UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014

OR

☐ **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: 001-35610

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

Delaware	**26-4753208**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1616 Eastlake Ave. East, Suite 510 **Seattle, WA** (Address of principal executive offices)	**98102** (Zip Code)

Registrant's telephone number, including area code: (206) 325-6086

Indicate by check mark whether the registrant: (1) has 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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company þ

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

The number of shares of the registrant's common stock, $0.001 par value per share, outstanding at May 7, 2014 was 24,428,568.

ATOSSA GENETICS INC.
FORM 10-Q
QUARTERLY REPORT

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

ATOSSA GENETICS INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED BALANCE SHEETS

	March 31, 2014 (Unaudited)	December 31, 2013 (Audited)
Assets		
Current assets		
Cash and cash equivalents	$ 16,590,951	$ 6,342,161
Accounts receivable, net	91,416	139,072
Prepaid expense	1,017,766	932,588
Total current assets	17,700,133	7,413,821
Fixed assets		
Furniture and equipment, net	129,942	163,147
Total fixed assets	129,942	163,147
Other assets		
Security deposit	61,309	36,446
Intangible assets, net	4,491,707	4,395,633
Total other assets	4,553,016	4,432,079
Total assets	$ 22,383,091	$ 12,009,047
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ -	$ 9,634
Accrued expenses	744,736	637,986
Deferred rent	35,023	48,157
Payroll liabilities	195,896	476,477
Contingent liabilities	96,201	211,493
Other current liabilities	10,189	23,649
Total current liabilities	1,082,045	1,407,396
Stockholders' Equity		
Preferred stock - $.001 par value; 10,000,000 shares authorized, 0 shares issued and outstanding	-	-
Common stock - $.001 par value; 75,000,000 shares authorized, 24,428,568 and 18,574,334 shares issued and outstanding	24,429	18,574
Additional paid-in capital	44,204,762	31,099,691
Accumulated deficit	(22,928,145)	(20,516,614)
Total stockholders' equity	21,301,046	10,601,651
Total liabilities and stockholders' equity	$ 22,383,091	$ 12,009,047

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

ATOSSA GENETICS INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the Three Months Ended March 31 ,		From April 30, 2009 (Inception) Through March 31,
	2014	2013	2014
Revenue			
Diagnostic testing services	$ 24,124	$ 169,230	$ 908,644
Product sales	-	13,440	231,380
Total revenue	24,124	182,670	1,140,024
Cost of revenue			
Diagnostic testing services	-	47,599	141,509
Product sales	-	18,865	244,919
Total cost of revenue	-	66,464	386,428
Loss on obsolete inventory & LCM	-	-	271,856
Gross profit	24,124	116,206	481,740
Selling expenses	237,838	272,575	2,135,505
Research and development expenses	422,503	220,192	5,084,999
General and administrative expenses	1,774,708	1,564,872	16,155,879
Total operating expenses	2,435,049	2,057,639	23,376,383
Operating loss	(2,410,925)	(1,941,433)	(22,894,643)
Interest income	143	-	7,026
Interest expense	749	7	40,280
Net loss before income taxes	(2,411,531)	(1,941,440)	(22,927,897)
Income taxes	-	-	248
Net loss	$ (2,411,531)	$ (1,941,440)	$ (22,928,145)
Loss per common share - basic and diluted	$ (0.10)	$ (0.14)	$ (2.16)
Weighted average shares outstanding, basic & diluted	24,419,060	13,421,119	10,604,575

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

ATOSSA GENETICS INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Three Months Ended March 31,		For The Period From April 30, 2009 (Inception) to March
	2014	2013	31, 2014
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$ (2,411,531)	$ (1,941,440)	$ (22,928,145)
Common shares issued for services	-	155,969	249,279
Compensation cost for stock options granted	230,181	274,512	1,966,205
Loss on reduction on obsolete inventory and LCM	-	-	271,856
Impairment loss on long-life assets			158,292
Loan initiation fee accrued for notes payable	-	-	2,000
Depreciation and amortization	125,097	98,945	744,206
Contingent loss		-	211,493
Bad debt expense	27,860	-	382,721
Adjustments to reconcile net loss to net cash provided by operating activities:			
Decrease (Increase) in accounts receivable	19,796	(117,675)	(474,137)
Increase in inventory	-		(271,856)
Increase in prepaid expenses	(245,178)	(90,789)	(425,805)
Increase in security deposits	(24,863)	-	(61,309)
Decrease in accounts payable	(9,634)	(33,626)	-
Decrease (Increase) in accrued payroll	(280,581)	94,371	195,896
Decrease (Increase) in deferred rent	(13,134)	-	35,023
Decrease (Increase) in accrued expenses	106,750	279,951	789,736
Decrease in contingent loss liability	(115,292)	-	(115,292)
Decrease (Increase) in other current liabilities	(13,460)	(55,030)	10,189
Net cash used in operating activities	(2,603,989)	(1,334,812)	(19,259,648)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of furniture & fixtures	(2,966)	-	(438,455)
Purchase of software	(100,000)	(8,500)	(425,839)
Net cash used in investing activities	(102,966)	(8,500)	(864,294)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from issuance of common stock and warrants	12,955,745	1,003,314	36,716,893
Repayments of loans from related parties	-	-	(2,000)
Net cash provided by financing activities	12, 955,745	1,003,314	36,714,893
NET INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	10,248,790	(339,998)	16,590,951
CASH & CASH EQUIVALENTS, BEGINNING BALANCE	6,342,161	1,725,197	-
CASH & CASH EQUIVALENTS, ENDING BALANCE	$ 16,590,951	$ 1,385,199	$ 16,590,951
SUPPLEMENTAL DISCLOSURES:			
Interest paid	$ 749	$ 2,682	$ 33,816
Income taxes paid	$ -	$ -	$ 248
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Common stock and warrants issued for asset purchase	$ -	$ -	$ 4,674,853
Noncash reclass of prepaid license fees	$ 15,000	-	$ 15,000
Options issued for previously accrued director compensation	$ -	$ -	$ 45,000
Commitment shares distributed for capital contribution	$ -	$ 2,387,250	$ 3,137,500
Amortization of commitment shares	$ 75,000	$ 79,575	$ 2,560,540

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

ATOSSA GENETICS INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1: NATURE OF OPERATIONS

Atossa Genetics Inc. (the "Company") was incorporated on April 30, 2009 in the State of Delaware. The Company was formed to develop and market the Mammary Aspirate Specimen Cytology Test System, or MASCT System, which is a medical device that collects specimens of nipple aspirate fluid (NAF). The Company's fiscal year ends on December 31st.

In December 2011, the Company established The National Reference Laboratory for Breast Health, Inc., or NRLBH, as a wholly-owned subsidiary. NRLBH is the Company's CLIA-certified laboratory which performs our NAF cytology test on NAF specimens including those collected with the MASCT System. The current version of the MASCT System, is called the ForeCYTE Breast Aspirator. The NRLBH is developing other tests such as the ArgusCYTE test, on blood samples from breast cancer survivors to detect circulating tumor cells.

In September 2012, the Company acquired the assets of Acueity Healthcare, Inc. ("Acueity"). The purchased assets included intellectual property rights related to the Viaduct Miniscope and accessories, the Manoa Breast Biopsy system, the Excisor Bioptome, the Acueity Medical Light Source, the Viaduct Microendoscope and accessories, and cash in the amount of $400,000. The microendoscopes are less than 0.9 mm outside diameter and can be inserted into a milk duct. This permits a physician to pass a microendoscope into the milk duct system of the breast and view the duct system via fiberoptic video images. Abnormalities that are visualized can then be biopsied from inside the duct with the biopsy tools that are inserted adjacent to the microendoscope. The acquired patents relate to intraductal diagnostic and therapeutic devices and methods of use. The Company did not, however, acquire an inventory of these diagnostic tools, manufacturing capabilities or any personnel to market and sell the tools. The Company cannot provide any assurance that it will be successful commercializing these tools.

Development Stage Risk

From April 30, 2009 (inception) through March 31, 2014, the Company earned $1,140,024 in revenue from the sale of its MASCT Systems and laboratory services. The Company's activities have been accounted for as those of a "Development Stage Enterprise" as set forth in Accounting Standards Codification ("ASC") 915 "Development Stage Entities", which was previously Statement of Financial Accounting Standards No. 7 ("SFAS 7"). Among the disclosures required by ASC 915 are that the Company's financial statements be identified as those of a development stage company, and that the statements of operations, stockholders' equity and cash flows disclose activity since the date of the Company's inception.

Since its inception, the Company has been dependent upon the receipt of capital investment to fund its continuing activities. In addition to the normal risks associated with a new business venture, there can be no assurance that the Company's business plan will be successfully executed. The Company's ability to execute its business plan will depend on its ability to obtain additional financing and achieve a profitable level of operations. There can be no assurance that sufficient financing will be obtained. Further, the Company cannot give any assurance that it will generate substantial revenue or that its business operations will prove to be profitable.

NOTE 2: GOING CONCERN

The Company's consolidated financial statements are prepared using generally accepted accounting principles in the United States of America applicable to a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has not yet established an ongoing source of revenue sufficient to cover its operating costs and allow it to continue as a going concern. The ability of the Company to continue as a going concern is dependent on the Company obtaining adequate capital to fund operating losses until it becomes profitable. If the Company is unable to obtain adequate capital, it could be forced to cease operations. The accompanying consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Management's Plan to Continue as a Going Concern

In order to continue as a going concern, the Company will need additional capital resources. Management's plans to obtain such resources for the Company include (1) obtaining capital from the sale of its equity securities, (2) sales of the MASCT System, which is now called the ForeCYTE Breast Aspirator, and laboratory service revenue , and (3) short-term or long-term borrowings from banks, stockholders or other party(ies) when needed. However, management cannot provide any assurance that the Company will be successful in accomplishing any of its plans.

The ability of the Company to continue as a going concern is dependent upon its ability to successfully accomplish the plans described in the preceding paragraph and eventually to secure other sources of financing and attain profitable operations.

NOTE 3: SUMMARY OF ACCOUNTING POLICIES

Basis of Presentation:

The accompanying consolidated financial statements include the financial statements of Atossa Genetics Inc. and its wholly-owned subsidiary NRLBH. All significant intercompany account balances and transactions have been eliminated in consolidation. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

Recently Issued Accounting Pronouncements:

The Company has adopted all recently issued accounting pronouncements that management believes to be applicable to the Company. The adoption of these accounting pronouncements, including those not yet effective, is not anticipated to have a material effect on the financial position or results of operations of the Company.

Revenue Recognition:

Overview

The Company recognizes product and service revenue in accordance with GAAP when the following overall fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or the service has been performed, (iii) the Company's price to the customer is fixed or determinable and (iv) collection of the resulting accounts receivable is reasonably assured.

Product Revenue

The Company recognizes revenue for sales of the MASCT kits and devices on an accrual basis for sales to distributors when the above four criteria are met. For sales of MASCT kits and devices directly to physicians, the revenue is typically recognized upon receipt of cash as the Company has an insufficient sales history on which to determine the collectability. Shipping documents and the completion of any customer acceptance requirements, when applicable, will be used to verify product delivery. The Company will assess whether a price is fixed or determinable based upon the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. For sales directly to physicians, once a history of sales and collectability has been established, the Company will recognize revenue on an accrual basis with an offsetting reserve for doubtful accounts based on the history during the initial sales period.

Service Revenue

The Company records revenue for diagnostic testing on an accrual basis at the Medicare allowed and invoiced amount. Amounts invoiced above the Medicare amount, namely non-Medicare, are not recognized on an accrual basis and instead are recognized on a cash basis as received. Diagnostic testing revenue at the Medicare rate is recognized upon completion of the test, communication of results to the patient's physician, and when collectability is reasonably assured. Customer purchase orders and/or contracts are generally used to determine the existence of an arrangement. Once the Company has historical sales and can determine the proper amount to recognize as uncollectible, it will then begin to recognize the entire amount, both Medicare and non-Medicare billing on an accrual basis, with an offsetting allowance for doubtful accounts recorded based on history.

Cost of Revenue:

Cost of revenue consists of cost of diagnostic testing services and cost of product sales. Cost of diagnostic testing services primarily includes direct cost of material, direct labor, equipment, and shipping to process the patient samples (including pathology, quality control analysis, and shipping charges to transport tissue sample) in our laboratory. Costs associated with performing the Company's tests are recorded as tests are processed. Costs recorded for tissue sample processing and shipping charges represent the cost of all the tests processed during the period regardless of whether revenue was recognized with respect to that test. Cost of product sales primarily includes manufacturing cost of our MASCT System for sales to distributors, which is recorded upon transfer of ownership of the goods.

Cash and Cash Equivalents:

Cash and cash equivalents include cash and all highly liquid instruments with original maturities of three months or less.

Use of Estimates:

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

Accounts Receivable:

Accounts receivable are recorded at net realizable value consisting of the carrying amount less allowance for doubtful accounts, as needed. The Company assesses the collectability of accounts receivable based primarily upon the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends, and changes in customer payment patterns to evaluate the adequacy of these reserves. The Company's allowance for doubtful accounts as of March 31, 2014 and December 31, 2013 was $382,721 and $354,861, respectively.

Inventories:

The Company's inventories are stated at lower of cost or market. Cost is determined on a moving-average basis. Costs of inventories include purchase and related costs incurred in delivering the products to their present location and condition. Market value is determined by reference to selling prices after the balance sheet date or to management's estimates based on prevailing market conditions. Inherent in the lower of cost or market calculation are several significant judgments based on a review of the aging of the inventory, inventory movement of products, economic conditions, and replacement costs. Management periodically evaluates the composition of its inventories at least quarterly to identify slow-moving and obsolete inventories to determine if any valuation allowance is required. During the course of our recall commenced in October 2013, we have recalled a substantial number of MASCT Systems. Based on management's assessment of those devices and the pending FDA clearance, management decided to establish 100% allowance for valuation reserve on all MASCT Systems, and recorded $149,946 of losses on obsolete inventory for the year ended December 31, 2013. During March 31, 2014, management identified no additional slow moving or obsolete inventory. The Company outsources product manufacturing to outside manufacturer contactors. The ownership of the goods transfers from the manufacturer to the Company's customer at the time the products are shipped to the customers. As of March 31, 2014 and December 31, 2013, inventories amounted to $0 after netting of the above valuation allowance.

The Company provides, either directly or through distributors, the NAF specimen collection kits to doctors with our MASCT System for doctors to collect specimens that are returned to the NRLBH or other laboratories for diagnostic analysis. These collection kits are considered part of the MASCT System. The Company's direct sales personnel distributes the kits directly to physicians free of charge, or by offering a rebate to physicians. The Company has not intended to deem the kits as a primary product line due to their nominal cost and value per unit. As a result, the kits are immediately expensed and recorded as selling expense upon purchasing of the kits.

Property, plant, and equipment:

Property, plant and equipment are stated at cost less accumulated depreciation. Expenditures for maintenance and repairs are charged to earnings as incurred; additions, renewals and betterments are capitalized. When property, plant and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

	Useful Life (in years)
Machinery and equipment	5
Leasehold improvements	2.083

The Company applies the provisions of FASB ASC Topic 360 (ASC 360), "Property, Plant, and Equipment" which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Company periodically evaluates the carrying value of long-lived assets to be held and used in accordance with ASC 360, at least on an annual basis. ASC 360 requires the impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal. For the three months ended March 31, 2014 and year ended December 31, 2013 $0 and $158,292 was assessed and recorded as impairment on long-life assets.

Intangible assets:

Intangible assets consist of intellectual property and software acquired. At least annually, we evaluate purchased intangibles for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. Estimating future cash flows related to an intangible asset involves significant estimates and assumptions. If our assumptions are not correct, there could be an impairment loss or, in the case of a change in the estimated useful life of the asset, a change in amortization expense. There was no impairment of intangible assets as of and for the three months ended March 31, 2014 and the year ended December 31, 2013, respectively.

Amortization is computed using the straight-line method over the estimated useful lives of the assets as follows:

	Useful Life (in years)
Patents	9-14
Capitalized license costs	10
Software	3

Research and Development Expenses:

Research and development costs are generally expensed as incurred. The Company's research and development expenses consist of costs incurred for internal and external research and development.

Share-Based Payments:

In December 2004, the Financial Accounting Standards Board, or the FASB, issued the Statement of Financial Accounting Standards, or SFAS, No. 123(R), "Share-Based Payment", which replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123(R) is now included in the FASB's ASC Topic 718, "Compensation – Stock Compensation." Under SFAS No. 123(R), companies are required to measure the compensation costs of share-based compensation arrangements based on the grant-date fair value and recognize the costs in the financial statements over the period during which employees or independent contractors are required to provide services. Share-based compensation arrangements include stock options and warrants, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, or SAB 107, which expresses views of the staff regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods. On April 14, 2005, the SEC adopted a new rule amending the compliance dates for SFAS No. 123(R). Companies may elect to apply this statement either prospectively, or on a modified version of retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures required for those periods under SFAS No. 123.

The Company has fully adopted the provisions of FASB ASC 718 and related interpretations as provided by SAB 107. As such, compensation cost is measured on the date of grant as the fair value of the share-based payments. Such compensation amounts, if any, are amortized over the respective vesting periods of the option grant.

NOTE 4: PREPAID EXPENSES

Prepaid expenses consisted of the following:

	March 31, 2014	December 31, 2013
Prepaid stock purchase agreement service fee	$ 576,961	$ 651,961
Prepaid marketing educational programs	230,000	-
Prepaid hardware and software	31,551	131,204
Prepaid insurance	125,714	112,517
Retainer and security deposits	29,540	36,906
Other	24,000	-
	$ 1,017,766	$ 932,588

NOTE 5: PROPERTY, PLANT, AND EQUIPMENT

Property, plant and equipment consisted of the following:

	March 31, 2014	December 31, 2013
Machinery and equipment	$ 329,790	$ 326,824
Leasehold improvements	93,665	93,665
Capitalized new product development costs	-	15,000
Less: Accumulated depreciation	(135,221)	(114,050)
Less: Allowance for loss on impairment	(158,292)	(158,292)
Property, plant, and equipment, net	$ 129,942	$ 163,147

Depreciation expense for the three months ended March 31, 2014 and 2013 was $21,171 and $4,869, respectively.

NOTE 6: INTANGIBLE ASSETS

Intangible assets consisted of the following:

	March 31, 2014	December 31, 2013
Patents	$ 4,794,853	$ 4,794,853
Capitalized license costs	200,000	-
Software	105,839	105,839
Less: Accumulated amortization	(608,985)	(505,059)
	$ 4,491,707	$ 4,395,633

Intangible assets amounted to $4,491,707 and $4,395,633 as of March 31, 2014 and December 31, 2013, respectively, and consisted of patents, capitalized license costs and software acquired. The acquired software mainly consisted of $58,000 in laboratory software and $31,500 in the newly developed Company website. The amortization period for the purchased software is 3 years. Amortization expense related to software for the three months ended March 31, 2014 and 2013 was $8,761 and $4,678, respectively.

Patents amounted to $4,794,853 as of March 31, 2014 and December 31, 2013, respectively, and mainly consisted of patents acquired from Acueity on September 30, 2012 in an asset purchase transaction. Patent assets are amortized based on their determined useful life, and tested annually for impairment. The amortization period was from 9 to 14 years. Amortization expense related to patents was $93,497 and $89,398 for the three months ended March 31, 2014 and 2013, respectively.

Capitalized license costs consist of fees paid to A5 Genetics KFT, Corporation, pursuant to which the Company received the world-wide (other than the European Union) exclusive license to use the software in the NextCYTE test. Amortization expense related to license costs was $1,668 and $0 for the three months ended March 31, 2014 and 2013, respectively.

Future estimated amortization expenses as of March 31, 2014 for the five succeeding years is as follows:

As of December 31,	Amounts
2014 (includes the remainder of the year)	$ 313,525
2015	412,212
2016	404,951
2017	393,982
2018	393,982
Thereafter	2,573,055
	$ 4,491,707

NOTE 7: PAYROLL LIABILITIES:

Payroll liabilities consisted of the following:

	March 31, 2014	December 31, 2013
Accrued bonus payable	$ 116,031	$ 408,362
Accrued payroll liabilities	67,003	48,232
Accrued payroll tax liabilities	12,862	19,883
	$ 195,896	$ 476,477

NOTE 8: STOCKHOLDERS' EQUITY

The Company is authorized to issue a total of 85,000,000 shares of stock consisting of 75,000,000 shares of Common Stock, par value $0.001 per share, and 10,000,000 shares of Preferred Stock, par value $0.001 per share.

Reverse Stock-Split

On September 28, 2010, the Board of Directors approved a 1-for-2.26332 reverse share split for all issued and outstanding shares of Common Stock, with no change to the par value of the Common Stock.

Prior Issuances of Common Stock at Inception

On April 30, 2009 (inception), the Company issued 1,767,316 shares (or 4,000,000 shares prior to the reverse stock-split on September 28, 2010) to Ensisheim Partners LLC, a related party to the Company through common ownership, for cash in the amount of $24,000, or $0.014 per share (or $0.006 per share prior to the reverse stock-split on September 28, 2010); 1,325,487 shares (or 3,000,000 shares prior to the reverse stock-split on September 28, 2010) to Manistee Ventures LLC, a related party to the Company through common ownership, for cash in the amount of $18,000, or $0.014 per share (or $0.006 per share prior to the reverse stock-split on September 28, 2010); and 883,662 shares (or 2,000,000 shares prior to the reverse stock-split on September 28, 2010) to the Chairman, CEO and President of the Company at that time for cash in the amount of $12,000, or $0.014 per share (or $0.006 per share prior to the reverse stock-split on September 28, 2010).

Private Placements and Warrants

On April 28, May 31, June 10, and June 23, 2011, pursuant to Securities Purchase Agreements with various investors (the "Investors"), the Company issued 5,256,800 shares of the Company's common stock and 5,256,800 warrants (the "Investor Warrants"), each of which entitles the investors to purchase the Company's common stock at $1.25 per share, for aggregate gross proceeds of $6,571,000 (the "Private Placement").

Placement Agent Fees

In connection with the Private Placement, the Company paid Dawson James Securities, Inc. (the "Placement Agent"), a cash fee equal to 10% of the gross proceeds from sale of the common stocks and warrants, plus a 3% non-accountable expense allowance, which resulted in a payment to the Placement Agent of an aggregate of $857,230 (the "Placement Agent Fee"). In addition, the Company entered into Warrant Agreements with the Placement Agent pursuant to which the Placement Agent received 788,520 warrants, each of which entitles the Placement Agent to purchase one share of the Company's common stock at $1.60 per share, plus an additional 788,520 warrants (collectively with the warrants exercisable at $1.25 per share, the "Placement Agent Warrants"), each of which entitles the placement agent to purchase the Company's common stock at $1.25 per share. The cash payment of the $857,230 Placement Agent Fee and the $495,876 aggregated initial fair value of the Placement Agent Warrants (see *Fair Value Considerations* below) were directly attributable to an actual offering and were charged through additional paid-in capital in accordance with the SEC Staff Accounting Bulletin (SAB) Topic 5A.

Warrants

The Warrants, including the Investor Warrants and the Placement Agent Warrants, are exercisable at any time commencing after June 23, 2011 which is the date that the Company completed a "significant private financing" under the terms of the Warrants (the "Initial Exercise Date"). The Warrants shall expire and no longer be exercisable on the fifth anniversary of the Initial Exercise Date (the "Expiration Date"). The Warrants may be exercised for cash or, at the option of the holder, may be exercised on a cashless basis; however if a registration statement is in effect for the resale of the common stock issuable upon exercise of the Warrants then the Warrants cannot be exercised on a cashless basis. As of March 31, 2014 such a registration statement was in effect and, therefore, the Warrants cannot be exercised on a cashless basis. There are no redemption features embodied in the Warrants and they have met the conditions provided in current accounting standards for equity classification.

Fair Value Considerations

The Company's accounting for the issuance of Warrants to the Investors and the Placement Agent required the estimation of fair values of the financial instruments. The development of fair values of financial instruments requires the selection of appropriate methodologies and the estimation of often subjective assumptions. The Company selected the valuation techniques based upon consideration of the types of assumptions that market participants would likely consider in exchanging the financial instruments in market transactions. The Warrants were valued using a Black-Scholes-Merton Valuation Technique because it embodies all of the requisite assumptions (including trading volatility, estimated terms and risk free rates) necessary to fair value these instruments.

The Investor Warrants and the Placement Agent Warrants were initially valued at $1,808,025 or $0.34 per warrant, $228,712 or $0.29 per warrant, and $267,164 or $0.34 per warrant, respectively. The following tables reflect assumptions used to determine the fair value of the Warrants:

	Fair Value Hierarchy Level	April-June 2011	December 2011	
		Investor Warrants	Placement Agent Warrants	Placement Agent Warrants
Indexed shares		5,256,800	788,520	788,520
Exercise price		$ 1.60	$ 1.60	$ 1.25
Significant assumptions:				
Stock price	3	$ 0.906	$ 0.906	$ 0.906
Remaining term	3	6 years	6 years	6 years
Risk free rate	2	2.49%	1.12%	1.12%
Expected volatility	3	53.55%	54.21%	54.21%

Fair value hierarchy of the above assumptions can be categorized as follows:

(1) There were no Level 1 inputs.

(2) Level 2 inputs include:

Risk-free rate- The risk-free rate of return reflects the interest rate for United States Treasury Note with similar time-to-maturity to that of the warrants.

(3) Level 3 inputs include:

Stock price- The Company's common stock was not publicly traded at the time the Warrants were issued. Therefore, the stock price was determined implicitly from an iterative process in order for the combined fair value of the common stock and the warrants to equal the amount of proceeds received in the Private Placement, based upon the assumption that the Private Placement was the result of an arm's length transaction.

Remaining term- The Company does not have a history to develop the expected term for its Warrants. Accordingly, the Company expected that the Initial Exercise Date would occur within one year from the date of issuance plus the contractual term in the calculations.

Expected volatility- We did not have a historical trading history sufficient to develop an internal volatility rate for use in the model. As a result, as required by ASC 718-10-30, the Company has accounted for the Warrants using the calculated value method. The Company identified seven public entities in the similar industry for which share price information was available, and considered the historical volatilities of those public entities' share prices in calculating the expected volatility appropriate to the Company.

Asset Purchase and Warrants

On September 30, 2012, pursuant to the asset purchase agreement with Acueity, the Company issued 862,500 shares of common stock and 325,000 warrants ("Acueity Warrants") to the shareholders of Acueity, each of which entitles the recipients to subscribe for and purchase from the Company one share of the Company's common stock at $5.00 per share (the "Exercise Price"), subject to a six-month lock up agreement.

Warrants

The Acueity Warrants are exercisable at any time commencing after September 30, 2012 (the "Issuance Date") and shall expire and no longer be exercisable on the fifth anniversary of the Issuance Date (the "Expiration Date"). The Company may at any time during the term of the Acueity Warrants reduce the then current Exercise Price to any amount and for any period of time deemed appropriate by the Board of Directors of the Company. The Acueity Warrants do not have a cashless exercise provision. There are no redemption features embodied in the Acueity Warrants and they have met the conditions provided in current accounting standards for equity classification.

Fair Value Considerations

The Company's accounting for the issuance of the Acueity Warrants required the estimation of fair values of the financial instruments. The development of fair values of financial instruments requires the selection of appropriate methodologies and the estimation of often subjective assumptions. The Company selected the valuation techniques based upon consideration of the types of assumptions that market participants would likely consider in exchanging the financial instruments in market transactions. The warrants were valued using a Black-Scholes-Merton Valuation Technique because it embodies all of the requisite assumptions (including trading volatility, estimated terms and risk free rates) necessary to fair value these instruments.

The Acueity Warrants were valued at $762,353 or $2.35 per warrant. The following tables reflect assumptions used to determine the fair value of the Warrants:

	Fair Value Hierarchy Level	September 2012 Acueity Warrants
Indexed shares		325,000
Exercise price		$ 5.00
Significant assumptions:		
Stock price	3	$ 5.00
Remaining term	3	5 years
Risk free rate	2	0.62%
Expected volatility	3	56.54%

Fair value hierarchy of the above assumptions can be categorized as follows:

(1) There were no Level 1 inputs.

(2) Level 2 inputs include:

Risk-free rate- The risk-free rate of return reflects the interest rate for United States Treasury Note with similar time-to-maturity to that of the warrants.

(3) Level 3 inputs include:

Stock price- The Company's common stock was not publicly traded at the time the Acueity Warrants were issued. Therefore, the stock price was determined at the offering price of the then contemplated initial public offering, for which the registration statement on Form S-1 (File No. 333-179500) was subsequently declared effective by the Securities and Exchange Commission on November 7, 2012, and a prospectus was subsequently filed pursuant to Rule 424(b)(4) on November 9, 2012 (see Note 14).

Remaining term- The Company does not have a history to develop the expected term for its warrants. Accordingly, the Company expected that the Initial Exercise Date would occur within one year from the date of issuance plus the contractual term in the calculations.

Expected volatility- We did not have a historical trading history sufficient to develop an internal volatility rate for use in the model. As a result, as required by ASC 718-10-30, the Company has accounted for the warrants using the calculated value method. The Company identified seven public entities in the similar industry for which share price information was available, and considered the historical volatilities of those public entities' share prices in calculating the expected volatility appropriate to the Company.

2014 Public Offering of Common Stock and Warrants

On January 29, 2014, the Company closed a public offering of 5,834,234 units at the price of $2.40 per unit for the total gross proceed of approximately $14.0 million. Each unit consists of one share of common stock and a warrant to purchase 0.20 of a share of common stock (the "2014 Investor Warrants"). The 2014 Investor Warrants are exercisable at $3.00 per share and callable by the Company at $6.00 per share if certain conditions are met.

Placement Agent Fees

In connection with the 2014 Public Offering, the Company paid Dawson James Securities, Inc. (the "Placement Agent"), a cash fee equal to 7% of the gross proceeds from sale of the units, which resulted in a payment to the Placement Agent of an aggregate of $980,151 (the "Placement Agent Fee"). In addition, the Company entered into Warrant Agreements with the Placement Agent pursuant to which the Placement Agent received 175,027 warrants, or 3% of the aggregate number of shares sold in the offering (the "2014 Placement Agent Warrants" and together with the 2014 Investor Warrants, the "2014 Warrants"). Each 2014 Placement Agent Warrant entitles the Placement Agent to purchase one share of the Company's common stock at $3.00 per share. The cash payment of the $980,151 2014 Placement Agent Fee and the $121,707 aggregated initial fair value of the 2014 Placement Agent Warrants (see *Fair Value Considerations* below) were directly attributable to an actual offering and were charged through additional paid-in capital in accordance with the SEC Staff Accounting Bulletin (SAB) Topic 5A.

Warrants

The 2014 Warrants are exercisable at any time commencing after January 29, 2014 (the "Initial Exercise Date"). Subject to the call right described above, the 2014 Warrants shall expire and no longer be exercisable on the fifth anniversary of the Initial Exercise Date on November 29, 2018 (the "Expiration Date"). The 2014 Warrants cannot be exercised on a cashless basis. There are no redemption features embodied in the 2014 Warrants and they have met the conditions provided in current accounting standards for equity classification.

Fair Value Consideration

The Company's accounting for the issuance of the 2014 Warrants required the estimation of fair values of the financial instruments. The development of fair values of financial instruments requires the selection of appropriate methodologies and the estimation of often subjective assumptions. The Company selected the valuation techniques based upon consideration of the types of assumptions that market participants would likely consider in exchanging the financial instruments in market transactions. The 2014 Warrants were valued using a Black-Scholes-Merton Valuation Technique because it embodies all of the requisite assumptions (including trading volatility, estimated terms and risk free rates) necessary to fair value these instruments.

The 2014 Investor Warrants and the 2014 Placement Agent Warrants were valued at $834,986 or $0.72 per warrant, and $121,707 or $0.70 per warrant, respectively. The following tables reflect assumptions used to determine the fair value of the 2014 Warrants:

	Fair Value Hierarchy Level	January 29, 2014	
		2014 Investor Warrants	Placement Agent Warrants
Indexed shares		1,166,849	175,027
Exercise price		$ 3.00	$ 3.00
Significant assumptions:			
Stock price	1	$ 2.50	$ 2.47
Remaining term	3	5 years	5 years
Risk free rate	2	1.45%	1.42%
Expected volatility	3	37.96%	37.95%

Fair value hierarchy of the above assumptions can be categorized as follows:

(1) Level 1 inputs include:
Stock price- The Fair value of Company's common was derived from the closing prices in NASDAQ Capital Market as of the issuance.

(2) Level 2 inputs include:
Risk-free rate- The risk-free rate of return reflects the interest rate for United States Treasury Note with similar time-to-maturity to that of the warrants.

(3) Level 3 inputs include:
Remaining term- The Company does not have a history to develop the expected term for its warrants. Accordingly, the Company expected that the Initial Exercise Date would occur within one year from the date of issuance plus the contractual term in the calculations.

Expected volatility- We did not have a historical trading history sufficient to develop an internal volatility rate for use in the model. As a result, as required by ASC 718-10-30, the Company has accounted for the warrants using the calculated value method. The Company identified five public entities in the similar industry for which share price information was available, and considered the historical volatilities of those public entities' share prices in calculating the expected volatility appropriate to the Company.

Outstanding Warrants

As of March 31, 2014, warrants to purchase 6,073,426 shares of common stock are outstanding including:

(1) 4,292,050 warrants from the 2011 private placement (exercisable at $1.25 or $1.60),

(2) 325,000 warrants issued in the Acueity transaction (exercisable at $5.00),

(3) 1,166,849 warrants from the January 29, 2014 Public Offering (exercisable at $3.00), and

(4) 242,027 warrants granted as placement agent fees for the Company's offerings during 2013 and January 29, 2014 (exercisable from $2.12 to $12.43).

(5) 47,500 warrants granted to an outside consulting firm (exercisable at $4.24).

Stock Options and Incentive Plan

On September 28, 2010, the Board of Directors approved the adoption of the 2010 Stock Option and Incentive Plan, or the 2010 Plan, subject to stockholder approval, to provide for the grant of equity-based awards to employees, officers, non-employee directors and other key persons providing services to the Company. Awards of incentive options may be granted under the 2010 Plan until September 2020. No other awards may be granted under the 2010 Plan after the date that is 10 years from the date of stockholder approval. An aggregate of 1,000,000 shares (or 2,263,320 shares prior to the reverse stock-split on September 28, 2010) were initially reserved for issuance in connection with awards granted under the 2010 Plan, such number of shares to be subject to adjustment as provided in the plan and in any award agreements entered into by the Company under the plan, and upon the exercise or conversion of any awards granted under the plan. On January 1, 2012, 450,275 shares were added to the 2010 Plan and on January 1, 2013, 516,774 shares were added to the 2010 Plan, and on January 1, 2014, 742,973 shares were added to the 2010 plan as provided under the terms of the 2010 Plan.

The Company granted options to purchase 334,397 shares of common stock to employees and directors during the three months ended March 31, 2014. During the quarter ended March 31, 2014, a new member of the Board of Directors was appointed and in connection with that appointment he earned the right to receive 22,728 shares of restricted stock under the 2010 Plan; however, these shares were not issued as of March 31, 2014. The Company issued no shares of common stocks in connection with the exercise of employee's stock options during the three months ended March 31, 2014. As of March 31, 2014, there are 897,617 options available for grant under the 2010 Plan.

NOTE 9: INCOME TAXES

The Company accounts for income taxes as outlined in ASC 740, "Income Taxes", which was previously Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under the asset and liability method of SFAS 109, deferred income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is provided for the amount of deferred tax assets that, based on available evidence, are not expected to be realized.

As a result of the Company's cumulative losses, management has concluded that a full valuation allowance against the Company's net deferred tax assets is appropriate. No income tax liabilities existed as of March 31, 2014 and December 31, 2013 due to the Company's continuing operating losses.

NOTE 10: CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash deposits. Accounts at each institution are insured by the Federal Deposit Insurance Corporation ("FDIC") up to $250,000. At March 31, 2014 and December 31, 2013, the Company had $16,340,951 and $6,092,161 in excess of the FDIC insured limit, respectively.

NOTE 11: COMMITMENTS AND CONTINGENCIES

Lease Commitments

On March 4, 2011, the Company entered into a commercial lease agreement with Sanders Properties, LLC for office space located in Seattle, WA. The lease provides for monthly rent of $1,100 and a security deposit of $1,500. The lease terms are from April 1, 2011 through March 31, 2014. On March 20, 2014, the Company entered into a new agreement with Sanders properties which extends the terms of the lease through March 31, 2015 with a monthly rent of $1,150.

On December 9, 2011, the Company entered into another commercial lease agreement with Fred Hutchinson Research Center for lab and office space located in Seattle, WA. The lease provides for monthly rent of $16,395 for the period from February 24, 2012 to August 31, 2012, $19,923 for the period from September 1, 2012 to August 31, 2013, and $20,548 for the period from September 1, 2013 to November 29, 2014. The security deposit of $32,789 was paid in March 2012 and recorded as Security Deposit on the consolidated balance sheet as of December 31, 2012. In July 2013, the Company entered into an agreement with ARE LLC (Alexandria) to lease additional office spaces in our existing building under a separate lease agreement. The lease is from August 2013 through November 2014, and the gross rent is $ 4,800 per month. For the three months ended March 31, 2014, the Company incurred $65,605 of rent expense for the lease, which included leasing office management expenses.

On March 24, 2014, the Company entered into another commercial lease agreement with ARE LLC (Alexandria) for the Company's laboratory space which extends the term of the existing lease with Fred Hutchison Research Center, which expires in November 2014, through November 30, 2016. The lease provides for monthly rent payments of $22,736 from December 2014 through November 2015 and $23,258 from December 2015 through November 2016. As of March 31, 2014, the Company incurred and recorded security deposits of $25,000.

The future minimum lease payments due subsequent to March 31, 2014 under all non-cancelable operating leases for the next five years are as follows:

As of December 31,	**Amount**
2014 (remainder of the year)	$ 247,939
2015	276,805
2016	255,845
2017	-
2018	-
Thereafter	-
Total minimum lease payments	**$ 780,589**

Affymetrix Purchase Commitment

In September 2013, the Company entered into an "OwnerChip Program Agreement" with Affymetrix, Inc, a manufacturer of GeneChip Systems, where Affymetrix has agreed to loan a GeneChip System 3000Dx v.2 ("instrument") to us if we purchase and take delivery of a minimum thirty GeneChip Human Genme U133 Plus 2.0 (30-pack) arrays at $21,590 per 30 pack for the next three years for a total purchase obligation of $647,700 with a minimum purchase of ten 30-pack arrays per contract year. At the end of the three year contract, upon fulfillment of the purchase commitment, the instrument title and ownership transfer to Atossa at no additional cost. In addition to the GeneChip Human Genme, we must purchase a two year service contract for $51,600 to cover maintenance of the instrument during the contract period. We placed an initial order for four 30-pack arrays during 2013 for $94,723. We are obligated to purchase 26 additional arrays during the next three year contract term.

A5 Software Development Commitment

On June 10, 2013 the Company entered into an irrevocable license and service agreement with A5 Genetics KFT, Corporation, pursuant to which the Company received the world-wide (other than the European Union) exclusive license to the software used in the NextCYTE test. The Company has the right to prosecute patents related to this software, two of which the Company has filed in the United States. The patent applications have been assigned to us. The Company paid a one-time fee of $100,000 to A5 Genetics in 2013 and in March 2014 the Company completed software validation and paid an additional $100,000 to A5 Genetics. The Company is obligated to pay up to an additional $1.2 million to A5 Genetics upon the achievement of future milestones. The Company must also pay a royalty of $50 for each NextCYTE Test performed and $65 as a service fee for each NextCYTE Test performed. The agreement terminates on the later of the ten year anniversary of the agreement or the expiration of the latest to expire patent covering the software.

Contingencies

On June 30, 2011, Robert Kelly, the Company's former President, filed a counterclaim against the Company in an arbitration proceeding, alleging breach of contract in connection with the termination of a consulting agreement between Mr. Kelly (dba Pitslayer LLC) and the Company that was entered into in July 2010 in connection with his resignation from the Company as President and a director. The consulting agreement was terminated by the Company in September 2010. Mr. Kelly seeks $450,000 in compensatory damages, which is the amount he claims would have been earned had the consulting agreement been fulfilled to completion.

On December 11, 2012, Mr. Kelly filed a complaint in the United States District Court, Western Division of Washington seeking compensatory damages, interest and attorneys' fees related to the termination of Mr. Kelly's consulting contract and the rescission of shares issued to him in July 2010 in connection with his resignation from the Company as President and a director. The specific amount of damages sought is to be proven at trial and is not specified. On July 8, 2013, the court granted the Company's motion to compel arbitration of these claims and therefore this action was stayed pending resolution of the arbitration of the claims; however, Mr. Kelly has not initiated arbitration of those claims.

On February 26, 2013, Mr. Victor Cononi filed a complaint in the United States District Court, Western Division of Washington seeking compensatory damages, interest and attorneys' fees related to the rescission of shares issued to him in July 2010 in connection with Mr. Kelly's resignation from the Company as President and a director. Mr. Cononi is the father of Mr. Kelly's paramour. The specific amount of damages sought is to be proven at trial and is not specified. In August 2013, the court granted the Company's motion to compel arbitration of these claims and therefore this action was stayed pending resolution of the arbitration of the claims; however, Mr. Cononi has not initiated arbitration of those claims.

A hearing in the arbitration has been held in abeyance to accommodate other third party civil and federal criminal proceedings alleging securities and wire fraud that have been brought against Mr. Kelly with respect to his prior employment and predating his service with the Company. On March 11, 2014 a press release was issued by the FBI stating that Mr. Kelly had pled guilty in Manhattan federal court to securities and wire fraud charges related to his employment as CEO of Wwebnet. Mr. Kelly also agreed to forfeit $2,111,600 and, separately, pay $2,111,600 in restitution. The sentencing hearing is scheduled for July 17, 2014.

The Company is reasonably confident in its defenses to Mr. Kelly's and Mr. Cononi's claims. Consequently, no provision or liability has been recorded for these claims as of March 31, 2014. However, it is at least reasonably possible that the Company's estimate of liability may change in the near term. Any payments by reason of an adverse determination in this matter will be charged to earnings in the period of determination.

On October 10, 2013, a putative securities class action complaint, captioned Cook v. Atossa Genetics, Inc., et al., No. 2:13-cv-01836-RSM, was filed in the United States District Court for the Western District of Washington against us, certain of our directors and officers and the underwriters of our November 2012 initial public offering. The complaint alleges that all defendants violated Sections 11 and 12(a)(2), and that we and certain of our directors and officers violated Section 15, of the Securities Act by making material false and misleading statements and omissions in the offering's registration statement, and that we and certain of our directors and officers violated Sections 10(b) and 20A of the Exchange Act and SEC Rule 10b-5 promulgated thereunder by making false and misleading statements and omissions in the registration statement and in certain of our subsequent press releases and SEC filings with respect to our NAF specimen collection process, our ForeCYTE Breast Health Test and our MASCT device. This action seeks, on behalf of persons who purchased our common stock between November 8, 2012 and October 4, 2013, inclusive, damages of an unspecific amount.

On February 14, 2014, the Court appointed plaintiffs Miko Levi, Bandar Almosa and Gregory Harrison (collectively, the "Levi Group") as lead plaintiffs, and approved their selection of co-lead counsel and liaison counsel. The Court also amended the caption of the case to read In re Atossa Genetics, Inc. Securities Litigation. No. 2:13-cv-01836-RSM. An amended complaint was filed on April 15, 2014.

We believe this lawsuit is without merit and plan to defend ourselves vigorously; however, failure by us to obtain a favorable resolution of the claims set forth in the complaint could have a material adverse effect on our business, results of operations and financial condition. Currently, the amount of such material adverse effect cannot be reasonably estimated, and no provision or liability has been recorded for these claims as of March 31, 2014. The costs associated with defending and resolving the lawsuit and ultimate outcome cannot be predicted. These matters are subject to inherent uncertainties and the actual cost, as well as the distraction from the conduct of our business, will depend upon many unknown factors and management's view of these may change in the future.

FDA Warning Letter

On February 21, 2013, the Company received a Warning Letter ("Warning Letter") from the FDA regarding its Mammary Aspirate Specimen Cytology Test (MASCT) System and MASCT System Collection Test (together, the "System"). The Warning Letter arises from certain FDA findings during a July 2012 inspection, to which the Company responded in August 2012, explaining why the Company believed it was in compliance with applicable regulations and/or was implementing changes responsive to the findings of the FDA inspection. The FDA alleges in the Warning Letter that following 510(k) clearance of the MASCT System, the Company changed the System in a manner that requires submission of an additional 510(k) notification to the FDA. Specifically, the FDA stated that the Instructions For Use (IFU) in the original 510(k) submission stated that the user must "Wash the collection membrane with fixative solution into the collection vial…" while the current IFU states "…apply one spray of Saccomanno's Fixative to the collection membrane…" and that "this change fixes the NAF specimen to the filter paper rather than washing it into a collection vial." At the time that the changes were made the Company determined and documented that the change could not significantly affect the safety or effectiveness of the MASCT System, and thus, that a new 510(k) was not required in accordance with the FDA's guidance document entitled, "Deciding When to Submit a 510(k) for a Change to an Existing Device." The Warning Letter also identified certain issues with respect to the Company's marketing of the System and the Company's compliance with FDA Good Manufacturing Practices (cGMP) regulations, among other matters. The Company responded to the Warning Letter on March 13, 2013, and identified the corrective actions that had been made, or were otherwise underway The Company also filed a new 510(k) application for the MASCT System which was withdrawn in August 2013 after receiving feedback from the FDA.

On October 4, 2013, the Company initiated a voluntary recall of the system to address FDA's concerns regarding the modifications identified in the Warning Letter. As a result of this recall, this product is currently not being marketed or distributed in the U.S. The Company submitted a new premarket notification or 510(k) application for submission to the FDA on December 23, 2013 that covers the collection, preparation, and processing of NAF specimens at our laboratory and includes the spray method of fixing specimens to the collection membrane. We received a request from the FDA on February 28, 2014 to submit additional information in support of the application. We have until August 20, 2014 to respond to the FDA. We cannot market or distribute the ForeCYTE Breast Aspirator within United States until we receive clearance for this device form FDA.

On March 14, 2014, the FDA completed a follow up inspection at our Seattle facility. A Form 483 was provided to us at the conclusion of the inspection. In the FDA's most recent Form 483, five inspectional observations were identified regarding our quality management system. The FDA inspector also orally identified five additional discussion points related to our product labeling prior to the recall of the MASCT System; sufficiency of the content of our pending 510(k) submission for the ForeCYTE Breast Aspirator; and other compliance issues. On March 26, 2014, we submitted a response to the FDA, which included our proposed corrective actions to address the FDA's observations and discussion points. Whether the FDA will accept our response is uncertain, particularly in light of the similar nature of certain of the current inspectional observations to previous inspectional observations. If the FDA does not agree with our proposed corrective actions, or accepts them but finds that we have not implemented them adequately, or if we otherwise are found to be out of compliance with applicable regulatory requirements at a later date, the FDA could initiate an enforcement action including additional warning letters, fines and penalties. The FDA also may not clear our pending 510(k) for the ForeCYTE Breast Aspirator or our other devices and services under development. Any of the foregoing would have a material adverse effect on our business.

As of March 31, 2014, the Company has $96,201 in contingent liability and has incurred $339,042 in actual expenses related to the costs of the recall, including the estimated costs of pursuing the additional 510(k) clearance. The recall and 510(k) process may take longer than expected and we may incur costs that we have not anticipated. Accordingly, the actual amount of the loss contingency may be higher than we currently expect.

NOTE 12: STOCK BASED COMPENSATION

In accordance with the guidance provided in ASC Topic 718, Stock Compensation (formerly SFAS 123R), the compensation costs associated with the options are recognized, based on the grant-date fair values of these options, over the requisite service period, or vesting period. Accordingly, the Company recognized a compensation expense of $230,181 and $274,511 for the three months ended March 31, 2014 and 2013, respectively.

The Company estimated the fair value of these options using the Black-Scholes-Merton option pricing model based on the following weighted-average assumptions:

Year Ended December 2013	**Employees**	**Employees & Officers**	**Directors**	**CEO & CSO**
Date of Grant	January - December 2013	January - June 2013	May & October 2013	March 2013
Fair value of common stock on date of grant (A)	$2.05 - $5.19	$4.11 - $4.58	$2.04 - $6.59	$ 6.57
Exercise price of the options	$2.05 - $5.19	$4.11 - $4.58	$2.04 - $6.59	$ 6.57
Expected life of the options (years)	6.09 - 6.11	5.00 – 6.11	5.00 – 5.31	5.00
Dividend yield	0.00%	0.00%	0.00%	0.00%
Expected volatility	40.73 – 41.81%	40.96 - 41.05%	41.06-41.53%	47.09%
Risk-free interest rate	1.73 -1.97%	1.03-1.36%	0.73 - 1.49%	1.13%
Expected forfeiture per year (%)	10.00%	10.00%	10.00%	0.00%
Weighted average fair value of the options per unit	$0.878 - $2.18	$1.69 - $1.89	$0.790 - $2.49	$ 2.70

Three Months Ended March 2014	Employees	Officers	Directors
Date of Grant	January 8, 2014	January 8, 2014	March 1, 2014
Fair value of common stock on date of grant(A)	$ 2.20	$ 2.20	$ 2.20
Exercise price of the options	$ 2.20	$ 2.20	$ 2.20
Expected life of the options (years)	6.06	6.06	5.09
Dividend yield	0.00%	0.00%	0.00%
Expected volatility	41.70- 41.72%	41.70%	38.68%
Risk-free interest rate	2.11%	2.11%	1.53%
Expected forfeiture per year (%)	10.00%	10.00%	10.00%
Weighted average fair value of the options per unit	$ 0.95	$ 0.95	$ 0.80

(A) The fair values of the Company's common stock were derived from the closing prices on the NASDAQ Capital Market as of the dates of grant.

Fair value hierarchy of the above assumptions can be categorized as follows:

(1) Level 1 inputs include:

Stock price- The fair values of the Company's common stock were derived from the closing prices on the NASDAQ Capital Market as of the dates of grant.

(2) Level 2 inputs include:

Risk-free rate- The risk-free rate of return reflects the interest rate for United States Treasury Note with similar time-to-maturity to that of the options.

(3) Level 3 inputs include:

Expected lives- The expected lives of options granted were derived from the output of the option valuation model and represented the period of time that options granted are expected to be outstanding.

Expected forfeitures per year- The expected forfeitures are estimated at the dates of grant and will be revised in subsequent periods pursuant to actual forfeitures, if significantly different from the previous estimates.

Expected volatility- We did not have a historical trading history sufficient to develop an internal volatility rate for use in the model. As a result, as required by ASC 718-10-30, the Company has accounted for the options using the calculated value method. The Company identified five to seven public entities in the similar industry for which share price information was available, and considered the historical volatilities of those public entities' share prices in calculating the expected volatility appropriate to the Company.

The estimates of fair value from the model are theoretical values of stock options and changes in the assumptions used in the model could result in materially different fair value estimates. The actual value of the stock options will depend on the market value of the Company's common stock when the stock options are exercised.

Options issued and outstanding as of March 31, 2014 and their activities during the three months then ended are as follows:

	Number of Underlying Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Contractual Life Remaining in Years	Aggregate Intrinsic Value
Outstanding as of January 1, 2014	2,282,719	$ 4.43		
Granted	311,669	$ 2.20		
Expired	-	$ -		
Forfeited	(61,221)	$ 4.70		
Exercised	-	$ -		
Outstanding as of March 31, 2014	2,533,167	$ 4.15	7.86	$ 107,800
Exercisable as of March 31, 2014	1,253,137	$ 4.47	6.52	$ 107,800
Vested and expected to vest (1)	2,355,778	$ 4.18	7.76	$ 107,800

(1) vested shares and unvested shares after a forfeiture rate is applied.

Issuance of Restricted Common Stock for Director's Compensation

On October 10, 2013, the Company issued 24,510 shares of restricted stock with a grant date value of $50,000 or $2.04 per share to a new board member. The restriction will be removed as the shares vest quarterly for a proportional number of granted shares over the first year of service on the board, and the grant date value of such shares will be expensed in the quarter the restriction is removed.

On March 1, 2014, the Company agreed to issue 22,728 shares of restricted stock with a grant date value of $50,000 or $2.20 per share to a new board member; however these shares have not been issued as of March 31, 2014. The restriction will be removed as shares vest quarterly for a proportional number of granted shares over the first year of service on the board, and the grant date value of such shares will be expensed in the quarter the restriction is removed.

For the three months ended March 31, 2014, $230,181 was recorded as stock compensation expenses, including $16,611 for restricted stock.

NOTE 13: SUBSEQUENT EVENTS

Management has evaluated subsequent events through May 14, 2014, the date which the consolidated financial statements were available to be issued. All subsequent events requiring recognition as of March 31, 2014 have been incorporated into these consolidated financial statements, and besides the disclosures herein, there are no subsequent events that require disclosure in accordance with FASB ASC Topic 855, "Subsequent Events".

On May 6, 2014, the Board of Directors of the Company approved the following changes to the compensation arrangements of the Company's named executive officers for fiscal year 2014:

Name	Title	Annual base salary	Annual bonus potential as a % of base salary	Stock option grant
Steven C. Quay, Ph.D., M.D.	Chief Executive Officer and President	$ 500,000	50%	250,000
Kyle Guse, CPA, J.D.	Chief Financial Officer, General Counsel and Secretary	$ 350,000	45%	200,000
Shu-Chih Chen, Ph.D.	Chief Scientific Officer and Director of Human Resources	$ 350,000	40%	125,000

The stock options were granted under the Company's 2010 Stock Option and Incentive Plan. The options have an exercise price of $1.22, which is the fair market value on the date of grant, and vest quarterly over four years so long as the executive remains employed with the Company. The options are otherwise subject to the terms and conditions of the employment agreements with the executives.

In addition to the foregoing named executive officers, certain other senior officers received salary adjustments on May 6, 2014 for the 2014 fiscal year totaling $143,438 for the quarter ended March 31, 2014. The estimated expense of those salary adjustments has been accrued as of March 31, 2014.

On May 6, 2014, options to purchase a total of 150,000 shares of common stock were also granted under the 2010 plan to non-employee directors and certain senior officers. The options have an exercise price of $1.22 which was the fair market value on the date of grant. the options granted to non-employee directors vest quarterly over one year and options granted to the senior officers vest quarterly over four years. As of the date of filing this report, management was still in the process of determining the fair value of the options as described above, in accordance with FASB ASC Topic 718.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the financial condition and results of operations should be read in conjunction with the financial statements and the related notes included elsewhere in this report. This discussion contains forward-looking statements, which are based on assumptions about the future of the Company's business. The actual results could differ materially from those contained in the forward-looking statements. Please read "Forward-Looking Statements" included below for additional information regarding forward-looking statements.

Forward-Looking Statements

This report contains, in addition to historical information, certain information, assumptions and discussions that may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We have made these statements in reliance on the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected or anticipated. Although we believe our assumptions underlying our forward-looking statements are reasonable as of the date of this report, we cannot assure you that the forward-looking statements set out in this report will prove to be accurate. We typically identify these forward-looking statements by the use of forward-looking words such as "expect," "potential," "continue," "may," "will," "should," "could," "would," "seek," "intend," "plan," "estimate," "anticipate" or the negative version of those words or other comparable words. Forward-looking statements contained in this report include, but are not limited to, statements about:

- Whether we will obtain in a timely manner clearance from the Food and Drug Administration to sell, market and distribute our MASCT System, which we also refer to as the ForeCYTE Breast Aspirator;
- our ability to successfully re-launch our ForeCYTE Breast Aspirator and NAF cytology test;
- the estimated costs associated with our product recall;
- our ability to successfully sell our products and services at currently expected prices or otherwise at prices acceptable to us;
- our ability to successfully develop and commercialize new tests, tools and treatments currently in development and in the time frames currently expected;
- our ability to maintain our business relationships, including with our distributors, suppliers and customers, while we are undergoing the recall we commenced in October 2013 and while we seek additional regulatory clearance to market, sell and distribute our ForeCYTE Breast Aspirator and NAF cytology test;
- our ability to engage third-party suppliers to manufacture the ForeCYTE Breast Aspirator, Microcatheter System, other devices under development and their components at quantities and costs acceptable to us;
- our ability to satisfy ongoing FDA requirements for the ForeCYTE Breast Aspirator, NAF cytology test and Microcatheter System and to obtain regulatory approvals and/or clearances for our other products and services in development, including our ability to timely and adequately respond to and ultimately close-out the Warning Letter we received from the FDA on February 21, 2013, and the inspectional observations and discussion points we received March 14, 2014 and any issues resulting therefrom;

- our ability to defend the securities class action law suit filed against us on October 10, 2013, and other similar complaints that may be brought in the future, in a timely manner and within the coverage, scope and limits of our insurance policies;

- the benefits and clinical accuracy of NAF cytology test and ArgusCYTE tests and whether any product or service that we commercialize is safer or more effective than competing products and services;

- our ability to establish and maintain intellectual property rights covering our products and services;

- the willingness of health insurance companies, including those who are members of the MultiPlan, FedMed and HealthSmart networks, and other third-party payors to approve our products and services for coverage and reimbursement;

- our ability to establish and maintain an independent sales representative force, including with our current and future distributors and their sub-distributors, to market our products and services that we may develop, both regionally and nationally;

- our expectations regarding, and our ability to satisfy, federal, state and foreign regulatory requirements;

- the accuracy of our estimates of the size and characteristics of the markets that our products and services may address;

- our expectations as to future financial performance, expense levels and liquidity sources;

- our ability to attract and retain key personnel; and

- our ability to sell additional shares of our common stock to Aspire Capital under the terms of our purchase agreement with them.

These and other forward-looking statements made in this report are presented as of the date on which the statements are made. We have included important factors in the cautionary statements included in this report, particularly in the section titled "RISK FACTORS," that we believe could cause actual results or events to differ materially from the forward-looking statements that we make. Our forward-looking statements do not reflect the potential impact of any new information, future events or circumstances that may affect our business after the date of this report. Except as required by law, we do not intend to update any forward-looking statements after the date on which the statement is made, whether as a result of new information, future events or circumstances or otherwise.

Company Overview

We are a healthcare company focused on improving breast health through the development of a suite of laboratory developed tests (LDTs), medical devices and therapeutics. Our laboratory tests are being developed by our subsidiary, The National Reference Laboratory for Breast Health, Inc. (the NRLBH), and are intended to address each of the four stages of the breast health care path: the cytological analysis of nipple aspirate fluid (NAF); the cytological analysis of ductal lavage fluid collected from each individual breast duct with our proprietary microcatheters; the profiling of newly diagnosed breast cancers through the determination of gene expression profiles in breast cancer biopsy tissue; and the monitoring of breast cancer survivors for pre-clinical recurrence through a blood test for circulating tumor cells.

Our medical devices under development include the ForeCYTE Breast Aspirator (510(k) pending, not for sale in the United States.) intended for the collection of NAF for cytological testing at a laboratory, intra ductal microcatheters for the collection of ductal lavage fluid and for the potential administration of a targeted therapeutic, and various tools for potential use by breast surgeons. Our ForeCYTE Breast Aspirator (previously called the MASCT System) was launched nationally in early 2013 and was recalled in October 2013. It will not be re-launched in the United States unless and until we receive additional regulatory clearance from the FDA. We submitted a new 510(k) for the ForeCYTE Breast Aspirator on December 23, 2013; we received questions from the FDA regarding this submission on February 28, 2014 and are in process of addressing such questions as of the date of this report.

We plan to develop certain of our medical devices and laboratory tests so that they can be used as companions to pharmaceutical therapies. For example, we plan to develop our patented intra ductal microcatheters for the potential delivery of a pharmaceutical targeted to a condition called ductal carcinoma in-situ (DCIS). We also plan to develop our medical devices and laboratory tests as companion diagnostics to pharmaceutical therapies to treat women at high risk of breast cancer and for the treatment of proliferative epithelial disease (PED). These programs are in the early pre-clinical stage and will require testing and approval and/or clearance from the FDA prior to commercialization.

Our strategy consists of the following:

(1) Re-launch ForeCYTE: We hope to obtain FDA clearance for the ForeCYTE Breast Aspirator, our lead medical device, and, if FDA clearance is obtained to re-launch it in the United States through a direct sales force and our distributors, including Fisher Healthcare and PSS McKesson. We also intend to introduce the ForeCYTE Breast Aspirator into one or more foreign markets.

(2) Introduce our other Laboratory Tests and other Medical Devices along the Care Path: We plan to make each of NRLBH's individual laboratory tests and medical devices available to healthcare providers by completing any necessary development and obtaining any necessary regulatory clearances and/or approvals.

(3) Develop Pharmaceutical Therapies to be used as Companions with our Devices and Laboratory Services: We plan to develop our patented microcatheters to deliver pharmaceuticals to initially treat DCIS. We also plan to develop our devices and laboratory services for use as companion diagnostics. For example, we intend to use our devices to collect specimens of NAF, test the NAF specimens in our laboratory, provide pharmaceutical treatment options for the breast health conditions detected by our tests and then use our medical devices to monitor treatment response. We expect that these companion diagnostic systems will initially target PED and/or high risk women and will require lengthy and costly clinical trials that we will undertake only with input and direction from the FDA.

(4) Advance Partnering Opportunities: We plan to work with third parties and partners to develop our business. For example, we plan to work with Fisher Healthcare and PSS McKesson to distribute the ForeCYTE Breast Aspirator and we may partner with one or more laboratories to act as NAF collection sites using our ForeCYTE Breast Aspirator if and when it is cleared by the FDA. We plan to retain clinical research organizations (CROs) for clinical development of potential therapeutic programs and we intend to partner with pharmaceutical companies to develop companion diagnostic systems, which may include therapeutics to treat PED, DCIS and/or high risk women.

(5) Promote Physician and Patient Awareness: Our products and services are highly innovative and gaining adoption will require that physicians change the way they practice medicine. To facilitate adoption, we will continue to educate physicians and patients by engaging key opinion leaders, publishing in peer reviewed journals, and working with patient advocacy groups.

All of our medical devices and the NRLBH's laboratory tests, as well as the breast health companion diagnostic systems, are currently under development and we must receive additional regulatory clearances and/or approvals prior to marketing and commercialization.

Our leading device, the MASCT System (which we currently refer to as the ForeCYTE Breast Aspirator), and our NAF cytology test, were launched in a "field experience" trial in 2012 and nationally in the beginning of 2013. In October 2013, we voluntarily recalled the MASCT System to address concerns raised by the FDA in a Warning Letter we received in February 2013. In December 2013, we submitted a pre- market notification to the FDA for a 510(k) clearance for the ForeCYTE Breast Aspirator, and on February 28, 2014, we received questions from the FDA regarding this submission which we are in the process of addressing as of the date of this report. As a result of this recall, we are not currently marketing this product in the U.S. If we obtain clearance from the FDA, we intend to re-launch the ForeCYTE Breast Aspirator and our NAF cytology test. However, the regulatory pathway to obtaining a 510(k) clearance can be lengthy, expensive and unpredictable; we therefore cannot provide any assurances that we will receive a new 510(k) clearance for ForeCYTE Breast Aspirator or any of our other tests under development in a timely fashion or at all.

The NRLBH has been certified pursuant to the Clinical Laboratory Improvement Amendments, or CLIA. CLIA certification is legally required to receive reimbursement from federal or state medical benefit programs, like Medicare and Medicaid, and is a practical requirement for most third-party insurance benefit programs. Our CLIA-certified laboratory, which is permitted to accept samples from all 50 states under its CLIA certification, its state licenses, or, in New York under recognized exemption provisions while its license application is pending, examines the NAF specimens by cytological analysis.

On April 30, 2013, we entered into a Distribution and Marketing Services Agreement with Millennium Medical Devices LLC, pursuant to which, once we receive any necessary FDA clearances, Millennium will market and distribute the ForeCYTE Breast Aspirator in New York City and Northern New Jersey. In May 2013, we entered into a distribution agreement with Fisher Healthcare, a division of Fisher Scientific Company, LLC, and in September 2013, we entered into a distribution agreement with McKesson Medical Surgical.

From our inception (April 30, 2009) through our recall in October, 2013, we have received, processed, and reported the results to physicians from approximately 2,808 NAF samples processed and reported with our NAF cytology test (representing 1,404 patients). From inception through March 31, 2014, we have generated $1,140,024 in product and service revenue. We incurred net losses of $2,411,531 for the three months ended March 31, 2014 and $22,928,145 since inception. We have not yet established an ongoing source of revenue sufficient to cover our operating costs and allow us to continue as a going concern. Our ability to continue as a going concern is dependent on obtaining adequate capital to fund operating losses until we become profitable. We plan to obtain additional capital resources by: selling our equity securities; if cleared by the FDA, selling the ForeCYTE Breast Aspirator and generating laboratory service revenue from our tests performed by the NRLBH; and borrowing from stockholders or others when needed. However, we cannot assure you that we will be successful in accomplishing any of these plans and, if we are unable to obtain adequate capital, we could be forced to cease operations.

Our Voluntary Product Recall

On October 4, 2013, we initiated a voluntary recall to remove the MASCT device (which was also called the "ForeCYTE Test" prior to the recall) from the market. This voluntary recall includes the MASCT System Kit and Patient Sample Kit. The vast majority of these products (approximately ninety percent) were in inventory with our distributors and the remaining quantities were at customer sites across the United States. As of the date of this report, the recall has been substantially completed.

The purpose of this voluntary recall is to address concerns raised by the FDA in a Warning Letter received by Atossa in February 2013. In that Warning Letter, the FDA raised concerns about (1) the current instructions for use (IFU); (2) certain promotional claims used to market these devices; and (3) the need for FDA clearance for certain changes made to the NAF specimen collection process identified in the current IFU.

The MASCT device was originally cleared by the FDA for use as a sample collection device, with the provision that the fluid collected using this device can be used to determine and/or differentiate between normal, pre-malignant, and malignant cells. The MASCT device has not been cleared by the FDA for the screening or diagnosis of breast cancer. In addition, our NAF cytology test has not been cleared or approved by the FDA for any indication as the company considered this to be a Laboratory Developed Test – or within a class of tests that has historically not required a 510(k) application. Our NAF cytology test and the MASCT device are not intended to serve as a replacement for screening mammograms, diagnostic imaging tests, or biopsies. Patients are instructed to follow the recommendations and instructions of their physician with respect to breast cancer screening and diagnosis.

To date, we are unaware of any adverse incidents or injuries associated with the use of our NAF cytology test and the MASCT device or the processing method identified in the latest version of the IFU. However, there is a risk that these devices may produce false positive or false negative results. Although not cleared or intended for this use, if these devices are used as a substitute for recommended screening or diagnosis of breast cancer, FDA is concerned that patients may choose to forgo recommended mammograms and necessary biopsies.

We submitted a new 510(k) application to the FDA on December 23, 2013 for the ForeCYTE Breast Aspirator which is intended for use in the collection of nipple aspirate fluid for cytological testing. On February 28, 2014, we received a request from the FDA to submit additional information in support of the application. We have until August 20, 2014 to respond to the FDA. We cannot market or distribute the ForeCYTE Breast Aspirator within the United States until we receive clearance for this device from the FDA.

As of March 31, 2014, we have incurred cumulative actual recall expenses of $339,042 and have recorded $96,201 as a contingent liability related to the estimated remaining costs of the recall, including the estimated costs of pursuing the additional 510(k) clearance. The recall and 510(k) process may take longer than expected; for example the FDA may require additional actions that we have not anticipated. As a result, we may incur costs that we have not anticipated. Accordingly, the actual amount of the loss contingency for the recall may be higher than we currently expect. Prior to the commencement of the recall in October 2013, substantially all of our revenue was from sales of the MASCT System and patient collection kits and from testing services performed by our laboratory. As a result of the recall of the MASCT System and patient collection kits, we have ceased generating product revenue. Our laboratory services revenue has also virtually ceased as of October 2013.

If and when we re-launch our ForeCYTE Breast Aspirator, we will incur additional sales and marketing expenses. We will need to revise our sales and marketing tools and continue hiring direct sales employees in an effort to build a regional, and ultimately national, sales force. We also expect to continue to hire clinical consultants to assist in the sale of our NAF cytology tests. The indication for use that we are seeking from the FDA for the ForeCYTE Breast Aspirator may be more limited than the indication sought in our 510(k) pre-market notification and may be more limited that the indication for the MASCT System that we previously marketed. If so, our potential sales will be negatively impacted.

Follow-up FDA Inspection

On March 14, 2014, the FDA completed a follow up inspection at our Seattle facility. A Form 483 was provided to us at the conclusion of the inspection. In the FDA's most recent Form 483, five inspectional observations were identified regarding our quality management system. The FDA inspector also verbally identified five additional discussion points related to our product labeling prior to the recall of the MASCT System; sufficiency of the content of our pending 510(k) submission for the ForeCYTE Breast Aspirator; and other compliance issues. On March 26, 2014, we submitted a response to the FDA, which included our proposed corrective actions to address the FDA's observations and discussion points. Whether the FDA will accept our response is uncertain, particularly in light of the similar nature of certain of the current inspectional observations to previous inspectional observations. If the FDA does not agree with our proposed corrective actions, or accepts them but finds that we have not implemented them adequately, or if we otherwise are found to be out of compliance with applicable regulatory requirements at a later date, the FDA could initiate an enforcement action including additional warning letters, fines and penalties. The FDA also may not clear our pending 510(k) for the ForeCYTE Breast Aspirator or our other devices and services under development. Any of the foregoing would have a material adverse effect on our business.

Revenue Sources

The commercialization of the MASCT System and NAF cytology test has provided us with two revenue sources: (i) sales-based revenue from the sale of the MASCT System device and patient kits to distributors, physicians, breast health clinics, and mammography clinics and (ii) service, or use-based, revenue from the preparation and interpretation of the NAF samples sent to our laboratory for analysis. We do not anticipate generating revenue until and unless we receive an additional 510(k) clearance from the FDA for our ForeCYTE Breast Aspirator and re-launch the device. If and when ForeCYTE is re-launched, we plan to initially sell the ForeCYTE Breast Aspirator through regional and national specialty product distributors, with independent sales representatives specializing in women’s Health, and through our own direct sale force.

Commercial Lease Agreements

On March 4, 2011, the Company entered into a commercial lease agreement with Sanders Properties, LLC for office space located in Seattle, WA. The lease terminated on March 31, 2014 and provides for monthly rent of $1,100 and a security deposit of $1,500. On March 20, 2014, the Company entered into a new agreement with Sanders properties which extends the terms of the lease through March 31, 2015 with a monthly rent of $1,150.

On December 9, 2011, the Company entered into another commercial lease agreement with Fred Hutchinson Research Center for lab and office space located in Seattle, WA. The lease provides for monthly rent of $16,395 for the period from February 24, 2012 to August 31, 2012, $19,923 for the period from September 1, 2012 to August 31, 2013, and $20,548 for the period from September 1, 2013 to November 29, 2014. The security deposit of $32,789 was paid in March 2012 and recorded as Security Deposit on the consolidated balance sheet. In July 2013, the Company entered into an agreement with ARE LLC (Alexandria) to lease additional office spaces in our existing building under a separate lease agreement. The lease is from August 2013 through November 2014, and the gross rent is $ 4,800 per month. For the three months ended March 31, 2014, the Company incurred $65,605 of rent expense for the lease, which included leasing office management expenses.

On March 24, 2014, the Company entered into another commercial lease agreement with ARE LLC (Alexandria) for the Company's laboratory space which extends the term of the existing lease with Fred Hutchison Research Center which expires in November 2014 through November 30, 2016. The lease provides for monthly rent payments of $22,736 from December 2014 through November 2015 and $23,258 from December 2015 through November 2016. As of March 31, 2014, the Company incurred and recorded security deposits of $25,000.

We expect that these new laboratory facilities will be sufficient to meet our needs for the foreseeable future and we do not expect to need additional laboratory space for at least the next 24 months. We may need to secure additional office space as we grow our sales and marketing force and add to our administrative staff. Additional office space is readily available in our local market and we believe we can rent when necessary additional office space on acceptable terms.

Critical Accounting Policies and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses. On an ongoing basis, we evaluate these estimates and judgments, including those described below. We base our estimates on our historical experience and on various other assumptions that we believe to be reasonable under the circumstances. These estimates and assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results and experiences may differ materially from these estimates.

While our significant accounting policies are more fully described in Note 3 to our financial statements, we believe that the following accounting policies are the most critical to aid you in fully understanding and evaluating our reported financial results and affect the more significant judgments and estimates that we use in the preparation of our financial statements.

Revenue Recognition:

Overview

We will recognize product and service revenue in accordance with GAAP when the following overall fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or the service has been performed, (iii) our price to the customer is fixed or determinable, and (iv) collection is reasonably assured.

Product Revenue

We recognize revenue for sales of the MASCT kits and devices on an accrual basis for sales to distributors when the above four criteria are met. For sales of MASCT kits and devices directly to physicians, the revenue is typically recognized upon receipt of cash as we have an insufficient sales history on which to determine the collectability. Shipping documents and the completion of any customer acceptance requirements, when applicable, will be used to verify product delivery. We will assess whether a price is fixed or determinable based upon the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. For sales directly to physicians, once a history of sales and collectability has been established, we will recognize revenue on an accrual basis with an offsetting reserve for doubtful accounts based on the history during the initial sales period.

Service Revenue

We record revenue for diagnostic testing on an accrual basis at the Medicare allowed and invoiced amount. Amounts invoiced above the Medicare amount, namely non-Medicare, are not recognized on an accrual basis and instead are recognized on a cash basis as received. Diagnostic testing revenue at the Medicare rate is recognized upon completion of the test, communication of results to the patient's physician, and when collectability is reasonably assured. Customer purchase orders and/or contracts will generally be used to determine the existence of an arrangement. Once the Company has historical sales and can determine the proper amount to recognize as uncollectible, it will then begin to recognize the entire amount, both Medicare and non-Medicare billing on an accrual basis, with an offsetting allowance for doubtful accounts recorded based on history.

Cost of Revenue:

Cost of revenue consists of cost of diagnostic testing services and cost of product sales. Cost of diagnostic testing services primarily includes direct cost of material, direct labor, equipment, and shipping to process the patient samples (including pathology, quality control analysis, and shipping charges to transport tissue sample) in our laboratory. Costs associated with performing the Company's tests are recorded as tests are processed. Costs recorded for tissue sample processing and shipping charges represent the cost of all the tests processed during the period regardless of whether revenue was recognized with respect to that test. Cost of product sales primarily includes manufacturing cost of our MASCT System for sales to distributors, which is recorded upon transfer of ownership of the goods.

Cash and Cash Equivalents:

Cash and cash equivalents include cash and all highly liquid instruments with original maturities of three months or less.

Accounts Receivable:

Accounts receivable are recorded at net realizable value consisting of the carrying amount less allowance for doubtful accounts, as needed. The Company assesses the collectability of accounts receivable based primarily upon the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends, and changes in customer payment patterns to evaluate the adequacy of these reserves. The Company's allowance for doubtful accounts as of March 31, 2014 and December 31, 2013 was $382,721 and $354,861, respectively.

Inventory:

The Company's inventories are stated at lower of cost or market. Cost is determined on a moving-average basis. Costs of inventories include purchase and related costs incurred in delivering the products to their present location and condition. Market value is determined by reference to selling prices after the balance sheet date or to management's estimates based on prevailing market conditions. Inherent in the lower of cost or market calculation are several significant judgments based on a review of the aging of the inventory, inventory movement of products, economic conditions, and replacement costs. Management periodically evaluates the composition of its inventories at least quarterly to identify slow-moving and obsolete inventories to determine if any valuation allowance is required. During the course of our recall commenced in October 2013, we have recalled a substantial number of MASCT Systems. Based on management's assessment of those devices and the pending FDA clearance, management decided to establish 100% allowance for valuation reserve on all MASCT Systems, and recorded $149,946 of losses on obsolete inventory as of and for the year ended December 31, 2013. During the quarter ended March 31, 2014 management identified no additional slow moving or obsolete inventory. The Company outsources product manufacturing to outside manufacturer contactors. The ownership of the goods transfers from the manufacturer to the Company's customer at the time the products are shipped to the customers. As of March 31, 2014 and December 31, 2013, inventories amounted to $0 after netting of the above valuation allowance.

The Company provides, either directly or through distributors, the NAF cytology testing specimen collection kits to doctors with our MASCT System for doctors to collect specimens that are returned to the NRLBH or other laboratories for diagnostic analysis. These collection kits are considered part of the MASCT System. During the initial marketing phase, we decided to distribute the kits to customers at no cost and bundle them with the MASCT pumps, and has not intended to deem the collection kits as a primary product line due to their nominal cost and value per unit. As a result, the kits are immediately expensed and recorded as selling expense upon purchasing of the kits.

Use of Estimates:

The preparation of financial statements in conformity with 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 financial statements and the reported amounts of revenue and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

Property, plant, and equipment:

Property, plant and equipment are stated at cost less accumulated depreciation. Expenditures for maintenance and repairs are charged to earnings as incurred; additions, renewals and betterments are capitalized. When property, plant and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations

The Company applies the provisions of FASB ASC Topic 360 (ASC 360), "Property, Plant, and Equipment" which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Company periodically evaluates the carrying value of long-lived assets to be held and used in accordance with ASC 360, at least on an annual basis. ASC 360 requires the impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal. For the three months ended March 31, 2014 and year ended December 31, 2013 $0 and $158,292 was assessed and recorded as impairment on long-life assets.

Intangible Assets:

Intangible assets consist of intellectual property and software acquired. At least annually, we evaluate purchased intangibles for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. Estimating future cash flows related to an intangible asset involves significant estimates and assumptions. If our assumptions are not correct, there could be an impairment loss or, in the case of a change in the estimated useful life of the asset, a change in amortization expense. There was no impairment of intangible assets as of and for the three months ended March 31, 2014 and year ended December 31, 2013, respectively.

Share-Based Payments:

In December 2004, the Financial Accounting Standards Board, or the FASB, issued the Statement of Financial Accounting Standards, or SFAS, No. 123(R), "Share-Based Payment," which replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123(R) is now included in the FASB's ASC Topic 718, "Compensation — Stock Compensation." Under SFAS No. 123(R), companies are required to measure the compensation costs of share-based compensation arrangements based on the grant-date fair value and recognize the costs in the financial statements over the period during which employees or independent contractors are required to provide services. Share-based compensation arrangements include stock options and warrants, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, or SAB 107, which expresses views of the staff regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods. On April 14, 2005, the SEC adopted a new rule amending the compliance dates for SFAS No. 123(R). Companies may elect to apply this statement either prospectively, or on a modified version of retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures required for those periods under SFAS No. 123.

We have fully adopted the provisions of FASB ASC 718 and related interpretations as provided by SAB 107. As such, compensation cost is measured on the date of grant as the fair value of the share-based payments. Such compensation amounts, if any, are amortized over the respective vesting periods of the option grant.

Results of Operations

Three Months Ended March 31, 2014 and 2013

Revenue and Cost of Goods Sold. For the three months ended March 31, 2014, revenue totaled $24,124, consisting of additional cash collected in excess of the amounts we accrued previously at the Medicare rates. Total revenue for the three months ended March 31, 2013 was $182,670, consisting of $169,230 in diagnostic service revenue and $13,440 for product sales. Cost of revenue totaled $0 for the three months ended March 31, 2014, compared to $66,464 in the same periods in 2013. The Company has recognized virtually no revenue or cost of revenue since the voluntary recall in October 2013.

For the three months ended March 31, 2014, gross profit totaled $24,124, compared to $116,206 in the same period in 2013. Loss on reduction of inventory to lower of cost or market or obsolete inventory was $0 for the three months ended March 31, 2014.

Operating Expenses. For the three months ended March 31, 2014, total operating expenses were $2,435,049 consisting of G&A expenses of $1,774,708, research and development expenses of $422,503, and selling expenses of $237,838, representing an increase of $377,410, or 18% from $2,057,639 in the same period in 2013, consisting of G&A expenses of $1,564,872, research and development expenses of $220,192, and selling expenses of $272,575.

We expect that our G&A and selling expenses will continue to increase in the foreseeable future, and if we successfully relaunch the ForeCYTE Breast Aspirator and our related laboratory service offerings, we would also begin to incur additional sales and marketing expenses as we continue building a regional, and ultimately national, sales force.

Selling Expenses. Selling expenses for the three months ended March 31, 2014 were $237,838, a decrease of $34,737, or 13%, from $272,575 for the three months ended March 31, 2013. Selling expense for the three months ended March 31, 2014 consisted primarily of $151,834 in selling and marketing professional fees and $86,003 in salaries and bonuses. Selling expenses decreased as a result of the voluntary recall in October 2013. We expect selling expenses will increase when we receive the FDA clearance and prepare for and execute the relaunch of ForeCYTE Breast Aspirator and NAF cytology test.

Research and Development Expenses. Research and Development expenses for the three months ended March 31, 2014 were $422,503, an increase of $202,311, or 92%, from $220,192 for the three months ended March 31, 2013. The increase in R&D expenses over the three months ended March 31, 2013 is attributed to additional R&D expenditures in 2014 on the development of our products, tests and therapeutic programs in the pipeline. We expect that our R&D expenses will continue to increase as we add additional full time employees and incur additional costs to continue the development of our products and services under development throughout 2014.

General and Administrative Expenses. G&A expenses for the three months ended March 31, 2014 were $1,774,708, an increase of $209,836, or 13%, from $1,564,872 in the same period in 2013. The G&A expenses for the three months ended March 31, 2014 consisted primarily of $665,136 in salaries and bonus expenses, $238,497 in legal and regulatory expenses, $169,763 in consulting expenses, $44,026 in travel expenses, and $132,792 in insurance expenses. G&A expenses for the three months ended March 31, 2013 were $1,564,872 which primarily consisted of $545,793 in salaries and bonus expenses, $177,947 in legal expenses, $279,286 in consulting and professional fee expenses, $76,634 in accounting expenses, $20,485 in travel expense, $42,041 in payroll taxes, and $93,374 in insurance expenses.

The increase in 2014 G&A expenses over 2013 was primarily attributable to an increase in salaries and employees benefits, travel expenses, cost of insurance, and legal and professional fees. We expect our G&A expenses to continue to grow as we hire additional administrative and manufacturing personnel as we prepare for and execute on the relaunch of the ForeCYTE Breast Aspirator, and our other products under development and as we incur additional costs associated with being a publicly traded company.

Liquidity and Capital Resources

We have a history of operating losses as we have focused our efforts on raising capital and building the MASCT System. The report of our independent auditors issued on our consolidated financial statements as of and for the years ended December 31, 2013 and 2012 expresses substantial doubt about our ability to continue as a going concern.

On March 27, 2013, we entered into a stock purchase agreement with Aspire Capital Fund, LLC, and pursuant to that agreement we sold common stock to Aspire from March 2013 through October 2013 for a total aggregate purchase price of $11,303,745. On November 8, 2013, we terminated this stock purchase agreement and entered into a new agreement with Aspire which provides that we may sell common stock to Aspire under the terms and subject to the conditions and limitations set forth therein. Under the new agreement, Aspire is committed to purchase up to an aggregate of $25 million of shares of our common stock over the 30 month term of the new agreement. On December 23, 2013, we sold $1 million of common stock to Aspire under this new agreement so that up to a total of $24 million remains available for sale to them as of the date of this report. However, in connection with our January 2014 public offering we agreed not to utilize the financing arrangement with Aspire for 120 days following completion of that offering.

On January 29, 2014, we closed a public offering of 5,834,234 units at the price of $2.40 per unit, with each unit consisting of one share of common stock and a warrant to purchase 0.20 a share of common stock, for gross proceeds of approximately $14.0 million. The warrants are exercisable at $3.00 per share and are callable by us if and when the trading price of our common stock is $6.00 per share over a defined period and subject to a daily volume minimum.

Our ability to continue as a going concern is dependent on our obtaining additional adequate capital to fund additional operating losses until we become profitable. If we are unable to obtain adequate capital, we could be forced to cease operations.

Cash Flows

For the three months ended March 31, 2014, we incurred a net loss of $2,411,531. Net cash used in operating activities was $2,603,989, net cash used in investing activities was $102,966 and net cash provided by financing activities was $12,955,745.

Funding Requirements

We expect to incur substantial expenses and generate ongoing operating losses for the foreseeable future as we prepare for the scale-up manufacturing and relaunch of the ForeCYTE Breast Aspirator, complete the development of and launch the ArgusCYTE test and NextCYTE tests, and other devices in the pipeline and start the development of our planned therapeutic programs. We expect our existing capital resources as of the date of this report to be sufficient to fund our planned operations for the remainder of 2014. If we are unable to raise additional capital when needed, however, we could be forced to curtail or cease operations. Our future capital uses and requirements depend on numerous forward-looking factors. These factors include the following:

- the time and expense needed to relaunch the ForeCYTE Breast Aspirator;
- the expense associated with building a network of sales representatives to market the ForeCYTE Breast Aspirator, and NAF cytology tests, NextCYTE test, ArgusCYTE test and our planned therapeutic programs; and
- the degree and speed of patient and physician acceptance of our products and the degree to which third-party payors approve the tests for reimbursement.

Since inception (April 30, 2009) through March 31, 2014, we have generated $1,140,024 in revenue. We do not expect to generate significant revenue until we receive FDA clearance to market the ForeCYTE Breast Aspirator. We expect our continuing operating losses to result in increases in cash used in operations over at least the next year. Although we expect our existing resources as of the date of this report, to be sufficient to fund our planned operations through 2014, we may require additional funds earlier than we currently expect to successfully commercialize the ForeCYTE Breast Aspirator. Because of the numerous risks and uncertainties associated with the development and commercialization of the ForeCYTE Breast Aspirator and our other devices, tests and therapeutics in the pipeline, we are unable to estimate the amounts of increased capital outlays and operating expenditures associated with our current and anticipated research and development activities and commercialization efforts.

Additional funding may not be available to us on acceptable terms or at all. In addition, the terms of any financing may adversely affect the holdings or the rights of our stockholders. For example, if we raise additional funds by issuing equity securities or by selling debt securities, if convertible, further dilution to our existing stockholders would result. To the extent our capital resources are insufficient to meet our future capital requirements, we will need to finance our future cash needs through public or private equity offerings, collaboration agreements, debt financings or licensing arrangements.

If adequate funds are not available, we may be required to terminate, significantly modify or delay our development programs, reduce our planned commercialization efforts, or obtain funds through collaborators that may require us to relinquish rights to our technologies or product candidates that we might otherwise seek to develop or commercialize independently. Further, we may elect to raise additional funds even before we need them if we believe the conditions for raising capital are favorable.

Off-Balance Sheet Arrangements

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts.

Recent Accounting Pronouncements

The Company has adopted all recently issued accounting pronouncements that management believes to be applicable to the Company. The adoption of these accounting pronouncements, including those not yet effective, is not anticipated to have a material effect on the financial position or results of operations of the Company.

ITEM 3. QUANTATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2014. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (“Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of March 31, 2014, our principal executive officer and principal financial officer concluded that, as of such date, the Company’s disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On June 30, 2011, Robert Kelly, the Company’s former President, filed a counterclaim against the Company in an arbitration proceeding, alleging breach of contract in connection with the termination of a consulting agreement between Mr. Kelly (dba Pitslayer LLC) and the Company that was entered into in July 2010 in connection with his resignation from the Company as President and a director. The consulting agreement was terminated by the Company in September 2010. Mr. Kelly seeks $450,000 in compensatory damages, which is the amount he claims would have been earned had the consulting agreement been fulfilled to completion.

On December 11, 2012, Mr. Kelly filed a complaint in the United States District Court, Western Division of Washington seeking compensatory damages, interest and attorneys' fees related to the termination of Mr. Kelly's consulting contract and the rescission of shares issued to him in July 2010 in connection with his resignation from the Company as President and a director. The specific amount of damages sought is to be proven at trial and is not specified. On July 8, 2013 the court granted the Company's motion to compel arbitration of these claims and therefore this action was stayed pending resolution of the arbitration of the claims; however, Mr. Kelly has not initiated arbitration of those claims.

On February 26, 2013, Mr. Victor Cononi filed a complaint in the United States District Court, Western Division of Washington seeking compensatory damages, interest and attorneys' fees related to the rescission of shares issued to him in July 2010 in connection with Mr. Kelly's resignation from the Company as President and a director. The specific amount of damages sought is to be proven at trial and is not specified. In August 2013, the court granted the Company's motion to compel arbitration of these claims and therefore this action was stayed pending resolution of the arbitration of the claims; however, Mr. Cononi has not initiated arbitration of those claims.

A hearing in the arbitration has been postponed pending certain procedures in the above Western Division action and may be delayed further to accommodate other third party civil and federal criminal proceedings alleging securities and wire fraud that have been brought against Mr. Kelly with respect to his prior employment and predating his service with the Company. On March 11, 2014 a press release was issued by the FBI stating that Mr. Kelly had pled guilty in Manhattan federal court to securities and wire fraud charges related to his employment as CEO of Wwebnet. Mr. Kelly also agreed to forfeit $2,111,600 and, separately, pay $2,111,600 in restitution. The sentencing hearing is scheduled for July 17, 2014.

The Company is reasonably confident in its defenses to Mr. Kelly's and Mr. Cononi's claims. Consequently, no provision or liability has been recorded for these claims as of March 31, 2014. However, it is at least reasonably possible that the Company's estimate of liability may change in the near term. Any payments by reason of an adverse determination in this matter will be charged to earnings in the period of determination.

On October 10, 2013, a putative securities class action complaint, captioned Cook v. Atossa Genetics, Inc., et al., No. 2:13-cv-01836-RSM, was filed in the United States District Court for the Western District of Washington against us, certain of our directors and officers and the underwriters of our November 2012 initial public offering. The complaint alleges that all defendants violated Sections 11 and 12(a)(2), and that we and certain of our directors and officers violated Section 15, of the Securities Act by making material false and misleading statements and omissions in the offering's registration statement, and that we and certain of our directors and officers violated Sections 10(b) and 20A of the Exchange Act and SEC Rule 10b-5 promulgated thereunder by making false and misleading statements and omissions in the registration statement and in certain of our subsequent press releases and SEC filings with respect to our NAF specimen collection process, our ForeCYTE Breast Health Test and our MASCT device. This action seeks, on behalf of persons who purchased our common stock between November 8, 2012 and October 4, 2013, inclusive, damages of an unspecific amount.

On February 14, 2014, the Court appointed plaintiffs Miko Levi, Bandar Almosa and Gregory Harrison (collectively, the "Levi Group") as lead plaintiffs, and approved their selection of co-lead counsel and liaison counsel. The Court also amended the caption of the case to read In re Atossa Genetics, Inc. Securities Litigation. No. 2:13-cv-01836-RSM. An amended complaint was filed on April 15, 2014.

We believe this complaint is without merit and plan to defend ourselves vigorously. Failure by us to obtain a favorable resolution of the claims set forth in the complaint could have a material adverse effect on our business, results of operations and financial condition. Currently, the amount of such material adverse effect cannot be reasonably estimated, and no provision or liability has been recorded for these claims as of March 31, 2014. The costs associated with defending and resolving the complaint and ultimate outcome cannot be predicted. These matters are subject to inherent uncertainties and the actual cost, as well as the distraction from the conduct of our business, will depend upon many unknown factors and management's view of these may change in the future.

ITEM 1A. RISK FACTORS

RISK FACTORS

A purchase of our shares of Common Stock is an investment in our securities and involves a high degree of risk. You should carefully consider the following information about these risks, together with the other information contained in this report, before purchasing our securities. If any of the following risks actually occur, our business, financial condition and results of operations would likely suffer. In that case, the market price of the Common Stock could decline, and you may lose part or all of your investment in our company. Additional risks of which we are not presently aware or that we currently believe are immaterial may also harm our business and results of operations.

There has been no material changes to the risk factors described in the Company's Annual Report on Form 10-K, as filed with the SEC on March 27, 2014, except for the following items which have been updated.

Anticipated liquidity issues in the next four to twelve months.

For the quarter ended March 31, 2014, we generated no revenue and we incurred a net loss of $2,411,531. Through March 31, 2014, we had an accumulated deficit of approximately $22.9 million. We expect that our existing resources will be sufficient to fund our planned operations through 2014. We have not yet established an ongoing source of revenue sufficient to cover our operating costs and allow us to continue as a going concern. Our ability to continue as a going concern is dependent on obtaining adequate capital to fund operating losses until we become profitable. We may not receive FDA clearance to relaunch ForeCYTE Breast Aspirator and other sources of capital may not be available when we need them or on acceptable terms. For example, we may not be able to raise capital by selling Common Stock to Aspire because the Aspire registration statement may not remain effective. If we are unable to raise in a timely fashion the amount of capital we anticipate needing, from Aspire or otherwise, we would be forced to curtail or cease operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

On May 12, 2014, Ben Chen, Sr. Vice President Global Regulatory Affairs and Quality Assurance, resigned from the Company. The Company is actively seeking a replacement.

ITEM 6. EXHIBITS

(a) Exhibits

10.1# Offer Letter Agreement with Peter Carbonaro dated May 23, 2013.

10.2# Offer Letter Agreement with Chris Destro dated November 12, 2012.

31.1 Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 of Steven C. Quay

31.2 Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 of Kyle Guse

32.1 Certification pursuant to 18 U.S.C. Section 1350 of Steven C. Quay

32.2 Certification pursuant to 18 U.S.C. Section 1350 of Kyle Guse

101* Interactive Data Files pursuant to Rule 405 of Regulation S-T

# Indicates management contract or compensatory plan, contract or arrangement.

* 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 Section 11 or 12 of the Securities Act, are deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under these 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.

Date: May 14, 2014

/s/ Steven C. Quay

President and Chief Executive Officer
(On behalf of the Registrant)

/s/ Kyle Guse

Kyle Guse
Chief Financial Officer, General Counsel and Secretary
(As Principal Financial and Accounting Officer)

Atossa Genetics Inc.

May 23, 2013

Mr. Peter Carbonaro

Re: Employment Offer

Dear Peter:

I would like to formally extend to you an offer of employment as Senior Vice President of Operations, reporting to the Chief Executive Officer. Your start date will be June 3, 2013.

Below are the key terms of our offer of employment to you:

Responsibilities: As the Senior Vice President of Operations, you will be the senior manager responsible for managing the company's day-to-day operations and reporting them to the chief executive officer (CEO). These include all manufacturing matters, including regulatory affairs matters, supply chain management, facilities, etc. The CSO, CFO, and VP Marketing will continue to report directly to the CEO and President.

Start Date: Upon your acceptance of this offer of employment with the Company, your employment shall commence within 15 days.

Salary: Your initial annual salary shall be $215,000, paid twice monthly. Your status will be a regular, full-time, exempt employee.

Bonus: You will receive a bonus of up to 30% of annual salary based on goals and objectives mutually set following hiring. $25,000 signing bonus; 50% up front and 50% at year end.

Other costs: You will be reimbursed for all approved office-and business-related expenses to perform your function.

Benefits: Atossa Genetics will provide Medical, Dental and Optical Insurance Benefits per company policy.

Vacation and Holidays: During your employment with Atossa Genetics, you are entitled to 20 days of PTO accrued at 1.25 days per month. Furthermore, you will receive 10 paid company holidays.

Stock Options: You will receive a grant of options to 250,000 shares of Atossa common stock with a strike price set at the fair market value on your date of employment. These vest over four years, with 25% after one year and then the remainder vesting as $1/12^{th}$ per quarter until they are fully vested. If there is a change in control of the company all shares will be vested.

As a new hire, your options will be granted from inside our 2010 Stock Option and Incentive Plan ("Plan") as incentive stock options (ISOs) to the maximum extent allowable and the remainder outside our Plan. All options will be subject to the terms of the plan and those issues outside the Plan will be considered "non-qualified" stock options for tax purposes.

By signing this offer of employment, you agree to abide by the rules, regulations, ethics and policies of Atossa. This offer of employment is contingent upon successful completion of our reference checking process, including a background check.

For purposes of federal immigration law, you will be required to provide to Atossa Genetics documentary evidence of your identity and eligibility for employment in the United States. Such documentation must be provided to Atossa Genetics on the first day of employment.

Atossa Genetics has an exciting future and we believe that you will bring great value to our organization.

Regards,

/s/ Steven Quay

Steve

Dr. Steven Quay, MD, PhD, FCAP
CEO & President, Atossa Genetics, Inc. (NASDAQ:ATOS)
"The Breast Health Company"
Director, National Reference Laboratory
for Breast Health, Inc.
1616 Eastlake Ave. E Suite 510
Seattle, WA 98102

Accepted.

/s/ Peter J. Carbonaro

Peter Carbonaro

Addendum
2014 Salary: $255,000

Atossa Genetics Inc.

November 12, 2012

Christopher S. Destro

Re: Employment Offer

Dear Chris:

I would like to formally extend to you an offer of employment as Vice President of Sales and Marketing with Atossa Genetics. Atossa Genetics has an exciting future and we believe that you will bring great value to our organization.

Below are the key terms of our offer of employment to you:

Responsibilities: As the Vice President of Sales & Marketing, you will be responsible for, but not limited to establishing a marketing and sales plan, in conjunction with the CEO and for the launch of Atossa's products and for the implementation of the plan, including but not limited to hiring, coaching, developing and managing the sales departments and our independent sales reps.

Reporting: You will report directly to Dr. Steven Quay until further notice.

Start Date: Your employment shall commence December 10, 2012.

Salary: Your initial base salary shall be $180,000 paid bi-weekly. Your status will be a regular, full-time, exempt employee.

Bonus: You will receive a bonus of up to 35% of base salary based on goals and objectives mutually set following hiring.

Other costs: You will be reimbursed for all office and business related expenses to perform your function.

Benefits: Atossa Genetics will provide Medical, Dental and Optical Insurance Benefits per company policy.

Vacation and Holidays: During your employment with Atossa Genetics, you are entitled to 15 days of PTO accrued at 1.25 days per month. Furthermore, you will receive 8 paid company holidays.

Stock Options: You will receive a grant of options to 200,000 shares of Atossa common stock with a strike price set at the fair market value on your date of employment. These vest over four years, with 25% after one year and then the remainder vesting as $1/12^{th}$ per quarter until they are fully vested. If there is a change in control of the company all shares will be vested.

By signing this offer of employment, you agree to abide by the rules, regulations, ethics and policies of Atossa. This offer of employment is contingent upon successful completion of our reference checking process, which includes a post-offer drug test and background screening.

For purposes of federal immigration law, you will be required to provide to Atossa Genetics documentary evidence of your identity and eligibility for employment in the United States. Such documentation must be provided to Atossa Genetics within three (3) business days of your date of hire.

I look forward to you joining Atossa and being an integral part of helping us build a company that will change the paradigm of breast cancer for women.

Regards,

/s/ Steven Quay

Steven Quay, MD, PhD, FCAP
CEO & President, Atossa Genetics, Inc.

Accepted.

/s/ Christopher S. Destro

Christopher Destro

Addendum:
2014 Salary: $205,000

Exhibit 31.1

CERTIFICATION PURSUANT TO RULE 13a-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Steven C. Quay, certify that:

1. I have reviewed this Report of Atossa Genetics Inc.;

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(s) 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 15d-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 subsidiaries, is made known to us by others within those entities, particularly during the period in which this 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 officers 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 (or persons performing the equivalent function):

(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.

Date: May 14, 2014

/s/ Steven C. Quay
Steven C. Quay
Chief Executive Officer and President
(Principal executive officer)

Exhibit 31.2

CERTIFICATION PURSUANT TO RULE 13a-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Kyle Guse, certify that:

1. I have reviewed this Report of Atossa Genetics Inc.;

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(s) 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 15d-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 subsidiaries, is made known to us by others within those entities, particularly during the period in which this 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 officers 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 (or persons performing the equivalent function):

(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.

Date: May 14, 2014

/s/ Kyle Guse
Kyle Guse
Chief Financial Officer, General Counsel and Secretary
(Principal financial and accounting officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Atossa Genetics Inc. (the "Company") on Form 10-Q for the period ending March 31, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven C. Quay, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 14, 2014

/s/ Steven C. Quay
Steven C. Quay
Chief Executive Officer and President
(Principal executive officer)

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Atossa Genetics Inc. (the "Company") on Form 10-Q for the period ending March 31, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Kyle Guse, Chief Financial Officer, General Counsel and Secretary of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 14, 2014

/s/ Kyle Guse
Kyle Guse
Chief Financial Officer, General Counsel and Secretary
(Principal financial and accounting officer)