DALRADA FINANCIAL CORP
Form 10QSB
May 24, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2005

or

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

Commission file No. 0-12641

DALRADA FINANCIAL CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	33-0021693
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(IRS EMPLOYER ID NO.)

9449 BALBOA AVENUE, SUITE 211
SAN DIEGO, CA 92123
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

Registrant's telephone number, including area code: (858) 277-5300

N/A
(FORMER NAME AND ADDRESS, IF CHANGED SINCE LAST REPORT)

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 [X] No [ ]

The number of shares outstanding of the registrant's common stock as of May 16, 2005 was 682,396,197.

Transitional Small Business Disclosure Format (check one): Yes [ ] No [X]

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PART I. - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
(formerly Imaging Technologies Corporation)
CONSOLIDATED BALANCE SHEET
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

	MARCH 31, 2005 (unaudited)
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 295
Accounts receivable, net of allowance of $96	1,139
Inventories, net of reserve of $15	--
Prepaid expenses and other current assets	761
TOTAL CURRENT ASSETS	2,195
PATENT, net of accumulated amortization of $270	1,348
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $2,021	267
TOTAL ASSETS	$ 3,810

LIABILITIES AND STOCKHOLDERS' DEFICIT

CURRENT LIABILITIES	
Borrowings under bank notes payable	$ 3,220
Lines of credit	209
Notes payable, current portion (including related party note of $1,561)	2,113
Convertible debentures, net of discount of $5	809
Accounts payable	805
Obligations under capital lease	10
PEO payroll taxes and other payroll deductions	6,723
Other accrued expenses	10,419
TOTAL CURRENT LIABILITIES	24,308
CONVERTIBLE DEBENTURES, net of current portion and net of discounts of $198	163
NOTES PAYABLE, net of current portion (including related party note of $282)	500
CAPITAL LEASE, net of current portion	44
TOTAL LIABILITIES	25,015
MINORITY INTEREST	--
COMMITMENTS AND CONTINGENCIES	--
STOCKHOLDERS' DEFICIT	
Series A convertible, redeemable preferred stock, $1,000 par value, 7,500 shares authorized 420.5 shares issued and outstanding	420
Common stock; $0.005 par value; 1,000,000,000 shares authorized; 682,396,197 shares issued and outstanding	3,412
Common stock warrants	475
Additional paid-in capital	82,823
Accumulated deficit	(108,335)
TOTAL STOCKHOLDERS' DEFICIT	(21,205)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 3,810

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

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
(formerly Imaging Technologies Corporation)
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE AND NINE MONTHS ENDED MARCH 31, 2005 AND 2004
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED		
	MARCH 31, 2005	MARCH 31, 2004	3
	(unaudited)	(unaudited)	(u
REVENUES			
Sales of products	$ 137	$ 91	$
Software sales, licenses and royalties	9	30	
Temporary staffing services	4,095	2,892	
PEO Services	1,208	475	
TOTAL REVENUES	5,449	3,488	
COST OF REVENUES			
Cost of products sold	23	28	
Cost of software sales, licenses and royalties	1	--	
Cost of temporary staffing	3,591	2,663	
Cost of PEO services	1,088	384	
TOTAL COST OF REVENUES	4,703	3,075	
GROSS PROFIT	746	413	
OPERATING EXPENSES			
Selling, general and administrative	904	(71)	
Research and development	--	--	
TOTAL OPERATING EXPENSES	904	(71)	
INCOME (LOSS) FROM OPERATIONS	(158)	484	
OTHER INCOME (EXPENSES):			
Interest and financing costs, net	(394)	(434)	
Gain on extinguishment of debt	165	228	
Gain resulting from reconciliation of payroll tax liabilities to taxing authorities	454	--	
Other, net	--	1	
TOTAL OTHER INCOME (EXPENSE)	225	(205)	
INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES AND DISCONTINUED OPERATIONS	67	279	
PROVISION FOR INCOME TAXES	--	--	
NET INCOME (LOSS) FROM CONTINUING OPERATIONS	67	279	
DISCONTINUED OPERATON:			
Gain on disposition of discontinued operations	--	5,049	
Loss from operations of discontinued operation	--	(693)	

	--	4,356	
NET INCOME (LOSS)	67	4,635	
PREFERRED STOCK DIVIDENDS	(5)	(5)	
NET INCOME (LOSS) ATTRIBUTED TO COMMON STOCKHOLDERS	$ 62	$ 4,630	$
NET INCOME (LOSS) PER SHARE - BASIC			
Continuing operations	$ 0.00	$ 0.00	$
Discontinued operations	--	0.01	
	$ 0.00	$ 0.01	$
WEIGHTED AVERAGE COMMON EQUIVALENT SHARES OUSTANDING - BASIC	682,396	348,926	

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
(formerly Imaging Technologies Corporation)
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED MARCH 31, 2005 AND 2004
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

	NINE
	MARCH 31, 2005
	(unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss from continuing operations	$ (65
Adjustment to reconcile net loss to net cash used in operating activities	
Depreciation and amortization	13
Stock issued for services	4
Amortization of debt discounts	30
Gain on forgiveness of inter-company debt from Greenland	-
Gain resulting from reconciliation of payroll tax liabilities to taxing authorities	(99
Changes in operating assets and liabilities:	
(Increase) decrease in:	
Accounts receivable	(55
Prepaid expenses and other current assets	(31
Other assets	-
Increase (decrease) in:	

Accounts payable and accrued expenses	(70
PEO liabilities	2,56
Net cash provided by (used in) operating activities from continuing operations	(18
Net cash used in operating activities from discontinued operations	-
Net cash used in operating activities	(18
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of furniture and equipment	(14
Net cash used in investing activities from continuing operations	(14
Net cash used in investing activities from discontinued operations	-
Net cash used in investing activities	(14
CASH FLOWS FROM FINANCING ACTIVITIES:	
Change in cash overdraft, net	-
Line of credit, net	20
Net borrowings under bank notes payable	-
Proceeds from sale of common stock	-
Proceeds from convertible debentures	-
Proceeds from notes payable	33
Repayments of notes payable	(12
Repayments of capital lease obligations	(1
Net cash provided by (used in) financing activities from continuing operations	40
Net cash used in financing activities from discontinued operations	-
Net cash provided by (used in) investing activities	40
NET DECREASE IN CASH AND CASH EQUIVALENTS	6
CASH AND CASH EQUIVALENTS, Beginning of period	22
CASH AND CASH EQUIVALENTS, End of period	$ 29

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

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
(formerly Imaging Technologies Corporation)
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
NINE MONTHS ENDED MARCH 31, 2005 AND 2004
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

NON-CASH INVESTING AND FINANCING ACTIVITIES

During the nine months ended March 31, 2005, the Company issued: (1) 8,623,110 shares of its common stock for services valued at $42; (2) 20,880,130 shares of its common stock for debt of $38; (3) 62,534,215 shares of its common stock for penalties of $94; and (4) 38,000,000 shares of its common stock for the conversion of convertible debentures in the amount of $175.

During the nine months ended March 31, 2004, the Company issued: (1) 7,445,000 shares of its common stock for services valued at $160,150; (2) 10,272,110 shares of its common stock for compensation valued at $140,332; (3) 25,297,220 shares of its common stock for debt of $471,542; and (4) 141,204,581 shares of its common stock for the conversion of convertible debentures in the amount of $1,342,464.

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
(formerly Imaging Technologies Corporation)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Dalrada Financial Corporation and Subsidiaries (the "Company" or "DRDF") have been prepared pursuant to the rules of the Securities and Exchange Commission (the "SEC") for quarterly reports on Form 10-QSB and do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America. These financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the periods presented. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the years ended June 30, 2004 included in the Company's annual report on Form 10-KSB filed with the SEC. Interim operating results are not necessarily indicative of operating results for any future interim period or for the full year. The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All inter-company transactions have been eliminated.

RECLASSIFICATIONS

Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

Comprehensive Income

The Company has adopted SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. During the nine months ended March 31, 2005 and 2004, the Company had no elements of comprehensive income.

NOTE 2. GOING CONCERN CONSIDERATIONS

The accompanying unaudited consolidated financial statements have been prepared assuming that the Company will continue as a going concern. For the nine months ended March 31, 2005, the Company had a net loss of $658. As of March 31, 2005, the Company had a negative working capital deficiency of $22,113 and had a stockholders' deficit of $21,205. In addition, the Company is in default on certain note payable obligations, is being sued by numerous trade creditors for nonpayment of amounts due and is late on its filings of payroll tax returns in certain of its PEO division. The Company is also deficient in its payments relating to payroll tax liabilities. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company must obtain additional funds to provide adequate working capital and finance operations. However, there can be no assurance that the Company will be able to complete any additional debt or equity financings on favorable terms or at all, or that any such financings, if completed, will be adequate to meet the Company's capital requirements including compliance with the Imperial Bank settlement agreement. Any additional equity or convertible debt financings could result in substantial dilution to the Company's stockholders. If adequate funds are not available, the Company may be required to delay, reduce or eliminate some or all of its planned activities, including any potential mergers or acquisitions. The Company's inability to fund its capital requirements would have a material adverse effect on the Company. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 3. STOCK BASED COMPENSATION

The Company accounts for employee stock options in accordance with Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees". Under APB 25, the Company does not recognize compensation expense related to options issued under the Company's employee stock option plans, unless the option is granted at a price below market price on the date of grant. In 1996, SFAS No. 123 "Accounting for Stock-Based Compensation", became effective for the Company. SFAS No. 123, which prescribes the recognition of compensation expense based on the fair value of options on the grant date, allows companies to continue applying APB 25 if certain pro forma disclosures are made assuming hypothetical fair value method, for which the Company uses the Black-Scholes option-pricing model.

For non-employee stock based compensation, the Company recognizes an expense in accordance with SFAS No. 123 and values the equity securities based on the fair value of the security on the date of grant. For stock-based awards, the value is based on the market value for the stock on the date of grant and if the stock has restrictions as to transferability, a discount is provided for lack of tradability. Stock option awards are valued using the Black-Scholes option-pricing model.

The Company applies Accounting Principles Board Opinion No. 25 and related Interpretations in accounting for its stock option plans. The Company has opted under SFAS No. 123 to disclose its stock-based compensation with no financial effect. The pro forma effects of applying SFAS No. 123 in this initial phase-in period are not necessarily representative of the effects on reported net income or loss for future years. Had compensation expense for the Company's stock option plans been determined based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed under SFAS No. 123, the Company's pro forma net loss and net loss per share would have been as follows for the nine months ended March 31, 2005 and 2004:

(In thousands, except share amounts)	2004	2003
Net loss attributed to common stockholders		
As reported	$ (673)	$ (163)
Compensation recognized under APB No. 25	--	--
Compensation recognized under SFAS No. 123	--	(825)
Pro forma	$ (673)	$ (988)
Basic earnings (loss) per share		
As reported	$ (0.00)	$ (0.00)
Pro forma	$ (0.00)	$ (0.03)

This option valuation model requires input of highly subjective assumptions. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing model does not necessarily provide a reliable single measure of fair value of its employee stock options.

The weighted average fair value of the options granted during fiscal years 2004 and 2003 is estimated on the date of grant using the Black-Scholes option-pricing model. All options granted in fiscal years 2004 and 2003 vested immediately. The weighted average fair values and weighted average assumptions used in calculating the fair values were as follows for the years ended June 30:

	2004	2003
Fair Value of options granted	N/A	$ 0.015
Risk free interest rate	N/A	3.5%
Expected life (years)	N/A	3
Expected volatility	N/A	421%
Expected dividends	N/A	0%

No options have been issued during fiscal year 2005.

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NOTE 4. EARNINGS (LOSS) PER COMMON SHARE

The Company reports earnings (loss) per share in accordance with SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share are computed by dividing income (loss) available to common stockholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Diluted earnings (loss) per share have not been presented since the effect of the assumed conversion of options and warrants to purchase common shares would have an anti-dilutive effect. The following potential common shares have been excluded from the computation of diluted net loss per share for the nine months ended March 31, 2005: warrants - 26,563,435 and stock options - 39,150,000.

Below is a computation of earnings per share for the three months ended March 31, 2004. Basic and diluted loss per share are the same for the nine months ended March 31, 2004 and the three and nine months ended March 31, 2005:

	THREE MONTHS ENDED MARCH			
	2005			
	INCOME/ (LOSS)	SHARES	PER SHARE	INCOM (LOS
BASIC EARNINGS (LOSS) PER SHARE				
Net income (loss) from continuing operations	$ 67			$
Preferred stock dividends	(5)			
	62			
Discontinued operations	--			4,
Net income (loss) attributed to common stockholders	$ 62			$ 4,
Weighed shares outstanding		682,396		
Continuing operations			$ 0.00	
Discontinued operations			$ --	
			$ 0.00	
DILUTED EARNINGS (LOSS) PER SHARE				
Net income (loss) from continuing operations	$ 67			$
Preferred stock dividends	(5)			
Interest on convertible debentures	25			
Amortization of discounts on convertible debentures	41			
	128			
Discontinued operations	--			4,
Net income (loss) attributed to common stockholders	$ 128			$ 4,
Weighed shares outstanding		682,396		
Conversion of convertible debentures into common stock		729,689		

		1,412,085	
Continuing operations			$ 0.00
Discontinued operations			$ --
			$ 0.00

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	NINE MONTHS ENDED MARCH			
	2005			
	INCOME/ (LOSS)	SHARES	PER SHARE	INCOM (LOS
BASIC EARNINGS (LOSS) PER SHARE				
Net income (loss) from continuing operations	$ (658)			$ (3,
Preferred stock dividends	(15)			
	(673)			(3,
Discontinued operations	--			2,
Net income (loss) attributed to common stockholders	$ (673)			$ (
Weighed shares outstanding		635,914		
Continuing operations			$ (0.00)	
Discontinued operations			$ --	
			$ (0.00)	

DILUTED EARNINGS (LOSS) PER SHARE -- N/A

NOTE 5. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued SFAS No. 151, entitled INVENTORY COSTS -- AN AMENDMENT OF ARB NO. 43, CHAPTER 4. SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, entitled INVENTORY PRICING [June 1953], to clarify the accounting for "abnormal amounts" of idle facility expense, freight, handling costs, and wasted material [spoilage]. Before revision by SFAS No. 151, the guidance that existed in ARB No. 43 stipulated that these type items may be "so abnormal" that the appropriate accounting treatment would be to expense these costs as incurred [i.e., these costs would be current-period charges]. SFAS No. 151 requires that these type items be recognized as current-period charges WITHOUT REGARD to

whether the "so abnormal" criterion has been met. Additionally, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of SFAS 151 did not impact the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 152, entitled ACCOUNTING FOR REAL ESTATE TIME-SHARING TRANSACTIONS -- AN AMENDMENT OF FASB STATEMENTS NO. 66 AND 67. SFAS No. 152 amends SFAS No. 66 to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position 04-2. SFAS No. 152 also amends SFAS No. 67 to state that the guidance for (a) incidental operations and (b) costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance of SOP 04-2. This statement is effective for financial statements for fiscal years beginning after June 15, 2005. The adoption of SFAS 152 did not impact the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, entitled EXCHANGES OF NONMONETARY ASSETS -- AN AMENDMENT OF APB OPINION No.29. SFAS No. 153 amends Opinion 29 to eliminate the exception for nonmonetary exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The adoption of SFAS 153 did not impact the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123 (Revised), entitled SHARE-BASED PAYMENT. This revised Statement eliminates the alternative to use APB Opinion No. 25's intrinsic value method of accounting that was provided in SFAS No. 123 as originally issued. Under Opinion 25, issuing stock options to employees generally resulted in recognition of no compensation cost. This Statement requires entities to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards. For public companies that file as a small business issuer, this Statement is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of SFAS 123 (Revised) will impact the consolidated financial statements as the Company in the future if it continues to issue equity instruments to employees.

NOTE 6. FACTORING LINES OF CREDIT

The Company's temporary staffing division entered into a factoring agreement that expires in January 2007 and in renewable for successive periods of 12 months assuming certain conditions are met. The agreement provides for the Company to sell to the factor accounts receivables at a discount of approximately 2% for each 30 day period the balances remain unpaid.

NOTE 7. CONVERTIBLE NOTES PAYABLE

Listed below is a roll-forward schedule of the convertible debentures:

(In Thousands)		
Balance at June 30, 2004	$	871
Issuance of convertible debentures during the nine months		

ended March 31, 2005	--
Increase in debt discount and beneficial conversion feature	--
Converted into common stock	(175)
Amortization of value of warrants and preferential conversion feature	276
Balance at March 31, 2005	$ 972

NOTE 8. NOTES PAYABLE

On July 1, 2004, the Company entered into two note payable obligations aggregating $275,000 that bear interest at an annual rate of 40% and are due on September 30, 2004. During the three months ended March 31, 2005, the Company repaid $85,000 on these two notes. In addition, in connection with these two notes payable, the Company issued to the holder a total of 5,000,000 warrants to purchase shares of the Company's common stock for $0.005 per shares. The estimated value of the warrants of $28,500 was determined using the Black-Scholes option pricing model and the following assumptions: term of 5 years, a risk free interest rate of 3.5%, a dividend yield of 0% and volatility of 426%. As of September 30, 2004, the entire $28,500 has been amortized to financings costs in the accompanying consolidated statements of operations.

NOTE 9. STOCKHOLDERS' DEFICIENCY

Stock Issuances

During the nine months ended March 31, 2005, DRDF issued the following:

- 8,623,110 shares of its common stock for legal, accounting and consulting services valued at $42.
- 20,880,130 shares of its common stock for debt of $38;
- 62,534,215 shares of its common stock for penalties of $94; and
- 38,000,000 shares of its common stock for the conversion of convertible debentures in the amount of $175.

The value of the common stock issued was determined as follows:

- for services - the market value of the Company's common stock at the date of issuance;
- for debt conversions - at contractually obligated amounts.

NOTE 10. SEGMENT INFORMATION

The Company managed and internally reported the Company's business has four reportable segments, principally, (1) products and accessories, (2) software, (3) temporary staffing, and (4) PEO services.

Segment information for the nine months ended March 31, 2005 is as follows:

(IN THOUSANDS)

	PRODUCTS	SOFTWARE	TEMPORARY STAFFING	PEO SERVICES	TOTAL
9-months ended 3/31/05					
Revenues	$ 468	$ 48	$ 11,749	$ 2,058	$ 14,323
Operating income (loss)	(237)	(357)	(103)	(168)	(865)
9-months ended 3/31/04					
Revenues	$ 546	$ 66	$ 6,328	$ 2,545	$ 9,485
Operating income (loss)	(733)	(2,999)	204	911	(2,617)

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NOTE 11. DISPOSITION OF GREENLAND CORPORATION

In January 2004, the Company determined to discontinue operations of Greenland Corporation, its professional employment business division, and sold its shares in Greenland, back to Greenland. Effective March 1, 2004, the Company completed the sale of Greenland. Effective March 1, 2004, four new directors were elected to serve on Greenland's Board of Directors due to the resignation of the four directors nominated by DRDF. The operations of Greenland have been shown as discontinued operations in the accompanying consolidated statements of operations.

The operations of Greenland for the six month period ended March 31, 2004 are shown as discontinued operations.

NOTE 12. RELATED PARTY TRANSACTIONS

Warning Management Services, Inc.

The Company CEO and Chairman, Mr. Brian Bonar, is also the CEO and Chairman of Warning Management, Inc. Warning a public company, located in Southern California. Warning's operations consist of a modeling agency and providing temporary staffing services to government agencies and private companies.

GUARANTEE OF INDEBTEDNESS OF WARNING

As of September 8, 2004, Warning Management Services, Inc. ("Warning") purchased all of the issued and outstanding shares of Employment Systems, Inc. ("ESI") for $1,500. The purchase was $750 cash paid at the closing and a $750 note payable. In connection with this transaction, the Company agreed to be a guarantor of the $750 note payable. As inducement to enter into this guarantee, the Company was given a non-cancelable 2-year payroll processing contract with ESI. Management has evaluated this contingent liability and has determined that no loss is anticipated as a result of this guarantee.

WARNING HAS A MONTH-TO-MONTH LEASE WITH THE COMPANY

Warning leases offices for its ESI subsidiary, on a month-to-month basis from

the Company that started in October 2004. Monthly rental expense will be approximately $3 per month.

PEO SERVICES AGREEMENT WITH WARNING PROVIDES FOR A FEE AT PREVAILING MARKET RATE

In April 2004, the Company entered into an Agreement to provide PEO services for Warning. The Company receives from Warning a monthly administrative fee. The Company recorded revenue totaling approximately $154 during the nine months ended March 31, 2005

NOTE 13. GAIN RESULTING FROM RECONCILIATION OF PAYROLL TAX LIABILITES TO TAXING AUTHORITIES

During the three and nine months ended March 31, 2005, the Company recorded an adjustment to earnings of $454 and $990, respectively, resulting from a reconciliation with the Internal Revenue Service and certain State taxing authorities of the amounts due for delinquent payment of payroll tax liabilities. The Company continually updates its estimate of the amount due related to delinquent payroll taxes and penalties as it receives correspondence or settlement agreements with the Internal Revenue Service and State taxing authorities.

NOTE 14. OTHER ACCRUED EXPENSES

Other accrued expenses at March 31, 2005 consisted of the following as of:

Interest	$ 3,655
Payroll and sales tax payable	658
IRS levy penalties and interest	387
Accrued judgments	3,799
Accrued salaries and related liabilities	624
Other	1,296
	$10,419

NOTE 15. LITIGATION

On February 10, 2005, Berryman & Henigar Enterprises, the former owners of ESI, filed a complaint in the Superior Court of California against Warning Model Management, Inc. for breach of the promissory note issued in connection with its acquisition of ESI. The Company has guaranteed Warnings' promissory note and is contingently liable for the balance of $750. Warning Model Management, Inc. has taken the position that Berryman & Henigar Enterprises failed to disclose certain material information regarding the transaction which invalidated the promissory note. The management of Warning intends to defend against the claims asserted.

On March 17, 2005, Greenland Corporation (Greenland) filed an amended complaint in the Superior Court of California against the Company and multiple other individuals and entities resulting from a transaction as evidenced by the "Agreement to Acquire Shares" dated August 9, 2002, whereby the Company obtained a controlling equity interest in Greenland. Greenland contends that the Company engaged in various forms of wrongdoing including breach of fiduciary duty,

conversion, conspiracy and aiding and abetting. The Company and each of its co-defendants have challenged the legal sufficiency of Plaintiff's claims and allegations. However, the court has not yet ruled on the multiple challenges although we believe that the claims generally lack merit. We intend to vigorously defend against the claims asserted in this case.

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

(IN THOUSANDS, EXCEPT SHARE DATA)

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto included in the Company Annual Report on Form 10-KSB for the year ended June 30, 2004. The statements contained in this Report on Form 10-QSB that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, hopes, intentions or strategies regarding the future. Forward-looking statements include statements regarding: future product or product development; future research and development spending and our product development strategies, and are generally identifiable by the use of the words "may", "should", "expect", "anticipate", "estimates", "believe", "intend", or "project" or the negative thereof or other variations thereon or comparable terminology. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements (or industry results, performance or achievements) expressed or implied by these forward-looking statements to be materially different from those predicted. The factors that could affect our actual results include, but are not limited to, the following: general economic and business conditions, both nationally and in the regions in which we operate; competition; changes in business strategy or development plans; our inability to retain key employees; our inability to obtain sufficient financing to continue to expand operations; and changes in demand for products by our customers.

OVERVIEW

We provide a variety of financial services to small and medium-size businesses. These services allow our customers to outsource many human resources tasks, including payroll processing, workers' compensation insurance, health insurance, employee benefits, 401k investment services, personal financial management, and income tax consultation. In November 2001, we began to provide these services to relieve some of the negative impact they have on the business operations of our existing and potential customers. To this end, through strategic acquisitions, we became a professional employer organization ("PEO").

We provide financial services principally through our wholly-owned SourceOne Group, Inc. ("SOG") subsidiary. These units provide a broad range of financial services, including: benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, and employer liability management. Through our Jackson Staffing subsidiary (and MedicalHR and CallCenterHR operating units), we provide temporary staffing services to small and medium-sized businesses - primarily to call centers and medical facilities.

In January 2003, we completed the acquisition of controlling interest (approximately 85%) in the shares of Greenland Corporation whose shares are traded on the NASD Electronic Bulletin Board under the symbol GRLC. Subsequently, in March 2004, we entered into an agreement with Greenland to

return most of our shares in Greenland in return for Greenland's forgiveness of certain DRDF indebtedness and business opportunities.

In January 2003, we completed the acquisition of a controlling interest (85%) in the shares of Quik Pix, Inc. ("QPI"). QPI shares are traded on the National Quotation Bureau Pink Sheets under the symbol QPIX. QPI is a visual marketing support firm located in Buena Park, California. Its principal service is to provide photographic and digital images mounted for customer displays in tradeshow and other displays .Its principal product, PhotoMotion is a patented color medium of multi-image transparencies. The process uses existing originals to create the illusion of movement, and allows for six to five distinct images to be displayed with an existing lightbox.

In September 2003, we hired two key persons and acquired the operations of the temporary staffing service then owned by Jackson Staffing, LLC. In order to formalize this arrangement, we entered into an acquisition agreement with Jackson Staffing effective September 1, 2003 and accordingly, the financial statements of Jackson Staffing from September 1, 2003 are included in our financial statements.

In April 2004, we transferred our ColorBlind software technology to QPI. ColorBlind software provides color management to improve the accuracy of color reproduction - especially as it relates to matching color between different

devices in a network, such as monitors and printers. ColorBlind software products are marketed internationally through direct distribution, resellers, and on the internet through our color.com website.

Our business continues to experience operational and liquidity challenges. Accordingly, year-to-year financial comparisons may be of limited usefulness now and for the next several periods due to anticipated changes in our business as these changes relate to potential acquisitions of new businesses and changes in products and services.

On June 28, 2004, we completed an acquisition of certain assets of M&M Nursing (M&M"). The purchase price was 5,000,000 shares of our common stock valued at $31 plus the assumption of $204 of liabilities. M&M is a temporary staffing agency primarily for nurses.

Our current strategy is: to expand our financial services businesses, including PEO services and temporary staffing, and to continue to commercialize imaging technologies, including PhotoMotion Images and ColorBlind color management software through our QPI subsidiary.

To successfully execute our current strategy, we will need to improve our working capital position. The report of our independent auditors accompanying our June 30, 2004 financial statements included in our Annual Report on Form 10KSB includes an explanatory paragraph indicating there is a substantial doubt about our ability to continue as a going concern, due primarily to our recent loss from operations, the decreases in our working capital and net worth. In addition, the Company is late in our filing of payroll tax returns for certain of our PEO divisions. We plan to overcome the circumstances that impact our ability to remain a going concern through a combination of achieving profitability, raising additional debt and equity financing, and renegotiating existing obligations. In addition, we will continue to work with the Internal Revenue Service and State taxing Authorities to reconcile and resolve all open accounts and issues.

In recent years, we have been working to reduce costs through the reduction in staff and reorganizing our business activities. Additionally, we have sought to reduce our debt through debt to equity conversions. We continue to pursue the acquisition of businesses that will grow our business.

There can be no assurance that we will be able to complete any additional debt or equity financings on favorable terms or at all, or that any such financings, if completed, will be adequate to meet our capital requirements. Any additional equity or convertible debt financings could result in substantial dilution to our shareholders. If adequate funds are not available, we may be required to delay, reduce or eliminate some or all of our planned activities, including any potential mergers or acquisitions. Our inability to fund our capital requirements would have a material adverse effect on the Company.

RESTRUCTURING AND NEW BUSINESS UNITS

In April 2004, we transferred our ColorBlind software products and technologies to our QPI subsidiary in order to focus on financial services and enable QPI to concentrate on imaging technology products and services.

ACQUISITIONS, DISPOSITIONS AND SALE OF BUSINESS UNITS

In August 2002, we entered into an agreement to acquire controlling interest in Greenland Corporation. Greenland shares are traded on the Electronic Bulletin Board under the symbol GRLC. On January 14, 2003, we completed the acquisition of shares, representing controlling interest, of Greenland. The terms of the acquisitions were disclosed on Form 8-K filed January 21, 2003.

Pursuant to a mutual agreement between the Board of Directors of both Greenland Corporation and us, Greenland has been separated from us, effective February, 23, 2004. Under the separation agreement, Greenland forgave its note receivable from us of $2,250 together with any accrued interest thereon in consideration for our granting our acquisition rights to acquire ePEO Link to Greenland. In addition, for returning 95,949,610 shares of Greenland common stock acquired by us pursuant to our acquisition agreement with Greenland in January 2003, Greenland forgave its inter-company account receivable from us, which amount aggregated approximately $1,375. Further, the agreement provided for us to effect the resignation of our Directors who also served on the Board of Directors of Greenland, which was completed in March 2004.

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In September 2003, we hired two key persons, and acquired the operations of the temporary staffing service then owned by Jackson Staffing, LLC. In order to formalize this arrangement, we entered into an acquisition agreement with Jackson Staffing effective September 1, 2003 and accordingly, the financial statements of Jackson Staffing from September 1, 2003 are included in our financial statements. On June 28, 2004, we completed an acquisition of certain assets of M&M Nursing (M&M"). The purchase price was 5,000,000 shares of our common stock valued at $31 plus the assumption of $204 of liabilities. M&M is a temporary staffing agency primarily for nurses. The financial statements of M&M from July 1, 2004 are included in our financial statements.

SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations discuss our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the

United States of America. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to allowance for doubtful accounts, value of intangible assets and valuation of non-cash compensation. We base our estimates and judgments on historical experiences and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The most significant accounting estimates inherent in the preparation of our consolidated financial statements include estimates as to the appropriate carrying value of certain assets and liabilities which are not readily apparent from other sources, primarily allowance for doubtful accounts, estimated fair value of equity instruments used for compensation, estimated tax liabilities fro PEO operations and estimated liabilities associated with Worker's Compensation liabilities. These accounting policies are described at relevant sections in this discussion and analysis and in the notes to the consolidated financial statements included in our Annual Report on Form 10-KSB for the fiscal year ended June 30, 2004.

REVENUE RECOGNITION

PEO SERVICE FEES AND WORKSITE EMPLOYEE PAYROLL COSTS

We recognize our revenues associated with our PEO business pursuant to EITF 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." Our revenues are reported net of worksite employee payroll cost (net method). Pursuant to discussions with the Securities and Exchange Commission staff, we changed our presentation of revenues from the gross method to an approach that presents our revenues net of worksite employee payroll costs (net method) primarily because we are not generally responsible for the output and quality of work performed by the worksite employees.

In determining the pricing of the markup component of the gross billings, we take into consideration our estimates of the costs directly associated with our worksite employees, including payroll taxes, benefits and workers' compensation costs, plus an acceptable gross profit margin. As a result, our operating results are significantly impacted by our ability to accurately estimate, control and manage our direct costs relative to the revenues derived from the markup component of our gross billings.

Consistent with our revenue recognition policy, our direct costs do not include the payroll cost of our worksite employees. Our direct costs associated with our revenue generating activities are comprised of all other costs related to our worksite employees, such as the employer portion of payroll-related taxes, employee benefit plan premiums and workers' compensation insurance premiums.

SALES OF PRODUCTS

Revenue is recognized when earned. Our revenue recognition policies are in compliance with all applicable accounting regulations, including American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, With Respect to Certain Transactions. Revenue from products licensed to original equipment manufacturers is recorded when OEMs ship licensed products while revenue from certain license programs is recorded when the software has been

delivered and the customer is invoiced. Revenue from packaged product sales to and through distributors and resellers is recorded when related products are shipped. Maintenance and subscription revenue is recognized ratably over the contract period. When the revenue recognition criteria required for distributor and reseller arrangements are not met, revenue is recognized as payments are received. Provisions are recorded for returns and bad debts. Our software arrangements do not contain multiple elements, and we do not offer post contract support.

TEMPORARY STAFFING

We record gross revenue for temporary staffing. We have concluded that gross reporting is appropriate because we (i) have the risk of identifying and hiring qualified employees, (ii) have the discretion to select the employees and establish their price and duties and (iii) bear the risk for services that are not fully paid for by customers. Temporary staffing revenues are recognized when the services are rendered by our temporary employees. Temporary employees placed by us are our legal employees while they are working on assignments. We pay all related costs of employment, including workers' compensation insurance, state and federal unemployment taxes, social security and certain fringe benefits. We assume the risk of acceptability of our employees to our customers.

RESULTS OF OPERATIONS (IN $000)

THREE MONTHS ENDED MARCH 31, 2005 COMPARED TO THREE MONTHS ENDED MARCH 31, 2004

REVENUES

Total revenues were $5,449 and $3,488 for the three months ended March 31, 2005 and 2004, respectively; an increase of $1,961 (56%). The increase was due primarily to the addition of temporary staffing services, which contributed $4,095 of revenues for the three months ended March 31, 2005 compared to $2,892 for the three months ended March 31, 2004 and an increase in PEO service revenue which was $1,208 for the three months ended March 31, 2005 compared to $475 for the same period in 2004.

PEO SERVICES

PEO revenues were $1,208 and $475 for the three months ended March 31, 2005 and 2004, respectively; an increase of $733 (154%) due primarily to the increase in our PEO customer base.

TEMPORARY STAFFING

In September 2003, we entered into an agreement to purchase a temporary staffing business through the organization of CallCenterHR and MedicalHR and the acquisition of Jackson Staffing. In June 2004, we entered into an agreement to purchase certain assets of M&M Nursing, a temporary staffing agency for nurses. Temporary Staffing revenues were $4,095 and $2,892 for the three months ended March 31, 2005 and 2004, respectively; an increase of $1,203 (42%). The significant increase is due to the acquisition of Jackson Staffing and M&M Nursing.

PRODUCTS

Sales of products were generated principally from our QPI subsidiary. Products

revenues were $137 and $91 for the three months ended March 31, 2005 and 2004, respectively; an increase of $46 (51%). The increase is principally due to additional sales of photographic and digital images though our QPI subsidiary.

SOFTWARE

Software revenues were $9 and $30 for the three months ended March 31, 2005 and 2004, respectively; a decrease of $21 (70%). Revenues from licenses and royalties for the periods were insignificant.

Royalties and licensing fees vary from quarter to quarter and are dependent on the sales of products sold by OEM customers using our technologies. These revenues continue to decline as we have elected to transfer our ColorBlind software to QPI, which has accelerated product development and begun to implement a more aggressive product sales program.

COST OF PRODUCTS SOLD

Cost of PEO services for the three months ended March 31, 2005 and 2004 $1,088 (90% of PEO revenues) and $384 (81% of PEO revenues), respectively. The decrease in gross profit is due primarily to us incurring additional employee benefit related costs.

Costs of temporary staffing for the three months ended March 31, 2005 and 2004 was $3,591 (88% of temporary staffing revenue) and $2,663 (92% of temporary staffing revenue), respectively.

Cost of products sold for the three months ended March 31, 2005 and 2004 were $23 (17% of product sales) and $28 (31% of product sales), respectively.

Cost of software, licenses and royalties for the three months ended March 31, 2005 and 2004 were $1 (11% of software, license and royalties revenue) and $0 (0% of software, license and royalties revenue), respectively.

OPERATING EXPENSES

Operating expenses have consisted primarily of salaries and commissions of sales and marketing personnel, salaries and related costs for general corporate functions, including finance, accounting, facilities and legal, advertising, rent, depreciation and amortization, and other marketing related expenses, and fees for professional services.

Operating expenses for the three months ended March 31, 2005 and 2004 were $904 and $(71), respectively; an increase of $975. As disclosed in "Significant Accounting Policies and Estimates", we rely on estimates for such liabilities related to, among other areas, worker's compensation and accrued payroll taxes. During the three month period ended March 31, 2004, we changed our estimate of workers' compensation and accrued payroll taxes, which resulted in a negative cost of PEO operations. The cumulative changes in estimates for these accounts aggregated approximately $1.2 million in the quarterly period ended March 31, 2004.

OTHER INCOME AND EXPENSE

Interest expense and financing costs for the three months ended March 31, 2005 and 2004 was $394 and $434 respectively; a decrease of $40 (9%). The decrease is principally due to the write off of the unamortized debt discounts associated

with the conversion of debentures into common stock for the three months ended March 31, 2004 (there were no conversion during the three months ended March 31, 2005) offset by an increase due to the amount of debt outstanding.

GAIN ON EXTINGUISHMENT OF DEBT

Gain on the extinguishment of debt was $165 and $228 for the three months ended March 31, 2005 and 2004, respectively. The amounts related to accounts payable, which had become stale and uncollectible under the Statute of Limitations in the State of California and upon obtaining a legal opinion with respect to the State of California Statute of Limitations.

GAIN FROM RECONCILIATION OF PAYROLL TAX LIABILITES TO TAXING AUTHORITIES

During the three months ended March 31, 2005, we recorded as other income an adjustment of accrued PEO payroll taxes payable of $454 resulting from reconciliations of certain liabilities with the Internal Revenue Service and certain State taxing authorities of amounts due for delinquent payment of payroll tax liabilities. We continually updates our estimate of the amount due related to delinquent payroll taxes and penalties as we receive correspondence or settlement agreements with the Internal Revenue Service and State taxing authorities.

NINE MONTHS ENDED MARCH 31, 2005 COMPARED TO NINE MONTHS ENDED MARCH 31, 2004

REVENUES

Total revenues were $14,323 and $9,485 for the nine months ended March 31, 2005 and 2004, respectively; an increase of $4,838 (51%). The principal reason for the increase is due to a full nine months of revenue from our temporary staffing division for the nine months ended March 31, 2005 as compared to only seven months for the same period in 2004.

PEO SERVICES

PEO revenues were $2,058 and $2,545 for the nine months ended March 31, 2005 and 2004, respectively; a decrease of $487 (19%) due primarily to the decrease in our PEO customer base in the first half of fiscal 2005 offset by an increase in the third fiscal quarter.

TEMPORARY STAFFING

In September 2003, we entered into an agreement to purchase a temporary staffing business through the organization of CallCenterHR and MedicalHR and the acquisition of Jackson Staffing. In June 2004, we entered into an agreement to purchase certain assets of M&M Nursing, a temporary staffing agency for nurses. Temporary Staffing revenues were $11,749 and $6,328 for the nine months ended March 31, 2005 and 2004, respectively; an increase of $5,421 (86%). The significant increase is due to the acquisition of Jackson Staffing and M&M Nursing.

PRODUCTS

Sales of products were generated principally from our QPI subsidiary. Products revenues were $468 and $546 for the nine months ended March 31, 2005 and 2004, respectively; a decrease of $78 (14%).

SOFTWARE

Software revenues were $48 and $66 for the nine months ended March 31, 2005 and 2004, respectively; a decrease of $18 (27%). Revenues from licenses and royalties for the periods were insignificant.

Royalties and licensing fees vary from quarter to quarter and are dependent on the sales of products sold by OEM customers using our technologies. These revenues continue to decline as we have elected to transfer our ColorBlind software to QPI, which has accelerated product development and begun to implement a more aggressive product sales program.

COST OF PRODUCTS SOLD

Cost of PEO services for the nine months ended March 31, 2005 and 2004 $1,716 (83% of PEO revenues) and $2,280 (90% of PEO revenues), respectively. The increase in gross profit is due primarily to us being able to provide more profitable services to our PEO customers, offset by higher employee benefit costs in the quarter ended March 31, 2005.

Costs of temporary staffing for the nine months ended March 31, 2005 and 2004 was $10,539 (90% of temporary staffing revenue) and $5,657 (89% of temporary staffing revenue), respectively. The significant increase is due to the increase in temporary staffing revenue.

Cost of products sold for the nine months ended March 31, 2005 and 2004 were $59 (13% of product sales) and $156 (29% of product sales), respectively.

Cost of software, licenses and royalties for the nine months ended March 31, 2005 and 2004 were $4 (8% of software, license and royalties revenue) and $3 (5% of software, license and royalties revenue), respectively.

OPERATING EXPENSES

Operating expenses for the nine months ended March 31, 2005 and 2004 were $2,870 and $4,006, respectively; a decrease of $1,136 (28%). The decrease is due to a reduction of payroll and related benefits due to a significant reduction in our personnel. Also, as disclosed in "Significant Accounting Policies and Estimates", we rely on estimates for such liabilities related to, among other areas, worker's compensation and accrued payroll taxes. During the nine months ended March 31, 2005, we changed our estimate of workers' compensation claims aggregating approximately $700 and $1,200 for the nine months ended March 31, 2005 and 2004, respectively.

OTHER INCOME AND EXPENSE

Interest expense and financing costs for the nine months ended March 31, 2005 and 2004 was $1,208 and $1,363 respectively; a decrease of $155 (11%). The decrease is principally due to the write off of the unamortized debt discounts associated with the conversion of debentures into common stock for the nine months ended March 31, 2004 (there were fewer conversions during the nine months ended March 31, 2005) offset by an increase due to the amount of debt outstanding.

GAIN ON EXTINGUISHMENT OF DEBT

Gain on the extinguishment of debt was $425 and $853 for the nine months ended March 31, 2005 and 2004,, respectively. The amounts related to accounts payable, which had become stale and uncollectible under the Statute of Limitations in the State of California and upon obtaining a legal opinion with respect to the State of California Statute of Limitations.

GAIN FROM RECONCILIATION OF PAYROLL TAX LIABILITES TO TAXING AUTHORITIES

During the nine months ended March 31, 2005, we recorded as other income an adjustment of accrued PEO payroll taxes payable of $990 resulting from reconciliations of certain liabilities with the Internal Revenue Service and certain State taxing authorities of amounts due for delinquent payment of payroll tax liabilities. We continually updates our estimate of the amount due related to delinquent payroll taxes and penalties as we receive correspondence or settlement agreements with the Internal Revenue Service and State taxing authorities.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have financed our operations primarily through cash generated from operations, debt financing, and the sale of equity securities. Additionally, in order to facilitate our growth and future liquidity, we have made some strategic acquisitions.

As a result of some of our financing activities, there has been a significant increase in the number of issued and outstanding shares. During the nine months ended March 31, 2005 and the year ended June 30, 2004, we issued an additional 130,037,455 and 371,126,679 shares, respectively. These shares of common stock were issued primarily for corporate expenses in lieu of cash, for acquisition of businesses, for the conversion of convertible debentures and other debt, and for the exercise of warrants.

As of March 31, 2005, we had negative working capital of $22,113, a decrease in working capital of $245 since June 30, 2004.

Net cash used in operating activities was $186 for the nine months ended March 31, 2005 as compared to net cash used in activities of $1,560 for the prior-year period; a decrease of $1,374.

Cash provided by financing activities was $400 for the nine months ended March 31, 2005, a decrease of $294 from the prior-year period.

We have no material commitments for capital expenditures. Our 5% convertible preferred stock (which ranks prior to our common stock), carries cumulative dividends, when and as declared, at an annual rate of $50 per share. The aggregate amount of such dividends in arrears at March 31, 2005, was approximately $498.

Our capital requirements depend on numerous factors, including market acceptance of our products and services, the resources we devote to marketing and selling our products and services, and other factors. The report of our independent auditors accompanying our June 30, 2004 financial statements includes an explanatory paragraph indicating there is a substantial doubt about our ability to continue as a going concern, due primarily to the decreases in our working capital and net worth.

CONTINGENT LIABILITY

The Company accrues and discloses contingent liabilities in its consolidated financial statements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 5, Accounting for Contingencies. SFAS No. 5 requires accrual of contingent liabilities that are considered probable to occur and that can be reasonably estimated. For contingent liabilities that are considered reasonably possible to occur, financial statement disclosure is required, including the range of possible loss if it can be reasonably determined. The Company has disclosed in its audited financial statements several issues that it believes are reasonably possible to occur, although it cannot determine the range of possible loss in all cases. As these issues develop, the Company will continue to evaluate the probability of future loss and the potential range of such losses. If such evaluation were to determine that a loss was probable and the loss could be reasonably estimated, the Company would be required to accrue its estimated loss, which would reduce net income in the period that such determination was made.

Off-Balance Sheet Arrangements

There are no off balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors, except for the following.. As of September 8, 2004, Warning Management Services, Inc. ("Warning") purchased all of the issued and outstanding shares of Employment Systems, Inc. ("ESI") for $1,500. The purchase was $750 cash paid at the closing and a $750 note payable. In connection with this transaction, the Company agreed to be a guarantor of the $750 note payable. Our CEO, Brian Bonar, is also the CEO of Warning. As inducement to enter into this guarantee, we were given a non-cancelable 2-year payroll processing contract with ESI. Currently the $750 note payable is in dispute. Warning is claiming that certain representations made by ESI were not correct and is proposing that the purchase price be reduced, thus reducing the $750 note payable to $258. Management has evaluated this contingent liability and has determined that no loss is anticipated as a result of this guarantee.

ITEM 3. CONTROLS AND PROCEDURES

As required by SEC rules, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures at the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. Based on this evaluation, we are adding a new corporate general ledger system, have hired a new chief accounting officer and are working to improve the design and operations of our disclosure controls. There were no changes in our internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting and we feel our disclosure and procedures were effective as of the quarter period ending March 31, 2005.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including principal executive officer and principal financial officer, as appropriate, to allow timely

decisions regarding required disclosure.

This current quarterly report was not filed on a timely basis as a result of additional research and confirmations required in establishing the basis for a reasonable reliance on the disclosures of certain large liabilities. Steps have been taken to ensure that this area will not be an issue in future reporting. Additional steps will also be taken to put into place additional controls to ensure the timely reporting of required information in the future.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In October 1999, the law firms of Weiss & Yourman and Stull, Stull & Brody made a public announcement that they had filed a lawsuit against the Company and certain current and past officers and/or directors, alleging violation of federal securities laws and, in November 1999, the lawsuit, filed in the name of Nahid Nazarian Behfarin, on her own behalf and others purported to be similarly situated, was served on the Company. In January 2003, the Company entered into a Stipulation of Settlement with the plaintiffs. It agreed to pay the plaintiffs 5,000,000 shares of common stock and $200 in cash. The Parties have accepted the settlement. DRDF has issued the shares, and its insurance carrier has paid the $200 cash payment. Pursuant to a hearing in May 2003 the Court provided approval to the settlement.

On August 22, 2002, the Company was sued by its former landlord, Carmel Mountain #8 Associates, L.P. or past due rent on its former facilities at 15175 Innovation Drive, San Diego, CA 92127.

DRDF was a party to a lawsuit filed by Symphony Partners, L.P. related to its acquisition of SourceOne Group, LLC. As reported on Form 8-K, dated July 22, 2003, the plaintiffs sought payment of $702. In June 2003, the Company entered into a settlement with the plaintiffs for a cash payment of $274, which has been paid.

DRDF is one of dozens of companies sued by The Massachusetts Institute of Technology, et al., related to a patent held by the plaintiffs that may be related to part of the Company's ColorBlind software. Subsequent to the period reported in this filing, in June 2003, the Company entered into a settlement with the plaintiffs who have agreed to dismiss their claims against DRDF with prejudice in exchange for a settlement fee payment of $10, which has been paid.

The Company has been sued in Illinois state court along with AIA/Mirriman, its insurance brokers by the Arena Football League-2 ("AFS"). Damages payable to AF2, should they win the suit, could exceed $700. The Company expects to defend its position and rely on representations of its insurance brokers.

On February 10, 2005, Berryman & Henigar Enterprises, the former owners of ESI, filed a complaint in the Superior Court of California against Warning Model Management, Inc. for breach of the promissory note issued in connection with its acquisition of ESI. The Company has guaranteed Warnings' promissory note and is contingently liable for the balance of $750. Warning Model Management, Inc. has taken the position that Berryman & Henigar Enterprises failed to disclose certain material information regarding the transaction which invalidated the promissory note. The management of Warning intends to defend against the claims asserted.

On March 17, 2005, Greenland Corporation (Greenland) filed an amended complaint in the Superior Court of California against the Company and multiple other individuals and entities resulting from a transaction as evidenced by the "Agreement to Acquire Shares" dated August 9, 2002, whereby the Company obtained a controlling equity interest in Greenland. Greenland contends that the Company engaged in various forms of wrongdoing including breach of fiduciary duty, conversion, conspiracy and aiding and abetting. The Company and each of its co-defendants have challenged the legal sufficiency of Plaintiff's claims and allegations. However, the court has not yet ruled on the multiple challenges although we believe that the claims generally lack merit. We intend to vigorously defend against the claims asserted in this case.

Throughout fiscal 2003 and 2004, and through the date of this filing, trade creditors have made claims and/or filed actions alleging the failure of the Company to pay its obligations to them in a total amount exceeding $3,000. These actions are in various stages of litigation, with many resulting in judgments being entered against the Company. Several of those who have obtained judgments have filed judgment liens on the Company's assets. These claims range in value from less than one thousand dollars to just over one million dollars, with the great majority being less than twenty thousand dollars.

In connection with the Company's acquisition of controlling interest of Quik Pix, Inc., we are unaware of any pending litigation. From time to time, QPI may be involved in litigation relating to claims arising out of its operations in the normal course of business.

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

Common Stock

During the three months ended March 31, 2005, DRDF issued the following:

- 210 shares of its common stock for services valued at 1 dollar. The value of the services was determined using the market value of DRDF's common stock on the date of issuance;

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

The Company is currently in default on certain bank loans that have an aggregate outstanding balance at March 31, 2005 of $3,220,000.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

31.1 Rule 13a-14(a) Certification of CEO

31.2 Rule 13a-14(a) Certification of CFO

32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CEO

32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CFO

SIGNATURES

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

Dated: May 23, 2005

DALRADA FINANCIAL CORPORATION
(Registrant)

By: /S/ Brian Bonar

Brian Bonar
Chairman and Chief Executive Officer

By: /S/ Randall Jones

Randall Jones
Chief Financial Officer