. Each note also grants the lender a collateralized security interest, *pari passu* with other lenders, in the Company's accounts receivable. The proceeds were used for general working capital purposes. On April 27, 2011, Mr. Rosen converted \$175,000 of previously issued promissory notes into 2,187,500 shares of the Company's common stock and five-year warrants to purchase 437,500 shares of common stock. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to closing. On September 12, 2011, Mr. Rosen converted \$50,000 of previously issued promissory notes into 793,651 shares of common stock and five-year warrants to purchase 238,096 shares of common stock. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to closing. As of September 30, 2011, the Company had an aggregate principal amount of outstanding demand notes payable to Mr. Rosen and his affiliates in the amount of \$4,913,364 and, to date, the Company has not received a demand for payment.

In connection with the Company's arrangement with Prestige for the sale of certain of its accounts receivable (see note 3), the Company's related party lenders agreed to subordinate their security interest in the Company's accounts receivable to that of Prestige.

On January 21, 2011, the Company borrowed \$20,000 from a Director of the Company. The note was payable in full upon ten days notice of demand from the lender, with accrued interest at the rate of 3.25% per annum, and granted the lender a collateralized security interest, *pari passu* with other lenders, in the Company's accounts receivable. On April 27, 2011, the principal balance of this note, along with the accrued interest, was converted into 252,160 shares of the Company's common stock and five-year warrants to purchase 50,432 shares of common stock. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to closing.

### **Promissory notes payable – non-related parties**

During 2008, the Company borrowed an aggregate of \$375,000 from two unrelated parties, of which \$333,870 remained outstanding as of December 31, 2010. The loans were evidenced by promissory notes which matured on various dates during the year ended December 31, 2010 bearing interest at the rate of 10% per annum. These notes automatically converted to demand notes on their respective maturity dates whereupon the outstanding principal and all accrued interest on the notes became payable in full upon ten days notice from the lender. These notes, along with all accrued interest thereon, were repaid in their entirety during the first nine months of 2011.

Also during 2008, the Company borrowed \$200,000 under a promissory note issued to an unrelated party. During 2010 the lender converted \$100,000 of this note into 769,231 shares of common stock and warrants to purchase 153,847 shares of common stock and agreed to extend the maturity date of the \$100,000 balance of the loan to February 8, 2011 while increasing the interest rate to 12 percent (12%) per annum. The note was not repaid by the maturity date. On August 5, 2011, \$50,000 of the outstanding principal on this note and approximately \$15,000 of accrued interest was converted into 644,987 shares of the Company's common stock and 5-year warrants to purchase 128,998 shares of common stock. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to conversion. On September 19, 2011 the remaining principal balance on the note in the amount of \$50,000 was repaid.

On December 22, 2010, the Company borrowed \$250,000 from an unrelated party, evidenced by a promissory note bearing interest at the rate of 3.25% per annum and which was payable in full upon ten days notice from the lender. On May 11, 2011 the entire principal balance of this note, along with \$3,139 of accrued interest, was converted into 2,531,387 shares of the Company's common stock and 5-year warrants to purchase 506,278 shares of common stock. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to conversion.

On September 19, 2011, as more fully described in note 3, the Company received an advance \$208,382 from Prestige in connection with its entering into an arrangement for the sale of certain of the Company's accounts receivable to Prestige. The advance is secured by a first priority lien on the Company's accounts receivable and is payable in 25 equal weekly installments which commenced in October of 2011. To date, the Company has made all required payments related to this advance.

## 9. Equity Transactions

During the first nine months of 2011, the Company entered into subscription agreements with 20 accredited investors, under which the Company issued an aggregate of 8,083,489 shares of common stock and five-year warrants to purchase 1,920,476 shares of the Company's common stock for aggregate consideration of \$0.7 million. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to closing.

As previously discussed in Note 8, two of the Company's directors and two unrelated note holders converted an aggregate of approximately \$0.6 million of promissory notes and accrued interest that were payable on demand into an aggregate of 6,409,685 shares of the Company's common stock and warrants to purchase 1,361,304 shares of the Company's common stock.

On May 16, 2011, an accredited investor converted 1,500 shares of Series A-1 Preferred Stock with an aggregate liquidation preference of \$1.5 million into 898,204 shares of the Company's common stock. Also on May 16, 2011, this same investor converted 750 shares of Series A-2 Preferred Stock with an aggregate liquidation preference of \$750,000 into 903,615 shares of common stock. These conversions were made in accordance with the respective terms of the preferred stock. On September 2, 2011, this investor returned the certificates evidencing this common stock to the Company and notified the Company that he was abandoning any and all rights associated with such shares, including but not limited to any future distributions or dividends that may be paid by the Company and voting rights on any matters on which the Company's shareholders are entitled to vote.

As of September 30, 2011, the Company is authorized to issue 300,000,000 shares of common stock, and there were 146,503,672 shares of common stock issued and outstanding.

## 10. Recently Adopted and Issued Accounting Pronouncements

In January 2010, the Financial Accounting Standard Board ("FASB") issued Accounting Standards Update ("ASU") No. 2010-06, "*Fair Value Measurements and Disclosures (Topic 820)—Improving Disclosures about Fair Value Measurements.*" ASU 2010-06 requires new disclosures regarding transfers in and out of the Level 1 and 2 and activity within Level 3 fair value measurements and clarifies existing disclosures of inputs and valuation techniques for Level 2 and 3 fair value measurements. ASU 2010-06 also includes conforming amendments to employers' disclosures about post-retirement benefit plan assets. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosure of activity within Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010, and for interim periods within those years. The adoption of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

In April 2010, the FASB issued ASU No. 2010-13, "*Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades.*" This new accounting guidance clarifies that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades shall not be considered to contain a market, performance, or service condition. Therefore, such an award is not to be classified as a liability if it otherwise qualifies as equity classification. The amendments in this update should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings. The cumulative-effect adjustment should be calculated for all awards outstanding as of the beginning of the fiscal year in which the amendments are initially applied, as if the amendments had been applied consistently since the inception of the award. The accounting guidance is effective for interim and annual periods beginning on or after December 15, 2010 and is not expected to have a material impact on the Company's consolidated financial position or results of operations.

In December 2010, the FASB issued ASU 2010-28, "*Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts.*" ASU 2010-28 provides amendments to Topic 350 to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts to clarify that, for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. For public entities, the amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. As a result of this standard, goodwill impairments may be reported sooner than under current practice. The adoption of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

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In May 2011, the FASB issued ASU 2011-04, "*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.*" ASU 2011-04 provides amendments to Topic 820 effective for public entities for interim and annual periods beginning after December 15, 2011, and should be applied prospectively. The amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Early adoption is not permitted for public entities. The Company has determined that the adoption of ASU 2011-04 will not have a material impact on its consolidated results of operations or financial position.

The Company does not believe that any other recently issued but not yet effective accounting pronouncements, if currently adopted, would have a material effect on the accompanying condensed consolidated interim financial statements.

### 11. Commitments and Contingencies

#### Legal Matters

On or about March 14, 2011, a landlord over premises leased by the Company commenced a proceeding in the New York City Civil Court, County of New York (Index No. 060260/11), in which the landlord sought to recover against the Company certain unpaid rent and related charges due under a lease agreement between the landlord and the Company, and to evict the Company from the premises. The Company filed its response to the landlord's claims on April 6, 2011. By Stipulation dated July 5, 2011, the landlord and the Company agreed that the landlord would be entitled to a judgment in the amount of \$228,645 and a warrant of eviction, but that the landlord would not enforce the judgment or execute the warrant as long as the Company complied with the Stipulation. To date, the Company has complied with all of its payment obligations under the Stipulation and the accompanying consolidated financial statements fully reflect the amounts owed to the landlord by the Company as of the date of the financial statements.

On July 30, 2008, a vendor that provided management consulting and software systems services filed a complaint in the Supreme Court for the State of New York (Software Synergy, Inc., v Fusion Telecommunications International, Inc., Index No. 602223/08) seeking damages in the amount of \$624,594 plus \$155,787 in Prejudgment interest and costs, allegedly due to the plaintiff under terms of a Professional Services Letter Agreement (the "PSLA") and a Master Software License Agreement (the "MSLA"). This complaint asserted claims for relief against the Company for breach of contract, failure to pay to plaintiff moneys allegedly due under the terms of the PSLA, violation of the terms of the MSLA, and prejudgment interest and costs. On September 17, 2008, the Company filed its Answer and Counterclaim against the vendor alleging the plaintiff materially breached its obligations to the Company under the PSLA and MSLA and is liable to the Company for damages, including full repayment of the amounts which the Company paid to the plaintiff for its failed development effort. On June 25, 2010, the parties entered into a Confidential Settlement Agreement resolving the litigation, providing for certain payments to the vendor by the Company, providing for the mutual release of all claims, and agreeing to the dismissal of the case. As of September 30, 2011, the Company's obligations under this agreement have been paid in full.

The Company is from time to time involved in claims and legal actions arising in the ordinary course of business. Management does not expect that the outcome of any such claims or actions will have a material effect on the Company's operations or financial condition. In addition, due to the regulatory nature of the telecommunications industry, the Company periodically receives and responds to various inquiries from state and federal regulatory agencies. Management does not expect the outcome of any such regulatory inquiries to have a material impact on the Company's operations or financial condition.

### 12. Segment Information

The Company complies with the accounting and reporting requirements on Disclosures about Segments of an Enterprise and Related Information. The guidance requires disclosures of segment information on the basis that is used internally for evaluating segment performance and for determining the allocation of resources to the operating segments.

The Company has two reportable segments that it operates and manages – corporate services and carrier services. These segments are organized by the products and services that are sold and the customers that are served. The Company measures and evaluates its reportable segments based on revenues and gross profit margins. The Company's executive, administrative and support costs are allocated to the Company's operating segments and are included in segment income. The Company's segments and their principal activities consist of the following:

#### Carrier Services

Carrier Services includes the termination of carrier traffic utilizing VoIP technology as well as traditional TDM (circuit switched) technology. VoIP permits a less costly and more rapid interconnection between the Company and international telecommunications carriers, and generally provides better profit margins for the Company than does TDM technology. The Company currently interconnects with over 270 carrier customers and vendors, and is working to expand its interconnection relationships, particularly with carriers in emerging markets.

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**Corporate Services and Other**

The Company provides a wide variety of communications services to small and medium-sized businesses, as well as enterprise customers, including basic voice and data communications services, broadband Internet access, private line services, audio and web conferencing services, e-fax services, and a variety of other value-added services. These customers are sold through both the Company's direct sales force and its partner sales program, which utilizes the efforts of independent third-party distributors to sell the Company's products and services.

Unaudited operating segment information for the three and nine months ended September 30, 2011 and 2010 is summarized as follows:

**Three Months Ended September 30, 2011**

	<u>Carrier Services</u>	<u>Corporate Services and Other</u>	<u>Corporate and Unallocated</u>	<u>Consolidated</u>
Revenues	\$ 9,319,824	\$ 611,423	\$ -	\$ 9,931,247
Cost of revenues (exclusive of depreciation and amortization)	8,436,781	383,676	-	8,820,457
Selling, general and administrative expenses	91,502	9,634	-	101,136
Advertising and marketing	1,137,305	914,342	-	2,051,647
Other (income) expenses	0	1,614	-	1,614
Loss from continuing operations	40,087	24,446	-	64,533
	<u>\$ (385,851)</u>	<u>\$ (722,289)</u>	<u>\$ -</u>	<u>\$ (1,108,140)</u>
Total assets	<u>\$ 2,924,130</u>	<u>\$ 1,759,982</u>	<u>\$ 25,834</u>	<u>\$ 4,709,946</u>

**Three Months Ended September 30, 2010**

	<u>Carrier Services</u>	<u>Corporate Services and Other</u>	<u>Corporate and Unallocated</u>	<u>Consolidated</u>
Revenues	\$ 10,709,148	\$ 440,825	\$ -	\$ 11,149,973
Cost of revenues (exclusive of depreciation and amortization)	9,837,505	271,272	-	10,108,777
Depreciation and amortization	197,419	687	-	198,106
Selling, general and administrative expenses	1,220,907	981,492	-	2,202,399
Advertising and marketing	-	15,358	-	15,358
Other (income) expenses	(129,704)	12,064	-	(117,640)
Loss from continuing operations	<u>\$ (416,979)</u>	<u>\$ (804,048)</u>	<u>\$ -</u>	<u>\$ (1,257,027)</u>
Total assets	<u>\$ 3,527,928</u>	<u>\$ 1,701,193</u>	<u>\$ 300,425</u>	<u>\$ 5,529,546</u>

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**Nine Months Ended September 30, 2011**

	<u>Carrier Services</u>	<u>Corporate Services and Other</u>	<u>Corporate and Unallocated</u>	<u>Consolidated</u>
Revenues	\$ 29,080,026	\$ 1,698,537	\$ -	\$ 30,778,563
Cost of revenues (exclusive of depreciation and amortization)	26,541,747	1,080,105		27,621,852
Depreciation and amortization	405,323	12,882		418,205
Selling, general and administrative expenses	3,433,213	2,785,178		6,218,391
Advertising and marketing	58	6,937		6,995
Other expenses	46,296	12,420		58,716
Loss from continuing operations	<u>\$ (1,346,611)</u>	<u>\$ (2,198,985)</u>	<u>\$ -</u>	<u>\$ (3,545,596)</u>
Capital expenditures	<u>\$ 46,174</u>	<u>\$ 1,981</u>	<u>\$ 9,232</u>	<u>\$ 57,387</u>

**Nine Months Ended September 30, 2010**

	<u>Carrier Services</u>	<u>Corporate Services and Other</u>	<u>Corporate and Unallocated</u>	<u>Consolidated</u>
Revenues	\$ 29,232,398	\$ 1,233,408	\$ -	\$ 30,465,806
Cost of revenues (exclusive of depreciation and amortization)	26,791,122	735,209	-	27,526,331
Depreciation and amortization	623,349	14,542	-	637,891
Selling, general and administrative expenses	4,215,425	2,378,866	-	6,594,291
Advertising and marketing	-	36,554	-	36,554
Other expenses (income)	(70,477)	38,672	-	(31,805)
Loss from continuing operations	<u>\$ (2,327,021)</u>	<u>\$ (1,970,435)</u>	<u>\$ -</u>	<u>\$ (4,297,456)</u>
Capital expenditures	\$ 91,173	\$ -	\$ 54,997	\$ 146,170

**13. Other Income and Expenses**

Other income (expenses) for the three and nine months ended September 30, 2011 and 2010 consists of the following:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Settlement or extinguishment of vendor liabilities	\$ 0	\$ 150,000	\$ 75,000	\$ 159,500
Loss on sale of accounts receivable	(7,610)	-	(7,610)	-
Loss on disposal of property and equipment	(24,615)	-	(24,615)	-
Other	5,124	10,161	39,953	18,890
Total operating expenses	<u>\$ (27,101)</u>	<u>\$ 160,161</u>	<u>\$ 82,728</u>	<u>\$ 178,390</u>

In September 2008, the Company entered into a settlement agreement with a vendor providing, in part, that the Company issue common stock in the amount of \$75,000 to the vendor in settlement of a debt. However, due to a failure by the vendor to perform its obligations under the settlement agreement, the Company never actually issued the shares, resulting in a transfer from equity to escrow payable in 2010 in the amount of \$75,000, and an adjustment to the number of shares issued and outstanding. On February 10, 2011, the Company executed a settlement agreement with the vendor which released the Company of all liability with respect to this matter. As a result, the Company reduced its escrow payable amount and recorded other income of \$75,000 in the first nine months of 2011.

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During the first nine months of 2011, in connection with its normal periodic review of property and equipment, the Company disposed of several assets which are no longer in use and recorded a loss of \$24,615 for the net book value those assets as of September 30, 2011.

During February 2004, the Company entered into a settlement agreement with a carrier vendor in a foreign country providing for, among other things, payment by the Company of \$600,000, of which \$450,000 was promptly paid, and the Company's agreement to make 12 monthly payments for the remaining \$150,000. In return, the vendor agreed to restore the Company's ability to terminate telecommunications traffic to that country at a favorable fixed rate. The vendor never complied with its obligations under the agreement, and the Company therefore did not make its remaining payments. Under the laws of that country, the vendor's ability to pursue payment of the remaining amount has expired under the statute of limitations for contractual claims. The remaining balance was extinguished on the Company's books during the first nine months of 2010. Also during the first nine months of 2010, the Company settled two billing disputes with vendors resulting in a net gain of \$9,500.

### **14. Related Party Transactions**

In addition to the financing transactions discussed in note 8, on March 29, 2011 the Company entered into a Desk Space Use and Occupancy Agreement with an entity affiliated with Mr. Rosen. Under the terms of the agreement, Mr. Rosen's affiliate will be able to utilize a portion of the Company's leased office space in New York City for a fee of \$9,000 per month. The term of the agreement runs from April 15, 2011 to October 14, 2011. The Company believes that the fee it is receiving under this agreement is comparable to what it would receive had the agreement been entered into with an unrelated third party. In August of 2011, the parties to this agreement agreed to extend the term for an additional six months, through April 14, 2012. The Company received an advance payment of \$54,000 from Mr. Rosen's affiliate in connection with this extension, which is reflected in accounts payable and accrued expenses in the Company's consolidated balance sheet as of September 30, 2011.

During the first nine months of 2011, the Company entered into subscription agreements with two of its directors whereby the Company issued an aggregate of 667,667 shares of common stock and five-year warrants to purchase 161,112 shares of the Company's common stock for aggregate consideration of \$55,000. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to closing. These amounts are included in the equity transactions discussed in note 9.

### **15. Subsequent Events.**

On October 31, 2011, the landlord over premises leased by the Company exercised its right under the lease to draw down the full amount of a letter of credit in the amount of \$428,000 that the Company had posted as security under the terms of the lease. The letter of credit was issued for the benefit of the Company by a third party lending institution and the Company had partially collateralized the letter of credit in the approximate amount of \$238,000 by depositing this amount in a money market account with the lending institution, which is reflected as restricted cash on the Company's balance sheet at September 30, 2011 and December 31, 2010. The Company is currently in discussions with the landlord as to the specific application of the funds pertaining to the letter of credit.

The Company currently does not have funds available to repay the issuer of the letter of credit for the difference between the full amount of the letter of credit and the amount of the collateral, which difference is approximately \$190,000. While the Company's failure to make this payment constitutes an event of default under the terms of the letter of credit, the Company has not received a default notice from the lending institution. Although the lending institution has indicated its willingness to negotiate a payment arrangement on terms that are acceptable to the Company and has not taken any action against the Company at this time, there can be no assurance that the Company will be successful in negotiating acceptable payment terms with the lending institution or that the lending institution will not declare the Company in default of the letter of credit agreement in the future.

Between October 1, and October 31, 2011, the Company entered into additional subscription agreements with 5 accredited investors, including one director of the Company, whereby the Company issued an aggregate of 1,751,325 shares of common stock and five-year warrants to purchase 525,400 shares of the Company's common stock for aggregate consideration of \$127,000. The warrants are exercisable at 125% of the average closing price of the Company's common stock for the five trading days prior to closing.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the information contained in our unaudited consolidated financial statements and the notes thereto appearing elsewhere herein and in conjunction with the Management's Discussion and Analysis set forth in our fiscal 2010 Annual Report on Form 10-K.

### Overview

We are an international telecommunications carrier delivering value-added communications solutions to corporations and carriers in the United States and throughout the world. We offer services that include voice and data communications using Voice over Internet Protocol ("VoIP"), private network services, broadband Internet access, and other advanced services.

The Company's corporate business segment focuses on small, medium, and large corporations headquartered in the United States, but with the ability to serve their global communications needs and to provide service virtually anywhere in the world. The Company's carrier business segment focuses on carriers across the globe, with a particular focus on providing services to and from emerging markets in Asia, the Middle East, Africa, Latin America, and the Caribbean.

### Revenues

Historically, we have generated the majority of our revenues from voice traffic sold to other carriers, with a strong focus in recent years on VoIP termination to emerging markets. We have focused on growing our existing customer base, which was primarily U.S. based, through the addition of new international customers. We have also focused on expanding the Company's vendor base through the addition of direct VoIP terminating arrangements to new countries and emerging markets. Although we believe that the carrier business segment continues to be of significant value to our long term strategy, ongoing competitive and pricing pressures have caused us to increase our focus on the higher margin corporate business segment and to expand our efforts to market to small and mid-sized corporations, as well as large enterprises, using both our direct and partner distribution channels.

While our corporate business segment is still a relatively small portion of our revenue base, we will continue to increase our emphasis on this segment and increase the percentage of the Company's total revenues contributed by the corporate business segment. We believe that this will complement the Company's carrier business segment by providing higher margins and a more stable customer base.

We manage our revenues by business segment and customer. We manage our costs by provider (vendor). We track revenues by business segment, as the Company's segments have different customer billing and payment terms and utilize different billing systems. We track total revenue at the customer level because our sales force manages revenue generation at the customer level, and because invoice charges are billed and collected at the customer level. We also track revenues and costs by product to manage product profitability.

### Operating Expenses

We manage our business segments based on gross margin, which is net revenue less the cost of revenue, and on net profitability. Although our infrastructure is largely built to support all business segments and products, many of the infrastructure costs, selling, general and administrative expenses and capital expenditures can be specifically associated with one of our two business segments. The majority of our operations, engineering, information systems, and finance personnel are assigned to either the corporate services or carrier services business segment for costing purposes, while a relatively small number of personnel are considered "overhead" and allocated to the segments as appropriate. For segment reporting purposes, common overhead expenses are generally allocated based on percentage of utilization of resources unless the items can be specifically identified to one of the business segments. Our operating expenses are categorized as cost of revenues, depreciation and amortization, selling, general and administrative expenses, and advertising and marketing.

Cost of revenues includes costs incurred in the operation of our leased network facilities, as well as the purchase of voice termination, Internet access, private line, and other services from telecommunications carriers and Internet service providers. We continue to work to lower the variable component of the cost of revenues through the use of least cost routing, and through on-going negotiation of usage-based costs with our many domestic and international service providers.

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES**

Depreciation and amortization includes the depreciation of our communications network equipment, leasehold improvements and office equipment and fixtures, as well as the amortization of our intangible assets.

Selling, general, and administrative expenses include salaries and benefits, sales commissions, occupancy costs, legal and professional fees and other administrative expenses.

Advertising and marketing expense includes costs for promotional materials for the marketing of our corporate products and services.

**Results of Operations**

The following table summarizes our results of operations for the periods indicated:

	<u>Three Months Ended September 30,</u>				<u>Nine Months Ended September 30,</u>			
	<u>2011</u>		<u>2010</u>		<u>2011</u>		<u>2010</u>	
<b>Revenues</b>	\$ 9,931,247	100.0%	\$11,149,973	100.0%	\$30,778,563	100.0%	\$30,465,806	100.0%
<b>Operating expenses:</b>								
Cost of revenues, exclusive of depreciation and amortization	8,820,457	88.8%	10,108,777	90.7%	27,621,852	89.7%	27,526,331	90.4%
Depreciation and amortization	101,136	1.0%	198,106	1.8%	418,205	1.4%	637,890	2.1%
Selling general and administrative	2,051,648	20.7%	2,202,399	19.8%	6,218,391	20.2%	6,594,291	21.6%
Advertising and marketing	1,614	0.0%	15,358	0.1%	6,995	0.0%	36,554	0.1%
Total operating expenses	<u>10,974,855</u>	110.5%	<u>12,524,640</u>	112.3%	<u>34,265,443</u>	111.3%	<u>34,795,066</u>	114.2%
<b>Operating loss</b>	<u>(1,043,608)</u>	(10.5)%	<u>(1,374,667)</u>	(12.3)%	<u>(3,486,880)</u>	(11.3)%	<u>(4,329,260)</u>	(14.2)%
Interest expense, net	(37,432)	(0.4)%	(42,521)	(0.4)%	(141,444)	(0.5)%	(146,585)	(0.5)%
Other (expenses) income	(27,100)	(0.3)%	160,161	1.4%	82,728	0.3%	178,390	0.6%
Total other (expenses) income	<u>(64,532)</u>	(0.6)%	<u>117,640</u>	1.1%	<u>(58,716)</u>	(0.2)%	<u>31,805</u>	0.1%
<b>Loss from continuing operations</b>	<u>\$(1,108,140)</u>	(11.2)%	<u>\$(1,257,027)</u>	(11.3)%	<u>\$(3,545,596)</u>	(11.5)%	<u>\$(4,297,455)</u>	(14.1)%

**Three Months Ended September 30, 2011 Compared with Three Months Ended September 30, 2010**

**Revenues**

Consolidated revenues were \$9.9 million during the three months ended September 30, 2011, compared to \$11.1 million during the three months ended September 30, 2010, a decrease of \$1.2 million or 10.9%. Revenues for the carrier services segment were \$9.3 million during the three months ended September 30, 2011, compared to \$10.7 million during the three months ended September 30, 2010, a decrease of \$1.4 million or 13.0%. During the third quarter of 2011 we experienced a 16% increase in minutes transmitted over our network, the effect of which was more than offset by a 25% decrease in the blended rate per minute of the traffic terminated. Revenues for the corporate services segment increased \$0.2 million, or 38.7%, to \$0.6 million during the three months ended September 30, 2011 as we continued to grow the customer base for this segment.

**Cost of Revenues and Gross Margin**

Consolidated cost of revenues was \$8.8 million during the three months ended September 30, 2011, compared to \$10.1 million during the three months ended September 30, 2010, a decrease of \$1.3 million, or 12.7%. Consolidated gross margin for the third quarter of 2011 was 11.2%, compared to 9.3% for the third quarter of 2010. In addition to the higher margin realized in the carrier services segment in 2011, consolidated gross margin also benefited from the higher margin corporate services business being a higher percentage of consolidated revenue in 2011 compared with 2010.

## FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES

Gross margin for the carrier services segment was 9.5% during the third quarter of 2011, compared to 8.1% during the third quarter of 2010, as the decrease in the blended cost per minute of traffic terminated exceeded the decrease in blended rates realized for the quarter. We also continued to benefit from a reduction in fixed costs related to this segment, mainly TDM circuits and Internet bandwidth for VoIP. Gross margin for the corporate services segment during the third quarter of 2011 was 37.2%, compared with 38.5% during the same period of a year ago. The decrease in gross margin during the period was mainly due to price discounts granted to certain customers in 2011 in response to increased competition experienced in this sector.

### **Depreciation and Amortization**

Depreciation and amortization decreased to \$0.1 million during the three months ended September 30, 2011, from \$0.2 million during the three months ended September 30, 2010, as more assets became fully depreciated during the period than were placed into service.

### **Selling, General, and Administrative**

Selling, general, and administrative expenses decreased by \$0.2 million during the third quarter of 2011 compared to the third quarter of 2010. The decrease was primarily due to reductions in rent expense in connection with the renewal of the lease at our network facility in New York City and employee compensation costs resulting from reduced headcount and lower stock-based compensation expense. These decreases were partially offset by higher bad debt expense and higher agent commissions resulting from the increase in corporate services revenue.

### **Advertising and Marketing**

Advertising and marketing expenses decreased by approximately \$14,000 in the three months ended September 30, 2011 compared to the same period in 2010, due to reduced spending on promotional materials related to our corporate services business.

### **Operating Loss**

Our operating loss of \$1.0 million for the three months ended September 30, 2011 represents a decrease of \$0.3 million, or 24.1%, from the three months ended September 30, 2010. The decrease in operating loss was primarily attributable to decreases in selling, general, and administrative expenses and depreciation expenses. In addition, the higher gross margin experienced during the quarter resulted in a \$70,000 increase in gross profit despite the overall decline in revenues.

### **Interest Expense**

Interest expense, net of interest income, was \$37,000 for the three months ended September 30, 2011 compared to \$43,000 in the same period of a year ago. The decrease was due to higher interest income in 2011.

### **Other (Expense) Income**

Total other expenses, net of other income, increased by \$0.2 million in the third quarter of 2011 compared to 2010, mainly due to the extinguishment of a vendor liability and related gain of \$150,000 in 2010. In connection with a review of our fixed assets performed during the third quarter of 2011 we wrote off the assets which are no longer in use with a net book value of approximately \$25,000, with no comparable amount in 2010. We also recognized a loss on the sale of receivables of approximately \$8,000 in the third quarter of 2011, with no comparable amount in 2010, as part of the new accounts receivable sale arrangement we entered into in September 2011.

### **Net Loss**

Net loss decreased during the third quarter of 2011 to \$1.1 million, from \$1.3 million in the third quarter of 2010, due to the reduced operating loss discussed above, partially offset by the miscellaneous income recorded in 2010 not present in 2011.

## **Nine Months Ended September 30, 2011 Compared with Nine Months Ended September 30, 2010**

### **Revenues**

Consolidated revenues were \$30.8 million for the first nine months of 2011, compared to \$30.5 million for the first nine months of 2010, an increase of \$0.3 million, or 1.0%. Carrier services revenue of \$29.1 million decreased by \$0.2 million, or 0.5%, over the same period of a year ago, as the 11% increase in the number of minutes transmitted over our network was more than offset by the decrease in the blended rate per minute of traffic terminated. Revenues for the corporate services segment increased \$0.5 million, or 37.7%, to \$1.7 million for the first nine months of 2011 compared to the first nine months of 2010 as we continued to grow the customer base for this segment.

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### **Cost of Revenues and Gross Margin**

Consolidated cost of revenues was \$27.6 million for the first nine months of 2011, compared to \$27.5 million during the first nine months of 2010. Consolidated gross margin was 10.3% for the first nine months of 2011, compared to 9.6% in the same period of a year ago. The increase is mainly due to the increased relative contribution of the higher margin corporate services business, and, to a lesser extent, the higher carrier services margin.

Gross margin for the carrier services segment was 8.7% during for the first nine months of 2011, compared to 8.4% for the first nine months of 2010. The higher margin was due to a reduction in fixed costs during the period. Gross margin for the corporate services segment for the first nine months of 2011 was 36.4%, compared with 40.4% during the first nine months of 2010. The decrease in gross margin during the period was mainly due to price discounts granted to certain customers in 2011 in order to secure long-term business and expand our customer base.

### **Depreciation and Amortization**

Depreciation and amortization decreased by \$0.2 million to \$0.4 million during the first nine months of 2011, as more assets became fully depreciated during the period than were placed into service.

### **Selling, General, and Administrative**

Selling, general, and administrative expenses decreased by \$0.4 million during the first nine months of 2011 compared to the first nine months of 2010. The decrease was primarily due to a \$0.4 million reduction in employee compensation costs, of which \$0.2 million was stock-based compensation, and a \$0.2 million reduction in rent and other occupancy costs, partially offset by a \$0.2 million increase in bad debt expense associated with the growth of the corporate services business.

### **Advertising and Marketing**

Advertising and marketing expenses decreased by approximately \$30,000 in the first nine months of 2011 compared to the same period in 2010, due to reduced spending on promotional materials related to our corporate services business.

### **Operating Loss**

Our operating loss of \$3.5 million in the first nine months of 2011 represents a decrease of \$0.8 million, or 19.5%, from the first nine months of 2010. The decrease in operating loss was primarily attributable to an increase in gross profit of \$0.2 million and decreases in depreciation expense and selling, general, and administrative expenses totaling \$0.6 million.

### **Interest Expense**

Interest expense, net of interest income, of \$0.1 million for the first nine months of 2011 was largely unchanged from the same period in 2010.

### **Other Income**

Total other income, net of other expenses, decreased by \$0.1 million in the first nine months of 2011 compared to the first nine months of 2010, mainly due to the settlement or extinguishment of vendor liabilities in the amount of \$75,000 in 2011, as compared to \$160,000 in 2010.

### **Discontinued Operations**

The income from our discontinued retail segment in the first nine months 2011 of approximately \$6,000 is mainly the result of cash we received from a former customer of this segment for a balance we had previously written off and a favorable adjustment to stock-based compensation expense, compared to a loss of approximately \$0.1 million during the first nine months of 2010, which was mainly attributable to higher legal fees related to this segment.

### **Net Loss**

Net loss for the first nine months of 2011 was \$3.5 million, as compared to \$4.4 million for the first nine months of 2010. The improvement is mainly due to reductions in operating loss and losses from discontinued operations.

**Liquidity and Capital Resources**

Since our inception, we have incurred significant operating and net losses. In addition, we have yet to generate positive cash flow from operations. As of September 30, 2011, we had a stockholders' deficit of \$10.3 million, as compared to \$8.1 million at December 31, 2010, and a working capital deficit of \$11.7 million, as compared to \$9.7 million at December 31, 2010. We currently do not have sufficient cash or other financial resources to fund our operations and meet our obligations for the next twelve months.

We have historically relied upon the sale of our equity securities and loans from non-related and related parties, including Marvin Rosen, the Chairman of the Board of Directors, to fund our operations. From January 1, 2011 through the date of this report, we raised approximately \$0.8 million from the sale of our securities through private placement financings and received \$2.7 million in new loans from Mr. Rosen. We expect to continue to rely on additional sales of our securities and additional borrowings to support our operations and meet the Company's financial obligations for the remainder of 2011. There are no current commitments for such funds and there can be no assurances that such funds will be available to the Company as needed. In addition, a substantial portion of our outstanding indebtedness is payable upon ten days notice from the lender. Although we have yet to receive any demand notices for this indebtedness, there are no assurances that we will not receive any such notices in the future, and we currently do not have the financial resources to repay these loans should we receive a demand for payment.

On October 31, 2011, the landlord over premises leased by us exercised its right under the lease to draw down the full amount of a letter of credit in the amount of \$428,000 that we had posted as security under the terms of the lease. The letter of credit was issued for our benefit by a third party lending institution and we had partially collateralized the letter of credit in the approximate amount of \$238,000 by depositing this amount in a money market account with the lending institution, which we reflect as restricted cash on our balance sheet. We currently do not have funds available to repay the issuer of the letter of credit for the difference between the full amount of the letter of credit and the amount of the collateral, which difference is approximately \$190,000. While our failure to make this payment constitutes an event of default under the terms of the letter of credit, we have not received a default notice from the lending institution. Although the lending institution has indicated its willingness to negotiate a payment arrangement on terms that are acceptable to the Company and has not taken any action against the Company at this time, there can be no assurance that the Company will be successful in negotiating acceptable payment terms with the lending institution or that the lending institution will not declare the Company in default of the letter of credit agreement in the future.

On September 12, 2011, we entered into a purchase and sale agreement with Prestige Capital Corporation ("Prestige"), whereby we may sell certain of our accounts receivable to Prestige, at discounts generally ranging from 1% to 3%, in order to improve our liquidity and cash flow. The initial sale of receivables closed on September 19, 2011 and we sold receivables to Prestige with a book value of approximately \$470,000. Under the terms of the purchase and sale agreement, Prestige pays us 75% of the face amount of the receivables at the time of sale, and the remainder, net of the discount, is paid to us within four business days after Prestige receives payment on the receivables, which generally have 30 day terms. We expect to make additional sales of accounts receivable in accordance with this agreement, the term of which is for nine months. The proceeds from such sales will be used to purchase termination capacity from carrier vendors with shorter payment terms, which is expected to result in higher margins, and for short term liquidity needs when necessary.

Prestige also provided the Company with a one-time advance of \$208,000 on the closing date. This advance is secured by a priority lien on the Company's accounts receivable. The proceeds from the advance were used to pay down other third party indebtedness and for general corporate purposes. The advance is payable in 25 equal weekly installments beginning in October of 2011 and an advance fee of approximately \$15,000 is payable 180 days after the closing date.

Our management is also seeking to supplement the funds available from the sale of our securities and from our borrowings with other financing arrangements, in order to further address the Company's short-term liquidity challenge. For the long-term, we seek to continue to grow both the corporate and carrier segments of our business in order to ultimately achieve positive cash flow. We are also actively seeking strategic partners and/or acquisition candidates that we believe will be accretive to earnings and offer synergies that will assist in achieving revenue growth and profitability.

In the event that we are unable to secure the necessary funding to meet our working capital requirements, either through the sale of our securities or through other financing arrangements, we may be required to downsize, reduce our workforce, sell assets, or possibly curtail or even cease operations.

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A summary of the Company's cash flows for the periods indicated is as follows:

	<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
Cash from continuing operations:		
Cash used in operating activities	\$ (3,132,533)	\$ (4,179,199)
Cash used in investing activities	(61,877)	(431,216)
Cash provided by financing activities	3,240,670	4,816,287
Increase (decrease) in cash and cash equivalents from continuing operations	46,260	205,872
Cash from discontinued operations	(44,755)	(47,403)
Net increase (decrease) in cash and cash equivalents	1,505	158,469
Cash and cash equivalents, beginning of period	20,370	99,019
Cash and cash equivalents, end of period	\$ 21,875	\$ 257,488

Cash used in operating activities was \$3.1 million during the first nine months of 2011, compared to \$4.2 million in the first nine months in 2010. The decrease is mainly due to a lower operating loss, improved collections of accounts receivable and increases in accounts payable and accrued expenses. As we continue to implement our business strategy with our carrier services and corporate services business segments we expect that our net cash flows from operating activities will continue to improve.

Cash used in investing activities was \$62,000 in the first nine months of 2011 compared to \$431,000 in the first nine months of 2010. The decrease is due to increases in restricted cash in 2010 in order to collateralize letters of credit required under our leasing arrangements, and lower capital expenditures in 2011. We expect our cash capital expenditures to be approximately \$50,000 for the remainder of 2011, primarily for additional infrastructure development for the carrier services and corporate services segments.

Cash provided by financing activities was \$3.2 million in the first nine months of 2011, compared to \$4.8 million in the first nine months of 2010. During 2011, we raised \$0.7 million from the sale of our common stock, compared to \$3.6 million in 2010. We also raised \$2.6 million from new borrowings, net of repayments, in 2011, compared with \$1.2 million in 2010.

### **Sources of Liquidity**

As of September 30, 2011, we had cash and cash equivalents of approximately \$22,000 and accounts receivable of approximately \$2.6 million. Our long-term liquidity is dependent on our ability to attain future profitable operations. We cannot predict if and when we will be able to attain future profitability.

### **Uses of Liquidity**

Our short-term and long-term liquidity needs arise primarily from working capital requirements to support the growth and day-to-day operations of our business, principal and interest payments related to our financing obligations, capital expenditures and any additional funds that may be required for business expansion opportunities. In some situations, we may be required to guarantee payment or performance under agreements, and in these circumstances we may be required to secure letters of credit or bonds to do so. These instruments may further limit unrestricted cash and cash equivalents, and may place a further strain on our liquidity.

### **Debt Service Requirements**

During the first nine months of 2011, we repaid \$0.4 million related to promissory notes held by unrelated parties. For the remainder of 2011, we expect to make payments aggregating to \$0.1 million to satisfy the obligations under the Prestige advance. At September 30, 2011, we had \$5.1 million of current-term debt, all of which is collateralized by a security interest in our accounts receivable.

### **Capital Instruments**

During the first nine months of 2011, we entered into subscription agreements with 20 accredited investors, under which we issued an aggregate of 8,043,489 shares of our common stock and five year warrants to purchase 1,920,476 shares of common stock and received net proceeds of \$0.7 million. The warrants are exercisable at prices ranging from \$0.08 to \$0.14 per share, which represents 125% of the average closing price of the Company's common stock for the five trading days prior to closing.

Also during the first nine months of 2011, two of our directors and two unrelated note holders converted an aggregate of approximately \$0.6 million of indebtedness and accrued interest evidenced by promissory notes that were payable on demand into an aggregate of 6,409,685 shares of our common stock and warrants to purchase 1,361,304 shares of common stock. There can be no assurances that any of our note holders will elect to make additional conversions to equity in the future.

**Critical Accounting Policies and Estimates**

We have identified the policies and significant estimation processes discussed below as critical to our business operations and to the understanding of our results of operations. In many cases, the accounting treatment of a particular transaction is dictated by specific accounting principles generally accepted in the United States, with no need for management's judgment in their application. In other cases, management is required to exercise judgment in the application of accounting principles with respect to particular transactions. For a detailed discussion on the application of these and other accounting policies, see Note 2 in the Notes to Consolidated Financial Statements for the Year Ended December 31, 2010, included in our Annual Report on Form 10-K. The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. There can be no assurance that actual results will not differ from those estimates and such differences could be significant.

**Revenue Recognition**

Our revenue is primarily derived from usage fees charged to carriers and corporations that terminate voice traffic over our network, and from the monthly recurring fees charged to customers that purchase our corporate products and services.

Variable revenue is earned based on the length (number of minutes duration) of a call. It is recognized upon completion of the call, and is adjusted to reflect customer billing adjustments. Revenue for each customer is calculated from information received through our network switches. Customized software has been designed to track the information from the switch and analyze the call detail records against stored detailed information about revenue rates. This software provides us the ability to complete a timely and accurate analysis of revenue earned in a period. Consequently, the recorded amounts are generally accurate and the recorded amounts are unlikely to be revised in the future.

Revenue earned from monthly services provided to our corporate services customers are fixed and recurring in nature, and are contracted for over a specified period of time. The initial start of revenue recognition is after the provisioning, testing and acceptance of the service by the customer. The charges continue to bill until the expiration of the contract, or until cancellation of the service by the customer. The majority of the Company's monthly recurring charges for corporate services are billed in advance. To the extent that any cash received is related to a future period, it is recorded as deferred revenue until the service is provided or the usage occurs.

**Accounts Receivable**

Accounts receivable is recorded net of an allowance for doubtful accounts. On a periodic basis, we evaluate our accounts receivable and adjust the allowance for doubtful accounts based on our history of past write-offs and collections and current credit conditions. Specific customer accounts are written off as uncollectible if the probability of a future loss has been established, collection efforts have been exhausted and payment is not expected to be received.

**Cost of Revenues and Cost of Revenues Accrual**

Cost of revenues is comprised primarily of costs incurred from other domestic and international communications carriers to originate, transport, and terminate voice calls for the Company's carrier and corporate customers. The majority of the Company's cost of revenues is thus variable, based upon the number of minutes actually used by the Company's customers and the destinations they are calling. Cost of revenues also includes the monthly recurring cost of certain platform services purchased from other service providers, as well as the monthly recurring costs of broadband Internet access and/or private line services purchased from other carriers to meet the needs of the Company's customers.

Call activity is tracked and analyzed with customized software that analyzes the traffic flowing through the Company's network switches. During each period, the call activity is analyzed and an accrual is recorded for the revenues associated with minutes not yet invoiced. This cost accrual is calculated using minutes from the system and the variable cost of revenue based upon predetermined contractual rates.

In addition to the variable cost of revenue, we incur fixed expenses associated with the facilities comprising our network backbone and the connectivity between our switch facilities and the network backbone. These expenses generally include hubbing charges at our New York switching facility that allow other carriers to send traffic to our switch, as well as satellite and/or fiber optic cable charges to connect to international destinations. Our fixed expenses also include monthly recurring charges associated with certain platform services purchased from other service providers and the monthly recurring costs associated with broadband Internet access and/or private line services purchased from other carriers to meet the needs of our corporate customers.

### Impairment of Long-Lived Assets

We periodically review long-lived assets, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If an impairment indicator is present, we evaluate recoverability by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If the asset is impaired, the impairment recognized is measured by the amount by which the carrying amount exceeds the estimated fair value of the asset. Although we did not record any impairment of long-lived assets in the first nine months of 2011 and 2010, we did write off certain of our property and equipment that we determined was no longer in use, and recorded a loss on disposal of approximately \$25,000 for the net book value of these assets as of September 30, 2011.

### Income Taxes

We account for income taxes in accordance with U.S. GAAP, which requires the recognition of deferred tax liabilities and assets for the expected future income tax consequences of events that have been recognized in our financial statements. Deferred tax liabilities and assets are determined based on the temporary differences between the condensed consolidated interim financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in the years in which the temporary differences are expected to reverse. In assessing the likelihood of utilization of existing deferred tax assets and recording a full valuation allowance, we have considered historical results of operations and the current operating environment.

### Recently Issued Accounting Pronouncements

In January 2010, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2010-06, *“Fair Value Measurements and Disclosures (Topic 820)—Improving Disclosures about Fair Value Measurements.”* ASU 2010-06 requires new disclosures regarding transfers in and out of the Level 1 and 2 and activity within Level 3 fair value measurements and clarifies existing disclosures of inputs and valuation techniques for Level 2 and 3 fair value measurements. ASU 2010-06 also includes conforming amendments to employers’ disclosures about post-retirement benefit plan assets. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosure of activity within Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010, and for interim periods within those years. The adoption of this standard did not have a material impact on our financial position or results of operations.

In April 2010, the FASB issued ASU No. 2010-13, *“Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades.”* This new accounting guidance clarifies that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity’s equity securities trades shall not be considered to contain a market, performance, or service condition. Therefore, such an award is not to be classified as a liability if it otherwise qualifies as equity classification. The amendments in this update should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings. The cumulative-effect adjustment should be calculated for all awards outstanding as of the beginning of the fiscal year in which the amendments are initially applied, as if the amendments had been applied consistently since the inception of the award. The accounting guidance is effective for interim and annual periods beginning on or after December 15, 2010 and is not expected to have a material impact on our financial position or results of operations.

In December 2010, the FASB issued ASU 2010-28, *“Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts.”* ASU 2010-28 provides amendments to Topic 350 to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts to clarify that, for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. For public entities, the amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. As a result of this standard, goodwill impairments may be reported sooner than under current practice. The adoption of this standard did not have a material impact on our financial position or results of operations.

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In May 2011, the FASB issued ASU 2011-04, "*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.*" ASU 2011-04 provides amendments to Topic 820 effective for public entities for interim and annual periods beginning after December 15, 2011, and should be applied prospectively. The amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Early adoption is not permitted for public entities. The Company has determined that the adoption of ASU 2011-04 will not have a material impact on its results of operations or its financial position.

We do not believe that any other recently issued but not yet effective accounting pronouncements, if currently adopted, would have a material effect on the accompanying condensed consolidated interim financial statements

### **Inflation**

We do not believe inflation has a significant effect on the Company's operations at this time.

### **Off Balance Sheet Arrangements**

Under SEC regulations, we are required to disclose the Company's off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. An off-balance sheet arrangement means a transaction, agreement or contractual arrangement to which any entity that is not consolidated with us is a party, under which we have:

- Any obligation under certain guarantee contracts
- Any retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets
- Any obligation under a contract that would be accounted for as a derivative instrument, except that it is both indexed to the Company's stock and classified in stockholder's equity in the Company's statement of financial position
- Any obligation arising out of a material variable interest held by us in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to us, or engages in leasing, hedging or research and development services with us

As of September 30, 2011, we have no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

### **Forward Looking Statements**

Certain statements and the discussion contained herein regarding the Company's business and operations may include "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1996. Such statements consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as "may", "expect", "anticipate", "intend", "estimate" or "continue" or the negative thereof or other variations thereof or comparable terminology. The reader is cautioned that all forward-looking statements are speculative, and there are certain risks and uncertainties that could cause actual events or results to differ from those referred to in such forward-looking statements. This disclosure highlights some of the important risks regarding the Company's business. The number one risk of the Company is its ability to attract fresh and continued capital to execute its comprehensive business strategy. There may be additional risks associated with the integration of businesses following an acquisition, concentration of revenue from one source, competitors with broader product lines and greater resources, emergence into new markets, the termination of any of the Company's significant contracts or partnerships, the Company's inability to maintain working capital requirements to fund future operations or the Company's inability to attract and retain highly qualified management, technical and sales personnel, and the other factors identified by us from time to time in the Company's filings with the SEC. However, the risks included should not be assumed to be the only things that could affect future performance. We may, among other things, also be subject to service disruptions, delays in collections, or facilities closures caused by potential or actual acts of terrorism or government security concerns.

All forward-looking statements included in this document are made as of the date hereof, based on information available to us as of the date thereof, and we assume no obligation to update any forward-looking statements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Disclosure under this section is not required for a smaller reporting company.

**Item 4. Controls and Procedures.**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, or the "Exchange Act") that are designed to ensure that information required to be disclosed in Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2011. Based upon that evaluation and subject to the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to accomplish their objectives.

Our Chief Executive Officer and Chief Financial Officer do not expect that our disclosure controls or our internal controls will prevent all error and all fraud. The design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be considered relative to their cost. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that we have detected all of our control issues and all instances of fraud, if any. The design of any system of controls also is based partly on certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions.

There have been no changes in our internal control over financial reporting that occurred during our fiscal quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings.**

On or about March 14, 2011, a landlord over premises leased by the Company commenced a proceeding in the New York City Civil Court, County of New York (Index No. 060260/11), in which the landlord sought to recover against the Company certain unpaid rent and related charges due under a lease agreement between the landlord and the Company, and to evict the Company from the premises. The Company filed its response to the landlord's claims on April 6, 2011. By Stipulation dated July 5, 2011, the landlord and the Company agreed that the landlord would be entitled to a judgment in the amount of \$228,645 and a warrant of eviction, but that the landlord would not enforce the judgment or execute the warrant as long as the Company complied with the Stipulation. To date, the Company has complied with all of its obligations under the Stipulation and the accompanying consolidated financial statements fully reflect the amounts owed to the landlord by the Company as of the date of the financial statements.

**Item 1A. Risk Factors.**

An investment in our Securities involves a high degree of risk. You should carefully consider the risks described below before you decide to invest in our Securities. If any of the following events actually occur, our business could be seriously harmed. In such case, the value of your investment may decline and you may lose all or part of your investment. You should not invest in our Securities unless you can afford the loss of your entire investment.

## Risks Related to Our Business

**We have a history of operating losses, working capital deficit, and stockholders' deficit. There can be no assurance that we will ever achieve profitability or have sufficient funds to execute our business strategy.**

At September 30, 2011 we had a working capital deficit of \$11.7 million and a stockholders' deficit of \$10.3 million. Although we have reduced our losses, we continue to sustain losses from operations and for the nine months ended September 30, 2011, and 2010 we incurred net losses applicable to common stockholders of \$3.9 million, and \$4.8 million, respectively. In addition, we did not generate positive cash flow from operations for the nine months ended September 30, 2011 and 2010. We may not be able to generate profits in the future and may not be able to support our operations or otherwise establish a return on invested capital. In addition, we may not have sufficient funds to execute our business strategy, which would require us to raise funds from the capital markets, consequently diluting our common stock.

These losses, among other things, have had and will continue to have an adverse effect on our working capital, total assets and stockholders' deficit. In light of our recurring losses, accumulated deficit and cash flow difficulties, the report of our independent registered public accounting firm on our financial statements for the fiscal year ended December 31, 2010 contained an explanatory paragraph raising substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments that may be necessary in the event we are unable to continue as a going concern.

**Our carrier services revenue performance is subject to both internal and external influences, which have and may continue to negatively impact our revenues.**

During 2010 and 2011, the Company's carrier services revenue was negatively impacted not only by seasonal and economic market fluctuations, but also by a general decline in the overall market for international communications as a result of current economic conditions. We were also adversely affected by limits on our ability to provide extended payment terms to larger customers. We anticipate that these revenue growth constraints will be eased as the general economic conditions and the Company's financial condition improve, but there is no assurance that we will be successful in our efforts to increase revenues and margin contribution in this business segment.

**The communications services industry is highly competitive and we may be unable to compete effectively.**

The communications industry, including the provisioning of voice services, Internet services and data services, is highly competitive, rapidly evolving, and subject to constant technological change and intense marketing by providers with similar products and services. We expect that new carrier competitors, as well as "gray market" operators (operators who arrange call termination in a manner that bypasses the authorized local telephone company, resulting in high margins for them and substantially lower revenues for the legitimate providers), may have an impact on the market. In addition, many of our current carrier and corporate competitors are significantly larger and have substantially greater market presence; greater financial, technical, operational, and marketing resources; and more experience. In the event that such a competitor expends significant sales and marketing resources in one or several markets where we compete with them, we may not be able to compete successfully in those markets. We also believe that competition will continue to increase, placing downward pressure on prices. Such pressure could adversely affect our gross margins if we are not able to reduce our costs commensurate with the price reductions of our competitors. In addition, the pace of technological change makes it impossible for us to predict whether we will face new competitors using different technologies to provide the same or similar services offered or proposed to be offered by us. If our competitors were to provide better and more cost effective services than ours, we may not be able to increase our revenues or capture any significant market share.

**Our business is capital intensive, and we do not currently generate sufficient revenues to offset our operating expenses. If we are unable to obtain additional funding, as and when required, we may have to significantly curtail or possibly terminate our operations.**

We will require substantial amounts of future capital in order to continue to fund our operating expenses and to otherwise execute our business plan. We currently do not have sufficient cash or other financial resources to fund our operations and meet our obligations for the next twelve months. If we are unable to obtain additional financing or generate sufficient sales revenue as needed to sustain our operations, as needed, we could be forced to significantly curtail, suspend or terminate our operations, which would result in our recording asset impairment write-downs and other measures. Additional capital may not be available to us when needed, or on terms that are acceptable to us, or at all.

In addition, limited cash resources may restrict our ability to sell those carrier services that require us to purchase termination capacity on shorter payment terms than the terms under which we are able sell to our customers. This could limit our ability to grow our revenues and/or margins, or limit our ability to achieve our revenue and/or margin targets.

**We have historically relied on our officers and directors to loan us funds to sustain our operations. If such loans are not available if and when we require them in the future, we may have insufficient capital to operate.**

We have historically relied upon the sale of our equity securities and loans from non-related and related parties, including Marvin Rosen, the Chairman of the Board of Directors, to fund our operations. From January 1, 2011 through the date of this report, we raised \$0.8 million from the sale of our securities through private placement financings and received \$2.7 million in new loans from Mr. Rosen. We expect to continue to rely on additional sales of our securities and additional borrowings to support our operations and meet the Company's financial obligations for the remainder of 2011. There are no current commitments for such funds and there can be no assurances that such funds will be available to the Company as needed.

**A substantial portion of our debt is due on demand and contains subordinated security interests in our accounts receivable.**

A substantial portion of our debt evidenced by promissory notes is payable upon ten days notice from the lender. Although we have yet to receive any demand notices for this indebtedness, there are no assurances that we will not receive any such notices in the future, and we currently do not have the financial resources to repay these loans should we receive a demand for payment. Moreover, in the event that a demand for payment is made that we cannot meet, lenders may attempt to foreclose on our accounts receivable, which we have pledged as collateral for payment of the notes.

**Our use of equity to fund operations or reduce our indebtedness is dilutive to stockholders and, depending upon the market price for our shares at the time of issuance, we may be required to issue shares at depressed prices.**

Historically, we have funded our working capital requirements through the sale of our equity. The use of our equity to fund operations is dilutive to the equity ownership of our securities by our existing stockholders. Unless we are able to generate substantial revenues to fund our operating expenses, we will, in all likelihood, be required to continue to fund operations through the sale of our equity. Moreover, the dilutive effect of the issuance of shares on our stockholders is directly impacted by the market price for our shares at the time of issuance. If we are required to issue shares at a time when the market price for our shares is depressed, we will issue more shares than if the market price was higher, and the dilutive effect on our stockholders will be greater. From time to time we have also, with concurrence from the holders of our promissory notes, converted such promissory notes into shares of our common stock. If we elect to continue to issue our equity securities in order to convert additional outstanding debt, it would have a further dilutive effect on our existing equity ownership.

**If we are unable to manage our growth or implement our expansion strategy, we may increase our costs without increasing our revenues.**

We may not be able to expand our product offerings, our client base and markets, or implement the other features of our business strategy at the rate or to the extent presently planned. Our projected growth will place a significant strain on our administrative, operational, and financial resources and may increase our costs. If we are unable to successfully manage our future growth, establish, and continue to upgrade our operating and financial control systems, recruit and hire necessary personnel or effectively manage unexpected expansion difficulties, we may not be able to maximize revenues or profitability.

**The success of our growth is dependent upon market developments and traffic patterns, which may lead us to make expenditures that do not result in increased revenues.**

Our purchase of network equipment and software will be based in part on our expectations concerning future revenue growth and market developments. As we expand our network, we will be required to make significant capital expenditures, including the purchase of additional network equipment and software, and to add additional employees. To a lesser extent our fixed costs will also increase from the ownership and maintenance of a greater amount of network equipment including our switching systems, gateways, routers, and other related systems. If our traffic volume were to decrease, or fail to increase to the extent expected or necessary to make efficient use of our network, our costs as a percentage of revenues would increase significantly.

**We may be unable to adapt to rapid technology trends and evolving industry standards, which could lead to our products becoming obsolete.**

The communications industry is subject to rapid and significant changes due to technology innovation, evolving industry standards, and frequent new service and product introductions. New services and products based on new technologies or new industry standards expose us to risks of technical or product obsolescence. We will need to use technologies effectively, continue to develop our technical expertise and enhance our existing products and services in a timely manner to compete successfully in this industry. We may not be successful in using new technologies effectively, developing new products, or enhancing existing products and services in a timely manner or that any new technologies or enhancements used by us or offered to our customers will achieve market acceptance.

**Some of our services are dependent upon multiple service platforms, network elements, and back-office systems that are reliant on third party providers.**

We have deployed back-office systems and services platforms that enable us to offer our customers a wide-array of services and features. Sophisticated back office information and processing systems are vital to our growth and our ability to monitor costs, bill clients, provision client orders, and achieve operating efficiencies. Some of these systems are dependent upon license agreements with third party vendors. These third party vendors may cancel or refuse to renew some of these agreements, and the cancellation or non-renewal of these agreements may harm our ability to bill and provide services efficiently.

**We may be impacted by litigation regarding patent infringement to which we were not a party.**

On March 8, 2007, a jury in the U.S. District Court for the Eastern District of Virginia ruled that Vonage Holdings had infringed on six patents held by Verizon Communications, and ordered Vonage to pay Verizon \$58 million plus a future royalty payment equal to 5.5% of Vonage's customer sales. The patents related in part to technologies used to connect Internet telephone use to the traditional telephone network. Vonage appealed the decision, but terminated its appeals options in November 2007, when it agreed to pay Verizon approximately \$120 million in settlement. The future impact, if any, of this litigation, or of similar litigation that might be initiated by other companies against VoIP service providers, including us, is unclear. If we were restricted from using certain VoIP technologies, it could increase our cost of service or preclude us from offering certain current or future services.

**Breaches in our network security systems may hurt our ability to deliver services and our reputation, and result in liability.**

We could lose clients or expose ourselves to liability, if there are any breaches to our network security systems that jeopardize or result in the loss of confidential information stored in our computer systems. Since our inception, we have experienced only two known breaches of network security, which resulted in a temporary failure of certain network operations, but neither breach resulted in any loss of confidential customer information or in any material financial loss. However, a future network security breach could harm our ability to deliver certain services, damage our reputation, or subject us to liability.

**Our revenue growth is dependent upon our ability to build new distribution relationships, and to bring on new customers, of which there can be no assurance.**

Our ability to grow through efficient and cost effective deployment of our VoIP services is in part dependent upon our ability to identify and contract with local entities that will assist in the distribution of our services. This will include local sales partners that sell our corporate services. If we are unable to identify or contract for such distribution relationships, or if the efforts of third party sales agents are not successful, we may not generate the customers or revenues currently envisioned.

**We are dependent upon our ability to obtain the necessary regulatory approvals and licenses to enter new domestic and international markets in which such approvals are required. Such approvals may or may not occur as planned and may or may not be delayed.**

Our entry into new domestic and international markets may in certain cases rely upon our ability to obtain licenses or other approvals to operate in those markets, our ability to establish good working relationships with the relevant telecommunications regulatory authorities in that jurisdiction, or our ability to interconnect to the local telephone networks in that market. If we are not able to obtain necessary licenses or approvals, our ability to enter into new markets may be delayed or prevented.

**Industry consolidation could make it more difficult for us to compete.**

Companies offering voice, Internet, data and communications services are, in some circumstances, consolidating. We may not be able to compete successfully with businesses that have combined, or will combine, to produce companies with substantially greater financial, technical, sales, and marketing resources, or with larger client bases, more extended networks, or more established relationships with vendors, distributors and partners. With these heightened competitive pressures, there is a risk that our revenues may not grow as expected and the value of our common stock could decline.

**Our ability to provide services is often dependent on our suppliers and other service providers who may not prove to be effective.**

A majority of the voice calls made by our clients are connected through other communication carriers, which provide us with transmission capacity through a variety of arrangements. Our ability to terminate voice traffic in our targeted markets is an essential component of our ongoing operations. If we do not secure or maintain operating and termination arrangements, our ability to increase services to our existing markets, and gain entry into new markets, will be limited. Therefore, our ability to maintain and expand our business is dependent, in part, upon our ability to maintain satisfactory relationships with other domestic carriers, Internet service providers, international carriers, satellite providers, fiber optic cable providers and other service providers, many of which are our competitors, and upon our ability to obtain their services on a cost effective basis. In addition, if a carrier with whom we interconnect does not carry the traffic routed to it, or does not provide the required capacity, we may be forced to route our traffic to, or buy capacity from, a different carrier on less advantageous terms, which could reduce our profit margins or degrade our network service quality. In the event network service is degraded, it may result in a loss of customers. To the extent that any of these carriers with whom we interconnect raise their rates, change their pricing structure, or reduce the amount of capacity they will make available to us, our revenues and profitability may be adversely affected.

**We rely on third party equipment suppliers who may not be able to provide us the equipment necessary to deliver the services that we seek to provide.**

We are dependent upon third party equipment suppliers for equipment, software, and hardware components, including Cisco, Nextone, BroadSoft, and Veraz. If these suppliers fail to continue product development and research and development or fail to deliver quality products or support services on a timely basis, or we are unable to develop alternative sources of supply, if and as required, it could result in an inability to deliver the services that we currently provide or intend to provide, and our financial condition and results of operations may be adversely affected.

**We rely on the cooperation of other international carriers and/or postal telephone and telegraph companies (PTTs), who may not always cooperate with us in our attempts to serve a specific country or market.**

In some cases, the growth of our carrier services business requires the cooperation of other international carriers and/or the incumbent PTT in order to provide services to or from specific countries or markets. In the event the PTT, or another in-country international carrier, does not cooperate with us or support us in our efforts to serve that country, our ability to provide service to or from that country may be delayed, or the costs to provide service might increase due to our being forced to use another more expensive carrier. If we are unable to develop and maintain successful relationships with other international carriers and PTT's, our ability to service an important market could be prevented or adversely affected.

**Service interruptions due to disputes could result in a loss of revenues and harm our reputation.**

Portions of our terminating network may be shut down from time to time, as a result of circumstances including disputes with vendors, acts of war, terrorism, acts of God or other issues, many of which are beyond our control. Any future network shut downs can have a significant negative impact on revenue and cash flows, as well as hurting our reputation. In addition, there is no assurance that we will be able to quickly resolve disputes or disruptions, which could result in a permanent loss of revenues.

**Because we do business on an international level, we are subject to an increased risk of tariffs, sanctions and other uncertainties that may hurt our revenues.**

There are certain risks inherent in doing business internationally, especially in emerging markets, such as unexpected changes in regulatory requirements, the imposition of tariffs or sanctions, licenses, customs, duties, other trade barriers, political risks, currency devaluations, high inflation, corporate law requirements, and even civil unrest. Many of the economies of these emerging markets we seek to enter are weak and volatile. We may not be able to mitigate the effect of inflation on our operations in these countries by price increases, even over the long-term. Further, expropriation of private businesses in such jurisdictions remains a possibility, whether by outright seizure by a foreign government or by confiscatory tax or other policies. Also, deregulation of the communications markets in developing countries may or may not continue. Incumbent service providers, trade unions and others may resist legislation directed toward deregulation and may resist allowing us to interconnect to their networks. The legal systems in emerging markets also frequently have insufficient experience with commercial transactions between private parties, and consequently, we may not be able to protect or enforce our rights in some emerging market countries. Governments and regulations may change, thus impacting the availability of new licenses or the cancellation or suspension of existing operating licenses. The instability of the laws and regulations applicable to our businesses, as well as their interpretation and enforcement, could materially and adversely affect our business, our financial condition, or results of operations in those countries.

The regulatory treatment of VoIP outside the United States varies from country to country. Some countries are considering subjecting VoIP services to the regulations applied to traditional telephone companies and they may assert that we are required to register as a telecommunications carrier in that country or impose other more onerous regulations. In such cases, our failure to register could subject us to fines, penalties, or forfeiture of our right to do business in that country. Regulatory developments such as these could have a material adverse effect on our international operations.

**Additional taxation and government regulations of the communications industry may slow our growth, resulting in decreased demand for our products and services and increased costs of doing business.**

As a result of changes in regulatory policy, we could be forced to pay additional taxes on the products and services we provide. We structure our operations and our pricing based on assumptions about various domestic and international tax laws, tax treaties, and other relevant laws. Taxation authorities or other regulatory authorities might not reach the same conclusions about taxation that we have reached in formulating our assumptions. We could suffer adverse tax and other financial consequences, if our assumptions about these matters are incorrect or the relevant laws are changed or modified.

In the U.S., our products and services are generally subject to varying degrees of federal, state, and local regulation, including regulation by the Federal Communications Commission (FCC) and various state public utility commissions. We may also be subject to similar regulation by foreign governments and their telecommunications and/or regulatory agencies. While these regulatory agencies grant us the authority to operate our business, they typically exercise minimal control over our services and pricing. However, they do require the filing of various reports, compliance with public safety and consumer protection standards, and the payment of certain regulatory fees and assessments.

We cannot assure you that the applicable U.S. and foreign regulatory agencies will grant us the required authority to operate, will allow us to maintain existing authority so we can continue to operate, or will refrain from taking action against us if we are found to have provided services without obtaining the necessary authority. Similarly, if our pricing, and/or terms or conditions of service, are not properly filed or updated with the applicable agencies, or if we are otherwise not fully compliant with the rules of the various regulatory agencies, regulators or other third parties could challenge our actions and we could be subject to forfeiture of our authority to provide service, or to penalties, fines, fees, or other costs. We have been delinquent in certain filing and reporting obligations in the past, including, but not limited to, filings with the FCC and Universal Service Fund (USF) reports and payments. We are currently working with various federal and state regulatory agencies to complete any outstanding filings.

**In addition to new regulations being adopted, existing laws may be applied to the Internet, which could hamper our growth.**

New and existing laws may cover issues that include: sales and other taxes; user privacy; pricing controls; characteristics and quality of products and services; consumer protection; cross-border commerce; copyright, trademark and patent infringement; and other claims based on the nature and content of Internet materials. This could delay growth in demand for our products and services and limit the growth of our revenue.

**A large percentage of our current revenues are related to a small group of customers and loss of any of those customers could negatively impact our revenues.**

A large percentage of our carrier services revenues are provided by a limited number of customers. Specifically, our five largest customers accounted for approximately 53.8% and 66.4% of our revenues for the years ended December 31, 2010, and December 31, 2009, respectively. The terms of the customer's agreements do not contractually bind the customer to continue using our services and, if our business with these customers were to significantly decrease or cease altogether, it could have a negative impact on our revenues and cash flow.

**Risks Related to Our Common Stock**

**Although our shares are widely dispersed, two voting blocs may influence the outcome of matters submitted to a vote of our stockholders; and the interests of these voting blocs may differ from other stockholders.**

West End Special Opportunity Fund II, LP ("West End") currently beneficially owns approximately 19.9 million shares, or 13.7%, of our outstanding common stock, and is the second largest single voting bloc in the Company. Additionally, our directors and executive officers as a group of persons currently beneficially own approximately 41 million shares, or 26%, of our common stock. As a result, while neither West End nor our directors and officers as a group have sufficient voting power to control the outcome of matters submitted to a vote of our stockholders, the extent of their ownership enables both groups to influence the outcome of these matters, including the election of directors and extraordinary corporation transactions including business combinations. Their interests may differ from those of other stockholders.

**We are not likely to pay cash dividends on our common stock in the foreseeable future.**

We have never declared or paid any cash dividends on our common stock. We intend to retain any future earnings to finance our operations and to expand our business and therefore do not expect to pay any cash dividends in the foreseeable future. Holders of our outstanding preferred stock are entitled to receive dividends prior to the payment of any dividends on our common stock. The payment of dividends is also subject to provisions of Delaware law prohibiting the payment of dividends except out of surplus and certain other limitations.

**Our common stock is subject to price volatility unrelated to our operations.**

The market price of our common stock could fluctuate substantially due to a variety of factors, including market perception of our ability to achieve our planned growth, quarterly operating results of other companies in the same industry, trading volume in our common stock, changes in general conditions in the economy and the financial markets or other developments affecting our competitors or us. In addition, the stock market is subject to extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies for reasons unrelated to their operating performance and could have the same effect on our common stock.

In addition, the market price of our common stock may fluctuate significantly in response to a number of other factors, many of which are beyond our control, including, but not limited to, the following:

- Ability to obtain securities analyst coverage
- Changes in securities analysts' recommendations or estimates of our financial performance
- Changes in the market valuations of companies similar to us
- Announcements by us or our competitors of significant contracts, new offerings, acquisitions, commercial relationships, joint ventures, or capital commitments
- Failure to meet analysts' expectations regarding financial performance

Furthermore, in the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. A securities class action lawsuit against us, regardless of its merit, could result in substantial costs and divert the attention of our management from other business concerns, which in turn could harm our business.

**Our common stock could become subject to the "Penny Stock" rules of the Commission, which will make transactions in our common stock cumbersome and may reduce the value of an investment in our common stock.**

For so long as the trading price of our common stock is less than \$5.00 per share, our common stock may be considered a "penny stock," and, in such event, trading in our common stock would be subject to the requirements of Rule 15g-9 under the Securities Exchange Act of 1934. Under this rule, broker/dealers who recommend low-priced securities to persons other than established customers and accredited investors must satisfy special sales practice requirements. The broker/dealer must make an individualized written suitability determination for the purchaser and receive the purchaser's written consent prior to the transaction. SEC regulations also require additional disclosure in connection with any trades involving a "penny stock," including the delivery, prior to any penny stock transaction, of a disclosure schedule explaining the penny stock market and its associated risks.

## FUSION TELECOMMUNICATIONS INTERNATIONAL, INC. AND SUBSIDIARIES

These requirements severely limit the liquidity of securities in the secondary market because few brokers or dealers are likely to undertake these compliance activities. In addition to the applicability of the penny stock rules, other risks associated with trading in penny stocks could also be price fluctuations and the lack of a liquid market.

To date, we have not been considered a “penny stock” due to an exemption for companies with average annual audited revenues for the prior three years in excess of \$6,000,000 per year. However, should the exclusions from the definition of a “penny stock” change, or should our annual revenues fall dramatically, we may become subject to rules applicable to “penny stocks” and the market for our shares may be adversely affected thereby.

### **The elimination of monetary liability against our directors, officers and employees under our certificate of incorporation and the existence of indemnification rights to our directors, officers and employees may result in substantial expenditures by our Company and may discourage lawsuits against our directors, officers and employees.**

Our certificate of incorporation contains provisions which eliminate the liability of our directors for monetary damages to our Company and stockholders to the maximum extent permitted under Delaware corporate law. Our by-laws also require us to indemnify our directors to the maximum extent permitted by Delaware corporate law. We may also have contractual indemnification obligations under our agreements with our directors, officers and employees. The foregoing indemnification obligations could result in our Company incurring substantial expenditures to cover the cost of settlement or damage awards against directors, officers and employees, which we may be unable to recoup. These provisions and resultant costs may also discourage our Company from bringing a lawsuit against directors, officers and employees for breaches of their fiduciary duties, and may similarly discourage the filing of derivative litigation by our stockholders against our directors, officers and employees even though such actions, if successful, might otherwise benefit our Company and stockholders.

### **The issuance of our common stock upon the exercise of options or warrants or the conversion of outstanding convertible securities may cause significant dilution to our stockholders and may have an adverse impact on the market price of our common stock.**

As of the date of this report, there were 148,254,997 shares of our common stock outstanding. The issuance of our shares upon the exercise or conversion of securities we have outstanding will increase the number of our publicly traded shares, which could depress the market price of our common stock. As of September 30, 2011, unexercised stock options to purchase 5,244,761 shares of our common stock, unexercised warrants to purchase 45,452,877 shares of our common stock and preferred stock convertible into 6,927,913 shares of common stock were outstanding.

The perceived risk of dilution may cause our stockholders to sell their shares, which would contribute to a downward movement in the stock price of our common stock. Moreover, the perceived risk of dilution and the resulting downward pressure on our stock price could encourage investors to engage in short sales of our common stock. By increasing the number of shares offered for sale, material amounts of short selling could further contribute to progressive price declines in our common stock.

### **We could use preferred stock to fund operations or resist takeovers, and the issuance of preferred stock may cause additional dilution.**

Our certificate of incorporation authorizes the issuance of up to 10,000,000 shares of preferred stock, of which 5,045 shares of Series A-1, A-2 and A-4 Preferred Stock are currently issued and outstanding. Our certificate of incorporation gives our board of directors the authority to issue preferred stock without the approval of our stockholders. We may issue additional shares of preferred stock to raise money to finance our operations. We may authorize the issuance of the preferred stock in one or more series. In addition, we may set the terms of preferred stock, including:

- Dividend and liquidation preferences
- Voting rights
- Conversion privileges
- Redemption terms
- Other privileges and rights of the shares of each authorized series

The issuance of large blocks of preferred stock could possibly have a dilutive effect to our existing stockholders. It can also negatively impact our existing stockholders' liquidation preferences. In addition, while we include preferred stock in our capitalization to improve our financial flexibility, we could possibly issue our preferred stock to friendly third parties to preserve control by present management. This could occur if we become subject to a hostile takeover that could ultimately benefit our stockholders and us.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

During the three months ended September 30, 2011, the Company sold and issued to seven accredited investors 3,037,702 shares of common stock and warrants to purchase 911,314 shares of the Company's common stock at exercise prices ranging from \$0.07 to \$0.09 per share, which represents 125% of the average closing price of the Company's common stock for the five trading days prior to closing. The net proceeds of \$197,000 were used for general working capital purposes. The securities were sold by the Company's officers and directors and no commissions or other remuneration were paid in connection with these transactions. These transactions were exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D thereunder.

**Item 3. Defaults Upon Senior Securities.**

None

**Item 4. Submission of Matters to a Vote of Security Holders.**

None

**Item 5. Other Information.**

On September 12, 2011, the Company entered into a purchase and sale agreement with Prestige Capital Corporation (“Prestige”), whereby the Company can sell certain of its accounts receivable to Prestige at a discount in order to improve the Company’s liquidity and cash flow. The initial sale of receivables closed on September 19, 2011 and the Company sold receivables to Prestige with a book value of approximately \$470,000. The Company recognized a loss on the sale of those receivables of approximately \$8,000. In connection with this sale and in accordance with the purchase and sale agreement, Prestige paid the Company 75% of the face amount of the receivables, or approximately \$352,000, on the closing date. The remainder, net of the discount, will be paid to the Company within four business days after Prestige receives payment on the receivables, which generally have 30 day terms. The Company has the option to make additional sales of accounts receivable provided they meet the criteria outlined in the agreement, the term of which is for nine months.

Prestige also provided the Company with a one-time advance of \$208,382 on the closing date. This advance is secured by a priority lien on the Company’s accounts receivable. The proceeds from the advance were used to pay down other third party indebtedness and for general corporate purposes. The advance is payable in 25 equal weekly installments beginning in October of 2011 and an advance fee of approximately \$15,000 is payable 180 days after the closing date.

**Item 6. Exhibits.**

EXHIBIT NO.	DESCRIPTION
31.1	Certification of the Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
10.41	Purchase and Sale Agreement dated September 12, 2011 between registrant and Prestige Capital Corporation.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

**SIGNATURES**

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

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.**

By: **/s/ MATTHEW D. ROSEN**

Matthew D. Rosen  
Chief Executive Officer

November 15, 2011

By: **/s/ GORDON HUTCHINS, JR.**

Gordon Hutchins, Jr.  
President, Chief Operating Officer and Acting Chief Financial Officer

November 15, 2011

**Index to Exhibits**

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101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

**EXHIBIT 31.1**

**Certification of the Chief Executive Officer**

I, **Matthew D. Rosen**, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 (the "Report") of Fusion Telecommunications International, Inc., a Delaware corporation ("the Registrant");
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;
4. The Registrant's other certifying officer and I, are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and internal control over financial reporting [as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)] for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - (d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.**

November 15, 2011

By: /s/ MATTHEW D. ROSEN  
Matthew D. Rosen  
Chief Executive Officer

## EXHIBIT 31.2

### Certification of the Chief Financial Officer

I, **Gordon Hutchins, Jr.**, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 (the "Report") of Fusion Telecommunications International, Inc., a Delaware corporation ("the Registrant");
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;
4. The Registrant's other certifying officer and I, are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and internal control over financial reporting [as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)] for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - (d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors;
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.**

November 15, 2011

By: /s/ GORDON HUTCHINS, JR.

Gordon Hutchins, Jr.

President, Chief Operating Officer and Acting Chief Financial Officer

**EXHIBIT 32.1**

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 (SUBSECTIONS (A) AND (B) OF SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE)**

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officer of Fusion Telecommunications International, Inc., a Delaware corporation (the "Company"), does hereby certify that:

The Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 (the "Form 10-Q") of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.**

November 15, 2011

By: /s/ MATTHEW D. ROSEN  
Matthew D. Rosen  
Chief Executive Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC or its staff upon request.

**EXHIBIT 32.2**

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 (SUBSECTIONS (A) AND (B) OF SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE)**

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officer of Fusion Telecommunications International, Inc., a Delaware corporation (the "Company"), does hereby certify that:

The Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 (the "Form 10-Q") of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.**

November 15, 2011

By: /s/ GORDON HUTCHINS, JR.

Gordon Hutchins, Jr.

President, Chief Operating Officer and Acting Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC or its staff upon request.