

QRS MUSIC TECHNOLOGIES INC
Form 10QSB
May 15, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended **March 31, 2007**

☐ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from _____ to _____

Commission file number 0-31955

QRS Music Technologies, Inc.

(Exact name of small business issuer as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

36-3683315

(IRS Employer Identification No.)

2011 Seward Avenue, Naples, Florida 34109

(Address of principal executive offices)

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(239) 597 - 5888

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Check whether issuer (1) Filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 9,783,956

Transitional Small Business Disclosure Format (Check One): Yes ☐ No ☒

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SIGNATURE

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QRS Music Technologies, Inc.
Unaudited Consolidated Balance Sheets

	March 31, 2007	June 30, 2006
Assets		
Current assets		
Cash	\$ 374,871	\$ 56,466
Accounts receivable (net of allowance for doubtful accounts of \$299,000, and \$475,000 respectively)	711,828	1,538,860
Inventories	7,625,617	8,272,748
Income taxes refundable	211,000	0
Deferred income taxes	929,000	929,000
Prepaid expenses and other current assets	59,873	109,668
	9,912,189	10,906,742
Property, plant and equipment	1,277,962	1,206,569
Goodwill	60,000	60,000
Other intangible assets	783,147	844,893
Other assets	299,333	27,549
	\$ 12,332,631	\$ 13,045,753
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 88,961	\$ 86,472
Accounts payable (including \$183,107 and \$123,296 due to related parties)	998,197	1,672,298
Accrued expenses	557,844	548,753
Note payable to stockholder	415,309	250,000
Income taxes payable	0	17,000
	2,060,311	2,574,523
Long-term debt	610,582	677,617
Commitments and contingencies		
Stockholders' equity		
Series A preferred stock, voting, \$.01 par value, 2,000,000 shares authorized, 534,925 shares issued and outstanding, liquidation value of \$2,524,850 and \$2,428,562, respectively.	5,349	5,349
Common stock, voting, \$.01 par value, 40,000,000 shares authorized, 9,783,956 and 9,658,956 shares issued and outstanding during 2007 and 2006 respectively.	97,840	96,590
Additional paid-in capital	5,488,075	5,358,075
Retained earnings	4,070,474	4,333,599
	9,661,738	9,793,613
	\$ 12,332,631	\$ 13,045,753

See accompanying notes

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QRS Music Technologies, Inc.
Unaudited Consolidated Statements of Operations
Three Months Ended March 31, 2007 and 2006

	March 31, 2007	March 31, 2006
Net sales	\$ 3,274,193	\$ 4,465,173
Cost of sales	2,307,511	2,730,047
Gross profit	966,682	1,735,126
Operating expenses		
Selling, general and administrative	1,135,068	1,594,314
Research and development	168,089	171,487
	1,303,157	1,765,801
Loss from operations	(336,475)	(30,675)
Interest expense	12,491	19,504
Loss before income taxes	(348,966)	(50,179)
Income tax benefit		
Federal	(106,000)	(19,000)
State	(18,000)	0
	(124,000)	(19,000)
Net loss	(224,966)	(31,179)
Less current period preferred stock dividends in arrears	(32,096)	(32,096)
Loss available to common stockholders	\$ (257,062)	\$ (63,275)
Loss per common share		
Basic	\$ (.03)	\$ (.01)
Assuming dilution	\$ (.03)	\$ (.01)
Weighted average number of common shares outstanding		
Basic	9,702,012	9,554,512
Assuming dilution	9,702,012	9,554,512

See accompanying notes

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QRS Music Technologies, Inc.
Unaudited Consolidated Statements of Operations
Nine months Ended March 31, 2007 and 2006

	March 31, 2007	March 31, 2006
Net sales	\$ 11,885,315	\$ 14,154,689
Cost of sales	8,536,008	9,276,930
Gross profit	3,349,307	4,877,759
Operating expenses		
Selling, general and administrative	3,332,133	3,582,617
Research and development	385,338	661,045
	3,717,471	4,243,662
Income (loss) from operations	(368,164)	634,097
Interest expense	33,961	29,606
Income (loss) before income taxes	(402,125)	604,491
Income tax expense (benefit)		
Federal	(119,000)	219,000
State	(20,000)	0
	(139,000)	219,000
Net income (loss)	(263,125)	385,491
Less current period preferred stock dividends in arrears	(96,288)	(96,288)
Income (loss) available to common stockholders	\$ (359,413)	\$ 289,203
Income (loss) per common share		
Basic	\$ (.04)	\$.03
Assuming dilution	\$ (.04)	\$.03
Weighted average number of common shares outstanding		
Basic	9,673,098	9,490,343
Assuming dilution	9,673,098	9,559,474

See accompanying notes

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QRS Music Technologies, Inc.
Unaudited Consolidated Statements of Cash Flows
Nine months Ended March 31, 2007 and 2006

	2007 (Unaudited)	2006 (Unaudited)
Operating activities		
Net income (loss)	\$ (263,125)	\$ 385,491
Depreciation and amortization	178,534	105,100
Provision for bad debt (recoveries)	(169,850)	151,025
Share based payments	131,250	0
Changes in		
Accounts receivable	996,882	(669,890)
Inventories	647,131	(303,168)
Income taxes refundable	(228,000)	49,000
Prepaid expenses and other current assets	49,795	7,195
Other assets	(284,760)	(29,659)
Accounts payable	(674,101)	(120,482)
Accrued expenses	9,092	12,371
Net cash provided by (used in) operating activities	399,329	(413,017)
Investing activities		
Acquisitions of property and equipment	(181,686)	(104,939)
Net cash (used in) investing activities	(181,686)	(104,939)
Financing activities		
Repayments of long term debt lending institution	0	(108,834)
Proceeds from exercise of stock options	0	200,000
Repayments of long term debt	(64,547)	(70,200)
Proceeds from stockholder loan	165,309	0
Net cash provided by financing activities	100,762	20,966
Increase (decrease) in cash	318,405	(496,990)
Cash		
Beginning of period	56,466	603,004
End of period	\$ 374,871	\$ 106,014
Supplemental disclosure of cash flow information		
Interest paid	\$ 33,961	\$ 19,504
Income taxes paid	\$ 89,000	\$ 170,000

See accompanying notes

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QRS Music Technologies, Inc. Notes to Condensed Financial Statements (Unaudited)

Note 1 Unaudited Interim Financial Statements

Interim condensed financial statements are prepared pursuant to the requirements for reporting on Form 10-QSB. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with US generally accepted accounting principles are omitted. For additional disclosures, see Notes to Consolidated Financial Statements contained in QRS Music Technologies, Inc. Annual Report on Form 10-KSB for the year ended June 30, 2006.

In the opinion of management of the Company, all adjustments, consisting solely of normal recurring adjustments, necessary for the fair presentation of the consolidated financial statements for these interim periods have been included. The current period's results of operations are not necessarily indicative of results which ultimately may be achieved for the year.

Note 2 Inventories

Inventories at March 31, 2007 and June 30, 2006 consisted of:

	March 31, 2007	June 30, 2006
Raw materials	\$ 5,350,161	\$ 5,138,868
Finished goods	3,067,456	3,904,261
	8,417,617	9,043,129
Valuation reserve	(792,000)	(770,381)
	\$ 7,625,617	\$ 8,272,748

Note 3 Dividends in arrears

Cumulative dividends in arrears on the Series A preferred stock amounted to \$385,150 at March 31, 2007.

Note 4 Earnings Per Share

The Company computes earnings per share (EPS) under Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share. Basic net earnings less preferred dividends are divided by the weighted average number of common shares outstanding during the year to calculate basic net earnings per common share. Diluted net earnings per common share are calculated to give effect to the potential dilution that could occur if convertible preferred stock, warrants, options or other contracts to issue common stock were exercised and resulted in the issuance of additional common shares.

The three month computation of basic and diluted EPS was as follows:

	March 31, 2007	March 31, 2006
Numerator		
Net (loss)	\$ (224,966)	\$ (31,179)
Preferred stock dividends in arrears	(32,096)	(32,096)
(Loss) available to common stockholders	\$ (257,062)	\$ (63,275)
Denominator		
Basic weighted average shares outstanding	9,702,012	9,554,512
Weighted average shares outstanding for options	0	0
Diluted weighted average shares outstanding	9,702,012	9,554,512
Basic net (loss) per share	\$ (.03)	\$ (.01)
Diluted net (loss) per share	\$ (.03)	\$ (.01)

In 2007 and 2006, 534,925 weighted average common shares from the conversion of convertible preferred stock were not included in the computation because they were antidilutive.

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The nine month computation of basic and diluted EPS was as follows:

	March 31, 2007	March 31, 2006
Numerator		
Net income (loss)	\$ (263,125)	\$ 385,491
Preferred stock dividends in arrears	(96,288)	(96,288)
Income (loss) available to common stockholders	\$ (359,413)	\$ 289,203
Denominator		
Basic weighted average shares outstanding	9,673,098	9,490,343
Weighted average shares outstanding for options	0	69,131
Diluted weighted average shares outstanding	9,673,098	9,559,474
Basic net income (loss) per share		
	\$ (.04)	\$.03
Diluted net income (loss) per share		
	\$ (.04)	\$.03

In 2006 and 2005, 534,925 weighted average common shares from the conversion of convertible preferred stock were not included in the computation because they were antidilutive.

Note 5 Share-based Payments

Effective July 1, 2005, the Company adopted the Statement of Financial Accounting Standards Board (SFAS) No. 123 (revised 2004),

Share-Based Payment (SFAS No. 123R). SFAS No. 123R requires entities to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions).

Compensation expense is recognized only for share-based payments. The fair value of these stock awards is based on the fair value of the Company's stock on the date of grant. The Company recognizes compensation expense on a straight-line basis.

Stock Grants

During the three months ended March 31, 2007, 50,000 shares of Common Stock were issued to employees as compared to 0 shares for the same period in 2006. For the quarter ended March 31, 2007, 75,000 shares were granted to outside directors, compared to zero for the same period in 2006. All shares granted vested immediately and the Company recognized share-based payments expense of \$131,250 for the quarter ended March 31, 2007.

Note 6 Notes Payable

During the year ended June 30, 2005 the Company borrowed \$500,000 from its major stockholder. That debt is evidenced by an unsecured demand note which bears interest at 6 per cent per annum. During the year ended June 30, 2006, the Company made a principal payment of \$250,000, leaving a principal balance due of \$250,000. Interest in the amount of \$3,690 has been accrued for each of the quarters ended March 31, 2007 and 2006. For the nine months ended March 31, 2007 and 2006 interest expense in the amount of \$11,260 was accrued.

During the quarter ended March 31, 2007 the majority stockholder paid down an obligation owed to a Chinese supplier. In exchange for that payment the Company issued a demand note to the majority stockholder in the amount of \$165,309. which bears interest at a rate of 6 per cent per annum. Interest in the amount of \$2,150 has been accrued for the quarter ended March 31, 2007.

During the third quarter of Fiscal 2006, the Company acquired software and intellectual assets from an unrelated party for \$855,403. The Company issued a note to the seller in that amount in consideration for the assets and software. The note, payable in quarterly installments equal to \$28,571 including interest at a rate of 3.8% is due no later than January 1, 2014 and is secured by assets of the Company equal to the outstanding balance of the loan. During the quarter ended March 2007 the Company made an interest payment to the note holder in the amount of \$6,646. The remaining principal balance on March 31, 2007 was \$699,543.

Note 7 Commitments and Contingencies

The Company is a party to various claims, legal actions and complaints arising in the ordinary course of business. In the opinion of management, all such matters are adequately covered by insurance, or if not so covered, are without merit or are of such kind or involve such amounts that

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unfavorable disposition would not have a material effect on the Company's financial position, results of operation or liquidity.

Note 8 Future Commitments

As reported in a Form 8K filed on February 13, 2006, the Company signed a letter of intent on February 10, 2006 to pursue discussions regarding possible acquisition of another company.

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Item 2.

Management's Discussion and Analysis or Plan of Operation

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS.

Certain statements in this Form 10-QSB constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: the effects of the changes in Homeland Security policies, specifically relating to the effects on international and domestic transportation of goods, the state of the economy; the financial condition of major OEM's; competition; seasonality; success of operating initiatives; new product development and introduction schedules; acceptance of new product offerings; advertising and promotional efforts; adverse publicity; changes in business strategy or development plans; availability and terms of capital; labor and employee benefit costs; changes in government regulations; uncertainty regarding economic recovery of the United States and international economies in general and consumer spending in particular, and other factors particular to the Company.

GENERAL.

The Company's fiscal year ends each June 30, and the fiscal years ended June 30, 2007, June 30, 2006 are referred to as fiscal 2007, fiscal 2006, respectively.

The Company is a Delaware Corporation and is a manufacturer and distributor of pianos, pianomation units, and music for electronic player systems (in a variety of forms) and music rolls for use in player pianos. The Company has two wholly owned subsidiaries, one in Hong Kong and one in Australia. All statements made encompass the main Company and its two subsidiaries. The Company sells its products to dealers and end-users, predominately in the United States and has offices in New York, Pennsylvania, Florida and Nevada. In addition, the Company leases space in Hong Kong.

THREE MONTHS ENDED MARCH 31, 2007 COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2006.

SALES. Total sales decreased 26.7% from \$4.47 million in the third three months of fiscal 2006 to \$3.27 million in the third three months of fiscal 2007. Sales of the Company's line of pianos decreased by 44.6% or approximately \$970,000 while sales of the Company's line of technology products increased by 3.9% or approximately \$67,000. The Company believes decreased piano sales were the result of a general decline in purchases of pianos by the marketplace. The increase in the sales of the technology category is primarily due to an increase in the number of technology products offered for sale. As new and unique products complete the research and development cycle, they are introduced into the Company's current line of technology products. Sales of these items, such as the Optiscan, have increased the revenues generated from this product line. A price increase went into effect prior to the beginning of the quarter, and also served to increase technology revenues. In an effort to increase its piano and technology sales, the Company has introduced a sales initiative to its dealer base to assist them in promoting and selling the Company product line to consumers. The expenses related to these initiatives are included in the Company's selling, general and administrative expenses. Those dealers who have adopted the sales concept are enthusiastic and the Company is planning a second phase of the initiative to give dealers additional support in selling the products.

COSTS AND EXPENSES. Total cost of sales decreased 15.5% from \$2.73 million in the third three months of fiscal 2006 to \$2.31 million in the third three months of fiscal 2007. As a percentage of sales, cost of sales increased 9.3 percentage points as a result the lower demand for the product, while the fixed costs remained constant. In an effort to reduce those fixed costs, the Company is undertaking a realignment and reduction in its labor force during the fourth quarter. The Company is also pursuing alternative and more cost-effective supplier initiatives to further reduce product costs.

Selling, general and administrative expenses decreased 28.8% from \$1.59 million in fiscal 2006 to \$1.14 million in fiscal 2007. The decrease is related to lower delivery expenses resulting from lower sales, a decrease in the retirement plan contribution on behalf of the employees, a decrease in bad debt expense, and a decrease in promotional expenditures. Last fiscal year the Company printed a Pianomation Software catalog, which they did not do this quarter of fiscal 2007.

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Research and development costs decreased 2.0% for the quarter from \$171,000 in the quarter ended March 2006 to \$168,000 for the quarter ended March 2007. The slight decrease is a result of maintaining similar resources and number of projects in each of the respective quarters. One product (the DH200, Digital Hymnal Player) entered the production phase during the quarter ended March 31, 2007 and required less outside resources as it neared its release date.

INTEREST EXPENSE, NET. Net interest expense decreased 36.0% from \$19,500 in the third three months of fiscal 2006 to \$12,500 in the

third three months of fiscal 2007. The decrease is due to a decrease in outside debt.

PROVISION FOR INCOME TAXES. The Company accrued a provision (benefit) for federal and state income taxes at an effective rate of 35.5% for fiscal 2007 and 37.9% for fiscal 2006.

NET INCOME. Net income decreased 621.5% from a loss of \$32,000 for the three month period ended March 31, 2006 to a loss of \$225,000 for the three month period ended March 31, 2007 as a result of the above mentioned variances.

NINE MONTHS ENDED MARCH 31, 2007 COMPARED TO THE NINE MONTHS ENDED MARCH 31, 2006.

SALES. Total sales decreased 16.0% from \$14.15 million in the first nine months of fiscal 2006 to \$11.89 million in the first nine months of fiscal 2007. The Company's piano sales decreased by 44.6% or approximately \$3.16 million, while its technology product line increased by 9.8% or approximately \$552,000. The Company believes decreased piano sales were the result of a general decline in purchases of pianos by the marketplace. The increase in technology sales is largely due to an increase of offerings in the product line, and a price increase that went into effect during the second quarter. In an effort to increase both piano and technology sales, the Company has introduced several sales initiatives to its dealer base to assist them in promoting and selling the Company product line to consumers. The offering of these initiatives began late during fiscal year 2006, and has continued for the nine months of fiscal 2007. The expenses related to these initiatives are included in the Company's selling, general and administrative expenses. The largest of the initiatives requires the dealer to make several commitments to the product line, some initially and some on an ongoing basis. The effects of the initial commitments adopted by the dealer base have been experienced during the first six months of fiscal 2007, with a decrease of response in the quarter ended March 2007.

COSTS AND EXPENSES. Total cost of sales decreased 8.0% from \$9.28 million in the first nine months of fiscal 2006 to \$8.54 million in the first nine months of fiscal 2007. As a percentage of sales, cost of sales increased 6.3 percentage points as a result of the mix of products that were sold, and a higher than average overhead burden as a result of the decreased demand. In an effort to increase sales, several promotions were offered during the quarter that decreased the dollars gained from sales, while the cost of the goods remained the same, overall decreasing the gross margin on those sales.

Selling, general and administrative expenses decreased 7.0% from \$3.58 million in fiscal 2006 to \$3.33 million in fiscal 2007. The decreases in bad debt expenses, administrative salary expenses, delivery expenses and retirement plan contributions were offset by increases in tradeshow expenses, sales expenses and expenses related to the Board of Directors. Management is taking positive long and short term initiatives to further reduce selling and administrative expenses. A portion of those initiatives includes restructuring of the management of the sales department.

Research and development costs decreased 41.7% for the period from \$661,000 in the period ended March 2006 to \$385,000 for the period ended March 2007. Less outside resources were required as the DH200 (Digital Hymnal Player) entered production, and several other products neared completion.

INTEREST EXPENSE, NET. Net interest expense increased 14.7% from \$29,600 in the first nine months of fiscal 2006 to \$34,000 in the first nine months of fiscal 2007. The increase is due to the additional interest expense from the note payable entered into during fiscal 2006.

PROVISION FOR INCOME TAXES. The Company accrued a provision (benefit) for federal and state income taxes at an effective rate of 34.6% for fiscal 2007 and 36.2% for fiscal 2006.

NET INCOME. Net income decreased 168.3% from a \$385,500 profit for the nine month period ended March 31, 2006 to a loss of \$263,000 for the nine month period ended March 31, 2007 as a result of the above mentioned variances.

LIQUIDITY AND CAPITAL RESOURCES.

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The primary sources of Company's cash are net cash flows from operating activities, short-term vendor financing, and additional borrowings. Currently, the Company does not have available any established lines of credit with banking facilities.

The Company's cash was \$375,000 and \$56,000 at March 31, 2007 and June 30, 2006, respectively. Cash increased from June 30, 2006 to March 31, 2007 primarily as a result of a decreases in inventory and accounts receivable and borrowing funds from its majority stockholder

During the fiscal year ended June 2005, the Company borrowed \$500,000 from its majority stockholder pursuant to a 6% demand note. The Company has since made a partial payment of principal against the note of \$250,000, and continues to accrue interest for the note.

During the quarter ended March 31, 2007 the majority stockholder paid down an obligation owed to a Chinese supplier. In exchange for that payment the Company issued a demand note to the majority stockholder in the amount of \$165,309 bearing interest at 6 per cent per annum.

During the fiscal year ended June 2006, the Company issued a note payable to an individual in exchange for the purchase of intellectual property (technology and copyrights). That note is payable in quarterly payments of \$28,571 plus accrued interest at 3.8%, due in full by January 1, 2014 and secured by assets of the Company equal to the remaining balance of the loan.

As the Company disclosed in its Form 8K filed on February 14, 2006 it is currently investigating an acquisition of National Educational Music Company (NEMC). Should that acquisition occur, the Company anticipates that it would be, in part, financed through debt. At this time the Company has identified several possible sources and possible terms of that debt. There are no other major capital expenditures planned for in the foreseeable future, nor any payments planned for off-balance sheet obligations. Except as stated above, the Company's management is not aware of any known trends or demands, commitments, events, or uncertainties, as they relate to liquidity which could negatively affect the Company's ability to operate and grow as planned.

Recently Issued Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes and interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is applicable beginning July 1, 2007. The Company has not yet determined the impact, if any, that may result from the adoption of FIN No. 48.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, (SFAS 157). SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. The statement provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. SFAS 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. The adoption of SFAS 157 is effective for the company beginning July 1, 2007. The Company does not expect the adoption of SFAS 157 will have a material impact on its financial condition, results of operations and cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 requires registrants to apply the new guidance for the first time that it identifies material errors in existence at the beginning of the first fiscal year ending after November 15, 2006 by correcting those errors through a one-time cumulative effect adjustment to beginning-of-year retained earnings. The Company is currently evaluating SAB 108 and has not yet determined the impact on its results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g. debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for the Company on July 1, 2007. The Company is currently determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS 159 will have on its financial condition, results of operations and cash flows.

Item 3. **Controls and Procedures**

Evaluation of Disclosure Controls and Procedures and Changes in Internal Control over Financial Reporting

The Company is currently in the process of updating and refining its internal communication and computer system in order to continue to address ongoing changing regulations and past deficiencies. With the deployment of the new communication and computer system new procedures and process flows are also being deployed and refined to further insure the accuracy and timeliness of financial reporting.

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During the year end audit process for fiscal year 2006, the Company's independent auditors noted a material weakness involving the Company's internal controls and operations, primarily relating to the year end close procedure. The Company has increased the frequency of its internal financial reviews, and has changed some closing procedures to a monthly rather than quarterly basis. The Company continues to address this issue and is committed to further improving its quarterly and year end close procedure. The Company is in the process of reorganizing the responsibilities in the accounting department to further ensure timely recording of all entries

The Company is committed to ongoing periodic reviews of its controls and their effectiveness. Controls have improved and management has no reason to believe that the financial statements included in this report are not fairly stated in all material respects. Management believes its practices

and procedures, although not as mature or as formal as management intends them to be in the future, are adequate under the circumstances, and that there are no material inaccuracies or omissions in this Form.

PART II OTHER INFORMATION

Item 6. Exhibits

a. Exhibit Index

31.1 Certifications (of Chief Financial Officer)

31.2 Certifications (of Chief Executive Officer)

32.1 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

32.2 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350

SIGNATURE

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

QRS Music Technologies, Inc.

Date 5/15/07

/s/ Ann A. Jones
Ann A. Jones, Chief Financial Officer