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DALRADA FINANCIAL CORP  
Form 10KSB  
October 13, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-KSB

(Mark One)

ANNUAL REPORT PURSUANT SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the fiscal year ended June 30, 2005.

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-12641

DALRADA FINANCIAL CORPORATION  
(Name of small business issuer in its charter)

DELAWARE

13-0021693

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(State or other jurisdiction of  
incorporation or organization)

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(I.R.S. Employer  
Identification No.)

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

Registrant's Telephone number, including area code: (858) 451-6120

Securities registered under 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Act: Common Stock

Indicate by check mark 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 preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 Regulation S-B is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

Yes  No

The issuer had revenues of \$19,476,000 for the fiscal year ended June 30, 2005.

The aggregate market value of the voting stock held by non-affiliates on June 30, 2005 was approximately \$2,153,000 based on the average of the bid and asked prices of the issuer's common stock in the over-the-counter market on such date as reported by the OTC Bulletin Board. As of June 30, 2005, 735,248,867 shares of the issuer's Common Stock were outstanding. As of August 31, 2005, 752,908,407 shares of the issuer's Common Stock were outstanding.

Indicate by check mark whether the registrant is a shell company (as defined in

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Rule 12b-2 of the Exchange Act).

(Check one): Yes [ ] No [X]

### DOCUMENTS INCORPORATED BY REFERENCE

None

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT: YES [ ] NO [X]

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### PART I

#### ITEM 1. DESCRIPTION OF BUSINESS

Dalrada Financial Corporation (OTCBB symbol: DRDF) ("DRDF" or the "Company") was incorporated in March 1982 under the laws of the State of California, and reincorporated in May 1983 under the laws of the State of Delaware. The Company's principal executive offices are located at 9949 Balboa Avenue, Suite 210, San Diego, CA 92123. The Company's main phone number is (858) 277-5300.

We provide a variety of financial, staffing, and human resources services to small and medium-size businesses. These services allow our customers to outsource many human resources tasks, including payroll processing, workers' compensation insurance, health insurance and employee benefits. These financial services relieve existing and potential customers of the burdens associated with personnel management and control.

DRDF provides services through its wholly-owned subsidiaries and division, SourceOne Group, Inc. ("SOG"), Master Staffing and Heritage Staffing; in addition, through The Solvis Group, Inc., ("Solvis") a 90% owned subsidiary that includes several operating units, including CallCenterHR(TM), Worldwide of California, and M&M Nursing. These companies and business units provide a broad range of financial services, including: benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, employer liability management, and temporary staffing services, to small and medium-sized businesses.

In January 2003, we completed the acquisition of a controlling interest approximating 88% of the shares of Greenland Corporation, whose shares were traded on the NASD Electronic Bulletin Board under the symbol GRLC. Subsequently, in March 2004, due to disagreements with Greenland's management, we entered into an agreement with Greenland to return most of our shares in Greenland in return for Greenland's forgiveness of certain DRDF indebtedness and business opportunities. Greenland is not longer affiliated with Dalrada.

In January 2003, we completed the acquisition of a controlling in the shares of Quik Pix, Inc. ("QPI"), located in Anaheim, California. QPI shares are traded on the National Quotation Bureau Pink Sheets(R) under the symbol QPIX. At the time of acquisition, QPI's principal business was providing products and services associated with visual marketing support. At that time, QPI's major source of revenues is in developing and mounting photographic and digital images for use in display advertising for tradeshows and customer building interiors. QPI also has a proprietary product PhotoMotion(TM), which is a patented color medium of multi-image transparencies. The process uses existing originals to create the illusion of movement, and allows for three to five distinct images to be displayed with an existing lightbox.

In July 2005, QPI acquired Solvis from DRDF and changed its name to The

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Solvis Group and its trading symbol to SLVG. Solvis principally serves as a staffing company and provides extensive human resources services. At this time, DRDF owns 90% of Solvis. Also in July 2005, Solvis organized a wholly-owned subsidiary, Imaging Tech, Inc., in order to separately pursue its remaining imaging business.

### Market Overview - Financial and Human Resources Services

Our entry into the financial services and human resources business, in November 2001, was through the acquisition of professional employer organizations ("PEO"). We are expanding the services we provide beyond PEO services, including staffing. Our services cover a broad range of services including payroll management, workers' compensation insurance, and safety programs. Expanded products and services are made available to employers and employees, such as payroll debit cards, group health insurance, 401(k) and 125-Flex plans, supplemental insurance, payroll advances, and other value-added benefits.

The burdens placed on small and medium-sized employers by the complex legal and regulatory issues related to human resources management caused our industry segment to grow beginning in the 1980's. While various service providers have been available to assist these businesses with specific tasks, companies like ours emerged as providers of a more comprehensive range of services relating to the employer/employee relationship. Integral to our client relationships, we assume broad aspects of the employer/employee relationship. Because we provide employee-related services to a large number of employees, we provide economies of scale that provide our clients employment-related functions more efficiently, provide a greater variety of employee benefits, and devote more attention to human resources management.

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We believe that the demand for our services is driven by (1) the trend by small and medium-sized businesses toward outsourcing management tasks outside of core competencies; (2) the difficulty of providing competitive health care and related benefits to attract and retain employees; (3) the increasing costs of health and workers' compensation insurance coverage and workplace safety programs; and (4) complex regulation of labor and employment issues and the related costs of compliance.

### Market Overview - Imaging Products

We continue to operate a business unit (Imaging Tech, Inc., a wholly-owned subsidiary of The Solvis Group) to market our proprietary imaging products and to provide photographic services to selected clientele.

ColorBlind software is a suite of software applications, which allow users to build color profiles of images in order to insure accurate output on digital devices such as printers, plotters, scanners, monitors, and cameras.

Color integrity is an important underlying requirement in the imaging process. The widespread use of color applications at the desktop, demand for higher quality color reproduction, expanded use of the Internet for document dissemination and e-commerce, growth of office networks, and the increased acceptance and use of digital photography are some of the factors that influence our markets.

Photomotion is a patented process for adding multiple images to backlit static displays that appear to change as the viewer passes by the image. The Photomotion process uses existing original art to create an illusion of

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movement; and allows for separate and distinct image displays. It allows for three to five distinct images to be displayed within an existing light box. Images appear to change or "morph" as the viewer passes the display.

We offer a spectrum of services allowing a client to produce color visuals (digital and photographic) according to parameters as specified by a client. We also offer a full range of color laboratory reproduction services.

The market for Photomotion and color reproduction services is large. The products are especially useful in point-of-purchase displays, indoor display advertising, and trade show exhibits and displays. To date, marketing has been limited to targeted customers such as beverage companies, casinos, sports arenas, and other specialty clients.

### Business Strategy

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#### Financial and Human Resources Services

Our business provides a broad range of services associated with human resources management. These include benefits and payroll administration, health and workers' compensation insurance programs, other benefits programs, personnel records management, employer liability management, employee recruiting and selection, performance management, and training and development services.

**Administrative Functions.** We perform a wide variety of processing and record keeping tasks, mostly related to payroll administration and government compliance. Specific examples include payroll processing, payroll tax deposits, quarterly payroll tax reporting, employee file maintenance, unemployment claims processing, workers' compensation claims management and reporting, safety programs, and other benefits administration..

**Workers' Compensation.** We provide workers' compensation insurance through independent carriers and coordinate rates, compliance, claims, safety programs, and medical review. We provide coverage through an A-rated national carrier and take responsibility for payment of premiums and the deposit of adequate reserves against claims.

**Benefit Plans Administration.** We sponsor benefit plans including individual and group health coverage, 401(k) and 125-Flex plans, and others. We are responsible for the costs and premiums associated with these plans, act as plan sponsor and administrator of the plans, negotiate the terms and costs of the plans, maintain the plans in accordance with applicable federal and state regulations, and serve as liaison for the delivery of such benefits to worksite employees.

**Personnel Management.** We provide a variety of personnel management services, which provide our client companies access to resources normally found in the human resources departments of larger companies. Our client companies will have access to a personnel guide, which will set forth a systematic approach to administering personnel policies and practices and can be customized to fit a client company's particular work culture/environment.

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**Employer Liability Management.** We assume many employment-related responsibilities associated with administrative functions and benefit plans administration. Upon request, we can also provide our clients guidance on

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avoiding liability for discrimination, sexual harassment, and civil rights violations. We employ counsel specializing in employment law.

Service Staffing and/or Services Agreement. All clients we serve sign a service staffing agreement and/or services agreement ("Client Agreement"), which establishes our service fee. The client agreement is subject to periodic adjustments to account for changes in the composition of the associated workforce and statutory changes that affect our costs. Our client agreement establishes the division of responsibilities between us and client management at the employee worksite. We are responsible for personnel administration and are liable for certain employment-related government regulation. In addition, we assume liability for payment of salaries, wages (including payroll taxes), and employee benefits of worksite employees. Client company management retains the employees' services and remains liable for the purposes of certain government regulations.

Our business represents a distribution channel for a wide variety of employer and employee benefit programs such as 401(k) plans, 125-Flex plans, legal services, tax consulting, payroll advances, and insurance programs. Our intention is to expand our business through offering a variety of financial services.

Our business is growing rapidly, but profit margins are small. Consequently, profitability depends on (1) economies of scale leading to greater operating efficiencies; and (2) value-added services such as training, education, Internet support, and other services that may be used by employers and employees.

The income model for the service segment of our business generally revolves around fees charged per employee. While gross profit is low, gross revenues are generally substantial. To this end, the Company intends to pursue acquisitions of small firms and strategic alliances with similar companies as ours.

We evaluate our business as one segment even though our staffing and human resources services and products are offered under various brand names.

### Imaging Products and Services

We continue to provide imaging products and services through the Imaging Tech subsidiary of The Solvis Group subsidiary. This business segment includes our proprietary ColorBlind color management software, our patented Photomotion visual images, and photographic services.

Accurate color reproduction is one of the largest single challenges facing the imaging industry. Customers demand systems that are easy to use, predictable and consistent. A color management system is needed so users can convert files for use with different devices. The varying characteristics of each device are captured in a device profile. The International Color Consortium ("ICC") has established a standard for the format for these profiles.

ColorBlind(R) color management software is a pre-packaged suite of applications, utilities, and tools that allow users to precisely create ICC profiles for each device in the color workflow including scanners, monitors, digital cameras, printers, and other specialized digital color input and output devices. Once profiled, ColorBlind balances these profiles to produce accurate, consistent, and reliable color rendering from input to output. ColorBlind software is sold as a stand-alone application or licensed to OEM's for resale to be bundled with peripheral devices.

We operate an internet site, color.com, as a resource center to provide information on the highest quality correct color. This site allows consumers to

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purchase our products, including ColorBlind software; and serves as an information resource for color imaging, including white papers on color imaging and management, links to color consultants and experts, and products.

Photomotion Images(TM) are based upon patented technology. The resulting product is a unique color medium that uses existing original images to create the illusion of movement or multiple static displays that allow three to five distinct images to be displayed in an existing light box. The images appear to change, or "morph," as a viewer passes the display. This ability to put multiple images in a single space, without the need for mechanical devices, allows for the creation of an active and entertaining display. The product is currently marketed in the U.S., Europe, Asia and Latin America.

Visual marketing, including out-of-home media, is a large and growing, multi-billion dollar worldwide industry. An industry survey suggests that the field of visual marketing will increase at a rate of 50% annual for the next ten years. Out-of-home media plays a critical role in the media plans of national and international advertisers.

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### Competition

The financial and human resources services business is highly competitive, with over 800 firms operating in the U.S. There are several firms that operate on a nationwide basis with revenues and resources far greater than ours. Some large PEO companies are owned by insurance carriers and some are public companies whose shares trade on Nasdaq, including Administaff, Inc., Team Staff, Inc., Barrett Business Services, and Staff Leasing, Inc. Also see "Risks and Uncertainties."

The markets for our imaging products and services are also highly competitive and rapidly changing. Our ability to compete in our markets depends on a number of factors, including the success and timing of product and services introductions by us and our competitors, selling prices, performance, distribution, marketing ability, and customer support. A key element of our strategy is to provide competitively-priced, quality products and services.

### Operations

Our corporate headquarters facility in San Diego, California houses most of our administrative operations. Human resource services operations are conducted from the Company's headquarters offices and small branch offices in Michigan and Anaheim California.

### Manufacturing, Production, and Sources of Supply

We manufacture our software products in-house and through selected outside vendors. Also see "Risks and Uncertainties."

### Research and Development

Some of our imaging products are characterized by rapidly evolving technology, frequent new product introductions, and significant price competition. Accordingly, we monitor new technology developments and coordinate with suppliers, distributors and dealers to enhance existing products and to lower costs. Advances in technology require ongoing investment. We have entered into no formal projects in research and development for several years; however, we do make modifications to existing products on an as-needed basis to maintain their currency. Also see "Risks and Uncertainties."

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### Intellectual Property

Our software products are copyrighted. However, copyright protection does not prevent other companies from emulating the features and benefits provided by our software. We protect our software source code as trade secrets and make our proprietary source code available to OEM customers only under limited circumstances and specific security and confidentiality constraints. Imaging Tech, Inc. (The Solvis Group) holds the patent for Photomotion Images. Technology products exist in a rapidly changing business environment. Consequently, we believe the effectiveness of patents, trade secrets, and copyright protection is less important in influencing long term success than the experience of our employees and our contractual relationships. Due to lack of sales of the Photomotion Images, Dalrada intends to fully write-off the value of the related patent at fiscal June 2005 year end. The book value is approximately \$1.6 million.

We have obtained U.S. registration for several of our trade names or trademarks, including ColorBlind, Photomotion Images, MedicalHR, CallCenterHR, SourceOne Group, and The Benefits Bank. These trade names are used to distinguish our products and services in the markets we serve. During fiscal 2005 the Company elected to fully reserve for the costs of the patents.

If we fail to establish that we have not violated the asserted rights, we could be prohibited from marketing the associated product and/or services, and we could be liable for damages. We rely on a combination of trade secret, copyright and trademark protection, and non-disclosure agreements to protect our proprietary rights. Also see "Risks and Uncertainties."

### Employees

Our Company (including subsidiaries, but not including employees pursuant to staffing and/or co-employer client contracts) employed a total of 50 individuals worldwide as of August 31, 2005. Of this number, 10 were involved in sales and marketing, 8 in corporate administration and finance, 30 were in human resources, payroll, and benefits administration, and 2 in engineering and technical support. There is no union representation for any of our employees.

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### Government Regulation

While many states do not explicitly regulate companies like ours, over 20 states have passed laws that have licensing or registration requirements for professional employer organizations ("PEO"), which is a component of our business. Such laws vary from state to state, but generally provide for monitoring the fiscal responsibility of PEOs and, in some cases, codify and clarify the co-employment relationship for unemployment, workers' compensation, and other purposes under state law. We estimate that the annual costs of compliance with these regulations is approximately \$250,000.

### ITEM 2. DESCRIPTION OF PROPERTY

DRDF owns no real property. Dalrada leases the facility at 9449 Balboa Avenue, Suite 210, San Diego, California, 92123. This is a new five year lease entered into on August 3, 2005 by the Christianson Group, a wholly-owned subsidiary.. The facility is approximately 5,397 square feet and will serve as our new corporate headquarters. Payments under the lease are currently \$10.8 thousand per month.

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Dalrada's, Source One Goup, Inc. subsidiary, leases the facility at 1520 Lewis Street, Anaheim California. This is a month-to-month agreement entered into on December 15, 2004 with Employment Systems, Inc.. The facility is approximately 10,000 square feet. Payments under the lease are currently \$2 thousand per month.

Dalrada's, The Solvis Group subsidiary leases the facility at 1520 Lewis Street, Anaheim, California. This is month-to-month agreement entered on December 15, 2004. The facility is approximately 10,000 square feet. Payments under the lease are currently \$6 thousand per month.

### ITEM 3. 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. The claims made by Arena against the Company and SOG are that SOG failed to perform under an agreement to procure and furnish workers' compensation insurance and that Arena incurred alleged damages in an amount no less than \$709 as a result. Management has vigorously contested the claims made by Arena. In addition, the Company has filed claims against Arena and Arena's agent, Thilman and Filippini, based on, among other things, the representations made to SOG that let it to enter into the agreement with Arena. The case remains in the discovery phase.

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 nature of the specific claims made by Liberty against the Company and SOG are that the Company and SOG were and are obligated to make additional premium payments to Liberty for workers' compensation insurance, which is related to the Arena litigation described above. The initial claim by Liberty was estimated by Liberty to be \$829 and is now claimed to exceed \$1,000. Management has vigorously contested the claims made by Liberty. The case remains in the discovery phase.

On February 10, 2005, Berryman & Henigar Enterprises ("Plaintiff"), filed a complaint in the Superior Court of California, County of San Diego, Case No. GIC842610, against Warning Model Management, Inc. for breach of a promissory note issued pursuant to terms and conditions of a certain stock purchase and sale agreement dated September 9, 2004. The Company and its subsidiary, Employment Systems, Inc. ("ESI"), each allegedly guaranteed payments on the underlying promissory note. Plaintiff seeks principal damages of \$750,000.00 in that regard. Warning Model Management, Inc. has taken the position that Plaintiff failed to disclose certain material information in the underlying transaction which thereby negates the promissory note. As such, the guarantees allegedly provided by the Company and ESI could thereby be invalidated. Discovery has commenced but is not complete at this time. Trial has not been set. Management has fully cooperated in our investigation of the facts and we intend to defend against the claims asserted. This Company has reached a verbal settlement with the plaintiff., pending the completion of the signed agreement.

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. Discovery has commenced but is not complete at this time. Trial has not been set. Management has fully cooperated in our investigation of the facts and we intend to continue with vigorous defense against the claims asserted.



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 case is in its early stages and discovery has not yet commenced. However, the Company intends to vigorously defend itself against the claims asserted.

On September 7, 2005, the arbitrator from the American Arbitration Association awarded to Accord Human Resources a judgment against Greenland Corporation and the Company as the guarantor, an amount equaling \$168. Legal counsel has estimated that the claim could amount to as much as \$214. The Company has reserved \$200 for the claim.

Throughout fiscal 2004 and 2005, and through the date of this filing, trade creditors have made claims and/or filed actions alleging the failure of the Company to pay its obligations to them in a total amount exceeding \$3,000. These actions are in various stages of litigation, with many resulting in judgments being entered against the Company. Several of those who have obtained judgments have filed judgment liens on the Company's assets. These claims range in value from less than one thousand dollars to just over one million dollars, with the great majority being less than twenty thousand dollars.

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

ANNUAL MEETING OF STOCKHOLDERS HELD ON MAY 14, 2004

Notice was given and the 2004 Annual Meeting of Stockholders of DALRADA FINANCIAL CORPORATION, formerly Imaging Technologies Corporation, was held at 9449 Balboa Avenue, Suite 211, San Diego, California 92123, at 10 a.m., local time, to where upon the following proposals were approved by a majority of the shareholders:

1. The election of five persons named in the accompanying Proxy Statement to serve as directors on the Company's board of directors (the "Board") and until their successors are duly elected and qualified;
2. To approve an amendment to the Company's certificate of incorporation (the "Certificate of Incorporation") to increase the number of the Common Stock, authorized to be issued from 500,000,000 shares to 1,000,000,000 shares;
3. To ratify the appointment of Pohl, McNabola, Berg and Company, LLP, as the Company's independent auditors for the fiscal year ending June 30, 2004; and
4. To consider and transact such other business as may properly come before the Meeting or any adjournment(s) thereof.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

(a) Our common stock is quoted on the Over-the Counter Bulletin Board, also called the OTCBB, under the trading symbol "DRDF". The following table set forth the quarterly high and low bid prices per share for our common stock. The

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bid prices reflect inter-dealer prices, without retail markup, markdown, or commission and may not represent actual transactions.

	High	Low
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Year ended June 30, 2004		
First quarter	\$ 0.04	\$ 0.01
Second quarter	0.04	0.02
Third quarter	0.02	0.01
Fourth Quarter	0.01	0.01
Year Ended June 30, 2005		
First quarter	\$ 0.01	\$ 0.01
Second quarter	0.00	0.00
Third quarter	0.00	0.00
Fourth quarter	0.00	0.00
Year Ended June 30, 2006		
First quarter	\$ 0.00	\$ 0.00

As of August 31, 2005, there were approximately 498 registered shareholders of DRDF's Common Stock and 747,103,929 shares issued and outstanding.

### Transfer Agent and Registrar

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DRDF's transfer agent is Atlas Stock Transfer, 5899 South State Street, Salt Lake City, Utah 54107, (801)266-7151.

### RECENT SALES OF UNREGISTERED SECURITIES

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DRDF made the following sales of stock without registration using the exceptions available under the Securities Act of 1933, as amended, including unregistered sales made pursuant to Section 4(2) of the Securities Act of 1933, as follows:

#### FISCAL YEAR 2004

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On July 18, 2003, 5,945,946 shares were issued to Bristol Investment Fund at \$0.019 per share for conversion of a convertible debenture valued at \$112,378. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On August 1, 2003, 5,000,000 shares were issued to MarketByte LLC at \$0.025 for consulting services valued at \$125,000. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On October 2, 2003, 12,402,597 shares were issued to Bristol Investment Fund at \$0.025 per share for conversion of a convertible debenture valued at \$312,545. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On October 9, 2003, 175,000 shares were issued to Stull, Stull & Brody at \$0.032 for legal services valued at \$5,600. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

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On October 9, 2003, 1,075,000 shares were issued to Weiss & Yourman at \$0.032 for legal services valued at \$34,400. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On October 2, 2003, 5,876,872 shares were issued to Bristol Investment Fund at \$0.021 per share for conversion of a convertible debenture valued at \$123,414. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On December 18, 2003, 2,454,146 shares were issued to Bristol Investment Fund at \$0.013 per share for conversion of a convertible debenture valued at \$32,640. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On January 4, 2004, 75,000 shares were issued to Gary Fong at \$0.015 for rent valued at \$1,125. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On January 7, 2004, 75,000 shares were issued to Gary Fong at \$0.02 for services valued at \$1,500. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On January 7, 2004, 150,000 shares were issued to Karim Alami at \$0.02 for services valued at \$3,000. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On January 15, 2004, 7,481,989 shares were issued to Amro at \$0.0124 for the conversion of convertible debentures and accrued interest of \$92,777. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On February 2, 2004, 4,523,810 shares were issued to Bristol Capital at \$0.0084 for the conversion of convertible debentures of \$38,000. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On February 4, 2004, 12,000,000 shares were issued (Bonar 7,000,000, Dietrich and Gaer both 2,500,000) pursuant to the exercise of stock options with an exercise price of \$0.006. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On February 19, 2004, 7,500,000 shares were issued (Fryer 5,000,000 and Green 2,500,000) pursuant to the exercise of stock options with an exercise price of \$0.006. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On March 1, 2004, 12,852,603 shares were issued to Bristol Capital at \$0.007 for the conversion of convertible debentures of \$89,968. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On March 5, 2004, 10,000,000 shares were issued (Green and Fryer both 4,875,000 and Dietrich Green 250,000) pursuant to the exercise of stock options with an exercise price of \$0.006. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On March 8, 2004, 2,747,287 shares were issued to Stonestreet at \$0.0073 for the conversion of convertible debentures of \$20,000. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933,

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as amended.

On March 15, 2004, 13,121,275 shares were issued to Bristol Capital at \$0.0049 for the conversion of convertible debentures of \$64,294. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On March 16, 2004, 6,911,011 shares were issued to Balmore at \$0.0088 for the conversion of convertible debentures of \$60,817. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

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On May 10, 2004, two certificates for 20,000,000 and 16,000,000 for an aggregate of 36,600,000 shares, were issued to Bicoastal Consulting Group at \$0.003 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Bicoastal Consulting Group was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On June 1, 2004, 300,000 shares were issued to Reid at \$0.011 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Reid was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On June 2, 2004, 38,927,428 shares were issued to Bristol Investment Fund, Ltd. as a partial conversion of \$118,000 of principal at \$0.003 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Bristol Investment Fund, Ltd. was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On June 2, 2004, 13,954,855 shares were issued to Stonestreet Limited Partnership at \$0.00475 per share for conversion of a convertible debenture valued at \$65,000 plus \$1,285.56 in interest. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On June 2, 2004, 36,771,937 shares were issued to Balmore S.A at \$0.0046526 per share for conversion of a convertible debenture valued at \$140,000 and \$31,087.79 in interest. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended.

On June 3, 2004, 24,524,070 shares were issued to the Stonestreet Limited Partnership as a conversion of a convertible debenture valued at \$98,000 of principal at \$0.004 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Longview Fund, LP was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

FISCAL YEAR 2005

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On July 12, 2004, 38,000,000 shares were issued to the Longview Fund, LP as a partial conversion of a convertible debenture valued at \$175,560 of principal at \$0.00462 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination

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that Longview Fund, LP was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On July 26, 2004, 450,000 shares were issued to Technipower, Inc, at \$.005 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Technipower, Inc. was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On September 28, 2004 Allen, Sheridan and Temple were issued an aggregate of 1,500,000 shares at \$.0025 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that the investors were sophisticated investors with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On September 28, 2004, 10,108,706 shares were issued to Bristol Investment Fund, Ltd. as a partial conversion of \$17,500 of principal and \$3,728.22 of interest at \$.0021 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Bristol Investment Fund, Ltd. was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On October 19, 2004, David Whiteford , Michael Brann , and Jason Brann were issued 375,000, 576,950 and 576,950 shares of Dalrada common stock respectively valued at \$.00458 a shares for they service they performed in relation to the acquisition of Jackson Staffing. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that David Whiteford, Michael Brann and Jason Brann were sophisticated investors with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On October 19, 2004, Anne Woelk was issued 144,000 shares valued at \$.00500 a share for administrative services rendered. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Anne Woelk was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

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On October 22, 2004, 28,427,032 shares were issued to Bristol Investment Fund, Ltd., as a conversion of \$35,000 of principal and \$7,640.55 of interest at \$.00147. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Bristol Investment Fund, Ltd., was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On October 25, 2004, Dominick Zack was issued 4,000,000 shares valued at \$.00500 a share for accounting services rendered in relation to the Jackson Staffing subsidiary. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Dominick Zack was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On October 25, 2004, Deborah McNeil was issued 1,000,000 shares valued at \$.00500 a share for accounting services rendered in relation to the Jackson Staffing subsidiary. These shares were issued pursuant to the exempt provided by

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Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Deborah McNeil was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On December 3, 2004, 23,757,224 shares were issued to Bristol Investment Fund, Ltd. for conversion of \$29,000 of principal and \$6,635.84 of interest at \$0.00154 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Bristol Investment Fund, Ltd., was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On December 13, 2004, 21,121,413 shares were issued to Stonestreet Limited Partnership at \$0.00151 per share for conversion of a convertible debenture valued at \$30,000 plus \$1893.56 in interest. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Stonestreet Limited Partnership was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On April 8, 2005, 46,852,670 shares were issued to Balmore S.A. at \$0.00181 per share for conversion of a convertible debenture valued at \$65,000 plus \$19,803.33 in interest. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Balmore S.A. was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

On June 13, 2005, 6,000,000 shares were issued to John Capezzuto at \$0.005 per share. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that John Capezzuto was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

### Subsequent Issuances

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On July 12, 2005, 17,659,540 shares were issued to Bristol Investment Fund, Ltd. at \$0.001267 per share for conversion of a convertible debenture valued at \$22,374.67. These shares were issued pursuant to the exempt provided by Section 4(2) of the Securities Act of 1933, as amended. We made a determination that Bristol Investment Fund, Ltd was a sophisticated investor with enough knowledge and experience in business to evaluate the risks and merits of the investment.

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## ITEM 6. 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 elsewhere in this Form 10-KSB. The statements contained in this Report on Form 10-KSB 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

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product development; future research and development spending and our product development strategies, and are generally identifiable by the use of the words "may", "should", "expect", "anticipate", "estimates", "believe", "intend", or "project" or the negative thereof or other variations thereon or comparable terminology. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements (or industry results, performance or achievements) expressed or implied by these forward-looking statements to be materially different from those predicted. The factors that could affect our actual results include, but are not limited to, the following: general economic and business conditions, both nationally and in the regions in which we operate; competition; changes in business strategy or development plans; our inability to retain key employees; our inability to obtain sufficient financing to continue to expand operations; and changes in demand for products by our customers.

### OVERVIEW

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

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

In January 2003, we completed the acquisition of controlling interest (approximately 85%) in the shares of Greenland Corporation whose shares are traded on the NASD Electronic Bulletin Board under the symbol GRLC. Subsequently, in March 2004, we entered into an agreement with Greenland to return most of our shares in Greenland in return for Greenland's forgiveness of certain DRDF indebtedness and business opportunities. We no longer have an affiliation with Greenland Corporation.

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

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

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

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

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

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

On April 4, 2005, we completed an acquisition of certain assets of Heritage Staffing Group, Inc. ("Heritage"). The purchase price was \$80 consisting of \$20 in cash, a \$45 note payable to the owner of Heritage and 5,000,000 warrants to purchase shares of DRDF common stock valued at \$14. Heritage is in the temporary staffing business and we acquired certain assets of Heritage to complement our other temporary staffing business.

On May 5, 2005 we established a self-insured worker's compensation program. In connection with this self-insured program, we were required to establish a worker's compensation deposit in the amount of \$2,625. Our maximum exposure under this self-insured worker's compensation program is \$4,200 and we are liable up to \$250 per occurrence. We purchase coverage from a worker's compensation insurer to cover additional losses above the policy limits. We believe that we can expand our staffing business as a result of us establishing this self-insured worker's compensation program

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

To successfully execute our current strategy, we will need to improve our working capital position. The report of our independent auditors accompanying our June 30, 2005 financial statements included elsewhere in this Form 10KSB includes an explanatory paragraph indicating there is a substantial doubt about our ability to continue as a going concern, due primarily to our recent loss from operations, the decreases in our working capital and net worth. In addition, we are late in our filing of payroll tax returns for certain of our PEO divisions and are delinquent on the payment of payroll tax withholdings. We plan to overcome the circumstances that impact our ability to remain a going concern through a combination of achieving profitability, raising additional debt and equity financing, and renegotiating existing obligations. In addition, we will continue to work with the Internal Revenue Service and State taxing Authorities to reconcile and resolve all open accounts and issues.

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

There can be no assurance that we will be able to complete any additional debt or equity financings on favorable terms or at all, or that any such financings, if completed, will be adequate to meet our capital requirements. Any additional



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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.

### SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

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

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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

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

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

Consistent with our revenue recognition policy, our direct costs do not include

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the payroll cost of our worksite employees. Our direct costs associated with our revenue generating activities are comprised of all other costs related to our worksite employees, such as the employer portion of payroll-related taxes, employee benefit plan premiums and workers' compensation insurance premiums.

### SALES OF PRODUCTS

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

### TEMPORARY STAFFING

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

### RESULTS OF OPERATIONS (IN \$000)

YEAR ENDED JUNE 30, 2005 COMPARED TO YEAR ENDED JUNE 30, 2004

#### REVENUES

Total revenues were \$19,476 and \$13,526 for the year ended June 30, 2005 and 2004, respectively; an increase of \$5,950 (44%). The principal reason for the increase is due to a full year of revenue from our temporary staffing division for the year ended June 30, 2005 as compared to only ten months for the same period in 2004 and an overall increase in revenue in our staffing division.

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#### PEO SERVICES

PEO revenues were \$1,930 and \$2,607 for the year ended June 30, 2005 and 2004, respectively; a decrease of \$667 (26%) due primarily to the decrease in our PEO customer base due to an increased focus by us to expand our temporary staffing business.

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### TEMPORARY STAFFING

In September 2003, we entered into an agreement to purchase a temporary staffing business through the organization of CallCenterHR and MedicalHR and the acquisition of Jackson Staffing. In June 2004, we entered into an agreement to purchase certain assets of M&M Nursing, a temporary staffing agency for nurses. During fiscal 2005, Jackson Staffing and M&M Nursing were renamed Solvis Group, Inc. Temporary Staffing revenues were \$17,029 and \$10,119 for the year ended June 30, 2005 and 2004, respectively; an increase of \$6,910 (68%). The principal reason for the increase is due to a full year of revenue from our temporary staffing division for the year ended June 30, 2005 as compared to only ten months for the same period in 2004 and an overall increase in revenue in our staffing division due to our focus to grow this segment of our business.

### PRODUCTS

Sales of products were generated principally from our QPI subsidiary. Products revenues were \$447 and \$764 for the year ended June 30, 2005 and 2004, respectively; a decrease of \$317 (41%). The decrease is principally due to lower sales of photographic and digital images through our QPI subsidiary.

### SOFTWARE

Software revenues were \$70 and \$36 for the year ended June 30, 2005 and 2004, respectively; an increase of \$34 (94%). Revenues from licenses and royalties for the periods were insignificant.

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

### COST OF PRODUCTS SOLD

Cost of PEO services for the year ended June 30, 2005 and 2004 was \$1,424 (74% of PEO revenues) and \$894 (34% of PEO revenues), respectively. The decrease in gross profit is due primarily to us incurring additional employee benefit related costs.

Costs of temporary staffing for the year ended June 30, 2005 and 2004 was \$15,010 (88% of temporary staffing revenue) and \$9,209 (91% of temporary staffing revenue), respectively. The significant increase is due to the increase in temporary staffing revenue.

Cost of products sold for the year ended June 30, 2005 and 2004 were \$93 (21% of product sales) and \$196 (26% of product sales), respectively.

Cost of software, licenses and royalties for the year ended June 30, 2005 and 2004 were \$3 (4% of software, license and royalties revenue) and \$3 (8% of software, license and royalties revenue), respectively.

### OPERATING EXPENSES

Operating expenses for the year ended June 30, 2005 and 2004 were \$5,578 and \$4,196, respectively; an increase of \$1,382 (33%). The increase is due to an overall increase in our business as reflected in the 44% increase in revenues.

During the year ended June 30, 2005, we determined that the cost of the patent was not recoverable and took a write-off related to the patent of \$1,348.

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### OTHER INCOME AND EXPENSE

Interest expense and financing costs for the year ended June 30, 2005 and 2004 was \$1,709 and \$1,930 respectively; a decrease of \$221 (11%). The decrease is principally due to the write off of the unamortized debt discounts associated with the conversion of debentures into common stock for the year ended June 30, 2004 (there were fewer conversions during the year ended June 30, 2005) offset by an increase due to the amount of debt outstanding.

### GAIN ON EXTINGUISHMENT OF DEBT

Gain on the extinguishment of debt was \$829 and \$1145 for the year ended June 30, 2005 and 2004, respectively. The amounts related to accounts payable, which had become stale and uncollectible under the Statute of Limitations in the State of California and upon obtaining a legal opinion with respect to the State of California Statute of Limitations.

### GAIN FROM RECONCILIATION OF PAYROLL TAX LIABILITES TO TAXING AUTHORITIES

During the year ended June 30, 2005, we recorded as other income an adjustment of accrued PEO payroll taxes payable of \$1,895 resulting from reconciliations of certain liabilities with the Internal Revenue Service and certain State taxing authorities of amounts due for delinquent payment of payroll tax liabilities. We continually updates our estimate of the amount due related to delinquent payroll taxes and penalties as we receive correspondence or settlement agreements with the Internal Revenue Service and State taxing authorities.

### LIQUIDITY AND CAPITAL RESOURCES

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

As a result of some of our financing activities, there has been a significant increase in the number of issued and outstanding shares. During the year ended June 30, 2005 and the year ended June 30, 2004, we issued an additional 182,890,125 and 371,126,679 shares, respectively. These shares of common stock were issued primarily for corporate expenses in lieu of cash, for acquisition of businesses, for the conversion of convertible debentures and other debt, and for the exercise of warrants.

As of June 30, 2005, we had negative working capital of \$26,780, a decrease in working capital of \$4,844 since June 30, 2004.

The Company is late on filing payroll tax returns and owes approximately 8.8 million in past due payroll taxes.

Net cash used in operating activities was \$4,351 for the year ended June 30, 2005 as compared to net cash used in activities of \$489 for the prior-year period; a decrease of \$3,862. The principal reason for the decrease was the payment of the worker's compensation premium and the worker's compensation deposit paid during the year ended June 30, 2005.

Cash provided by financing activities was \$4,482 for the year ended June 30, 2005 as compared to \$526 for the year ended June 30, 2004, an increase of \$3,956 from the prior-year period. The primary reason for the increase was the issuance

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of two notes payable totaling \$3,710 to pay the worker's compensation premium and deposit.

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 June 30, 2005, was approximately \$453.

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, 2005 financial statements includes an explanatory paragraph indicating there is a substantial doubt about our ability to continue as a going concern, due primarily to the decreases in our working capital and net worth.

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### CONTINGENT LIABILITY

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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.

During the fiscal year ended June 30, 2005 the Company recorded approximately \$463,000 in loss reserves.

### OFF-BALANCE ARRANGEMENTS

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

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### ITEM 7. Financial Statements

The report of our independent auditors and our financial statements are set forth in this report beginning on Page F-1.

### ITEM 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

On September 3, 2003, the Registrant appointed Pohl, McNabola, Berg & Company, LLP ("PMBC") as Dalrada Financial Corporation's ("DRDF," the "Registrant", or the "Company") independent auditors upon the recommendation of its Audit Committee.

### ITEM 8A. Controls and Procedures.

(a) 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 June 30, 2005, covered by this annual 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.

(b) Except as described below, during our fourth quarter of fiscal 2005, 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.

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Attached as Exhibits 31.1 and 31.2 to this annual report are certifications of the Chief Executive Officer and Chief Financial Officer required in accordance with Rule 13a-14(a) of the Exchange Act. This portion of the Company's annual 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), the Company's 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

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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 the Company's 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 the company's 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 the Company's Accounting System; (2) Financial Statement closing process; (3) Ineffective Information Technology control environment, including the design of the Company's 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 the Company's 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. The Company will continue to evaluate the material weaknesses and will take all necessary action to correct the internal control deficiencies identified. The Company will also further develop and enhance its internal control policies, procedures, systems and staff to allow it to mitigate the risk that material accounting errors might go undetected and be included in its consolidated financial statements.

The Company contemplates undertaking a thorough review of its internal controls as part of the Company's preparation for compliance with the requirements under Section 404 of the Sarbanes-Oxley Act of 2002 and the Company is using this review to further assist in identifying and correcting control deficiencies. At this time, the Company has not completed its 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 the Company will be able to assert that its internal control over financial reporting is effective, pursuant to the rules adopted by the SEC under Section 404, when those rules take effect.

ITEM 8B.

None

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### PART III

ITEM 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

The directors and executive officers of the Company, their ages and positions with the Company as of June 30, 2004 are as follows:

Name	Age	Since	Director Title
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Brian Bonar	58	1995	Director and Chief Executive Officer
Richard H. Green	69	2000	Director
Robert A. Dietrich	60	2000	Director
Eric W. Gaer	57	2000	Director
Stephen J. Fryer	67	2000	Director
Randall Jones	51	2005	Chief Financial Officer

BRIAN BONAR has served as a director of the Company since August 1995 and became the Company's Chairman of the Board in December 1999. From August 1992 through April 1994, Mr. Bonar served as the Company's Director of Technology Sales and from April 1994 through September 1994 as the Company's Vice President, Sales and Marketing. In September 1994, Mr. Bonar became the Company's Executive Vice President and, in July 1997, was appointed as the Company's President and Chief Operating Officer. In April 1998 Mr. Bonar assumed the post of CEO. From 1991 to 1992, Mr. Bonar was Vice President of Worldwide Sales and Marketing for Bezier Systems, Inc., a San Jose, California-based manufacturer and marketer of laser printers. From 1990 to 1991, he was Worldwide Sales Manager for Adaptec, Inc., a San Jose-based laser printer controller developer. From 1988 to 1990, Mr. Bonar was Vice President of Sales and Marketing for Rastek Corporation, a laser printer controller developed located in Huntsville, Alabama. From 1984 to 1988, Mr. Bonar was employed as Executive Director of Engineering at QMS, Inc., an Alabama-based developer and manufacturer of high-performance color and monochrome printing solutions. Prior to these positions, Mr. Bonar was employed by IBM, U.K. Ltd. for approximately 17 years.

DR. RICHARD H. GREEN has served as a director since September 2000. He is currently the President of International Power & Environmental Company (IPEC), a consulting company located in San Diego, California. From 1993 through 1995, he served as Deputy Secretary of the State of California Environmental Protection Agency (Cal/EPA). From 1988 through 1993 Dr. Green served as Manager of Program Engineering and Review Office in the Office of Technology and Applications at the Jet Propulsion Laboratory (JPL) in Pasadena, California, where he had held various management positions since 1967. From 1965 through 1967, Dr. Green served as Senior Engineer for The Boeing Company, Space Division. From 1983 through 1985, Dr. Green held the Corwin D. Denny Chair as Professor of Energy and Director of the Energy Institute at the University of LaVerne, and from 1961 through 1964 served as Assistant Professor of Civil Engineering (Environmental Sciences) at Washington State University. Dr. Green currently is a member of the Governing Board of Pasadena City College. Dr. Green completed his bachelor's degree at Whitman College in 1958, his Master of Science at Washington State University in 1961, and his Ph.D. at Washington State University, under a United States Public Health Services Career Development Award, in 1965.

Robert A. Dietrich has served as a director of the Company since January 2000 and currently serves on the Audit Committee of the Board. For a period of time during 2002 he served as Chief Accounting Officer and President of Source One Group. He is currently a Director, COO and CFO of Security First International Holdings, Inc. ("SFNH:PK"). During 2004 and 2005 he was President and CEO of Energy Transfer Corporation, a privately held bio-energy company. In 2003 and 2004 he was Founder and Chief Financial Officer of Modofood USA, Inc., a privately held food technology enterprise. In 1998 he helped found Cyber Air Communications, Inc. in which he served as a Director and President until 2002. Mr. Dietrich has been performing investment banking and consulting services for clients since 1990. Prior to that he has served as CEO, COO or CFO of privately held middle market companies. He is an accounting graduate from Notre Dame and possesses an MBA from U.of Detroit. He possesses a CPA certificate from Illinois.



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ERIC W. GAER has served as a director since March 2000. Since 1998, Mr. Gaer has been the President and CEO of Arroyo Development Corporation, a privately-held, San Diego-based management consulting company. From 1996 to 1998, he was Chairman, President and CEO of Greenland Corporation, a publicly-held high technology company in San Diego, California. In 1995, he was CEO of Ariel Systems, Inc., a privately-held engineering development company in Vista, California. Over the past 25 years, Mr. Gaer has served in executive management positions at a variety of high-technology companies, including ITEC, Daybreak Technologies, Inc., Venture Software, Inc., and Merisel, Inc. In 1970, he received a Bachelor of Arts degree in mass communications from California State University, Northridge.

STEPHEN J. FRYER has served as a director of the Company since March 2000. He is currently Managing Director for Grant Bettingen, Inc, a Newport Beach, CA based full service Investment Banking firm. Mr. Fryer has also served as CEO, Founder and President of World Comnet, Inc., which went public on the Vancouver Stock Exchange and was Managing Director of Ventana International, Inc., a venture capital and boutique investment-banking firm with over \$150 million in capital. Previously, he was Chairman and CEO of Pen Interconnect, Inc., an electronic circuit board manufacturer. Previously, he spent over 28 years in the computer business in the USA as well as Asia and Europe. He is a graduate of the University of Southern California with a degree in Mechanical Engineering and a minor in Economics.

RANDALL JONES became the CFO for Dalrada in January of 2005. Mr. Jones is also the CFO for Kaire Holdings Incorporated and Warning Management Services, Inc. Prior to that, Mr. Jones was CEO of South Coast Corporate Development since 1981. Mr. Jones has over twenty-five years experience as a financial executive. He has consulted to companies in a variety of industries, from aerospace, manufacturing, retail, employee staffing to banking. His area of specialty is consulting to companies that either want to enter the public marketplace or are already publicly held and need assistance in the reorganization of their accounting operations and public reporting.

### AUDIT COMMITTEE FINANCIAL EXPERT

The Audit Committee of the Board of Directors consists of Mr. Dietrich and Dr. Green, both of whom are independent and qualify as financial experts under SEC regulations.

### COMPLIANCE WITH SECTION 16 OF THE SECURITIES EXCHANGE ACT OF 1934

Section 16(a) of the Securities Exchange Act of 1934 requires DRDF's directors and executive officers, and persons who own more than 10% of a registered class of DRDF's equity securities to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of Common Stock and other DRDF equity securities. Officers, directors and greater than 10% shareholders are required by SEC regulations to furnish DRDF with copies of all Section 16(a) forms they file.

To DRDF's knowledge, based solely on its review of the copies of such reports furnished to the company and written representations that no other reports were required during the fiscal year ended June 30, 2005, all Section 16(a) filing requirements applicable to its officers, directors and greater than 10% beneficial owners were complied with.

### BUSINESS ETHICS CONFLICTS OF INTERESTS POLICY

The Company has adopted a Policy Statement on Business Ethics and

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Conflicts of Interest, which was approved by the Board of Directors, applicable to all employees, which is attached as exhibit 33.1 to this report.

### ITEM 10. Executive Compensation

NAME AND PRINCIPAL POSITION	FISCAL YEAR	ANNUAL COMPENSATION		LONG TERM
		SALARY	OTHER	COMPENSATION AWARDS
				OPTIONS/ SARS (#)
Brian Bonar	2005	\$282,000	\$0	0
Chairman, Board of Directors,	2004	\$150,000	\$0	0
President and C.E.O.	2003	\$76,814	\$0	15,000,000
James R. Downey, Jr. (1)	2004	\$100,000	\$20,000	-
Former Chief Operating Officer	2003	\$79,000		9,500,000
and Chief Accounting Officer				
Randall Jones	2005	120,000	40,000	
Chief Financial Officer				

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(1) Mr. Downey joined the Company effective January 6, 2003 and resigned effective January 31, 2004.

The following table provides information on Options/SARs granted in the 2004 Fiscal Year to the Named Officers.

Name	Number of Securities Underlying Options/SARs Granted (#)	Percent of Total Options/SARs Granted to Employees in Fiscal Year	Exercise or Base Price (\$/share)	Expiration Date	Potential Value Annual Stock Appreciation Options 5% (\$)
Brian Bonar	7,000,000	23.7%	\$0.015	12/1/05	5,250
James R. Downey, Jr. (1)	0				

(1) Mr. Downey resigned effective January 30, 2004

N/A

### AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND FY-END OPTION/SAR VALUES

The following table provides information on option exercises in the 2004 Fiscal Year by the Named Officers and the value of such Named Officers'

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unexercised options at June 30, 2004. Warrants to purchase Common Stock are included as options. No stock appreciation rights were held by them at the end of the 2004 Fiscal Year.

NAME	SHARES ACQUIRED ON EXERCISE (#)	VALUE REALIZED (\$)	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS/SAR'S AT FY-END (#)		VALUE OF
			EXERCISABLE	UNEXERCISABLE	IN-THE-MO AT FISCAL
Brian Bonar	---		8,000,000	---	\$0
James R. Downey, Jr. (1)	---	---	9,500,000	---	\$0

(1) Mr. Downey resigned effective January 30, 2004

N/A

COMPENSATION OF DIRECTORS

Each member of the Board of Directors of the Company receives a fee of \$500 from the Company for each meeting attended.

EMPLOYMENT CONTRACTS, TERMINATION OF EMPLOYMENT, AND CHANGE-IN-CONTROL ARRANGEMENTS

None

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

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The Compensation Committee currently consists of Messrs. Gaer and Green. Neither of these individuals was an officer or employee of the Company at any time during the 2005 Fiscal Year. Mr. Gaer owns a company that receives consulting fees from the Company.

AUDIT COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Audit Committee currently consists of Messrs. Green and Dietrich. Neither of these individuals was an officer or employee of the Company at any time during the 2004 Fiscal Year.

ITEM 11. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information known to DRDF with respect to the beneficial ownership of DRDF's common stock as of August 31, 2005 by (i) each person who is known by the Company to own beneficially more than 5% of the Company's common stock, (ii) each of DRDF's directors and executive officers, and (iii) all officers and directors of DRDF as a group. Except as otherwise listed below, the address of each person is c/o Dalrada Financial Corporation., 9449 Balboa Avenue, Suite 211, San Diego, CA 92123

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Name and Address Of Beneficial Owner Owned (1)	Number of Shares Beneficially owned	Percent of class	Percent of class
ALPHA Capital AG (4) Pradafant 7 9490 Furstentums, Vaduz, Liechtenstein	36,642,857 (13)	.05%	.04%
Gamma Opportunity Capital (5) Partners, LP British Colonial Centre of Commerce One Bay Street, Suite 401 Nassau (NP), The Bahamas	36,642,857 (14)	.05%	.04%
LONGVIEW FUND, L.P. (6) 1325 Howard Avenue, #422 Burlingame, CA 94010	32,571,428 (15)	.04%	.03%
Stonestreet Limited Partnership (7) C/o Canaccord Capital Corporation 320 Bay Street, Suite 1300 Toronto, Ontario M5H 4A6, Canada	24,428,571 (16)	.03%	.02%
Director and Officers			
Brian Bonar (8)	19,007,500	.03%	.02%
Robert A. Dietrich (9)	11,384,500	.01%	.01%
Stephen J. Fryer (10)	7,453,250	.01%	.01%
Eric W. Gaer (11)	9,936,000	.02%	.01%
Richard Green (12)	9,969,500	.02%	.01%
All current directors and Executive officers (group of 5)	58,003,750	.09%	.06%

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(1) Beneficial Ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of common stock subject to options or warrants currently exercisable or convertible, or exercisable or convertible within 60 days of August 31, 2005 are deemed outstanding for computing the percentage of the person holding such option or warrant but are not deemed outstanding for computing the percentage of any other person. Except as pursuant to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock beneficially owned.

(2) Percentage based on 747,103,929 shares of common stock outstanding as of August 31, 2005, plus shares underlying each shareholders convertible note.

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(3) Percentage based on 991,675,358 shares of common stock outstanding after the offering.

(4) Alpha Capital Aktiengesellschaft: In accordance with Rule 13d-3 under the Securities Exchange Act of 1934, Konard Ackerman may be deemed the control person of the shares owned by such entity. ALPHA Capital AG is a private investment fund that is owned by all its investors and managed by Mr. Ackerman. Mr. Ackerman disclaims beneficial ownership of the shares of common stock being registered hereto.

(5) Gamma Opportunity Capital Partners, LP: In accordance with Rule 13d-3 under the Securities Exchange Act 1934, Gamma Capital Advisors, Ltd., an Anguilla, British West Indies company, is the general partner to the stockholder Gamma Opportunity Capital Partners, LP, a Cayman Islands registered limited partnership, with the power to vote and dispose of the common shares being registered on behalf of the stockholder. As such, Gamma Capital Advisors, Ltd. may be deemed to be the beneficial owner of said shares. Christopher Rossman and Jonathan P. Knight, PhD. are the Directors of Gamma Capital Advisors, Ltd., each possessing the power to act on its behalf. Gamma Capital Advisors, Ltd., Christopher Rossman and Jonathan P. Knight, PhD. each disclaim beneficial ownership of the shares of common stock being registered hereto.

(6) Longview Fund, LP is a private investment fund that is in the business of investing publicly-traded securities for their own accounts and is structured as a limited liability company whose members are the investors in the fund. The General Partner of the fund is Viking Asset Management, LLC, a California limited liability company which manages the operations of the fund. Peter T. Benz is the managing member of Viking Asset Management, LLC. As the control person of the shares owned by Longview Fund, LP, Peter T. Benz may be viewed as the beneficial owner of such shares pursuant to Rule 13d-3 under the Securities Exchange Act of 1934.

(7) Stonestreet Limited Partnership: In accordance with Rule 13d-3 under the Securities Exchange Act of 1934, Mr. Michael Finkelstein may be deemed the control person of the shares owned by such entity. Stonestreet Limited Partnership is a private investment fund that is owned by all its investors and managed by Ms. Libby Leonard.

(8) Includes 12,000,000 shares issuable upon exercise of warrants that are currently exercisable or will become exercisable within 60 days after June 30, 2005.

(9) Includes 9,125,000 shares issuable upon exercise of warrants that are currently exercisable or will become exercisable within 60 days after June 30, 2005.

(10) Includes 4,875,000 shares issuable upon exercise of warrants that are currently exercisable or will become exercisable within 60 days after June 30, 2005.

(11) Includes 7,375,000 shares issuable upon exercise of warrants that are currently exercisable or will become exercisable within 60 days after June 30, 2005.

(12) Includes 40,750,000 shares issuable upon exercise of warrants that are currently exercisable or will become exercisable within 60 days after June 30, 2005.

(13) Concerning Alpha Capital Aktiengesellschaft: Assuming \$225,000 of Convertible Debentures converted at \$0.007 plus 4,500,000 warrants.

(14) Concerning Gamma Opportunity Capital Partners, LP: Assuming \$225,000 of

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Convertible Debentures converted at \$0.007 plus 4,500,000 warrants.

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(15) Concerning Longview Fund, LP: Assuming \$200,000 of Convertible Debentures converted at \$0.007 plus 4,000,000 warrants.

(16) Concerning Stonestreet Limited Partnership: Assuming \$150,000 of Convertible Debentures converted at \$0.007 plus 3,000,000 warrants.

ITEM 12. Certain Relationships and Related Transactions

Transactions with a Director of the Company  
-----

A director of the Company is a majority shareholder in a consulting firm that provides management and public relations services to the Company. The Company accrued consulting fees and expenses to this consulting firm in the amount of approximately \$0 and \$120 for the years ended June 30, 2005 and 2004, respectively.

Transactions with Officers and Key Executives  
-----

During the year ended June 30, 2004, common stock with an aggregate fair market value of \$8 was awarded to key executives as compensation and advances.

During the year ended June 30, 2004, the Company issued 7,272,110 shares of common stock to the Company's CEO as payment for accrued expenses and a note payable in the aggregate amount of \$109.

Transactions with a Related Party  
-----

In April 2004, the Company had a PEO services client whose Chairman of the Board is the Company's current CEO and Chairman. The Company received fees of \$7 during the year ended June 30, 2004. The transaction is at fair value.

Warning Management Services, Inc.  
-----

The Company's CEO and Chairman, Mr. Brian Bonar, is also the CEO and Chairman of Warning Management Services, Inc. In addition, the Company's CFO, Mr. Randall A. Jones, is also the CFO 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.

GUARANTEE OF INDEBTEDNESS OF WARNING  
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As of September 8, 2004, Warning Management Services, Inc. ("Warning") purchased all of the issued and outstanding shares of Employment Systems, Inc. ("ESI") for \$1,500. The purchase was \$750 cash paid at the closing and a \$750 note payable. In connection with this transaction, the Company agreed to be a guarantor of the \$750 note payable. As inducement to enter into this guarantee, the Company was given a non-cancelable 2-year payroll processing contract with ESI. Management

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has evaluated this contingent liability and has determined that no loss is anticipated as a result of this guarantee.

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

Warning leases offices for its ESI subsidiary, on a month-to-month basis from the Company that started in October 2004. Monthly rental expense will be approximately \$3 per month.

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

In April 2004, the Company entered into an Agreement to provide PEO services for Warning. The Company receives from Warning a monthly administrative fee. During the year ended June 30, 2005, the Company has invoiced Warning \$390 for management services and \$45 for reimbursement of costs. Warning also paid expenses of \$38 on behalf of the Company. As of June 30, 2005, the Company has an amount due to Warning of \$194 that is included in current liabilities.

Kaire Holdings, Inc.  
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The Company's Source One subsidiary processes the payroll for Effective Health, Inc. which is a wholly-owned subsidiary of Kaire Holdings, Inc. The Company's CFO, Mr. Randall A. Jones, is also the CFO of Kaire Holding, Inc.

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ITEM 13. Exhibits, List and Reports in Form 8-K

a. Exhibits

- 3(a) Certificate of Incorporation of the Company, as amended, and currently in effect. See also below (Incorporated by reference to Exhibit 3(a) to 1988 Form 10-K) \*
- 3(b) Certificate of Amendment of Certificate of Incorporation of the Company, filed February 8, 1995, as amended, and currently in effect (Incorporated by reference to Exhibit 3(b) to 1995 Form 10-K) \*
- 3(c) Certificate of Amendment of Certificate of Incorporation of the Company, filed May 23, 1997, as amended, and currently in effect (Incorporated by reference to 1997 Form 10-K) \*
- 3(d) Certificate of Amendment of Certificate of Incorporation, filed January 12, 1999, as amended and currently in effect (Incorporated by reference to Form 10-Q for the period ended December 31, 1998) \*
- 3(e) Certificate Eliminating Reference to Certain Series of Shares of Stock from the Certificate of Incorporation, filed January 12, 1999, as amended and currently in effect (Incorporated by reference to Form 10-Q for the period ended December 31, 1998) \*

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- 3(f) By-Laws of the Company, as amended, and currently in effect (Incorporated by reference to Exhibit 3(b) to 1987 Form 10-K) \*
- 3(g) Certificate of Amendment of Certificate of Incorporation, filed May 12, 2000, as amended and currently in effect (Incorporated by reference to Exhibit 3(g) to 2001 Form 10-K) \*
- 4(a) Amended Certificate of Designation of Imaging Technologies Corporation with respect to the 5% Convertible Preferred Stock (Incorporated by reference to Exhibit 4(d) to 1987 Form 10-K) \*
- 4(b) Amended Certificate of Designation of Imaging Technologies Corporation with respect to the 5% Series B Convertible Preferred Stock (Incorporated by reference to Exhibit 4(b) to 1988 Form 10-K) \*
- 4(c) Certificate of Designations, Preferences and Rights of Series C Convertible Preferred Stock of Imaging Technologies Corporation (Incorporated by reference to Exhibit 4(c) to 1998 Form 10-K) \*
- 4(d) Certificate of Designation, Powers, Preferences and Rights of the Series of Preferred Stock to be Designated Series D Convertible Preferred Stock, filed January 13, 1999 (Incorporated by reference to Form 10-Q for the period ended December 31, 1998) \*
- 4(e) Certificate of Designation, Powers, Preferences and Rights of the Series of Preferred Stock to be Designated Series E Convertible Preferred Stock, filed January 28, 1999 (Incorporated by reference to Form 10-Q for the period ended December 31, 1998) \*
- 10(a) Private Equity Line of Credit Agreement by and among certain Investors and the Company (Incorporated by reference to Form 8-K, filed July 26, 2000) \*
- 10(b) Convertible Note Purchase Agreement dated December 12, 2000 between the Company and Amro International, S.A., Balmore Funds, S.A., and Celeste Trust Reg. (Incorporated by reference to Form 8-K, filed January 19, 2001.) \*
- 10(c) Convertible Note Purchase Agreement dated July 26, 2001 between the Company and Balmore Funds, S.A. (Incorporated by reference to Form 8-K filed August 2, 2001.) \*
- 10(d) Share Purchase Agreement, dated December 1, 2000, between ITEC and EduAdvantage.com, Inc. (Incorporated by reference to Form 10-Q for the period ended September 30, 2000) \*
- 10(e) Agreement to Acquire Shares, dated December 1, 2000, between ITEC and Quik Pix, Inc. (Incorporated by reference to Form 10-Q for the period ended September 30, 2000) and subsequently cancelled. \*
- 10(f) Agreement to Acquire Shares, dated December 17, 2000, between ITEC and Pen Internconnect, Inc. (Incorporated by reference to Form 10-Q for the period ended September 30, 2000) and subsequently cancelled. \*
- 10(g) Share Purchase Agreement, dated December 1, 2000, between ITEC and EduAdvantage.com, Inc. (Incorporated by reference to Form 10-Q for



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	the period ended September 30, 2000)	*
10(h)	Convertible Promissory Note dated September 21, 2001 between the Company and Stonestreet Limited Partnership. (Incorporated by reference to Exhibit 10(u) of 2001 Form 10-K)	*
10(i)	Convertible Note Purchase Agreement dated September 21, 2001 between the Company and Stonestreet Limited Partnership. (Incorporated by reference to Exhibit 10(v) of 2001 Form 10-K)	*
10(j)	Registration Rights Agreement dated September 21, 2001 between the Company and Stonestreet Limited Partnership. (Incorporated by reference to Exhibit 10(w) of 2001 Form 10-K)	*
10(k)	Form of Warrant to Purchase 11,278,195 Shares of Common Stock of ITEC, dated September 21, 2001, between ITEC and Stonestreet Limited Partnership. (Incorporated by reference to Exhibit 10(x) of 2001 Form 10-K)	*
10(l)	Asset Purchase Agreement, dated October 25, 2001, among the Company and Lisa Lavin, Gary J. Lavin, and Roland A. Fernando. (Incorporated by reference to Exhibit 10(a) to September 2001 Form 10-Q) *	
10(m)	Audited Financial Statements of SourceOne Group, LLC. (Incorporated by reference to Form 8-K filed on January 25, 2002)	*
10(n)	Secured Convertible Debenture issued by the Company to Bristol Investment Fund, Ltd., dated January 22, 2002. (Incorporated by reference to Exhibit 10(a) of December 2001 Form 10-Q)	*
10(o)	Securities Purchase Agreement between the Company and Bristol Investment Fund, Ltd., dated January 22, 2002. (Incorporated by reference to Exhibit 10(b) of December 2001 Form 10-Q)	*
10(p)	Registration Rights Agreement between the Company and Bristol Investment Fund, Ltd., dated January 22, 2002. (Incorporated by reference to Exhibit 10(c) of December 2001 Form 10-Q)	*
10(q)	Transaction Fee Agreement between the Company and Alexander Dunham Securities, Inc., dated January 22, 2002. (Incorporated by reference to Exhibit 10(d) of December 2001 Form 10-Q)	*
10(r)	Stock Purchase Warrant issued to Alexander Dunham Securities, Inc., dated January 22, 2002. (Incorporated by reference to Exhibit 10(e) of December 2001 Form 10-Q)	*
10(s)	Stock Purchase Warrant issued to Bristol Investment Fund, Ltd., dated January 22, 2002. (Incorporated by reference to Exhibit 10(f) of December 2001 Form 10-Q)	*
10(t)	Security Agreement between the Company and Bristol Investment Fund, Ltd., dated January 22, 2002. (Incorporated by reference to Exhibit 10(g) of December 2001 Form 10-Q)	*
10(u)	Convertible Promissory Note between the Company and Stonestreet	

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	Limited Partnership, dated November 7, 2001. (Incorporated by reference to Exhibit 10(h) of December 2001 Form 10-Q)	*
10(v)	Convertible Note Purchase Agreement between the Company and Stonestreet Partnership, dated November 7, 2001. (Incorporated by reference to Exhibit 10(i) of December 2001 Form 10-Q)	*
10(w)	Registration Rights Agreement between the Company and Stonestreet Limited Partnership, dated November 7, 2001. (Incorporated by reference to Exhibit 10(j) of December 2001 Form 10-Q)	*
10(x)	Stock Purchase Warrant issued to Stonestreet Limited Partnership, dated November 7, 2001 . (Incorporated by reference to Exhibit 10(k) of December 2001 Form 10-Q)	*
10(y)	Acquisition Agreement between the Company and Dream Canvas, Inc., dated May 17, 2002; subject to completion of its terms. (Incorporated by reference to Exhibit 10(y) of Form 10-K filed D November 18, 2002.)	*
10(z)	Closing Agreement between the Company and Quik Pix, Inc., dated July 23, 2002, subject to completion of its terms. (Incorporated by reference to Exhibit 10(z) of Form 10-K filed November 18, 2002.)	*
10(aa)	Agreement to Acquire Shares between the Company and Greenland Corporation, dated August 5, 2002, subject to completion of its terms. (Incorporated by reference to Exhibit 10(aa) to Form 10-K filed November 18, 2002.)	*
10(ab)	Acquisition Agreement, dated December 13, 2002, between the Company and Baseline Worldwide, Limited. (Incorporated by reference to Exhibit 99.3 of Form 8-K filed December 19, 2002.)	*
10(ac)	Secured Promissory Note in the amount of \$2,250,000 issued by the Company to Greenland Corporation, dated January 7, 2003. (Incorporated by reference to Exhibit 99.1 of Form 8-K filed January 21, 2003.)	*
10(ad)	Security Agreement, dated January 7, 2003, between the Company and Greenland Corporation. (Incorporated by reference to Exhibit 99.2 of Form 8-K filed January 21, 2003.)	*
10(ae)	Agreement to Acquire Shares, dated August 9, 2002 between the Company and Greenland Corporation. (Incorporated by reference to Exhibit 99.3 of Form 8-K filed January 21, 2003.)	*
10(af)	Closing Agreement, dated January 7, 2003, between the Company and Greenland Corporation. (Incorporated by reference to Exhibit 99.4 of Form 8-K filed January 21, 2003.)	*
10(ag)	Share Acquisition Agreement, dated June 12, 2002, between the Company and Quik Pix, Inc. (Incorporated by reference to Exhibit 99.5 of Form 8-K filed January 21, 2003.)	*
10(ah)	Closing Agreement, dated July 23, 2002, between the Company and Quik Pix, Inc. (Incorporated by reference to Exhibit 99.6 of Form 8-K filed January 21, 2003.)	*
10(ai)	Stock Purchase Agreement among the Company, Greenland Corporation, and ExpertHR- Oklahoma, dated March 18, 2003. (Incorporated by reference to Exhibit 10(j) to Form 10-Q filed May 20, 2003.)	*

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10(aj)	Assignment of Patent between John Capezzuto and Quik Pix, Inc. dated January 14, 2003.	*
10(ak)	Promissory Note between the Company and John Capezzuto dated June 1, 2003 (signed June 9, 2003).	*
10(al)	Promissory Note between the Company and John Capezzuto dated June 9, 2003	*
10(am)	Agreement and Assignment of Rights, dated February 1, 2003, between Accord Human Resources, Inc. and Greenland Corporation, and Imaging Technologies. (Incorporated by reference to Exhibit 10(k) of Form 10-KSB filed April 7, 2003 by Greenland Corporation.)	*

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10(an)	Agreement and Assignment of Rights, dated March 1, 2003, between StaffPro Leasing 2, Greenland Corporation, and ExpertHR. (Incorporated by reference to Exhibit 10(l) of Form 10-KSB filed April 7, 2003 by Greenland Corporation.)	*
10(ao)	Promissory Note, dated March 1, 2003, payable to StaffPro Leasing 2 by Greenland Corporation. (Incorporated by reference to Exhibit 10(k) of Form 10-KSB filed April 7, 2003 by Greenland Corporation.)	*
10(op)	Agreement to Acquire Shares between the Company and The Christensen Group, et al, dated April 1, 2003. *	
21	List of Subsidiaries of the Company	*
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) (Section 302 of the Sarbanes-Oxley Act of 2002)	**
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) (Section 302 of the Sarbanes-Oxley Act of 2002)	**
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C.ss.1350 (Section 906 of the Sarbanes-Oxley Act of 2002)	**
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C.ss.1350 (Section 906 of the Sarbanes-Oxley Act of 2002)	**

All exhibits except those followed by an asterisk (\*) are incorporated by reference only and a copy is not included in this Form 10-K filing. Those exhibits followed by a double asterisk (\*\*) are included as part of this filing.

The Company will furnish a copy of any exhibit to a requesting shareholder upon payment of the Company's reasonable expenses in furnishing such exhibit.

(b) Reports on Form 8-K

DATE	SUBJECT
10/14/2003	Late filing of Form 10-KSB for fiscal year 2003, ended June 30, 2003
01/13/2004	Resignation of Thomas Brown as Senior Vice President and Chief Financial Officer

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03/04/2004 Disposition of Greenland Financial Corporation  
05/24/2005 Transfer Solvis Group to Quik Pix, Inc. a wholly owed subsidiary  
9/20/2005 Appointment of Chief Financial Officer

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ITEM 14. Principal Accountant Fees and Services

The Company paid or accrued the following fees in each of the prior two fiscal years to its independent certified public accountants, Pohl, McNabola Berg & Company, LLP

	For the Year Ended June 30,	
	2005	2004
	----	----
Audit Fees	\$110,000	\$65,000
Audit-Related Fees	\$95,033	\$22,085
Tax Fees	\$0.00	\$-
All Other Fees	\$0.00	\$7,848
-----	-----	-----
Total Fees	\$205,033	\$94,933

"Audit Fees" consisted of fees billed for services rendered for the audit of the Company's annual financial statements and audit related fees are for review of the financial statements included in the Company's quarterly reports on Form 10-QSB.

AUDIT COMMITTEE'S PRE-APPROVAL POLICIES AND PROCEDURES  
-----

The Audit committee is in the process of establishing a pre-approval policy and procedure.

PERCENTAGE OF HOURS EXPENDED  
-----

The amount of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees was less than 50%.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DALRADA FINANCIAL CORPORATION

By: /s/ BRIAN BONAR

-----  
Brian Bonar, Chief Executive Officer

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Dated: October 13, 2005

By: /s/ BRIAN BONAR

-----  
Brian Bonar, Acting Chief Accounting Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints, Brian Bonar as his attorney-in-fact, each with full power of substitution and resubstitution, for him or her in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K (including post-effective amendments), and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming that said attorney-in-fact, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed below by the following persons in the capacities and on the dates indicated.

SIGNATURE -----	TITLE -----	DATE ----
/s/ Brian Bonar ----- Brian Bonar	Chairman of the Board of Directors, Chief Executive Officer, and (PRINCIPAL EXECUTIVE OFFICER)	October 13, 2005
/s/ Robert A. Dietrich ----- Robert A. Dietrich	Director	October 13, 2005
/s/ Eric W. Gaer ----- Eric W. Gaer	Director	October 13, 2005
/s/ Stephen J. Fryer ----- Stephen J. Fryer	Director	October 13, 2005
/s/ Richard H. Green ----- Richard H. Green	Director	October 13, 2005
/s/ Randall Jones ----- Randall Jones	Chief Financial Officer	October 13, 2005

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
YEARS ENDED JUNE 30, 2005 AND 2004

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
-----

To the Board of Directors and Stockholders  
Dalrada Financial Corporation  
San Diego, California

We have audited the accompanying consolidated balance sheet of Dalrada Financial Corporation and Subsidiaries as of June 30, 2005, and the related consolidated statements of operations, stockholders' deficit and cash flows for years ended June 30, 2005 and 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Dalrada Financial Corporation and Subsidiaries as of June 30, 2005 and the consolidated results of their operations and their consolidated cash flows for each of the years ended June 30, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

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The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the accompanying consolidated financial statements, for the year ended June 30, 2005 the Company experienced a net loss from continuing operations of \$4,218,000 and as of June 30, 2005, the Company had a negative working capital deficit of \$26,780,000 and had a negative stockholders' deficit of \$24,695,000. In addition, the Company is in default on certain note payable obligations and is being sued by numerous trade creditors for nonpayment of amounts due. The Company is also deficient in its payments relating to payroll tax liabilities. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plan in regard to these matters is also discussed in Note 1. These consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ POHL, McNABOLA, BERG & COMPANY, LLP  
 POHL, McNABOLA, BERG & COMPANY, LLP  
 CERTIFIED PUBLIC ACCOUNTANTS

San Francisco, California  
 October 12, 2005

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### CONSOLIDATED BALANCE SHEET JUNE 30, 2005

	(in thousands)
	-----
ASSETS	
Current assets	
Cash	\$ 171
Accounts receivable (net of reserve for bad debt of \$51)	1,414
Prepaid worker's compensation premiums	1,130
Prepaid expenses and other current assets	1,040
	-----
Total Current Assets	3,755
Property and equipment, net of accumulated depreciation of \$2,071	258
Customer list, net of accumulated amortization of \$6	66
Worker's compensation deposit	2,625
Other assets	11
	-----
Total Assets	\$ 6,715
	=====

(continued)

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET (CONTINUED)  
JUNE 30, 2005

	(in thousands) 2005
	-----
LIABILITIES AND SHAREHOLDERS' DEFICIT	
Current Liabilities	
Borrowings under bank notes payable	\$ 3,220
Cash overdraft	167
Factoring lines of credit	769
Short-term notes payable, including amounts due to related parties of \$1,727	5,269
Convertible debentures, net of discounts of \$1	919
Accounts payable	1,310
PEO payroll taxes and other payroll deductions	8,775
Capital lease - current	10
Other accrued expenses	10,096
	-----
Total Current Liabilities	30,535
	-----
Long Term Liabilities	
Capital lease - long term portion	42
Convertible debentures - long term portion, net of discounts of \$170	191
Long-term notes payable, including amounts due to related parties of \$425	642
	-----
Total Long Term Liabilities	875
	-----
Total Liabilities	31,410
	-----
Minority interest in subsidiary	--
	-----
Shareholders' Deficit	
Series A convertible, redeemable preferred stock, \$1 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; 735,248,867 shares issued and outstanding	3,676
Common stock warrants	475
Paid-in capital	82,629
Accumulated deficit	(111,895)
	-----
Total Shareholders' Deficit	(24,695)
	-----



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Total Liabilities and Shareholders' Deficit                   \$    6,715  
 =====

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS  
 FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	(in thousands)	
	2005	2004
	-----	-----
Revenues		
Sales of products	\$    447	\$    764
Software sales, licenses and royalties	70	36
Temporary staffing services	17,029	10,119
PEO services	1,930	2,607
	-----	-----
Total Revenues	19,476	13,526
	-----	-----
Cost of Sales		
Cost of products sold	93	196
Cost of software sales, licenses and royalties	3	3
Cost of temporary staffing	15,010	9,209
Cost of PEO services	1,424	894
	-----	-----
Total Cost of Sales	16,530	10,302
	-----	-----
Gross Profit	2,946	3,224
	-----	-----
Operating Expenses		
Selling, general and administrative	5,578	4,196
Impairment of patent	1,348	--
	-----	-----
Total Operating Expenses	6,926	4,196
	-----	-----
Loss from operations	(3,980)	(972)
	-----	-----

(continued)

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

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF OPERATIONS (CONTINUED) FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	(in thousands)	
	2005	2004
	-----	-----
Other Income/(Expense):		
Other	--	19
Loss on sale of assets	--	(341)
Gain on settlement of debt	829	1,145
Other expenses	(11)	
Interest expense	(1,709)	(1,930)
Bad debt	--	(10)
Penalties	(1,312)	(795)
Gain resulting from reconciliation of payroll tax liabilities to taxing authorities	1,895	--
	-----	-----
Total Other Income/(Expense)	(297)	(1,923)
	-----	-----
Loss before income taxes, minority interest and discontinued operations	(4,277)	(2,895)
Income tax expense	--	--
	-----	-----
Loss before minority interest and discontinued operations	(4,277)	(2,895)
Minority interest in subsidiary loss	59	--
	-----	-----
Net loss from continuing operations	(4,218)	(2,895)
	-----	-----
Discontinued Operation:		
Loss from operations of discontinued operation	--	(2,052)
Gain on disposition of discontinued operation	--	5,049
	-----	-----
Net income (loss)	(4,218)	102
Preferred stock dividends	(21)	(21)
	-----	-----
Net income (loss) attributed to common stockholders	\$ (4,239)	81
	=====	=====
Earnings (loss) per common share		
Continuing operations	\$ (0.01)	\$ (0.01)
Discontinued operations	--	0.01
	=====	=====
	\$ (0.01)	\$ 0.00
	=====	=====
Weighted average common shares, basic and diluted	658,436,000	331,004,000
	=====	=====

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT

	SERIES A PREFERRED STOCK		COMMON STOCK		COMMON STOCK WARRANTS
	SHARES	AMOUNT	SHARES	AMOUNT	
	(thousands)		(thousands)		(thousands)
BALANCE, JUNE 30, 2003	420.5	420	181,232,063	906	475
Issuance of common stock for:					
Cash - exercise of options			29,500,000	148	
Business acquisition			6,329,478	31	
Compensation			10,272,110	51	
Services			7,745,000	39	
Conversion of liabilities			317,280,091	1,587	
Beneficial conversion on notes					
Value of warrants issued with notes					
Value of repriced options/warrants					
Net income					
BALANCE, JUNE 30, 2004	420.5	420	552,358,742	2,762	475
Issuance of common stock for:					
Services			14,623,110	73	
Conversion of liabilities			168,267,015	841	
Value of warrants issued with notes payable					
Value of warrants issued in Heritage acquisition					
Contribution of Solvis Group, Inc. to QPI resulting in minority interest					
Net loss					
BALANCE, JUNE 30, 2005	420.5	420	735,248,867	3,676	475

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

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands)

	2005	2004
	-----	-----
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>		
Net loss from continuing operations	\$ (4,218)	\$ (2,895)
Net income (loss) from discontinued operations	--	2,997
Adjustment to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	173	164
Write-off of patent	1,348	--
Stock issued for services	73	302
Amortization of debt discounts	337	1,011
Value of repriced options/warrants	--	141
Gain on settlement of debt	(829)	(1,145)
Gain resulting from reconciliation of payroll liabilities to taxing authorities	(264)	--
Loss attributed to minority interest	(59)	--
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(832)	(180)
Inventories	--	15
Prepaid worker's compensation premiums	(1,130)	--
Other current assets	(596)	(424)
Worker's compensation deposit	(2,625)	--
Other assets	(11)	21
Increase (decrease) in:		
Accounts payable and accrued expenses	394	585
PEO liabilities	3,888	787
	-----	-----
Net cash used in operating activities from continuing operations	(4,351)	1,379
Net cash provided by (used in) operations of discontinued operations	--	(1,868)
	-----	-----
Net cash used in operating activities	(4,351)	(489)
	-----	-----
<b>CASH FLOW FROM INVESTING ACTIVITIES:</b>		
Cash paid for acquisition	(20)	--
Cash acquired with acquisition	--	104
Purchase of furniture and equipment	(168)	(93)
	-----	-----
Net cash provided by (used in) investing activities from continuing operations	(188)	11
Net cash used in investing activities of discontinued operations	--	--
	-----	-----
Net cash provided by (used in) investing activities	(188)	11
	-----	-----
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Change in cash overdraft, net	167	(87)
Net borrowings under bank notes payable	--	(25)
Proceeds from line of credit	4,092	--
Repayment on line of credit	(3,323)	--
Proceeds from sale of common stock	--	177
Proceeds from convertible debentures	--	800

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Proceeds from issuance of notes payable	3,990	--
Repayments of notes payable	(423)	(72)
Repayments of capital lease obligations	(21)	(267)
	-----	-----
Net cash provided by financing activities from continuing operations	4,482	526
Net cash used in financing activities of discontinued operations	--	--
	-----	-----
Net cash provided by financing activities	4,482	526
	-----	-----
CASH OF DISCONTINUED OPERATION	--	--
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(57)	48
CASH AND CASH EQUIVALENTS, Beginning of period	228	180
	-----	-----
CASH AND CASH EQUIVALENTS, End of period	\$ 171	\$ 228
	=====	=====

(continued)

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	(in thousands)	
	2005	2004
	-----	-----
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest Paid	\$ 137	\$ --
	=====	=====
Income taxes paid	\$ --	\$ --
	=====	=====
SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Conversion of convertible debentures into common stock	\$ 241	\$ 2,026
	=====	=====
Conversion of accounts payable and accrued liabilities into common stock	\$ 151	\$ 575
	=====	=====
Net assets acquired in business combinations:		
Cash	\$ --	\$ 104
Receivables	--	261
Property and equipment	7	25
Customer list	72	--
Accounts payable and accrued liabilities	--	(102)

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Notes payable and capital lease

-- (227)

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

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004  
(in thousands, except share information)

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

-----

The accompanying consolidated financial statements include the accounts of Dalrada Financial Corporation ("DRDF" or the "Company"), incorporated under the laws of the state of California in March 1982 and subsequently reincorporated under the laws of the state of Delaware in May 1983, and its following active subsidiaries (there are ten inactive subsidiaries not listed):

- a) SourceOne Group, Inc., ("SourceOne") - 100% owned by DRDF;
- b) The Christianson Group ("TCG") - 100% owned by DRDF;
- c) Quik Pix, Inc. ("QPI") - 85% owned by DRDF.

During the year ended June 30, 2005, the Company contributed its wholly-owned subsidiary, Solvis Group, Inc. ("Solvis") f/k/a Jackson Staffing, Inc. to QPI. As of June 30, 2005, Solvis is a wholly-owned subsidiary of QPI.

All significant intercompany accounts and transactions have been eliminated.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. For the year ended June 30, 2005, the Company experienced a net loss from continuing operations of \$4,218 and as of June 30, 2005, the Company had a negative working capital deficit of \$26,780 and had a negative stockholders' deficit of \$24,695. In addition, the Company is in default on certain note payable obligations, delinquent on payroll tax obligations and is being sued by numerous 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 continue as a going concern. Management believes that it can continue to raise debt and equity financing to support its operations.

Nature of Business

-----

The Company business operations are as follows:

- a) The Company is a professional employer organization (PEO) that provides comprehensive personnel management services including benefits and payroll administration, medical and workers'

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compensation insurance programs, personnel records management, and employer liability management;

- b) The Company also develops and mounts photographic and digital images for use in display advertising for tradeshow, building interiors, and other point-of-sale locations; and
- c) The Company is a provider of temporary staffing services that includes providing all related costs of employment, such as workers' compensation insurance, state and federal unemployment taxes, social security and certain fringe benefits.

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

##### Use of Estimates

-----

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported periods. Significant estimates made by the Company's management include but are not limited to recoverability of property and equipment, payroll tax liabilities, reserves for contingent liabilities and deferred taxes. Actual results could materially differ from those estimates.

##### Revenue Recognition

###### PEO SERVICE FEES AND WORKSITE EMPLOYEE PAYROLL COSTS

-----

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

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

Consistent with its revenue recognition policy, the Company's direct costs do not include the payroll cost of its worksite employees. The Company's direct

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costs associated with its revenue generating activities are comprised of all other costs related to its worksite employees, such as the employer portion of payroll-related taxes, employee benefit plan premiums and workers' compensation insurance premiums.

### SALES OF PRODUCTS

-----

Revenue is recognized when earned. The Company's revenue recognition policies are in compliance with all applicable accounting regulations, including American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, With Respect to Certain Transactions. Revenue from products licensed to original equipment manufacturers is recorded when OEMs ship licensed products while revenue from certain license programs is recorded when the software has been delivered and the customer is invoiced. Revenue from packaged product sales to and through distributors and resellers is recorded when related products are shipped. Maintenance and subscription revenue is recognized ratably over the

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

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. The Company's software arrangements do not contain multiple elements, and the Company does not offer post contract support.

### TEMPORARY STAFFING

The Company records gross revenue for temporary staffing. The Company has concluded that gross reporting is appropriate because the Company (i) has the risk and responsibility of identifying and hiring qualified employees, (ii) has the discretion to select the employees and establish their price and duties and (iii) bears the risk for services that are not fully paid for by customers. Temporary staffing revenues are recognized when the services are rendered by the Company's temporary employees. Temporary employees placed by the Company are the Company's legal employees while they are working on assignments. The Company pays all related costs of employment, including workers' compensation insurance, state and federal unemployment taxes, social security and certain fringe benefits. The Company assumes the risk of acceptability of its employees to its customers.

### Worker's Compensation

-----

During the year ended June 30, 2005, the Company established a self-insured worker's compensation program. In connection with this self-insured program, the Company was required to establish a worker's compensation deposit in the amount of \$2,625. The Company's maximum exposure under this self-insured worker's compensation program is \$4,200 and the Company is liable up to \$250 per



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occurrence. The Company purchases coverage from a worker's compensation insurer to cover additional losses above the policy limits. Loss reserves from this program amounted to \$229 during the year ended June 30, 2005.

### Contingent Liabilities

-----

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.

### Reclassifications

-----

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

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

### Cash and Cash Equivalents

-----

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

### Concentration of Credit Risk

-----

The Company places its cash in what it believes to be credit-worthy financial institutions. However, cash balances may exceed FDIC and SPIC insured levels at various times during the year.

Financial instruments that could potentially subject the Company to concentration of credit risk include accounts receivable. The Company generally requires clients to pay invoices for service fees no later than one day prior to the applicable payroll date. As such, the Company generally does not require

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collateral.

Additionally, during 2004, all revenue derived from temporary staffing was from one client and during 2005 96% of revenue derived from temporary staffing was from two clients.

### Allowance Method Used to Record Bad Debts

-----

The Company provides an allowance for doubtful accounts equal to the estimated uncollectible amounts. The Company's estimate is based on historical collection experience and a review of the current status of trade accounts receivable. It is reasonably possible that the Company's estimate of the allowance for doubtful accounts will change. Accounts receivable are presented net of an allowance for doubtful accounts of \$51 at June 30, 2005. Accounts deemed uncollectible are written off against the allowance.

### Long-Lived Assets and Intangible Assets

-----

In accordance with SFAS Nos. 142 and 144, long-lived assets to be held and used are analyzed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. SFAS No. 142 relates to assets with an indefinite life where as SFAS 144 relates to assets that can be amortized and the life determinable. The Company evaluates at each balance sheet date whether events and circumstances have occurred that indicate possible impairment. If there are indications of impairment, the Company uses future undiscounted cash flows of the related asset or asset grouping over the remaining life in measuring whether the assets are recoverable. In the event such cash flows are not expected to be sufficient to recover the recorded asset values, the assets are written down to their estimated fair value. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value of asset less the cost to sell.

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

### Property and Equipment

-----

Property and equipment are recorded at cost. Depreciation, including amortization of assets recorded under capitalized leases, is generally computed on a straight-line basis over the estimated useful lives of assets ranging from three to seven years. Amortization of leasehold improvements is provided over the initial term of the lease, on a straight-line basis. Maintenance, repairs, and minor renewals and betterments are charged to expense.

The Company reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value

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of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, and the effects of obsolescence, demand, competition, and other economic factors.

### Customer lists

-----

Customer lists includes customer purchased with the acquisition of certain assets of Heritage Group, Inc. The customer lists are being amortized over their estimated useful life of 36 months using the straight-line method. Amortization expense for the fiscal years 2006, 2007 and 2008 is expected to be \$24, \$24, and \$18, respectively.

### Patent Costs

-----

Patent costs include direct costs of obtaining the patent. Costs for new patents are capitalized and amortized over the estimated useful life of the patent, generally over the life of the patent on a straight-line method. The cost of patents in process is not amortized until issuance. During the year ended June 30, 2005, the Company determined that the cost of the patent was not recoverable and took a write-off related to the patent of \$1,348.

### Advertising Costs

-----

The Company expenses advertising and promotion costs as incurred. During fiscal 2005 and 2004, the Company incurred advertising and promotion costs of approximately \$135 and \$76, respectively.

### Research and Development

-----

Research and development costs are charged to expense as incurred.

### Loss per Common Share

-----

The Company reports earnings (loss) per share in accordance with SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share are computed by dividing income (loss) available to common shareholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Diluted earnings (loss) per share have not been presented since the effect of the assumed conversion of options and warrants and convertible debt securities to purchase common shares would have an anti-dilutive effect. The following potential common shares have been excluded

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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from the computation of diluted net loss per share for the years ended June 30, 2005 and 2004, respectively: warrants - 31,563,430 and 21,563,430; stock options - 39,150,000 and 39,150,000; and convertible securities of 415,751,623 and 210,896,000. The Company has no dilutive shares due to having a loss from operations.

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

	YEAR ENDED JUNE 30,		
	2005		
	INCOME/ (LOSS) (THOUSANDS)	SHARES (THOUSANDS)	PER SHARE (LOSS)
	(THOUSANDS)	(THOUSANDS)	INCOME/ (LOSS)
<b>BASIC EARNINGS (LOSS) PER SHARE</b>			
Net income (loss) from continuing operations	\$ (4,218)		\$ (2,895)
Preferred stock dividends	(21)		(21)
	(4,239)		(2,916)
Discontinued operations	--		2,997
	\$ (4,239)		\$ 81
	=====		=====
Weighted shares outstanding		658,436	
Continuing operations			\$ (0.01)
Discontinued operations			\$ --
			\$ (0.01)
			=====

### Debt Discounts

-----

Debt discounts costs are principally the values attributed to the detachable warrants issued in connection with the convertible debentures and the value of the preferential conversion feature associated with the convertible debentures. These debt issuance costs are accounted for in accordance with Emerging Issues Task Force ("EITF") 00-27 issued by the Financial Accounting Standards Board ("FASB").

### Minority Interest

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On April 1, 2005, the Company contributed its wholly-owned subsidiary, Solvis, to QPI. At that date, Solvis had a stockholders' equity of \$393. As a result of the Company contributing Solvis to an 85% owned subsidiary, the Company recognized minority interest on its consolidated balance sheet in the amount of \$59. During the year ended June 30, 2005, QPI incurred a net loss of which 15% is attributed to the minority interest. In the accompanying consolidated statement of operations, the Company has only recognized the minority interests' share of the net loss to the extent of the minority interest recorded on the consolidated balance sheet. Recognizing the minority interests' entire share of the net loss would have resulted in the recording of a minority interest receivable.

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

##### Income Taxes

-----

The Company utilizes SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

The Company recognizes the amount of taxes payable or refundable for the current year and recognizes deferred tax liabilities and assets for the expected future tax consequences of events and transactions that have been recognized in the Company's financial statements or tax returns. The Company currently has substantial net operating loss carryforwards. The Company has recorded a 100% valuation allowance against net deferred tax assets due to uncertainty of their ultimate realization.

##### Stock Based Compensation

-----

SFAS No. 123, "Accounting for Stock-Based Compensation," establishes and encourages the use of the fair value based method of accounting for stock-based compensation arrangements under which compensation cost is determined using the fair value of stock-based compensation determined as of the date of grant and is recognized over the periods in which the related services are rendered. The statement also permits companies to elect to continue using the current intrinsic value accounting method specified in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," to account for stock-based compensation. The Company has elected to use the intrinsic value based method and has disclosed the pro forma effect of using the fair value based method to account for its stock-based compensation issued to employees. For options granted to employees where the exercise price is less than the fair value of the stock at the date of grant, the Company recognizes an expense in

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accordance with APB 25. For non-employee stock based compensation the Company recognizes an expense in accordance with SFAS No. 123 and values the equity securities based on the fair value of the security on the date of grant. For stock-based awards the value is based on the market value for the stock on the date of grant and if the stock has restrictions as to transferability a discount is provided for lack of tradability. Stock option awards are valued using the Black-Scholes option-pricing model.

If the Company had elected to recognize compensation expense based upon the fair value at the grant date for awards under the Stock Option Plan consistent with the methodology prescribed by SFAS No. 123, the Company's net loss and loss per share would be reduced to the pro forma amounts indicated below for the years ended June 30, 2005 and 2004:

	2005	2004
	-----	-----
Net income (loss) attributed to common stockholders:		
As reported	\$ (4,239)	\$ 81
Compensation recognized under APB 25	--	--
Compensation recognized under SFAS 123	--	(825)
	-----	-----
Pro forma	\$ (4,239)	\$ (744)
	=====	=====
 Basic loss per common share		
As reported	\$ (0.01)	\$ 0.00
Pro forma	\$ (0.01)	\$ (0.00)

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

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

The weighted average fair value of the options granted during fiscal years 2005 and 2004 is estimated on the date of grant using the Black-Scholes option-pricing model. The weighted average fair values and weighted average assumptions used in calculating the fair values were as follows for the years ended June 30:

	2005	2004
	-----	-----
Fair Value of options granted	\$ n/a	\$ 0.025
Risk free interest rate	n/a	3.5%
Expected life (years)	n/a	3
Expected volatility	n/a	426%
Expected dividends	n/a	--

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### Fair Value of Financial Instruments

-----

For certain of the Company's financial instruments, including accounts receivable, inventories, accounts payable, and accrued expenses, the carrying amounts approximate fair value, due to their relatively short maturities. The amounts owed for long-term debt also approximate fair value because current interest rates and terms offered to the Company are at current market rates.

### Comprehensive Income

-----

The Company adopted SFAS No. 130, "Reporting Comprehensive Income." This statement establishes standards for reporting other comprehensive income and its components in a financial statement. Comprehensive income, as defined, includes all changes in equity (net assets) during a period from non-owner sources. Examples of items to be included in comprehensive income, which are excluded from net income, include foreign currency translation adjustments and unrealized gains and losses on available-for-sale securities. Comprehensive income is not presented in the Company's financial statements since the Company did not have any of the items of other comprehensive income in any period presented.

### Segment Disclosure

-----

SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information," was issued, which changes the way public companies report information about segments. SFAS No. 131, which is based on the selected segment information, requires quarterly and entity-wide disclosures about products and services, major customers, and the material countries in which the entity holds assets and reports revenues. The Company has four segment. (See Note 8).

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

### Recent Accounting Pronouncements

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In November 2004, the FASB issued SFAS No. 151, entitled INVENTORY COSTS -- AN AMENDMENT OF ARB NO. 43, CHAPTER 4. SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, entitled INVENTORY PRICING [June 1953], to clarify the accounting for "abnormal amounts" of idle facility expense, freight, handling costs, and wasted material [spoilage]. Before revision by SFAS No. 151, the guidance that existed in ARB No. 43 stipulated that these type items may be "so abnormal" that the appropriate accounting treatment would be to expense these costs as incurred [i.e., these costs would be current-period charges]. SFAS No. 151 requires that these type items be recognized as current-period charges WITHOUT REGARD to whether the "so abnormal" criterion has been met. Additionally, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of SFAS 151 did not impact the consolidated financial statements.

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

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

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

In May 2005, the FASB issued SFAS No. 154, entitled ACCOUNTING CHANGES AND ERROR CORRECTIONS--A REPLACEMENT OF APB OPINION NO. 20 AND FASB STATEMENT NO. 3. This Statement replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement defines RETROSPECTIVE APPLICATION as the application of a different accounting principle to prior accounting periods as if that principle



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had always been used or as the adjustment of previously issued financial statements to reflect a change in the reporting entity. This Statement also redefines RESTATEMENT as the revising of previously issued financial statements to reflect the correction of an error. The adoption of SFAS 154 did not impact the consolidated financial statements.

### NOTE 2 - PROPERTY AND EQUIPMENT

The cost of property and equipment at June 30, 2005 consisted of the following:

Computer and other equipment	\$	1,025
Office furniture and fixtures		1,233
Leasehold improvements		71
		-----
		2,329
Less accumulated depreciation and amortization		(2,071)
		-----
	\$	258
		=====

Depreciation expense for the years ended June 30, 2005 and 2004 was \$77 and \$44, respectively. Leased equipment amounted to \$56 as of June 30, 2005.

### NOTE 3 - RELATED PARTY TRANSACTIONS

#### Transactions with a Director of the Company

-----

A director of the Company is a majority shareholder in a consulting firm that provides management and public relations services to the Company. The Company accrued consulting fees and expenses to this consulting firm in the amount of approximately \$0 and \$120 for the years ended June 30, 2005 and 2004, respectively.

#### Transactions with Officers and Key Executives

-----

During the year ended June 30, 2004, common stock with an aggregate fair market value of \$8 was awarded to key executives as compensation and advances.

During the year ended June 30, 2004, the Company issued 7,272,110 shares of common stock to the Company's CEO as payment for accrued expenses and a note payable in the aggregate amount of \$109.

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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#### Transactions with a Related Party

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In April 2004, the Company had a PEO services client whose Chairman of the Board is the Company's current CEO and Chairman. The Company received fees of \$7 during the year ended June 30, 2004. The transaction is at fair value.

Warning Management Services, Inc.  
-----

The Company's CEO and Chairman, Mr. Brian Bonar, is also the CEO and Chairman of Warning Management Services, Inc. In addition, the Company's CFO, Mr. Randall A. Jones, is also the CFO 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.

GUARANTEE OF INDEBTEDNESS OF WARNING  
-----

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

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

Warning leases offices for its ESI subsidiary, on a month-to-month basis from the Company that started in October 2004. Monthly rental expense will be approximately \$3 per month.

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

In April 2004, the Company entered into an Agreement to provide PEO services for Warning. The Company receives from Warning a monthly administrative fee. During the year ended June 30, 2005, the Company has invoiced Warning \$390 for management services and \$45 for reimbursement of costs. Warning also paid expenses of \$38 on behalf of the Company. As of June 30, 2005, the Company has an amount due to Warning of \$194 that is included in current liabilities.

Kaire Holdings, Inc.  
-----

The Company's Source One subsidiary processes the payroll for Effective Health, Inc. which is a wholly-owned subsidiary of Kaire Holdings, Inc. The Company's CFO, Mr. Randall A. Jones, is also the CFO of Kaire Holding, Inc.

NOTE 4 - ACQUISITIONS AND DISPOSITIONS

Heritage Staffing Group, Inc.  
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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

On April 4, 2005, DRDF completed its acquisition of certain assets of Heritage Staffing Group, Inc. ("Heritage"). The purchase price was \$79 consisting of \$20 in cash, a \$45 note payable to the owner of Heritage and 5,000,000 warrants to purchase shares of DRDF common stock valued at \$14. Heritage is in the temporary staffing business and the Company acquired certain assets of Heritage to complement its other temporary staffing business.

The operating results of Heritage beginning April 4, 2005 are included in the accompanying consolidated statements of operations.

The total purchase price was valued at \$80 and is summarized as follows in accordance with SFAS No. 141 and 142:

Computer equipment	\$	4
Furniture and fixtures		3
Customer list		72
		-----
Purchase price	\$	79
		=====

The customer list is being amortized over 36 months.

The pro forma financial information that the consolidated operations of the Company as if the Heritage acquisition had occurred as of the beginning of the periods presented is not presented since the operations of Heritage prior to the acquisition by DRDF are immaterial.

#### Jackson Staffing, Inc.

-----

On September 1, 2003, DRDF completed its acquisition of 100% of the issued and outstanding shares of common stock of Jackson Staffing, Inc. ("Jackson"). The purchase price was 1,329,478 shares of DRDF common stock valued at \$30. Established in 2003, Jackson is a temporary staffing agency.

The operating results of Jackson beginning September 1, 2003 are included in the accompanying consolidated statements of operations.

The total purchase price was valued at approximately \$30 and is summarized as follows in accordance with SFAS No. 141 and 142:

Cash	\$	104
Receivables		28
Property and equipment		23
Accounts payable		(19)
Accrued expenses		(83)
Notes payable		(23)
		-----
Purchase price	\$	30
		=====

#### M&M Nursing

-----

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

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

The operating results of M&M beginning July 1, 2004 will included in the accompanying consolidated statements of operations.

The total purchase price was valued at approximately \$235 and is summarized as follows in accordance with SFAS No. 141 and 142:

Receivables	\$	233
Property and equipment		2
		-----
Purchase price	\$	235
		=====

During the year ended June 30, 2005, the operations of Jackson and M&M combined and the combined companies were renamed the Solvis Group, Inc. ("Solvis"). Also during the year ended June 30, 2005, the Company contributed its wholly-owned subsidiary, Solvis to QPI. As of June 30, 2005, Solvis is a wholly-owned subsidiary of QPI.

Greenland Corporation  
-----

#### DISPOSITION

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

The terms of the sale are as follows: the Company returned all common shares of Greenland except for 19,183,390 restricted common shares; assign or grant all rights, title and interest the Company had in acquiring any or all interest in ePEO Link, Inc. to Greenland; Greenland canceled a convertible promissory note in the amount of \$2.225 issued by the Company to Greenland; and Greenland agreed to forgive and cancel the inter-company transfer debt of the Company to Greenland of approximately \$1,300.

Greenland's revenues were \$5,211 for the period starting July 1, 2003 to February 29, 2004, and were \$400 for the period January 14, 2003 to June 30, 2003. The results of operations of Greenland have been reported separately as discontinued operations.

The assets sold consisted primarily of accounts receivable, deposits, property

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and equipment, and other assets. The Greenland also assumed all accounts payable and accrued liabilities.

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

The following is a summary of the net assets sold at February 29, 2004:

	February 29, 2004
	-----
<b>Assets:</b>	
Cash	\$ -
Accounts receivable	406
Other current assets	135
Property and equipment, net	77
Other assets	3,830
	-----
Total assets	\$ 4,448
<b>Liabilities:</b>	
Accounts payable	\$ 1,237
Notes payable	830
PEO payroll taxes and payroll deduction	3,993
Accrued liabilities	1,265
Other non-current liabilities	798
	-----
Total liabilities	\$ 8,123
	-----
Net liabilities of discontinued operations	\$ 3,675
	=====

#### NOTE 5 - OTHER ACCRUED EXPENSES

Other accrued expenses at June 30, 2005 consisted of the following as of:

Accrued interest and penalties	\$ 3,923
Accrued judgments	3,377
Other taxes	160
Accrued salaries and related liabilities	784
Loss reserves	464
Other	1,388
	-----
	\$ 10,096
	=====

#### NOTE 6 - DEBT

Borrowings under Banks Notes Payable

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On June 6, 2000, the Company entered into a settlement agreement with Imperial Bank ("Imperial"). Under this agreement, the Company would pay \$150 per month until the balance was paid in full. Payments have been reduced to \$100 per month through January 2002 and further reduced to \$50 subsequent to January 2002. During the year ended June 30, 2002, the Company paid \$1,023 toward this

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

obligation. Due to the uncertainty regarding the Company's ability to meet its obligations and certain defaults under this agreement, the debt has been classified as current. The debt is accruing interest at 5.75% per annum, which will be waived if all principal payments are made timely. The debt is collateralized by substantially all assets of the Company.

As of June 30, 2005, the Company owed Export-Import Bank ("ExIm") \$1,730 plus interest under a Working Capital Guarantee Facility whereby Imperial made a demand upon ExIm who responded by making a claim payment to Imperial. The note bears interest at 10% per annum. ExIm has made a demand for immediate payment and note is currently in default.

The following is a summary of the borrowings under bank notes payable at June 30, 2004:

Imperial	\$	1,490
Export-Import Bank		1,730
		-----
Total	\$	3,220
		=====

#### Notes Payable, including amounts due to related parties

-----

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

The following summarizes notes payable at June 30, 2005:

Payable to investor, 8%	\$	150
Payable in connection with QPI acquisition		156
Payable to two investors, 40%		190

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Payable to investor, 8%	37
Payable to related party	425
Payable in connection with Heritage acquisition	45
Payable to bank related to financing of worker's compensation deposit	600
Payable to finance company related to financing of worker's compensation premium and deposit	2,799
Payable to equipment finance companies	9
Payable to a former director, 16%	1,500
	-----
	5,911
Less current portion	(5,269)
	-----
Long-term portion	\$ 642
	=====

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

Notes payable mature as follows:

During the years ended June 30,	
2006	\$ 5,269
2007	642
	-----
	\$ 5,911
	=====

#### Factoring Lines of Credit

-----

The Company's temporary staffing division entered into a factoring agreement that expires in January 2007 and is renewable for successive periods of 12 months assuming certain conditions are met. The agreement provides for the Company to borrow against factored accounts receivables at a discount of approximately 2% for each 30 day period the balances remain unpaid. Customer payments are made directly to the factoring company and there is full recourse for uncollected accounts.

#### Convertible Debentures

-----

On December 12, 2000, the Company entered into a Convertible Note Purchase Agreement with Amro International, S.A., Balmore Funds, S.A. and Celeste Trust Reg. Pursuant to this agreement, the Company sold to each of the purchasers convertible promissory notes in the aggregate principal amount of \$850 bearing interest at the rate of eight percent (8%) per annum, due December 12, 2003, each convertible into shares of the Company's common stock. Interest shall be payable, at the option of the purchasers, in cash or shares of common stock. At any time after the issuance of the notes, each note is convertible into such number of shares of common stock as is determined by dividing (a) that portion

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of the outstanding principal balance of the note as of the date of conversion by (b) the lesser of (x) an amount equal to seventy percent (70%) of the average closing bid prices for the three (3) trading days prior to December 12, 2000 and (y) an amount equal to seventy percent (70%) of the average closing bid prices for the three (3) trading days having the lowest closing bid prices during the thirty (30) trading days prior to the conversion date. The Company has recognized interest expense of \$364 relating to the beneficial conversion feature of the above notes. Additionally, the Company issued a warrant to each of the purchasers to purchase 502,008 shares of the Company's common stock at an exercise price equal to \$1.50 per share.

On July 26, 2001, the Company entered into a convertible note purchase agreement with certain investors whereby the Company sold to the investors a convertible debenture in the aggregate principal amount of \$1,000 bearing interest at the rate of eight percent (8%) per annum, due July 26, 2004, convertible into shares of the Company's common stock. Interest is payable, at the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$1.30 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, the Company issued a warrant to the investor to purchase 769,231 shares of the Company's common stock at an exercise price equal to \$1.30 per share. The investor may

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

exercise the warrant through July 26, 2006. In accordance with EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is \$492 and \$508, respectively. The value of the note was then allocated between the note and the preferential conversion feature, which amounted to \$0 and \$492, respectively.

On September 21, 2001, the Company entered into a convertible note purchase agreement with an investor whereby the Company sold to the investor a convertible promissory note in the aggregate principal amount of \$300 bearing interest at the rate of eight percent (8%) per annum, due September 21, 2004, convertible into shares of the Company's common stock. Interest is payable, at the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.532 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, the Company issued a warrant to the investor to purchase 565,410 shares of the Company's common stock at an exercise price equal to \$0.76 per share. The investor may exercise the warrant through September 21, 2006. In December 2001, \$70 of this note was converted into 209,039 shares of common stock. In accordance with EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is



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\$106 and \$194, respectively. The value of the note was then allocated between the note and the preferential conversion feature, which amounted to \$0 and \$106, respectively.

On November 7, 2001, the Company entered into a convertible note purchase agreement with an investor whereby the Company sold to the investor a convertible promissory note in the aggregate principal amount of \$200 bearing interest at the rate of eight percent (8%) per annum, due November 7, 2004, convertible into shares of the Company's common stock. Interest is payable, at the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.532 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, the Company issued a warrant to the investor to purchase 413,534 shares of the Company's common stock at an exercise price equal to \$0.76 per share. The investor may exercise the warrant through November 7, 2006. In accordance with EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is \$92 and \$108, respectively. The value of the note was then allocated between the note and the preferential conversion feature, which amounted to \$0 and \$92, respectively.

On January 22, 2002, the Company entered into a convertible note purchase agreement with an investor whereby the Company sold to the investor a convertible promissory note in the aggregate principal amount of \$500 bearing interest at the rate of eight percent (8%) per annum, due January 22, 2003, convertible into shares of the Company's common stock. Interest is payable, at the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.332 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, the Company issued a warrant to the investor to purchase 3,313,253 shares of the Company's common stock at an exercise price equal to \$0.332 per share. The investor may exercise the warrant through January 22, 2009. In accordance with

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is \$101 and \$399, respectively. The value of the note was then allocated between the note and the preferential conversion feature, which amounted to \$0 and \$101, respectively.

On August 5, 2002, the Company entered into a convertible note purchase agreement with an investor in the aggregate principal amount of \$100 bearing interest at the rate of eight percent (8%) per annum, due August 5, 2005, convertible into shares of the Company's common stock. Interest is payable, at

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the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.03 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. In accordance with EITF 00-27, the value of the note was allocated between the note and the preferential conversion feature, which amounted to \$57 and \$43, respectively.

On January 31, 2003, the Company entered into a convertible note purchase agreement with an investor whereby the Company converted a previous advance from the investor into a convertible promissory note in the aggregate principal amount of \$150 bearing interest at the rate of eight percent (8%) per annum, due January 31, 2005, convertible into shares of the Company's common stock. Interest is payable, at the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.0226 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. In accordance with EITF 00-27, the value of the note was allocated between the note and the preferential conversion feature, which amounted to \$86 and \$64, respectively.

On April 1, 2003, the Company entered into a convertible note purchase agreements with three investors whereby the Company converted a previous advances from the investors into a convertible promissory notes in the aggregate principal amount of \$390 bearing interest at the rate of eight percent (8%) per annum, due April 1, 2005, convertible into shares of the Company's common stock. Interest is payable, at the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.0226 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. In accordance with EITF 00-27, the value of the note was allocated between the note and the preferential conversion feature, which amounted to \$223 and \$167, respectively.

On December 17, 2003, the Company entered into convertible note purchase agreements with four investor, whereby the Company sold to the investors convertible promissory notes in the aggregate principal amount of \$800 bearing interest at the rate of eight percent (8%) per annum, due December 17, 2006, convertible into shares of the Company's common stock. Interest is payable, at the option of the investor, in cash or shares of the Company's common stock. The note is convertible into such number of shares of the Company's common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.02 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, the Company issued a warrant to the investor to purchase 16,000 shares of the Company's common stock at an exercise price equal to \$0.02 per share. The

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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The 5% convertible preferred stock is convertible, at any time, into shares of the Company's common stock, at a price of \$17.50 per common share. This conversion price is subject to certain anti-dilution adjustments, in the event of certain future stock splits or dividends, mergers, consolidations or other similar events. In addition, the Company shall reserve, and keep reserved, out of its authorized but un-issued shares of common stock, sufficient shares to effect the conversion of all shares of the 5% convertible preferred stock.

In the event of any involuntary or voluntary liquidation, dissolution or winding up of the affairs of the Company, the 5% convertible preferred shareholders shall be entitled to receive \$1 per share, together with accrued dividends, to the date of distribution or payment, whether or not earned or declared.

The 5% convertible preferred stock is callable, at the Company's option, at call prices ranging from \$1,050 to \$1,100 per share. No call on the 5% convertible preferred stock was made during fiscal 2005 and 2004. As of June 30, 2005, the accumulated dividend in arrears was approximately \$453 on the Series A.

#### Common Stock Warrants

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In connection with certain convertible debentures issued during fiscal 2004, the Company issued to the debenture holders warrants to purchase up to 16,000,000 shares of its common stock at an exercise price of \$0.02. The warrants expire on December 17, 2008. The value of these warrants was estimated at \$305. The Black-Scholes option-pricing model was used to determine the value of these warrants. The following assumptions were used: average risk-free interest rate of 3.5%; expected life of 5 years; dividend yield of 0%; and expected volatility of 426%. The value was then compared to the value of the underlying convertible debenture and the proportionate value was assigned to the detachable warrants and the underlying convertible debenture.

The following is a summary of the warrant activity:

	PRICE PER SHARE	UNDERLYING COMMON SHARES
	-----	-----
JUNE 30, 2003	\$0.20 - \$10.00	6,002,350
Granted	\$0.02	16,000,000
Exercised	--	--
Canceled	\$0.20 - \$10.00	(438,920)
		-----
JUNE 30, 2004	\$0.02 - \$1.50	21,563,430
Granted	\$0.003 - \$0.005	10,000,000
Exercised	--	--
Canceled	--	--
		-----
EXERCISABLE AT JUNE 30, 2005		31,563,430
		-----

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

The weighted average remaining contractual life of warrants outstanding at June 30, 2005 is 2.97 years. The exercise prices for warrants outstanding at June 30, 2005 are as follows:

NUMBER OF WARRANTS	EXERCISE PRICE
-----	-----
5,000,000	\$0.003
5,000,000	\$0.005
16,000,000	\$0.021
5,563,430	\$0.33 - \$1.50
-----	
31,563,430	
=====	

#### Common Stock Option Plans

-----

In July 1984 ("1984 Plan"), November 1987 ("1988 Plan") and September, 1996 ("1997 Plan"), the Company adopted stock option plans, under which incentive stock options and non-qualified stock options may be granted to employees, directors, and other key persons, to purchase shares of the Company's common stock, at an exercise price equal to no less than the fair market value of such stock on the date of grant, with such options exercisable in installments at dates typically ranging from one to not more than ten years after the date of grant.

Under the terms of the 1988 and 1997 Plans, loans may be made to option holders, which permit the option holders to pay the option price, upon exercise, in installments. A total of 10,600 and 50,000 shares of common stock are authorized for issuance under the 1988 and 1997 Plans, respectively.

No shares are available for future issuance under the 1984 Plan due to the expiration of the plan during 1994. As of June 30, 1999, options to acquire 100 shares were outstanding under the 1984 Plan and options to acquire 33,500 shares remained available for grant under the 1988 and 1997 Plans.

In addition, the Board of Directors, outside the 1984, 1988 and 1997 Plans ("Outside Plan"), granted to employees, directors and other key persons of DRDF or its subsidiaries options to purchase shares of the Company's common stock, at an exercise price equal to no less than the fair market value of such stock on the date of grant. Options are exercisable in installments at dates typically ranging from one to not more than ten years after the date of grant.

In October 1995, the Board of Directors authorized the exercise price for employee options and warrants to be reduced to the current market value. Accordingly, the exercise price on an aggregate of 911 and 13,750 options under the 1988 and Outside Plans, respectively, were canceled and reissued at an exercise price of \$20.00 per share.

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## DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

The 1997 Employee Stock Purchase Plan ("Purchase Plan") was approved by the Company's shareholders in September 1996. The Purchase Plan permits employees to purchase the Company's common stock at a 15% discounted price. The Purchase Plan is designed to encourage and assist a broad spectrum of employees of the Company to acquire an equity interest in the Company through the purchase of its common stock. It is also intended to provide participating employees the tax benefits under Section 421 of the Code. The Purchase Plan covers an aggregate of 25,000 shares of the Company's common stock.

All employees, including executive officers and directors who are employees, customarily employed more than 20 hours per week and more than five months per year by the Company are eligible to participate in the Purchase Plan on the first enrollment date following employment. However, employees who hold, directly or through options, five percent or more of the stock of the Company are not eligible to participate.

Participants may elect to participate in the Purchase Plan by contributing up to a maximum of 15 percent of their compensation, or such lesser percentage as the Board may establish from time to time. Enrollment dates are the first trading day of January, April, July and October or such other dates as may be established by the Board from time to time. On the last trading day of each December, March, June and September, or such other dates as may be established by the Board from time to time, the Company will apply the funds then in each participant's account to the purchase of shares. The cost of each share purchased is 85 percent of the lower of the fair market value of common stock on (i) the enrollment date or (ii) the purchase date. The length of the enrollment period may not exceed a maximum of 24 months. No participant's right to acquire shares may accrue at a rate exceeding \$25 of fair market value of common stock (determined as of the first trading day in an enrollment period) in any calendar year. No shares have been issued under the Purchase Plan.

#### 2001 Stock Option and Stock Purchase Plans.

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The Company's shareholders approved the 2001 Stock Option Plan, pursuant to which 5,000,000 shares of common stock are reserved for issuance to eligible employees and directors of, and consultants to, the Company or any of its subsidiaries. Upon expiration, cancellation or termination of unexercised options, the shares of the Company's Common Stock subject to such options will again be available for the grant of options under the 2001 Stock Option Plan. Options granted under the 2001 Stock Option Plan may either be incentive or nonqualified stock options.

The Company's shareholders approved the 2001 Stock Purchase Plan, as amended, which enables eligible employees to purchase in the aggregate up to 2,500,000 shares of common stock.

#### Stock Option Activity

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The following is a summary of the stock option activity:

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004  
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	STOCK OPTION PLANS	
	PRICE PER SHARE	UNDERLYING COMMON SHARES
	-----	-----
JUNE 30, 2003	\$0.01 - \$28.20	34,158,100
Granted	\$0.01 - \$0.025	34,500,000
Exercised	\$0.01 - \$0.025	(29,500,000)
Canceled	\$28.20	(8,100)
		-----
JUNE 30, 2004	\$0.01 - \$0.025	39,150,000
Granted	-	-
Exercised	-	-
Canceled	-	-
		-----
EXERCISABLE AT JUNE 30, 2005	\$0.01 - \$0.025	39,150,000
		-----

The weighted average remaining contractual life of options outstanding issued under the Stock Option Plans is 0.98 years at June 30, 2005. The exercise prices for options outstanding at June 30, 2005 are as follows:

NUMBER OF OPTIONS	EXERCISE PRICE
-----	-----
6,000,000	\$0.010
7,650,000	\$0.015
25,500,000	\$0.025
-----	
39,150,000	
=====	

For options granted during the year ended June 30, 2004 where the exercise price was equal to the stock price at the date of the grant, the weighted-average fair value of such options was \$0.025 and the weighted-average exercise price of such options was \$0.025. In connection with the issuance of these options, the Company recognized an expense of \$0 related since the exercise price was equal to the value of the Company's stock at the date of issuance. During the year ended June 30, 2004, the Company repriced certain options that were previously issued and recorded a charge to earnings in the amount of \$141.

Common stock issued for services and compensation

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The table below shows all the issuances of common stock for services during the

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year ended June 30, 2005 and 2004. The value of the services was derived by multiplying the market value of the Company's common stock at the date a transaction for services was entered into by the number of shares issued.

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

#### FISCAL 2005

ISSUE DATE	DESCRIPTION	SHARES ISSUED	AMOUNT
7/26/04	Strategic planning/marketing	450,000	\$ 2
9/28/04	Strategic planning/marketing	1,500,000	8
10/19/04	Strategic planning/marketing	1,673,110	8
10/25/05	Strategic planning/marketing	5,000,000	25
6/13/05	Professional services	6,000,000	30
		-----	-----
		14,623,110	\$ 73
		=====	=====

#### FISCAL 2004

ISSUE DATE	DESCRIPTION	SHARES ISSUED	AMOUNT
1/7/2004	Strategic planning/marketing	75,000	\$ 1
6/1/2004	Strategic planning/marketing	300,000	2
7/31/2003	Strategic planning/marketing	100,000	2
9/17/2003	Strategic planning/marketing	120,000	2
12/29/2003	Strategic planning/marketing	250,000	3
12/10/2003	Professional services	175,000	3
1/7/2004	Strategic planning/marketing	150,000	3
12/31/2003	Strategic planning/marketing	500,000	5
12/10/2003	Professional services	1,075,000	16
8/1/2003	Strategic planning/marketing	5,000,000	125
		-----	-----
		7,745,000	\$ 162
		=====	=====

NOTE 8 - SEGMENT AND GEOGRAPHIC INFORMATION



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During fiscal 2005 and 2004, the Company managed and internally reported the Company's business as four (4) reportable segments as follows:

- (1) professional employer organization
- (2) temporary staffing
- (3) imaging products;
- (4) imaging software;

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

Segment information for the fiscal year ended June 30, 2005 and 2004, was as follows:

	PEO BUSINESS	TEMPORARY STAFFING	IMAGING PRODUCTS	IMAGING SOFTWARE	TO TOTAL
<b>SELECTED STATEMENT OF OPERATIONS ACTIVITY:</b>					
Fiscal year ended June 30, 2005					
Revenues	1,930	17,029	447	70	19,476
Cost of revenues	1,424	15,010	93	3	16,530
Gross profit	506	2,019	354	67	2,946
Impairment of patent	--	--	1,348	--	1,348
Fiscal year ended June 30, 2004					
Revenues	\$ 2,607	\$ 10,119	\$ 764	\$36	\$ 13,526
Cost of revenues	894	9,209	196	3	10,302
Gross profit	1,713	910	568	33	3,224

During 2004, all revenue derived from temporary staffing was from one client and during 2005 96% of revenue derived from temporary staffing was from two clients. At June 30, 2005, 36% of the accounts receivable balance is due from these two clients.

All sales were made in the United States of America

#### NOTE 9 - INCOME TAXES

The Company's provision for income taxes is accounted for in accordance with SFAS 109. SFAS 109 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under the SFAS 109 asset and liability method, deferred tax assets and liabilities are determined based upon the difference between the financial statement and tax bases of assets and liabilities using the enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is then provided for deferred tax assets that are more likely than not to not be realized.

The provision (benefit) for income taxes is as follows for the years ended June

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	2005	2004
	-----	-----
Current - State	\$ -	\$ -
Deferred benefit	-	-
	-----	-----
	\$ -	\$ -
	=====	=====

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DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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The components of deferred income taxes are as follows at June 30:

	2005	2004
	-----	-----
Deferred tax assets		
Net operating loss carryforwards	\$ 38,927	\$ 37,600
Other	524	500
	-----	-----
	39,451	38,100
Valuation allowance	(39,451)	(38,100)
	-----	-----
	\$ --	\$ --
	=====	=====

The Company's federal and state net operating loss carryforwards expire in various years through 2017. The Company has made numerous equity issuances that could result in limitations on the annual utilization of the Company's net operating loss carryforwards. The Company has not performed an analysis to determine the effect of such changes.

The provision for income taxes results in an effective rate that differs from the federal statutory rate. Reconciliation between the actual tax provision and taxes computed at the statutory rate is as follows for the year ended June 30, 2005:

	Tax	Percentage
Federal Tax	\$ (1,434)	34.0%
State tax	(253)	6.0%
Penalties	306	(7.3)
Other	59	(1.4%)
Net operating loss	1,322	(31.3%)
	-----	-----
	\$ --	0%
	=====	=====

Reconciliation between the actual tax provision and taxes computed at the statutory rate is as follows for the year ended June 30, 2004:

Tax	Percentage
-----	------------

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Federal Tax	\$	35	34.0%
State tax		6	6.0%
Penalties		304	292.6%
Reserves		5	4.9%
Discontinued operations		(551)	(530.3%)
Repriced options		48	46.1%
Net operating loss		153	146.7%
		-----	-----
	\$	--	0%
		=====	=====

At June 30, 2005, the Company had federal and state net operating loss ("NOL") carryforwards of approximately \$94,000,000 and \$73,000,000, respectively. Federal NOLs could, if unused, expire in varying amounts in the years 2010 through 2020.

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

#### NOTE 10 - COMMITMENTS AND CONTINGENCIES

##### Lease Commitment

The Company leases its operating facilities under lease agreements that expire through August 2010. In addition, the Company leases other facilities and equipment under operating and capital short-term leases.

Total rental expense was approximately \$299 and \$242 for the years ended June 30, 2005 and 2004, respectively.

Future minimum lease payments under non-cancelable capital and operating leases with initial or remaining terms of one year or more are as follows:

		Capital Leases	Operating Leases
		-----	-----
YEAR ENDING JUNE 30,			
2006	\$	15	\$ 275
2007		15	275
2008		15	275
2009		15	230
2010		3	207
		-----	-----
Net Minimum Lease Payments	\$	63	\$ 1,262
			=====
Less: Amounts Representing Interest		(11)	
		-----	
Present Value of Net Minimum Lease Payments		52	
Less: Current Portion		(10)	
		-----	
Long-Term Portion	\$	42	
		=====	

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### Legal Matters

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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. The claims made by Arena against the Company and SOG are that SOG failed to perform under an agreement to procure and furnish workers' compensation insurance and that Arena incurred alleged damages in an amount no less than \$709 as a result. Management has vigorously contested the claims made by Arena. In addition, the Company has filed claims against Arena and Arena's agent, Thilman and Filippini, based on, among other things, the representations made to SOG that let it to enter into the agreement with Arena. The case remains in the discovery phase.

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 nature of the specific claims made by Liberty against the Company and SOG are that the Company and SOG were and are obligated to make additional premium payments to Liberty for workers' compensation insurance, which is related to the Arena litigation described above. The initial claim by Liberty was estimated by Liberty to be \$829 and is now claimed to exceed \$1,000. Management has vigorously contested the claims made by Liberty. The case remains in the discovery phase.

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On February 10, 2005, Berryman & Henigar Enterprises ("Plaintiff"), filed a complaint in the Superior Court of California, County of San Diego, Case No. GIC842610, against Warning Model Management, Inc. for breach of a promissory note issued pursuant to terms and conditions of a certain stock purchase and sale agreement dated September 9, 2004. The Company and its subsidiary, Employment Systems, Inc. ("ESI"), each allegedly guaranteed payments on the underlying promissory note. Plaintiff seeks principal damages of \$750 in that regard. Warning Model Management, Inc. has taken the position that Plaintiff failed to disclose certain material information in the underlying transaction which thereby negates the promissory note. As such, the guarantees allegedly provided by the Company and ESI could thereby be invalidated. Discovery has commenced but is not complete at this time. Trial has not been set. Management has fully cooperated in our investigation of the facts and we intend to defend against the claims asserted. This Company has reached a verbal settlement with the plaintiff., pending the completion of the signed agreement.

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. Discovery has commenced but is not complete at this time. Trial has not been set. Management has fully cooperated in our investigation of the facts and we intend to continue with vigorous defense against the claims asserted.

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 case is in its early stages and discovery has not yet commenced. However, the Company intends to vigorously defend itself against the claims asserted.

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Throughout fiscal 2004 and 2005, and through the date of this filing, trade creditors have made claims and/or filed actions alleging the failure of the Company to pay its obligations to them in a total amount exceeding \$3,000. These actions are in various stages of litigation, with many resulting in judgments being entered against the Company. Several of those who have obtained judgments have filed judgment liens on the Company's assets. These claims range in value from less than \$1,000 to just over \$1,000,000, with the great majority being less than \$20,000.

On September 7, 2005, the arbitrator from the American Arbitration Association awarded to Accord Human Resources a judgment against Greenland Corporation and the Company as the guarantor, an amount equaling \$168. Legal counsel has estimated that the claim could amount to as much as \$214. The Company has reserved \$200 for the claim.

The Company is currently in dispute with one of its investors regarding the pay down of a convertible note payable with shares of the Company's common stock issued during the year ended June 30, 2005. The Company has currently reserved \$263 regarding this dispute and is hopeful that the matter can be resolved amicably.

>From time to time, the Company is involved in litigation relating to claims arising out of their operations in the normal course of business.

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### DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (in thousands, except share information)

##### NOTE 11 - GAIN ON SETTLEMENT OF DEBT

During the years ended June 30, 2005 and 2004, the Company recognized a gain on settlement of debt of \$829 and \$1,145, respectively. This gain resulted primarily from the write off of stale accounts 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 12 - GAIN RESULTING FROM RECONCILIATION OF PAYROLL TAX LIABILITIES TO TAXING AUTHORITIES

During the year ended June 30, 2005, the Company recorded an adjustment to earnings of \$1,895, resulting from a reconciliation with the Internal Revenue Service and certain State taxing authorities of the amounts due for delinquent payment of payroll tax liabilities. The Company continually updates its estimate of the amount due related to delinquent payroll taxes and penalties as it receives correspondence or settlement agreements with the Internal Revenue Service and State taxing authorities.

The Company is delinquent in filing its payroll tax returns and owes \$8,683 in delinquent payroll tax payments, interest and penalties.

##### NOTE 13 - SUBSEQUENT EVENTS

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On July 18, 2005, the Company entered into an agreement with World Wide Personnel Services of California, Inc. whereby the Company purchased 51% issued and outstanding stock of World Wide for \$1,000 in cash plus warrants to purchase 1,000,000 shares of the Company's common stock.

On September 21, 2005, the Company entered into an agreement with PointMark Staffing, Inc. whereby the Company purchased all of the issued and outstanding stock of PointMark for \$2,500 in cash.

On July 12, 2005, 17,659,540 shares of the Company's common stock were issued to Bristol Investment Fund, Ltd. at \$0.001267 per share for conversion of a convertible debenture valued at \$22.

Subsequent to June 30, 2005, the Company entered into three new operating lease agreements for office space in California, Michigan and Toronto, Canada. The terms of the leases are from 41 to 60 months and the minimum lease payment due under these new operating lease agreements are included in Note 10.

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