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DALRADA FINANCIAL CORP  
Form 10QSB  
May 20, 2004

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, 2004

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) 451-6120

IMAGING TECHNOLOGIES CORPORATION  
17075 VIA DEL CAMPO  
SAN DIEGO, CA 92127  
(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  No

The number of shares outstanding of the registrant's common stock as of May 10, 2004 was 394,950,974

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

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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)

#### ASSETS

##### Current assets

		MARCH 31, 2004
Cash . . . . .	\$	
Accounts receivable, net of allowance of \$80 . . . . .		
Inventories, net . . . . .		
Prepaid expenses and other current assets . . . . .		
Total current assets . . . . .		1
Patent, net of accumulated amortization of \$150 . . . . .		1
Property and equipment, net of accumulated depreciation . . . . .		
Total assets . . . . .	\$	2

#### LIABILITIES AND SHAREHOLDERS' DEFICIENCY

##### Current liabilities

Borrowings under bank notes payable . . . . .	\$	3
Notes payable, current portion (including related party note of \$1,500) . . . . .		1
Convertible debentures, net of discounts of \$64 . . . . .		4
Accounts payable . . . . .		4
Obligations under capital lease . . . . .		5
PEO payroll taxes and other payroll deductions . . . . .		5

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Advances from related party . . . . .		7
Other accrued expenses . . . . .		----- 23
Total current liabilities . . . . .		----- 23
Long-term liabilities:		
Long-term capital lease . . . . .		
Long-term convertible debentures, less discounts of \$798 . . . . .		
Long-term notes payable (including related party note of \$268) . . . . .		
-----		
Total liabilities . . . . .		----- 24
Shareholders' deficiency		
Series A convertible, redeemable preferred stock, \$1,000 par value, 7,500 shares authorized, 20.5 shares issued and outstanding . . . . .		
Common stock, \$0.005 par value, 500,000,000 shares authorized; 394,950,974 shares issued and outstanding . . . . .		1
Common stock warrants and options . . . . .		83
Paid-in capital . . . . .		(107)
Accumulated deficit . . . . .		----- (22)
Total shareholders' deficiency . . . . .		----- (22)
Total liabilities and shareholders' deficiency . . . . .	\$	----- 2

See accompanying notes to these consolidated financial statements.

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES  
 (formerly Imaging Technologies Corporation)  
 CONSOLIDATED STATEMENTS OF OPERATIONS  
 THREE MONTHS ENDED MARCH 31, 2004 AND 2003  
 (in thousands, except share data)

(In thousands, except per share amounts)

	2004	2003
	-----	-----
Revenues		
Sales of products . . . . .	\$ 91	\$
Software sales, licenses and royalties . . . . .	30	
Temporary staffing services . . . . .	2,892	
PEO services (gross billings of \$3,205 and \$2,694 respectively; less worksite employee payroll costs of \$2,730 and \$2,845, respectively) . . . . .	475	
-----		
Total revenue . . . . .	3,488	----- -----
Costs of revenues		
Cost of products sold . . . . .	28	
Cost of software sales, licenses and royalties . . . . .	-	
Cost of temporary staffing . . . . .	2,663	
Cost of PEO services . . . . .	384	
-----		
Total cost of revenues . . . . .	3,075	----- -----

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Gross profit . . . . .	413	
Operating expenses		
Selling, general, and administrative. . . . .	(71)	
	(71)	
Income (loss) from operations. . . . .	484	(
Other income (expense):		
Interest and finance costs, net . . . . .	(434)	(
Gain on extinguishment of debt. . . . .	228	1,
Other . . . . .	1	
	(205)	
Income (loss) before provision for income taxes and discontinued operations . . . . .	279	
Provision for income taxes . . . . .	-	
Net income (loss) from continuing operations . . . . .	279	
Discontinued operations:		
Gain on disposition of discontinued operations. . . . .	5,049	(
Loss from operations of discontinued operations . . . . .	(693)	(
	4,356	(
Net income (loss). . . . .	\$ 4,635	\$
Preferred stock dividends. . . . .	(5)	
Net income (loss) attributed to common shareholders. . . . .	\$ 4,630	\$
Earnings (loss) per common shares (See Note 4)		
Basic . . . . .	\$ 0.013	\$ 0.
Diluted . . . . .	\$ 0.009	\$ 0.
Weighted average common shares - basic and diluted . . . . .	348,926	140,

See accompanying notes to these consolidated financial statements.

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES  
(formerly Imaging Technologies Corporation)  
CONSOLIDATED STATEMENTS OF OPERATIONS  
NINE MONTHS ENDED MARCH 31, 2004 AND 2003  
(in thousands, except share data)  
(unaudited)

(In thousands, except per share amounts)

	2004	
Revenues		
Sales of products. . . . .	\$ 546	\$

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Software sales, licenses and royalties . . . . .	66	
Temporary staffing services. . . . .	6,328	
PEO services (gross billings of \$12,077 and \$2,694 respectively; less worksite employee payroll costs of \$13,949 and \$2,439, respectively). . . . .	2,545	
Total revenue. . . . .	9,485	
Costs of revenues		
Cost of products sold. . . . .	156	
Cost of software sales, licenses and royalties . . . . .	3	
Cost of temporary staffing . . . . .	5,657	
Cost of PEO services . . . . .	2,280	
Total cost of revenues . . . . .	8,096	
Gross profit. . . . .	1,389	
Operating expenses		
Selling, general, and administrative . . . . .	4,006	
	4,006	
Loss from operations. . . . .	(2,617)	(
Other income (expense):		
Interest and finance costs, net. . . . .	(1,363)	(
Gain on extinguishment of debt . . . . .	853	
Other. . . . .	(18)	
	(528)	
Income (loss) before provision for income taxes and discontinued operations . . . . .	(3,145)	(
Provision for income taxes. . . . .	-	
Net income (loss) from continuing operations. . . . .	(3,145)	(
Discontinued operations:		
Gain on disposition of discontinued operations . . . . .	5,049	
Loss from operations of discontinued operations. . . . .	(2,052)	
	2,997	
Net income (loss) . . . . .	\$ (148)	\$ (
Preferred stock dividends . . . . .	(15)	
Net income (loss) attributed to common shareholders . . . . .	\$ (163)	\$ (
Earnings (loss) per common shares (See Note 4)		
Basic. . . . .	\$ (0.001)	\$ (
Diluted. . . . .	\$ (0.001)	\$ (
Weighted average common shares. . . . .	292,602	9

See accompanying notes to these consolidated financial statements.

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES  
(formerly Imaging Technologies Corporation)  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
NINE MONTHS ENDED MARCH 31, 2004 AND 2003  
(in thousands, except share data)  
(unaudited)

	2004	2003
	-----	-----
Cash flows from operating activities		
Net loss from continuing operations . . . . .	\$ (3,145)	\$ (2,400)
Adjustments to reconcile net loss to net cash from operating activities		
Depreciation and amortization . . . . .	265	
Writedown of fixed assets . . . . .	-	
Stock issued for services . . . . .	368	600
Amortization of debt discount . . . . .	626	600
Value of service for exercise of warrants . . . . .	-	100
Value of warrants issued for services . . . . .	-	
Gain on forgiveness of inter-company debt from Greenland . . . . .	(1,375)	
Gain on extinguishments of debt . . . . .	-	(1,900)
Changes in operating assets and liabilities:		
Accounts receivable . . . . .	(21)	400
Inventories . . . . .	-	100
Prepaid expenses and other . . . . .	(13)	(400)
Accounts payable and accrued expenses . . . . .	230	
PEO liabilities . . . . .	1,467	1,700
Other assets . . . . .	38	
	-----	-----
Net cash used in operating activities from continuing operations . . . . .	(1,560)	(700)
	-----	-----
Net cash provided by (used in) operating activities of discontinued operations . . . . .	(678)	
Net cash used in operating activities . . . . .	(2,238)	(600)
	-----	-----
Cash flows from investing activities		
Purchase of furniture & equipment . . . . .	(158)	(100)
	-----	-----
Net cash used in investing activities . . . . .	(158)	(100)
	-----	-----
Cash flows from financing activities		
Change in cash overdraft, net . . . . .	(87)	
Net borrowings under bank notes payable . . . . .	(25)	(0)
Issuance of convertible debentures . . . . .	800	400
Repayment of notes payable . . . . .	(165)	
Repayment of capital lease obligation . . . . .	(6)	
Net proceeds from issuance of common stock . . . . .	177	500
	-----	-----
Net cash provided by (used in) financing activities from continuing operations . . . . .	694	900
	-----	-----
Net cash provided by (used in) financing activities of discontinued operations . . . . .		

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discontinued operation. . . . .	678	(
Net cash provided by financing activities . . . . .	1,372	8
Net increase (decrease) in cash and cash equivalents. . . . .	(1,024)	
Cash and cash equivalents, beginning of period. . . . .	1,223	
Cash and cash equivalents, end of period. . . . .	\$ 199	\$ 1

See accompanying notes to these consolidated financial statements.

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES  
(formerly Imaging Technologies Corporation)  
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
NINE MONTHS ENDED MARCH 31, 2004 AND 2002  
(in thousands, except share data)  
(unaudited)

NON-CASH INVESTING AND FINANCING ACTIVITIES

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.

During the nine months ended March 31, 2003, the Company (1) rescinded \$70,000 conversion of convertible notes payable into common stock, (2) converted \$80,000 of debt into 8,000,000 shares of common stock, (3) issued 4,020,000 shares of common stock for services valued at \$56,300, (4) issued 500,000 shares of common stock for compensation valued at \$7,500, (5) issued 12,500,000 shares of common stock for the acquisition of Quick Pix, Inc. valued at \$150,000, (6) issued 12,190,013 shares of common stock for conversion of convertible debentures in the amount of \$88,129 and (7) issued 100,000 shares of common stock in connection with the acquisition of Dream Canvas Technologies, Inc.

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

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read in conjunction with the Company's audited financial statements and notes thereto for the years ended June 30, 2003, 2002, and 2001 included in the Company's annual report on Form 10-K filed with the SEC. Interim operating results are not necessarily indicative of operating results for any future interim period or for the full year.

### 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, 2004, the Company had a loss from continuing operations of \$2,617,000. As of March 31, 2004, the Company had a negative working capital deficiency of \$22,643,000 and had a shareholders' deficiency of \$22,024,000. In addition, the Company is in default on certain note payable obligations and is being sued by numerous trade creditors for nonpayment of amounts due. 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.

On August 20, 1999, at the request of Imperial Bank, the Company's primary lender, the Superior Court of San Diego appointed an operational receiver who took control of the Company's day-to-day operations on August 23, 1999. On June 21, 2000, in connection with a settlement agreement reached with Imperial Bank, the Superior Court of San Diego issued an order dismissing the operational receiver.

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 shareholders. 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



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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 31,2004:

(In thousands, except share amounts). . . .	2004	2003
	-----	-----
Loss from continuing operations		
As reported . . . . .	\$ (3,145)	\$ (2,407)
Compensation recognized under APB No. 25. . . . .	-	-
Compensation recognized under SFAS No. 123. . . . .	(825)	(250)
	-----	-----
Pro forma . . . . .	\$ (3,970)	\$ (2,657)
	=====	=====
 Basic earnings (loss) per share		
As reported . . . . .	\$ (0.01)	\$ (0.02)
	=====	=====
Pro forma . . . . .	\$ (0.02)	\$ (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. . . . .	\$0.025	\$0.01
Risk free interest rate. . . . .	3.5%	3.5%
Expected life (years). . . . .	3	3
Expected volatility. . . . .	426%	421%
Expected dividends . . . . .	0%	0%-

#### 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 shareholders 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

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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, 2004: warrants - 21,563,435 and stock options - 39,158,100.

Below is a computation of earning (loss) per share:

(in thousands, except per share). . . . THREE MONTHS ENDED MARCH 31,  
-----

INCOME/ . . . . .	PER	INCOME/	PER	SHARE	(LOSS)	SHARES
(LOSS). . . . .	SHARES					
<b>BASIC EARNINGS (LOSS) PER SHARE</b>						
Net income (loss) from continuing operations						\$
Preferred stock dividends						-
Discontinued operations						-
Net income (loss) attributed to common stockholders						\$ =
<b>Weighted shares outstanding</b>						
Continuing operations						\$
Discontinued operations						\$ -
<b>DILUTED EARNINGS (LOSS) PER SHARE</b>						
Net income (loss) from continuing operations						\$
Preferred stock dividends						-
Interest on convertible debentures						-
Amortization of discounts on convertible debentures						-
Discontinued operations						-
Net income (loss) attributed to common stockholders						\$ =
<b>Weighted shares outstanding</b>						
Conversion of convertible debentures into common stock						-

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Continuing operations  
 Discontinued operations

\$  
 \$  
 -

(in thousands, except per share). . . . NINE MONTHS ENDED MARCH 31,  
 -----

INCOME/ . . . . . PER	INCOME/ PER		
(LOSS). . . . . SHARES	SHARE (LOSS)	SHARES	SH
BASIC EARNINGS (LOSS) PER SHARE			

Net income (loss) from continuing operations	\$
Preferred stock dividends	--

Discontinued operations --

Net income (loss) attributed to common stockholders	\$
	==

Weighed shares outstanding 2

Continuing operations	\$
Discontinued operations	\$
	--

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

NOTE 5. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

During April 2003, the FASB issued SFAS 149 - "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", effective for contracts entered into or modified after September 30, 2003, except as stated below and for hedging relationships designated after September 30, 2003. In addition, except as stated below, all provisions of this Statement were applied prospectively. The provisions of this Statement that relate to Statement 133 Implementation Issues that were effective for fiscal quarters that began prior to June 15, 2003, were applied in accordance with their respective effective dates. In addition, paragraphs 7(a) and 23(a), which relate to forward purchases or sales of when-issued securities or other securities that do not yet exist, should be applied to both existing contracts and new contracts entered into after September 30, 2003. The Company does not participate in such transactions and accordingly, the adoption of FASB 149 did not have an impact on the Company's consolidated financial statements.

During May 2003, the FASB issued SFAS 150 - "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for public entities at the beginning of the first interim period

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beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a freestanding financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, Elements of Financial Statements. The Company has adopted FASB 150 which did not have an impact on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria were based on control through voting interest. Interpretation 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity. The consolidation requirements of Interpretation 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to other entities in the first fiscal year or interim period beginning after December 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. In December 2003, the FASB concluded to revise certain elements of FIN 46, which will be issued shortly. The FASB also modified the effective date of FIN 46. For all entities that were previously considered special purpose entities, FIN 46 should be applied in periods ending after December 15, 2003. Otherwise, FIN 46 is to be applied for registrants who file under Regulation SX in periods ending after March 15, 2004, and for registrants who file under Regulation SB, in periods ending after December 15, 2004. The Company does not expect the adoption to have a material impact on the Company's consolidated financial position or results of operations.

In December 2003, the FASB concluded to revise certain elements of FIN 46, primarily to clarify the required accounting for interests in variable interest entities. FIN-46R replaces FIN-46 that was issued in January 2003. FIN-46R exempts certain entities from its requirements and provides for special effective dates for entities that have fully or partially applied FIN-46 as of December 24, 2003. In certain situations, entities have the option of applying or continuing to apply FIN-46 for a short period of time before applying FIN-46R. In general, for all entities that were previously considered special purpose entities, FIN 46 should be applied for registrants who file under Regulation SX in periods ending after March 31, 2004, and for registrants who file under Regulation SB, in periods ending after December 15, 2004. The Company does not expect the adoption to have a material impact on the Company's financial position or results of operations.

In December 2003, the FASB issued a revised SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" which replaces the previously issued Statement. The revised Statement increases the existing disclosures for defined benefit pension plans and other defined benefit postretirement plans. However, it does not change the measurement or recognition of those plans as required under SFAS No. 87, "Employers' Accounting for Pensions," SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Specifically, the revised Statement requires companies to provide additional disclosures about pension plan assets, benefit obligations, cash flows, and benefit costs of defined benefit pension plans and other defined benefit postretirement plans. Also, companies are required to provide a breakdown of

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plan assets by category, such as debt, equity and real estate, and to provide certain expected rates of return and target allocation percentages for these asset categories. The Company has implemented this pronouncement and has concluded that the adoption has no material impact to the consolidated financial statements.

### NOTE 6. REVENUE RECOGNITION RELATED TO PEO SEGMENT

The Company recognizes its revenues associated with its PEO business pursuant to EITF 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." Previously, the Company reported its worksite employees as a component of direct costs. The Company's revenues are now reported net of worksite employee payroll cost (net method). To conform to the net method, the Company reclassified worksite employee payroll costs for each of its quarters in the fiscal year ended June 30, 2003 and its Form 10K for the year ended June 30, 2002. These reclassifications had no effect on gross profit, operating loss, or net loss.

### NOTE 7. CONVERTIBLE NOTES PAYABLE

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

(In Thousands)

Balance at June 30, 2003 . . . . .	\$	1,857
Issuance of convertible debentures during the nine months ended March 31, 2004 . . . . .		800
Increase in debt discount and beneficial conversion feature.		(770)
Converted into common stock. . . . .		(1,342)
Amortization of value of warrants and preferential conversion feature . . . . .		626
		-----
Balance at March 31, 2004. . . . .	\$	1,171
		=====

### NOTE 8. SHAREHOLDERS' DEFICIENCY

#### Stock Issuances

-----

During the nine months ended March 31, 2004, DRDF issued the following:

- 7,445,000 shares of its common stock for legal and consulting services valued at \$160,150. The value of the services was determined using the market value of DRDF's common stock on the date of issuance;
- 10,272,110 shares of its common stock for compensation valued at \$140,332. The value of the services was determined using the market value of DRDF's common stock on the date of issuance;
- 25,297,220 shares of its common stock for debt of \$471,542;
- 141,204,581 shares of its common stock for the conversion of convertible debentures in the amount of \$1,342,464; and
- 29,500,000 shares of its common stock upon the exercise of options.

### NOTE 9. SEGMENT INFORMATION

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The Company managed and internally reported the Company's business as three 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, 2004 is as follows:

(in thousands)

		TEMPORARY PRODUCTS		SOFTWARE		STAFFING		PEO SERVICES		TOTAL
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)
9-months ended 3/31/03										
Revenues . . . . .	\$	742	\$	241	\$	-	\$	809	\$	1,792
Operating income (loss)		(58)		(265)		-		(2,505)		(2,828)

### NOTE 10. ACQUISITION AND DISPOSITION OF GREENLAND CORPORATION

#### ACQUISITION

On January 14, 2003, the Company completed the acquisition of shares, representing controlling interest, of Greenland Corporation ("Greenland"). Under the terms of the Greenland acquisition, DRDF acquired 19,183,390 shares of common stock of Greenland and received warrants to purchase an additional 95,319,510 shares of Greenland common stock contingent upon the contribution of certain PEO contracts to Greenland. The payment of the exercise price of the warrants was made via the contribution of the required PEO contracts. The purchase price was \$2,225,000 in the form of a promissory note payable to Greenland and is convertible into shares of DRDF common stock at the maturity date, the number of which will be determined by a formula applied to the market price of the shares at the time that the promissory note is converted. The promissory note of \$2,225,000 is payable to Greenland and is eliminated during the consolidation.

The Company contributed the required PEO contracts to Greenland resulting in the warrants being exercised. 115.1 million Greenland common shares were issued to DRDF and delivered pursuant to the terms of the Closing Agreement. The conditions of the exercise of warrants pursuant to the Closing Agreement were met. Accordingly, DRDF holds voting rights to 115.1 million shares of Greenland common stock, representing approximately 85% of the total outstanding Greenland common shares.

On January 14, 2003, four new directors were elected to serve on Greenland's Board of Directors as nominees of DRDF

The purchase price was determined through analysis of Greenland's financial reports as filed with the Securities and Exchange Commission and the potential future performance of Greenland's ExpertHR subsidiary. The total purchase price was arrived at through negotiations.

Greenland's ExpertHR subsidiary provides professional employer services (PEO) to niche markets. Greenland's Check Central subsidiary is an information technology company that has developed the Check Central Solutions' transaction processing system software and related MAXcash Automated Banking Machine (ABM) kiosk designed to provide self-service check cashing and ATM-banking

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functionality. Greenland's common stock trades on the OTC Bulletin Board under the symbol GRLC.

Pursuant to the terms of the Agreement, the actual purchase price was \$0, based on the stated purchase price of \$2,225,000 per the agreement less promissory note payable to \$2,225,000 to Greenland, which was eliminated in the consolidation.

The operating results of Greenland beginning January 14, 2003 are included in the accompanying consolidated statements of operations.

The total purchase price was valued at approximately \$0 and is summarized and allocated as follows in accordance with SFAS No. 141 and 142:

(in thousands)	
Other current assets . . . . .	\$ 4
Property and equipment . . . . .	90
Other non-current assets . . . . .	18
Accounts payable and accrued expenses, and other current liabilities.	(3,202)
Other long-term liabilities. . . . .	(28)
Goodwill . . . . .	3,118
	-----
Purchase price . . . . .	\$ -
	=====

The excess purchase price was allocated to goodwill, as there were no other identifiable intangible assets of Greenland in which to allocate part of the purchase price.

The pro forma consolidated results of operations have not been presented as if the acquisition of Greenland, Inc. had occurred at July 1, 2002, due to the sale of Greenland stock back to Greenland effective March 1, 2004. The pro forma information is not meaningful due to sale of Greenland.

### DISPOSITION

In January 2004, the Company determined to discontinue operations of Greenland, Inc., its professional employment business division, and sold its shares in Greenland, Inc., 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 terms of the sale are as follows: the Company returned all common shares of Greenland except for \$19,183,390 common shares; assign or grant all rights, title and interest the Company had in acquiring any or all interest in ePEO Link, Inc. to Greenland; Greenland canceled a convertible promissory note in the amount of \$2,225,000 issued by the Company to Greenland; and Greenland agreed to forgive and cancel the inter-company transfer debt of the Company to Greenland of approximately \$1.3 million.

Greenland's revenues were \$5,211,000 for the period starting July 1, 2003 to March 31, 2004, and were \$197,000 for the period January 14, 2003 to March 31, 2003. The results of operations of Greenland have been reported separately as discontinued operations.

The assets sold consisted primarily of accounts receivable, deposits, property and equipment, and other assets. The Greenland also assumed all accounts payable

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and accrued liabilities.

Actual operating losses of Greenland during the period from January 1, 2004 through February 29, 2004, were \$693,000, and the gain on the sale of Greenland is estimated to be \$5,049,000 (net of income taxes of \$0). Accordingly, the accompanying Statement of Operations for the three month period ending March 31, 2004 includes a gain of \$4,356,000.

Greenland's revenues for the period starting January 1, 2004 to March 31, 2004, and for the period starting March 17, 2003 date of acquisition to March 31, were \$732,000 and \$197,000, respectively.

The following is a summary of the net assets sold at February 28, 2004:

(in thousands) . . . . .	February 28, 2004	June 30, 2003
	-----	-----
<b>Assets:</b>		
Cash . . . . .	\$ -	\$ 1,043
Accounts receivable . . . . .	406	365
Other current assets . . . . .	135	394
Property and equipment, net . . . . .	77	64
Other assets . . . . .	3,830	4,101
	-----	-----
Total assets . . . . .	\$ 4,448	\$ 5,967
<b>Liabilities:</b>		
Accounts payable . . . . .	\$ 1,237	\$ 1,015
Notes payable . . . . .	830	914
PEO payroll taxes and payroll deduction . . . . .	3,993	2,899
Accrued liabilities . . . . .	1,265	1,907
Other non-current liabilities . . . . .	798	854
	-----	-----
Total liabilities . . . . .	\$ 8,123	\$ 7,589
	-----	-----
Net liabilities of discontinued operations . . . . .	\$ 3,675	\$ 1,622
	=====	=====

### NOTE 11. SUBSEQUENT EVENTS

On April 16, 2004, the Company transferred its ColorBlind software technology, including intellectual property to its Quik Pix, Inc. subsidiary.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-QSB. 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



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"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 three to five distinct images to be displayed with an existing lightbox.

In September 2003, we hired two key persons, the operations, and results thereof 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 for the three and nine months ended March 31, 2004 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.

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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.

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, 2003 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. 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 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. Also see "Liquidity and Capital Resources." and "Risks and Uncertainties - Future Capital Needs."

### RESTRUCTURING AND NEW BUSINESS UNITS

During the year-ended June 30, 2003, we suspended our sales efforts related to the resale of products from other manufacturers, including printers, copiers, and other digital imaging products in order to concentrate on providing financial services to small and medium-size businesses.

Additionally, 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 \$2,250,000 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

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January 2003, Greenland forgave its inter-company account receivable from us, which amount aggregated approximately \$1,375,000. 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.

In March 2003, we purchased certain PEO contracts from Staff Pro Leasing 2 and Staff Pro Leasing, Inc. for \$269,000. The purchase price was paid via an initial cash payment of \$45,000 and the remainder of the purchase price is in the form of a promissory note to be paid over 24 months. The value attributed to the purchased PEO contracts is included as a component of intangible assets in the accompanying consolidated balance sheet and is being amortized over the expected life of the contracts of 5 years.

In September 2003, we hired two key persons, the operations, and results thereof 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 for the three and nine months ended March 31, 2004 are included in our financial statements.

### SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses 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-K for the fiscal year ended June 30, 2003.

### REVENUE RECOGNITION RELATED TO PEO SEGMENT

We recognize revenues associated with its PEO business pursuant to EITF 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." Previously, we reported our worksite employees as a component of direct costs, our revenues are now reported net of worksite employee payroll cost (net method). To conform to the net method, we reclassified worksite employee payroll costs for each of its quarters within the fiscal year ended June 30, 2003 and the annual report on Form 10K for the year ended June 30, 2002. These reclassifications had no effect on gross profit, operating loss, or net loss.

### RESULTS OF OPERATIONS

Revenues

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Total revenues were \$3.5 million and \$379 thousand for the three-month period ended March 31, 2004 and 2003, respectively; an increase of \$3.1 million (820%). The increase was due primarily to the addition of temporary staffing services, which contributed \$2.9 million (83%) of revenues in the 2004 quarter.

Total revenues for the nine-month period ended March 31, 2004 and 2003 were \$9.5 million and \$1.8 million, respectively; and increase of \$7.7 million (429%). The increase was due primarily to the addition of temporary staffing services, which has contributed \$6.3 million (67%) of revenues in the nine month period of 2004. Additionally, we had an increase of \$1.7 (214%) in PEO services from the prior-year period, which is attributed to an increase in our PEO customer base.

### PEO Services

PEO revenues for the three-month period ended March 31, 2004 and 2003 were \$475 thousand and \$155 thousand, respectively; and increase of \$320 thousand (206%) due primarily to an increase in our PEO customer base.

PEO revenues for the nine month period ended March 31, 2004 and 2003 were \$2.5 million and \$809 thousand, respectively; an increase of \$1.7 million (210%). The increase in revenues was due primarily to an increase in our PEO customer base.

### Temporary Staffing

In September 2003, we entered the temporary staffing business through the organization of CallCenterHR and MedicalHR and the acquisition of Jackson Staffing. There were no revenues from temporary staffing in the 2003 fiscal year.

For the three-month and nine-month period ended March 31, 2004, we had \$2.9 million and \$6.2 million in revenues, respectively from our temporary staffing business.

### Imaging Products

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

For the three-month period ended March 31, 2004 and 2003, imaging products revenues were \$91 thousand and \$162 thousand, respectively, a decrease of \$71 thousand (44%). The decrease in product sales was due to the suspension of sales and marketing activities associated with the resale of office products in order to concentrate on color management products and services, including ColorBlind software and PhotoMotion Images.

For the nine-month period ended March 31, 2004 and 2003, imaging products revenues were \$576 thousand and \$742 thousand, respectively; a decrease of \$166 thousand (22%). The decrease in product sales was due to the suspension of sales and marketing activities associated with the resale of office products as described above.

For the three-months ended March 31, 2004 and 2003, revenues from software sales were \$30 thousand and \$62 thousand, respectively. The reduction in software revenues was due to a delay in completing certain versions of our software which can be used with multiple computer operating systems. Revenues from licenses and royalties for the periods were insignificant.

For the nine-months ended March 31, 2004 and 2003, revenues from software sales were \$66 thousand and \$241 thousand, respectively; a decrease of \$175 thousand (73%). The reduction in software revenues was due to circumstances described above. Royalties from the licensing of ColorBlind source code are insignificant and are reported as part of software sales.

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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 month period ended March 31, 2004 and 2003 were \$384 thousand (81% of PEO revenues) and \$58 thousand (37% of PEO revenues), respectively. The decrease in gross profit is due primarily to increased costs of workers' compensation insurance premiums, which could not be passed on to our clients. These costs tend to vary from period-to-period, depending on timing of new contracts and employee risk classifications. However, as noted above, the impact of changes in accrued payroll taxes and workers' compensation serve to offset some of the decrease.

For the nine month period ended March 31, 2004 and 2003, cost of PEO services were \$2.3 million (90% of PEO revenues) and \$201,000 (25% of PEO revenues), respectively. The decrease in gross profit is due primarily to increased costs of workers' compensation insurance premiums, which could not be passed on to our clients. These costs tend to vary from period-to-period, depending on timing of new contracts and employee risk classifications. However, as noted above, the impact of changes in accrued payroll taxes and workers' compensation serve to offset some of the decrease.

For the three-month and nine-month period ended March 31, 2004, the cost of temporary staffing were \$2.7 million (92% of temporary staffing revenues) and \$5.7 million (89% of temporary staffing revenues), respectively. There were no such revenues in the prior-year period.

For the three-month period ended March 31, 2004 and 2003, cost of products sold were \$28 thousand (31% of product sales) and \$48 thousand (30% of product sales), respectively. Product sales continue to decline as we concentrate on other products and services. The decrease in margins is not material.

For the nine month period ended March 31, 2004 and 2003, cost of products sold were \$156 thousand (29% of product sales) and \$365 thousand (49% of product sales), respectively. The decrease in margins is due primarily to changes in product mix and our competitive position with customers.

For the three-month period ended March 31, 2004 and 2003, cost of software, licenses and royalties were \$0 and \$9 thousand, respectively. Costs associated with the production of software and providing licenses is negligible.

For the nine-month period ended March 31, 2004 and 2003, cost of software, licenses and royalties were \$3 thousand (5% of associated revenues) and \$71 thousand (29% of associated revenues), respectively. The decrease is due primarily to decreased business activity while awaiting the completion of new releases of ColorBlind software.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative 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 and other marketing related expenses, and fees for professional services.

Selling, general and administrative expenses for the three-month period ended March 31, 2004 and 2003 were negative \$71 thousand and \$818 thousand (216% of

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total revenues), respectively. As disclosed in "Significant Accounting Policies and Estimates", we rely on estimates for such liabilities related to, among other areas, workers' 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.

Selling, general and administrative expenses for the nine month period ended March 31, 2004 and 2003, were \$4.0 million (42% of total revenues) and \$4 million (222% of total revenues), respectively.

The increase in expenses, after considering the \$1.2 million adjustment for changes in estimates of certain payroll and workers' compensation liabilities, for both the three-month and nine-month period of fiscal 2004 over the prior year is due primarily with increased employee and outside consultants' costs related to the acquisition and integration of Greenland and QPI. However, the decrease in the percentage of total revenues of such costs is due to an overall increase in revenues and business activity.

### OTHER INCOME AND EXPENSE

For the three-month period ended March 31, 2004 and 2003, interest and financing costs were \$434 thousand and \$411 thousand, respectively; an increase of \$23 thousand (6%), which was due, primarily, to a reduction of amortization of debt.

For the nine-month period ended March 31, 2004 and 2003, interest and financing costs were \$1.4 million and \$1.5 million, respectively. The 10% decrease is due to less amortization of debt discounts in the current period.

### GAIN ON EXTINGUISHMENT OF DEBT

For the three-month period ended March 31, 2004 and 2003, gain on extinguishment of debt was \$228 thousand and \$1.3 million, respectively. For the nine-month period ended March 31, 2004 and 2003, gain on extinguishment of debt was \$853 thousand and \$1.9 million, respectively. These amounts are related to accounts payable, which had become stale and uncollectible. Pursuant to an opinion provided by counsel, we elected to record these gains pursuant to the Statute of Limitations in the State of California.

### 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 month period ended March 31, 2004, we issued an additional 213,718,911 shares. These shares of common stock were issued primarily for corporate expenses in lieu of cash, for the conversion of convertible debentures and other debt, and for the exercise of warrants.

As of March 31, 2004, we had negative working capital of \$21 million, an increase in working capital of approximately \$5.8 million since June 30, 2003. This increase was due primarily to our disposition of Greenland Corporation, gains on the disposition of debt, and a change in estimates as previously discussed.

Net cash used in operating activities was \$1.6 million for the nine months ended March 31, 2004 as compared to \$749 thousand for the prior-year period; an

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increase of \$811 thousand. The increase was due primarily to increases in selling, general and administrative expenses associated with the acquisitions of Greenland Corporation and QPI.

Cash used in investing activities was \$158 thousand for the nine-month period ended March 31, 2004, an increase of \$57 thousand from the year-earlier 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 \$50.00 per share. The aggregate amount of such dividends in arrears at March 31, 2004, was approximately \$396 thousand.

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, 2003 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.

### RISKS AND UNCERTAINTIES

Risks Relating to our Business:

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IF WE ARE UNABLE TO SECURE FUTURE CAPITAL, WE WILL BE UNABLE TO CONTINUE OUR OPERATIONS.

Our business has not been profitable in the past and it may not be profitable in the future. We may incur losses on a quarterly or annual basis for a number of reasons, some within and others outside our control. See "Potential Fluctuation in Our Quarterly Performance." The growth of our business will require the commitment of substantial capital resources. If funds are not available from operations, we will need additional funds. We may seek such additional funding through public and private financing, including debt or equity financing. Adequate funds for these purposes, whether through financial markets or from other sources, may not be available when we need them. Even if funds are available, the terms under which the funds are available to us may not be acceptable to us. Insufficient funds may require us to delay, reduce or eliminate some or all of our planned activities.

To successfully execute our current strategy, we will need to improve our working capital position. The report of our independent auditors accompanying the Company's June 30, 2003 financial statements includes an explanatory paragraph indicating there is a substantial doubt about the Company's ability to continue as a going concern, due primarily to the decreases in our working capital and net worth. The Company plans to overcome the circumstances that impact our ability to remain a going concern through a combination of increased revenues and decreased costs, with interim cash flow deficiencies being addressed through additional equity financing.

IF OUR QUARTERLY PERFORMANCE CONTINUES TO FLUCTUATE, IT MAY HAVE A NEGATIVE IMPACT ON OUR BUSINESS.

Our quarterly operating results can fluctuate significantly depending on a number of factors, any one of which could have a negative impact on our results of operations. We may experience significant quarterly fluctuations in revenues and operating expenses as we introduce new products and services. Accordingly, any inaccuracy in our forecasts could adversely affect our financial condition and results of operations. Demand for our products and services could be adversely affected by a slowdown in the overall demand for imaging products

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and/or financial and PEO services. Our failure to complete shipments during a quarter could have a material adverse effect on our results of operations for that quarter. Quarterly results are not necessarily indicative of future performance for any particular period.

SINCE MANY OF OUR COMPETITORS HAVE GREATER FINANCIAL AND MARKETING RESOURCES THAN WE DO, WE MAY EXPERIENCE A REDUCTION IN MARKET SHARE AND REVENUES.

The markets for our products and services are highly competitive and rapidly changing. Some of our current and prospective competitors have significantly greater financial, technical, and marketing resources than we do. Our ability to compete in our markets depends on a number of factors, some within and others outside our control. These factors include: the frequency and success of product and services introductions by us and by our competitors, the selling prices of our products and services and of our competitors' products and services, the performance of our products and of our competitors' products, product distribution by us and by our competitors, our marketing ability and the marketing ability of our competitors, and the quality of customer support offered by us and by our competitors.

The PEO industry is highly fragmented. While many of our competitors have limited operations, there are several PEO companies equal or substantially greater in size than ours. We also encounter competition from "fee-for-service" companies such as payroll processing firms, insurance companies, and human resources consultants. The large PEO companies have substantially more resources than us and provide a broader range of resources than we do.

IF WE ACQUIRE COMPLEMENTARY BUSINESSES, WE MAY NOT BE ABLE TO EFFECTIVELY INTEGRATE THEM INTO OUR CURRENT OPERATIONS, WHICH WOULD ADVERSELY AFFECT OUR OVERALL FINANCIAL PERFORMANCE.

In order to grow our business, we may acquire businesses that we believe are complementary. To successfully implement this strategy, we must identify suitable acquisition candidates, acquire these candidates on acceptable terms, integrate their operations and technology successfully with ours, retain existing customers and maintain the goodwill of the acquired business. We may fail in our efforts to implement one or more of these tasks. Moreover, in pursuing acquisition opportunities, we may compete for acquisition targets with other companies with similar growth strategies. Some of these competitors may be larger and have greater financial and other resources than we do. Competition for these acquisition targets likely could also result in increased prices of acquisition targets and a diminished pool of companies available for acquisition. Our overall financial performance will be materially and adversely affected if we are unable to manage internal or acquisition-based growth effectively. Acquisitions involve a number of risks, including: integrating acquired products and technologies in a timely manner, integrating businesses and employees with our business, managing geographically-dispersed operations, reductions in our reported operating results from acquisition-related charges and amortization of goodwill, potential increases in stock compensation expense and increased compensation expense resulting from newly-hired employees, the diversion of management attention, the assumption of unknown liabilities, potential disputes with the sellers of one or more acquired entities, our inability to maintain customers or goodwill of an acquired business, the need to divest unwanted assets or products, and the possible failure to retain key acquired personnel.

Client satisfaction or performance problems with an acquired business could also have a material adverse effect on our reputation, and any acquired business could significantly under perform relative to our expectations. We cannot be certain that we will be able to integrate acquired businesses, products or technologies successfully or in a timely manner in accordance with our strategic objectives, which could have a material adverse effect on our overall financial



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performance.

In addition, if we issue equity securities as consideration for any future acquisitions, existing stockholders will experience ownership dilution and these equity securities may have rights, preferences or privileges superior to those of our common stock.

IF WE ARE UNABLE TO DEVELOP AND/OR ACQUIRE NEW PRODUCTS IN A TIMELY MANNER, WE MAY EXPERIENCE A SIGNIFICANT DECLINE IN SALES AND REVENUES, WHICH MAY HURT OUR ABILITY TO CONTINUE OPERATIONS.

The markets for our products are characterized by rapidly evolving technology, frequent new product introductions and significant price competition. Consequently, short product life cycles and reductions in product selling prices due to competitive pressures over the life of a product are common. Our future success will depend on our ability to continue to develop new versions of our ColorBlind software and to successfully market PhotoMotion Images. We monitor new technology developments and coordinate with suppliers, distributors and dealers to enhance our products and to lower costs. If we are unable to develop and acquire new, competitive products in a timely manner, our financial condition and results of operations will be adversely affected.

IF WE ARE FOUND TO BE INFRINGING ON A COMPETITOR'S INTELLECTUAL PROPERTY RIGHTS OR IF WE ARE REQUIRED TO DEFEND AGAINST A CLAIM OF INFRINGEMENT, WE MAY BE REQUIRED TO REDESIGN OUR PRODUCTS OR DEFEND A LEGAL ACTION AT SUBSTANTIAL COSTS TO US.

We currently hold only one patent through our QPI subsidiary for its Photomotion product. Our software products are copyrighted and trademarked. However, copyright protection does not prevent other companies from emulating the features and benefits provided by our software. We protect our software source code as trade secrets and make our proprietary source code available to OEM customers only under limited circumstances and specific security and confidentiality constraints.

IF OUR DISTRIBUTORS REDUCE OR DISCONTINUE SALES OF OUR PRODUCTS, OUR BUSINESS MAY BE MATERIALLY AND ADVERSELY AFFECTED.

Some of our products are marketed and sold through a distribution channel of value added resellers, manufacturers' representatives, retail vendors, and systems integrators. We have a small network of dealers and distributors in the United States and internationally. We support our worldwide distribution network and end-user customers through operations headquartered in San Diego and Anaheim, California.

Portions of our sales are made through distributors, who may carry competing product lines. These distributors could reduce or discontinue sales of our products, which could adversely affect us. These independent distributors may not devote the resources necessary to provide effective sales and marketing support of our products. In addition, we are dependent upon the continued viability and financial stability of these distributors, many of which are small organizations with limited capital. These distributors, in turn, are substantially dependent on general economic conditions and other unique factors affecting our markets.

INCREASES IN HEALTH INSURANCE PREMIUMS, UNEMPLOYMENT TAXES, AND WORKERS' COMPENSATION RATES WILL HAVE A SIGNIFICANT EFFECT ON OUR FUTURE FINANCIAL PERFORMANCE.

Health insurance premiums, state unemployment taxes, and workers' compensation rates are, in part, determined by our PEO companies' claims experience, and comprise a significant portion of our direct costs. We employ risk management

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procedures in an attempt to control claims incidence and structure our benefits contracts to provide as much cost stability as possible. However, should we experience a large increase in claims activity, the unemployment taxes, health insurance premiums, or workers' compensation insurance rates we pay could increase. Our ability to incorporate such increases into service fees to clients is generally constrained by contractual agreements with our clients. Consequently, we could experience a delay before such increases could be reflected in the service fees we charge. As a result, such increases could have a material adverse effect on our financial condition or results of operations.

### WE CARRY SUBSTANTIAL LIABILITY FOR WORKSITE EMPLOYEE PAYROLL AND BENEFITS COSTS.

Under our client service agreements, we become a co-employer of worksite employees and we assume the obligations to pay the salaries, wages, and related benefits costs and payroll taxes of such worksite employees. We assume such obligations as a principal, not merely as an agent of the client company. Our obligations include responsibility for (a) payment of the salaries and wages for work performed by worksite employees, regardless of whether the client company makes timely payment to us of the associated service fee; and (2) providing benefits to worksite employees even if the costs incurred by us to provide such benefits exceed the fees paid by the client company. If a client company does not pay us, or if the costs of benefits provided to worksite employees exceed the fees paid by a client company, our ultimate liability for worksite employee payroll and benefits costs could have a material adverse effect on the our financial condition or results of operations.

AS A MAJOR EMPLOYER, OUR OPERATIONS ARE AFFECTED BY NUMEROUS FEDERAL, STATE, AND LOCAL LAWS RELATED TO LABOR, TAX, AND EMPLOYMENT MATTERS.

By entering into a co-employer relationship with employees assigned to work at client company locations, we assume certain obligations and responsibilities or an employer under these laws. However, many of these laws (such as the Employee Retirement Income Security Act ("ERISA") and federal and state employment tax laws) do not specifically address the obligations and responsibilities of non-traditional employers such as PEOs; and the definition of "employer" under these laws is not uniform. Additionally, some of the states in which we operate have not addressed the PEO relationship for purposes of compliance with applicable state laws governing the employer/employee relationship. If these other federal or state laws are ultimately applied to our PEO relationship with our worksite employees in a manner adverse to us, such an application could have a material adverse effect on our financial condition or results of operations.

While many states do not explicitly regulate PEOs, over 20 states have passed laws that have licensing or registration requirements for PEOs, and several other states are considering such regulation. Such laws vary from state to state, but generally provide for monitoring the fiscal responsibility of PEOs and, in some cases, codify and clarify the co-employment relationship for unemployment, workers' compensation, and other purposes under state law. There can be no assurance that we will be able to satisfy licensing requirements of other applicable relations for all states. Additionally, there can be no assurance that we will be able to renew our licenses in all states.

THE MAINTENANCE OF HEALTH AND WORKERS' COMPENSATION INSURANCE PLANS THAT COVER WORKSITE EMPLOYEES IS A SIGNIFICANT PART OF OUR BUSINESS.

The current health and workers' compensation contracts are provided by vendors with whom we have an established relationship, and on terms that we believe to be favorable. While we believe that replacement contracts could be secured on competitive terms without causing significant disruption to our business, there can be no assurance in this regard.

OUR STANDARD AGREEMENTS WITH PEO CLIENTS ARE SUBJECT TO CANCELLATION ON 60-DAYS

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WRITTEN NOTICE BY EITHER THE COMPANY OR THE CLIENT.

Accordingly, the short-term nature of our client service agreements make us vulnerable to potential cancellations by existing clients, which could materially and adversely affect our financial condition and results of operations. Additionally, our results of operations are dependent, in part, upon our ability to retain or replace client companies upon the termination or cancellation of our agreements.

A NUMBER OF PEO INDUSTRY LEGAL ISSUES REMAIN UNRESOLVED WITH RESPECT TO THE CO-EMPLOYMENT AGREEMENT BETWEEN A PEO AND ITS WORKSITE EMPLOYEES, INCLUDING QUESTIONS CONCERNING THE ULTIMATE LIABILITY FOR VIOLATIONS OF EMPLOYMENT AND DISCRIMINATION LAWS.

Our client service agreement establishes a contractual division of responsibilities between our clients and us for various personnel management matters, including compliance with and liability under various government regulations. However, because we act as a co-employer, we may be subject to liability for violations of these or other laws despite these contractual provisions, even if we do not participate in such violations. Although our agreement provides that the client is to indemnify us for any liability attributable to the conduct of the client, we may not be able to collect on such a contractual indemnification claim, and thus may be responsible for satisfying such liabilities. Additionally, worksite employees may be deemed to be our agents, subjecting us to liability for the actions of such worksite employees.

IF THE SUPERIOR SECURITY INTEREST HELD BY IMPERIAL BANK IS REMOVED AND IF ALL OF THE LAWSUITS CURRENTLY FILED WERE DECIDED AGAINST US AND/OR ALL THE JUDGMENTS CURRENTLY OBTAINED AGAINST US WERE TO BE IMMEDIATELY COLLECTED, WE WOULD HAVE TO CEASE OUR OPERATIONS.

Throughout fiscal 2001, 2002 and 2003, and through the date of this filing, approximately fifty trade creditors have made claims and/or filed actions alleging the failure of us to pay our obligations to them in a total amount exceeding \$3 million. These actions are in various stages of litigation, with many resulting in judgments being entered against us. Several of those who have obtained judgments have filed judgment liens on our 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. Should we be required to pay the full amount demanded in each of these claims and lawsuits, we may have to cease our operations. However, to date, the superior security interest held by Imperial Bank has prevented nearly all of these trade creditors from collecting on their judgments.

IF OUR OPERATIONS CONTINUE TO RESULT IN A NET LOSS, NEGATIVE WORKING CAPITAL AND A DECLINE IN NET WORTH, AND WE ARE UNABLE TO OBTAIN NEEDED FUNDING, WE MAY BE FORCED TO DISCONTINUE OPERATIONS.

For several recent periods, up through the present, we had a net loss and negative working capital, which raises substantial doubt about our ability to continue as a going concern. Our losses have resulted primarily from an inability to achieve revenue targets due to insufficient working capital. Our ability to continue operations will depend on positive cash flow, if any, from future operations and on our ability to raise additional funds through equity or debt financing. Although we have reduced our work force, suspended some of our operations, and entered into new market segments (financial services), if we are unable to achieve the necessary revenues or raise or obtain needed funding, we may be forced to discontinue operations.

IF AN OPERATIONAL RECEIVER IS REINSTATED TO CONTROL OUR OPERATIONS, WE MAY NOT BE ABLE TO CARRY OUT OUR BUSINESS PLAN.

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On August 20, 1999, at the request of Imperial Bank, our primary lender, the Superior Court, San Diego appointed an operational receiver to us. On August 23, 1999, the operational receiver took control of our day-to-day operations. On June 21, 2000, the Superior Court, San Diego issued an order dismissing the operational receiver as a part of a settlement of litigation with Imperial Bank pursuant to the Settlement Agreement effective as of June 20, 2000. The Settlement Agreement requires that we make monthly payments of \$150,000 to Imperial Bank until the indebtedness is paid in full. This agreement does not require us to pay any interest unless we default on the settlement agreement and fail to cure the default. Regardless, we have continued to accrue interest on this debt until it has been paid and there is no possibility that such interest will become due and payable. However, in the future, without additional funding sufficient to satisfy Imperial Bank and our other creditors, as well as providing for our working capital, there can be no assurances that an operational receiver may not be reinstated. If an operational receiver is reinstated, we will not be able to expand our products nor will we have complete control over sales policies or the allocation of funds.

The penalty for noncompliance of the Settlement Agreement is a stipulated judgment that allows Imperial Bank to immediately reinstate the operational receiver and begin liquidation proceedings against us. Our current arrangement with Imperial Bank reduces are monthly payments to \$50,000. The remaining balance due is approximately \$3.1 million.

WE HAVE NOT REMAINED CURRENT IN OUR PAYMENT OF FEDERAL AND STATE INCOME AND OTHER PAYROLL-RELATED TAXES WITHHELD IN OUR PEO BUSINESS.

We have not been able to remain current in our payments of federal and state tax obligations related to our PEO operations. We are currently working with the Internal Revenue Service and state agencies to resolve these issues and establish repayment plans. If we are not able to establish repayment plans that allow us to continue our operations, we may be forced to cease doing business in the financial services marketplace.

Risks Relating to our Stock:

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THE ISSUANCE OF THE SHARES PURSUANT TO OUTSTANDING CONVERTIBLE NOTES WILL RESULT IN DILUTION.

There are a large number of shares underlying convertible notes and warrants that may be available for future sale and the sale of these shares may depress the market price of our common stock and may cause substantial dilution to existing stockholders.

The number of shares of common stock issuable upon conversion of convertible notes may increase if the market price of our stock declines. Nearly all of the shares issuable upon conversion of notes and debentures and upon exercise of warrants, may be sold without restriction. The sale of these shares may adversely affect the market price of our common stock. The issuance of shares upon conversion of convertible notes and debentures and exercise of outstanding warrants will also cause immediate and substantial dilution to existing stockholders and may make it difficult to obtain additional capital.

THE OVERHANG AFFECT FROM THE RESALE OF SELLING SHAREHOLDERS' SECURITIES ON THE MARKET COULD RESULT IN LOWER STOCK PRICES WHEN CONVERTED

Overhang can translate into a potential decrease in our market price per share. The common stock underlying unconverted debentures represents overhang. These outstanding debentures are converted into common stock at a discount to the market price providing the debenture holder the ability to sell his or her stock at or below market and still make a profit, which is incentive for the holder to

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sell the shares as quickly as possible to ensure as much profit as possible in case the stock price falls. If the share volume cannot absorb the discounted shares, our market price per share will likely decrease. As the market price decreases, each subsequent conversion will require a larger quantity of shares.

SHORT SELLING COMMON STOCK BY WARRANT AND DEBENTURE HOLDERS MAY DRIVE DOWN THE MARKET PRICE OF OUR STOCK.

The warrant and debenture holders may sell shares of our common stock on the market before exercising the warrant or converting the debenture. The stock is usually offered at or below market since the warrant and debenture holders receive stock at a discount to market. Once the sale is completed the holders exercise or convert a like dollar amount of shares. If the stock sale lowered the market price, upon exercise or conversion, the holders would receive a greater number of shares than they would have absent the short sale. This pattern may result in the spiraling down of our stock's market price.

THE MARKET PRICE OF OUR COMMON STOCK HISTORICALLY HAS FLUCTUATED SIGNIFICANTLY.

Our stock price could fluctuate significantly in the future based upon any number of factors such as: general stock market trends, announcements of developments related to our business, fluctuations in our operating results, a shortfall in our revenues or earnings compared to the estimates of securities analysts, announcements of technological innovations, new products or enhancements by us or our competitors, general conditions in the markets we serve, general conditions in the worldwide economy, developments in patents or other intellectual property rights, and developments in our relationships with our customers and suppliers.

In addition, in recent years the stock market in general, and the market for shares of technology and other stocks have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. Similarly, the market price of our common stock may fluctuate significantly based upon factors unrelated to our operating performance.

OUR COMMON STOCK IS SUBJECT TO THE "PENNY STOCK" RULES OF THE SEC AND THE TRADING MARKET IN OUR SECURITIES IS LIMITED, WHICH MAKES TRANSACTIONS IN OUR STOCK CUMBERSOME AND MAY REDUCE THE VALUE OF AN INVESTMENT IN OUR STOCK.

Our shares of Common Stock are "penny stocks" as defined in the Exchange Act, which are quoted in the over-the-counter market on the OTC Bulletin Board. As a result, an investor may find it more difficult to dispose of or obtain accurate quotations as to the price of the shares of the Common Stock being registered hereby. In addition, the "penny stock" rules adopted by the Commission under the Exchange Act subject the sale of the shares of the Common Stock to certain regulations which impose sales practice requirements on broker-dealers. For example, broker-dealers selling such securities must, prior to effecting the transaction, provide their customers with a document that discloses the risks of investing in such securities. Included in this document are: (1) the bid and offer price quotes for the penny stock, and the number of shares to which the quoted prices apply; (2) the brokerage firm's compensation for the trade; and (3) the compensation received by the brokerages firm's salesperson for the trade.

In addition, the brokerage firm must send the investor: (1) monthly account statement that gives an estimate of the value of each penny stock in your account; (2) a written statement of your financial situation and investment goals; and (3) legal remedies, which may be available to you, are as follows: (a) if penny stocks are sold to you in violation of your rights listed above, or other federal or state securities laws, you may be able to cancel your purchase and get your money back.; (b) if the stocks are sold in a fraudulent manner, you

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may be able to sue the persons and firms that caused the fraud for damages; and (c) if you have signed an arbitration agreement, however, you may have to pursue your claim through arbitration.

If the person purchasing the securities is someone other than an accredited investor or an established customer of the broker-dealer, the broker-dealer must also approve the potential customer's account by obtaining information concerning the customer's financial situation, investment experience and investment objectives. The broker-dealer must also make a determination whether the transaction is suitable for the customer and whether the customer has sufficient knowledge and experience in financial matters to be reasonably expected to be capable of evaluating the risk of transactions in such securities. Accordingly, the Commission's rules may limit the number of potential purchasers of the shares of the Common Stock.

RESALE RESTRICTIONS ON TRANSFERRING "PENNY STOCKS" ARE SOMETIMES IMPOSED BY SOME STATES, WHICH MAY MAKE TRANSACTIONS IN OUR STOCK CUMBERSOME AND MAY REDUCE THE VALUE OF AN INVESTMENT IN OUR STOCK.

Various state securities laws impose restrictions on transferring "penny stocks" and as a result, investors in the Common Stock may have their ability to sell their shares of the Common Stock impaired. For example, the Utah Securities Commission prohibits brokers from soliciting buyers for "penny stocks", which makes selling them more difficult.

OUR ABSENCE OF DIVIDENDS OR THE ABILITY TO PAY THEM PLACES A LIMITATION ON ANY INVESTORS RETURN.

We anticipate that, for the foreseeable future, earnings will be retained for the development of its business. Accordingly, we do not anticipate paying dividends on the common stock in the foreseeable future. The payment of future dividends will be at the sole discretion of our Board of Directors and will depend on our general business condition.

Information about forward-looking statements  
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This report contains certain forward-looking statements, which involve substantial risks and uncertainties. These forward-looking statements can generally be identified because the context of the statement includes words such as "may," "will," "except," "anticipate," "intend," "estimate," "continue," "believe," or other similar words. Similarly, this prospectus also contains forward-looking statements about our future. Forward-looking statements include statements about our plans, objectives, goals, strategies, expectations for the future, future performance and events, underlying assumptions for all of the above, and other statements, which are not statements of historical facts.

These forward-looking statements involve risks and uncertainties discussed in the risk factor section, which could cause our actual results to materially differ from our forward-looking statements. We make these forward-looking statements based on our analysis of internal and external historical trends, but there can be no assurance that we will achieve the results set forth in these forward-looking statements. Our forward-looking statements are expressed in good faith and we believe that there is a reasonable basis for us to make them.

We have no obligation to update or revise these forward-looking statements to reflect future events.

### 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

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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, these officers have concluded that the design and operation of our disclosure controls and procedures are effective. 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.

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.

### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

On August 22, 2002, we were sued by our former landlord, Carmel Mountain #8 Associates, L.P. or past due rent on its former facilities at 15175 Innovation Drive, San Diego, CA 92127. The amount related to this obligation was included as an expense in the year ended June 30, 2003.

We have been sued in Illinois state court along with AIA/Merriman, our insurance brokers, by the Arena Football League-2 ("AF2"). Damages payable to AF2, should they win the suit, could exceed \$700,000. We expect to defend our position and rely on representations of our insurance brokers. We have also issued a counter suit against the AF2 for failure to disclose information required by our contract and other material misrepresentations management believes the AF2 has made. We are also now considering suing AIA/Merriman, our insurance brokers, for material errors and omissions.

Over the past few years, and through the date of this filing, approximately fifty trade creditors have made claims and/or filed actions alleging the failure of us to pay our obligations to them in a total amount exceeding \$3.0 million, which has been reduced to \$1.8 million during the 2003. These actions are in various stages of litigation, with many resulting in judgments being entered against us. Several of those who have obtained judgments have filed judgment liens on our 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 we and/or our subsidiary companies may be involved in litigation relating to claims arising out of operations in the normal course of business.

#### ITEM 2. CHANGES IN SECURITIES

Common Stock

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During the nine months ended March 31, 2004, we issued the following:

- 7,445,000 shares of its common stock for legal and consulting services valued at \$160,150. The value of the services was determined using the market value of our common stock on the date of issuance;
- 10,272,110 shares of its common stock for compensation valued at \$140,332. The value of the services was determined using the market value of our common stock on the date of issuance;
- 25,297,220 shares of its common stock for debt of \$471,542;
- 141,204,581 shares of its common stock for the conversion of convertible debentures in the amount of \$1,342,464; and
- 29,500,000 shares of its common stock upon the exercise of options.

### 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, 2004 of \$3,145,000.

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

We have filed a Definitive Proxy Statement on Form 14A and the Annual Meeting of Shareholders is scheduled for May 20, 2003 in San Diego, California at our principal offices. There are three proposals included in the Statement, including (1) election of directors, (2) amendment of our Articles of Incorporation to increase the authorized amount of common stock to 1,000,000,000 shares, and (3) appointment of auditors. We will report the results of the shareholders' vote on these proposals as soon as possible following the Annual Meeting.

### ITEM 5. OTHER INFORMATION

None

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

31.1 Rule 13a-14(a) Certification

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

10.1 Agreement of Acquisition between the Company and Quik Pix, Inc., dated April 16, 2004.

#### (b) Reports on Form 8-K

On January 13, 2004, we filed a Current Report on Form 8-L announcing the appointment and subsequent resignation of Thomas Brown as our Chief Financial Officer.

On March 4, 2004, we filed a Current Report on Form 8-K announcing that we had entered into an agreement to dispose of Greenland Corporation.

SIGNATURES

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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 19, 2004

DALRADA FINANCIAL CORPORATION  
(Registrant)

By: /S/ Brian Bonar

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Brian Bonar  
Chairman , Chief Executive Officer, and Acting Chief Financial Officer