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DALRADA FINANCIAL CORP
Form 10QSB
May 21, 2007

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

FORM 10-QSB

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

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
(State or other jurisdiction of
incorporation or organization)

38-3713274
(IRS Employer ID Number)

9449 BALBOA AVENUE, SUITE 210
SAN DIEGO, CA 92123
(Address of principal executive offices)

Registrant's telephone number, including area code:
(858) 427 8700

N/A

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

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

The number of shares outstanding of the registrant's common stock as of May 15, 2007 was 5,136,392.

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

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

PART I - FINANCIAL INFORMATION

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PART I. - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheet
(in thousands, except share data)

| | |
|--|---|
| | March 31, 2007 ----- (unaudited) |
| ASSETS | |
| CURRENT ASSETS | |
| Cash and cash equivalents | \$ -- |
| Accounts receivable, net of allowance of \$248 | 6,514 |
| Debt issue costs | 194 |
| Other current assets | 1,284 |

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| | |
|---|-----------|
| TOTAL CURRENT ASSETS | 7,992 |
| CUSTOMER LIST, net of accumulated amortization of \$181 | 513 |
| PROPERTY AND EQUIPMENT, net of accumulated depreciation of \$144 | 615 |
| WORKER'S COMPENSATION DEPOSIT | 311 |
| TOTAL ASSETS | \$ 9,431 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | |
| CURRENT LIABILITIES | |
| Cash overdraft | \$ 399 |
| Notes payable, current portion (includes related party notes of \$1,620) | 2,370 |
| Accounts payable | 2,848 |
| PEO payroll taxes and other payroll deductions | 9,822 |
| Other accrued expenses | 5,145 |
| Warrant liability | 4,357 |
| Accrued derivative liability | 2,165 |
| TOTAL CURRENT LIABILITIES | 27,106 |
| CONVERTIBLE DEBENTURES, net of discounts of \$2,694 | 4,981 |
| NOTES PAYABLE, net of current portion (includes related party note of \$9,735) | 10,473 |
| TOTAL LIABILITIES | 42,560 |
| COMMITMENTS AND CONTINGENCIES | -- |
| STOCKHOLDERS' DEFICIT | |
| Series A convertible, redeemable preferred stock, \$1,000 par value, 7,500 shares authorized 420.5 shares issued and outstanding | 420 |
| Common stock; \$0.005 par value; 1,000,000,000 shares authorized; 5,136,392 shares issued and outstanding | 26 |
| Common stock warrants | |
| Additional paid-in capital | 88,969 |
| Prepaid consulting | (132) |
| Accumulated deficit | (122,412) |
| TOTAL STOCKHOLDERS' DEFICIT | (33,129) |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$ 9,431 |

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

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations
(in thousands, except share data)

Three Months

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| | March 31, 2007 | March 31, 2006 |
|---|-------------------|-------------------|
| | (unaudited) | (unaudited) |
| REVENUES | | |
| Temporary staffing services | \$ 33,770 | \$ -- |
| PEO Services | 10,482 | 90 |
| Other | 122 | 841 |
| TOTAL REVENUES | 44,374 | 931 |
| COST OF REVENUES | | |
| Cost of temporary staffing | 32,342 | -- |
| Cost of PEO services | 10,981 | 14 |
| Other | -- | -- |
| TOTAL COST OF REVENUES | 43,323 | 14 |
| GROSS PROFIT | 1,051 | 917 |
| OPERATING EXPENSES | | |
| Selling, general and administrative | 4,460 | 1,395 |
| TOTAL OPERATING EXPENSES | 4,460 | 1,395 |
| LOSS FROM OPERATIONS | (3,409) | (478) |
| OTHER INCOME (EXPENSES): | | |
| Interest expense | (686) | (1,135) |
| Note payable settlement | -- | (915) |
| Penalties and interest | (1,822) | (282) |
| Gain on extinguishment of debt | 47 | 3,444 |
| Change in derivative and warrant liabilities | 689 | (720) |
| Gain resulting from reconciliation of payroll tax liabilities to taxing authorities | -- | 1,924 |
| Other, net | (20) | -- |
| TOTAL OTHER INCOME (EXPENSE) | (1,792) | 2,316 |
| INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES AND DISCONTINUED OPERATIONS | (5,201) | 1,838 |
| PROVISION FOR INCOME TAXES | 208 | -- |
| INCOME (LOSS) BEFORE MINORITY INTEREST AND DISCONTINUED OPERATIONS | (5,409) | 1,838 |
| MINORITY INTEREST IN SUBSIDIARY (INCOME) | -- | -- |
| NET INCOME (LOSS) FROM CONTINUING OPERATIONS | (5,409) | 1,838 |

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DISCONTINUED OPERATION:

| | | |
|--|------------|-----------|
| Loss from discontinued operation | -- | -- |
| | ----- | ----- |
| NET INCOME (LOSS) | (5,409) | 1,838 |
| PREFERRED STOCK DIVIDENDS | (5) | (5) |
| NET INCOME (LOSS) ATTRIBUTED TO COMMON | | |
| STOCKHOLDERS | \$ (5,414) | \$ 1,833 |
| | ===== | ===== |
| EARNINGS (LOSS) PER SHARE - BASIC | | |
| Continuing operations | \$ (1.09) | \$ 0.44 |
| Discontinued operations | -- | -- |
| | ----- | ----- |
| | \$ (1.09) | \$ 0.44 |
| | ===== | ===== |
| WEIGHTED AVERAGE COMMON EQUIVALENT | | |
| SHARES OUSTANDING - BASIC | 4,971,914 | 4,164,407 |
| | ===== | ===== |

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statement of Stockholders' Deficit
(in thousands, except share data)
(Unaudited)

| | Series A Preferred Stock Shares | Amount | Common Stock Shares | Amount | Additional Paid-in Capital |
|--|------------------------------------|--------|------------------------|--------|----------------------------------|
| | ----- | ----- | ----- | ----- | ----- |
| Balance, June 30, 2006 | 420.5 | 420 | 4,920,066 | 25 | 87,451 |
| Adjusted for separation of reporting entity | | | | | |
| | ----- | ----- | ----- | ----- | ----- |
| Balance, June 30, 2006, as restated | 420.5 | 420 | 4,920,066 | 25 | 87,451 |
| Amortization of prepaid consulting | | | | | |
| Common stock issued for: | | | | | |
| Conversion of notes payable | | | 216,326 | 1 | 126 |
| Value of vested options issued to officers and directors | | | | | 1,392 |
| Net loss | | | | | |
| | ----- | ----- | ----- | ----- | ----- |
| Balance, March 31, 2007 | 420.5 | \$ 420 | 5,136,392 | \$ 26 | \$ 88,969 |
| | ===== | ===== | ===== | ===== | ===== |

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows
(in thousands, except share data)

| | Nine Months Ended | |
|---|----------------------|----------------------|
| | March 31, 2007 | March 31, 2006 |
| | ----- (unaudited) | ----- (unaudited) |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$(13,301) | \$ 4,040 |
| Adjustment to reconcile net income (loss) to net cash used in operating activities | | |
| Depreciation and amortization | 214 | 23 |
| Stock issued for services | -- | 15 |
| Amortization of prepaid consulting | 113 | 19 |
| Amortization of debt discounts | 2,885 | 553 |
| Settlements with investors | -- | 1,231 |
| Change in value of warrant and accrued derivative liabilities | 1,901 | 821 |
| Gain on extinguishment of debt | (550) | (9,047) |
| Gain resulting from reconciliation of payroll tax liabilities to taxing authorities | -- | (1,924) |
| Value of vested option issued to officers and directors | 1,392 | -- |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in: | | |
| Accounts receivable | (4,075) | (609) |
| Other current assets | (581) | 54 |
| Due from affiliates | 6,914 | 885 |
| Worker's compensation deposit | 58 | -- |
| Other assets | 205 | -- |
| Increase (decrease) in: | | |
| Accounts payable and accrued expenses | 1,567 | (97) |
| PEO liabilities | 1,940 | 1,717 |
| Net cash used in operating activities | ----- (1,318) | ----- (2,319) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Cash acquired with (paid for) acquisition | (178) | -- |
| Purchase of furniture and equipment | (48) | (158) |
| Increase in restricted cash | -- | (1,922) |
| Net cash used in investing activities | ----- (226) | ----- (2,080) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Change in cash overdraft, net | 399 | 174 |
| Line of credit, net | -- | 69 |
| Proceeds from notes payable | -- | 4,608 |
| Repayments of notes payable | (230) | (485) |

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| | | |
|--|---------|----------|
| Repayment of borrowings under bank notes payable | -- | (483) |
| Repayments of capital lease obligations | -- | (4) |
| | ----- | ----- |
| Net cash provided by financing activities | 169 | 3,879 |
| | ----- | ----- |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,375) | (520) |
| CASH AND CASH EQUIVALENTS, Beginning of period | 1,375 | -- |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, End of period | \$ -- | \$ (520) |
| | ===== | ===== |

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, Continued
(in thousands, except share data)

| | Nine Months Ended | |
|--|-------------------|-------------|
| | March 31, | March 31, |
| | 2007 | 2006 |
| | ----- | ----- |
| | (unaudited) | (unaudited) |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Interest paid | \$ -- | \$ -- |
| | ===== | ===== |
| Income taxes paid | \$ -- | \$ -- |
| | ===== | ===== |
| SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES: | | |
| Conversion of convertible debentures into common stock | \$ -- | \$278,000 |
| | ===== | ===== |
| Conversion of accounts payable and accrued liabilities into common stock | \$ 127 | \$ 100 |
| | ===== | ===== |
| Net assets acquired in business combinations: | | |
| Cash | \$ 72 | \$ -- |
| Receivables | 1,781 | -- |
| Other current assets | 477 | -- |
| Property and equipment | 384 | -- |
| Worker's compensation deposit | 369 | -- |
| Customer list | 127 | -- |
| Other assets | 205 | -- |
| Accounts payable | 30 | -- |
| Accrued expenses | 2,397 | -- |
| Line of credit | 500 | -- |
| Notes payable | 238 | -- |

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

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

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Dalrada Financial Corporation and Subsidiaries (the "Company" or "DFCO") have been prepared pursuant to the rules of the Securities and Exchange Commission (the "SEC") for quarterly reports on Form 10-QSB and do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America. These financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the periods presented. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended June 30, 2006 included in the Company's annual report on Form 10-KSB filed with the SEC. Interim operating results are not necessarily indicative of operating results for any future interim period or for the full year ended June 30, 2007. The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All inter-company transactions have been eliminated.

STOCK SPLIT

On September 15, 2006, the Company authorized a one for two hundred (1 for 200) reverse stock split of its common stock. There was no change made to the par value of the Company's common stock. All share information for common shares has been retroactively restated for this reverse stock split.

RECLASSIFICATIONS

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

COMPREHENSIVE INCOME

The Company has adopted SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. During the nine months ended March 31, 2007, the Company had no elements of comprehensive income.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, FASB issued SFAS 157 'Fair Value Measurements'. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any

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new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The management is currently evaluating the effect of this pronouncement on financial statements.

In September 2006, FASB issued SFAS 158 'Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106, and 132(R)' This Statement improves financial reporting by requiring an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity

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securities is required to disclose the following information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The management is currently evaluating the effect of this pronouncement on financial statements.

In February of 2007 the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities--Including an amendment of FASB Statement No. 115." The statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The company is analyzing the potential accounting treatment.

FASB Staff Position on FAS No. 115-1 and FAS No. 124-1 ("the FSP"), "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," was issued in November 2005 and addresses the determination of when an investment is considered impaired, whether the impairment on an investment is other-than-temporary and how to measure an impairment loss. The FSP also addresses accounting considerations subsequent to the recognition of other-than-temporary impairments on a debt security, and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The FSP replaces the impairment guidance on Emerging Issues Task Force (EITF) Issue No. 03-1 with references to existing authoritative literature concerning other-than-temporary determinations. Under the FSP, losses arising from impairment deemed to be other-than-temporary, must

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be recognized in earnings at an amount equal to the entire difference between the securities cost and its fair value at the financial statement date, without considering partial recoveries subsequent to that date. The FSP also required that an investor recognize other-than-temporary impairment losses when a decision to sell a security has been made and the investor does not expect the fair value of the security to fully recover prior to the expected time of sale. The FSP is effective for reporting periods beginning after December 15, 2005. The adoption of this statement will not have a material impact on our consolidated financial statements.

FASB Interpretation 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. The amount of tax benefits to be recognized for a tax position that meets the more-likely-than-not recognition threshold is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax benefits relating to tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met or certain other events have occurred. Previously recognized tax benefits relating to tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Interpretation 48 also provides guidance on the accounting for and disclosure of tax reserves for unrecognized tax benefits, interest and penalties and accounting in interim periods. Interpretation 48 is effective for fiscal years beginning after December 15, 2006. The change in net assets as a result of applying this pronouncement will be a change in accounting principle with the cumulative effect of the change required to be treated as an adjustment to the opening balance of retained earnings on January 1, 2007, except in certain cases involving uncertainties relating to income taxes in purchase business combinations. In such instances, the impact of the adoption of Interpretation 48 will result in an adjustment to goodwill. The adoption of this standard had no material impact on the Company's consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The Company adopted SAB 108 in the fourth quarter of 2006 with no impact on its consolidated financial statements.

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, 2007, the Company had a net loss of \$13,301. As of March 31, 2007, the Company had a working capital deficiency of \$19,114 and had a stockholders' deficit of \$33,129. In addition, the Company is delinquent on payroll tax obligations and has been sued by trade creditors for nonpayment of amounts due. The Company is also delinquent in its payments relating to payroll tax liabilities. These conditions raise substantial doubt about its ability to

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continue as a going concern. Management believes that it can continue to raise debt and equity financing to support its operations.

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. Any additional equity or convertible debt financings could result in substantial dilution to the Company's stockholders. If adequate funds are not available, the Company may be required to delay, reduce or eliminate some or all of its planned activities. 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. CHANGE IN REPORTING ENTITY

On March 29, 2007, the Company completed a separation and sale agreement with an effective date of January 1, 2007 with its majority owned subsidiary, The Solvis Group, Inc. ("Solvis"). The purpose of this transaction between the Company and Solvis was to separate the two companies into unrelated reporting entities. Solvis was principally in the business of leasing staff to its customers on a temporary basis. In connection with this separation agreement, the Company also sold its Heritage Staffing, Inc. subsidiary to Solvis. The terms of the separation and sale agreement provided for the Company issuing two notes payable in the amount of \$11,300 and returning shares of Solvis common stock currently owned by the Company which reduced the Company's ownership in Solvis from approximately 85% to approximately 9.9%. In return, the Company received cash, accounts receivable, a forgiveness of intercompany debt and Solvis' clients that are California based staff leasing customers. The Company has valued its 9.9% investment in Solvis at its historical cost of \$0. There are certain payroll tax liabilities of Solvis that the Company may still be liable to pay if not paid by Solvis.

For accounting purposes, this transaction has been recorded as a change in reporting entity. The Company has reported the effect of this change in reporting entity in the financial statements as a prior-period adjustment by adjusting the assets and liabilities balances of the first reporting period presented. An offsetting adjustment of \$160 has been made to the opening balance of accumulated deficit for the first period presented in the accompanying financial statements. The accompanying financial statements have been restated to reflect this change in reporting entity as if it occurred on the beginning of the earliest period presented.

The effect of the separation and sale agreement for operations of the Company as of June 30, 2006 and for the nine months ended March 31, 2007 and 2006 are presented below:

AS OF JUNE 30, 2006

| ASSETS | NEW REPORTING ENTITY ----- | (in thousand) OLD REPORTING ENTITY ----- |
|--------|-------------------------------------|--|
|--------|-------------------------------------|--|

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| | | |
|---|-----------|----------|
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 1,375 | \$ 3,26 |
| Accounts receivable, net | 5 | 1,21 |
| Debt issue costs | 359 | 35 |
| Other current assets | 226 | 3,01 |
| Net assets of discontinued operations | 22 | 2 |
| | ----- | ----- |
| TOTAL CURRENT ASSETS | 1,987 | 7,87 |
| | ----- | ----- |
| CUSTOMER LIST, net | 544 | 58 |
| PROPERTY AND EQUIPMENT, net | 239 | 35 |
| WORKER'S COMPENSATION DEPOSIT | -- | 3,07 |
| INVESTMENT IN ALLIANCE INSURANCE GROUP | -- | 1,40 |
| RECEIVABLE FROM RELATED PARTY | -- | 1,40 |
| OTHER LONG-TERM ASSETS | -- | 1 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 2,770 | \$ 14,69 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| CURRENT LIABILITIES | | |
| Notes payable, current portion | 1,022 | 5,15 |
| Accounts payable | 1,402 | 1,73 |
| PEO payroll taxes and other payroll deductions | 7,882 | 8,45 |
| Accrued payroll and related payroll taxes and deductions | 75 | 9,30 |
| Other accrued expenses | 2,818 | 3,52 |
| Due to affiliate | 3,756 | - |
| Warrant liability | 3,138 | 3,13 |
| Accrued derivative liability | 1,483 | 1,48 |
| | ----- | ----- |
| TOTAL CURRENT LIABILITIES | 21,576 | 32,78 |
| | ----- | ----- |
| CONVERTIBLE DEBENTURES, net of discounts | 2,261 | 2,26 |
| NOTES PAYABLE, net of current portion | 393 | 1,27 |
| | ----- | ----- |
| TOTAL LIABILITIES | 24,230 | 36,31 |
| | ----- | ----- |
| MINORITY INTEREST | -- | - |
| COMMITMENTS AND CONTINGENCIES | -- | - |
| STOCKHOLDERS' DEFICIT | | |
| Series A convertible, redeemable preferred stock, \$1,000 par value, 7,500 shares authorized 420.5 shares issued and outstanding | 420 | 42 |
| Common stock; \$0.005 par value; 1,000,000,000 shares authorized; 4,920,066 shares issued and outstanding | 25 | 2 |
| Additional paid-in capital | 87,451 | 87,45 |
| Prepaid consulting | (245) | (24 |
| Accumulated deficit | (109,111) | (109,27 |
| | ----- | ----- |
| TOTAL STOCKHOLDERS' DEFICIT | (21,460) | (21,62 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$ 2,770 | \$ 14,69 |
| | ===== | ===== |

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FOR THE NINE MONTHS ENDED MARCH 31, 2007

| | (in thousands) | | |
|--|----------------------------|----------------------------|-------------|
| | NEW REPORTING ENTITY | OLD REPORTING ENTITY | DIFFERENCE |
| | ----- | ----- | ----- |
| REVENUES | | | |
| Temporary staffing services | \$ 41,270 | \$ 100,367 | \$ (59,097) |
| PEO Services | 26,229 | 26,229 | -- |
| Other | 1,136 | 1,201 | (65) |
| | ----- | ----- | ----- |
| TOTAL REVENUES | 68,635 | 127,797 | (59,162) |
| | ----- | ----- | ----- |
| COST OF REVENUES | | | |
| Cost of temporary staffing | 39,092 | 91,480 | (52,388) |
| Cost of PEO services | 25,502 | 25,502 | -- |
| Other | -- | 20 | (20) |
| | ----- | ----- | ----- |
| TOTAL COST OF REVENUES | 64,594 | 117,002 | (52,408) |
| | ----- | ----- | ----- |
| GROSS PROFIT | 4,041 | 10,795 | (6,754) |
| | ----- | ----- | ----- |
| OPERATING EXPENSES | | | |
| Selling, general and administrative | 10,298 | 12,545 | (2,247) |
| | ----- | ----- | ----- |
| TOTAL OPERATING EXPENSES | 10,298 | 12,545 | (2,247) |
| | ----- | ----- | ----- |
| LOSS FROM OPERATIONS | (6,257) | (1,750) | (4,507) |
| | ----- | ----- | ----- |
| OTHER INCOME (EXPENSES): | | | |
| Interest expense | (3,657) | (3,775) | 118 |
| Penalties and interest | (1,822) | (1,822) | -- |
| Gain on extinguishment of debt | 550 | 655 | (105) |
| Change in derivative and warrant liabilities | (1,901) | (1,901) | -- |
| Other, net | 16 | (7) | 23 |
| | ----- | ----- | ----- |
| TOTAL OTHER INCOME (EXPENSE) | (6,814) | (6,850) | 36 |
| | ----- | ----- | ----- |
| INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES AND DISCONTINUED OPERATIONS | (13,071) | (8,600) | (4,471) |
| | ----- | ----- | ----- |
| PROVISION FOR INCOME TAXES | 208 | 208 | -- |
| | ----- | ----- | ----- |
| INCOME (LOSS) BEFORE MINORITY INTEREST AND DISCONTINUED OPEATIONS | (13,279) | (8,808) | (4,471) |
| | ----- | ----- | ----- |
| MINORITY INTEREST IN SUBSIDIARY (INCOME) | -- | (550) | 550 |
| | ----- | ----- | ----- |
| NET INCOME (LOSS) FROM CONTINUING OPERATIONS | (13,279) | (9,358) | (3,921) |
| | ----- | ----- | ----- |
| DISCONTINUED OPERATION: | | | |
| Loss from discontinued operation | (22) | (22) | -- |

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| | | | |
|---|-------------|------------|------------|
| NET INCOME (LOSS) | (13,301) | (9,380) | (3,921) |
| PREFERRED STOCK DIVIDENDS | (15) | (15) | -- |
| NET INCOME (LOSS) ATTRIBUTED TO COMMON STOCKHOLDERS | \$ (13,316) | \$ (9,395) | \$ (3,921) |
| EARNINGS (LOSS) PER SHARE - BASIC | | | |
| Continuing operations | \$ (2.69) | \$ (1.79) | \$ (0.91) |
| Discontinued operations | (0.00) | (0.00) | -- |
| | \$ (2.69) | \$ (1.79) | \$ (0.91) |

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FOR THE NINE MONTHS ENDED MARCH 31, 2006

| | (in thousands) | | |
|--|----------------------------|----------------------------|-------------|
| | NEW REPORTING ENTITY | OLD REPORTING ENTITY | DIFFERENCE |
| REVENUES | | | |
| Temporary staffing services | \$ -- | \$ 47,400 | \$ (47,400) |
| PEO Services | 772 | 772 | -- |
| Other | 1,434 | 590 | 844 |
| TOTAL REVENUES | 2,206 | 48,762 | (46,556) |
| COST OF REVENUES | | | |
| Cost of temporary staffing | -- | 41,737 | (41,737) |
| Cost of PEO services | 667 | 668 | (1) |
| Other | -- | 26 | (26) |
| TOTAL COST OF REVENUES | 667 | 42,431 | (41,764) |
| GROSS PROFIT | 1,539 | 6,331 | (4,792) |
| OPERATING EXPENSES | | | |
| Selling, general and administrative | 3,569 | 6,610 | (3,041) |
| TOTAL OPERATING EXPENSES | 3,569 | 6,610 | (3,041) |
| LOSS FROM OPERATIONS | (2,030) | (279) | (1,751) |
| OTHER INCOME (EXPENSES): | | | |
| Interest expense | (1,480) | (1,670) | 190 |
| Note payable settlement | (1,231) | (1,231) | -- |
| Penalties and interest | (849) | (849) | -- |
| Gain on extinguishment of debt | 9,047 | 9,207 | (160) |
| Change in derivative and warrant liabilities | (821) | (821) | -- |
| Gain resulting from reconciliation of | | | |

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| | | | |
|--|----------|----------|------------|
| payroll tax liabilities to taxing authorities | 1,924 | 1,924 | -- |
| Other, net | -- | (67) | 67 |
| | ----- | ----- | ----- |
| TOTAL OTHER INCOME (EXPENSE) | 6,590 | 6,493 | 97 |
| | ----- | ----- | ----- |
| INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES AND DISCONTINUED OPERATIONS | 4,560 | 6,214 | (1,654) |
| PROVISION FOR INCOME TAXES | -- | -- | -- |
| | ----- | ----- | ----- |
| INCOME (LOSS) BEFORE MINORITY INTEREST AND DISCONTINUED OPEATIONS | 4,560 | 6,214 | (1,654) |
| | ----- | ----- | ----- |
| MINORITY INTEREST IN SUBSIDIARY (INCOME) | -- | (256) | 256 |
| | ----- | ----- | ----- |
| NET INCOME (LOSS) FROM CONTINUING OPERATIONS | 4,560 | 5,958 | (1,398) |
| | ----- | ----- | ----- |
| DISCONTINUED OPERATION: | | | |
| Loss from discontinued operation | (520) | (520) | -- |
| | ----- | ----- | ----- |
| NET INCOME (LOSS) | 4,040 | 5,438 | (1,398) |
| PREFERRED STOCK DIVIDENDS | (15) | (15) | -- |
| | ----- | ----- | ----- |
| NET INCOME (LOSS) ATTRIBUTED TO COMMON STOCKHOLDERS | \$ 4,025 | \$ 5,423 | \$ (1,398) |
| | ===== | ===== | ===== |
| EARNINGS (LOSS) PER SHARE - BASIC | | | |
| Continuing operations | \$ 1.16 | \$ 1.58 | \$ (0.42) |
| Discontinued operations | (0.13) | (0.13) | -- |
| | ----- | ----- | ----- |
| | \$ 1.03 | \$ 1.38 | \$ (0.36) |
| | ===== | ===== | ===== |

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NOTE 4. STOCK BASED COMPENSATION

The Company adopted SFAS No. 123 (Revised 2004), SHARE BASED PAYMENT ("SFAS No. 123R"), under the modified-prospective transition method on January 1, 2006. SFAS No. 123R requires companies to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value. Share-based compensation recognized under the modified-prospective transition method of SFAS No. 123R includes share-based compensation based on the grant-date fair value determined in accordance with the original provisions of SFAS No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, for all share-based payments granted prior to and not yet vested as of January 1, 2006 and share-based compensation based on the grant-date fair-value determined in accordance with SFAS No. 123R for all share-based payments granted after January 1, 2006. SFAS No. 123R eliminates the ability to account for the award of these instruments under the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and allowed under the original provisions of SFAS No. 123. Prior to the adoption of SFAS No. 123R, the Company accounted for our stock

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option plans using the intrinsic value method in accordance with the provisions of APB Opinion No. 25 and related interpretations.

For periods presented prior to the adoption of SFAS No. 123R, pro forma information regarding net loss and loss per share as required by SFAS No. 123R has been determined as if the Company had accounted for its employee stock options under the original provisions of SFAS No. 123. The fair value of these options was estimated using the Black-Scholes option pricing model. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the option's vesting period. The pro forma information regarding the effect on operations that is required by SFAS 123 has not been presented since there is no pro forma expense to be shown for the six months ended December 31, 2005. During the nine months ended March 31, 2007, the Company Recognized an expense of \$1,392 related to vested options issued to officers and directors in accordance with SFAS 123R.

NOTE 5. EARNINGS (LOSS) PER COMMON SHARE

The Company reports earnings (loss) per share in accordance with SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share are computed by dividing income (loss) available to common stockholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. The following potential common shares have been excluded from the computation of diluted net loss per share for the nine months ended March 31, 2007: warrants - 7,330,000 and stock options - nil. All warrants are anti-dilutive at March 31, 2007 since the Company incurred a net loss.

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Below is the computation of basic and diluted earnings per share:

| | THREE MONTHS ENDED | | |
|--|--------------------|-----------|--------------|
| | 2007 | | |
| | INCOME/ (LOSS) | SHARES | PER SHARE |
| BASIC EARNINGS (LOSS) PER SHARE | | | |
| Net income (loss) from continuing operations | \$ (5,409) | | \$ |
| Preferred stock dividends | (5) | | |
| | (5,414) | | |
| Discontinued operations | -- | | |
| | \$ (5,414) | | \$ |
| | ===== | | ===== |
| Weighted shares outstanding | | 4,971,914 | |
| Continuing operations | | | \$ (1.09) |
| Discontinued operations | | | \$ -- |
| | | | ----- |

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\$ (1.09)
=====

DILUTED EARNINGS (LOSS) PER SHARE

Net income (loss) from continuing operations N/A
Preferred stock dividends
Interest on convertible debentures
Amortization of discounts on convertible debentures

Discontinued operations

Net income (loss) attributed to common stockholders

Weighed shares outstanding

Conversion of convertible debentures into common stock

Continuing operations

Discontinued operations

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NINE MONTHS ENDED

2007

INCOME/ PER
(LOSS) SHARES SHARE

BASIC EARNINGS (LOSS) PER SHARE

Net income (loss) from continuing operations \$ (13,279)
Preferred stock dividends (15)

(13,294)

Discontinued operations (22)

\$ (13,316)
=====

Net income (loss) attributed to common stockholders

Weighed shares outstanding 4,936,369

Continuing operations \$ (2.69)

Discontinued operations (0.00)

\$ (2.69)
=====

DILUTED EARNINGS (LOSS) PER SHARE

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| | |
|---|-----|
| Net income (loss) from continuing operations | N/A |
| Preferred stock dividends | |
| Interest on convertible debentures | |
| Amortization of discounts on convertible debentures | |

Discontinued operations

Net income (loss) attributed to common stockholders

Weighed shares outstanding

Conversion of convertible debentures into common stock

Continuing operations

Discontinued operations

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NOTE 6. ACQUISITION

On September 12, 2006, DFCO acquired all the outstanding stock for All Staffing Inc., a Tennessee corporation for \$250 in cash and a warrant to purchase 450,000 shares to DFCO's stock, to be valued at \$3,000 36 months after issuance (closing), subject to adjustment.

All Staffing Inc, established in 1991, is a Professional Employer Organization (PEO) located in Lansford, PA. The Company has clients in PA, NJ and NY. All Staffing provides comprehensive outsourcing of human resource and benefit administration, as well as payroll and tax processing as a co-employer with its client companies. All Staffing will undertake certain employment processes and administration for the benefit of all the Dalrada Financial companies.

The operating results of All Staffing beginning September 12, 2006 are included in the accompanying consolidated statements of operations.

The total purchase price was valued at \$250 and is summarized as follows in accordance with SFAS No. 141 and 142:

| | |
|-------------------------------|---------|
| Cash | \$ 72 |
| Accounts receivable | 1,781 |
| Other current assets | 477 |
| Property and equipment | 384 |
| Worker's compensation deposit | 369 |
| Customer list | 127 |
| Other assets | 205 |
| Accounts payable | (30) |
| Accrued expenses | (2,397) |
| Line of credit | (500) |
| Notes payable | (238) |
| | ----- |

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Purchase price \$ 250
=====

The customer list is being amortized over 48 months.

NOTE 7. CONVERTIBLE DEBT FINANCING AND DERIVATIVE LIABILITIES

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS 133"), the holder's conversion right provision, interest rate adjustment provision, liquidated damages clause, cash premium option, and the redemption option (collectively, the debt features) contained in the terms governing the Notes are not clearly and closely related to the characteristics of the Notes. Accordingly, the features qualified as embedded derivative instruments at issuance and, because they do not qualify for any scope exceptions within SFAS 133, they were required by SFAS 133 to be accounted for separately from the debt instrument and recorded as derivative financial instruments.

During the nine months ended March 31, 2007, we recorded an other expense item of \$682 and \$1,219, which relates to the convertible debt features and warrants, respectively, to reflect the change in fair value of the derivative liability.

At each balance sheet date, we adjust the derivative financial instruments to their estimated fair value and analyze the instruments to determine their classification as a liability or equity. As of March 31, 2007, the estimated fair value of our derivative liability was \$2,165, as well as a warrant liability of \$4,357.

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NOTES PAYABLE

During the year ended June 30, 2006, the Company issued notes to third parties, which included six investors. As part of the several financing transactions, the Company also issued warrants to purchase shares of stock at various exercise prices.

| Date of Note ----- | Amount of Notes ----- | Conversion Price(1) ----- | Term of Note ----- |
|-----------------------|--------------------------|------------------------------|-----------------------|
| February 9, 2006 (1) | \$ 130 | \$ 0.452 | 2 years |
| February 13, 2006 | \$ 7,545 | 75% (3) | 2 years |

| Date of Warrants Issued ----- | Number of Warrants ----- | Exercise Price ----- | Term of Warrants ----- |
|----------------------------------|-----------------------------|-------------------------|---------------------------|
| February 13, 2006 | 6,760,000 | \$ 0.105 | 7 years |
| February 13, 2006 (2) | 520,000 | \$ 0.105 | 7 years |

- (1) = no warrants issued with this financing transaction.
- (2) = no debt associated with these warrants.
- (3) = 75% of 20-day pre-conversion market-based price.

The notes contain provisions on interest accrual at the "prime rate" published in The Wall Street Journal from time to time, plus three percent (3%). The

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Interest Rate shall not be less than fifteen percent (15%). Interest shall be calculated on a 360 day year. Interest on the Principal Amount shall be payable monthly, commencing 120 days from the closing and on the first day of each consecutive calendar month thereafter (each, a "Repayment Date") and on the Maturity Date.

Following the occurrence and during the continuance of an Event of Default (as discussed in the Note), the annual interest rate on the Note shall automatically be increased by two percent (2%) per month until such Event of Default is cured.

Debt features. The Holder shall have the right, but not the obligation, to convert all or any portion of the then aggregate outstanding Principal Amount of this Note, together with interest and fees due hereon, into shares of Common Stock.

The proceeds from the financing transactions were allocated to the debt features and to the warrants based upon their fair values. After the latter allocations, the remaining value, if any, is allocated to the Note on the financial statements.

The debt discount is being accreted using the effective interest method over the term of the note.

The value of the discount on the converted notes on the books is being accreted over the term of the note (two years). For the nine months ended March 31, 2007, the Company accreted \$2,720, of debt discount related to the Notes.

WARRANTS ISSUED

The estimated fair value of the warrants at issuance were as follows:

| Date of Warrants Issued | Number of Warrants | Value at Issuance | Volatility Factor |
|-------------------------|--------------------|-------------------|-------------------|
| February 13, 2006 | 6,760,000 | \$ 3,582 | 72% |
| February 13, 2006 | 520,000 | \$ 302 | 72% |

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These amounts have been classified as a derivative instrument and recorded as a liability on the Company's balance sheet in accordance with current authoritative guidance. The estimated fair value of the warrants was determined using the Black-Scholes option-pricing model with a closing price of on the date of issuance and the respective exercise price, a 7.0 year term, and the volatility factor relative to the date of issuance. The model uses several assumptions including: historical stock price volatility (utilizing a rolling 120 day period), risk-free interest rate (3.50%), remaining time till maturity, and the closing price of the Company's common stock to determine estimated fair value of the derivative liability. In valuing the warrants at March 31, 2007, the Company used the closing price of \$0.61, the respective exercise price, as well as the remaining term on each warrant, as well as a volatility of 157%. In accordance with the provisions of SFAS No. 133, Accounting for Derivative Instruments, the Company is required to adjust the carrying value of the instrument to its fair value at each balance sheet date and recognize any change since the prior balance sheet date as a component of Other Income (Expense). The warrant derivative liability at March 31, 2007, had increased to a fair value of

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\$4,357, due in part to an increase in the market value of the Company's common stock to \$0.61 from \$0.15 at June 30, 2006 amount, as well as an increase in the volatility from 90% to 157% which resulted in other expense of \$1,219 on the Company's books.

The recorded value of such warrants can fluctuate significantly based on fluctuations in the market value of the underlying securities of the issuer of the warrants, as well as in the volatility of the stock price during the term used for observation and the term remaining for the warrants.

DEBT FEATURES

In accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS 133"), the debt features provision (collectively, the features) contained in the terms governing the Notes are not clearly and closely related to the characteristics of the Notes. Accordingly, the features qualified as embedded derivative instruments at issuance and, because they do not qualify for any scope exception within SFAS 133, they were required by SFAS 133 to be accounted for separately from the debt instrument and recorded as derivative financial instruments.

Pursuant to the terms of the Notes, these notes are convertible at the option of the holder, at anytime on or prior to maturity. There is an additional interest rate adjustment feature, a liquidated damages clause, a cash premium option, as well as the redemption option. The debt features represents an embedded derivative that is required to be accounted for apart from the underlying Notes. At issuance of the Notes, the debt features had an estimated initial fair value as follows, which was recorded as a discount to the Notes and a derivative liability on the consolidated balance sheet.

Debt Features

| Date of Note | Amount of Notes | Value at Issuance | Carrying Value |
|-------------------|-----------------|-------------------|----------------|
| January 27, 2006 | \$ 112 | \$ 69 | \$ 43 |
| February 9, 2006 | \$ 246 | \$ 133 | \$ 113 |
| February 13, 2006 | \$ 7,545 | \$ 2,515 | \$ 1,448 |

In subsequent periods, if the price of the security changes, the embedded derivative financial instrument related to the debt features will be adjusted to the fair value with the corresponding charge or credit to other expense or income. In valuing the debt features at March 31, 2007, the company used the closing price of \$0.61 and the respective conversion price, a remaining term coinciding with each contract, and a volatility of 0%. For the nine months ended March 31, 2007, due in part to an increase in the market value of the Company's common stock to \$0.61 the Company recorded other expense on the consolidated statement of operations for the change in fair value of the debt features of approximately \$682. At March 31, 2007, the estimated fair value of the debt features was approximately \$2,165.

The recorded value of the debt features related to the Notes can fluctuate significantly based on fluctuations in the fair value of the Company's common stock, as well as in the volatility of the stock price during the term used for observation and the term remaining for the warrants.

The significant fluctuations can create significant income and expense items on the financial statements of the Company.

Because the terms of the convertible notes ("notes") require such classification, the accounting rules required additional convertible notes and non-employee warrants to also be classified as liabilities, regardless of the terms of the new notes and / or warrants. This presumption has been made due to the company no longer having the control to physical or net share settle subsequent convertible instruments because it is tainted by the terms of the notes. Were the notes to not have contained those terms or even if the transactions were not entered into, it could have altered the treatment of the other notes and the conversion features of the latter agreement may have resulted in a different accounting treatment from the liability classification. The notes and warrants, as well as any subsequent convertible notes or warrants, will be treated as derivative liabilities until all such provisions are settled.

For the nine months ended March 31, 2007, the Company recorded other expense of \$1,219 and \$682, related to the increase in value of the debt features and warrants. A tabular reconciliation of this adjustment follows:

For the nine months ended March 31, 2007:

| | |
|----------|--|
| \$ 1,219 | expense, increase in value of warrant liability |
| \$ 682 | expense, increase in value of derivative liability |
| ----- | |
| \$ 1,901 | other expense related to convertible debt |

For the nine months ended March 31, 2007, the Company recorded \$2,720 of interest expense related to the accretion of debt related to the convertible financing.

For the nine months ended March 31, 2007:

| | |
|----------|--|
| \$ 2,720 | of interest expense related to accretion of convertible debt |
| ----- | |
| \$ 2,720 | of interest expense related to convertible debt |

The balance of the carrying value of the convertible debt as of March 31, 2007 is:

| | |
|----------|---|
| \$ 1,605 | original carrying value on convertible debt |
| \$ (228) | converted to equity |
| \$ 3,604 | accretion of convertible debt |
| ----- | |
| \$ 4,981 | March 31, 2007 carrying value of debt |

The balance of the carrying value of the derivative liability as of March 31, 2007 is:

| | |
|-----------|--|
| \$ 2,717 | original value of derivative liability |
| \$(1,234) | income, decrease in value of derivative liability |
| ----- | |
| \$ 1,483 | June 30, 2006 value of derivative liability |
| \$ 682 | expense, increase in value of derivative liability |
| ----- | |
| \$ 2,165 | March 31, 2007 value of derivative liability |

The balance of the carrying value of the warrant liability as of March 31, 2007 is:

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| | |
|----------|---|
| \$ 3,892 | original carrying value of warrant liability |
| \$ (754) | income, decrease in value of warrant liability |
| ----- | |
| \$ 3,138 | June 30, 2006 value of warrant liability |
| \$ 1,219 | expense, increase in value of warrant liability |
| ----- | |
| \$ 4,357 | March 31, 2007 value of warrant liability |

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NOTE 8. NOTES PAYABLE

The following summarizes notes payable (including amounts due to a related party) at March 31, 2007:

| | |
|---|-----------|
| Notes payable to The Solvis Group; interest at 8% per annum; monthly principal payments of \$85 beginning on April 1, 2007 with any unpaid principal and interest due on April 1, 2012. | \$ 8,060 |
| Notes payable to The Solvis Group; interest at 8% per annum; monthly principal payments of \$50 beginning on April 1, 2007 with any unpaid principal and interest due on April 1, 2012. | 3,240 |
| Notes payable to related party | 55 |
| Note payable to a former director | 750 |
| Note payable to individuals assumed with acquisition of All Staffing | 738 |
| | ----- |
| | 12,843 |
| Less current portion | (2,370) |
| | ----- |
| Long-term portion | \$ 10,473 |
| | ===== |

NOTE 9. STOCKHOLDERS' DEFICIENCY

STOCK ISSUANCES

During the nine months ended March 31, 2007, the Company issued 216,326 shares of common stock for the settlement of certain notes payable and accrued interest.

COMMON STOCK WARRANTS

The following is a summary of the warrant activity:

| | PRICE PER SHARE | UNDERLYING COMMON SHARES |
|-------------------------------|-----------------|-----------------------------|
| | ----- | ----- |
| JUNE 30, 2006 | \$0.105 | 7,280,000 |
| Granted | - | - |
| Exercised | - | - |
| Canceled | - | - |
| | | ----- |
| EXERCISABLE AT MARCH 31, 2007 | \$0.105 | 7,280,000 |
| | | ----- |

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The weighted average remaining contractual life of warrants outstanding at March 31, 2007 is 5.85 years. The intrinsic value of the outstanding warrants at March 31, 2007 was \$3,676. The exercise prices for warrants outstanding at March 31, 2007 are as follows:

| NUMBER OF WARRANTS | EXERCISE PRICE |
|-----------------------|-------------------|
| 7,280,000 | \$ 0.105 |
| 7,280,000 | |

Stock Option Activity

The following is a summary of the stock option activity:

| | STOCK OPTION PLANS | UNDERLYING COMMON SHARES |
|-------------------------------|--------------------|--------------------------------|
| | PRICE PER SHARE | |
| JUNE 30, 2006 | \$2.00 - \$5.00 | 340,000 |
| Granted | \$0.36 - \$1.10 | 2,050,910 |
| Exercised | - | - |
| Canceled/Expired | \$0.36 - \$5.00 | (135,000) |
| EXERCISABLE AT MARCH 31, 2007 | | 2,255,910 |

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NOTE 10. RELATED PARTY TRANSACTIONS

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

In September, 2006, the Company entered into a new Agreement to provide Administrative Payroll Services to Employment Systems, Inc., ("ESI") a wholly owned subsidiary of Warning. For the nine months ended March 31, 2007 and 2006, the Company invoiced ESI for services rendered of \$320 and \$401, respectively.

NOTE 11. LITIGATION

The Company and its SourceOne Group ("SOG") subsidiary have been sued by the Arena Football 2 Operating Company, LLC ("Arena") in Wayne County Circuit Court, Michigan. In April 2006, Dalrada and SourceOne Group, Inc. entered into a settlement with AF2 Operating Company, LLC and other parties involved in the matter of AF2 Operating Company, LLC v. SourceOne Group Inc., et al. The net result of the settlement was that Dalrada and SourceOne Group, Inc. are obligated to make a net settlement payment of \$203.

The Company and SOG have been sued by Liberty Mutual Insurance Company ("Liberty") in the United States District Court for the Northern District of

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Illinois. The initial claim by Liberty was estimated by Liberty to be \$829 and is now claimed to exceed \$1,000. In July 2006, the judge dismissed Dalrada from the litigation and dismissed many, but not all, of the claims against SourceOne Group. Management has vigorously contested the claims made by Liberty. Trial is scheduled for October 2007.

On March 17, 2005, Greenland Corporation ("Plaintiff"), filed an amended complaint in the Superior Court of California, County of San Diego, Case No. GIC842605, against the Company and multiple other individuals and entities resulting from a transaction as evidenced by the "Agreement to Acquire Shares" dated August 9, 2002, whereby the Company obtained a controlling equity interest in Plaintiff. Plaintiff contends that the Company engaged in various forms of wrongdoing including breach of fiduciary duty, conversion, conspiracy and aiding and abetting. The Company has filed a cross-complaint alleging various causes of action against Plaintiff and its officers, directors and/or managing agents including Thomas J. Beener, Gene Cross, George Godwin, and Edward Sano. The subject cross-complaint seeks pecuniary and punitive damages resulting from various fraudulent transactions as well as legal malpractice against Mr. Beener. In July 2006, the matter was settled with Dalrada paying \$150 of legal fees incurred by Greenland.

On August 29, 2005, United Bank & Trust filed suit against the Company and other parties. The allegations of the lawsuit are that the Company guaranteed certain debt owed by InfoServices, Inc. and is liable in the amount of \$678. The Company has settled this matter and at March 31, 2007, the remaining amount due is \$189.

The Company was in a dispute with former creditors regarding the amount of debt converted into common stock. These creditors were seeking damages totaling \$316. The Company proposed a settlement in the amount of \$316, based on the advice of the Company's legal counsel. Consequently, \$316 was charged to operations in the accompanying financial statements for the year ended June 30, 2006. The plaintiffs have accepted the settlement offer.

NOTE 12. GAIN ON SETTLEMENT OF DEBT

During the nine months ended March 31, 2007 and 2006, the Company recognized a gain on settlement of debt of \$550 and \$9,047, respectively, which resulted primarily from the write off of stale accounts payable and judgments and the settlement of certain notes payable. The Company, based upon an opinion provided by independent legal counsel, has been released as the obligator of these liabilities. Accordingly, management has elected to adjust its accounts payable and to classify such adjustments as settlement of debt.

NOTE 13. DISCONTINUED OPERATIONS

In November 2005, the Company determined to discontinue operations of Master Staffing, its executive recruiting division. The decision was based on the Master Staffing lack of ability to generate sufficient revenue and the Company's lack of expertise in the executive recruiting business. The Company has completely closed Master Staffing.

For the nine months ended March 31, 2007 and 2006, Master Staffing's revenues were \$0 and \$11, respectively; losses from operations were \$22 and \$520, respectively. The results of operations of Master Staffing have been reported separately as discontinued operations.

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

(in thousands, except share data)

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto included on Form 10-KSB for the year ended June 30, 2006. The statements contained in this Report on Form 10-QSB that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, hopes, intentions or strategies regarding the future. Forward-looking statements include statements regarding: future product or product development; future research and development spending and our product development strategies, and are generally identifiable by the use of the words "may", "should", "expect", "anticipate", "estimates", "believe", "intend", or "project" or the negative thereof or other variations thereon or comparable terminology. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements (or industry results, performance or achievements) expressed or implied by these forward-looking statements to be materially different from those predicted. The factors that could affect our actual results include, but are not limited to, the following: general economic and business conditions, both nationally and in the regions in which we operate; competition; changes in business strategy or development plans; our inability to retain key employees; our inability to obtain sufficient financing to continue to expand operations; and changes in demand for products by our customers.

OVERVIEW

We provide financial and human resource management services, including staffing services and PEO services. Staffing services revenues are generated primarily from short-term staffing, contract staffing, and on-site management. PEO service fees are generated from contractual agreements with clients under which we act as a co-employer of our client's workforce with responsibility for some or all of the client's human resource functions. We recognize revenues from our staffing services for all amounts invoiced, including direct payroll, employer payroll-related taxes, workers' compensation coverage and an administrative fee). PEO service fee revenues are recognized on a net basis in accordance with Emerging Issues Task Force No.99-19, "REPORTING REVENUES GROSS AS A PRINCIPAL VERSUS NET AS AN AGENT" ("EITF No.99-19"). Therefore PEO service fee revenues represent the gross margin generated from our PEO services after deducting the amounts invoiced to PEO customers for direct payroll expenses such as salaries, wages, health insurance and employee out-of-pocket expenses incurred incidental to employment. These amounts are also excluded from cost of revenues. PEO service fees also include amounts invoiced to our clients for employer payroll-related taxes and workers' compensation coverage.

Our business is conducted in California, Colorado, Pennsylvania and Texas. In addition to seeking new markets, we expect to derive most of our revenues from our current markets for the near term. Any weakness in economic conditions or changes in the regulatory environments in these regions could have a material adverse effect on our financial results.

Our services and products are marketed through our operating divisions and subsidiaries. PEO and staffing services are marketed by Dalrada Financial Services (formerly Strategic Staff Leasing), and All Staffing (acquired in September 2006).

Our business continues to experience some liquidity problems. Accordingly,

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year-to-year comparisons may be of limited usefulness as our business continues to experience rapid growth.

Our current strategy is to expand our financial service business, including staff leasing, PEO services, and value added products and services to small and medium-size businesses.

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, 2006 financial statements included in Form 10KSB for the year ended June 30, 2006 includes an explanatory paragraph indicating there is a substantial doubt about our ability to continue as a going concern, due primarily to a working capital deficiency and negative net worth, which is exacerbated by our losses in prior years. In addition, we are current on all our payroll tax filings and have made current payroll tax deposits since October 1, 2006.

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We have sought to reduce our debt through debt to equity conversions. In February 2006 we issued promissory notes for \$7,545, which consisted of a rolling over of approximate \$2,545 in existing debt and \$5,000 in cash. The proceeds were used primarily to pay off promissory notes, convertible note debt, factoring debt, and other debt and to establish collateral backed ACH credit lines.

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.

On March 29, 2007, we completed a separation and sale agreement with an effective date of January 1, 2007 with its majority owned subsidiary, The Solvis Group, Inc. (Solvis). The purpose of this transaction between us and Solvis was to separate the two companies into unrelated reporting entities. Solvis was principally in the business of leasing staff to its customers on a temporary basis. In connection with this separation agreement, we also sold our Heritage Staffing, Inc. subsidiary to Solvis. The terms of the separation and sale agreement provided for us issuing two notes payable in the amount of \$11,300 and returning shares of Solvis common stock currently owned by us which reduced our ownership in Solvis from approximately 85% to approximately 9.9%. In return, we received cash, accounts receivable, a forgiveness of intercompany debt and Solvis' clients that are California based staff leasing customers. There are certain payroll tax liabilities of Solvis that we may still be liable to pay if not paid by Solvis.

For accounting purposes, this transaction has been recorded as a change in reporting entity. We have reported the effect of this change in reporting entity in the financial statements as a prior-period adjustment by adjusting the assets and liabilities balances of the first reporting period presented. An offsetting adjustment of \$160 has been made to the opening balance of accumulated deficit for the first period presented in the accompanying financial statements. The accompanying financial statements have been restated to reflect this change in reporting entity as if it occurred on the beginning of the earliest period presented.

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SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Discussion and Analysis of Financial Condition and Results of Operations discuss our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to allowance for doubtful accounts, value of intangible assets and valuation of non-cash compensation. We base our estimates and judgments on historical experiences and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The most significant accounting estimates inherent in the preparation of our consolidated financial statements include estimates as to the appropriate carrying value of certain assets and liabilities which are not readily apparent from other sources, primarily allowance for doubtful accounts, estimated fair value of equity instruments used for compensation, estimated tax liabilities from 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 elsewhere in this Form 10-KSB.

REVENUE RECOGNITION

PEO SERVICE FEES AND WORKSITE EMPLOYEE PAYROLL COSTS

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

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

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

TEMPORARY STAFFING

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

ALLOWANCE FOR DOUBTFUL ACCOUNTS

We are required to make estimates of the collectibility of accounts receivables. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in the customers' payment tendencies when evaluating the adequacy of the allowance for doubtful accounts. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

INTANGIBLE ASSETS AND GOODWIL

We assess the recoverability of intangible assets and goodwill annually and whenever events or changes in circumstances indicate that the carrying value might be impaired. Factors that are considered include significant underperformance relative to expected historical or projected future operating results, significant negative industry trends and significant change in the manner of use of the acquired assets. Management's current assessment of the carrying value of intangible assets and goodwill indicates there was no impairment as of March 31, 2007. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets.

SALES OF PRODUCTS

Revenue is recognized when earned. Our revenue recognition policies are in compliance with all applicable accounting regulations, including American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, Revenue from packaged product sales to and through distributors and resellers is recorded when related products are shipped. Maintenance and subscription revenue, if any, is recognized ratably over the contract period. When the revenue recognition criteria required for distributor and reseller arrangements are not met, revenue is recognized as payments are received. Provisions are recorded for returns and bad debts. Our software arrangements do not contain multiple elements, and we do not offer post contract support.

RESULTS OF OPERATIONS (IN \$000)

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

REVENUES

Total revenues were \$44,374 and \$931 for the three months ended March 31, 2007 and 2006, respectively; an increase of \$43,443 (4,663%). The principal reason for the increase is due the acquisition of Strategic Staffing on May 1, 2006 and All Staffing on September 12, 2006.

STAFFING

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Revenues from our staffing business units were \$33,770 and \$0 for the three months ended March 31, 2007 and 2006, respectively; an increase of \$33,770. The principal reason for the increase is due the acquisition of Strategic Staffing on May 1, 2006 and All Staffing on September 12, 2006.

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PEO SERVICES

PEO revenues were \$10,482 and \$90 for the three months ended March 31, 2007 and 2006, respectively; an increase of \$10,392 which is due to the aforementioned acquisitions.

Under current GAAP rules, we are required to book PEO revenues on a net fee basis rather than as gross billed payrolls. Gross billing for the three months ended March 31, 2007 and 2006 were approximately \$31,763 and \$270 respectively.

COST OF PRODUCTS SOLD

Costs of staffing for the three months ended March 31, 2007 and 2006 was \$32,342 (95.8% of temporary staffing revenue) and \$0, respectively. The increase in is due to the aforementioned acquisitions.

Cost of PEO services for the three months ended March 31, 2007 and 2006 was \$10,981 (104.8% of PEO revenues) and \$14 (15.6% of PEO revenues), respectively. The decrease in gross profit is due primarily to higher workers' compensation costs and the aforementioned acquisitions.

OPERATING EXPENSES

Operating expenses for the three months ended March 31, 2007 and 2006 were \$4,460 and \$1,395, respectively; an increase of \$3,065 (219.7%). The increase is due to additional operating costs with the acquisition of Strategic Staffing and All Staffing and to the recognition of \$1,392 in stock option compensation expense in accordance with SFAS 123R.

OTHER INCOME AND EXPENSE

Interest expense and financing costs for the three months ended March 31, 2007 and 2006 was \$686 and \$1,135 respectively; a decrease of \$449 (39.6%). The decrease was principally due to higher amortization of debt discounts for the three months ended March 31, 2006.

PENALTIES AND INTEREST

During the three months ended March 31, 2007 and 2006, the Company recognized penalties and interest expense on its tax obligations of \$1,822 and \$282, respectively.

GAIN ON EXTINGUISHMENT OF DEBT

During the three months ended March 31, 2007 and 2006, the Company recognized a gain on settlement of debt of \$47 and \$3,444, respectively, which resulted primarily from the write off of stale accounts payable and the settlement of bank debt and judgments. We, based upon an opinion provided by independent legal counsel, have been released as the obligator of these liabilities.

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CHANGES IN DERIVATIVES AND WARRANTY LIABILITIES

For the three months ended March 31, 2007, we recorded other income of \$689 related to the change in the value of the debt features and warrants principally a result of the decrease in our stock price. For the three months ended March 31, 2006, we recorded other expense of \$720 related to the change in the value of the debt features and warrants principally a result of the increase in our stock price.

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

REVENUES

Total revenues were \$68,635 and \$2,206 for the nine months ended March 31, 2007 and 2006, respectively; an increase of \$66,439 (3,011%). The principal reason for the increase is due the acquisition of Strategic Staffing on May 1, 2006 and All Staffing on September 12, 2006.

STAFFING

Revenues from our staffing business units were \$41,270 and \$0 for the nine months ended March 31, 2007 and 2006, respectively; an increase of \$41,270. The principal reason for the increase is due the acquisition of Strategic Staffing on May 1, 2006 and All Staffing on September 12, 2006.

PEO SERVICES

PEO revenues were \$26,229 and \$772 for the nine months ended March 31, 2007 and 2006, respectively; an increase of \$25,457 (3,298%) which is due to the aforementioned acquisitions.

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Under current GAAP rules, we are required to book PEO revenues on a net fee basis rather than as gross billed payrolls. Gross billing for the nine months ended March 31, 2007 and 2006 were approximately \$79,482 and \$2,339, respectively.

COST OF PRODUCTS SOLD

Costs of staffing for the nine months ended March 31, 2007 and 2006 was \$39,092 (94.7% of temporary staffing revenue) and \$0, respectively. The increase in is due to the aforementioned acquisitions.

Cost of PEO services for the nine months ended March 31, 2007 and 2006 was \$25,502 (97.2% of PEO revenues) and \$667 (86.4% of PEO revenues), respectively. The decrease in gross profit is due primarily to higher workers' compensation costs and the aforementioned acquisitions.

OPERATING EXPENSES

Operating expenses for the nine months ended March 31, 2007 and 2006 were \$10,298 and \$3,569, respectively; an increase of \$6,729 (188.5%). The increase is due to the additions operating costs with the acquisition of Strategic Staffing and All Staffing and to the recognition of \$1,392 in stock option compensation expense in accordance with SFAS 123R.

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OTHER INCOME AND EXPENSE

Interest expense and financing costs for the nine months ended March 31, 2007 and 2006 was \$3,657 and \$1,480 respectively; an increase of \$2,177 (147.1%). The increase was principally due to the increase in debt associated with the February 2006 refinancing, the amortization of debt discount and debt issue cost associated with the February 2006 refinancing and a non-registration penalty.

PENALTIES AND INTEREST

During the nine months ended March 31, 2007 and 2006, the Company recognized penalties and interest expense on its tax obligations of \$1,822 and \$849, respectively.

GAIN ON EXTINGUISHMENT OF DEBT

During the nine months ended March 31, 2007 and 2006, the Company recognized a gain on settlement of debt of \$550 and \$9,047, respectively, which resulted primarily from the write off of stale accounts payable and the settlement of bank debt and judgments. We, based upon an opinion provided by independent legal counsel, have been released as the obligator of these liabilities.

CHANGES IN DERIVATIVES AND WARRANTY LIABILITIES

For the nine months ended March 31, 2007, we recorded other expense of \$1,219 and \$682, related to the increase in value of the debt features and warrants. A tabular reconciliation of this adjustment follows:

For the nine months ended March 31, 2007:

| | |
|----------|--|
| \$ 1,219 | expense, increase in value of warrant liability |
| \$ 682 | expense, increase in value of derivative liability |
| ----- | |
| \$ 1,901 | other expense related to convertible debt |

For the nine months ended March 31, 2007, the Company recorded \$2,720 of interest expense related to the accretion of debt related to the convertible financing.

For the nine months ended March 31, 2007:

| | |
|----------|--|
| \$ 2,720 | of interest expense related to accretion of convertible debt |
| ----- | |
| \$ 2,720 | of interest expense related to convertible debt |

The balance of the carrying value of the convertible debt as of March 31, 2007 is:

| | |
|----------|---|
| \$ 1,605 | original carrying value on convertible debt |
| \$ (228) | converted to equity |
| \$ 3,604 | accretion of convertible debt |
| ----- | |
| \$ 4,981 | March 31, 2007 carrying value of debt |

The balance of the carrying value of the derivative liability as of March 31, 2007 is:

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| | |
|-----------|--|
| \$ 2,717 | original value of derivative liability |
| \$(1,234) | income, decrease in value of derivative liability |
| ----- | |
| \$ 1,483 | June 30, 2006 value of derivative liability |
| \$ 682 | expense, increase in value of derivative liability |
| ----- | |
| \$ 2,165 | March 31, 2007 value of derivative liability |

The balance of the carrying value of the warrant liability as of March 31, 2007 is:

| | |
|----------|---|
| \$ 3,892 | original carrying value of warrant liability |
| \$ (754) | income, decrease in value of warrant liability |
| ----- | |
| \$ 3,138 | June 30, 2006 value of warrant liability |
| \$ 1,219 | expense, increase in value of warrant liability |
| ----- | |
| \$ 4,357 | March 31, 2007 value of warrant liability |

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 year ended June 30, 2006 and the year ended June 30, 2005, we issued an additional 1,241,283 and 914,450 post split shares, respectively. These shares of common stock were issued primarily for corporate expenses in lieu of cash, for acquisition of businesses, for the conversion of convertible debentures and other debt, and for the exercise of warrants.

As of March 31, 2007, we had negative working capital of \$19,114. The Company is current on filing payroll tax returns, but owes approximately \$9.8 million in past due payroll taxes, interest and penalties.

Net cash used in operating activities was \$1,318 for the nine months ended March 31, 2007 as compared \$2,319 for the nine months ended March 31, 2006; an decrease of \$1,001.

Cash provided by financing activities was \$169 for the nine months ended March 31, 2007 as compared to \$3,879 for the nine months ended March 31, 2006, a increase of \$3,710 from the nine months ended March 31, 2006. The primary reason for the increase was due to the issuance of notes payable during the nine months ended March 31, 2006.

We have no material commitments for capital expenditures. Our 5% convertible preferred stock (which ranks prior to our common stock), carries cumulative dividends, when and as declared, at an annual rate of \$50 per share. The aggregate amount of such dividends in arrears at March 31, 2007 was approximately \$489.

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, 2006 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 deficit in our working

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capital and net worth.

CONTINGENT LIABILITY

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

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OFF-BALANCE ARRANGEMENTS

There are no off balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Warning Model Management, Inc. reached a settlement with Berryman & Henigar Enterprises, during the nine months ended March 31, 2007, to pay the aggregate sum of \$380, which has been paid in full. Accordingly, Dalrada's guarantee of this indebtedness is no longer applicable.

ITEM 3. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the period ended March 31, 2007, covered by this quarterly report (the "Evaluation Date"), and based on such evaluation, such officers have concluded, as of the Evaluation Date, that our disclosure controls and procedures were not effective in ensuring that all information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

The material weaknesses in internal control over financial reporting resulting from the Chief Executive Officer and Chief Financial Officer's evaluation are described below. In addition there are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Except as described below, during our third quarter of fiscal 2006, there were no changes made in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Attached as Exhibits 31.1 and 31.2 to this annual report are certifications of the Chief Executive Officer and Chief

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Financial Officer required in accordance with Rule 13a-14(a) of the Exchange Act. This portion of the Company's quarterly report includes the information concerning the controls evaluation referred to in the certifications and should be read in conjunction with the certifications for a more complete understanding of the topics presented.

In conjunction with their audit of our fiscal year 2005 consolidated financial statements, PMB & Co., LLP (PMB), our independent registered public accounting firm, identified and orally reported to management and the Audit Committee the material weaknesses under standards established by the Public Company Accounting Oversight Board (PCAOB). A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects our ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is a more than a remote likelihood that a misstatement of our annual or interim financial statements that is more than inconsequential will not be prevented or detected.

The material weaknesses were identified as:

(1) Planning and implementation of our Accounting System; (2) Financial Statement closing process; (3) Ineffective Information Technology control environment, including the design of our information security and data protection controls; (4) Untimely detection and assessment of impairment of intangible assets (i.e., patents where indicators of impairment are present; (5) Inadequate review of the valuation of certain payroll tax liabilities that resulted in post-closing journal entries to properly reflect our payroll tax liabilities; (6) Proper recording of conversion of debt into shares of common stock, including the ability of certain managers to record journal entries without adequate review or supporting documentation and an inability by management to adequately review the issuance of common stock; and, (7) Lack of the necessary depth of personnel with sufficient technical accounting experience with U.S. GAAP to perform an adequate and effective secondary review of technical accounting matters. We will continue to evaluate the material weaknesses and will take all necessary action to correct the internal control deficiencies identified. We will also further develop and enhance our internal control policies, procedures, systems and staff to allow us to mitigate the risk that material accounting errors might go undetected and be included in our consolidated financial statements.

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We contemplate undertaking a thorough review of our internal controls as part of our preparation for compliance with the requirements under Section 404 of the Sarbanes-Oxley Act of 2002 and we are using this review to further assist in identifying and correcting control deficiencies. At this time, we have not completed our review of the existing controls and their effectiveness. Unless and until the material weaknesses described above, or any identified during this review, are completely remedied, evaluated and tested, there can be no assurances that we will be able to assert that our internal control over financial reporting is effective, pursuant to the rules adopted by the SEC under Section 404, when those rules take effect.

At present, we have taken steps to improve our internal controls through the acquisition and implementation of new accounting systems and additional personnel in our finance departments.

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PART II - OTHER INFORMATION

(in thousands, except per share data)

ITEM 1. LEGAL PROCEEDINGS

The Company and its SourceOne Group ("SOG") subsidiary have been sued by the Arena Football 2 Operating Company, LLC ("Arena") in Wayne County Circuit Court, Michigan. In April 2006, Dalrada and SourceOne Group, Inc. entered into a settlement with AF2 Operating Company, LLC and other parties involved in the matter of AF2 Operating Company, LLC v. SourceOne Group Inc., et al. The net result of the settlement was that Dalrada and SourceOne Group, Inc. are obligated to make a net settlement payment of \$203.

The Company and SOG have been sued by Liberty Mutual Insurance Company ("Liberty") in the United States District Court for the Northern District of Illinois. The initial claim by Liberty was estimated by Liberty to be \$829 and is now claimed to exceed \$1,000. In July 2006, the judge dismissed Dalrada from the litigation and dismissed many, but not all, of the claims against SourceOne Group. Management has vigorously contested the claims made by Liberty. Trial is scheduled for October 2007.

On March 17, 2005, Greenland Corporation ("Plaintiff"), filed an amended complaint in the Superior Court of California, County of San Diego, Case No. GIC842605, against the Company and multiple other individuals and entities resulting from a transaction as evidenced by the "Agreement to Acquire Shares" dated August 9, 2002, whereby the Company obtained a controlling equity interest in Plaintiff. Plaintiff contends that the Company engaged in various forms of wrongdoing including breach of fiduciary duty, conversion, conspiracy and aiding and abetting. The Company has filed a cross-complaint alleging various causes of action against Plaintiff and its officers, directors and/or managing agents including Thomas J. Beener, Gene Cross, George Godwin, and Edward Sano. The subject cross-complaint seeks pecuniary and punitive damages resulting from various fraudulent transactions as well as legal malpractice against Mr. Beener. In July 2006, the matter was settled with Dalrada paying \$150 of legal fees incurred by Greenland.

On August 29, 2005, United Bank & Trust filed suit against the Company and other parties. The allegations of the lawsuit are that the Company guaranteed certain debt owed by InfoServices, Inc. and is liable in the amount of \$678. The Company has settled this matter and at March 31, 2007, the remaining amount due is \$189.

The Company was in a dispute with former creditors regarding the amount of debt converted into common stock. These creditors were seeking damages totaling \$316. The Company proposed a settlement in the amount of \$316, based on the advice of the Company's legal counsel. Consequently, \$316 was charged to operations in the accompanying financial statements for the year ended June 30, 2006. The plaintiffs have accepted the settlement offer.

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

During the three months ended March 31, 2007, the Company issued 166,326 shares of common stock for the settlement of certain notes payable and accrued interest.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

a) Exhibits

- 31.1 Rule 13a-14(a) Certification of CEO
- 31.2 Rule 13a-14(a) Certification of CFO
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CEO
- 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CFO

SIGNATURES

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

Dated: May 21, 2007

DALRADA FINANCIAL CORPORATION
(Registrant)

By: /S/ Brian Bonar

Brian Bonar
Chairman and Chief Executive Officer

By: /S/ David P. Lieberman

David P. Lieberman
Chief Financial Officer

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