

DIGITAL ALLY INC
Form DEF 14A
March 20, 2009

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C.

SCHEDULE 14A

**Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934
(Amendment No. __)**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-12

Digital Ally, Inc.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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(4) Date Filed:

Digital Ally, Inc.
7311 West 130th Street, Suite 170
Overland Park, KS 66213

Stanton E. Ross
President, Chief Executive Officer and Chairman of the Board

March 20, 2009
To our Stockholders:

I am pleased to invite you to attend the annual meeting of stockholders of Digital Ally, Inc. (Digital) to be held on Monday, May 4, 2009 at 10:00 a.m., CST, at the Sheraton Overland Park Hotel at the Convention Center located at 6100 College Blvd., Overland Park, Kansas. Details regarding admission to the annual meeting and the business to be conducted are more fully described in the accompanying Notice of Annual Meeting and Proxy Statement.

If you are unable to attend the annual meeting in person, you may participate through the Internet. To participate in the live webcast, log on at www.digitalallyinc.com and select the link for the webcast in the Upcoming and Featured Events section of the site. The webcast will begin at 10:00 a.m. and will remain on Digital s website for one year. You cannot record your vote on this website.

We have elected to take advantage of new Securities and Exchange Commission rules that allow issuers to furnish proxy materials to their stockholders on the Internet. We believe that the new rules will allow us to provide our stockholders with the information they need, while lowering the costs of delivery and reducing the environmental impact of our annual meeting.

Your vote is important. Whether or not you plan to attend the annual meeting, I hope that you will vote as soon as possible. Please review the instructions on each of your voting options described in the Proxy Statement and the Notice you received in the mail.

Thank you for your ongoing support of, and continued interest in, Digital.

Sincerely,

Admission to the annual meeting will be limited to stockholders. Please note that admission ticket and picture identification will be required to enter the annual meeting. Each stockholder will be entitled to bring a guest to the annual meeting. For stockholders of record, an admission ticket is printed on the back cover of these proxy materials and on the Notice. An individual arriving without an admission ticket will not be admitted unless it can be verified that the individual was a Digital stockholder as of the record date. Backpacks, cameras, cell phones with cameras, recording equipment and other electronic recording devices will not be permitted at the annual meeting. Digital reserves the right to inspect any persons or items prior to their admission to the annual meeting. Failure to follow the meeting rules or permit inspection will be grounds for exclusion from the meeting.

Digital Ally, Inc.

7311 West 130th Street, Suite 170
Overland Park, KS 66213
(913) 814-7774

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held on Monday, May 4, 2009**

The Annual Meeting of the Stockholders of Digital Ally, Inc., a Nevada corporation (Digital or the Company), will be held at the Sheraton Overland Park Hotel at the Convention Center located at 6100 College Blvd., Overland Park, Kansas on Monday, May 4, 2009 at 10:00 a.m., CST, for the following purposes:

1. To elect five directors;
2. To approve the 2009 Stock Option and Restricted Stock Plan;
3. To ratify the appointment of McGladrey & Pullen LLP as our independent registered public accounting firm; and
4. To act upon such other business as may properly come before the Annual Meeting.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

Only stockholders of record at the close of business on March 6, 2009 will be entitled to vote at the Annual Meeting or any adjournment or postponement thereof.

You are cordially invited to attend the Annual Meeting. Whether or not you plan to attend the Annual Meeting, please sign, date and return your proxy to us promptly. Your cooperation in signing and returning the proxy will help avoid further solicitation expense.

Copies of our Notice of Annual Meeting, Proxy Statement and Annual Report to Stockholders are available at www.digitalallyinc.com

By order of the Board of Directors

Stanton E. Ross
Chairman of the Board, President and Chief Executive Officer

March 20, 2009
Overland Park, Kansas

YOUR VOTE IS IMPORTANT

TO ASSURE YOUR REPRESENTATION AT THE ANNUAL MEETING, YOU ARE REQUESTED TO COMPLETE, SIGN AND DATE THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE AND RETURN IT IN THE ENCLOSED ENVELOPE PROVIDED, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES.

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Digital Ally, Inc.

PROXY STATEMENT FOR THE 2009 ANNUAL MEETING OF STOCKHOLDERS

INFORMATION CONCERNING SOLICITATION AND VOTING

General

The enclosed proxy is solicited on behalf of the Board of Directors of Digital Ally, Inc., a Nevada corporation, for use at the Annual Meeting of Stockholders to be held Monday, May 4, 2009 at 10:00 a.m., CST, or at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Annual Meeting of Stockholders. The Annual Meeting will be held at the Sheraton Overland Park Hotel at the Convention Center located at 6100 College Blvd., Overland Park, Kansas. The telephone number at that location is (913) 234-2100.

These proxy solicitation materials were first mailed on or about March 20, 2008 to all stockholders entitled to vote at the meeting.

Record Date and Voting Securities

Stockholders of record at the close of business on March 6, 2009 are entitled to notice of and to vote at the meeting. At the record date, 15,926,077 shares of our authorized common stock were issued and outstanding and held of record by 115 stockholders.

Revocability of Proxies

You may revoke your proxy at any time before it is voted at the Annual Meeting. In order to do this, you may either:

- sign and return another proxy bearing a later date;
- provide written notice of the revocation to Thomas J. Heckman, our Secretary, prior to the time we take the vote at the Annual Meeting; or
- attend the meeting and vote in person.

Voting

You are entitled to one vote for each share of common stock held by you on the record date.

If a broker, bank or other nominee holds your shares, you will receive instructions from it that you must follow in order to have your shares voted.

If you hold your shares in your own name as a holder of record, you may instruct the proxy holders how to vote your common stock by signing, dating and mailing the proxy card in the postage paid reply envelope that we have provided. Of course, you may also choose to come to the Annual Meeting and vote your shares in person. The proxy holders will vote your shares in accordance with those instructions. If you sign and return a proxy card without giving specific voting instructions, your shares will be voted as recommended by our Board of Directors.

Quorum Requirement

A quorum, which is a majority of our outstanding shares of common stock as of the record date, must be present or represented by proxy in order to hold the Annual Meeting and to conduct business. Your shares will be counted as being present at the meeting if you attend the meeting in person or if you submit a properly executed proxy card.

Stockholder List

The stockholder list as of the record date will be available for examination by any stockholder at our corporate office, 7311 West 130th Street, Suite 170, Overland Park, KS 66213, beginning April 15, 2009, which is at least ten business days prior to the date of the meeting and the stockholder list will be available at the Annual Meeting.

Abstentions and Broker Non-Votes

If you return a proxy card that indicates an abstention from voting on all matters, the shares represented will be counted as present for the purpose of determining a quorum, but they will not be voted on any matter at the Annual Meeting. Consequently, if you abstain from voting on the proposal to elect directors, your abstention will have no effect on the outcome of the vote with respect to this proposal.

Under the rules that govern brokers who have record ownership of shares that are held in street name for their clients, who are the beneficial owners of the shares, brokers have discretion to vote these shares on routine matters but not on non-routine matters. Thus, if you do not otherwise instruct your broker, the broker may turn in a proxy card voting your shares for routine matters but expressly instructing that the broker is NOT voting on non-routine matters. A broker non-vote occurs when a broker expressly instructs on a proxy card that it is not voting on a matter, whether routine or non-routine. Broker non-votes are counted for the purpose of determining the presence or absence of a quorum, but are not counted for determining the number of votes cast for or against a proposal. Your broker will have discretionary authority to vote your shares on Proposal One, Proposal Two, Proposal Three and any other business that properly comes before the meeting, all of which are routine matters.

Proxy Solicitation Costs

This solicitation of proxies is made by our Board of Directors, and we will bear all related costs. None of our directors intends to oppose any action for which stockholder approval is being solicited. In addition, we may reimburse brokerage firms and other persons representing beneficial owners of shares for their expenses in forwarding solicitation materials to such beneficial owners. Proxies may also be solicited by certain of our directors, officers and regular employees, without additional compensation, personally or by telephone or facsimile.

Our Voting Recommendations

Our Board of Directors recommends that you vote:

- **FOR** the election of the five nominees to the Board of Directors;
- **FOR** the approval of the 2009 Stock Option and Restricted Stock Plan; and
- **FOR** the ratification of the appointment of McGladrey & Pullen LLP as our independent registered public accounting firm.

Voting Results

The preliminary voting results will be announced at the Annual Meeting. The final voting results will be calculated by our Inspector of Elections, and published in our Quarterly Report on Form 10-Q for the second quarter of our fiscal year 2009.

Stockholders Sharing the Same Address

Digital has adopted a procedure called householding, which has been approved by the Securities and Exchange Commission. Under this procedure, Digital is delivering only one copy of the annual report and proxy statement to multiple stockholders who share the same address, unless Digital has received contrary instructions from an affected stockholder. This procedure reduces Digital's printing costs, mailing costs, and fees. Stockholders who participate in householding will continue to receive separate proxy cards.

Digital will deliver, promptly upon written or oral request, a separate copy of the annual report and the proxy statement to any stockholder at a shared address to which a single copy of either of those documents was delivered. To receive a separate copy of the annual report or proxy statement, you may write or call Digital's Investor Relations Department at 7311 West 130th Street, Suite 170, Overland Park, KS 66213, telephone (913) 814-7774. Any stockholders of record who share the same address and currently receive multiple copies of Digital's annual report and proxy statement who wish to receive only one copy of these materials per household in the future, please contact Digital's Investor Relations Department at the address or telephone number listed above to participate in the householding program.

A number of brokerage firms have instituted householding. If you hold your shares in street name, please contact your bank, broker, or other holder of record to request information about householding.

Deadline for Receipt of Stockholder Proposals for 2010 Annual Meeting of Stockholders

As a stockholder, you may be entitled to present proposals for action at an upcoming meeting if you comply with the requirements of the proxy rules established by the Securities and Exchange Commission and our bylaws. Stockholders wishing to present a proposal at our 2010 Annual Meeting of Stockholders must submit such proposal to us by November 18, 2009, if they wish it to be eligible for inclusion in the proxy statement and form of proxy relating to that meeting. In connection with our 2010 Annual Meeting of Stockholders, we intend to solicit proxies granting discretionary authority to the proxyholders to vote on any matters submitted by stockholders on or after November 18, 2009. In addition, under our bylaws, a stockholder wishing to make a proposal at the 2010 Annual Meeting of Stockholders must submit such a proposal to us prior to November 18, 2009. Any such proposals should be in compliance with our bylaws and should be submitted to Digital Ally, Inc., 7311 West 130th Street, Suite 170, Overland Park, KS 66213, Attention: Thomas J. Heckman, Secretary.

Other Matters

Other than the proposals listed above, our Board of Directors does not intend to present any other matters to be voted on at the meeting. Our Board of Directors is not currently aware of any other matters that will be presented by others for action at the meeting. However, if other matters are properly presented at the meeting and you have signed and returned your proxy card, the proxy holders will have discretion to vote your shares on these matters to the extent authorized under the Securities Exchange Act of 1934, as amended.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON MAY 4, 2009:

Copies of our Notice of Annual Meeting, Proxy Statement and Annual Report to Stockholders are available online at www.digitalallyinc.com.

**PROPOSAL ONE
ELECTION OF DIRECTORS**

Nominees

A Board of five directors is to be elected at the Annual Meeting of Stockholders. Unless otherwise instructed, the proxy holders will vote the proxies received by them for the five nominees named below, all of whom are presently directors of Digital. If any nominee is unable or declines to serve as a director at the time of the Annual Meeting of Stockholders, the proxies will be voted for any nominee who shall be designated by the present Board of Directors to fill the vacancy. We are not aware of any nominee who will be unable or will decline to serve as a director. The term of office for each person elected as a director will continue until the next Annual Meeting of Stockholders or until a successor has been elected and qualified.

The names of the nominees and certain information about them as of the date of this proxy statement are set forth below:

| Name of Nominee | Principal Occupation | Age | Director Since |
|---------------------------|--|------------|-----------------------|
| Stanton E. Ross | Chairman, President and Chief Executive Officer | 47 | 2005 |
| Leroy C. Richie (1)(2)(3) | Lead Outside Director, attorney | 67 | 2005 |
| Daniel F. Hutchins (1) | Chairman of Audit Committee, Chief Financial Officer of Infinity Energy Resources, Inc., Certified | 53 | 2007 |

| | Public Accountant | | |
|------------------------------|---|----|------|
| Edward Juchniewicz (1)(2)(3) | Chairman of the Nominating Committee | 78 | 2005 |
| Elliot M. Kaplan (1)(2)(3) | Chairman of the Compensation Committee, attorney | 58 | 2005 |

(1) Member of Audit Committee

(2) Member of Compensation Committee

(3) Member of Nominating Committee

Stanton E. Ross. Mr. Ross has served as Chairman and Chief Executive Officer since September 2005. From March 1992 to June 2005, Mr. Ross was the Chairman and President of Infinity Energy Resources, Inc., a publicly held oil and gas exploration and production company (Infinity), and served as an officer and director of each of Infinity s subsidiaries. He resigned all of his positions with Infinity in June 2005, except Chairman, but was reappointed President in October 2006. From 1991 until March 1992, he founded and served as President of Midwest Financial, a financial services corporation involved in mergers, acquisitions and financing for corporations in the Midwest. From 1990 to 1991, Mr. Ross was employed by Duggan Securities, Inc., an investment banking firm in Overland Park, Kansas, where he primarily worked in corporate finance. From 1989 to 1990, he was employed by Stifel, Nicolaus & Co., a member of the New York Stock Exchange, where he was an investment executive. From 1987 to 1989, Mr. Ross was self-employed as a business consultant. From 1985 to 1987, Mr. Ross was President and founder of Kansas Microwave, Inc., which developed a radar detector product. From 1981 to 1985, he was employed by Birdview Satellite Communications, Inc., which manufactured and marketed home satellite television systems, initially as a salesman and later as National Sales Manager. Mr. Ross devotes such time to the business of Digital as he deems necessary to discharge his fiduciary duties to it. Mr. Ross estimated that he divided his time equally between Infinity and Digital through the first quarter of 2007 and thereafter, Mr. Ross has devoted the majority of his time to Digital. In late 2007, Infinity sold a substantial portion of its operating assets. Mr. Ross holds no public company directorships other than with the Company and Infinity.

Leroy C. Richie. Mr. Richie has been the Lead Outside Director of Digital Ally since September 2005. He is also a member of the Audit, Compensation and Nominating Committees. Since June 1, 1999 Mr. Richie has been a director of Infinity Energy Resources, Inc., a publicly held oil and gas exploration and production company. Additionally, Mr. Richie serves as a member of the boards of directors of the following corporations and serves in the additional capacities noted: OGE Energy Corp., member of the Compensation and Corporate Governance Committees; RiverSource Funds, member of the board of directors of the mutual fund family managed by Ameriprise Financial, Inc., Vibration Control Technologies, LLC, Great Lakes Assemblies, LLC and Gulf Shore Assemblies, LLC. Since 2004, he has been of counsel to the Detroit law firm of Lewis & Munday, P.C. From September 2000 to November 2004, he was Chairman and Chief Executive Officer of Q Standards World Wide, Inc. From April 1999 to August 2000, he was President of Capitol Coating Technologies, Inc. Mr. Richie was formerly Vice President of Chrysler Corporation and General Counsel for automotive legal affairs, where he directed all legal affairs for that company s automotive operations from 1986 until his retirement in 1997. Before joining Chrysler, he served as director of the New York office of the Federal Trade Commission. Mr. Richie received a B.A. from City College of New York, where he was valedictorian, and a J.D. from the New York University School of Law, where he was awarded an Arthur Garfield Hays Civil Liberties Fellowship.

Daniel F. Hutchins. Mr. Hutchins was elected as a Director of Digital in December 2007. He also serves as Chairman of the Audit Committee and the Board s financial expert. Mr. Hutchins, a Certified Public Accountant, is a Principal with the accounting firm of Hutchins & Haake, LLC and currently serves as the Chief Financial Officer of Infinity Energy Resources, Inc., a publicly held oil and gas exploration and development company, of which Stanton E. Ross is the Chairman and President. He was previously a member of the Advisory Board of Digital. Mr. Hutchins has served as an instructor for the Becker CPA exam with the Keller Graduate School of Management and has over 17 years of teaching experience preparing CPA candidates for the CPA exam. He has 30 years of public accounting experience, including five years with Deloitte & Touche, LLP. He has served on the boards of various non-profit groups and is a member of the American Institute of Certified Public Accountants. Mr. Hutchins earned his Bachelor of Business Administration degree in Accounting at Washburn University in Topeka, Kansas. Mr. Hutchins holds no other public company directorships.

Edward Juchniewicz. Mr. Juchniewicz has been a Director since September 2005 and he is Chairman of the Nominating Committee and a member of the Audit and Compensation Committees. He joined the Central Intelligence Agency in 1953 and retired in 1986 as Associate Deputy Director for Operations. Prior to joining the CIA, he was a Senior Noncommissioned Intelligence Officer. Since retirement, he has been involved in the intelligence and communications fields as president of ESL International (1986-1990) and an Advisory Board member of Elsin

Corporation, a subsidiary of TRACOR, Inc. (1990-1991). Mr. Juchniewicz currently serves on the Advisory Board at the Higgins Foundation on Terrorism in Washington, DC. He attended the Naval Intelligence Language School, Georgetown University School of Foreign Service, and Sophia University in Tokyo. Mr. Juchniewicz has acted as a consultant on espionage to the PBS television series Frontline. Mr. Juchniewicz holds no other public company directorships.

Elliot M. Kaplan. Mr. Kaplan has been a Director since September 2005 and he is Chairman of the Compensation Committee and a member of the Audit and Nominating Committees. Mr. Kaplan was a practicing attorney with Daniels & Kaplan, P.C. from 1994 through 2006, with a concentration in corporate strategy. During the years 1985 through 1993, Mr. Kaplan practiced with the law firms of Berman, DeLeve, Kuchan and Chapman (1991-1993); DeWitt, Zeldin and Bigus (1990-1991); and Husch, Eppenberger, Donahue, Cornfeld and Jenkins (1985-1990). From 1983 to 1985, he served as Vice President, Assistant General Counsel and Assistant Secretary of Air One, Inc. He also served on the board of directors of Infinity Energy Resources, Inc., a publicly held oil and gas exploration and development company, from July 2004 through June 18, 2008. Mr. Kaplan serves as the chairman of the Advisory Board of Executive Action and is a member of the SCCA ProRacing Advisory Board. Mr. Kaplan currently holds no other public company directorships.

Our Directors are elected annually and hold office until the next annual meeting of our stockholders or until their successors are elected and qualified. Officers are elected annually and serve at the discretion of the Board of Directors. There is no family relationship between any of our directors, director nominees and executive officers. Board vacancies are filled by a majority vote of the Board.

Vote Required

If a quorum is present and voting, the five nominees receiving the greatest number of votes will be elected to the Board of Directors. Votes withheld from any nominee will be counted for purposes of determining the presence or absence of a quorum for transaction of business at the meeting but will have no other legal effect upon the election of directors under Nevada law.

OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT STOCKHOLDERS VOTE FOR EACH OF THE FIVE NOMINEES NAMED ABOVE.

CORPORATE GOVERNANCE

Board of Directors and Committee Meetings

Our Board of Directors held four regular and two telephonic meetings during the fiscal year ended December 31, 2008. Each of our directors attended at least 75% of the meetings of the Board of Directors and the committees on which he served in the fiscal year ended December 31, 2008. Our directors are expected, absent exceptional circumstances, to attend all Board meetings and meetings of committees on which they serve, and are also expected to attend our Annual Meeting of Stockholders. All directors then in office attended the 2008 Annual Meeting of Stockholders.

Our Board of Directors currently has three committees: an Audit Committee, a Compensation Committee and a Nominating Committee. Each committee has a written charter approved by the Board of Directors outlining the principal responsibilities of the committee. These charters are also available on the Investor Relations page of our website. All of our directors, other than our Chief Executive Officer, plan to meet in executive sessions without management present on a regular basis in 2009, as they did in 2008.

Audit Committee

Our Audit Committee appoints the Company's independent auditors, reviews audit reports and plans, accounting policies, financial statements, internal controls, audit fees, and certain other expenses and oversees our accounting and financial reporting process. Specific responsibilities include selecting, hiring and terminating our independent auditors; evaluating the qualifications, independence and performance of our independent auditors; approving the audit and non-audit services to be performed by our auditors; reviewing the design, implementation, adequacy and effectiveness of our internal controls and critical accounting policies; overseeing and monitoring the integrity of our

financial statements and our compliance with legal and regulatory requirements as they relate to financial statements or accounting matters; reviewing any earnings announcements and other public announcements regarding our results of operations, in conjunction with management and our public auditors; and preparing the report that the Securities and Exchange Commission requires in our annual proxy statement. The report of the Audit Committee for the year-ended December 31, 2008 is included in this proxy statement.

The Audit Committee is comprised of four Directors, each of whom is independent, as defined by the rules and regulations of the Securities and Exchange Commission. The Audit Committee held four meetings during the year-ended December 31, 2008. On September 22, 2005, the Company created the Audit Committee and adopted a written charter for it. The members of our Audit Committee are Daniel F. Hutchins, Leroy C. Richie, Elliot M. Kaplan and Edward Juchniewicz. Mr. Hutchins was the Chairman of the Committee during the fiscal year ended December 31, 2008. The Board of Directors determined that Mr. Hutchins qualifies as an audit committee financial expert, as defined under the rules and regulations of the Securities and Exchange Commission, and is independent as noted above.

Under the Sarbanes-Oxley Act of 2002, all audit and non-audit services performed by the Company's independent accountants must be approved in advance by the Audit Committee to assure that such services do not impair the accountants' independence from the Company. Accordingly, the Audit Committee has adopted an Audit and Non-Audit Services Pre-Approval Policy (the Policy) that sets forth the procedures and the conditions pursuant to which services to be performed by the independent accountants are to be pre-approved. Pursuant to the Policy, certain services described in detail in the Policy may be pre-approved on an annual basis together with pre-approved maximum fee levels for such services. The services eligible for annual pre-approval consist of services that would be included under the categories of Audit Fees, Audit-Related Fees and Tax Fees in the above table, as well as services for limited review of actuarial reports and calculations. If not pre-approved on an annual basis, proposed services must otherwise be separately approved prior to being performed by the independent accountants. In addition, any services that receive annual pre-approval but exceed the pre-approved maximum fee level also will require separate approval by the Audit Committee prior to being performed. The Audit Committee may delegate authority to pre-approve audit and non-audit services to any member of the Audit Committee, but may not delegate such authority to management.

Compensation Committee

Our Compensation Committee assists our Board of Directors in determining the development plans and compensation of our officers, directors and employees. Specific responsibilities include approving the compensation and benefits of our executive officers; reviewing the performance objectives and actual performance of our officers; administering our stock option and other equity compensation plans; and reviewing and discussing with management the compensation discussion and analysis that the Securities and Exchange Commission requires in our future Form 10-Ks and proxy statements. The report of the Compensation Committee for the year-ended December 31, 2008 is included in this proxy statement.

Our Compensation Committee is comprised of four Directors, whom the Board considers to be independent under the rules of the Securities and Exchange Commission. The Compensation Committee held two meetings during the year-ended December 31, 2008. On September 22, 2007, the Board of Directors adopted a written charter. The members of our Compensation Committee are Elliot M. Kaplan, Chairman, Leroy C. Richie, Daniel F. Hutchins and Edward Juchniewicz.

Nominating Committee

Our Nominating Committee assists our Board of Directors by identifying and recommending individuals qualified to become members of our Board of Directors, reviewing correspondence from our stockholders, and establishing, evaluating and overseeing our corporate governance guidelines. Specific responsibilities include the following: evaluating the composition, size and governance of our Board of Directors and its committees and making recommendations regarding future planning and appointing directors to our committees; establishing a policy for considering stockholder nominees for election to our Board of Directors; and evaluating and recommending candidates for election to our Board of Directors.

Our Nominating Committee is comprised of four Directors, whom the Board considers to be independent under the rules of the Securities and Exchange Commission. The Nominating Committee held one meeting during the

year-ended December 31, 2008. The members of our Nominating Committee are Edward Juchniewicz, Chairman, Elliot M. Kaplan, Daniel F. Hutchins and Leroy C. Richie. The Nominating Committee was created by our Board of Directors on December 27, 2007, when the Board of Directors adopted a written charter.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee is made up of four independent, non-employee directors, Messrs. Richie, Kaplan, Hutchins and Juchniewicz. No interlocking relationship exists between the members of our Compensation Committee and the board of directors or compensation committee of any other company.

Director Independence

In accordance with the Nasdaq listing standards, our Board of Directors undertook its annual review of the independence of the directors and considered whether any director had a material relationship with Digital or its management that could compromise his ability to exercise independent judgment in carrying out his responsibilities. As a result of this review, the Board affirmatively determined that the current board members, other than Mr. Ross, our President and Chief Executive Officer, are independent directors under the Nasdaq Rules. Additionally, the members of our three standing committees are required to be, and the Board of Directors has determined that each member is, independent in accordance with the Nasdaq and SEC rules.

Stockholder Communications with the Board of Directors

Stockholders may communicate with the Board of Directors by writing to us at Digital Ally, Inc., Attention: Corporate Secretary, 7311 West 130th Street, Suite 170, Overland Park, KS 66213. Stockholders who would like their submission directed to a particular member of the Board of Directors may so specify and the communication will be forwarded as appropriate.

Policy for Director Recommendations and Nominations

Our Nominating Committee of the Board will consider candidates for Board membership suggested by Board members, management and our stockholders. It is the policy for our Nominating Committee to consider recommendations for candidates to the Board of Directors from any stockholder of record in accordance with our bylaws. A director candidate recommended by our stockholders will be considered in the same manner as a nominee recommended by a Board member, management or other sources. In addition, a stockholder may nominate a person directly for election to the Board of Directors at an Annual Meeting of Stockholders, provided the stockholder meets the requirements set forth in our bylaws.

When the Nominating Committee has either identified a prospective nominee or determined that an additional or replacement director is required, the Nominating Committee may take such measures as it considers appropriate in connection with its evaluation of a director candidate, including candidate interviews, inquiry of the person or persons making the recommendation or nomination, engagement of an outside search firm to gather additional information, or reliance on the knowledge of the members of the Board of Directors or management. In its evaluation of director candidates, including the members of the Board eligible for re-election, the Nominating Committee considers a number of factors, including: the current size and composition of the Board of Directors, the needs of the Board of Directors and the respective committees of the Board, and such factors as judgment, independence, character and integrity, age, area of expertise, diversity of experience, length of service, and potential conflicts of interest.

The Nominating Committee of the Board selects director nominees. In relation to such nomination process, the Nominating Committee:

- determines the criteria for the selection of prospective directors and committee members;
- reviews the composition and size of the Board and its committees to ensure proper expertise and diversity among its members;

- evaluates the performance and contributions of directors eligible for re-election;
- determine the desired qualifications for individual directors and desired skills and characteristics for the Board;
- identifies persons who can provide needed skills and characteristics;
- screens possible candidates for Board membership;
- reviews any potential conflicts of interests between such candidates and the Company's interests; and
- shares information concerning the candidates with the Board, and solicit input from other directors.

The Nominating Committee has specified the following minimum qualifications that it believes must be met by a nominee for a position on the Board: the highest personal and professional ethics and integrity; proven achievement and competence in the nominee's field and the ability to exercise sound business judgment; skills that are complementary to those of the existing Board; the ability to assist and support management and make significant contributions to our success; an understanding of the fiduciary responsibilities that are required of a member of the Board of Directors; and the commitment of time and energy necessary to diligently carry out those responsibilities.

After completing its evaluation, the Nominating Committee makes a recommendation to the full Board of Directors as to the persons who should be nominated to the Board, and the Board of Directors determines the nominees after considering the recommendation and report of the Nominating Committee.

Code of Ethics and Conduct

Our Board of Directors has adopted a *Code of Ethics and Conduct* that is applicable to all of our employees, officers and directors. Our *Code of Ethics and Conduct* is intended to ensure that our employees act in accordance with the highest ethical standards. The *Code of Ethics and Conduct* is available on the Investor Relations page of our website at <http://www.digitalally.com>. and the *Code of Ethics and Conduct* has been filed as an exhibit to our Annual Report on Form 10-K.

Director Compensation

The non-employee directors received the stock option grants noted in the section below entitled "Compensation of Directors and Advisory Board Members" for agreeing to serve on our Board, including on the Audit and Compensation Committees. Our Directors and members of our Advisory Board, who are neither employees nor our affiliates, receive options upon their appointment as Directors and as members of our Advisory Board. Each member of our Advisory Board receives a grant of 10,000 options upon appointment to a one-year term on our Advisory Board and has received 2,000 options upon reappointment in succeeding years. The options are exercisable at the closing price of our common stock on the day of the grant of such options. The grants to such Directors are set forth in the Section entitled "Compensation of Directors and Advisory Board Members." In 2008, we paid each of our non-employee directors an annual fee of \$30,000 and a meeting fee of \$4,000 for their services as a Board member. We paid Leroy C. Richie an additional annual fee of \$10,000 as our lead director. Daniel F. Hutchins received an annual fee of \$10,000 as Chairman of the Audit Committee and members of such Committee were paid \$4,000 annually. Elliot M. Kaplan was paid an annual fee of \$5,000 as Chairman of the Compensation Committee and members of such Committee were paid \$1,000 annually. Edward Juchniewicz received an annual fee of \$5,000 as Chairman of the Nominating Committee and members of such Committee were paid \$1,000 annually. We also compensated non-employee directors at the rate of \$500 per telephonic meeting. In 2009, our compensation of Directors will remain the same as 2008. Our directors and officers have agreed to defer 25% of their 2009 monetary compensation until our year-to-date sales reach a threshold of \$50 million in 2009.

In addition, in 2008 we have granted to each of our non-employee directors options to purchase 50,000 shares of our Common Stock, vesting 5,000 shares on January 2, 2009; 10,000 shares on January 2, 2010; 15,000 shares on January 2, 2011; and 20,000 shares on January 2, 2012. All of the foregoing options were approved as part of the 2008 Stock Option and Restricted Stock Plan by the shareholders at the 2008 Annual Meeting.

Director Compensation

The following table summarizes the compensation earned by our directors for the fiscal year ended December 31, 2008:

| Name | Fees earned or paid in cash (\$) | Stock awards (\$) | Option) awards (\$)(2) | Total (\$) |
|---------------------|---|------------------------------|---------------------------------------|-------------------|
| Stanton E. Ross (1) | \$ -0- | \$ -0- | \$ -0- | \$ -0- |
| Leroy C. Richie | \$ 46,000 | \$ -0- | \$ 93,162 | \$ 139,162 |
| Edward Juchniewicz | \$ 44,000 | \$ -0- | \$ 93,162 | \$ 137,162 |
| Elliot M. Kaplan | \$ 44,000 | \$ -0- | \$ 93,162 | \$ 137,162 |
| Daniel F. Hutchins | \$ 46,000 | \$ -0- | \$ 93,162 | \$ 139,162 |

- (1) Mr. Ross compensation and option awards are noted in the Executive Compensation table because he did not receive compensation or stock options for his services as a director.
- (2) Option awards noted represent the amount of stock option expense recorded by the Company as determined under Statement of Financial Accounting Standards No. 123 (revised 2004) *Share Based Payment* during 2008. Please refer to Note 10 to the financial statements for further description of the awards and the underlying assumptions utilized to determine the amount of expense related to such grants.

PROPOSAL TWO**APPROVAL OF THE 2009 STOCK OPTION AND RESTRICTED STOCK PLAN**

The Company is seeking stockholder approval for the 2009 Stock Option and Restricted Stock Plan (the 2009 Plan) including the reservation of 750,000 shares issuable under the 2009 Plan. The 2009 Plan was adopted by the Board of Directors on March 9, 2009, subject to stockholder approval at the Annual Meeting. Accordingly, no grants of options have been made under the 2009 Plan to date. Upon stockholder approval of the 2009 Plan, 750,000 shares will be available for future grants.

The Board of Directors believes that it is in the best interests of the Company and its stockholders for the Company to approve the 2009 Plan. There are relatively few shares available for grant under the existing stock option plans of the Company. Due to the economic recession and dramatic stock market decline, including in the price of the Company's stock, the exercise prices of the vast majority of the options now outstanding are well above the current market price. The Board believes that equity awards assist in retaining, motivating and rewarding employees, executives and consultants by giving them an opportunity to obtain long-term equity participation in the Company. In addition, equity awards are an important contributor to aligning the incentives of the Company's employees with the interests of the Company's stockholders. The Board also believes equity awards are essential to attracting new employees and retaining current employees. Further, the granting of options to new and existing employees frequently permits the Company to pay lower salaries than might otherwise be the case. The Board of Directors believes that to remain competitive with other technology companies with regard to its long-term incentive plans, the Company must continue to provide employees with the opportunity to obtain equity in the Company and that an inability to offer equity incentives to new and current employees would put the Company at a competitive disadvantage with respect to attracting and retaining qualified personnel. Our named executive officers and directors have an interest in this proposal because they are expected to receive awards under the 2009 Plan if it is approved at the Annual Meeting.

Vote Required and Recommendation

The affirmative vote of a majority of the votes cast will be required to approve the 2009 Plan.

**OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT STOCKHOLDERS VOTE
FOR THE APPROVAL OF THE 2009 STOCK OPTION AND RESTRICTED STOCK PLAN.**

Summary of the 2009 Stock Option and Restricted Stock Plan

Our Board of Directors adopted the 2009 Plan on March 9, 2009. At the annual meeting, we are asking stockholders to approve the 2009 Plan and to approve the reservation of 500,000 shares issuable under the 2009 Plan. The 2009 Plan authorizes us to issue 500,000 shares of common stock upon exercise of options and grant of restricted stock awards. No options have been granted under the 2009 Plan to date. The 2009 Plan authorizes us to grant (i) to the key employees incentive stock options to purchase shares of common stock and non-qualified stock options to purchase shares of common stock and restricted stock awards and (ii) to non-employee directors and consultants non-qualified stock options and restricted stock.

The following paragraphs provide a summary of the principal features of the 2009 Plan and its operation. The following summary is qualified in its entirety by reference to the 2009 Plan as set forth in Appendix A.

Objectives. The objective of the 2009 Plan is to provide incentives to our key employees, directors and consultants to achieve financial results aimed at increasing shareholder value and attracting talented individuals to us. Persons eligible to be granted stock options or restricted stock under the 2009 Plan will be those persons whose performance, in the judgment of the Compensation Committee of our Board of Directors, can have significant effect on our success.

Oversight. Our Board will administer the 2009 Plan by making determinations regarding the persons to whom options or restricted stock should be granted and the amount, terms, conditions and restrictions of the awards. The Board also has the authority to interpret the provisions of the 2009 Plan and to establish and amend rules for its administration subject to the 2009 Plan's limitations.

Number of Shares of Common Stock Available Under the 2009 Plan. If the stockholders approve the 2009 Plan, a total of 500,000 shares of our common stock will be reserved for issuance under the 2009 Plan.

Types of Grants. The 2009 Plan allows for the grant of incentive stock options, non-qualified stock options and restricted stock awards. The 2009 Plan does not specify what portion of the awards may be in the form of incentive stock options, non-statutory options or restricted stock. Incentive stock options awarded to our employees are qualified stock options under the Internal Revenue Code.

Statutory Conditions on Stock Option Exercise Price. Incentive stock options granted under the 2009 Plan must have an exercise price at least equal to 100% of the fair market value of the common stock as of the date of grant. Incentive stock options granted to any person who owns, immediately after the grant, stock possessing more than 10% of the combined voting power of all classes of our stock, or of any parent or subsidiary corporation, must have an exercise price at least equal to 110% of the fair market value of the common stock on the date of grant. Non-statutory stock options may have an exercise price at least equal to 100% of the fair market value of the common stock as of the date of the grant.

- Dollar limit. The aggregate fair market value, determined as of the time an incentive stock option is granted, of the common stock with respect to which incentive stock options are exercisable by an employee for the first time during any calendar year cannot exceed \$100,000. However, there is no aggregate dollar limitation on the amount of non-statutory stock options that may be exercisable for the first time during any calendar year.

- Expiration date. Any option granted under the 2009 Plan will expire at the time fixed by our Board of Directors, which cannot be more than ten years after the date it is granted or, in the case of any person who owns more than 10% of the combined voting power of all classes of our stock or of any subsidiary corporation, not more than five years after the date of grant.

- Exercisability. Our Board may also specify when all or part of an option becomes exercisable, but in the absence of such specification, the option will ordinarily be exercisable in whole or in part at any time during its term.

However, the board of directors may accelerate the exercisability of any option at its discretion.

- **Assignability.** Options granted under the 2009 Plan are not assignable. Incentive stock options may be exercised only while the optionee is employed by us or within twelve months after termination by reason of death or disabilities or within three months after termination for any other reason.

Payment upon Exercise of Options. Payment of the exercise price for any option may be in cash, or with our consent, by withheld shares which, upon exercise, have a fair market value at the time the option is exercised equal to the option price (plus applicable withholding tax) or in the form of shares of common stock, subject to restrictions.

Restricted Stock. Our Board is authorized to grant restricted stock awards. A restricted stock grant is a grant of shares of our common stock, which is subject to restrictions on transferability, risk of forfeiture and other restrictions and which may be forfeited in the event of certain terminations of employment or service prior to the end of a restricted period specified by the Board of Directors. A participant granted restricted stock generally has all of the rights of one of our shareholders, unless otherwise determined by the committee.

Merger or Sale of Assets. In the event of our merger with or into another corporation, or the sale of all or substantially all of our assets, any unvested Awards will vest immediately prior to closing of the event resulting in the change of control, and the Board shall have the power and discretion to provide for each award holder's election alternatives regarding the terms and conditions for the exercise of such awards. The alternative may provide that each outstanding stock option and restricted stock award will be assumed or substituted for by the successor corporation (or a parent or subsidiary or such successor corporation). If there is no assumption or substitution of outstanding awards, the administrator will provide notice to the recipient of their alternatives regarding their right to exercise the stock option as to all of the shares subject to the stock option.

Amendment and Termination of the 2009 Plan. The administrator has the authority to amend, alter, suspend, or terminate the 2009 Plan, except that stockholder approval will be required for any amendment to the 2009 Plan to the extent required by any applicable law, regulation, or Nasdaq or stock exchange rule. Any amendment, alteration, suspension, or termination will not, without the consent of the participant, materially adversely affect any rights or obligations under any stock option or restricted stock award previously granted. The 2009 Plan has a term of ten (10) years beginning March 9, 2009, unless terminated earlier by the administrator.

Recent Stock Option and Restricted Stock Award Grants to Employees, Consultants, and Directors

Our Board of Directors adopted the 2005 Stock Option and Restricted Stock Plan (the 2005 Plan) on September 1, 2005. The 2005 Plan authorizes us to issue 2,500,000 shares of our common stock for issuance upon exercise of options and grant of restricted stock awards. We have issued all of the options available under the 2005 Plan. The grants under the 2005 Plan were effective upon stockholder approval of the 2005 Plan. On January 17, 2006, our Board adopted the 2006 Stock Option and Restricted Stock Plan (the 2006 Plan). The 2006 Plan authorizes us to reserve 1,500,000 shares for future grants under it. We have issued all 1,500,000 of the options available under the 2006 Plan. The grants under the 2006 Plan were effective upon stockholder approval of the 2006 Plan. On January 24, 2007, our Board adopted the 2007 Stock Option and Restricted Stock Plan (the 2007 Plan). The 2007 Plan authorizes us to reserve 1,500,000 shares for future grants under it. We have issued 1,493,600 of the options available under the 2007 Plan, all of which were effective on grant. On January 2, 2008, our Board adopted the 2008 Stock Option and Restricted Stock Plan (the 2008 Plan). The 2008 Plan authorizes us to reserve 1,000,000 shares for future grants under it. We have issued 958,000 of the options available under the 2008 Plan, 900,000 of which were effective upon shareholder approval on May 1, 2008 and the remaining 58,000 on November 9, 2008. The 2005 Plan, 2006 Plan, 2007 Plan and 2008 Plan are referred to as the Plans.

The number of stock options and restricted stock awards that an employee, director, or consultant may receive under our Plans is in the discretion of the administrator and therefore cannot be determined in advance, although the Board of Directors' policy for 2008 was to grant directors an award of 50,000 shares, which options vest over a four-year period. To date, only stock options have been granted under the Plans.

The following table sets forth (a) the aggregate number of shares subject to options granted under the Plans during the year-ended December 31, 2008 and (b) the average per share exercise price of such options.

Stock Option Grants

| Name of Individual or Group | Number of Options Granted | Average per Share Exercise Price |
|--|---------------------------------|---|
| Stanton E. Ross | 300,000 | \$ 6.80 |
| Leroy C. Richie | 50,000 | \$ 6.80 |
| Edward Juchniewicz | 50,000 | \$ 6.80 |
| Elliot M. Kaplan | 50,000 | \$ 6.80 |
| Daniel F. Hutchins | 50,000 | \$ 6.80 |
| Robert D. Haler | 150,000 | \$ 6.80 |
| Kenneth L. McCoy | 150,000 | \$ 6.80 |
| Thomas J. Heckman | 100,000 | \$ 6.80 |
| All executive officers, as a group | 700,000 | \$ 6.80 |
| All directors who are not executive officers, as a group | 200,000 | \$ 6.80 |
| All employees who are not executive officers, as a group | 83,000 | \$ 5.20 |

Please see our Compensation Tables below for more information about option grants.

Federal Tax Aspects

The following summary is a brief discussion of certain federal income tax consequences to U.S. taxpayers and to the Company of stock option, stock appreciation rights, and restricted stock awards granted under the 2009 Plan. This summary is not intended to be a complete discussion of all of the federal income tax consequences of the 2009 Plan or of all of the requirements that must be met in order to qualify for the tax treatment described below. The following summary is based upon the provisions of U.S. federal tax law as in effect on the date hereof, which is subject to change (perhaps with retroactive effect), and does not constitute tax advice. In addition, because tax consequences may vary, and certain exceptions to the general rules discussed in this summary may be applicable, depending upon the personal circumstances of individual recipients and each recipient should consider his or her personal situation and consult with his or her own tax advisor with respect to the specific tax consequences applicable to him or her. The following assumes stock options have been granted at an exercise price per share at least equal to 100% of the fair market value of the Company's common stock on the date of grant.

Tax consequences of nonqualified stock options. In general, an employee, director or consultant will not recognize income at the time of the grant of nonqualified options under the 2009 Plan. When an optionee exercises a nonqualified stock option, he or she generally will recognize ordinary income equal to the excess, if any, of the fair market value (determined on the day of exercise) of the shares of the common stock received over the option exercise price. The tax basis of such shares to the optionee will be equal to the exercise price paid plus the amount of ordinary income includible in his or her gross income at the time of the exercise. Upon a subsequent sale or exchange of shares acquired pursuant to the exercise of a nonqualified stock option, the optionee will have taxable capital gain or loss, measured by the difference between the amount realized on the sale or exchange and the tax basis of the shares. The capital gain or loss will be short-term if the or long-term depending on holding period of the shares sold.

Tax consequences of incentive stock options. In general, an employee will not recognize income on the grant of incentive stock options under the 2009 Plan. Except with respect to the alternative minimum tax, an optionee will not recognize income on the exercise of an incentive stock option unless the option exercise price is paid with stock acquired on the exercise of an incentive stock option and the following holding period for such stock has not been

satisfied. For purposes of the alternative minimum tax, however, an optionee will be required to treat an amount equal to the difference between the fair market value (determined on the day of exercise) of our shares of the common stock received and the exercise price as an item of adjustment in computing the optionee's alternative minimum taxable income.

An optionee will recognize long-term capital gain or loss on a sale of the shares acquired on exercise, provided the shares acquired are not sold or otherwise disposed of before the earlier of: (i) two years from the date of grant of the option, or (ii) one year from the date of exercise of the option. In general, the amount of gain or loss will equal the difference, if any, between the sale price of such shares and the exercise price. If the stock is not held for the required period of time, the optionee will recognize ordinary income to the extent the fair market value (determined on the day of exercise) of the stock exceeds the option price, but limited to the gain recognized on sale. The balance of any such gain will be a short-term or long-term capital gain (depending on the applicable holding period).

For the exercise of a stock option to qualify for the foregoing incentive stock option tax treatment, an optionee generally must be an employee of the Company continuously from the date of the grant until any termination of employment, and in the event of a termination of employment, the stock option must be exercised within three months after the termination.

Tax consequences of restricted stock awards. In general, the recipient of a stock award will recognize ordinary income at the time the shares are received equal to the excess, if any, of the fair market value of the shares received over the amount, if any, the recipient paid in exchange for the shares. If, however, the shares are subject to vesting or other restrictions (that is, they are nontransferable and subject to a substantial risk of forfeiture) when the shares are granted (for example, if the employee is required to work for a period of time in order to have the right to sell the stock), the recipient generally will not recognize income until the shares becomes vested or the restrictions otherwise lapse, at which time the recipient will recognize ordinary income equal to the excess, if any, of the fair market value of the shares on the date of vesting (or the date of the lapse of a restriction) less the amount, if any, the recipient paid in exchange for the shares. If the shares are forfeited under the terms of the restricted stock award, the recipient will not recognize income and will not be allowed an income tax deduction with respect to the forfeiture.

A recipient may file an election under Section 83(b) of the Internal Revenue Code with the Internal Revenue Service within thirty (30) days of his or her receipt of the stock award, to recognize ordinary income, as of the award date, equal to the excess, if any, of the fair market value of the shares on the award date less the amount, if any, the recipient paid in exchange for the shares. If a recipient makes a Section 83(b) election, then the recipient will not otherwise be taxed in the year the vesting or restriction lapses, and, if the stock award is forfeited, he or she will not be allowed an income tax deduction. If the recipient does not make a Section 83(b) election, dividends paid to the recipient on the shares prior to the date the vesting or restrictions lapse will be treated as compensation income.

The recipient's tax basis for the determination of gain or loss upon the subsequent disposition of shares acquired as stock awards will be the amount paid for such shares plus the amount includible in his or her gross income as compensation in respect of such shares. A recipient's holding period for the shares will begin on the day after the later of the day the shares are transferred to the recipient or the day that the vesting or other restriction lapses.

Tax consequences of stock appreciation right awards. In general, there are no immediate tax consequences of receiving an award of stock appreciation rights under the 2009 Plan (whether as a stand-alone award or in tandem with a related option award). Upon the exercise of a stock appreciation right, the recipient will recognize ordinary income equal to difference between the amount of cash, if any, and the fair market value of our shares, if any, that the recipient receives as a result of the exercise and the stock appreciation right grant price, if any. The tax basis of any shares received by the recipient pursuant to a stock appreciation right should be equal to the amount includible in his or her gross income as compensation in respect of such shares, and the recipient's holding period should normally commence on the day after the day on which he or she recognizes taxable income in respect of such shares.

Withholding and other consequences. Any compensation includible in the gross income of a recipient will be subject to appropriate federal and state income tax withholding.

Tax effect for the Company. The Company generally is entitled to an income tax deduction in connection with a stock option, stock appreciation right or restricted stock award granted under the 2009 Plan in an amount equal to the ordinary income realized by a participant at the time the participant recognizes such income (for example, the exercise of a nonqualified stock option). Special rules may limit the deductibility of compensation paid to the Company's Chief Executive Officer and to each of its four most highly compensated executive officers under Section 162(m) of the Internal Revenue Code to the extent that annual compensation paid to any of the foregoing individuals exceeds \$1,000,000.

THE FOREGOING IS ONLY A BRIEF SUMMARY OF THE EFFECT OF FEDERAL INCOME TAXATION UPON PARTICIPANTS AND THE COMPANY WITH RESPECT TO THE GRANT AND EXERCISE OF STOCK OPTIONS, STOCK APPRECIATION RIGHTS, AND RESTRICTED STOCK AWARDS UNDER THE 2009 PLAN. IT DOES NOT PURPORT TO BE COMPLETE, AND DOES NOT DISCUSS THE TAX CONSEQUENCES OF A RECIPIENT'S DEATH OR THE PROVISIONS OF THE INCOME TAX LAWS OF ANY MUNICIPALITY STATE OR FOREIGN COUNTRY IN WHICH THE RECIPIENT MAY RESIDE. THE FOREGOING SUMMARY IS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED BY ANY TAXPAYER, FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER.

PROPOSAL THREE

RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee of the Board of Directors has appointed McGladrey & Pullen LLP as the independent registered public accounting firm to audit our financial statements for the year ending December 31, 2009 and recommends that stockholders vote for ratification of such appointment. During the 2008 fiscal year, McGladrey & Pullen LLP served as our independent registered public accounting firm and also provided certain tax and other non-audit services. Although we are not required to seek stockholder approval of this appointment, the Board believes it to be sound corporate governance to do so. Notwithstanding the selection by the Audit Committee of McGladrey & Pullen LLP, the Audit Committee may direct the appointment of a new independent registered public accounting firm at any time during the year if the Board of Directors determines that such a change would be in our best interest and in that of our stockholders. If the appointment is not ratified, the Audit Committee will investigate the reasons for stockholder rejection and will reconsider the appointment.

Representatives of McGladrey & Pullen LLP are expected to attend the Annual Meeting, where they will be available to respond to questions and, if they desire, to make a statement.

Audit and Related Fees

The following table is a summary of the fees billed to us by McGladrey & Pullen LLP for professional services for the fiscal years ended December 31, 2008 and December 31, 2007:

| Fee Category: | Fiscal 2008 Fees | Fiscal 2007 Fees |
|----------------------|-----------------------------|-----------------------------|
| Audit Fees | \$ 178,855 | \$ 113,937 |
| Audit-Related Fees | 2,634 | 49,971 |
| Tax Fees | 20,515 | 29,963 |
| All Other Fees | | |

| | | |
|------------|------------|------------|
| Total Fees | \$ 202,004 | \$ 193,871 |
|------------|------------|------------|

Audit Fees. Such amount consists of fees billed for professional services rendered in connection with the audit of our annual financial statements and review of the interim financial statements included in our quarterly reports. It also includes services that are normally provided by our independent registered public accounting firms in connection with statutory and regulatory filings or engagements.

Audit-Related Fees. Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not reported under Audit Fees. These services include employee benefit plan audits, accounting consultations in connection with acquisitions, attest services that are not required by statute or regulation, and consultations concerning financial accounting and reporting standards.

Tax Fees. Tax fees consist of fees billed for professional services related to tax compliance, tax advice and tax planning. These services include assistance regarding federal, state and international tax compliance, tax audit defense, customs and duties, mergers and acquisitions, and international tax planning.

All Other Fees. Consists of fees for products and services other than the services reported above. In fiscal 2008 and 2007, there were no fees related to this category.

The Audit Committee's practice is to consider and approve in advance all proposed audit and non-audit services to be provided by our independent registered public accounting firm.

The audit report of McGladrey & Pullen LLP on the financial statements of the Company for the year ended December 31, 2008 did not contain an adverse opinion or disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles. The audit report for the year ended December 31, 2007 did not contain an adverse opinion or disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles.

During our fiscal years ended December 31, 2008 and 2007, there were no disagreements with McGladrey & Pullen LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements if not resolved to McGladrey & Pullen LLP's satisfaction would have caused it to make reference to the subject matter of such disagreements in connection with its reports on the financial statements for such periods.

During our fiscal years ended December 31, 2008 and 2007, there were no reportable events (as described in Item 304(a)(1)(v) of Regulation S-K).

Vote Required

If a quorum is present, the affirmative vote of a majority of the shares present and entitled to vote at the Annual Meeting will be required to ratify the appointment of McGladrey & Pullen LLP as our independent registered public accounting firm. Abstentions will have the effect of a vote against this proposal, and broker non-votes will have no effect on the outcome of the vote with respect to this proposal.

OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE RATIFICATION OF THE APPOINTMENT OF MCGLADREY & PULLEN LLP AS THE INDEPENDENT REGISTERED ACCOUNTING FIRM OF DIGITAL ALLY, INC. FOR THE YEAR ENDING DECEMBER 31, 2009.

Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate future filings, including this proxy statement, in whole or in part, the Audit Committee Report shall not be incorporated by reference into any such filings.

REPORT OF THE AUDIT COMMITTEE

Below is the report of the Audit Committee with respect to our audited financial statements for the fiscal year ended December 31, 2008, which include our balance sheets as of December 31, 2008 and 2007, and the related

statements of income, stockholders' equity and cash flows for each of the fiscal years ended December 31, 2008 and December 31, 2007 and the notes thereto.

In accordance with the written charter adopted by the Board of Directors, the Audit Committee of the Board of Directors has the primary responsibility for overseeing our financial reporting, accounting principles and system of internal accounting controls, and reporting its observations and activities to the Board of Directors. It also approves the appointment of our independent registered public accounting firm and approves in advance the services performed by such firm.

Review and Discussion with Management

The Audit Committee has reviewed and discussed with management our audited financial statements for the fiscal year ended December 31, 2008, the process designed to achieve compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our assessment of internal control over financial reporting and the report by our independent registered public accounting firm thereon.

Review and Discussions with Independent Registered Public Accounting Firm

The Audit Committee has discussed with McGladrey & Pullen LLP, our independent registered public accounting firm for fiscal year 2008, the matters the Audit Committee is required to discuss pursuant to Statement on Auditing Standards No. 61 (Communications with Audit Committees), which includes, among other items, matters related to the conduct of the audit of our consolidated financial statements.

The Audit Committee also has received the written disclosures and the letter from McGladrey & Pullen LLP required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with McGladrey & Pullen LLP any relationships that may impact its independence, and satisfied itself as to the independent registered public accounting firm's independence.

Conclusion

Based on the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that our audited financial statements for the fiscal year ended December 31, 2008 be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 for filing with the Securities and Exchange Commission.

Respectfully submitted by:
THE AUDIT COMMITTEE OF THE BOARD OF
DIRECTORS OF DIGITAL ALLY, INC.

Daniel F. Hutchins, Chairman
Leroy C. Richie
Elliot M. Kaplan
Edward Juchniewicz

EXECUTIVE COMPENSATION**Summary Compensation**

The following table presents information concerning the total compensation of the Company's Chief Executive Officer, Chief Financial Officer and the three other most highly compensated officers during the last fiscal year (the Named Executive Officers) for services rendered to the Company in all capacities for the year ended December 31, 2008:

| Name | Year | Salary (\$) | Bonus (\$) | Option awards (\$) (2) | All other compensation (\$) (3) | Total (\$) |
|--|------|----------------|---------------|------------------------------|--|--------------|
| Stanton E. Ross Chairman, CEO and President (1) | 2008 | \$ 425,000 | \$ -0- | \$ 561,775 | \$ 15,621(4) | \$ 1,002,396 |
| | 2007 | \$ 150,000 | \$ 100,000 | \$ 391,767 | \$ -0- | \$ 641,767 |
| | 2006 | \$ -0- | \$ -0- | \$ 178,342 | \$ -0- | \$ 274,592 |
| Robert D. Haler Executive Vice President and Director of Product Development | 2008 | \$ 250,000 | \$ -0- | \$ 203,485 | \$ 5,963(5) | \$ 459,448 |
| | 2007 | \$ 125,000 | \$ 25,000 | \$ 170,830 | \$ 3,233(5) | \$ 324,063 |
| | 2006 | \$ 120,000 | \$ 35,000 | \$ 101,910 | \$ -0- | \$ 540,712 |
| Kenneth L. McCoy Vice President - Marketing | 2008 | \$ 250,000 | \$ -0- | \$ 203,485 | \$ 18,295(6) | \$ 471,780 |
| | 2007 | \$ 93,750 | \$ 35,840 | \$ 185,868 | \$ 27,921(6) | \$ 343,379 |
| | 2006 | \$ 90,000 | \$ 11,991 | \$ 101,910 | \$ 12,000(6) | \$ 540,712 |
| Thomas J. Heckman CFO, Treasurer and Secretary (9) | 2008 | \$ 204,166 | \$ -0- | \$ 125,523 | \$ 8,668(7) | \$ 338,357 |
| | 2007 | \$ 21,000 | \$ 1,000 | \$ 33,444 | \$ -0- | \$ 55,444 |
| | 2006 | \$ -0- | \$ -0- | \$ -0- | \$ -0- | \$ -0- |
| Jeffrey A. Bakalar Former CFO, Treasurer and Secretary (10) | 2008 | \$ -0- | \$ -0- | \$ -0- | \$ -0- | \$ -0- |
| | 2007 | \$ 132,000 | \$ 15,000 | \$ 93,864 | \$ 13,636(8) | \$ 254,500 |
| | 2006 | \$ 120,000 | \$ 9,500 | \$ 73,885 | \$ -0- | \$ 236,962 |
| Charles A. Ross Former President and Director of Product Development (11) | 2008 | \$ -0- | \$ -0- | \$ -0- | \$ -0- | \$ -0- |
| | 2007 | \$ -0- | \$ -0- | \$ -0- | \$ -0- | \$ -0- |
| | 2006 | \$ 45,000 | \$ 25,000 | \$ -0- | \$ -0- | \$ 70,000 |

(1) Mr. Ross did not receive a salary or bonus from the Company during 2006.

(2) Option awards noted represent the amount of stock option expense recorded by the Company during 2008 as determined under Statement of Financial Accounting Standards No. 123 (revised 2004) *Share Based Payment*. Please refer to Note 10 to the financial statements for further description of the awards and the underlying assumptions utilized to determine the amount of expense related to such grants. This expense is included in the total compensation column for 2008 in the above table. Please see *Recent Stock Option and Restricted Stock Award Grants to Employees, Consultants and Directors* for additional information on the options set forth in this table.

(3)

Amounts included in all other compensation include two items: 1) The employer contribution to the Company's 401(k) Retirement Savings Plan (the 401(k) Plan) on behalf of the named executive. The Company is required to provide a 100% matching contribution for all who elect to contribute up to 3% of their compensation to the plan and a 50% matching contribution for all employees' elective deferral between 4% and 5%. The employee is 100% vested at all times in the employee contributions and employer matching contributions, and 2) Company paid healthcare insurance.

- (4) Other compensation amounts for Mr. Ross include: 1) Company contribution to 401 (k) Plan totaled \$7,872 for 2008, and 2) Company paid healthcare insurance totaled \$7,749 for 2008.
- (5) Other compensation amounts for Mr. Haler include: 1) Company contribution to 401 (k) Plan totaled \$2,966 for 2008, and 2) Company paid healthcare insurance totaled \$2,997 for 2008 and \$3,233 for 2007.
- (6) Other compensation amounts for Mr. McCoy include: 1) Company paid housing allowance of \$12,000 per year for 2008, 2007 and 2006, and 2) Company paid healthcare insurance totaled \$6,295 for 2008 and \$15,921 for 2007.
- (7) Other compensation amounts for Mr. Heckman include: 1) Company contribution to 401 (k) Plan totaled \$2,373 for 2008, and 2) Company paid healthcare insurance totaled \$6,295 for 2008.
- (8) Other compensation amounts for Mr. Bakalar include Company paid healthcare insurance totaled \$13,636 for 2007.
- (9) Mr. Heckman worked as a consultant to the Company during 2007 and effective December 31, 2007, was appointed CFO, Treasurer and Secretary, replacing Mr. Bakalar.
- (10) Mr. Bakalar resigned as CFO, Treasurer and Secretary on December 31, 2007.
- (11) Mr. Charles A. Ross, Jr., who is the brother of Stanton E. Ross, resigned as a director and officer of the Company effective February 23, 2006.

Compensation Policy. The Company's executive compensation plan is based on attracting and retaining qualified professionals who possess the skills and leadership necessary to enable the Company to achieve earnings and profitability growth to satisfy its stockholders. The Company must, therefore, create incentives for these executives to achieve both Company and individual performance objectives through the use of performance-based compensation programs.

No one component is considered by itself, but all forms of the compensation package are considered in total. Wherever possible, objective measurements will be utilized to quantify performance, but many subjective factors still come into play when determining performance.

Compensation Components. The main elements of its compensation package consist of base salary, stock options and bonus.

Base Salary. The base salary for each executive officer is reviewed and compared to the prior year, with considerations given for increase. During 2007 and 2006, the executive officers noted (with the exception of Mr. Ross) had no significant change their base salaries because the Company was in the development stage up until March 2006, and began delivering product to become an operating company in second quarter 2006. During 2008, adjustments were made to each named executive's base compensation to reflect the increased responsibilities and demands due to the tremendous growth in revenues and net income during 2006 through 2008. The Company will review the base salaries for possible adjustments on an annual basis.

Base salary adjustments will be based on both individual and Company performance and will include both objective and subjective criteria specific to each executive's role and responsibility with the Company.

Our directors and officers have agreed to defer 25% of their 2009 monetary compensation until our year-to-date sales reach a threshold of \$50 million in 2009.

Stock Options. Stock option awards were determined by the Compensation Committee based on numerous factors, some of which include responsibilities incumbent with the role of each executive to the Company, tenure with the Company, as well as Company performance, such as shipment of product at certain thresholds. The vesting period of said options is also tied, in some instances, to Company performance directly related to certain executive's responsibilities with the Company.

Bonuses. To date, bonuses have been granted on a limited basis, with these bonuses related to meeting certain performance criteria that are directly related to areas within the executive's responsibilities with the Company, such as production of product and sales of product to customers. As the Company continues to grow, more defined bonus programs will be created to attract and retain its employees at all levels.

Other. In July 2008, the Company amended and restated its 401(k) retirement savings plan (the 401(k) Plan). The amended plan requires the Company to provide a 100% matching contribution for employees who elect to contribute up to 3% of their compensation to the plan and a 50% matching contribution for employee's elective deferrals between 4% and 5%. The Company has made matching contributions for executives who elected to contribute to the 401(k) Plan during 2008. Each participant is 100% vested at all times in employee and employer matching contributions.

The Company has no profit sharing plan in place for employees. However, it may give consideration to adding such a plan to provide yet another level of compensation to its compensation plan.

The following table presents information concerning the grants of Plan-based awards to the Named Executive Officers during the year ended December 31, 2008:

Grants of Plan-Based Awards

| Name (a) | Grant date | Date approved by compensation committee | All other option awards: number of securities under-lying options (#) | Exercise or base price of option awards (\$/Sh) | Grant date fair value of stock option awards |
|--|------------|---|---|---|--|
| Stanton E. Ross Chairman, CEO and President | 5/1/08 | 1/2/08 | 300,000 | \$ 6.80 | \$ 1,298,008 |
| Robert D. Haler Executive Vice President and Director of Product Development | 5/1/08 | 1/2/08 | 150,000 | \$ 6.80 | \$ 649,004 |
| Kenneth L. McCoy Vice President Marketing | 5/1/08 | 1/2/08 | 150,000 | \$ 6.80 | \$ 649,004 |
| Thomas J. Heckman CFO, Treasurer and Secretary | 5/1/08 | 1/2/08 | 100,000 | \$ 6.80 | \$ 432,669 |

These awards were all made pursuant to the 2008 Plan and vest over a graduated four-year vesting period with 10% vesting on January 2, 2009; 20% on January 2, 2010; 30% on January 2, 2011; and 40% on January 2, 2012.

Option awards noted represent the amount of stock option expense recorded by the Company during 2008 as determined under Statement of Financial Accounting Standards No. 123 (revised 2004) *Share Based Payment*. Please refer to Note 10 to the financial statements for further description of the awards and the underlying assumptions utilized to determine the amount of expense related to such grants. This expense is included in the total compensation column for 2008 in the above table. Please see Recent Stock Option and Restricted Stock Award Grants to Employees, Consultants and Directors for additional information on the options set forth in this table.

The following table presents information concerning the outstanding equity awards for the Named Executive Officers as of December 31, 2008:

Outstanding Option Awards

| Name | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options | Option Exercise Price (\$) | Option Expiration Date |
|-----------------|---|---|--|----------------------------|------------------------|
| Stanton E. Ross | 30,000 | 270,000 | | \$ 6.80 | 1/2/2018 |

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| | | | | |
|--|---------|---------|---------|------------|
| Chairman, CEO and President | 109,375 | 65,625 | \$ 4.05 | 10/15/2017 |
| | 200,000 | | \$ 1.60 | 3/1/2017 |
| | 303,488 | | \$ 2.15 | 9/25/2011 |
| | 193,823 | | \$ 1.00 | 8/31/2015 |
| Robert D. Haler | 15,000 | 135,000 | \$ 6.80 | 1/2/2018 |
| Executive Vice President and | 100,000 | | \$ 1.60 | 3/1/2017 |
| Director of Product Development | 200,000 | | \$ 2.15 | 9/25/2011 |
| | 500,000 | | \$ 1.00 | 8/31/2015 |
| Kenneth L. McCoy Vice President Marketing | 15,000 | 135,000 | \$ 6.80 | 1/2/2018 |
| | 100,000 | | \$ 1.60 | 3/1/2017 |
| | 200,000 | | \$ 2.15 | 9/25/2011 |
| | 500,000 | | \$ 1.00 | 8/31/2015 |
| Thomas J. Heckman | 10,000 | 90,000 | \$ 6.80 | 1/2/2018 |
| CFO, Treasurer and Secretary | 20,000 | | \$ 4.05 | 10/15/2017 |

The following table presents information concerning the stock options exercised and the vesting of stock awards during 2008 for the Named Executive Officers as of December 31, 2008.

Options Exercised and Stock Vested

| Name | <u>OPTION AWARDS</u> | | <u>STOCK AWARDS</u> | |
|---|---|---------------------------------|--|--------------------------------|
| | Number of Shares acquired on exercise (#) | Value realized on exercise (\$) | Number of Shares acquired on vesting (#) | Value realized on vesting (\$) |
| Stanton E. Ross Chairman, CEO and President | 306,177 | \$ 1,874,080 | | \$ |
| Robert D. Haler Executive Vice President and Director of Product Development | | \$ | | \$ |
| Kenneth L. McCoy Vice President Marketing | | \$ | | \$ |
| Thomas J. Heckman CFO, Treasurer and Secretary | | \$ | | \$ |

Stock Option Plans

Our board of directors adopted the 2005 Plan on September 1, 2005. The 2005 Plan authorizes us to issue 2,500,000 shares of our common stock for issuance upon exercise of options and grant of restricted stock awards. We have issued all of the options available under the 2005 Plan. The grants under the 2005 Plan were effective upon shareholder approval of the 2005 Plan.

On January 17, 2006, our Board adopted the 2006 Plan, which authorizes us to reserve 1,500,000 shares for future grants under it. We have issued all 1,500,000 of the options available under the 2006 Plan. The grants under the 2006 Plan were effective upon shareholder approval of the Plan.

On January 26, 2007, our Board adopted the 2007 Plan, which authorizes us to reserve 1,500,000 shares for future grants under it. We have issued 1,493,600 of the options available under the 2007 Plan.

On January 2, 2008, our Board adopted the 2008 Plan. The 2008 Plan authorizes us to reserve 1,000,000 shares for future grants under it. We have issued 900,000 of the options available under the 2008 Plan. The grants under the 2008 Plan became effective upon stockholder approval of the 2008 Plan at the Annual Shareholders meeting on May 1, 2008. The 2005 Plan, 2006 Plan, 2007 Plan and the 2008 Plan are referred to as the Plans. The Plans authorize us to grant (i) to the key employees incentive stock options (except for the 2007 Plan) to purchase shares of common stock and non-qualified stock options to purchase shares of common stock and restricted stock awards, and (ii) to non-employee directors and consultants non-qualified stock options and restricted stock. Our Compensation Committee administers the Plans by making recommendations to the board or determinations regarding the persons to whom options or restricted stock should be granted and the amount, terms, conditions and restrictions of the awards.

Incentive stock options granted under the Plans must have an exercise price at least equal to 100% of the fair market value of the common stock as of the date of grant. Incentive stock options granted to any person who owns, immediately after the grant, stock possessing more than 10% of the combined voting power of all classes of our stock, or of any parent or subsidiary corporation, must have an exercise price at least equal to 110% of the fair market value of the common stock on the date of grant. Non-statutory stock options may have exercise prices as determined by our Compensation Committee.

The Compensation Committee is also authorized to grant restricted stock awards under the Plans. A restricted stock award is a grant of shares of the common stock that is subject to restrictions on transferability, risk of forfeiture and other restrictions and that may be forfeited in the event of certain terminations of employment or service prior to the end of a restricted period specified by the Compensation Committee.

Compensation of Directors and Advisory Board Members

The non-employee directors received the stock option grants noted in the section above entitled "Stock Option Grants in Fiscal Year 2008" for agreeing to serve on the Board of Directors in 2008, including on the Audit and Compensation Committees. Our Directors and members of our Advisory Board, who are neither employees nor our affiliates, receive options upon their appointment as Directors and as members of our Advisory Board. Each member of our Advisory Board receives a grant of 2,000 options upon appointment to a one-year term. The options are exercisable at the closing price of our common stock on the day of the grant of such options. The grants to such Directors are set forth in the Section entitled "Stock Option Grants in Fiscal Year 2008." In 2007, members of our Board of Directors received compensation of \$5,000 per quarter for their services as Board members, with Leroy C. Ritchie, our lead director, receiving \$6,000 in compensation per quarter. The non-employee directors also receive fees as members of various committees of the Board and are reimbursed for their out-of-pocket costs in attending the meetings of the Board of Directors. In 2008, we paid each of our non-employee directors an annual fee of \$30,000 and a meeting fee of \$4,000 for their services as a Board member. We paid Leroy C. Ritchie an additional annual fee of \$10,000 as our lead director. Daniel F. Hutchins received an annual fee of \$10,000 as Chairman of the Audit Committee and members of such Committee will be paid \$4,000 annually. Elliot M. Kaplan was paid an annual fee of \$5,000 as Chairman of the Compensation Committee and members of such Committee were paid \$1,000 annually. Edward Juchniewicz received an annual fee of \$5,000 as Chairman of the Nominating Committee and members of such Committee were paid \$1,000 annually. We also compensated non-employee directors at the rate of \$500 per telephonic meeting. See "Corporate Governance - Director."

Our directors and officers have agreed to defer 25% of their 2009 monetary compensation until our year-to-date sales reach a threshold of \$50 million in 2009.

Director Compensation

| Name | Fees earned or paid in cash (\$) | Stock awards (\$) | Option awards (\$) (2) | Total (\$) |
|--|---|-------------------------|------------------------------|------------|
| Stanton E. Ross Chairman of the Board (1) | \$ -0- | \$ -0- | \$ -0- | \$ -0- |
| Leroy C. Ritchie | \$ 46,000 | \$ -0- | \$ 93,162 | \$ 139,162 |
| Edward Juchniewicz | \$ 44,000 | \$ -0- | \$ 93,162 | \$ 137,162 |
| Elliot M. Kaplan | \$ 44,000 | \$ -0- | \$ 93,162 | \$ 137,162 |
| Daniel F. Hutchins | \$ 46,000 | \$ -0- | \$ 93,162 | \$ 139,162 |

- (1) Mr. Ross' compensation and option awards are noted in the Executive Compensation table because he did not receive compensation or stock options for his services as a director.
- (2) Option awards noted represent the amount of stock option expense recorded by the Company as determined under Statement of Financial Accounting Standards No. 123 (revised 2004) *Share Based Payment* during 2008. Please refer to Note 10 to the financial statements for further description of the awards and the underlying assumptions utilized to determine the amount of expense related to such grants.

Employment Contracts; Termination of Employment and Change-in-Control Arrangements

We do not have any employment agreements with any of our executive officers. However, we have entered into retention agreements with our executive officers. On December 23, 2008, the Company entered into retention agreements with the following executive officers of the Company: Stanton E. Ross, Thomas J. Heckman, Robert D. Haler and Kenneth L. McCoy.

The retention agreements guarantee the executive officers specific payments and benefits upon a Change in Control of the Company. The retention agreements also provide for specified severance benefits if, after a Change in Control of the Company occurs, the executive officer voluntarily terminates employment for Good Reason or is involuntarily terminated without Cause.

Under the retention agreements, a **Change in Control** means (i) one party alone, or acting with others, has acquired or gained control over more than fifty percent (50%) of the voting shares of the Company; or (ii) the Company merges or consolidates with or into another entity or completes any other corporate reorganization, if more than fifty percent (50%) of the combined voting power of the surviving entity's securities outstanding immediately after such merger, consolidation or other reorganization is owned by persons who were not shareholders of the Company immediately prior to such merger, consolidation or other reorganization; or (iii) a majority of the Company's Board of Directors is replaced and/or dismissed by the shareholders of the Company without the recommendation of or nomination by the Company's current Board of Directors; or (iv) the Company's Chief Executive Officer (the **CEO**) is replaced and/or dismissed by shareholders without the approval of the Company's Board of Directors; or (v) the Company sells, transfers or otherwise disposes of all or substantially all of the consolidated assets of the Company and the Company does not own stock in the purchaser or purchasers having more than fifty percent (50%) of the voting power of the entity owning all or substantially all of the consolidated assets of the Company after such purchase.

Good Reason means either (i) a material adverse change in the executive's status as an executive or other key employee of the Company, including without limitation, a material adverse change in the executive's position, authority, or aggregate duties or responsibilities; or (ii) any adverse change in the executive's base salary, target bonus or benefits; or (iii) a request by the Company to materially change the executive's geographic work location.

Cause means (i) the executive has acted in bad faith and to the detriment of the Company; (ii) the executive has refused or failed to act in accordance with any specific lawful and material direction or order of his or her supervisor; (iii) the executive has exhibited, in regard to employment, unfitness or unavailability for service, misconduct, dishonesty, habitual neglect, incompetence, or has committed an act of embezzlement, fraud or theft with respect to the property of the Company; (iv) the executive has abused alcohol or drugs on the job or in a manner that affects the executive's job performance; and/or (v) the executive has been found guilty of or has plead *nolo contendere* to the commission of a crime involving dishonesty, breach of trust, or physical or emotional harm to any person. Prior to termination for Cause, the Company shall give the executive written notice of the reason for such potential termination and provide the executive a thirty (30) day period to cure such conduct or act or omission alleged to provide grounds for such termination.

If any Change in Control occurs and the executive continues to be employed as of the completion of such Change in Control, upon completion of such Change in Control, as payment for the executive's additional efforts during such Change in Control, the Company shall pay the executive a Change in Control benefit payment equal to three (3) months of the executive's base salary at the rate in effect immediately prior to the Change in Control completion date, payable in a lump sum net of required tax withholdings.

If any Change in Control occurs, and if, during the one (1) year period following the Change in Control, the Company terminates the executive's employment without Cause or the executive submits a resignation for Good Reason (the effective date of such termination or resignation, the **Termination Date**), then:

(a) The Company shall pay the executive severance pay equal to twelve (12) months of the executive's base salary at the higher of the rate in effect immediately prior to the Termination Date or the rate in effect immediately prior to the occurrence of the event or events constituting Good Reason, payable on the Termination Date in a lump sum net of required tax withholdings, plus all other amounts then payable by the Company to the executive less any amounts then due and owing from the executive to the Company;

(b) The Company shall provide continuation of the executive's health benefits at the Company's expense for eighteen (18) months following the Termination Date; and

(c) The executive's outstanding employee stock options shall fully vest and be exercisable for a 90-day period following the Termination Date.

The executive is not entitled to the above severance benefits for a termination based on death or disability, resignation without Good Reason or termination for Cause. Following the Termination Date, the Company shall also pay the executive all reimbursements for expenses in accordance with the Company's policies, within ten (10) days of submission of appropriate evidence thereof by the executive.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT- SECTION 16(a)
BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

The following table sets forth, as of March 1, 2009, the number and percentage of outstanding shares of common stock beneficially owned by (a) each person known by us to beneficially own more than five percent of such stock, (b) each director of the Company, (c) each named officer of the Company, and (d) all our directors and executive officers as a group. We have no other class of capital stock outstanding.

| Name and address for each Beneficial Owner | Number of Shares of Common Stock | Percent of Class |
|---|---|------------------------|
| <u>5% Shareholders (excluding executive officers and directors):</u> | | |
| FMR, LLC (1) 82 Devonshire Street Boston, Massachusetts 02109 | 1,571,571 | 10.0% |
| Intana Management, LLC (2) 505 Park Avenue, 3 rd Floor New York, NY 10022 | 1,571,470 | 10.0% |
| Intana Management Master Fund, Ltd. (2) c/o Dundee Leeds Management Services (Cayman) Ltd. 2 nd Floor, Waterfront Centre, 28 N. Church Street Georgetown, Cayman Islands, BWI | | |
| <u>Executive Officers & Directors: (3)</u> | | |
| Stanton E. Ross (4) | 1,537,036 | 8.0% |
| Leroy C. Richie (5) | 439,782 | 2.3% |
| Elliot M. Kaplan (6) | 470,433 | 2.4% |
| Edward Juchniewicz (7) | 384,434 | 2.0% |
| Daniel F. Hutchins (8) | 18,000 | 0.1% |
| Robert D. Haler (9) | 1,035,384 | 5.3% |
| Kenneth L. McCoy (10) | 817,000 | 4.2% |
| Thomas J. Heckman (11) | 31,000 | 0.2% |
| All officers and directors as a group (8 individuals) | 4,733,069 | 24.5% |

- (1) Based on information provided by FMR, LLC in Schedule 13D filed in February 2009.
- (2) Based on information provided by Intana Management, LLC and Intana Capital Master Fund Ltd. in Schedule 13D filed in February 2009.
- (3) The address of these persons is c/o 7311 West 130th Street, Suite 170, Overland Park, KS 66213.
- (4) Mr. Ross' total shares include vested options to purchase 858,561 shares of common stock and 21,875 options that will vest within sixty days. Mr. Ross has pledged 660,600 common shares to financial institutions as collateral for personal loans.
- (5) Mr. Richie's total shares include vested options to purchase 360,782 shares of common stock.

- (6) Mr. Kaplan's total shares include vested options to purchase 335,433 shares of common stock. Mr. Kaplan has pledged 125,000 common shares to financial institutions and 330,433 outstanding unexercised options as collateral for personal loans.
- (7) Mr. Juchniewicz's total shares include vested options to purchase 325,000 shares of common stock.
- (8) Mr. Hutchins's total shares include vested options to purchase 15,000 shares of common stock.
- (9) Mr. Haler's total shares include vested options to purchase 815,000 shares of common stock.
- (10) Mr. McCoy's total shares include vested options to purchase 815,000 shares of common stock.
- (11) Mr. Heckman's total shares include vested options to purchase 30,000 shares of common stock.

Section 16(a) Beneficial Ownership Reporting

Section 16(a) of the Securities Act of 1934, as amended, requires our executive officers and directors, and persons who own more than ten percent (10%) of our common stock, to file with the Securities and Exchange Commission reports of ownership of, and transactions in, our securities and to provide us with copies of those filings. To our knowledge, based solely on our review of the copies of such forms received by us, or written representations from certain reporting persons, we believe that during the year ended December 31, 2008, all filing requirements applicable to our officers, directors and greater than ten percent beneficial owners were complied with, with the following exceptions: Messrs. Ross and Richie each failed to file one Form 4 in a timely fashion during fiscal year 2008.

TRANSACTIONS WITH RELATED PERSONS

Certain Relationships and Related Person Transactions

On September 1, 2004, we borrowed \$500,000 from Acme Resources, LLC, a Mississippi limited liability company controlled by Brooks Warren, one of our shareholders. The note bears interest at the rate of seven percent per annum and is due and payable on May 15, 2007. The note is payable in cash or, at the option of the holder, by conversion of the note into 500,000 shares of our common stock. Charles A. Ross, Jr., who was a director and officer, personally guaranteed our obligation from September 1, 2004 to May 15, 2006 and agreed to pledge shares of his common stock to provide collateral for the note. The note holder converted the note to 500,000 shares of common stock on May 15, 2007.

On September 25, 2006, we issued options to purchase 10,000 shares of our common stock to Daniels & Kaplan, P.C. for services rendered. The options had a term of five years and were exercisable at \$2.15 per share. Mr. Elliot Kaplan, a director of the Company since September 2005, chairman of our Compensation Committee and a member of the Audit Committee, was a practicing attorney with Daniels & Kaplan, P.C. through 2006. In early 2007, Daniels & Kaplan dissolved and such options were returned to the Company for cancellation.

The Company sells primarily through a network of unaffiliated distributors/sales agents. An entity that serves as an independent sales agent is owned by the spouse of Kenneth L. McCoy, an executive officer. The Company paid commissions on sales generated by this sales agent aggregating \$52,561 and \$251,982 for the years ended December 31, 2008 and 2007, respectively. As of December 31, 2008 and 2007, the Company had \$-0- and \$5,107, respectively, representing accrued and unpaid commissions due to this entity. Subsequent to December 31, 2007, this entity was dissolved and no longer serves as an independent sales agent for the Company.

OTHER MATTERS

The Board of Directors is not aware of any other matters to be presented for action at the Annual

Meeting. However, if any other matter is properly presented at the Annual Meeting, it is the intention of the persons named in the enclosed proxy to vote the shares they represent as the Board of Directors may recommend.

ADVANCE NOTICE PROVISIONS FOR STOCKHOLDER PROPOSALS AND NOMINATIONS

The bylaws of the Company provide that in order for a stockholder to nominate directors at an annual meeting or to propose business to be brought before an annual meeting, the stockholder must give timely, written notice to the Secretary of the Company and such notice must be received at the principal executive offices of the Company not less than 120 days before the date of its release of the proxy statement to stockholders in connection with its previous year's annual meeting of stockholders. Such stockholder's notice shall include, with respect to each matter that the stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the

annual meeting and the reasons for conducting such business at the annual meeting, and with respect to each person whom the stockholder proposes to nominate for election as a director, all information relating to such person, including such person's written consent to being named in the proxy statement as a nominee and to serving as a director, that is required under the Securities Exchange Act of 1934, as amended. In addition, the stockholder must include in such notice the name and address, as they appear on the Company's records, of the stockholder proposing such business or nominating such persons, and the name and address of the beneficial owner, if any, on

whose behalf the proposal or nomination is made, the class and number of shares of capital stock of the Company that are owned beneficially and of record by such stockholder of record and by the beneficial owner, if any, on whose behalf the proposal or nomination is made, and any material interest or relationship that such stockholder of record and/or the beneficial owner, if any, on whose behalf the proposal or nomination is made may respectively have in such business or with such nominee. At the request of the Board of Directors, any person nominated for election as a director shall furnish to the Secretary of the Company the information required to be set forth in a stockholder's notice of nomination which pertains to the nominee.

FUTURE PROPOSALS OF STOCKHOLDERS

The deadline for stockholders to submit proposals to be considered for inclusion in the proxy statement for the next Annual Meeting of Stockholders is November 18, 2009.

BY ORDER OF THE BOARD OF DIRECTORS

**Chairman of the Board, Chief Executive Officer
and President**

March 20, 2009
Overland Park, Kansas

DIGITAL ALLY, INC.

2009 STOCK OPTION AND RESTRICTED STOCK PLAN

1. PURPOSES.

(a) Background. This 2009 Stock Option and Restricted Stock Plan was adopted on March 9, 2009 by the Board of Directors, subject to the approval of the Company's stockholders. Options granted under the Plan prior to the stockholders' approval will be effective upon approval of the stockholders as of their respective dates of grant.

(b) Eligible Award Recipients. The persons eligible to receive Awards are the Employees and Directors of the Company and its Affiliates.

(c) Available Awards. The purpose of the Plan is to provide a means by which eligible recipients may be given an opportunity to benefit from increases in value of the Common Stock through the granting of the following: (i) Incentive Stock Options, (ii) Nonqualified Stock Options, (iii) rights to acquire restricted stock, and (iv) stock appreciation rights.

(d) General Purpose. The Company, by means of the Plan, seeks to retain the services of the group of persons eligible to receive Awards, to secure and retain the services of new members of this group and to provide incentives for such persons to exert maximum efforts for the success of the Company and its Affiliates.

2. DEFINITIONS.

(a) Affiliate means any entity that controls, is controlled by, or is under common control with the Company.

(b) Award means any right granted under the Plan, including an Option, a right to acquire restricted Common Stock, and a stock appreciation right.

(c) Award Agreement means a written agreement between the Company and a holder of an Award (other than an Option) evidencing the terms and conditions of an individual Award grant.

(d) Board means the board of directors of the Company.

(e) Code means the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder.

(f) Committee means a pre-existing or newly formed committee of members of the Board appointed by the Board in accordance with subsection 3(c).

(g) Common Stock means the shares of the Company's common stock par value \$0.001 and other rights with respect to such shares.

(h) Company means Digital Ally, Inc., a Nevada corporation.

(i) Continuous Service means that the Participant's service with the Company or an Affiliate, whether as an Employee or Director is not interrupted or terminated. Unless otherwise provided in an Award Agreement or Option Agreement, as applicable, the Participant's Continuous Service shall not be deemed to have terminated merely because of a change in the capacity in which the Participant renders service to the Company or an Affiliate as an Employee or

Director or a change in the entity for which the Participant renders such service, provided that there is no interruption or termination of the Participant's service to the Company or an Affiliate as an Employee or Director. The Board, in its sole discretion, may determine whether Continuous Service shall be considered interrupted in the case of any leave of absence, including sick leave, military leave or any other personal leave.

(j) **Covered Employee** means the Company's chief executive officer and the four (4) other highest compensated officers of the Company for whom total compensation is required to be reported to stockholders under the Exchange Act, as determined for purposes of Section 162(m) of the Code.

(k) **Director** means a member of the Board of the Company.

(l) **Disability** means the Participant's inability, due to illness, accident, injury, physical or mental incapacity or other disability, to carry out effectively the duties and obligations to the Company and its Affiliates performed by such person immediately prior to such disability for a period of at least six (6) months, as determined in the good faith judgment of the Board.

(m) **Dollars** or \$ means United States dollars.