

MANHATTAN PHARMACEUTICALS INC  
Form 10QSB/A  
August 14, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**Amendment No. 1 to  
FORM 10-QSB**

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

For the quarterly period ended March 31, 2006

OR

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

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

Commission file number 001-32639

**Manhattan Pharmaceuticals, Inc.**

(Exact Name of Small Business Issuer as Specified in Its Charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

36-3898269  
(I.R.S. Employer Identification No.)

810 Seventh Avenue, 4th Floor, New York, New York 10019  
(Address of principal executive offices)

(212) 582-3950  
(Issuer's telephone number)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the issuer 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 is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes  No

As of May 4th, 2006 there were 60,120,038 shares of the issuer's common stock, \$.001 par value, outstanding.

Traditional Small Business Disclosure Format (check one): Yes  No

Explanatory Note:

This Amendment No. 1 to Quarterly Report on Form 10-QSB (the "Form 10-QSB/A") of Manhattan Pharmaceuticals, Inc. (the "Company," "we," "us" or "our") amends the Company's Quarterly Report on Form 10-QSB for the quarter ended March 31, 2006 (the "Form 10-QSB"), which was originally filed with the Securities and Exchange Commission ("SEC") on May 15, 2006. We are filing this Form 10-QSB/A to restate our financial statements for the quarter ended March 31, 2006 to increase our prepaid expenses and reduce our research and development expenses by \$416,798 and to disclose a material commitment of \$2,151,840 entered into in March 2006 for the conduct of a Phase IIa study of our obesity product, Oleoyl-estrone. The increase in our prepaid expenses and reduction in our research and development expenses of \$416,798 related to a correction of our recording the initial invoice of \$430,368 relative to this commitment. In our Form 10-QSB we recorded as expense the entire invoice amount of \$430,368. The invoice should have been recorded as \$13,570 of research and development expense and an increase of \$416,798 in our prepaid expenses.

This Form 10-QSB/A is being filed solely to amend and restate Items 1, 2 and 3 of Part I, and Item 6 of Part II, of the original Form 10-QSB.

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### Forward-Looking Statements

This quarterly report on Form 10-QSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Exchange Act. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as “anticipate,” “estimate,” “plan,” “project,” “expect,” “may,” “intend” and similar words or phrases. Accordingly, these statements involve estimates, assumptions and uncertainties that could cause actual results to differ materially from those expressed in them. These statements are therefore subject to risks and uncertainties, known and unknown, which could cause actual results and developments to differ materially from those expressed or implied in such statements. Such risks and uncertainties relate to, among other factors:

- the development of our drug candidates;
- the regulatory approval of our drug candidates;
- our use of clinical research centers and other contractors;
- our ability to find collaborative partners for research, development and commercialization of potential products;
- acceptance of our products by doctors, patients or payers;
- our ability to market any of our products;
- our history of operating losses;
- our ability to compete against other companies and research institutions;
- our ability to secure adequate protection for our intellectual property;
- our ability to attract and retain key personnel;
- availability of reimbursement for our product candidates;
- the effect of potential strategic transactions on our business;
- our ability to obtain adequate financing; and
- the volatility of our stock price.

Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which factors will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

**PART I - FINANCIAL INFORMATION****Item 1. Unaudited Condensed Consolidated Financial Statements****MANHATTAN PHARMACEUTICALS, INC. AND SUBSIDIARIES**

(A Development Stage Company)

## Condensed Consolidated Balance Sheets

| Assets   | <b>March 31,<br/>2006</b><br>(Unaudited,<br>as restated) | <b>December 31,<br/>2005</b><br><br>(Note 1) |
|--|--|--|
| Current assets:  |  |  |
| Cash and cash equivalents  | \$ 8,532,374   | \$ 9,826,336                                 |
| Short-term investments, available for<br>sale, at market   | 509,310  | 1,007,818                                    |
| Prepaid expenses   | 479,287  | 194,776                                      |
| Total current assets   | 9,520,971  | 11,028,930                                   |
| Property and equipment, net  | 100,524  | 106,877                                      |
| Other assets   | 70,506   | 70,506                                       |
| Total assets   | \$ 9,692,001   | \$ 11,206,313                                |
| <b>Liabilities and Stockholders' Equity</b>  |  |  |
| Current liabilities:   |  |  |
| Accounts payable   | \$ 1,991,037   | \$ 1,617,489                                 |
| Accrued expenses   | 255,909  | 48,328                                       |
| Total liabilities  | 2,246,946  | 1,665,817                                    |
| Commitments and contingencies  |  |  |
| Stockholders' equity:  |  |  |
| Common stock, \$.001 par value.<br>Authorized 150,000,000 shares;<br>60,092,697 shares issued and<br>outstanding | 60,093   | 60,093                                       |
| Additional paid-in capital   | 43,052,858   | 42,751,111                                   |
| Deficit accumulated during the<br>development stage  | (35,669,885)   | (33,271,695)                                 |
| Accumulated other comprehensive<br>income  | 1,989  | 987  |
| Total stockholders' equity   | 7,445,055  | 9,540,496                                    |
| Total liabilities and stockholders'<br>equity  | \$ 9,692,001   | \$ 11,206,313                                |

See accompanying notes to unaudited condensed consolidated financial statements.



**MANHATTAN PHARMACEUTICALS, INC. AND SUBSIDIARIES**  
(A Development Stage Company)

Condensed Consolidated Statements of Operations  
(Unaudited)

|   | <b>Three months ended March</b> |                | <b>Cumulative<br/>period from<br/>August 6,<br/>2001<br/>(inception) to</b> |
|---|---------------------------------|----------------|---|
|   | <b>31,</b>                      |                | <b>March 31,</b>  |
|   | <b>2006</b>                     | <b>2005</b>    | <b>2006</b>   |
|   | (As restated)                   |                | (As restated)   |
| Revenue   | \$ —                            | \$ —           | \$ —  |
| Costs and expenses:                                   |                                 |                |   |
| Research and development                              | 1,606,521                       | 964,040        | 13,387,032  |
| General and administrative                            | 890,865                         | 493,243        | 7,307,476   |
| In-process research and development charge            | —                               | —              | 11,887,807  |
| Impairment of intangible assets                       | —                               | —              | 1,248,230   |
| Loss on disposition of intangible assets              | —                               | —              | 1,213,878   |
| Total operating expenses                              | 2,497,386                       | 1,457,283      | 35,044,423  |
| Operating loss  | (2,497,386)                     | (1,457,283)    | (35,044,423)  |
| Other (income) expense:                               |                                 |                |   |
| Interest and other income                             | (98,706)                        | (31,204)       | (500,551)   |
| Interest expense                                      | —                               | —              | 23,893  |
| Realized gain on sale of marketable equity securities | (490)                           | —              | (77,524)  |
| Total other income                                    | (99,196)                        | (31,204)       | (554,182)   |
| Net loss  | (2,398,190)                     | (1,426,079)    | (34,490,241)  |
| Preferred stock dividends (including imputed amounts) | —                               | (127,466)      | (1,179,644)   |
| Net loss applicable to common shares                  | \$ (2,398,190)                  | \$ (1,553,545) | \$ (35,669,885)   |

Net loss per common  
share:

|                   |    |        |    |        |
|-------------------|----|--------|----|--------|
| Basic and diluted | \$ | (0.04) | \$ | (0.05) |
|-------------------|----|--------|----|--------|

Weighted average shares  
of common stock  
outstanding:

|                   |            |            |
|-------------------|------------|------------|
| Basic and diluted | 60,092,697 | 28,665,144 |
|-------------------|------------|------------|

See accompanying notes to unaudited condensed consolidated financial statements.

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**MANHATTAN PHARMACEUTICALS, INC. AND SUBSIDIARIES**  
(A Development Stage Company)

Condensed Consolidated Statements of Stockholders' Equity (Deficiency)  
(Unaudited, as restated)

|   | Series A<br>convertible<br>preferred stock<br>Shares | Amount | Common stock<br>Shares | Amount     | Additional<br>paid-in<br>capital | Subscription<br>receivable | Deficit<br>accumulated<br>during<br>development<br>stage | Dividends<br>payable<br>in<br>Series A<br>preferred<br>shares | Accumulated<br>other<br>comprehensive<br>income(loss) | Unearned<br>consulting<br>services |
|---|--|--------|------------------------|------------|----------------------------------|----------------------------|--|---|---|------------------------------------|
| Stock issued at<br>\$0.0004 per<br>share for  |  |        |                        |            |                                  |                            |  |   |   |                                    |
| subscription<br>receivable  | —  | \$     | —                      | 10,167,741 | \$                               | 10,168                     | \$   | (6,168)   | \$  | (4,000)                            |
| Net loss  | —  |        | —                      |            | —                                |                            | —  | (56,796)  | —   | —                                  |
| Balance at<br>December 31,<br>2001  | —  |        | —                      | 10,167,741 | 10,168                           | (6,168)                    | (4,000)  | (56,796)  | —   | —                                  |
| Proceeds from<br>subscription<br>receivable   | —  |        | —                      |            | —                                | 4,000                      |  | —   | —   | —                                  |
| Stock issued at<br>\$0.0004 per share<br>for  |  |        |                        |            |                                  |                            |  |   |   |                                    |
| license rights  | —  |        | —                      | 2,541,935  | 2,542                            | (1,542)                    | —  | —   | —   | —                                  |
| Stock options<br>issued for<br>consulting<br>services   | —  |        | —                      |            | —                                | 60,589                     | —  | —   | —   | (60,589)                           |
| Amortization of<br>unearned<br>consulting<br>services   | —  |        | —                      |            | —                                |                            | —  | —   | —   | 22,222                             |
| Sales of<br>common stock<br>at \$0.63 per<br>share through<br>private placement,<br>net of expenses | —  |        | —                      | 3,043,332  | 3,043                            | 1,701,275                  | —  | —   | —   | —                                  |
| Net loss  | —  |        | —                      |            | —                                |                            | —  | (1,037,320)   | —   | —                                  |
| Balance at<br>December 31,<br>2002  | —  |        | —                      | 15,753,008 | 15,753                           | 1,754,154                  | —  | (1,094,116)   | —   | (37,367)                           |
| Common  | —  |        | —                      | 1,321,806  | 1,322                            | 742,369                    | —  | —   | —   | —                                  |

|   |           |       |            |        |            |   |             |           |         |    |
|---|-----------|-------|------------|--------|------------|---|-------------|-----------|---------|----|
| stock issued at<br>\$0.63 per<br>share, net<br>of expenses  |           |       |            |        |            |   |             |           |         |    |
| Effect of reverse<br>acquisition  | —         | —     | 6,287,582  | 6,287  | 2,329,954  | — | —           | —         | —       |    |
| Amortization<br>of unearned<br>consulting<br>costs  | —         | —     | —          | —      | —          | — | —           | —         | —       | 37 |
| Unrealized<br>loss on<br>short-term<br>investments  | —         | —     | —          | —      | —          | — | —           | —         | (7,760) |    |
| Payment for<br>fractional shares<br>for<br>stock<br>combination   | —         | —     | —          | —      | (300)      | — | —           | —         | —       |    |
| Preferred<br>stock issued at<br>\$10 per<br>share, net<br>of expenses                                   | 1,000,000 | 1,000 | —          | —      | 9,045,176  | — | —           | —         | —       |    |
| Imputed<br>preferred stock<br>dividend  |           |       |            |        | 418,182    | — | (418,182)   | —         | —       |    |
| Net loss  | —         | —     | —          | —      | —          | — | (5,960,907) | —         | —       |    |
| Balance at<br>December 31,<br>2003  | 1,000,000 | 1,000 | 23,362,396 | 23,362 | 14,289,535 | — | (7,473,205) | —         | (7,760) |    |
| Exercise of<br>stock options  | —         | —     | 27,600     | 27     | 30,073     | — | —           | —         | —       |    |
| Common<br>stock issued<br>through<br>private<br>placement at<br>\$1.10<br>per share,<br>net of expenses | —         | —     | 3,368,952  | 3,369  | 3,358,349  | — | —           | —         | —       |    |
| Conversion<br>of preferred<br>stock to<br>common<br>stock   | (170,528) | (171) | 1,550,239  | 1,551  | (1,380)    | — | —           | —         | —       |    |
| Preferred<br>stock dividends<br>paid by   | 24,901    | 25    | —          | —      | 281,073    | — | —           | (282,388) | —       |    |

|   |         |     |            |        |            |   |              |         |        |        |
|---|---------|-----|------------|--------|------------|---|--------------|---------|--------|--------|
| issuance<br>of shares   |         |     |            |        |            |   |              |         |        |        |
| Preferred<br>stock dividend<br>accrued  | —       | —   | —          | —      | —          | — | (585,799)    | 585,799 | —      |        |
| Warrants<br>issued for<br>consulting<br>services  | —       | —   | —          | —      | 125,558    | — | —            | —       | —      | —(120  |
| Amortization of<br>unearned<br>consulting costs   | —       | —   | —          | —      | —          | — | —            | —       | —      | — 100  |
| Reversal of<br>unrealized loss<br>on<br>short-term<br>investments and<br>unrealized<br>gain on<br>short-term<br>investments | —       | —   | —          | —      | —          | — | —            | —       | —      | 20,997 |
| Net loss  | —       | —   | —          | —      | —          | — | (5,896,031)  | —       | —      | —      |
| Balance at<br>December 31,<br>2004  | 854,373 | 854 | 28,309,187 | 28,309 | 18,083,208 | — | (13,955,035) | 303,411 | 13,237 | (20    |
| Common<br>stock issued<br>through<br>private<br>placement at<br>\$1.11 and<br>\$1.15 per<br>share, net of<br>expenses       | —       | —   | 11,917,680 | 11,918 | 12,238,291 | — | —            | —       | —      | —      |
| Common<br>stock issued to<br>vendor at<br>\$1.11 per<br>share in<br>satisfaction of<br>accounts<br>payable                  | —       | —   | 675,675    | 676    | 749,324    | — | —            | —       | —      | —      |
| Exercise of<br>stock options  | —       | —   | 32,400     | 33     | 32,367     | — | —            | —       | —      | —      |
| Exercise of<br>warrants   | —       | —   | 279,845    | 279    | 68,212     | — | —            | —       | —      | —      |

|  |           |       |           |               |          |     |           |              |          |
|--|-----------|-------|-----------|---------------|----------|-----|-----------|--------------|----------|
| Conversion of preferred stock to common stock                            | (896,154) | (896) | 8,146,858 | 8,147         | (7,251)  | —   | —         | —            | —        |
| Preferred stock dividends paid by issuance of shares                     | 41,781    | 42    | —         | —             | 477,736  | —   | —         | (479,074)    | —        |
| Preferred stock dividend accrued   | —         | —     | —         | —             | —        | —   | (175,663) | 175,663      | —        |
| Share-based compensation   | —         | —     | —         | —             | 66,971   | —   | —         | —            | 20       |
| Reversal of unrealized gain on short-term investments                    | —         | —     | —         | —             | —        | —   | —         | —            | (12,250) |
| Stock issued in connection with acquisition of Tarpan Therapeutics, Inc. | —         | —     | —         | —             | —        | —   | —         | —            | —        |
| Net loss   | —         | —     | —         | —             | —        | —   | —         | (19,140,997) | —        |
| Balance at December 31, 2005   | —         | —     | —         | —             | —        | —   | —         | —            | —        |
| Share-based compensation   | —         | —     | —         | —             | 311,913  | —   | —         | —            | —        |
| Unrealized gain on short-term investments                                | —         | —     | —         | —             | —        | —   | —         | —            | 1,002    |
| Costs associated with private placement                                  | —         | —     | —         | —             | (10,166) | —   | —         | —            | —        |
| Net loss   | —         | —     | —         | —             | —        | —   | —         | (2,398,190)  | —        |
| Balance at March 31, 2006  | —         | —     | —         | —             | —        | —   | —         | —            | —        |
|  | —\$       | —\$   | \$ 60,093 | \$ 43,052,858 | \$       | —\$ | —\$       | —\$          | 1,989 \$ |

See accompanying notes to unaudited condensed consolidated financial statements.

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**MANHATTAN PHARMACEUTICALS, INC. AND SUBSIDIARIES**  
(A Development Stage Company)

Condensed Consolidated Statements of Cash Flows  
(Unaudited)

|   | Three months ended March 31, |                | Cumulative<br>period from<br>August 6,<br>2001(inception)<br>to<br>March 31,<br>2006 |
|---|------------------------------|----------------|--|
|   | 2006                         | 2005           |  |
|   | (As restated)                |                | (As restated)  |
| <b>Cash flows from operating activities:</b>                                |                              |                |  |
| Net loss  | \$ (2,398,190)               | \$ (1,426,079) | \$ (34,490,241)  |
| Adjustments to reconcile net loss to net cash used in operating activities: |                              |                |  |
| Common stock issued for license rights                                      | —                            | —              | 1,000  |
| Stock-based compensation  | 311,913                      | 20,168         | 560,441  |
| Warrants issued for consulting services                                     | —                            | —              | 4,590  |
| Amortization of intangible assets   | —                            | —              | 145,162  |
| Gain on sale of marketable equity securities                                | (490)                        | —              | (77,524)   |
| Depreciation  | 14,852                       | 12,743         | 102,146  |
| Non cash portion of in-process research and development charge              | —                            | —              | 11,721,623   |
| Loss on impairment of intangible assets                                     | —                            | —              | 1,248,230  |
| Loss on disposition of intangible assets                                    | —                            | —              | 1,213,878  |
| Changes in operating assets and liabilities, net of acquisitions:           |                              |                |  |
| Decrease (increase) in prepaid expenses and other current assets            | (284,511)                    | 39,786         | (421,042)  |
| Increase in other assets  | —                            | —              | (70,506)   |
| Increase (decrease) in accounts payable                                     | 373,548                      | (31,508)       | 2,391,251  |
| Increase (decrease) in accrued expenses                                     | 207,581                      | 106,387        | (284,412)  |
| Net cash used in operating activities                                       | (1,775,297)                  | (1,278,503)    | (17,955,404)   |
| <b>Cash flows from investing activities:</b>                                |                              |                |  |
| Purchase of property and equipment  | (8,499)                      | (20,081)       | (192,948)  |
| Cash paid in connection with acquisitions                                   | —                            | (128,233)      | (32,808)   |
| Purchase of short-term investments  | —                            | —              | (5,000,979)  |
| Proceeds from sale of short-term investments                                | 500,000                      | 997,067        | 4,931,088  |
| Proceeds from sale of license   | —                            | —              | 200,001  |
| Cash acquired in acquisition  | —                            | —              | 6,777  |
| Net cash provided by (used in) investing activities                         | 491,501                      | 848,753        | (88,869)   |
| <b>Cash flows from financing activities:</b>                                |                              |                |  |
|   | —                            | —              | 233,500  |

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|  |              |            |    |            |
|--|--------------|------------|----|------------|
| Proceeds from issuances of notes payable to stockholders                 |              |            |    |            |
| Repayments of notes payable to stockholders                              | —            | —          |    | (884,902)  |
| Proceeds from issuance of note payable to bank                           | —            | —          |    | 600,000    |
| Repayment of note payable to bank  | —            | —          |    | (600,000)  |
| Proceeds from subscriptions receivable                                   | —            | —          |    | 4,000      |
| Payment for fractional shares for Preferred stock dividends              | —            | (446)      |    | (2,286)    |
| (Costs) proceeds related to sale of common stock, net                    | (10,166)     | —          |    | 18,049,168 |
| Proceeds from sale of preferred stock, net                               | —            | —          |    | 9,046,176  |
| Proceeds from exercise of stock options                                  | —            | 1,000      |    | 62,500     |
| Proceeds from exercise of warrants                                       | —            | 68,491     |    | 68,491     |
| Net cash (used in) provided by financing activities                      | (10,166)     | 69,045     |    | 26,576,647 |
| Net (decrease) increase in cash and cash equivalents                     | (1,293,962)  | (360,705)  |    | 8,532,374  |
| Cash and cash equivalents at beginning of period                         | 9,826,336    | 905,656    |    | —          |
| Cash and cash equivalents at end of period                               | \$ 8,532,374 | \$ 544,951 | \$ | 8,532,374  |
| Supplemental disclosure of cash flow information:                        |              |            |    |            |
| Interest paid  | \$ —         | \$ —       |    | 23,893     |
| Supplemental disclosure of noncash investing and financing activities:   |              |            |    |            |
| Common stock issued in satisfaction of accounts payable                  | \$ —         | \$ —       |    | 750,000    |
| Imputed preferred stock dividend   | —            | —          |    | 418,182    |
| Preferred stock dividends accrued  | —            | 127,466    |    | 761,462    |
| Conversion of preferred stock to common stock                            | —            | 154        |    | 1,067      |
| Preferred stock dividends paid by issuance of shares                     | —            | 246,436    |    | 759,134    |
| Issuance of common stock for acquisitions                                | —            | —          |    | 13,389,226 |
| Marketable equity securities received in connection with sale of license | —            | —          |    | 359,907    |
| Net liabilities assumed over assets acquired in business combination     | —            | —          |    | (675,416)  |

See accompanying notes to unaudited condensed consolidated financial statements.

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MANHATTAN PHARMACEUTICALS, INC. and SUBSIDIARIES  
(A Development Stage Company)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2006

(1) BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Manhattan Pharmaceuticals, Inc. and its subsidiaries ("Manhattan" or the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, the consolidated financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete annual financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting of only normal recurring adjustments, considered necessary for a fair presentation. Interim operating results are not necessarily indicative of results that may be expected for the year ending December 31, 2006 or for any subsequent period. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements as of and for the year ended December 31, 2005, which are included in the Company's Annual Report on Form 10-KSB for such year. The condensed consolidated balance sheet as of December 31, 2005 has been derived from the audited consolidated financial statements included in the Form 10-KSB for that year.

(2) LIQUIDITY

The Company realized a net loss of \$2,398,190 and negative cash flows from operating activities of \$1,775,297 for the three months ended March 31, 2006. The net loss from date of inception, August 6, 2001 to March 31, 2006 amounts to \$34,490,241.

Management believes that the Company will continue to incur net losses through at least March 31, 2007 and for the foreseeable future. Based on the resources of the Company available at March 31, 2006, management believes that the Company will need additional equity or debt financing or will need to generate revenues during 2006 through licensing of its products or entering into strategic alliances to be able to sustain its operations beyond 2006 and that it will need additional financing thereafter until it can achieve profitability, if ever.

The Company's continued operations will depend on its ability to raise additional funds through various potential sources such as equity and debt financing, collaborative agreements, strategic alliances and its ability to realize the full potential of its technology in development. Additional funds may not become available on acceptable terms, and there can be no assurance that any additional funding that the Company does obtain will be sufficient to meet the Company's needs in the long-term.

(3) COMPUTATION OF NET LOSS PER COMMON SHARE

Basic net loss per common share is calculated by dividing net loss applicable to common shares by the weighted-average number of common shares outstanding for the period. Diluted net loss per common share is the same as basic net loss per common share, since potentially dilutive securities from stock options and stock warrants would have an antidilutive effect because the Company incurred a net loss during each period presented. The amount of potentially dilutive securities excluded from the calculation was 13,149,909 and 13,575,304 as of March 31, 2006 and 2005, respectively.



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(4) STOCK-BASED COMPENSATION

The Company has stockholder-approved stock incentive plans for employees, directors, officers and consultants. Prior to January 1, 2006, the Company accounted for the employee, director and officer plans using the intrinsic value method under the recognition and measurement provisions of Accounting Principles Board Opinion (“APB”) No. 25, “Accounting for Stock Issued to Employees” and related interpretations, as permitted by Statement of Financial Accounting Standards (“SFAS” or “Statement”) No. 123, “Accounting for Stock-Based Compensation.”

Effective January 1, 2006, the Company adopted SFAS No. 123(R), “Share-Based Payment,” (“Statement 123(R)”) for employee options using the modified prospective transition method. Statement 123(R) revised Statement 123 to eliminate the option to use the intrinsic value method and required the Company to expense the fair value of all employee options over the vesting period. Under the modified prospective transition method, the Company recognized compensation cost for the three months ended March 31, 2006 which includes 1) period compensation cost related to share-based payments granted prior to, but not yet vested, as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123; and 2) period compensation cost related to share-based payments granted on or after January 1, 2006, based on the grant date fair value estimated in accordance with Statement 123(R). In accordance with the modified prospective method, the Company has not restated prior period results.

Total share-based compensation expense for the three months ended March 31, 2006 amounted to \$311,913, including \$23,971 related to options granted to consultants, accounted for under EITF No. 96-18 “Accounting for Equity Instruments That Are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services” and \$287,942 related to options granted to employees and directors, accounted for under Statement 123(R).

For the three months ended March 31, 2006, the Company recognized share-based employee compensation cost of \$287,942 in accordance with Statement 123(R), which was recorded as general and administrative expenses. \$273,791 of this expense resulted from the grants of stock options to employees and directors of the Company from February 2002 to December 2005. The Company recognized compensation expense related to these stock options on a straight-line basis over the vesting period. The balance of \$14,151 related to the granting of stock options to employees and officers on or after January 1, 2006. The Company did not capitalize any share-based compensation cost.

As a result of adopting Statement 123(R), net loss for the three months ended March 31, 2006 was \$287,942 greater than if the Company had continued to account for share-based compensation under APB 25. The effect of adopting Statement 123(R) on basic and diluted earnings per share for the three months ended March 31, 2006 was less than \$0.01 per share.

The net loss for the three months ended March 31, 2005 does not include any compensation charges related to options granted to employees. The following table illustrates the pro forma effect on net loss and loss per share assuming the Company had applied the fair value recognition provisions of SFAS No. 123 instead of the intrinsic value method under APB No. 25 to stock-based employee compensation for the three months ended March 31, 2005.



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March 31, 2006

|  | <b>Three<br/>months<br/>ended<br/>March<br/>31,<br/>2005</b> |
|--|--|
| Net loss applicable to common shares, as reported  | \$ (1,553,545)   |
| Deduct: Total stock-based employee compensation expense determined under fair value method | (114,935)  |
| Net loss applicable to common shares, pro forma  | \$ (1,668,480)   |
| Net loss per common share - basic and diluted  |  |
| As reported  | \$ (0.05)  |
| Pro forma  | (0.06)   |

As noted above, the Company has shareholder-approved stock incentive plans for employees under which it has granted non-qualified and incentive stock options. Options granted under these plans must be at a price per share not less than the fair market value per share of common stock on the date the option is granted. The options generally vest over a three year period and expire ten years from the date of grant. Certain option and share awards provide for accelerated vesting upon a change in control of the Company, as defined.

***Stock Options***

***2003 Stock Option Plan***

In December 2003, the Company established the 2003 Stock Option Plan (the "2003 Plan"), which provided for the granting of up to 5,400,000 options to officers, directors, employees and consultants for the purchase of stock. In August 2005, the Company increased the number of shares of common stock reserved for issuance under the 2003 Plan by 2,000,000 shares. At March 31, 2006, 7,400,000 shares were authorized for issuance. The options have a maximum term of 10 years and vest over a period determined by the Company's Board of Directors (generally 3 years) and are issued at an exercise price equal to the fair market value of the shares at the date of grant. The 2003 Plan expires on December 10, 2013 or when all options have been granted, whichever is sooner.

***1995 Stock Option Plan***

In July 1995, the Company established the 1995 Stock Option Plan (the "1995 Plan"), which provided for the granting of up to 130,000 options to officers, directors, employees and consultants for the purchase of stock. In July 1996, the 1995 Plan was amended to increase the total number of shares authorized for issuance by 60,000 shares to a total of 190,000 shares and beginning with the 1997 calendar year, by an amount equal to one percent (1%) of the shares of common stock outstanding on December 31 of the immediately preceding calendar year. At March 31, 2006, there were no shares authorized for issuance. The options have a maximum term of 10 years and vest over a period determined by the Company's Board of Directors (generally 4 years) and are issued at an exercise price equal to the fair market value of the shares at the date of grant. The 1995 Plan expired on June 30, 2005 and no further options are available for issuance under this plan.

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March 31, 2006

On January 26, 2006, the Company granted employees options to purchase an aggregate of 174,500 shares of common stock under the Company's 2003 Stock Option Plan (the "2003 Plan") at an exercise price of \$1.35 per share. The shares subject to these options vest in three equal annual installments starting one year from the grant date and continuing each anniversary thereafter, provided the optionee continues employment. On February 1, 2006, the Company granted its Chief Medical Officer, Alan Harris an option to purchase 300,000 shares of common stock under the 2003 Plan also at an exercise price of \$1.35 per share. The shares subject to this option vest in three equal annual installments starting one year from the grant date and continuing each anniversary thereafter, provided the optionee continues employment.

The Company estimated the fair value of each option award on the date of grant using the Black-Scholes model. The Company based expected volatility on historical volatility and expectations of future volatility. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The Company estimated the expected term of stock options using historical exercise and employee forfeiture experience.

The following table shows the weighted average assumptions the Company used to develop the fair value estimates for the determination of the compensation charges in 2006 and the pro forma charges in 2005:

|                          | <b>Three Months Ended</b> |             |
|--------------------------|---------------------------|-------------|
|                          | <b>March 31,</b>          |             |
|                          | <b>2006</b>               | <b>2005</b> |
| Expected volatility      | 55%                       | 70%         |
| Dividend yield           | —                         | —           |
| Expected term (in years) | 4                         | 5           |
| Risk-free interest rate  | 4.25%                     | 3.4%        |

A summary of the status of the Company's stock options as of March 31, 2006 and changes during the three months then ended is presented below:

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|  | Shares    | Weighted<br>average<br>exercise<br>price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(years) | Aggregate<br>Intrinsic<br>Value |
|--|-----------|--|--|---------------------------------|
| Outstanding at<br>December 31,<br>2005                                     | 6,328,754 | \$ 1.33                                  |  |                                 |
| Granted  | 474,500   | 1.35                                     |  |                                 |
| Exercised  | -         | -  |  |                                 |
| Cancelled  | (120,750) | 1.20                                     |  |                                 |
| Outstanding at<br>March 31, 2006   | 6,682,504 | \$ 1.34                                  | 8.39   | \$ 1,241,972                    |
| Options<br>exercisable at<br>March 31, 2006                                | 3,722,728 | \$ 1.26                                  | 7.85   | \$ 1,117,173                    |
| Weighted-average<br>fair value of<br>options granted<br>during the quarter | \$ 0.63   |  |  |                                 |

As of March 31, 2006, the total compensation cost related to non-vested option awards not yet recognized is \$2,395,675. The weighted average period over which it is expected to be recognized is approximately 1.56 years.

(5) ACQUISITION OF TARPAN THERAPEUTICS, INC.

On April 1, 2005, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Tarpan Therapeutics, Inc., a Delaware corporation ("Tarpan"), and Tarpan Acquisition Corp., a Delaware corporation and wholly-owned subsidiary of the Company ("TAC"). The Merger Agreement provided that TAC would merge with and into Tarpan, with Tarpan remaining as the surviving corporation and a wholly-owned subsidiary of the Company (the "Merger"). The Merger was completed April 1, 2005 and accounted for as a purchase. Accordingly, the results of operations for the three months ended March 31, 2005 do not include the results of Tarpan.

The following unaudited pro forma financial information presents the condensed consolidated results of operations of the Company and Tarpan, as if the acquisition had occurred on January 1, 2005 instead of April 1, 2005, after giving effect to certain adjustments, including the issuance of the Company's common stock as part of the purchase price. The unaudited pro forma information does not necessarily reflect the results of operations that would have occurred had



the entities been a single company during these periods.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2006

|  | <b>Three<br/>months<br/>ended<br/>March<br/>31,<br/>2005</b> |
|--|--|
| Net loss   | \$ (1,553,340)   |
| Weighted average<br>number of common<br>shares outstanding | 39,396,196   |
| Loss per common<br>share - basic and<br>fully diluted      | \$ (0.04)  |

(6) COMMITMENTS

On March 27, 2006, the Company entered into an agreement with Swiss Pharma Contract Ltd. (“Swiss Pharma”) to perform a Phase IIa study on the Company’s Oleoyl-estrone product. The terms of the contract call for the Company to pay Swiss Pharma a total of \$2,151,840. The payment terms are: 20%, or \$430,368, on contract signing, 20% after the first patient has received the initial dose, 20% after half the patients have received the initial dose, 20% after all the patients have completed dosing, 10%, or \$215,184, on receipt of statistical analyses and 10% on acceptance by the Company of the Phase IIa study.

As of March 31, 2006, the Company had incurred a liability to Swiss Pharma of 20%, \$430,368, and recognized \$13,570 of research and development expense for the Phase IIa study. The remainder, \$416,798, is included in prepaid expenses.

These financial statements amend and restate the Company’s financial statements included in its Form 10-QSB for the quarterly period ended March 31, 2006 originally filed on May 14, 2006. These financial statements have been restated, to increase prepaid expenses and reduce research and development expenses by \$416,798 and to disclose a material commitment of \$2,151,840 entered into in March 2006 for the conduct of a Phase IIa study of our obesity product, Oleoyl-estrone. The increase in prepaid expenses and reduction in research and development expenses of \$416,798 related to a correction in recording the initial invoice of \$430,368 relative to this commitment. In the Form 10-QSB for the three months ended March 31, 2006 originally filed, the Company recorded as expense the entire invoice amount of \$430,368. The invoice should have been recorded as \$13,570 of research and development expense and an increase of \$416,798 in prepaid expenses.

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

**You should read the following discussion of our results of operations and financial condition in conjunction with our Annual Report on Form 10-KSB for the year ended December 31, 2005 (the "Annual Report") and our financial statements as of and for the three months ended March 31, 2006 included elsewhere in this report.**

### RESULTS OF OPERATIONS

#### THREE-MONTH PERIOD ENDED MARCH 31, 2006 VS 2005

During each of the quarters ended March 31, 2006 and 2005, we had no revenues, and are considered a development stage company. We do not expect to have revenues relating to our technologies prior to March 31, 2007.

For the quarter ended March 31, 2006 research and development expense was \$1,606,521 as compared to \$964,040 for the quarter ended March 31, 2005. The increase of \$642,481 is due primarily to an acceleration of pre-clinical and clinical development of our Oleoyl-estrone drug and the pre-clinical and clinical development of our PTH (1-34) product candidate. As we enter Phase IIa clinical trials in Oleoyl-estrone and PTH (1-34), we expect research and development expense to continue to increase through 2006.

For the three months ended March 31, 2006, general and administrative expense was \$890,865 as compared to \$493,243 for the three months ended March 31, 2005. The increase of \$397,622 is due primarily to increases in payroll and stock-based compensation expenses associated with the adoption of Statement 123(R), of \$123,000 and \$288,000, respectively, partially offset by a reduction in consulting fees of approximately \$89,000. Additionally, we had increases in legal and accounting fees and all other expenses of approximately \$48,000, \$25,000 and \$3,000 respectively.

For the quarter ended March 31, 2006, interest and other income including realized gain on the sale of marketable equity securities was \$99,196 as compared to \$31,204 for the quarter ended March 31, 2005. The increase of \$67,992 is a result of higher average balances in cash and short-term investments earning higher yields.

Net loss for the three months ended March 31, 2006, was \$2,398,190 as compared to \$1,426,079 for the three months ended March 31, 2005. This increase of \$972,111 in net loss is attributable to increases in research and development expenses of \$642,481 and general and administrative expenses of \$397,622, partially offset by an increase in interest and other income of \$67,992.

Preferred stock dividends were \$0 and \$127,466 for the three months ended March 31, 2006 and 2005, respectively, which had no impact on loss per share for such periods.

### LIQUIDITY AND CAPITAL RESOURCES

From inception to March 31, 2006, we incurred a deficit during the development stage of \$35,669,885 primarily as a result of our net losses, and we expect to continue to incur additional losses through at least March 31, 2007 and for the foreseeable future. These losses have been incurred through a combination of research and development activities related to the various technologies under our control and expenses supporting those activities.

We have financed our operations since inception primarily through equity financing and our licensing and sale of residual royalty rights of CT-3 to Indevus. During the three months ended March 31, 2006, we had a net decrease in cash and cash equivalents of \$1,293,962. This decrease resulted largely from net cash used in operating activities of \$1,775,297 partially offset by net cash provided by investing activities of \$491,501. Total liquid resources including short term investments as of March 31, 2006 were \$9,041,684 compared to \$10,834,154 at December 31, 2005.

Our current liabilities as of March 31, 2006 were \$2,246,946 compared to \$1,665,817 at December 31, 2005, an increase of \$581,129. The increase was primarily due to an increase in expenditures associated with our Phase I clinical trial for our Oleoyl-estrone product candidate and commencement of Phase II clinical trial for our PTH (1-34) product candidate. As of March 31, 2006, we had working capital of \$6,857,227 compared to \$9,363,113 at December 31, 2005.

In March 2006, we entered into an agreement with Swiss Pharma Contract Ltd., or Swiss Pharma, to perform a Phase IIa clinical study of 100 patients on our Oleoyl-estrone product. The agreement requires us to pay \$2,151,840 to Swiss Pharma for conducting the study. The payment schedule is 20%, or \$430,368, upon signing the agreement, which occurred in late March 2006, 20% at the start of the clinical study, which occurred in late June 2006, 20% after half the subjects had been enrolled, which we expect to occur in the second half of 2006, 20% after completion of the clinical study, which we expect to occur in 2007, and the final 20% on delivery of the statistical analyses by Swiss Pharma and acceptance of the study by us, which we also expect to occur in 2007.

Expenses will be recognized on an activity basis; therefore, expense recognition will differ from the payment schedule. Approximately \$14,000 of expense was recognized in the three months ended March 31, 2006. Because of the difference in timing of payments to be made under the contract and the recognition of expense at March 31, 2006, we recognized a prepaid expense of approximately \$417,000.

We are filing this Form 10-QSB/A to restate our financial statements for the three months ended March 31, 2006, to increase our prepaid expenses and reduce our research and development expenses by \$416,798 and to disclose a material commitment of \$2,151,840 entered into in March 2006 for the conduct of a Phase IIa study of our obesity product, Oleoyl-estrone. The increase in our prepaid expenses and reduction in our research and development expenses of \$416,798 related to a correction of our recording the initial invoice of \$430,368 relative to this commitment. In our Form 10-QSB for the three months ended March 31, 2006, we recorded as expense the entire invoice amount of \$430,368. The invoice should have been recorded as \$13,570 of research and development expense and an increase of \$416,798 in our prepaid expenses.

Our available working capital and capital requirements will depend upon numerous factors, including progress of our research and development programs, our progress in and the cost of ongoing and planned pre-clinical and clinical testing, the timing and cost of obtaining regulatory approvals, the cost of filing, prosecuting, defending, and enforcing patent claims and other intellectual property rights, competing technological and market developments, changes in our existing collaborative and licensing relationships, the resources that we devote to developing manufacturing and commercializing capabilities, the status of our competitors, our ability to establish collaborative arrangements with other organizations and our need to purchase additional capital equipment.

Our continued operations will depend on whether we are able to raise additional funds through various potential sources, such as equity and debt financing, other collaborative agreements, strategic alliances, and our ability to realize the full potential of our technology in development. Such additional funds may not become available on acceptable terms and there can be no assurance that any additional funding that we do obtain will be sufficient to meet our needs in the long term. Through March 31, 2006, a significant portion of our financing has been through private placements of common and preferred stock and warrants to purchase common stock. Unless our operations generate significant revenues and cash flows from operating activities, we will continue to fund operations from cash on hand and through the similar sources of capital previously described. We can give no assurances that any additional capital

that we are able to obtain will be sufficient to meet our needs. Management believes that we will continue to incur net losses and negative cash flows from operating activities for the foreseeable future. Based on the resources available to us at March 31, 2006, management believes that we will need additional equity or debt financing or will need to generate revenues through licensing our products or entering into strategic alliances during 2006 to be able to sustain our operations beyond 2006 and we will need additional financing thereafter until we can achieve profitability, if ever.

## RESEARCH AND DEVELOPMENT PROJECTS

### *Oleoyl-estrone*

In January 2005, the FDA accepted our filed investigational new drug application, or “IND” for the human clinical testing of Oleoyl-estrone. We completed Phase Ia and Phase Ib clinical trials in May 2005 and July 2005, respectively, and released data on both trials in October 2005. Both trials were completed in Basel, Switzerland after obtaining formal approval from the Swiss medical authority, Swissmedic, however only the Phase Ia trial was conducted pursuant to the IND accepted by the FDA. The objective of both dose escalation studies was to determine the safety and tolerability of defined doses of orally administered Oleoyl-estrone in obese adult volunteers as well as the pharmacokinetic profile (i.e. the manner in which the drug is absorbed, distributed, metabolized and excreted by the body) of Oleoyl-estrone in both men and women.

The Phase Ia study involved 36 obese volunteers. Twelve of the 36 patients received placebo and 24 received a single dose in one of six strengths ranging from 1 mg to 150 mg. Oleoyl-estrone was shown to be safe with no serious adverse events noted in this study.

The Phase Ib study was a repeat dose study involving 24 obese volunteers in four cohorts of 6 patients each who received either placebo or Oleoyl-estrone in doses ranging from 10 mg to 150 mg once daily for seven consecutive days. The results indicated that Oleoyl-estrone was generally well-tolerated at all doses and no serious adverse events were reported. There were also no clinically significant changes in the physical exams, vital signs, ECGs, coagulation and liver function tests. The study demonstrated evidence of greater weight loss among the treated groups compared with the placebo group as well as evidence of reduction in desire to eat, hunger levels, fasting glucose and LDL cholesterol. Important clinical laboratories findings included reversible, dose-dependent elevations in estrone and estradiol levels, as well as reductions in testosterone levels. We recently received Swiss regulatory approval from Swissmedic, the Swiss Medical Authority to commence our Phase IIa study with Oleoyl-estrone.

To date, we have incurred \$8,784,602 of project costs related to our development of oleoyl-estrone, including milestone payments triggered under our license agreement for oleoyl-estrone, of which \$794,786 was incurred in the first three months of 2006. Currently, we anticipate that we will need to expend approximately an additional \$3,800,000 in development costs in fiscal 2006. Since oleoyl-estrone is regarded by the FDA as a new entity, it is not realistic to predict the size and the design of future studies at this time.

Although we currently have sufficient capital to fund our anticipated 2006 R&D expenditures relating to oleoyl-estrone, we will need to raise additional capital in order to complete the anticipated five or six year development program for the product. If we are unable to raise such additional capital, we may have to sublicense our rights to oleoyl-estrone to a third party as a means of continuing development, or, although less likely, we may be required to abandon further development efforts altogether, either of which would have a material adverse effect on the prospects of our business.

In addition to raising further capital, whether we are successful in developing oleoyl-estrone is dependent on numerous other factors, including unforeseen safety issues, lack of effectiveness, significant unforeseen delays in the clinical trial and regulatory approval process, both of which could be extremely costly, and inability to monitor patients adequately before and after treatments. The existence of any of these factors could increase our development costs or make successful completion of development impractical, which would have a material adverse affect on the prospects of our business.

### ***PTH (1-34)***

PTH (1-34), which we acquired as a result of our April 2005 acquisition of Tarpan Therapeutics, Inc., is being developed as a topical treatment for psoriasis. In August 2003, researchers, led by Michael Holick, MD, Professor of Medicine, Physiology, and Biophysics at Boston University Medical Center, reported positive results from a US Phase I and II clinical trial evaluating the safety and efficacy of PTH (1-34) as a topical treatment for psoriasis. This double-blind, controlled trial in 15 patients compared PTH (1-34) formulated in the Novasome® Technology versus the Novasome® vehicle alone. Following 8 weeks of treatment, the topical application of PTH (1-34) resulted in complete clearing of the treated lesion in 60% of patients and partial clearing in 85% of patients. Additionally, there was a statistically significant improvement in the global severity score. Ten patients continued into an open label extension study in which the Psoriasis Area and Severity Index (PASI) was measured; PASI improvement across all 10 patients achieved statistically significant improvement compared to baseline. This study showed PTH (1-34) to be a safe and effective treatment for plaque psoriasis with no patients experiencing any clinically significant adverse events.

Due to the high response rate seen in patients in the initial trial with PTH (1-34) we believe that it may have an important clinical advantage over current topical psoriasis treatments. A follow on physician IND Phase IIa trial involving PTH (1-34) was initiated in December 2005 under the auspices of Boston University. Dosing of topical PTH (1-34) in the Investigator IND-conducted Phase IIa study has been delayed due to issues identified with the current formulation and the difficulty of conducting a psoriasis study in the summer. Ideally, psoriasis trials are conducted in the fall and winter due to the natural improvement of the disease during the summer months. We are working with formulation experts to assist in addressing the issues and anticipate a one- to two-quarter formulation effort. We believe these formulation activities may lead to additional intellectual property surrounding the product.

To date, we have incurred \$1,767,433 of project costs related to our development of PTH (1-34), which has been incurred since April 1, 2005, the date of the Tarpan Therapeutics, Inc. acquisition, of which \$797,926 was incurred in the first three months of 2006. Currently, we anticipate that we will need to expend approximately an additional \$2,800,000 in development costs in fiscal 2006. As with the development of our other product candidates, we believe we currently have sufficient capital to fund our development activities of PTH (1-34) during 2006. Since PTH (1-34) is already available in the injectable form, we should be able to utilize much of the data that is publicly available in planning our future studies. However, since PTH (1-34) will be used topically, bridging studies will need to be performed and we are not able to realistically predict the size and the design of those studies at this time.

### *Lingual spray propofol*

We are developing propofol lingual spray, the right to which we license from NovaDel Pharma, Inc., for light to medium sedation on a Section 505b2 bioequivalence regulatory pathway toward FDA approval. In January 2005, the FDA accepted our IND for propofol lingual spray, allowing us to commence clinical trials. The FDA has indicated to us in discussions that we may proceed to a pivotal Phase III trial of propofol lingual spray following completion of Phase I trials. We are actively planning the next steps for the clinical development of this product candidate, meeting with our scientific advisors, NovaDel and other formulation partners regarding formulation, reviewing existing data, developing trial design and evaluating plans to re-enter the clinic.

To date, we have incurred \$2,834,996 of project costs related to our development of propofol lingual spray, of which \$13,810 was incurred in the first three months of 2006. Currently, we anticipate that we will need to expend approximately an additional \$100,000 in development costs in fiscal 2006 and at least an aggregate of approximately \$3,000,000 to \$5,000,000 until we receive FDA approval for propofol, should we opt to continue development until then, including anticipated 2006 costs. As with our development of oleoyl-estrone, we believe we currently have sufficient capital to fund our development activities of propofol lingual spray during 2006. Since our business does not generate any cash flow, however, we will need to raise additional capital to continue development of the product beyond 2006. We expect to raise such additional capital through debt financings or by selling shares of our capital stock. To the extent additional capital is not available when we need it, we may be forced to sublicense our rights to propofol lingual spray or abandon our development efforts altogether, either of which would have a material adverse effect on the prospects of our business.

### **Off-Balance Sheet Arrangements**

We have not entered into any off-balance sheet arrangements.

### **Item 3. Controls and Procedures**

The Company's management, with the participation of our Chief Executive Officer and Chief Financial Officer, has re-evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act of 1934, as amended) as of March 31, 2006, the end of the period covered by this report. Based on that re-evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were not effective. As further discussed below, the Company's management identified that a deficiency existed as of March 31, 2006 in the controls associated with the Company's reporting of prepaid and research and development expenses, and the disclosure of a material commitment. In accordance with Auditing Standard No. 2 and consistent with PCAOB Release No. 2005-023 issued in November 2005, in determining whether a control deficiency existed at March 31, 2006, judgment must be applied to identify the cause of the misstatement, rather than merely attributing it to the period(s) affected. In this case, an error originated with respect to the Company's recognition of a material commitment entered into during the first quarter ended March 31, 2006. Accordingly, the Company's management deems such control deficiency to be a material weakness in its controls and procedures. A material weakness is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.



The Company's management, including its Chief Executive Officer and its Chief Financial Officer, does not expect that disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud, even as the same are improved to address any deficiencies. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls.

During the first quarter of 2006, there were no changes in our internal controls over financial reporting that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting subsequent to the date of such evaluation.

#### **Restatement and Remediation of Internal Control Weaknesses**

On July 10, 2006, the Company hired a Chief Financial Officer, with substantial Sarbanes-Oxley compliance experience. With the hiring of its Chief Financial Officer, the Company has been developing a detailed plan to address compliance with Section 404 of the Sarbanes-Oxley Act of 2002. In July 2006, the Company initiated and since then has made progress on several projects focused on assessing potential risks, better understanding and documenting its processes, and implementing certain preventative or detective controls to address key risks. These are important first steps toward designing and implementing an effective compliance plan. As a non-accelerated filer with a calendar year end of December 31, the Company must first begin to comply with the requirements of Section 404 for the fiscal year ending December 31, 2007.

As part of its risk assessment, the Company undertook an extensive review of its controls associated with its research and development contract accounting process. The Company identified an error in the recording of a research and development contract during the quarter ended March 31, 2006. For this period, the Company's research and development expense was overstated and prepaid expenses were understated by \$416,798, and a related material commitment in excess of \$2 million was not disclosed.

**PART II - OTHER INFORMATION**

**Item 6. Exhibits**

| <u>Exhibit<br/>No.</u> | <u>Description</u>   |
|------------------------|--|
| 10.1                   | Employment Agreement dated January 26, 2006 between the Company and Alan G. Harris (previously filed).                           |
| 31.1                   | Certification of Chief Executive Officer   |
| 31.2                   | Certification of Chief Financial Officer   |
| 32.1                   | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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**SIGNATURES**

In accordance with the requirements of the Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MANHATTAN PHARMACEUTICALS, INC.

Date: August 14, 2006

By: /s/ Douglas Abel

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Douglas Abel  
President and Chief Executive Officer

Date: August 14, 2006

By: /s/ Michael G. McGuinness

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Michael G. McGuinness  
Chief Financial Officer

**Index to Exhibits Filed with this Report**

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