

VIRTRA SYSTEMS INC
Form 10QSB
May 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 2007

or

**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 000-28381

VIRTRA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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Texas
(State or other jurisdiction of incorporation or
organization)

93-1207631
(IRS Employer Identification No.)

2500 City West Blvd., Suite 300, Houston, Texas
(Address of principal executive offices)

77042
(Zip Code)

(832) 242-1100

(Registrant's telephone number, including area code)

Check whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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

As of April 27, 2006, the Registrant had outstanding 102,257,599 shares of common stock, par value \$.005 per share.

PART I. FINANCIAL INFORMATION

Item 1.

Financial Statements.

VIRTRA SYSTEMS, INC.

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VIRTRA SYSTEMS, INC.
BALANCE SHEET
March 31, 2007 and December 31, 2006

| | March 31, 2007 | December 31, 2006 |
|---|---------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and equivalents | \$ 97,751 | \$ 91,221 |
| Accounts receivable | 313,759 | 406,784 |
| Allowance for Uncollectible Accounts | (135,000) | - |
| Cost in Excess of Billings | 96,027 | - |
| Total Current Assets | 372,536 | 498,005 |
| Property and equipment, net | 87,852 | 96,839 |
| Capitalized development cost, net | 99,062 | 115,412 |
| Other Assets | 16,056 | 17,209 |
| Total Assets | 575,506 | 727,465 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| Current Liabilities: | | |
| Notes payable | 120,000 | 133,145 |
| Obligations under product financing arrangements | 348,586 | 454,980 |
| Accounts payable | 695,352 | 848,390 |
| Accrued liabilities | 2,269,942 | 2,390,039 |
| Advances held on deposit | 189,331 | 39,625 |
| Convertible debentures net of discount of \$122,388 | 347,729 | 347,729 |
| Other current liabilities | 129,420 | 71,750 |
| Payable to related party | 82,252 | 82,252 |
| Billing in excess of cost on uncompleted contracts | - | 24,946 |

| | | |
|---|-----------|-----------|
| Total Current Liabilities | 4,182,613 | 4,392,856 |
| Redeemable common stock, 371,834 shares at \$.005 par value | 1,859 | 1,859 |
| Total Liabilities | 4,184,472 | 4,394,715 |
| Commitments and contingencies | | |
| Stockholders' deficit: | | |

| | | |
|---|--------------|--------------|
| Common Stock, \$.005 par value, 500,000,000 shares authorized, 102,257,599 and 99,732,599 share issued and outstanding as of March 31, 2007 and December 31, 2006 respectively | 511,288 | 483,663 |
| Common Stock Committed | 225,000 | 150,000 |
| Additional Paid in Capital | 11,171,743 | 10,921,467 |
| Accumulated Deficit | (15,516,997) | (15,222,379) |
| Total stockholders' deficit | (3,608,966) | (3,667,249) |
| Total liabilities and stockholders' equity | \$ 575,506 | \$ 727,466 |

See accompanying notes to financial statements

VIRTRA SYSTEMS, INC.
STATEMENT OF OPERATIONS
For the three months ended March 31, 2007 and 2006

| | Three Months Ended March 31, | |
|--|-------------------------------------|------------------|
| | 2007 | 2006 |
| Revenue: | | |
| Custom applications: | | |
| Training/simulation | \$ 106,977 | \$ 545,938 |
| Advertising/promotion | 102,676 | - |
| Other Revenue | 29,733 | 12,714 |
| Total revenue | 239,386 | 558,652 |
| Cost of sales and services | 197,174 | 228,650 |
| Gross margin | 42,212 | 330,002 |
| General and administrative expenses | 537,782 | 385,695 |
| Net loss from operations | (495,570) | (55,693) |
| Other income (expenses) | | |
| Interest expense | (75,468) | (209,788) |
| Gain on Legal Settlement | 273,607 | - |
| Gain/(Loss) on sale of assets | 2,813 | - |
| Total other income (expenses) | (200,952) | (209,788) |
| Net loss | \$ (294,618) | \$ (265,471) |
| Weighted averages shares outstanding | 100,637,475 | 67,396,767 |
| Basic and diluted earnings per share | (\$0.003) | (\$0.004) |

VIRTRA SYSTEMS, INC.
STATEMENT OF CASH FLOWS
for the three months ended March 31, 2007 and 2006

| | Three Months Ended March 31, | |
|---|-------------------------------------|--------------|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ (294,618) | \$ (265,471) |
| Adjustments to reconcile net loss with net cash used in operating activities: | | |
| Depreciation and amortization | 27,587 | 40,941 |
| Bad Debt Expense | 135,035 | 25,105 |
| Effect of beneficial conversion feature | - | 111,546 |
| Stock issued as compensation for services | (150,000) | - |
| Gain/(Loss) on sale of assets | (273,607) | - |
| Gain/(Loss) on sale of assets | (2,813) | - |
| Increase in operating assets | 133,186 | (327,473) |
| Increase (decrease) in accounts payable and accrued liabilities | 247,338 | 243,295 |
| Net cash used in operating activities: | (177,891) | (172,057) |
| Cash flows from investing activities: | | |
| Capital expenditures | (2,249) | (9,226) |
| Proceeds from sale of PP&E | 2,813 | - |
| Net cash used in investing activities | 564 | (9,226) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of notes payable and other advances | 106,770 | 127,000 |
| Payments on notes payable and other advances | (200,744) | (160,720) |
| Proceeds from common stock to be issued | - | 300,000 |
| Increase in product finance obligations | - | 12,281 |
| Sales of common stock | 277,901 | - |
| Net cash provided by financing activities | 183,927 | 278,561 |
| Net increase (decrease) in cash and cash equivalents | 6,600 | 97,278 |
| | 91,221 | 764 |

Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

\$ 97,821

\$ 98,042

Non-cash operating, investing and financing activities:

Common stock committed for legal settlement

\$ 225,000

\$ -

Common stock issued upon conversion of debentures

\$ -

\$ 182,604

Reclassification of product financing obligations to accrued legal settlement

\$ 106,394

\$ -

Interest paid

\$ 73,440

\$ -

See attached notes to financial statements

VIRTRA SYSTEMS, INC.
STATEMENT OF STOCKHOLDERS' DEFICIT
For the three months ended March 31, 2007

| | Common Stock | | Common Stock Committed | Additional Paid in Capital | Accumulated Deficit | Total |
|--|--------------|-----------|------------------------|----------------------------|---------------------|----------------|
| | Shares | Amount | | | | |
| Balance as of December 31, 2006 | 96,732,599 | \$483,663 | \$ 150,000 | \$ 10,921,467 | \$(15,222,379) | \$ (3,667,249) |
| Common stock issued for services | 3,000,000 | 15,000 | (150,000) | 135,000 | - | - |
| Common stock issued for cash | 1,875,000 | 9,375 | - | 71,875 | - | 81,250 |
| Common stock committed for issuance | - | - | 225,000 | - | - | 225,000 |
| Common stock issued for debt reduction | 650,000 | 3,250 | - | 43,401 | - | 46,651 |
| Net loss | - | - | - | - | (294,618) | (294,618) |
| Balance at March 31, 2007 | 102,257,599 | \$511,288 | \$ 225,000 | \$ 11,171,743 | \$(15,516,997) | \$ (3,608,966) |

See attached notes to financial statements

VIRTRA SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS

1.

Basis of Presentation

The accompanying un-audited interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the U.S. Securities and Exchange Commission, and should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2006. They do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the financial statements for the year ended December 31, 2006 included in the Company's Form 10-KSB filed with the Securities and Exchange Commission. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been included. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the respective full year.

2.

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 reported amounts and related disclosures. Actual results could differ from those estimates.

3.

Acquisitions

On January 10, 2006 the Company entered into an agreement to merge with a newly formed entity, Virtra Merger Corporation, which in anticipation of the merger, was to acquire Altatron International, Inc., Chrysalis Manufacturing Corporation and Dynalyst Manufacturing. After due diligence, the Company withdrew from the proposed business combination.

4.

Convertible Debentures

During February 2005 and August 2005 the Company issued \$750,000 and \$500,000, respectively, in convertible debentures. The debentures bear interest at 8% per year payable in cash or registered common stock at the Company's option. The debentures mature in February and August 2008 and are convertible, at the option of the holder, to shares of the Company's common stock at a conversion price per share equal to the lower of (i) 80% of the lowest closing bid price for the common stock for the fifteen days prior to the conversion date; or (ii) 125% of the volume weighted average price on the closing date.

In addition the Company issued to the holders of the convertible debentures warrants to purchase 750,000 and 500,000 shares of the Company's common stock. In accordance with generally accepted accounting principles, the Company allocates the proceeds received from debt or convertible debt with detachable warrants or shares of common stock using the relative fair value of the individual elements at the time of issuance. Using the Black-Scholes valuation model, the Company has determined the aggregate value of the 750,000 warrants to be \$117,427 (approximately \$0.16 per warrant) and the value of the 500,000 warrants to be \$48,655 (approximately \$0.10 per warrant). The amount allocated to the warrants as debt discount has been recognized as additional interest expense over the period from the date of issuance of the note to the earlier of the conversion date or the stated maturity date.

In accordance with generally accepted accounting principles, in the event the conversion price on debentures is less than the Company's stock price on the date of issuance, the difference is considered to be a beneficial conversion feature and is amortized as interest expense over the period from the date of issuance to the earlier of the conversion

date or the stated maturity date. The Company has calculated the aggregate beneficial conversion feature of these convertible debentures to be \$398,677 on the \$750,000 debentures and \$140,760 on the \$500,000 debentures.

During the quarter ended March 31, 2007, the Company did not recognize any interest expense related to the accretion of the debt discount and beneficial conversion features recorded on these convertible debentures because no principal was converted to common stock. As of March 31, 2007, the remaining balance of the debt discount and beneficial conversion features was \$122,388.

5.

Stock Options and Warrants

Effective January 1, 2006, the Company adopted the Statement of Financial Accounting Standards No. 123 (Revised), Share-Based Payments (SFAS 123R) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. The Company adopted SFAS 123R using the modified prospective method, therefore, the prior period financial statements will not reflect any restated amounts. The Company estimates that there is no additional stock based compensation expense related to outstanding options to be recorded during the quarter ended March 31, 2006. The outstanding stock options as of March 31, 2006, are based on certain performance criteria and vest upon the occurrence of an event. Therefore, the Company used an estimate of when the event will occur to determine which options will ultimately vest and if expense should be recorded.

The Company periodically issues incentive stock options to key employees, officers, directors, and outside consultants to provide additional incentives to promote the success of the Company's business and to enhance the ability to attract and retain the services of qualified persons. There were no stock options issued during the three months ended March 31, 2006.

A summary of the Company's stock option activity and related information for the year ended December 31, 2006 follows. There was no activity in the first three months of 2007.

| | <u>Number of Shares Under Options</u> | <u>Weighted-Average Exercise Price</u> |
|-------------------------------|--|---|
| Exercisable December 31, 2005 | 4,300,000 | \$0.30 |
| Granted | 3,000,000 | \$0.035 |
| Exercised | - | - |

Forfeited/cancelled

Outstanding December 31, 2006 8,800,000 \$0.16

Following is a summary of outstanding stock options at March 31, 2007:

| <u>Number of</u> | | <u>Expiration</u> | <u>Weighted Average</u> |
|------------------|------------------|-------------------|-------------------------|
| <u>Shares</u> | <u>Vested</u> | <u>Date</u> | <u>Exercise Price</u> |
| 100,000 | 100,000 | 2012 | \$0.21 |
| 700,000 | 200,000 | 2009 | \$0.10 |
| 1,000,000 | - | 2009 | \$0.005 |
| 4,000,000 | 4,000,000 | 2009 | \$0.31 |
| <u>3,000,000</u> | <u>1,000,000</u> | 2010 | \$.035 |
| <u>8,800,000</u> | <u>5,300,000</u> | | |

A summary of the Company's stock warrant activity is as follows:

| | | <u>Number of Shares</u> | <u>Weighted-Average Exercise Price</u> |
|-------------|-------------------|------------------------------------|---|
| Outstanding | December 31, 2004 | 996,703 | \$0.38 |
| Granted | | 1,750,000 | \$0.29 |
| Exercised | | - | |
| Forfeited | | <u>-</u> | |
| Outstanding | December 31, 2005 | 2,746,703 | \$0.29 |
| Granted | | - | |
| Exercised | | - | |
| Forfeited | | <u>-</u> | |
| Outstanding | March 31, 2006 | 2,746,703 | \$0.29 |

6.

Possible Indemnification Claim

In October of 2005 the Company registered the sale by Dutchess Private Equities Fund II, L.P. of an aggregate of 8,000,000 shares of its common stock issuable to that company upon conversion of convertible debentures and upon exercise of warrants issued to it. On July 1, 2006, a portion of the shares covered by that registration statement remained unsold and the financial statements included in that registration statement's prospectus exceeded the maximum age for financial statements permitted under the SEC's regulations. The Company did not inform Dutchess, as it was required to do under its contract, that the prospectus could no longer be used. As a result, sales made by Dutchess after July 1, 2006 by means of the outdated prospectus were regarded as unregistered for purposes of the Securities Act of 1933, giving purchasers of those shares a right to rescind their purchases at any time within one year after the date of purchase. During the period from July 6, 2006 through October 20, 2006, Dutchess sold an aggregate of 5,434,138 shares using the updated prospectus, at prices ranging from \$0.03 to \$0.073. The aggregate sales price for all of those sales was \$254,977. The Company is required under its agreement with Dutchess to indemnify

Dutchess for any loss it might suffer as a result of any exercise of those rescission rights by purchasers. The Company is unable to predict whether any of those purchasers will seek rescission of their purchases. If they do, the Company will be obligated to indemnify Dutchess for an amount equal to the difference between the sales prices of those shares and the value of the shares it receives back from the purchasers upon rescission. If all of the purchasers were to rescind their purchases and if all of the shares taken back by Dutchess as a result or to become totally valueless, the Company would owe Dutchess \$254,977 as a result of the rescission.

7.

Going Concern Considerations

During the three months ended March 31, 2007 and 2006, the Company has defaulted on its notes payable and obligations under product financing arrangements, has continued to accumulate payables to its vendors and has experienced negative financial results as follows:

| | <u>2007</u> | <u>2006</u> |
|--|----------------|----------------|
| Net loss for the three months ended March 31 | \$ (294,618) | \$ (265,471) |
| Negative cash flows from operations | \$ (177,891) | \$ (172,057) |
| Negative working capital | \$ (3,810,077) | \$ (4,573,648) |
| Accumulated deficit | \$(15,516,997) | \$(14,014,343) |
| Stockholders' deficit | \$ (3,608,966) | \$ (3,446,036) |

Management has developed specific current and long-term plans to address its viability as a going concern as follows:

The Company's anticipated entry into the training/simulation market was advanced by the aftermath of September 11, 2001. The Company is currently in advanced discussions with representatives of various government authorities regarding use of the Company's technology in detecting and mitigating the risk of similar problems in the future.

The Company has also raised funds through debt and/or equity offerings. The company continues to raise funds through equity offerings, and needs working capital financing to fund the purchase and assembly of components into systems for resale. If successful, these additional funds would be used to pay down debt and for working capital purposes.

In the long-term, the Company believes that cash flows from continued growth in its operations will provide the resources for continued operations.

There can be no assurance that the Company's debt reduction plans will be successful or that the Company will have the ability to implement its business plan and ultimately attain profitability. The Company's long-term viability as a going concern is dependent upon three key factors, as follows:

The Company's ability to obtain adequate sources of debt or equity funding to meet current commitments and fund the continuation of its business operations in the near term.

The ability of the Company to control costs and expand revenues from existing or new businesses.

The ability of the Company to ultimately achieve adequate profitability and cash flows from operations to sustain its operations.

8.

Subsequent Events

As of March 31, 2007, the Company had \$891,823 accrued for various payroll tax liabilities. In May 2006, the Company received notices from the IRS of tax liens that have been filed related to these accrued amounts, and in April, 2007 the Company received further notices of intent to levy by the Internal Revenue Service.

In February, 2007 the Company entered into an agreement with Charter Capital Partners, LLC to repay \$184,100 in amounts that had been advanced by other companies during the course of 2006. As of April 30 2007 the Company was in default on this note to the extent of approximately \$107,000.

In the first quarter of 2006, a judgment was entered against the Company in a lawsuit brought on by one of the leaseholders, Edward Slagle. As part of the agreement, the plaintiff agreed to wait one year for payment. The Company has not yet been able to pay, and in February, 2007 the Company received notice from the plaintiff s

lawyer that the plaintiff intends to enforce the judgment. The amount owed is approximately \$90,000 and has been accrued for on the books.

On April 27, 2007 the Chief Executive Officer dismissed J. David Rogers, the Company's Chief Financial Officer. General Dalby assumed the dual role of CEO and CFO. As of May 10, 2007, no accountant had yet been hired or contracted.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The statements contained in this report that are not historical are forward-looking statements, including statements regarding our expectations, intentions, beliefs, or strategies regarding the future. Forward-looking statements include our statements regarding liquidity, anticipated cash needs, and availability and anticipated expense levels. All forward-looking statements included in this report are based on information available to us on this date, and we assume no obligation to update any such forward-looking statement. It is important to note that our actual results could differ materially from those in such forward-looking statements. The following discussion and analysis should be read in conjunction with the financial statements and accompanying notes appearing elsewhere in this report.

Business Overview

Our principal business began in 1993 with the organization of Ferris Productions, Inc. Ferris designed, developed, distributed, and operated virtual reality products for the entertainment, simulation, promotion, and education markets.

Virtual reality is a generic term associated with computer systems that create a real-time visual/audio/haptic (touch and feel) experience. Virtual reality immerses participants into a three-dimensional real-time synthetic environment generated or controlled by one (or several) computer(s). In September of 2001, Ferris merged into GameCom, Inc., a publicly held Texas company whose principal business at the time was the development and marketing of an Internet-enabled video game system. Our historic areas of application have included the entertainment/amusement, advertising/promotion, and training/simulation markets. We effectively left the entertainment/amusement market in the spring of 2003 in order to more fully focus on the advertising/promotional and training/simulation markets.

Our “*immersive virtual reality*™” devices are computer-based, and allow participants to view and manipulate graphical representations of physical reality. Stimulating the senses of sight, sound, touch, and smell simultaneously, our virtual reality devices envelop the participant in dynamic filmed or computer-generated imagery, and allow the participant to interact with what he or she sees using simple controls and body motions. Virtual reality products have traditionally employed head-mounted displays that combine high-resolution miniature image source monitors, wide field-of-view optics, and tracking sensors in a unit small and light enough to be worn on the head. These products usually surround the participant with dynamic three-dimensional imagery, allowing the user to change perspective on the artificial scenes by simply moving his or her head. Virtual reality devices have in the past been used primarily in connection with electronic games, as, by surrounding the player with the sights, sounds, and smells he or she would experience in the real world, play is made far more realistic than it would be if merely presented in a two-dimensional flat screen display. Now, however, virtual reality is finding increasing applications in the advertising/promotion and training/simulation markets.

We maintain our corporate office at 2500 City West Blvd., Suite 300, Houston, Texas 77042, and our telephone number is (832) 242-1100. We also maintain engineering, technical, and production offices, and a demonstration facility, at 1406 West 14th Street, Tempe, Arizona 85281, with a phone number of (480) 968-1488.

We face all the risks, expenses, and difficulties frequently encountered in connection with the expansion and development of a business, difficulties in maintaining delivery schedules if and when volume increases, the need to develop support arrangements for systems at widely dispersed physical locations, and the need to control operating and general and administrative expenses.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. These estimates and assumptions provide a basis for making judgments about the carrying values of assets and liabilities that are not

readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and these differences may be material. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

Revenue Recognition

Revenue from custom application contracts are recognized on a percentage-of-completion basis, measured by the percentage of costs incurred to date, to the total estimated costs for each contract. Contract costs include all direct material, and those indirect costs related to contract performance, such as supplies, tools, and repairs costs. General and administrative costs, including all salaries and wages, are charged to expense as incurred.

Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability may result in revisions to costs and income, and are recognized in the period in which the revisions are determined. An amount equal to contract costs attributable to claims is included in revenue when realization is probable and the amount can be reliably estimated.

Costs and estimated earnings in excess of billings on uncompleted contracts represent revenue recognized in excess of amounts billed. Billings in excess of costs and estimated earnings on uncompleted contracts represent amounts billed in excess of revenue recognized.

Results of Operations

Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006

The Company's revenues declined by 57% to \$239,386 compared to the first quarter of 2006. The net loss from operations widened to \$495,570 from \$55,693. A \$273,607 gain on the settlement of the lawsuit with Jones & Cannon, P.C. mitigated the losses somewhat. The net loss for the first quarter of 2007 grew 11% from the prior year period to \$294,618.

Despite the presence of a backlog of orders, cash constraints have continued to hamper production. Many of the components required to assemble the systems have a long lead-time between ordering and delivery and our creditworthiness with vendors often requires prepayment. In addition, custom component development on three projects delayed billings, required additional labor and component expenses to complete, all of which diluted the

efforts of our production staff from significant progress on working down the backlog of orders. The end result was a reduction in gross margin to 17.6% compared to the more customary 59% experienced in the same period a year ago, in spite of receiving a significantly greater number of project orders than ever before during the first quarter.

The Company's advertising and promotional sales activity continues to show promise with a second consecutive strong quarter.

General and administrative expense rose \$152,087 in the first quarter compared to the same period last year. The biggest single item is a \$135,000 provision for bad debt the company recorded on a receivable from ComCon Manufacturing Services, formerly known as Virtra Merger Corporation., which originated from assuming a debt they, or a related company, had to one of our shareholders. Salaries, wages, and payroll taxes rose \$86,635 over the same period last year. The addition of a CFO represented approximately \$32,000 of that. The Board of Directors is now compensated collectively at \$40,000 per quarter whereas in the period a year ago, they were unpaid. The remainder is due to salary increments for existing staff. The Company maintains tight controls on personnel additions. VirTra has become less reliant upon outside consulting, legal, and other professional fees, showing a nearly \$19,000 reduction compared to the same period last year. The sale of our Phoenix real estate last September manifested itself in over \$13,000 less depreciation expense than in the first quarter of 2006.

Interest expense and finance charges fell to \$75,468 for the quarter compared to last year's \$209,778. No charge was taken to amortize, and of the remaining debt discount and beneficial conversion feature as Dutchess Private Equities did not convert any shares in the first quarter of 2007. During the first quarter of 2006, those charges were \$111,546.

Liquidity and Plan of Operations

As of March 31, 2007, our liquidity position remained extremely precarious. Though current liabilities declined slightly to \$4,182,613 from \$4,392,856, current assets declined as well as lower billings generated fewer customer receivables. The Company's working capital position has improved over 16% compared to the first quarter of 2006 but it remains negative and precarious. As of March 31, 2007, there was only \$372,536 in current assets available to meet current liabilities.

Historically, VirTra Systems met capital requirements by acquiring needed equipment under the Ferris non-cancelable leasing arrangements, through capital contributions, loans from principal shareholders and officers, certain private placement offerings, through our previous equity line financing with Dutchess Private Equities Fund, L.P., and through our current convertible debenture with Dutchess Private Equities Fund, L.P. and Dutchess Private Equities Fund II, L.P.

For the three months ended March 31, 2007, our net loss was \$(294,618). After taking into account the non-cash items included in that loss, our cash requirements for operations were \$177,891, marginally changed from the \$172,057 cash deficit from operations in the same period of the year before. Capital expenditures were only \$2,250. The predominant source of cash to cover the operating deficit was the sale of approximately \$278,000 in a private placement of restricted common stock.

As of March 31, 2007, the Company had \$891,823 accrued for various payroll tax liabilities for prior periods. After the Company's offer in compromise with the Internal Revenue Service that was rejected as deficient last year, VirTra received notice from the IRS of tax liens that had been filed that relate to these accrued amounts. The Company later negotiated a 120-day stand still agreement in November, 2006. That agreement expired before VirTra could pay the amounts due and in March, 2007, the Company received new notices of intent to levy. The Company has engaged another law firm to negotiate a resolution with the Internal Revenue Service.

The opinion of our independent auditor for the year ended December 31, 2006 expressed substantial doubt as to our ability to continue as a going concern. Despite expense reductions that the Company has implemented, VirTra will need substantial additional capital or new lucrative custom application projects with deposits on account to become profitable. Management believes that a continuation of sales growth, purchase order financing to sustain the production and additional sales of common stock will carry the Company through the next twelve months.

Item 3.

Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our chief executive officer and the chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures in accordance with Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, our chief executive officer and the chief financial officer concluded that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information that we are required to disclose in the reports we file under the Exchange Act, within the time periods specified in the SEC's rules and forms. Our chief executive officer and the chief financial officer also concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to our company required to be included in our periodic SEC filings.

PART II - OTHER INFORMATION

Item 6.

Exhibits and Reports on Form 8-K.

- (a) Exhibits

31

Chief Executive Officer and Chief Financial Officer Rule 13a-15(e) Certification

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Chief Executive Officer and Chief Financial Officer Sarbanes-Oxley Act Section 906 Certification

SIGNATURES

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

Date: May 15, 2007

VIRTRA SYSTEMS, INC.

By: /s/ Perry V. Dalby

Perry V. Dalby

Chief Executive Officer and Chief Financial Officer