Rim Semiconductor CO
Form 10QSB/A
July 11, 2006

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

FORM 10-QSB/A

|X| QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JANUARY 31, 2006

|_| 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 0-21785

Rim Semiconductor Company
(Exact name of registrant as specified in its charter)

UTAH (State or other jurisdiction of incorporation or organization)	95-4545704 (I.R.S. employer identification no.)
305 NE 102ND AVE., SUITE 105 PORTLAND, OR 97220 (Address of principal executive offices, including zip code)	(503) 257-6700 (Registrant's telephone number, including area code)

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 [X] No [ ]

The number of shares of the issuer's Common Stock, par value $.001 per share, outstanding as of July 5, 2006, was 324,973,732.

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

EXPLANATORY NOTE

This Quarterly Report on Form 10-QSB/A (the "Report") is being filed by Rim Semiconductor Company (the "Company") to amend the Company's Quarterly Report on Form 10-QSB for the period ended January 31, 2006 that was initially filed with the Securities and Exchange Commission (the "SEC") on March 17, 2006 (the "Original Report"). The Company is also filing amendments to its Annual Report on Form 10-KSB for the fiscal year ended October 31, 2005 and its Quarterly Reports on Form 10-QSB for the periods ended July 31, 2005 and April 30, 2006.

This Report reflects the restatement of the Company's previously issued condensed consolidated financial statements at and for the period ended January 31, 2006, and the notes related thereto, as discussed in Note 2 to the condensed consolidated financial statements included herein.

This Report only amends and restates Items 1, 2 and 3 of Part I of the Original

Report to reflect the restatement. The foregoing items have not been updated to reflect other events occurring after the date of the Original Report, or to modify or update those disclosures affected by subsequent events. Other events occurring after the filing of the Original Report and other disclosures necessary to reflect subsequent events have been addressed in the Company's periodic reports filed with the SEC subsequent to the filing of the Original Report, including the Company's Quarterly Reports on Form 10-QSB for the periods ended January 31, 2006 and April 30, 2006, as amended (collectively, the "Subsequent Reports"). The information in the Subsequent Reports updates and supersedes the information contained in the Original Report and this Report. In addition, the exhibit list in Item 6 of Part II has not been updated except that currently-dated certifications from the Company's Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, are filed with this Form 10-QSB/A as Exhibits 31.1 and 32.1.

FORM 10-QSB/A

RIM SEMICONDUCTOR COMPANY

JANUARY 31, 2006

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ITEM I - FINANCIAL STATEMENTS

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
January 31, 2006
(UNAUDITED)
(RESTATED)

ASSETS

Current Assets:	
Cash	$ 355,853
Other current assets	32,458
TOTAL CURRENT ASSETS	388,311
Property and equipment (net of accumulated depreciation of $6,434)	9,303
Technology license and capitalized software development fee (net of accumulated amortization of $102,696)	5,648,304
Deferred financing costs (net of accumulated amortization of $924,576)	164,840
Other assets	7,642
TOTAL ASSETS	$ 6,218,400

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Convertible notes payable (net of debt discount of $15,583)	$ 653,997
Convertible debentures (net of debt discount of $34,287)	90,713
Notes payable (net of debt discount of $169,587)	1,352,750
Conversion option liability	216,434
Derivative liabilities - warrants	110,200
Accounts payable and accrued expenses	942,692
TOTAL CURRENT LIABILITIES	3,366,786
Long-term portion of convertible debentures (net of debt discount of $389,809)	115,178
TOTAL LIABILITIES	3,481,964
Commitments, Contingencies and Other Matters	
Stockholders' Equity:	
Preferred stock - $0.01 par value; 15,000,000 shares	

authorized; -0- shares issued and outstanding	--
Common stock - $0.001 par value; 500,000,000 shares authorized; 266,163,519 shares issued and 265,663,665 shares outstanding	266,164
Treasury stock - 499,854 shares at cost	(7,498)
Additional paid-in capital	63,662,109
Unearned compensation	(4,907)
Accumulated deficit	(61,179,432)
TOTAL STOCKHOLDERS' EQUITY	2,736,436
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 6,218,400

See notes to condensed consolidated financial statements.

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RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For The Three Months Ended January 31,	
	2006 (Restated)	2005
REVENUES	$ 40,176	$ 8,801
OPERATING EXPENSES:		
Cost of sales	--	6,625
Amortization of technology license and capitalized software development fee	102,696	--
Research and development expenses (including stock based compensation of $5,044 and $0, respectively)	85,044	7,053
Selling, general and administrative expenses (including stock based compensation of $333,958 and $279,548, respectively)	807,071	596,945
TOTAL OPERATING EXPENSES	994,811	610,623
OPERATING LOSS	(954,635)	(601,822)
OTHER (INCOME) EXPENSES:		
Interest expense	1,244,956	278,783
Derivative loss	24,138	--
Amortization of deferred financing costs	243,967	24,619
Gain on forgiveness of principal and interest on Zaiq Note	(1,169,820)	--

TOTAL OTHER (INCOME) EXPENSES	343,241	303,402
NET LOSS	$ (1,297,876)	$ (905,224)
BASIC AND DILUTED NET LOSS PER COMMON SHARE	$ (0.01)	$ (0.01)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	229,136,730	87,568,203

See notes to condensed consolidated financial statements.

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RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED JANUARY 31, 2006
(UNAUDITED)
(RESTATED)

	Common Stock		Treasury Stock		Additional Paid-In	Unear
	Shares	Amount	Shares	Amount	Capital	Compens
Balance at October 31, 2005	184,901,320	$184,902	--	--	$61,359,999	$ (22,
Repurchase of common stock for cash	--	--	(499,854)	(7,498)	--	
Issuance of common stock for conversion of convertible debentures and accrued interest	81,262,199	81,262	--	--	1,299,239	
Stock options issued to key employees and advisory board members	--	--	--	--	321,138	(321,
Reclassification of conversion option liability	--	--	--	--	681,733	
Amortization of unearned compensation expense	--	--	--	--	--	339,
Net loss	--	--	--	--	--	
Balance at						

January 31, 2006	266,163,519	$266,164	(499,854)	$(7,498)	$63,662,109	$ (4,

See notes to condensed consolidated financial statements.

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RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For The Three Months Ended January 31,	
	2006 (Restated)	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(1,297,876)	$ (905,224)
Adjustments to reconcile net loss to net cash used in operating activities:		
Consulting fees and other compensatory elements of stock issuances	339,002	279,548
Derivative loss	24,138	--
Gain on forgiveness of principal and interest on Zaiq Note	(1,169,820)	--
Amortization of deferred financing costs	243,967	24,619
Amortization of film in production costs	--	6,625
Amortization of debt discount on notes	1,193,195	225,503
Amortization of technology license and capitalized software development fee	102,696	--
Depreciation	619	4,168
Change in Assets (Increase) Decrease:		
Other current assets	1,573	3,712
Other assets	2,582	--
Change in Liabilities Increase (Decrease):		
Accounts payable and accrued expenses	92,877	(101,440)
NET CASH USED IN OPERATING ACTIVITIES	(467,047)	(462,489)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of common stock	--	212,900
Purchase of treasury stock	(7,498)	--
Proceeds from notes payable	750,000	300,000
Capitalized financing costs	(82,500)	(33,029)
Repayments of notes payable	(122,291)	--
Repayments of convertible notes payable	(88,292)	(7,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	449,419	472,871
(DECREASE) INCREASE IN CASH	(17,628)	10,382

CASH - BEGINNING OF PERIOD	373,481	127,811
CASH - ENDING OF PERIOD	$ 355,853	$ 138,193

See notes to condensed consolidated financial statements.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For The Three Months Ended January 31,	
	2006	2005
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ --	$ 5,400
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Common stock issued for conversion of convertible debentures, notes payable and accrued interest	$ 1,380,501	$ 211,714
Value assigned to warrants issued in connection with notes payable	$ 120,000	$ --
Common stock issued for accrued liquidated damages	$ --	$ 88,000
Stock offering costs	$ --	$ 9,355
Accrued expenses converted to note payable	$ --	$ 55,251
Reclassification of conversion option liability to equity	$ 681,733	$ --

See notes to condensed consolidated financial statements.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - PRINCIPLES OF CONSOLIDATION, BUSINESS AND CONTINUED OPERATIONS

The condensed consolidated financial statements include the accounts of Rim Semiconductor Company (formerly New Visual Corporation) and its wholly owned operating subsidiary, NV Entertainment, Inc. ("NV Entertainment") including its 50% owned subsidiary Top Secret Productions, LLC), collectively, the "Company"). All significant intercompany balances and transactions have been eliminated. The Company consolidates its 50% owned subsidiary Top Secret Productions, LLC due to the Company's control of management and financial matters of such entity.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the Unites States of America ("US GAAP"). In the opinion of management, the accompanying unaudited financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. These financial statements should be read in conjunction with the financial statements and notes related thereto included in the Annual Report on Form 10-KSB (Admendment No. 2) for the fiscal year ended October 31, 2005.

These results for the three months ended January 31, 2006 are not necessarily indicative of the results to be expected for the full fiscal year. The preparation of the consolidated financial statements in conformity with US GAAP 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 reporting period. Actual results could differ from those estimates.

Rim Semiconductor Company was incorporated under the laws of the State of Utah on December 5, 1985. The Company operates in two business segments, the production of motion pictures, films and videos ("Entertainment Segment") and the development of new semiconductor technologies ("Semiconductor Segment"). The Company's Entertainment Segment is dependent on future revenues from the Company's film "Step Into Liquid" ("Film"). The Semiconductor Segment is dependent on the Company's ability to successfully commercialize its developed technology, and has generated no revenues to date. The Company's first chipset was first made available to prospective customers for evaluation and testing during the three months ended January 31, 2006.

Through its subsidiary NV Entertainment the Company has operating revenues for its Entertainment Segment, but may continue to report operating losses for this segment. The Semiconductor Segment will have no operating revenues until successful commercialization of its developed technology, but will continue to incur substantial operating expenses, capitalized costs and operating losses.

Historically, the Company has experienced significant recurring net operating losses as well as negative cash flows from operations. The Company's main source of liquidity has been equity and debt financing, which was used to fund historical losses from operating activities. Based on the Company's current cash position and its subsequent debt financing (see note 13), the Company believes it has sufficient cash to meet its funding needs for at least the next 12 months.

NOTE 2 - RESTATEMENT

On July 6, 2006, the Company's Board of Directors, after consultations by management and the Audit Committee with the Company's independent registered public accounting firm, concluded that the classification of warrants issued in connection with the 2005 and 2006 convertible debentures was not in accordance with interpretations of Emerging Issues Task Force ("EITF") Issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed To and Potentially Settled In, a Company's Own Stock." Accordingly, the condensed consolidated financial statements included in the Company's Quarterly Report on Form 10-QSB for the period ended January 31, 2006, as filed on March 17, 2006 (the "January 2006 10-QSB") have been restated to correct the accounting for the warrants as derivative liabilities. The previously issued condensed consolidated financial statements included in the January 2006 10-QSB should not be relied upon. As a result of this restatement, $110,200 included in stockholders' equity at January 31, 2006 should have been recorded as a derivative liability and

NOTE 2 - RESTATEMENT (CONTINUED)

the Company should have recorded a loss of $24,138 on the change in fair value of derivative liabilities for the three months ended January 31, 2006. The treatment of this non-cash accounting item results in an increase in the Company's net loss for the three months ended January 31, 2006 as follows:

	For the Three Months Ended January 31, 2006	
	(As Reported)	(As Restated)
Net loss	$(1,273,738)	$(1,297,876)
Basic and diluted net loss per share of common stock	$ (0.01)	$ (0.01)

The correction of the above also results in the following changes to the Company's stockholders' equity and liabilities at January 31, 2006:

	(As Reported)	(As Restated)
Total liabilities	$ 3,371,764	$ 3,481,964
Stockholders' equity	$ 2,846,636	$ 2,736,436

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

FILM IN DISTRIBUTION

Statement of Position 00-2, Accounting by Producers or Distributors of Films ("SOP-00-2") requires that film costs be capitalized and reported as a separate asset on the balance sheet. Film costs include all direct negative costs incurred in the production of a film, as well as allocations of production overhead and capitalized interest. Direct negative costs include cost of scenario, story, compensation of cast, directors, producers, writers, extras and staff, cost of set construction, wardrobe, accessories, sound synchronization, rental of facilities on location and post production costs. SOP-00-2 also requires that film costs be amortized and participation costs accrued, using the individual-film-forecast-computation method, which amortizes or accrues such costs in the same ratio that the current period actual revenue (numerator) bears to the estimated remaining unrecognized ultimate revenue as of the beginning of the fiscal year (denominator). The Company makes certain estimates and judgments of its future gross revenue to be received for each film based on information received by its distributors, historical results and management's knowledge of the industry. Revenue and cost forecasts are continually reviewed by management and revised when warranted by changing conditions. A change to the estimate of gross revenues for an individual film may result in an increase or decrease to the percentage of amortization of capitalized film costs relative to a previous period.

In addition, SOP-00-2 also requires that if an event or change in circumstances indicates that an entity should assess whether the fair value of a film is less than its unamortized film costs, then an entity should determine the fair value of the film and write-off to the statement of operations the amount by which the unamortized film costs exceeds the films fair value.

As a result of impairment reviews during the years ended December 31, 2005 and 2004, the Company wrote down the carrying value attributed to the Film to $0.

REVENUE RECOGNITION

The Company recognizes revenue from the sale of its semiconductor products when evidence of an arrangement exists, the sales price is determinable or fixed, legal title and risk of loss has passed to the customer, which is generally upon shipment of our products to our customers, and collection of the resulting receivable is probable. To date the Company has not recognized any revenues related to the sale of its semiconductor products.

The Company recognizes film revenue from the distribution of its feature film and related products when earned and reasonably estimable in accordance with SOP 00-2. The following conditions must be met in order to recognize revenue in accordance with SOP 00-2:

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION (CONTINUED)

- persuasive evidence of a sale or licensing arrangement with a customer exists;
- the film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery;
- the license period of the arrangement has begun and the customer can begin its exploitation, exhibition or sale;
- the arrangement fee is fixed or determinable; and
- collection of the arrangement fee is reasonably assured.

Under a rights agreement with Lions Gate Entertainment ("LGE") the domestic distributor for its Film entitled "Step Into Liquid", the Company shares with LGE in the profits of the Film after LGE recovers its marketing, distribution and other predefined costs and fees. The agreement provides for the payment of minimum guaranteed license fees, usually payable on delivery of the respective completed film, that are subject to further increase based on the actual distribution results in the respective territory.

RESEARCH AND DEVELOPMENT

Research and development costs are charged to expense as incurred. Amounts allocated to acquired-in-process research and development costs, from business combinations, are charged to earnings at the consummation of the acquisition.

CAPITALIZED SOFTWARE DEVELOPMENT COSTS

Capitalization of computer software development costs begins upon the establishment of technological feasibility. Technological feasibility for the Company's computer software is generally based upon achievement of a detail program design free of high-risk development issues and the completion of research and development on the product hardware in which it is to be used. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized computer software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology.

Amortization of capitalized computer software development costs commences when the related products become available for general release to customers. Amortization is provided on a product-by-product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product, or (b) the straight-line method over the remaining estimated economic life of the product. The estimated useful life of the Company's existing product is seven years.

The Company periodically performs reviews of the recoverability of such capitalized software costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, the capitalized costs of each software product is then valued at the lower of its remaining unamortized costs or net realizable value.

No assurance can be given that such technology will receive market acceptance. Accordingly it is possible that the carrying amount of the technology license may be reduced materially in the near future.

The Company had amortization expense of $102,696 and $0 for the three months ended January 31, 2006 and 2005, respectively, related to its capitalized software development costs.

LOSS PER COMMON SHARE

Basic loss per common share is computed based on weighted average shares outstanding and excludes any potential dilution. Diluted loss per share reflects the potential dilution from the exercise or conversion of all dilutive securities into common stock based on the average market price of common shares outstanding during the period. For the three months ended January 31, 2006 and 2005, respectively, no effect has been given to outstanding options, warrants or convertible debentures in the diluted computation, as their effect would be anti-dilutive.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

STOCK-BASED COMPENSATION

On November 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including stock options based on estimated fair values. SFAS 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") for periods beginning on November 1, 2005. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company early adopted SFAS 123(R) using the modified prospective transition method, as of November 1, 2005, the first day of the Company's fiscal year 2006. The Company's condensed consolidated financial statements as of and for the three months ended January 31, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company's condensed consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R).

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's condensed consolidated statement of operations. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Under the intrinsic value method, no stock-based compensation expense for employee stock options had been recognized in the Company's condensed consolidated statement of operations because the exercise price of the Company's stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Stock-based compensation expense recognized in the Company's condensed consolidated statement of operations for the three months ended January 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of October 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to October 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). The Company has continued to attribute the value of stock-based compensation to expense on the straight-line single option method.

Stock-based compensation expense recognized under SFAS 123(R) related to employee stock options was $69,037 for the three months ended January 31, 2006.

Stock based-compensation expense for share-based payment awards granted prior to, but not yet vested as of October 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 was $247,057 for the three months ended January 31, 2006. Stock based-compensation expense recognized for non-employees under other accounting standards was $22,908 for the three months ended January 31, 2006.

There was no stock-based compensation expense related to employee stock options under other accounting standards for the three months ended January 31, 2005. Stock based-compensation expense recognized for non-employees under other accounting standards was $279,548 for the three months ended January 31, 2005.

As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three months ended January 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2005, the FASB published Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"). SFAS 154 establishes new standards on accounting for changes in accounting principles. Pursuant to the new rules, all such changes must be accounted for by retrospective application to the financial statements of prior periods unless it is impracticable to do so. SFAS 154 completely replaces Accounting Principles Bulletin No. 20 and SFAS 3, though it carries forward the guidance in those pronouncements with respect to accounting for changes in estimates, changes in the reporting entity, and the correction of errors. The requirements in SFAS 154 are effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company will apply these requirements to any accounting changes after the implementation date.

The Emerging Issues Task Force ("EITF") reached a tentative conclusion on EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option" that no gain or loss should be recognized upon the conversion of an instrument that becomes convertible as a result of an issuer's exercise of a call option pursuant to the original terms of the instrument. The adoption of this pronouncement is not expected to have an impact on the Company's consolidated financial position, results of operations, or cash flows.

In June 2005, the FASB ratified EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'" ("EITF No. 05-2"), which addresses when a convertible debt instrument should be considered 'conventional' for the purpose of applying the guidance in EITF No. 00-19. EITF No. 05-2 also retained the exemption under EITF No. 00-19 for conventional convertible debt instruments and indicated that convertible preferred stock having a mandatory redemption date may qualify for the exemption provided under EITF No. 00-19 for conventional convertible debt if the instrument's economic characteristics are more similar to debt than equity. EITF No. 05-2 is effective for new instruments entered into and instruments modified in periods beginning after June 29, 2005. The Company has applied the requirements of EITF No. 05-2 since the required implementation date. The adoption of this pronouncement did not have an impact on the Company's consolidated financial position, results of operations, or cash flows.

EITF Issue No. 05-4 "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'" ("EITF No. 05-4") addresses financial instruments, such as stock purchase warrants, which are accounted for under EITF No. 00-19 that may be issued at the same time and in contemplation of a registration rights agreement that includes a liquidated damages clause. The consensus of EITF No. 05-4 has not been finalized. The adoption of this pronouncement is not expected to have an impact on the Company's consolidated financial position, results of operations, or cash flows.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS (CONTINUED)

In September 2005, the FASB ratified EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues" ("EITF No. 05-7"), which addresses whether a modification to a conversion option that changes its fair value affects the recognition of interest expense for the associated debt instrument after the modification and whether a borrower should recognize a beneficial conversion feature, not a debt extinguishment, if a debt modification increases the intrinsic value of the debt (for example, the modification reduces the conversion price of the debt). EITF No. 05-7 is effective for the first interim or annual reporting period beginning after December 15, 2005. The Company will adopt EITF No. 05-7 as of the beginning of the Company's interim reporting period that begins on February 1, 2006. The Company is currently in the process of evaluating the effect that the adoption of this pronouncement will have on its financial statements.

In September 2005, the FASB ratified EITF Issue No. 05-8, "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature" ("EITF No. 05-8"), which addresses the treatment of convertible debt issued with a beneficial conversion feature as a temporary difference under the guidance in SFAS 109. In addition, deferred taxes recognized for a temporary difference of debt with a beneficial conversion feature should be recognized as an adjustment of additional paid-in capital. Entities should apply the guidance in EITF No. 05-8 in the first interim or annual reporting period that begins after December 15, 2005. Its provisions should be applied retrospectively under the guidance in SFAS 154 to all convertible debt instruments with a beneficial conversion feature accounted for under the guidance in EITF No. 00-27 "Application of EITF Issue No. 98-5 'Accounting for Convertible Securities with Beneficial Conversion

Features or Contingently Adjustable Conversion Ratios.'" The Company has applied the requirements of EITF No. 05-8 to all previously existing convertible debt instruments with a beneficial conversion feature and will apply the requirements of EITF No. 05-8 beginning on February 1, 2006 for all new convertible debt instruments with a beneficial conversion feature. The adoption of this pronouncement for new convertible debt instruments with a beneficial conversion feature is not expected to have an impact on the Company's consolidated financial position, results of operations or cash flows.

In February 2006, the FASB published Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments- an amendment of FASB Statements No. 133 and 140" ("SFAS 155"). SFAS 155 resolves issues addressed in SFAS 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." The requirements in SFAS 155 are effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this pronouncement is not expected to have an impact on the Company's consolidated financial position, results of operations, or cash flows.

NOTE 4 - FILM IN DISTRIBUTION

The Company recognized revenues of $40,176 and $8,801 for the three months ended January 31, 2006 and 2005, respectively. The Company had amortization costs of $0 and $6,625 for the three months ended January 31, 2006 and 2005, respectively.

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NOTE 5 - DEFERRED FINANCING COST

As of January 31, 2006, deferred financing cost consisted of costs incurred and warrants issued in connection with the sale of $3,500,000 of 2005 Debentures, $1,350,000 of 7% convertible debentures, and promissory notes:

Deferred financing cost	$1,089,416
Less: accumulated amortization	(924,576)
Deferred financing cost, net	$ 164,840

Costs incurred in connection with debt financings are capitalized as deferred financing costs and amortized over the term of the related debt. If any or all of the related debt is converted or repaid prior to its maturity date, a pro-rata share of the related deferred financing costs are written off and recorded as amortization expense in the period of the conversion or repayment in the consolidated statement of operations.

For the three months ended January 31, 2006 and 2005, amortization of deferred financing cost was $243,967 and $24,619 respectively.

NOTE 6 - EXCHANGE AGREEMENT

In April 2005, the Company entered into an Exchange Agreement (the "Exchange Agreement") with Zaiq Technologies, Inc. ("Zaiq"), pursuant to which the Company issued 4,651,163 shares of common stock with a value of $744,186 and a promissory note in the principal amount of $2,392,000 (the "Zaiq Note") (see Note 9) in exchange for the surrender by Zaiq of 3,192 shares of Redeemable Series B Preferred Stock. The Company issued the Redeemable Series B Preferred Stock to Zaiq pursuant to a Receivables Purchase and Stock Transfer Restriction Agreement dated as of April 17, 2002. These shares had an aggregate liquidation preference of $3,192,000, constituted all of the Redeemable Series B Preferred Stock issued and outstanding as of the date of the Exchange Agreement, and were cancelled upon the closing of the Exchange Agreement. The fair value of the common stock and promissory note on the closing date was determined to be less than the aggregate liquidation preference of the Redeemable Series B Preferred Stock and accordingly a gain of $55,814 was recognized during the year ended October 31, 2005.

The Exchange Agreement provides that, subject to certain exceptions, if the Company, at any time prior to the payment in full of the amount due under the promissory note, issues common stock or securities convertible into or exercisable for shares of common stock at a price below the fair market value of the common stock or such securities (a "Below Market Issuance"), then the Company will issue to Zaiq additional shares of common stock in an amount that is determined in accordance with a formula that takes into consideration both the number of shares of common stock or other securities issued and the total consideration received by the Company in the Below Market Issuance. During the year ended October 31, 2005, the Company issued 529,311 additional shares of common stock with an aggregate par value of $529 and a fair value of $18,504 to Zaiq as a result of Below Market Issuances.

Under the terms of the agreements with Zaiq, a portion of the proceeds of any new financing consummated by the Company through the first anniversary of the agreement are to be applied to the prepayment of the note. See Note 9.

On December 19, 2005, the Company entered into a letter agreement with Zaiq, pursuant to which the Company agreed to repurchase from Zaiq for total consideration of $200,000 the following Zaiq assets: (i) 5,180,474 shares (the "Zaiq Shares") of the Company's common stock held of record by Zaiq, and (ii) the remaining principal balance of the Zaiq Note.

The Company had the right under the letter agreement to assign any or all of its purchase commitment, and assigned its right to purchase 4,680,620 of the Zaiq Shares to an unaffiliated third party that has been a prior investor in the Company.

On December 20, 2005, the Company paid Zaiq an aggregate of $129,789, out of an advance on the note payable that was subsequently signed in January 2006, as further discussed in Note 9, to purchase the Zaiq Note and 499,854 Zaiq Shares. The Zaiq Shares repurchased by the Company have been accounted for as treasury stock, carried at cost, and reflected as a reduction to stockholders' equity. The remaining principal and accrued interest of $1,292,111 on the Zaiq Note has been canceled resulting in a gain of $1,169,820.

NOTE 7 - CONVERTIBLE NOTES PAYABLE

The Company entered into several convertible promissory note agreements with various trusts and individuals to fund the operations of the Company. The Company agreed to pay the principal and an additional amount equal to 50% of the principal on all notes below except for one note for $10,000 which accrues interest at the rate of 9% per annum and the March 2005 convertible promissory note discussed below.

The outstanding convertible notes are summarized below:

	At January 31, 2006
Note payable (1)	$ 72,000
Notes payable (ten notes) (2)	478,000
Note payable, 9% interest (3)	10,000
Note payable - related party (4)	109,580
TOTAL	$ 669,580
less: unamortized debt discount	(15,583)
	$ 653,997

(1) The note was issued in October 2001 in the amount of $250,000, and due only when receipts received by the Company from its Top Secret Productions, LLC joint venture exceed $375,000. The note and any accrued and unpaid interest may be converted at any time, in whole or in part, into shares of common stock at a conversion price per share of $0.40. The Company made payments of $25,000 during the three months ended January 31, 2006.

(2) The notes were issued during the period from March 2002 through July 2003 in the aggregate amount of $478,000, and due only when receipts received by the Company from its Top Secret Productions, LLC joint venture exceed $2,250,000. The notes and any accrued and unpaid interest may be converted at any time, in whole or in part, into shares of common stock at conversion prices per share ranging from $0.33 to $1.00.

(3) The note was issued in July 2003 in the amount of $10,000, and due only when receipts received by the Company from its Top Secret Productions, LLC joint venture exceed $750,000. The note and any accrued and unpaid interest may be converted at any time, in whole or in part, into shares of common stock at a conversion price per share of $0.60.

(4) In March 2005, the Company issued in favor of the Company's executive vice president, a non-interest bearing convertible promissory note in the principal amount of $383,911. The convertible promissory note was issued in evidence of the Company's obligation for deferred compensation. In accordance with APB 21, imputed interest (at an effective rate of 15%) was calculated to arrive at the fair value of the convertible promissory note. The difference between the face amount and the present value upon issuance of the convertible promissory note is shown as a discount that is amortized as interest expense over the life of the convertible promissory note. Amortization of debt discount on this note was $5,292 for the three months ended January 31, 2006. The convertible promissory note is payable in monthly installments, on the first day of each month, beginning on April 1, 2005. Each month, the Company must pay to the executive vice president an amount not less than the monthly base salary paid to the

Company's chief executive officer. However, if the Company determines in its sole discretion that it has the financial resources available, it may pay up to $20,833 per month. The Company made payments of $63,292 during the three months ended January 31, 2006. The note may be converted into shares of common stock at a conversion price per share equal to the closing price of the common stock on the Over-the-Counter Bulletin Board on the date of conversion. In March 2006, the remaining principal amount of this note and additional deferred compensation payable to the note holder of $212,450 were converted into a convertible promissory note with an aggregate principal amount of $301,197. See Note 14 for further details.

NOTE 8 - CONVERTIBLE DEBENTURES

2005 DEBENTURES (Restated)

On May 26, 2005, the Company completed a private placement to certain individual and institutional investors of $3,500,000 in principal amount of its three-year 7% Senior Secured Convertible Debentures (the "2005 Debentures"). All principal is due and payable on May 26, 2008. The 2005 Debentures are convertible into shares of common stock at a conversion price equal to the lower of (x) 70% of the 5 day volume weighted average price of the Company's common stock immediately prior to conversion or (y) if the Company entered into certain financing transactions subsequent to the closing date, the lowest purchase price or conversion price applicable to that transaction.

The Company received net proceeds of approximately $3.11 million, following repayment of offering related expenses. These offering related expenses were recorded as deferred financing costs (see Note 5).

Interest on the 2005 Debentures accrues at the rate of 7% per annum and is payable on a bi-annual basis, commencing December 31, 2005, or on conversion and may be paid, at the option of the Company, either in cash or in shares of common stock. The Company may prepay the amounts outstanding on the 2005 Debentures by giving advance notice and paying an amount equal to 120% of the sum of (x) the principal being prepaid plus (y) the accrued interest thereon.

In connection with the issuance of the 2005 Debentures, the Company issued to the purchasers thereof warrants (the "Investor Warrants") to purchase 33,936,650 shares of common stock valued at $2,000,000 on the issuance date, with warrants for 11,312,220 shares being exercisable through the last day of the month in which the first anniversary of the effective date of the Registration Statement occurs (August 31, 2006) at a per share exercise price of $0.1547 and warrants for 22,624,430 shares being exercisable through the last day of the month in which the third anniversary of the effective date of the Registration Statement occurs (August 31, 2008) at a per share exercise price of $0.3094.

In connection with the issuance of the 2005 Debentures, the Company also issued to a placement agent warrants to purchase up to 5,656,108 shares of Common Stock (the "Compensation Warrants") valued at $319,066 on the issuance date. This amount was recorded as a deferred financing cost and is being charged to interest expense over the term of the 2005 Debentures. Warrants to purchase up to 2,262,443 shares are exercisable through the last day of the month in which the third anniversary of the effective date of the Registration Statement occurs (August 31, 2008) at a per share exercise price of $0.3094. Warrants to purchase up to 2,262,443 shares are exercisable through the last day of the month in which the third anniversary of the closing occurs (May 31, 2008) at a per share exercise price of $0.1547. Warrants to purchase up to 1,131,222 shares are exercisable through the last day of the month in which the first anniversary of the effective date of the Registration Statement occurs (August 31, 2006) at a per share exercise price of $0.1547. The Compensation Warrants are otherwise exercisable on substantially the same terms and conditions as the Investor Warrants.

Holders of the Investor Warrants are entitled to exercise those warrants on a cashless basis following the first anniversary of issuance if the Registration Statement is not in effect at the time of exercise.

The gross proceeds of $3,500,000 were recorded net of a debt discount of $3,500,000. The debt discount consisted of a $2,000,000 value related to the Investor Warrants and a $1,500,000 value related to the embedded conversion feature in accordance with EITF issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock". Due to certain factors, including an uncapped liquidated damages provision in the registration rights agreement and an indeterminate amount of shares to be issued upon conversion of the debentures, the Company separately values and accounts for the embedded conversion feature related to the 2005 Debentures, Investor Warrants, Compensation Warrants, and the registration rights as derivative liabilities. Accordingly, these derivative liabilities are measured at fair value with changes in fair value reported in earnings as long as they remain classified as liabilities. The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification. Due to various factors, including substantial conversions of the 2005 Debentures and the registration statement becoming effective on August 1, 2005, the value of the registration rights was deemed to be de minimus.

NOTE 8 - CONVERTIBLE DEBENTURES (CONTINUED)

2005 DEBENTURES (Restated) (CONTINUED)

As of January 31, 2006, the conversion option liability of $1,500,000 had been reduced to $216,434 as a result of conversions of the 2005 Debentures. An aggregate of $1,283,566 has been reflected as a reclassification to stockholders' equity since the issuance of the 2005 Debentures.

A loss on the change in fair value of the derivative liabilities of $24,138 was recognized during the three months ended January 31, 2006.

Certain terms of the Investor and Compensation Warrants were modified in February 2006 (see Note 13).

To secure the Company's obligations under the 2005 Debentures, the Company granted a security interest in substantially all of its assets, including without limitation, its intellectual property, in favor of the investors under the terms and conditions of a Security Interest Agreement dated as of the date of the 2005 Debentures. The security interest terminates upon the earlier of (i) the date on which less than one-third of the original principal amount of the 2005 Debentures issued on the closing date are outstanding or (ii) payment or satisfaction of all of the Company's obligations under the loan agreement. During the three months ended January 31, 2006, condition (i) was met and therefore the security interest terminated.

A registration statement (the "Registration Statement") covering the Common Stock issuable upon conversion of the 2005 Debentures, the Investor Warrants and the Compensation Warrants referred to above was declared effective on August 1, 2005.

During the three months ended January 31, 2006, $1,310,724 of principal amount of 2005 Debentures plus accrued interest of $69,777 were converted into 81,262,199 shares of common stock.

Included in interest expense for the three months ended January 31, 2006 is $1,164,160 related to the amortization of the debt discount related to these debentures.

The 2005 Debentures are summarized below as of January 31, 2006:

	Outstanding Principal Amount	Unamortized Debt Discount	Net Carrying Value
Long-term portion	$ 504,987	$ 389,809	$ 115,178

7% DEBENTURES

In December 2003, April 2004 and May 2004, the Company completed a private placement to certain private and institutional investors of $1,350,000 in principal amount of its three-year 7% Convertible Debentures (the "7% Debentures"). All principal is due and payable three years from the issuance date.

During the three months ended January 31, 2006, no principal or accrued interest was converted into shares of common stock. During the three months ended January 31, 2005, $199,450 of principal amount plus accrued interest of $12,264 were converted into 1,411,428 shares of common stock.

The 7% Debentures are summarized below as of January 31, 2006:

	Outstanding Principal Amount	Unamortized Debt Discount	Net Carrying Value
Current portion	$ 125,000	$ 34,287	$ 90,713

The remaining 7% Debentures outstanding at January 31, 2006 were originally issued in December 2003 and are due and payable in December 2006.

NOTE 9 - NOTES PAYABLE

The outstanding notes payable are summarized below:

	January 31, 2006
Note payable (five individual notes with identical terms), unsecured, 6% interest, due on demand with three days notice (1)	$ 256,886
Note payable, 10% interest, unsecured, due on demand with three days notice (2)	443,451
Note payable (3)	12,000
Note payable (4)	--
Note payable (5)	810,000
TOTAL	$ 1,522,337
Less: unamortized debt discount	(169,587)
	$ 1,352,750

(1) In February 2006, the Company issued shares of restricted common stock in exchange for the return and cancellation of all outstanding principal and interest on these notes.

(2) Outstanding principal of $39,973 and interest of $110,027 was paid in June 2005 from the proceeds of the private placement of the 2005 Debentures further discussed in Note 8. In February 2006, the Company issued shares of restricted common stock in exchange for the return and cancellation of all outstanding principal and interest on this note.

(3) On March 26, 2004, the Company entered into a loan agreement, pursuant to which the Company borrowed $12,000 from the lender. The loan is evidenced by an installment note dated as of March 26, 2004. The principal amount of the loan and any accrued and unpaid interest at a rate of 5% were due and payable on July 26, 2004. On July 26, 2004, the lender agreed to extend payment and unpaid accrued interest until November 15, 2004. The lender has subsequently agreed to modify the repayment terms such that the principal and interest are due on demand with three days notice.

(4) In April 2005, the Company issued a promissory note in connection with the cancellation of the Redeemable Series B Preferred Stock which bears interest at the rate of 7% per annum. In December 2005, the Company entered into an agreement to repay a portion of the outstanding principal and accrued interest on the promissory note with the remaining principal balance and accrued interest being forgiven. See Note 6 for further details.

(5) In December 2005 and January 2006, the Company entered into loan agreements with a third party pursuant to which the Company borrowed $750,000 from the lender. An amount equal to 108% of the principal amount ($810,000) of the loans is due and payable on the earlier of May 25, 2006 or the date the Company effects a financing transaction or series of transactions resulting in gross proceeds to the Company of at least $2,000,000. The difference between the gross proceeds and amount

due at maturity is shown as a discount that is amortized as interest expense over the life of the loans. The Company issued to the lender warrants to purchase 7,500,000 shares of its Common Stock at an exercise price of $0.10 per share. The fair value of the warrants is $120,000 and is shown as a discount that is amortized as interest expense over the life of the loans. In connection with the loans, the Company granted a security interest in all of its assets. The Company received net proceeds of $672,470 following the payment of due diligence fees and transaction fees and transaction related fees and expenses. These transaction related fees were recorded as deferred financing costs (see Note 5). For the three months ended January 31, 2006 amortization of debt discount on this loan was $10,413. In March 2006, the outstanding principal and interest were repaid from the proceeds of the private placement of the 2006 Debentures (see Note 13).

NOTE 10 - STOCKHOLDERS' EQUITY

COMMON STOCK

During the three months ended January 31, 2006, the Company issued 81,262,199 shares of common stock for conversion of convertible debentures and accrued interest valued at $1,380,501; and repurchased 499,854 shares of common stock for $7,498 from Zaiq.

STOCK OPTION PLANS

During 2000, the Board of Directors and the stockholders of the Company approved the 2000 Omnibus Securities Plan (the "2000 Plan"), which provides for the granting of incentive and non-statutory options and restricted stock for up to 2,500,000 shares of common stock to officers, employees, directors and consultants of the Company.

During August 2001, the Board of Directors of the Company approved the 2001 Stock Incentive Plan (the "2001 Plan"), which provides for the granting of incentive and non-statutory options, restricted stock, dividend equivalent rights and stock appreciation rights for up to 2,500,000 shares of common stock to officers, employees, directors and consultants of the Company. The stockholders of the Company ratified the 2000 Plan in May 2000 and the 2001 Plan in July 2002.

In January 2003, the Board of Directors of the Company approved the 2003 Consultant Stock Plan (the "2003 Plan" and together with the 2000 Plan and the 2001 Plan, the "Plans"), which provides for the issuance of up to 6,000,000 non-qualified stock options or stock awards to consultants to the Company. Directors, officers and employees are not eligible to participate in the 2003 Plan. A total of 3,200,000 shares of common stock have been issued under the 2003 Plan to four consultants. As of January 31, 2006, no options have been awarded under the 2003 Plan.

Option awards under the Plans are generally granted with an exercise price equal to the market price of the Company's common stock at the date of grant, a 10 year contractual term, and vest based on the schedule included in the related option agreement (typically a period that does not exceed five years).

On November 1, 2005, the Company early adopted SFAS 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors including employee stock options based on estimated fair values.

Upon adoption of SFAS 123(R), the Company continued to estimate the value of stock options on the date of grant using the Black-Scholes model and the assumptions noted in the table below. Prior to the adoption of SFAS 123(R), the value of each stock option was also estimated on the date of grant using the Black-Scholes model for the purpose of the pro forma financial information in accordance with SFAS 123.

The Company used its historical stock price volatility in accordance with SFAS 123(R) and SAB 107. The selection of the historical volatility approach was based upon the lack of availability of actively traded options on the Company's stock and the Company's assessment that historical volatility is representative of future stock price trends.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of the Company's stock options. The dividend yield assumption is based on the Company's history and expectation of dividend payouts. The expected life of stock options represents the Company's historical experience with regards to the exercise behavior of its option holders and the contractual term of the options.

As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three months ended January 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

NOTE 10 - STOCKHOLDERS' EQUITY (CONTINUED)

STOCK OPTION PLANS (CONTINUED)

The weighted-average estimated fair value of stock options granted during the three months ended January 31, 2006 was $0.026 per share using the Black-Scholes model with the following assumptions:

Expected volatility	145%
Risk-free interest rate	4.3%
Expected dividends	0.0%
Expected life	10 years

There were no options granted during the three months ended January 31, 2005 and there was no difference between the reported net income and pro forma net income under FAS 123. Accordingly, pro forma disclosures for the three months ended January 31, 2005 have not been provided.

A summary of option activity as of January 31, 2006 and changes during the period then ended is as follows:

	UNDER THE PLANS	WEIGHTED AVERAGE EXERCISE PRICE	OUTSIDE THE PLANS	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at October 31, 2005	993,750	$ 0.97	15,900,000	$ 0.25
Options granted:				
Under the Plans	--	--	--	--
Outside the Plans	--	--	22,400,000	$ 0.027
Options expired/cancelled:				
Under the Plans	--	--	--	--
Outside the Plans	--	--	(14,000,000)	$ 0.17
Options exercised:				
Under the Plans	--	--	--	--
Outside the Plans	--	--	--	--
Outstanding at January 31, 2006	993,750	$ 0.97	24,300,000	$ 0.09
Exercisable at January 31, 2006	980,417	$ 0.98	1,900,000	$ 0.86

The aggregate intrinsic value of options outstanding as of January 31, 2006 was $22,400. There was no intrinsic value for options that were exercisable as of January 31, 2006.

The weighted-average remaining contractual term of stock options outstanding under the Plans as of January 31, 2006 was 5.93 years. The weighted-average remaining contractual term of stock options outstanding outside the Plans as of January 31, 2006 was 9.49 years.

The weighted-average remaining contractual term of stock options currently exercisable under the Plans as of January 31, 2006 was 5.92 years. The weighted-average remaining contractual term of stock options currently exercisable outside the Plans as of January 31, 2006 was 4.15 years.

As of January 31, 2006, total compensation cost related to nonvested stock options not yet recognized was $517,783 which is expected to be recognized through July 2006 over a weighted-average period of 4.9 months.

The total fair value of options vested during the three months ended January 31, 2006 was $247,057.

NOTE 10 - STOCKHOLDERS' EQUITY (CONTINUED)

OPTIONS GRANTED

In April 2005, the Company issued to each of its Chief Executive Officer and Executive Vice President, 1,000,000 shares of common stock, and performance based options to purchase 7,000,000 shares of restricted common stock at an exercise price of $0.17, which was equal to the closing price of the common stock on the Over-the-Counter Bulletin Board on the date of grant. Options to purchase 2,000,000 shares of restricted common stock vested upon the Company's consummation of the sale of the 2005 Debentures in May 2005 and options to purchase 12,000,000 shares of restricted common stock vested in December 2005 upon the Company's release of a beta version of its semiconductor technologies. In January 2006, all of the these options were canceled. During the three months ended January 31, 2006, the Company recognized $247,057 of stock-based compensation expense related to these vested options.

In January 2006, options to purchase 22,400,000 shares of common stock were granted to the Company's Chief Executive Officer, the Executive Vice President, and an advisory board member. These options were valued at $591,863 and have a 10 year term, an exercise price of $0.027 per share, and vest at various times between February 2006 and July 2006. During the three months ended January 31, 2006, the Company recognized $74,081 of stock-based compensation expense related to these options.

OPTIONS EXPIRED, CANCELLED AND FORFEITED

During the three months ended January 31, 2006, options to purchase 14,000,000 shares of common stock were canceled.

WARRANTS GRANTED

In January 2006, the Company granted warrants to purchase 7,500,000 shares of its common stock at an exercise price of $0.10 per share to the lender in connection with the loan agreement (see Note 9(4)). The fair value of the stock warrants estimated on the date of grant using the Black-Scholes option pricing model is $0.016 per share or $120,000.

WARRANTS EXPIRED

During the three months ended January 31, 2006, warrants to purchase 200,000 shares of common stock expired.

NET LOSS PER SHARE

Securities that could potentially dilute basic earnings per share (EPS), in the future, that were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented, consist of the following:

2005 Debentures and accrued interest (1)	26,585,798
Warrants to purchase common stock	58,112,757
Options to purchase common stock	25,293,750
Convertible notes payable and accrued interest	5,768,837
7% Debentures and accrued interest	960,980
Total as of January 31, 2006	116,722,122

(1) based on a five day volume weighted average common stock price discounted by 30% at January 31, 2006 of $0.01918

Substantial issuances after January 31, 2006 through March 13, 2006

Options granted to purchase shares of common stock	4,100,000

Restricted common stock issued to consultants	11,000,000
Common stock issued in exchange for return and cancellation of notes payable	12,064,494
Warrants issued in connection with the 2006 Debentures (See note 13)	85,146,660
Common stock issuable upon conversion of 2006 Debentures (See note 13) (2)	67,438,462

(2) based on a twenty day volume weighted average common stock price discounted by 30% at March 13, 2006 of $0.08897

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NOTE 11 - COMMITMENTS, CONTINGENCIES AND OTHER MATTERS

RESEARCH AND DEVELOPMENT AGREEMENT

The Company and HelloSoft entered into an amendment, effective as of October 11, 2004 (the "Amendment"), to their Services Agreement dated as of March 31, 2004 (the "Original Agreement") pursuant to which HelloSoft will provide development services relating to the Company's semiconductor technologies. The Original Agreement provides that, upon the Company's request from time to time, HelloSoft is to provide services to be specified pursuant to mutually agreed upon terms. The Amendment represents the first project that HelloSoft is undertaking pursuant to the Original Agreement.

In consideration for the services being rendered under the Amendment, the Company agreed to pay to HelloSoft $185,000, half of which was paid in the form of restricted common stock issued at a discount of 25% to the closing price of the Company's Common Stock on the day of the commencement of services. The other half will be remitted in cash, periodically, upon completion by HelloSoft and acceptance by the Company of specified milestones. HelloSoft has assigned to the Company the rights to any improvements, developments, discoveries or other inventions that may be generated by HelloSoft in its performance of the services to be provided under the Amendment.

On July 26, 2005, the Company signed an amendment to the Original Agreement that defines and prices the next two phases of the technology development. The Company will expend $445,000 on Phase II and $350,000 on Phase III. Half of Phase II, or $222,500, was paid to HelloSoft on July 26, 2005, in the form of restricted common stock issued at a discount of 25% to the closing price of the Company's common stock on that date, and the other $222,500 will be paid to them in cash when they complete Phase II, which the Company anticipates will occur in the second calendar quarter of 2006. The restricted common stock issued to HelloSoft was valued at $296,667 and recorded as research and development expense. When HelloSoft commences Phase III, the Company will issue to them $175,000 worth of restricted common stock, and the other $175,000 will be paid to them in cash when they complete Phase III. Phase III will be deemed complete when HelloSoft releases the E30 Rel. 1.5 to the Company. The Company projects that this also will occur in the second calendar quarter of 2006.

On November 3, 2003 and January 24, 2006, the Company and HelloSoft, Inc. entered into further amendments to the Original Agreement. Pursuant to the amendments, the Company agreed to pay HelloSoft an aggregate of $80,000 in cash, and the parties agreed upon certain additions to the development services to be performed by HelloSoft pursuant to the Original Agreement, as amended. $60,000 was paid to HelloSoft during the three months ended January 31, 2006 and $20,000 was accrued and is payable to HelloSoft as of January 31, 2006.

NOTE 12 - SEGMENT INFORMATION

Summarized financial information concerning the Company's reportable segments is shown in the following table:

For the Three Months Ended January 31, 2006

	Telecommunications Business	Entertainment Business	Unallocable	Tota
Net Sales - domestic	$ --	$ 6,234	$ --	$
Net Sales - foreign	$ --	$ 33,942	$ --	$
Operating income (loss)	$ (103,315)	$ 36,291	$ (887,611)	$ (9
Depreciation and amortization	$ 103,315	$ --	$ --	$ 1
Total Identifiable Assets at January 31, 2006	$ 5,822,447	$ --	$ 395,953	$ 6,2

For the Three Months Ended January 31, 2005

	Telecommunications Business	Entertainment Business	Unallocable	Tota
Net Sales - domestic	$ --	$ 2,501	$ --	$
Net Sales - foreign	$ --	$ 6,300	$ --	$
Operating income (loss)	$ (1,159)	$ (3,716)	$ (596,946)	$ (6
Depreciation and amortization	$ 1,159	$ 3,009	$ --	$
Total Identifiable Assets at January 31, 2005	$ 5,966,529	$ 1,015,097	$ 149,899	$ 7,1

NOTE 13 - SUBSEQUENT EVENTS

EQUITY TRANSACTIONS

In February 2006:

(i) 22,311,367 shares of common stock were issued upon conversion of May 2005 Debentures with a principal amount of $453,350 and interest of $1,833;

(ii) options to purchase 2,000,000 shares of common stock were granted to directors. These options were valued at approximately $85,000 and have a 10 year term, an exercise price of $0.0319 per share, and vest in May 2006;

(iii) options to purchase 2,000,000 shares of common stock were granted to a service provider. These options were valued at approximately $85,000 and have a 10 year term, an exercise price of $0.0319 per share, and vested on March 1, 2006;

(iv) options to purchase 100,000 shares of common stock were granted to an employee. These options were valued at approximately $17,000 and have a 10 year term, an exercise price of $0.08 per share, and vest on a straight-line basis over three years;

(v) 12,064,494 shares of common stock were issued in exchange for the return and cancellation of notes payable with a principal amount of $700,337 and interest of $144,178;

(vi) 5,656,108 shares of common stock were issued upon exercise of warrants resulting in gross proceeds of $282,805;

In March 2006:

(i) 5,714,516 shares of common stock were issued upon exercise of warrants resulting in gross proceeds of $285,726; and

(ii) 11,000,000 shares of restricted common stock were issued to consultants for services valued at $1,870,000.

CONVERTIBLE PROMISSORY NOTE

On March 7, 2006, the Company issued a convertible promissory note in the principal amount of $301,197 to the Company's executive vice president. The note replaces a promissory note in the principal amount of $383,911, dated March 25, 2005, which had a remaining balance due of $88,747, and also includes $212,450 owed for deferred compensation.

The note bears interest at the rate of 8% per annum and is due on the earlier of March 3, 2008 or the date on which the holder's employment is terminated by the Company.

The note is convertible, at the holder's option, into shares of the Company's common stock at a conversion price per share equal to the closing price of the common stock on the Over-the-Counter Bulletin Board on the date of conversion. The holder has certain registration rights set forth in the note.

TECHNOLOGY LICENSE AGREEMENT

On February 6, 2006, the Company entered into a technology license agreement with HelloSoft. Under the agreement, the Company has obtained a license to include HelloSoft's integrated VoIP software suite in the Company's E30 semiconductor. In exchange for this license, the Company has agreed to pay HelloSoft a license fee and certain royalties based on its sales of products including the licensed technology.

AMENDMENTS TO INVESTOR AND COMPENSATION WARRANTS

On February 21, 2006, the Company and certain holders of Investor and Compensation Warrants entered into an amendment (the "Warrant Amendment") to the terms of their warrants.

The Investor and Compensation Warrants were issued by the Company to the buyers of the Company's 2005 Debentures and to a finder in connection with the same transaction. Warrants for 12,443,442 shares were exercisable at a per share exercise price of $0.1547, and warrants for 27,149,316 shares were exercisable at a per share exercise price of $0.3094.

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NOTE 13 - SUBSEQUENT EVENTS (CONTINUED)

AMENDMENTS TO INVESTOR AND COMPENSATION WARRANTS (CONTINUED)

Pursuant to the Warrant Amendment, the Company and certain holders of the Investor and Compensation Warrants agreed to temporarily reduce the exercise price of the Investor and Compensation Warrants to $0.05 per share for a period beginning February 21, 2006 and ending at midnight, New York City time on March 10, 2006 (the "New Price Exercise Period"). The warrant holders that are parties to the Warrant Amendment may, but are not required to, exercise all or any portion of their Investor and Compensation Warrants at a per share price of $0.05 at any time during the New Price Exercise Period, but cannot do so by means of a cashless exercise. This reduction in the exercise price of the Investor and Compensation Warrants expired on March 10, 2006. During the New Price Exercise Period, holders of the Investor and Compensation Warrants exercised warrants to purchase 11,370,624 shares of common stock at the reduced exercise price of $0.05 per share, resulting in gross proceeds to the Company of $568,531.

Any shares of common stock issued with any exercise of an Investor or Compensation Warrant to a holder of the Investor or Compensation Warrant who or which executed the Warrant Amendment, whether during the New Price Exercise Period (on the terms contemplated in the Warrant Amendment) or thereafter (on the original terms provided in the Investor and Compensation Warrants) shall be restricted common stock, but shall have the registration rights provided in the Warrant Amendment. Except as expressly provided in the Warrant Amendment, the terms and conditions of the Investor and Compensation Warrants and any related registration rights agreement shall be unchanged and remain in full force and effect. In addition, the warrant holders agreed to waive any claims arising out of or relating to the failure, if any, to have available registered Warrant Shares, as defined in the Investor and Compensation Warrants, prior to the New Required Effective Date (as defined below).

The Company agreed to include the shares of common stock purchased by an Investor or Compensation Warrant holder through the exercise of each Investor or Compensation Warrant (whether or not pursuant to the terms of the Warrant Amendment) in a registration statement to be filed by the Company with the Securities and Exchange Commission (the "SEC") no later than the earlier of the date the Company files its next registration statement with the SEC (other than on Form S-8 or S-4) for the sale of shares by the Company or other selling stockholders, or May 1, 2006. The term "New Required Effective Date" means the date which is the later of 120 days from the expiration of the New Price Exercise Period, or sixty days after the filing of such registration statement; provided, however, that in no event shall such date be later than the required effective date contemplated by the terms of any new transaction consummated by the Company after February 21, 2006, where the shares of common stock issued or issuable to the investors in such transaction are included in a registration statement that is required to be made effective by a stated date.

2006 DEBENTURES

On March 10, 2006, the Company raised gross proceeds of $6.0 million from the private placement to 17 institutional and individual investors (the "Investors") of its two-year 7% Senior Secured Convertible Debentures (the "2006 Debentures"). Of this amount, $3.0 million was delivered by the Company to a security agent, acting on behalf of the Investors (the "Security Deposit"), to secure certain obligations of the Company to the Investors if the Company does not file an amendment, with the approval of the Company's shareholders, to its charter documents to reflect the increase in the Company's authorized common stock from 500 million to 900 million shares (the "Authorized Share Increase"). The Company will be obligated to prepay $3 million of the Debentures (plus accrued interest) if evidence of the Authorized Share Increase is not provided by the Company to a designated party by the close of business on April 28, 2006. If, however, the Company provides such evidence by then, the $3.0 million Security Deposit will be released to the Company, and it will not have to prepay such principal amount of the Debentures. The Company intends to submit the proposal to approve this increase to its shareholders at the Company's upcoming annual shareholders meeting.

In connection with the issuance of the 2006 Debentures, the Company issued to the Investors warrants to purchase 70,955,548 shares of the Company's common stock at an exercise price of $0.15 per share valued at $9,036,727 on the issuance date (subject to adjustments for stock splits, stock dividends, recapitalizations, mergers, spin-offs, and certain other transactions). If the Company is required to prepay $3 million of the 2006 Debentures as described in the preceding paragraph, the Investors will return one-half of such Warrants to the Company. The warrants are exerciseable until the end of the month in which the third anniversary of the registration statement (as defined below) occurs.

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NOTE 13 - SUBSEQUENT EVENTS (CONTINUED)

2006 DEBENTURES (CONTINUED)

On March 10, 2006, after taking into account the $3.0 million Security Deposit, the Company received net proceeds of approximately $1.8 million from the proceeds of the 2006 Debentures, after the payment of offering related fees and expenses and after the repayment in full of bridge loans, made in December 2005 and January 2006, in the aggregate amount of $810,000.

The 2006 Debentures are convertible into shares of common stock at the holder's option at any time on or after the earlier of (i) the 65th day following issuance or (ii) the effective date of the registration statement, with the conversion price for any such conversion equal to the lower of (x) 70% of the volume weighted average price ("VWAP") of the common stock for the twenty days ending on the trading day immediately preceding the conversion date or (y) if the Company enters into certain financing transactions, the lowest purchase price or conversion price applicable to that transaction. The conversion price is subject to adjustment.

Interest on the 2006 Debentures accrues at the rate of 7% per annum, payable upon conversion or semi-annually (June 30 and December 31 of each year) or upon maturity, whichever occurs first, and will continue to accrue until the 2006 Debentures are fully converted and/or paid in full. Interest is payable, at the option of the Company, either (i) in cash, or (2) in shares of common stock at the then applicable conversion price.

To secure the Company's obligations under the 2006 Debentures, the Company has granted a security interest in substantially all of its assets, including without limitation, its intellectual property, in favor of the Investors. The security interest terminates upon the earlier of (i) the date on which less than one-fourth of the original principal amount of the March 2006 Debentures issued on the Closing Date are outstanding or (ii) payment or satisfaction of all of the Company's obligations under the Securities Purchase Agreement.

The Company has undertaken to file, within 45 days after the Closing Date or two days after the next shareholders meeting, whichever is later, but in no event later than April 28, 2006, a registration statement covering the common stock underlying the 2006 Debentures and the warrants.

In connection with the placement of the March 2006 Debentures, a placement agent will receive a placement agent fee equal to (i) 10% of the aggregate purchase price (i.e., $600,000, one-half of which was paid at the initial closing and the remainder of which will be paid if the second $3.0 million is released to the Company), (ii) 10% of the proceeds realized in the future from exercise of warrants issued to the Investors, (iii) warrants to purchase an aggregate of 7,095,556 shares of common stock having an initial exercise price equal to $0.1693 per share valued at $888,779 on the issuance date, and (iv) warrants to purchase an aggregate of 7,095,556 shares of common stock having an initial exercise price equal to $0.15 per share valued at $903,673 on the issuance date. The exercise price of the placement agent warrants is subject to adjustments for stock splits, stock dividends, recapitalizations, mergers, spin-offs, and certain other transactions.

The aggregate fair value of the placement agent's warrants of $1,792,452 on the issuance date was recorded as a deferred financing cost and is being charged to interest expense over the term of the 2006 Debentures.

The gross proceeds of $6,000,000 are recorded as a liability net of a debt discount of $6,000,000 consisting of an allocation of the fair values attributed to the Investors' warrants and to the embedded conversion feature in accordance with EITF issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock." The debt discount consisted of a $3,428,571 value related to the Investors' warrants and a value attributed to the embedded conversion feature of $2,571,429. The debt discount was first allocated to the embedded conversion feature based on its fair value. After reducing the gross proceeds by the value allocated to the embedded conversion feature, the remaining unallocated debt discount of $3,428,571 was allocated to the Investors' warrants. The excess of the fair value of the Investors' warrants above the debt discount allocated to the Investors' warrants was $5,608,156 and was recorded as interest expense.

In accordance with EITF No. 00-19, due to certain factors, including an uncapped liquidated damages provision in the registration rights agreement and an indeterminate amount of shares to be issued upon conversion of the debentures, the Company separately values and accounts for the embedded conversion feature related to the 2006 Debentures, the Investors' warrants, the placement agent's warrants, and the registration rights as derivative liabilities. Accordingly, these derivative liabilities are measured at fair value with changes in fair value reported in earnings as long as they remain classified as liabilities. The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

We urge you to read the following discussion in conjunction with our condensed consolidated financial statements and the notes thereto included elsewhere herein.

This Quarterly Report on Form 10-QSB/A reflects a restatement of the Company's previously issued condensed consolidated financial statements included in our Quarterly Report on Form 10-QSB for the period ended January 31, 2006 (the "Original Report"), as discussed below and in Note 2 to the condensed consolidated financial statements included herein. In the preparation of this report, we have revised language within Management's Discussion and Analysis of Financial Condition and Results of Operations from the Original Report to reflect the restatement. No other information has been amended or updated to reflect other events occurring after the date of the Original Report or to modify or update those disclosures affected by subsequent events. Information contained herein continues to speak as of the date of the Original Report, and we have not updated the disclosures contained herein to reflect subsequent events.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Our prospects are subject to uncertainties and risks. In this Quarterly Report on Form 10-QSB/A, we make forward-looking statements in this Item 3 and elsewhere that also involve substantial uncertainties and risks. These forward-looking statements are based upon our current expectations, estimates and projections about our business and our industry, and that reflect our beliefs and assumptions based upon information available to us at the date of this report. in some cases, you can identify these statements by words such as "if," "may," "might," "will, "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continue," and other similar terms. These forward-looking statements include, among other things, projections of our future financial performance and our anticipated growth, descriptions of our strategies, our product and market development plans, the trends we anticipate in our business and the markets in which we operate, and the competitive nature and anticipated growth of those markets.

We caution readers that forward-looking statements are predictions based on our current expectations about future events. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Our actual results, performance or achievements could differ materially from those expressed or implied by the forward-looking statements as a result of a number of factors, including but not limited to the risks and uncertainties discussed in our other filings with the SEC. We undertake no obligation to revise or update any forward-looking statement for any reason.

RESTATEMENT

On July 6, 2006, the Company's Board of Directors, after consultations by management and the Audit Committee with the Company's independent registered public accounting firm, concluded that the classification of warrants issued in connection with the 2005 and 2006 convertible debentures was not in accordance with interpretations of Emerging Issues Task Force ("EITF") Issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed To and Potentially Settled In, a Company's Own Stock." Accordingly, the condensed consolidated financial statements included in the Company's Quarterly Report on Form 10-QSB for the period ended January 31, 2006, as filed on March 17, 2006 (the "January 2006 10-QSB") have been restated to correct the accounting for the warrants as derivative liabilities. The previously issued condensed consolidated financial statements included in the January 2006 10-QSB should not be relied upon. As a result of this restatement, $110,200 included in stockholders' equity at January 31, 2006 should have been recorded as a derivative liability and the Company should have recorded a loss of $24,138 on the change in fair value of derivative liabilities for the three months ended January 31, 2006. The treatment of this non-cash accounting item results in an increase in the Company's net loss for the three months ended January 31, 2006 as follows:

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	For the Three Months Ended January 31, 2006	
	(As Reported)	(As Restated)
Net loss	$(1,273,738)	$(1,297,876)
Basic and diluted net loss per share of common stock	$ (0.01)	$ (0.01)

The correction of the above also results in the following changes to the Company's stockholders' equity and liabilities at January 31, 2006:

	(As Reported)	(As Restated)
Total liabilities	$ 3,371,764	$ 3,481,964
Stockholders' equity	$ 2,846,636	$ 2,736,436

OVERVIEW

We are developing advanced transmission technology products to enable data to be transmitted across copper telephone wire at speeds and over distances that exceed those offered by leading DSL technology providers. Our first chipset in a planned family of transport processors, the Embarq(TM) E30 (Release 1.3) digital signal processor, was first made available to prospective customers for evaluation and testing in the first quarter of fiscal 2006. We are presently working on Release 1.4 of the E30 and Release 1.1 of the Embarq(TM) E20 analog front end. We market this novel technology to leading equipment makers in the telecommunications industry. Our products are designed to substantially increase the capacity of existing copper telephone networks, allowing telephone companies, office building managers, and enterprise network operators to provide enhanced and secure video, data and voice services over the existing copper telecommunications infrastructure.

We expect that system-level products that use our technology will have a significant advantage over existing system-level products that use existing broadband technologies, such as digital subscriber line (DSL), because such products will transmit data faster, and over longer distances. We expect products using our technology will offer numerous advantages to the network operators that deploy them, including the ability to support new services, the ability to offer existing and new services to previously unreachable locations in their network, reduction in total cost of ownership, security and reliability.

Our semiconductor business segment is dependent upon our ability to generate future revenues and positive cash flow from our advanced transmission technology products, such as the E30 and E20. No assurance can be provided that our target customers will purchase these products in large volumes, or at all.

In April 2000, our NV Entertainment subsidiary entered into a joint venture production agreement to produce a feature length film, "Step into Liquid" (the "Film"). We own a 50% interest in the joint venture. The financial condition and results of operations of the joint venture are consolidated with our financial condition and results of operations on the accompanying condensed consolidated financial statements. The Film was released to theaters in the United States in 2003 and is currently in foreign and DVD distribution. During the three months ended January 31, 2006 and 2005, we received revenues of $40,176 and $8,801, respectively, from the Film. As a result of impairment reviews during the years ended December 31, 2005 and 2004, the Company reduced the carrying value of the Film to $0 on our balance sheet. We do not intend to make further investment in our entertainment business.

CRITICAL ACCOUNTING POLICIES

The preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Our estimates are based on historical experience, other information that is currently available to us and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions and the variances could be material.

Our critical accounting policies are those that affect our condensed consolidated Financial statements materially and involve difficult, subjective or complex judgments by management. We have identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

CONVERTIBLE DEBENTURES

Proceeds of the 2006 and 2005 Debentures are recorded as a liability net of a debt discount consisting of the fair values attributed to the related warrants and to the embedded conversion features. In accordance with EITF issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock," due to certain factors, including an uncapped liquidated damages provision in the registration rights agreement and an indeterminate amount of shares to be issued upon conversion of the debentures, the Company separately values and accounts for the embedded conversion features, related warrants, and registration rights as derivative liabilities. Accordingly, these derivative liabilities are measured at fair value with changes in fair value reported in earnings as long as they remain classified as liabilities. The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification.

STOCK-BASED COMPENSATION

On November 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including stock options based on estimated fair values. SFAS 123(R) supersedes our previous accounting under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") for periods beginning on November 1, 2005. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

We early adopted SFAS 123(R) using the modified prospective transition method, as of November 1, 2005, the first day of our fiscal year 2006. Our condensed consolidated financial statements as of and for the three months ended January 31, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, our condensed consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R).

Stock-based compensation expense recognized under SFAS 123(R) related to employee stock options was $69,037 for the three months ended January 31, 2006. Stock based-compensation expense for share-based payment awards granted prior to, but not yet vested as of October 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 was $247,057 for the three months ended January 31, 2006. Stock-based compensation expense recognized for non-employees under other accounting standards was $22,908 for the three months ended January 31, 2006.

There was no stock-based compensation expense related to employee stock options under other accounting standards for the three months ended January 31, 2005. Stock based-compensation expense recognized for non-employees under other accounting standards was $279,548 for the three months ended January 31, 2005.

Stock-based compensation expense recognized in our condensed consolidated statement of operations for the three months ended January 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of October 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to October 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). We have continued to attribute the value of stock-based compensation to expense on the straight-line single option method.

As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three months ended January 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In our pro forma information required under SFAS 123 for the periods prior to fiscal 2006, we accounted for forfeitures as they occurred.

REVENUE RECOGNITION

We recognize revenue from the sale of our semiconductor products when evidence of an arrangement exists, the sales price is determinable or fixed, legal title and risk of loss has passed to the customer, which is generally upon shipment of our products to our customers, and collection of the resulting receivable is probable. To date we have not recognized any revenues related to the sale of our semiconductor products.

We recognize revenue from the distribution of our Film and related products when earned and reasonably estimable in accordance with Statement of Position 00-2 -- "Accounting by Producers or Distributors of Films" (SOP 00-2). The following are the conditions that must be met in order to recognize revenue in accordance with SOP 00-2:

(i) persuasive evidence of a sale or licensing arrangement with a customer exists;

(ii) the film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery;

(iii) the license period of the arrangement has begun and the customer can begin its exploitation, exhibition or sale;

(iv) the arrangement fee is fixed or determinable; and (v) collection of the arrangement fee is reasonably assured.

Under a rights agreement with our distributor for our Film, we share with the distributor in the profits of the Film after the distributor recovers its marketing, distribution and other predefined costs and fees. The agreement provides for the payment of minimum guaranteed license fees, usually payable on delivery of the completed film, that are subject to further increase based on the actual distribution results.

In accordance with the provisions of SOP 00-2, a film is classified as a library title after three years from the film's initial release. The term library title is used solely for the purpose of classification and for identifying previously released films in accordance with the provisions of SOP 00-2. Revenue recognition for such titles is in accordance with our revenue recognition policy for film revenue.

FILM IN DISTRIBUTION

SOP 00-2 requires that film costs be capitalized and reported as a separate asset on the balance sheet. Film costs include all direct negative costs incurred in the production of a film, as well as allocations of production overhead and capitalized interest. Direct negative costs include cost of scenario, story, compensation of cast, directors, producers, writers, extras and staff, cost of set construction, wardrobe, accessories, sound synchronization, rental of facilities on location and post production costs. SOP 00-2 also requires that film costs be amortized and participation costs accrued, using the individual-film-forecast- computation method, which amortizes or accrues such costs in the same ratio that the current period actual revenue (numerator) bears to the estimated remaining unrecognized ultimate revenue as of the beginning of the fiscal year (denominator). We make certain estimates and judgments of future gross revenue to be received for the Film based on information received by its distributor, historical results and management's knowledge of the industry. Revenue and cost forecasts are continually reviewed by management and revised when warranted by changing conditions. A change to the estimate of gross revenues for the Film may result in an increase or decrease to the percentage of amortization of capitalized film costs relative to a previous period.

In addition, SOP 00-2 also requires that if an event or change in circumstances indicates that an entity should assess whether the fair value of a film is less than its unamortized film costs, then an entity should determine the fair value of the film and write-off to the statement of operations the amount by which the unamortized film costs exceeds the film's fair value. As a result of impairment reviews during the years ended December 31, 2005 and 2004, we wrote down the carrying value attributed to the Film to $0.

CAPITALIZED SOFTWARE DEVELOPMENT COSTS

Capitalization of computer software development costs begins upon the establishment of technological feasibility. Technological feasibility for our computer software is generally based upon achievement of a detail program design free of high-risk development issues and the completion of research and development on the product hardware in which it is to be used. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized computer software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology.

Amortization of capitalized computer software development costs commences when the related products become available for general release to customers. Amortization is provided on a product-by-product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product, or (b) the straight-line method over the remaining estimated economic life of the product. The estimated useful life of our existing product is seven years.

We periodically perform reviews of the recoverability of our capitalized software development costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, the capitalized costs of each software product is then valued at the lower of its remaining unamortized costs or net realizable value.

No assurance can be given that products we release based upon the licensed technology will receive market acceptance. If we determine in the future that our capitalized costs are not recoverable, the carrying amount of the technology license would be reduced, and such reduction could be material.

We have commenced amortization of capitalized software development costs during the three months ended January 31, 2006 and recorded amortization expense of $102,696 during that period.

RESEARCH AND DEVELOPMENT

Research and development expenses relate to the design and development of advanced transmission technology products. We outsource to independent third parties all of our design and development activities. Payments made to independent software developers under development agreements are capitalized to software development costs once technological feasibility is established or if the development costs have an alternative future use. Prior to establishing technological feasibility, software development costs are expensed to research and development costs and to cost of sales subsequent to confirmation of technological feasibility. Internal development costs are capitalized to software development costs once technological feasibility is established. Technological feasibility is evaluated on a product-by-product basis.

Research and development expenses generally consist of salaries, related expenses for engineering personnel and third-party development costs incurred.

TECHNOLOGY LICENSES

We have entered into two technology license agreements that may impact our future results of operations. Royalty payments, if any, under each license would be reflected in our consolidated statements of operations as a component of cost of sales.

In April, 2002, we entered into a development and license agreement with Adaptive Networks, Inc. ("Adaptive"), to acquire a worldwide, perpetual license to Adaptive's PowerstreamTM technology, intellectual property and patent portfolio. The licensed PowerstreamTM technology provides the core technology for our semiconductor products. We have also jointly developed technology with Adaptive that enhances the licensed technology.

In consideration of the development services provided and the licenses granted to us by Adaptive, we paid Adaptive an aggregate of $5,571,000 between 2002 and 2004 consisting of cash and our assumption of certain Adaptive liabilities. In addition to the above payments, Adaptive is entitled to a percentage of any net sales of products sold by us and any license revenue we receive from the licensed and co-owned technologies less the first $5,000,000 that would otherwise be payable to them under this royalty arrangement.

In February 2006, we obtained a license to include HelloSoft, Inc.'s integrated VoIP software suite in the EmbarqTM E30 semiconductor. We believe the inclusion of VoIP features in our products will eliminate VoIP dedicated components currently needed in modems and thereby lower their production costs by more than 20%. In consideration of this license, we have paid HelloSoft a license fee and will pay certain royalties based on our sale of products, including the licensed technology.

RESULTS OF OPERATIONS

COMPARISON OF THE THREE MONTHS ENDED JANUARY 31, 2006 AND THE THREE MONTHS ENDED JANUARY 31, 2005

REVENUES. Revenues for the three months ended January 31, 2006 were $40,176. Of this amount, $6,234 was in the form of guarantee and/or license payments related to the U.S. distribution of the Film and $33,942 was related to foreign distribution of the Film. Revenues for the three months ended January 31, 2005 were $8,801 from our Entertainment Business. No revenues were recorded in connection with our semiconductor business during the three months ended January 31, 2006 and 2005.

OPERATING EXPENSES. Operating expenses included cost of sales, amortization of technology license and capitalized software development fee, research and development expenses in connection with the semiconductor business, and selling, general and administrative expenses.

Total operating expenses increased 63% or $384,188 to $994,811 for the three months ended January 31, 2006 from $610,823 for the three months ended January 31, 2005. Cost of sales for the three months ended January 31, 2005 represents the amortization of film cost for the Film. The decrease for the three months ended January 31, 2006 was a result of the impairment of the Film costs in 2005 which reduced the carrying value of the Film costs to $0.

Amortization of technology license and capitalized software development fee increased by 100% or $102,696 due to the commencement of amortization related to the market release of the E30 (Release 1.3) to prospective customers for evaluation and testing during December 2005. No amortization was recorded prior to this period.

Research and development expenses increased $77,991 for the three months ended January 31, 2006, principally as the result of additional payments made to HelloSoft, Inc. ("HelloSoft") in accordance with the terms of our services agreement, as amended. Selling, general and administrative expenses increased 35% or $210,126 to $807,071 primarily as a result of an increase in professional fees and stock based compensation related to options granted to key employees and an advisory board member.

OTHER (INCOME) EXPENSES. Other expenses included interest expense, a loss on the change in fair value of derivative liabilities, and amortization of deferred financing costs. Interest expense increased $966,173 primarily as a result of issuing $3,500,000 of convertible debentures in May 2005 (the "2005 debentures") as well as the increase in amortization of debt discount. Amortization of deferred financing costs increased to $243,967 from $24,619 as a result of the additional deferred financing costs primarily related to the issuance of the 2005 debentures. Both the amortization of debt discount, which is included in interest expense, and the amortization of deferred financing costs, increased significantly due to the increase in conversions of convertible debentures into common stock. Upon conversion or repayment of debt prior to its maturity date, a pro-rata share of debt discount and deferred financing costs are written off and recorded as expense.

There were no derivative liabilities outstanding during the three months ended January 31, 2005.

Other income in the three months ended January 31, 2006 consisted primarily of a gain on forgiveness of principal and interest on a promissory note (the "Zaiq Note") to Zaiq Technologies, Inc. ("Zaiq") of $1,169,820. The Zaiq Note was entered into in April 2005, had an original principal amount of $2,392,000 and was originally due and payable in April 2007. Pursuant to the terms of the note, the principal amount of the note decreased by $797,333.33 on each of the six and 12 month anniversaries of the note. In December 2005, when we would not have otherwise been required to make a payment under the Zaiq Note, we entered into a letter agreement with Zaiq pursuant to which we agreed to repurchase from Zaiq for $200,000 the remaining balance of the Zaiq Note and 5,180,474 shares of our common stock held of record by Zaiq. We had the right to assign any or all of our purchase commitment under the letter agreement. We assigned to an unaffiliated third party that had been a prior investor in the Company the right to purchase 4,680,620 of the Zaiq shares. On December 20, 2005, we purchased the Zaiq Note and 499,854 shares of our common stock held by Zaiq for an aggregate purchase price of $129,789. The Zaiq shares we repurchased have been accounted for as treasury stock, carried at cost, and reflected as a reduction to stockholders' equity. The remaining principal and accrued interest of $1,292,111 on the Zaiq Note was canceled resulting in a gain of $1,169,820.

NET LOSS. For the three months ended January 31, 2006 our net loss increased 43% or $392,652 to $1,297,876 from $905,224 as the result of higher interest costs, a loss on the change in fair value of derivative liabilities, higher amortization of deferred financing costs, higher selling, general, and administrative expense, and higher research and development expenses, partially offset by an increase in revenues and the gain on the forgiveness of principal and interest on the promissory note to Zaiq Technologies, Inc. discussed above.

LIQUIDITY AND CAPITAL RESOURCES

Cash balances totaled $2,301,686 at March 13, 2006, $355,853 at January 31, 2006 and $373,481 at October 31, 2005.

Net cash used in operating activities was $467,047 for the three months ended January 31, 2006, compared to $462,489 for the three months ended January 31, 2005. The increase in cash used in operations was principally the result of the following items:

- an increase in the net loss, which was $1,297,876, compared with $905,224 for the three months ended January 31, 2005; and

- an increase for the three months ended January 31, 2006 of accounts payable and accrued liabilities of $92,877, compared to a decrease of accounts payable and accrued liabilities for the three months ended January 31, 2005 of $101,440, resulting in a net decrease in cash used of $194,317;

impacted by the following non-cash items:

- o increased amortization of deferred financing costs, which were $243,967 for the three months ended January 31, 2006, compared to $24,619 for the three months ended January 31, 2005, principally due to increased conversions of the May 2005 debentures;

- o a loss on the change in fair value of derivative liabilities of $24,138 relating to warrants issued in May 2005 in connection with the May 2005 debentures;

- o increased amortization of debt discount on notes, which was $1,193,195 for the three months ended January 31, 2006, compared to $225,503 for the three months ended January 31, 2005, principally due to increased conversions of the May 2005 debentures;

- o increased amortization of technology license and capitalized software development fee, which was $102,696 for the three months ended January 31, 2006, compared to $0 for the three months ended January 31, 2005, due to the commencement of amortization related to the market release of the E30 (Release 1.3) to prospective customers for evaluation and testing;

- o gain on forgiveness of principal and interest on the promissory note to Zaiq Technologies, Inc. of $1,169,820 during the three months ended January 31, 2006; and

- o increased stock-based compensation expense, which was $339,002 for the three months ended January 31, 2006 compared to $279,548 for the three months ended January 31, 2005.

We did not use cash for investing activities during either the three months ended January 31, 2006 or January 31, 2005.

Net cash provided by financing activities was $449,419 in the three months ended January 31, 2006 compared to $472,871 for the three months ended January 31, 2005. Net cash provided by financing activities in the three months ended January 31, 2006 was the result of proceeds from notes payable of $750,000 offset by capitalized financing costs of $82,500, total payments of $129,789 in connection with the cancellation of the promissory note to Zaiq Technologies, Inc. and the repurchase of common stock previously issued to Zaiq Technologies, Inc., and repayments of convertible notes payable of $88,292.

Net cash provided by financing activities for the three months ended January 31, 2005 was the result of proceeds from the issuance of common stock in the amount of $212,900 and proceeds from notes payable of $300,000, offset by capitalized financing costs of $33,029, and repayments of convertible notes payable of $7,000.

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

Our liquidity improved significantly as a result of a series of transactions completed subsequent to January 31, 2006.

First, as described in Note 13 to the accompanying condensed consolidated financial statements, we raised gross proceeds of $6.0 million in March 2006 from the private placement to 17 institutional and individual investors of our two-year 7% Senior Secured Convertible Debentures (the "2006 Debentures"). Of this amount, $3.0 million is being held by a security agent, acting on behalf of the investors (the "Security Deposit"). This amount will be released to us if we file an amendment to our charter documents to reflect an increase in our authorized common stock from 500 million to 900 million shares (the "Authorized Share Increase") and provide evidence of such amendment by April 28, 2006. If we fail to do so, we are obligated to prepay $3 million of the Debentures (plus accrued interest). After taking into account the $3.0 million Security Deposit, we received net proceeds of approximately $1.8 million from the proceeds of the 2006 Debentures, after the payment of offering related fees and expenses and after the repayment in full of bridge loans, made in December 2005 and January 2006, in the aggregate amount of $810,000.

Second, we received approximately $570,000 from the exercise of warrants to purchase 11,370,624 shares of our common stock.

Third, we reduced our current liabilities by approximately $845,000 by issuing 12,064,494 shares of restricted common stock to several holders of notes payable.

Without taking into account the Security Deposit, these transactions increased our working capital by over $3.2 million.

Since inception, we have funded our operations primarily through the issuance of our common stock and debt securities. Our recent financings are discussed below.

In December 2005 and January 2006, we entered into secured bridge loan agreements with a third party pursuant to which we borrowed $750,000 from the lender. After payment of due diligence fees and transaction related fees and expenses, we received net proceeds of $672,470. An amount equal to 108% of the principal amount of the loans is due and payable on the earlier of May 25, 2006 or the date we effect a financing transaction or series of transactions resulting in gross proceeds to us of at least $2,000,000. We repaid the loans in their entirety from the proceeds of the 2006 Debentures.

In May 2005, we sold $3,500,000 in aggregate principal amount of our Senior Secured 7% convertible debentures and warrants, receiving net proceeds of approximately $3.11 million after the payment of offering related costs. As of January 31, 2006, $3,101,121 of principal amount and interest of the 2005 Debentures had been converted into 147,468,595 shares of our common stock and there was $504,987 of principal amount of the 2005 Debentures outstanding. As of March 13, 2006, as a result of additional conversions, $51,650 principal amount of the 2005 Debentures was outstanding. The 2005 Debentures mature in May 2008.

In December 2003, April 2004 and May 2004, we raised net proceeds of approximately $1,024,000 from the private placement to certain private and institutional investors of our three year 7% Convertible Debentures. $125,000 of principal issued in December 2003 was outstanding as of January 31, 2006 and matures in December 2006.

As of March 13, 2006, we had cash balances of approximately $2.3 million. Although Management believes funds on hand will enable us to meet our liquidity needs for at least the next 12 months, we will need to raise additional funds to fulfill our business plan and to meet our future operating requirements, prior to the receipt of revenues from our semiconductor business.

We may not be successful in our efforts to raise additional funds. Our cash needs could be heavier than anticipated in which case we could be forced to raise additional capital. Even after we begin to sell our products, we do not yet know what payment terms will be required by our customers or if our products will be successful. At the present time, we have no commitments for any additional financing, and there can be no assurance that, if needed, additional capital will be available to us on commercially acceptable terms or at all.

Additional equity financings are likely to be dilutive to existing holders of our Common Stock and debt financing, if available, may involve significant payment obligations and covenants that restrict how we operate our business.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2005, the FASB published Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"). SFAS 154 establishes new standards on accounting for changes in accounting principles. Pursuant to the new rules, all such changes must be accounted for by retrospective application to the financial statements of prior periods unless it is impracticable to do so. SFAS 154 completely replaces Accounting Principles Bulletin No. 20 and SFAS 3, though it carries forward the guidance in those pronouncements with respect to accounting for changes in estimates, changes in the reporting entity, and the correction of errors. The requirements in SFAS 154 are effective for accounting changes made in fiscal years beginning after December 15, 2005. We will apply these requirements to any accounting changes after the implementation date.

The Emerging Issues Task Force ("EITF") reached a tentative conclusion on EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option" that no gain or loss should be recognized upon the conversion of an instrument that becomes convertible as a result of an issuer's exercise of a call option pursuant to the original terms of the instrument. The adoption of this pronouncement is not expected to have an impact on our consolidated financial position, results of operations, or cash flows.

In June 2005, the FASB ratified EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'" ("EITF No. 05-2"), which addresses when a convertible debt instrument should be considered 'conventional' for the purpose of applying the guidance in EITF No. 00-19. EITF No. 05-2 also retained the exemption under EITF No. 00-19 for conventional convertible debt instruments and indicated that convertible preferred stock having a mandatory redemption date may qualify for the exemption provided under EITF No. 00-19 for conventional convertible debt if the instrument's economic characteristics are more similar to debt than equity. EITF No. 05-2 is effective for new instruments entered into and instruments modified in periods beginning after June 29, 2005. We have applied the requirements of EITF No. 05-2 since the required implementation date. The adoption of this pronouncement did not have an impact on our consolidated financial position, results of operations, or cash flows.

EITF Issue No. 05-4 "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'" ("EITF No. 05-4") addresses financial instruments, such as stock purchase warrants, which are accounted for under EITF No. 00-19 that may be issued at the same time and in contemplation of a registration rights agreement that includes a liquidated damages clause. The consensus of EITF No. 05-4 has not been finalized. The adoption of this pronouncement is not expected to have an impact on our consolidated financial position, results of operations, or cash flows.

In September 2005, the FASB ratified EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues" ("EITF No. 05-7"), which addresses whether a modification to a conversion option that changes its fair value affects the recognition of interest expense for the associated debt instrument after the modification and whether a borrower should recognize a beneficial conversion feature, not a debt extinguishment, if a debt modification increases the intrinsic value of the debt (for example, the modification reduces the conversion price of the debt). EITF No. 05-7 is effective for the first interim or annual reporting period beginning after December 15, 2005. We will adopt EITF No. 05-7 as of the beginning of our interim reporting period that begins on February 1, 2006. We are currently in the process of evaluating the effect that the adoption of this pronouncement will have on our financial statements.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS (CONTINUED)

In September 2005, the FASB ratified EITF Issue No. 05-8, "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature" ("EITF No. 05-8"), which addresses the treatment of convertible debt issued with a beneficial conversion feature as a temporary difference under the guidance in SFAS 109. In addition, deferred taxes recognized for a temporary difference of debt with a beneficial conversion feature should be recognized as an adjustment of additional paid-in capital. Entities should apply the guidance in EITF No. 05-8 in the first interim or annual reporting period that begins after December 15, 2005. Its provisions should be applied retrospectively under the guidance in SFAS 154 to all convertible debt instruments with a beneficial conversion feature accounted for under the guidance in EITF No. 00-27 "Application of EITF Issue No. 98-5 'Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios.'" We have applied the requirements of EITF No. 05-8 to all previously existing convertible debt instruments with a beneficial conversion feature and will apply the requirements of EITF No. 05-8 beginning on February 1, 2006 for all new convertible debt instruments with a beneficial conversion feature. The adoption of this pronouncement for new convertible debt instruments with a beneficial conversion feature is not expected to have an impact on our consolidated financial position, results of operations, or cash flows.

In February 2006, the FASB published Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments- an amendment of FASB Statements No. 133 and 140" ("SFAS 155"). SFAS 155 resolves issues addressed in SFAS 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." The requirements in SFAS 155 are effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this pronouncement is not expected to have an impact on our consolidated financial position, results of operations, or cash flows.

ITEM 3. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Exchange Act as of this report. As described in Part I, Item 2 above under the heading, "RESTATEMENT," the Company's Board concluded that the classification of warrants issued by the Company in connection with the 2005 and 2006 convertible debentures was not in accordance with the interpretations of Emerging Issues Task Force ("EITF") Issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed To and Potentially Settled In, a Company's Own Stock." Accordingly, the Board has authorized the restatement of the Company's consolidated financial statements at and for the fiscal year ended October 31, 2005 and at and for the periods ended July 31, 2005, January 31, 2006 and April 30, 2006. Because the above error was not prevented by the Company's then-existing disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer has concluded based upon his evaluation that the Company's disclosure controls and procedures were not effective as of the end of the period covered by this report to provide reasonable assurance that material information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. The Company believes that, as a result of its consultations with counsel, the Company's outside auditors, and other accounting professionals, it has improved its disclosure controls and procedures in the area of financial reporting of complex equity transactions such as the convertible debentures and accompanying warrants.

Management is aware that there is a lack of segregation of duties at the Company due to the small number of employees dealing with general administrative and financial matters. This constitutes a significant deficiency in the internal controls. In the past, management had decided that considering the employees involved, the control procedures in place, and the outsourcing of certain financial functions, the risks associated with such lack of segregation were low and the potential benefits of adding additional employees to clearly segregate duties did not justify the expenses associated with such increases. Management periodically reevaluates this situation. In light of the Company's receipt of additional financing in March 2006, it is the Company's intention over the next six months to increase staffing to mitigate the current lack of segregation of duties within the general administrative and financial functions.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Such limitations include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures, such as simple errors or mistakes or intentional circumvention of the established process.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING. Except as described above, during the three months ended January 31, 2006, there have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

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PART II - OTHER INFORMATION

Item 6. Exhibits

4.1 Form of 7% Senior Secured Convertible Debenture, Series 06-01C, of the Company (incorporated by reference to Exhibit 4.1 of the Company's Report on Form 8-K filed with the Commission on March 13, 2006 (the "March 13, 2006 8-K")

4.2 Amendment to Class 2005-A, -B, and -C Common Stock Purchase Warrants, dated as of February 21, 2006, among the Company and the Warrant holders that are parties thereto (incorporated by reference to Exhibit 4.1 of the Company's Report on Form 8-K filed with the Commission on March 8, 2006)

10.1 Amendment 3.0 to the Services Agreement dated as of November 3, 2005 between the Company and HelloSoft, Inc. (Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Commission) (incorporated by reference to Exhibit 10.40 of the Company's Annual Report on Form 10-KSB for the fiscal year ended October 31, 2005 (the "2005 10-KSB"))

10.2 Letter Agreement dated as of December 16, 2005 between the Company and Zaiq Technologies, Inc. (incorporated by reference to Exhibit 10.41 of the Company's 2005 10-KSB)

10.3 Bridge Loan Agreement between the Company and Double U Master Fund, L.P. dated January 24, 2006 (incorporated by reference to Exhibit 10.1 of the Company's Report on Form 8-K filed with the Commission on January 30, 2006 (the "January 30, 2006 8-K"))

10.4 Form of Note issued in connection with the Bridge Loan Agreement (incorporated by reference to Exhibit 10.2 of the Company's January 30, 2006 8-K)

10.5 Form of Warrant issued in connection with the Bridge Loan Agreement (incorporated by reference to Exhibit 10.3 of the Company's January 30, 2006 8-K)

10.6 Security Interest Agreement, dated as of January 24, 2006 among the Company, Double U Master Fund, L.P. (the "Secured Party") and Krieger & Prager, LLP, as agent for the Secured Party (incorporated by reference to Exhibit 10.4 of the Company's January 30, 2006 8-K)

10.7 Stock Option Agreement dated January 26, 2006 between the Company and Brad Ketch (incorporated by reference to Exhibit 10.42 of the Company's 2005 10-KSB) (1)

10.8 Stock Option Agreement dated January 26, 2006 between the Company and Ray Willenberg, Jr. (incorporated by reference to Exhibit 10.43 of the Company's 2005 10-KSB) (1)

10.9 Stock Option Agreement dated January 26, 2006 between the Company and Walter Chen (incorporated by reference to Exhibit 10.43 of the Company's 2005 10-KSB)

10.10 License Agreement dated as of February 6, 2006 between the Company and HelloSoft, Inc. (Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Commission)*

10.11 Stock Option Agreement dated February 16, 2006 between the Company and Davis Munck Butrus, P.C.*

10.12	Stock Option Agreement dated February 16, 2006 between the Company and Jack Peckham* (1)
10.13	Stock Option Agreement dated February 16, 2006 between the Company and Thomas Cooper* (1)
10.14	Form of Securities Purchase Agreement, dated as of March 6, 2006, between the Company and the investors named therein (incorporated by reference to Exhibit 10.1 of the Company's March 13, 2006 8-K)
10.15	Form of Warrant issued in connection with the Securities Purchase Agreement (incorporated by reference to Exhibit 10.2 of the Company's March 13, 2006 8-K)

10.16	Form of Security Interest Agreement, dated as of March 6, 2006, among the Company, the Secured Parties named therein, and Krieger & Prager, LLP, as agent for the Secured Parties (incorporated by reference to Exhibit 10.3 of the Company's March 13, 2006 8-K)
10.17	Form of Registration Rights Agreement, dated as of March 6, 2006, between the Company and the investors named therein (incorporated by reference to Exhibit 10.4 of the Company's March 13, 2006 8-K)
10.18	Placement Agency Agreement, dated as of March 3, 2006, between the Company and Pond Equities (incorporated by reference to Exhibit 10.5 of the Company's March 13, 2006 8-K)
10.19	Employment Agreement between the Company and Ray Willenberg, Jr. dated as of March 7, 2006 (incorporated by reference to Exhibit 10.1 of the Company's Report on Form 8-K filed with the Commission on March 15, 2006 (the "March 15, 2006 8-K")) (1)
10.20	Convertible Promissory Note dated March 1, 2006 by the Company in favor of Ray Willenberg, Jr. (incorporated by reference to Exhibit 10.2 of the Company's March 15, 2006 8-K)
10.21	Consulting Agreement between the Company and LF Technology Group, LLC dated March 7, 2006 (incorporated by reference to Exhibit 10.3 of the Company's March 15, 2006 8-K)
10.22	Consulting Agreement between the Company and Starburst Innovations, LLC dated March 7, 2006 (incorporated by reference to Exhibit 10.4 of the Company's March 15, 2006 8-K)
10.23	Consulting Agreement between the Company and Advisor Associates, Inc. dated March 8, 2006 (incorporated by reference to Exhibit 10.5 of the Company's March 15, 2006 8-K)
31.1	Rule 13a-14(a)/15d-14(a) Certification**
32.1	Section 1350 Certification**

*Incorporated by reference to the same numbered exhibit of the Company's Quarterly Report on Form 10-QSB for the period ended January 31, 2006, as filed with the Commission on March 17, 2006.

** Filed herewith.

(1) Signifies a management agreement or compensatory plan or arrangement.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RIM SEMICONDUCTOR COMPANY

DATED: July 10, 2006

BY: /S/ BRAD KETCH

BRAD KETCH
PRESIDENT AND CHIEF EXECUTIVE OFFICER
(PRINCIPAL EXECUTIVE, FINANCIAL AND ACCOUNTING OFFICER AND AUTHORIZED SIGNATORY)