VIRTRA SYSTEMS INC
Form 10KSB/A
August 20, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB/A

Amendment No. 2

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2005

or

|_| TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____________ to _____________

Commission File Number 000-28381

VIRTRA SYSTEMS, INC.

(Exact name of Registrant as specified in its Charter)

Texas	93-1207631
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2500 City West Blvd, Suite 300, Houston TX	77042
(Address of principal executive offices)	(Zip Code)

(832) 242-1100

(Registrant's telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

None

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

Common Stock, par value $.005 per share

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. |__|

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. |X|

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

|__| Yes |X| No

The aggregate market value of the voting stock held by non-affiliates of Registrant at March 15, 2006 was approximately $4,807,971. The number of shares of Registrant's common stock outstanding on March 15, 2006 was 67,331,801. Revenue for the most recent fiscal year was $977,358.

Transitional Small Business Disclosure Format (Check one): |__| Yes; |X| No

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Part I

STATEMENT REGARDING THIS AMENDMENT

We are amending our Annual Report on Form 10KSB/A to restate our financial statements for the years ended December 31, 2005 and the related disclosures. We have identified certain accounting errors related to the

recording of our debt arrangements. We have performed an analysis of our existing debt agreements and have concluded that we incorrectly recorded our debt obligations and associated warrants as a beneficial conversion feature pursuant to EITF 98-5. Our analysis determined that the warrants associated with our convertible notes payable are derivatives as defined under SFAS No. 133 and EITF 00-19. We also did not appropriately account for financing costs incurred as a direct result of these debt arrangements.

During February 2005 and August 2005 the Company issued $750,000 and $500,000, respectively, in convertible debentures. These debentures contained conversion features that were based upon market value and outside of the control of the Company, as a result the Company has accounted for the convertible debt and associated warrants as derivative instrument liabilities. Additionally, the embedded conversion features of the debentures have been bifurcated from the debt and accounted for separately as derivative instrument liabilities. We have amended Note 12 to disclose the derivative instrument liabilities and provide information on subsequent changes.

We are required to record the fair value of the conversion features and the warrants on our balance sheet at fair value with changes in the values of these derivatives reflected in the statement of operations as "Gain/(loss) on derivative liability." Moreover, we are now amortizing the value attributed to the conversion features as interest expense using the effective interest method over the life of the note. The effect of the (non-cash) changes related to accounting separately for these derivative instrument liabilities and amortization on our statement of operations for the twelve months ended December 31, 2005 was a decrease of $326,786 in our net loss attributable to common shareholders, for a restated net loss of $1,668,270. Basic loss attributable to common shareholders per share for the year ended December 31, 2005 was not materially affected by the restatement. The cumulative effect on our balance sheet was to increase total current liabilities by $378,732 and to reduce shareholders deficit by the same amount.

In all other material respects, this Amended Annual Report on Form 10-KSB/A-2 is unchanged from the Amended Annual Report on Form 10-KSB/A previously filed by us on May 23, 2007. This Amended Annual Report on Form 10-KSB-2 does not attempt to modify or update any other disclosures set forth in the Form 10-KSB and Form 10-KSB/A previously filed or discuss any other developments after the respective dates of those filings except to reflect the effects of the restatements described above, certain risk factor disclosure and except as otherwise specifically identified herein.

Item 1. Description of Business

BUSINESS OVERVIEW

Our principal business began in 1993 with the organization of Ferris Productions, Inc. Ferris designed, developed, distributed, and operated virtual reality products for the entertainment, simulation, promotion, and education markets. Virtual reality is a generic term associated with computer systems that create a real-time visual/audio/haptic (touch and feel) experience. Virtual reality immerses participants into a three-dimensional real-time synthetic environment generated or controlled by one (or several) computer(s).

In September of 2001, Ferris merged into GameCom, Inc., a publicly held Texas company whose principal business at the time was the development and marketing of an internet-enabled video game system.

Our historic areas of application have included the entertainment/amusement, advertising/promotion, and training/simulation markets.

Our *"immersive virtual reality*™*"* devices are computer-based, and allow participants to view and manipulate graphical representations of physical reality. Stimulating the senses of sight, sound, touch, and smell simultaneously, our virtual reality devices envelop the participant in dynamic filmed or computer-generated imagery, and allow the participant to interact with what he or she sees using simple controls and body motions. Virtual reality products have traditionally employed head-mounted displays that combine high-resolution miniature image source monitors, wide field-of-view optics, and tracking sensors in a unit small and light enough to be worn on the head. These products usually surround the participant with dynamic three-dimensional imagery, allowing the

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user to change perspective on the artificial scenes by simply moving his or her head. Virtual reality devices have in the past been used primarily in connection with electronic games, as, by surrounding the player with the sights, sounds, and smells he or she would experience in the real world, play is made far more realistic than it would be if merely presented in a two-dimensional flat screen display.

In 2003, we made the strategic decision to take our 360-degree core technology from headset-based systems to larger, more complex projection-based systems.

We currently manufacture, market, and sell our *immersive virtual reality* products in two distinct markets: training/simulation and advertising/promotion. Within the training and simulation market, we offer two different versions of our patent-pending IVR™ 360-degree high-definition firearms training simulators: the IVR HD™, launched in March of 2004, for use in marksmanship, conflict resolution, and situational awareness training of law enforcement and security officers, and the IVR 4G™, launched in December of 2004, for use in military firearms/marksmanship training, situational awareness, and fourth-generation squad-based training.

Within the advertising/promotion market, we market the patented Immersa-Dome® personal *immersive virtual reality* theater, featuring the sensations of sight, sound, touch, and smell, and our 3-D multisensory theater, a product offering customized three-dimensional projected content in high-definition, with multisensory effects, for multiple viewers.

We maintain our corporate office at 2500 City West Blvd., Suite 300, Houston, Texas 77042, and our telephone number is (832) 242-1100. We also maintain engineering, technical, and production offices, and a demonstration facility, at 5631 South 24th Street, Phoenix, Arizona 85040, with a phone number of (602) 470-1177.

Entertainment/Amusement

The entertainment/amusement market was the original market for our products. Our *"immersive virtual reality™"* devices were designed to produce a highly-realistic experience at a significantly lower cost than traditional virtual reality technology. Historically, the software for virtual reality games and other applications was separately created for each application. Our systems were developed using our patented Universe Control Board™, which, when installed in an ordinary PC, makes it possible to quickly adapt PC games for the arcade market, permitting easy conversion of PC games to behave as coin-operated arcade games, and allows the operator to change from one game to another without expensive hardware replacement.

Within the entertainment/amusement market, we installed and operated virtual reality entertainment centers known as VR Zones in over a dozen theme parks and high-traffic visitor locations, such as:

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Six Flags,

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Paramount Parks,

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Busch Gardens, and

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Carnival Cruise Lines.

These VR Zones were equipped with systems we developed and manufactured, and were operated by our employees on a revenue-share basis with the theme park locations. We sold our VR Zones and effectively left this market in the spring of 2003, in order to more fully focus on the advertising/promotional and training/simulation markets.

Advertising/Promotion

We entered the advertising/promotion market, our second, with our 2000 “Drive With Confidence Tour™” for Buick, featuring a virtual reality “test-drive” of a Buick LeSabre with PGA professional Ben Crenshaw accompanying the participant. This project led us to additional projects within this market, such as:

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a virtual reality bi-plane experience for Red Baron® Pizza,

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a virtual reality ski jump promotional program for Chevrolet in conjunction with its *“Olympic Torch City Celebration Tour™,”*

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an interactive promotional project for Shell Oil Product’s Pennzoil® division’s *“Vroom Tour*™”, which featured Jay Leno “inside” an automobile engine demonstrating how oil functions inside an automobile engine, and ended with the visitor driving Pennzoil’s Formula One car around the Las Vegas Motor Speedway at speeds in excess of 220 miles per hour,

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a 50-seat, 3-D immersive theater for Red Baron® Pizza’s *“3-D Flying Adventure*™*,”* which featured special glasses, Dolby® 5.1 sound, and special effects that literally “jump” off the screen,

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a virtual reality recruitment tool for the United States Army, in which participants ride in an Army Black Hawk helicopter performing an exciting rescue mission, and

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a 3-D immersive theater project for Sea-Doo®, using our 3-D technology for 2-D to 3-D video conversion and 3-D computer animation, for 1) a motion simulator utilizing polarized glasses, 2) a theater-style presentation utilizing anaglyph (cyan-blue) glasses, and 3) a web-suitable version utilizing 3-D anaglyph glasses, all in connection with Bombardier's launch of its new 2004 Sea-Doo® 3D™ personal watercraft.

The year 2004 witnessed the completion of a strategic move from headset-based to projection-based technology, evidenced by the development and launch of our patented Immersa-Dome®, featuring a domed-shaped screen which surrounds the seated viewer and delivers a high-definition resolution virtual reality experience.

The May 3, 2004, launch of the Immersa-Dome product was rapidly followed by several new projects:

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a mobile promotional experience for Buick's new Terraza™ and LaCrosse™ vehicles, using four Immersa-Dome units installed in two of Buick's event-marketing trailers. This was our second collaboration with Buick's event marketing agency, Momentum Detroit,

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a sale of three Immersa-Domes to the United States Army Recruiting Command in Fort Knox, Kentucky, for installation in mobile recruiting trailers traveling the United States to major events, high schools, and universities in connection with the Army's recruiting efforts,

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the installation of three Immersa-Domes at the new Red Baron® Museum in Marshall, Minnesota, providing the visual experience of flying an acrobatic bi-plane with the Red Baron® Pizza Squadron™ in an 180-degree multisensory experience,

2005 advertising/promotion projects included projects for both new and returning customers. In addition, 2005 witnessed a new custom project that adapted our IVR™ product for use in the treatment of patients, and training of clinicians, for speech disorders. This speech disorder project represented the application of our *immersive virtual reality* technology into a new market medical treatment and training.

Returning customers during 2005 requested license renewals and/or upgrades of previous projects, including:

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the Schwan Food Company s renewal and upgrade of both its promotions for the Red Baron Pizza Squadron's 2005 air show season; renewal of the *Red Baron Flight Club*™ virtual reality experience, and integration of the Red Baron brand's *3-D Flying Adventure*™, a 3-D multisensory theater promotion, inside of a new, standard 18-wheel trailer, and

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Buick renewed and upgraded its Immersa-Dome® promotional experience for the 2006 Lucerne™ luxury sedan ,with new high-definition content featuring professional golfer Tiger Woods promoting Buick's new Lucerne automobile, which was installed into two themed trailers traveling throughout North America, stopping at Buick special events and selected PGA Tour events.

In addition, two new projects were received in 2005:

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An Immersa-Dome® promotional tour for Pfizer Pharmaceuticals trade show activities, featuring three specially themed Immersa-Domes delivering customized promotional content describing newly-developed drugs, and

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the sale of a specially-modified IVR 180 to Case Western Reserve University s speech pathology department, for researching the efficacy of virtual reality to treat patients for, and educate clinicians in, diagnoses of speech disorders.

We currently have proposals under submission to a number of advertising/promotional and government agencies, Fortune 500 companies, and governmental agencies in conjunction with pending advertising/promotional campaigns and customized projects.

Training/Simulation

In 2004, we unveiled our IVR™ line of projection-based training simulators for judgmental use-of-force, situational awareness, combat-readiness, and tactical judgment objectives. The two IVR product lines provide the law enforcement, military, and security markets with 360-degree immersive training environments.

Our IVR HD™ series, designed primarily for law enforcement objectives, was completed in January of 2004, and was publicly debuted to the domestic law enforcement market in late March of 2004, at the industry's Trexpo West trade show in Long Beach, California.

Our military-oriented IVR 4G™ system, designed to train soldiers for "fourth generation" warfare, was debuted at the industry-leading I/ITSEC trade show in Orlando, Florida in December of 2004. " Fourth generation warfare, as discussed in the October, 1988 *Marine Corps Gazette,* is characterized by transnational groups without territorially-based armies, engaging in highly irregular practices such as guerilla warfare, terrorist tactics, and low-intensity, close quarter conflict, enabling groups that are weaker militarily to defeat larger, stronger forces. Fourth-generation battlefields may include the whole of the enemy's society, where small, well-trained, highly maneuverable forces may tend to dominate.

In 2005, the installation base of our IVR HD and IVR 4G models grew both internationally and domestically, as we gained new military and law enforcement customers. We sold or installed IVR HD law enforcement simulators to law enforcement agencies in Washington County, Utah; Manistee, Michigan; Duluth, Georgia; and Charleston, South Carolina. In addition, our IVR 4G military version simulators were sold or installed, both domestically and abroad, at MacDill AFB, Florida: Fort Hood, Texas; and at two Mexican locations.

We announced our initial sale in this market in September of 2003, and, as of March 15, 2006, we had sold 36 systems, all variations of the IVR series, to the United States Air Force, the United States Army, a classified Department of Defense customer, several domestic law enforcement agencies, and state police and security organizations in Malaysia, Mexico, and India. Our initial IVR series installation was accomplished in March of 2004. We have recently received several confidential purchase commitments, both domestically and internationally, and we have numerous additional confidential proposals currently under review.

Virtual Reality Products

Our *“immersive virtual reality*™*”* products include:

Training/Simulation Products

The IVR HD™ and IVR 4G™ series, designed for law enforcement and military use, respectively, are projection-based, multi-screened, high-definition resolution, combat-readiness and judgmental use-of-force firearms training simulators. The IVR™ series simulators use company-produced high-definition filmed content as well as our Hybrid-CGI™ content. Our Hybrid-CGI software combines film content with computer-generated images, allowing users to create their own customized 360-degree training scenarios by combining “green-screen video, panoramic photorealistic images, computer-generated images, and 3-D sound. Green-screen filming is the technique of filming actors and other visual elements in the foreground against an evenly-colored green background, and subsequently extracting the actors and other visual elements and placing them onto a new panoramic background specifically suited to the user s needs and locale.

The IVR systems use off-the-shelf computer equipment, extremely-accurate laser-based weapons tracking, 360-degree video and audio, and ultra-high resolution interactive graphics. The systems deliver both photorealistic and computer-generated imagery -based video for training scenarios. The systems support one to six users, and have the option to be reconfigured into a 20-lane, military-approved, virtual shooting range for realistic marksmanship training.

Trainees step into the simulator, and then interact with a training scenario selected by the instructor, using their weapon of choice. The training scenarios teach combat-readiness, situational awareness, fourth-generation warfare tactics, and judgmental use-of-force with both lethal and non-lethal weapons currently used by military, law enforcement, and security agencies.

The IVR 4G military series of simulator products are offered in four different configurations:

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the IVR 4G-base™ is a single-screen model, and its compact size offers portability and supports one to four trainees.

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the IVR 4G-180™ offers an 180-degree field-of-view for more realistic combat training and marksmanship. It supports one to four trainees.

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the IVR 4G-300™ delivers 300-degree field-of-view for more realistic combat scenarios and marksmanship training, and supports one to five trainees.

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the IVR 4G-360™ offers a 360-degree field-of-view for combat and marksmanship training, and supports one to six trainees.

The IVR HD law enforcement series is offered in four different configurations:

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the IVR HD-base™ is a single-screen model, offering portability, and supports one to four trainees.

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the IVR HD-180™ offers an 180-degree field-of-view for more realistic training and target tracking. It supports one to four trainees.

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the IVR HD-300™ delivers 300-degree use-of-force scenarios, and supports one to five trainees.

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the IVR-360™ HD offers 360-degree firearms training, and supports one to six trainees.

We also have developed and market proprietary training accessories for use with both our IVR product lines, as well as those manufactured by third-parties:

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the wireless Threat-Fire™ belt permits the simulator's instructor to deliver an electric "stun" to the trainee, simulating the sensation of being shot, thus enhancing the multi-directional experience of our IVR simulators by increasing the seriousness and stress of training scenarios.

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our Hybrid-CGI™ scenario creation software integrates "green-screen" video, panoramic photorealistic images, computer-generated images, and 3-D sound, decreasing both cost and time of scenario production. Our Hybrid-CGI software offers the end-user more custom scenario options than traditional scenario production methods and other forms of training software.

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a wireless/tetherless drop-in recoil conversion kit, which transforms a live weapon into an accurate and safe training weapon. It features 1) a laser-based tracking mechanism, 2) self-contained, tetherless pneumatic recoil, and 3) instructor-controlled weapon malfunction capability to simulate a jammed weapon in the field. The system provides no possibility of chambering a live bullet while in training mode.

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laser-based pneumatic recoil conversion kits for most military and law enforcement handguns, assault rifles, and shotguns.

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less-lethal, laser-based training tools, including Taser® and canister OC pepper spray.

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TMaR (Trainee Monitor and Recording) debriefing product, which records and plays back the trainee s actions in the simulator, allowing systematic review of the trainee s performance.

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wireless/tetherless handgun training conversion drop-in recoil kits, which transform a handgun into a safe training weapon, allowing modification of a trainee's sidearm for training in our IVR simulators.

Advertising/Promotional Products

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the Immersa-Dome® is a patented projection-based virtual reality system, which uses a domed-shaped screen to surround the viewer. The Immersa-Dome offers photorealistic environments with 180-degree

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field-of-view and high-definition resolution. The system is composed of the dome's base, the viewer's seat, and a separate projector/mirror stand.

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the 3-D Multisensory Theater™ is a portable-seat, high-capacity (50-100 viewers) 3-D theater with special effects packages, including fog, wind, and simulated lighting, among others. This theater system features 3-D, high-resolution imagery on a large projected screen. Participants wear polarized glasses, which facilitate 3-D depth in the screen images. This system also features time-triggered smells, wind simulation, and a Dolby® 5.1 sound system. The 3-D Multisensory Theater uses a silver screen and two projectors. Three-dimensional filming techniques are used and processed to finalize the 3-D experience. Computer-generated 3-D imagery is an alternative development method to 3-D filming.

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the 360-degree headset-based virtual reality system delivers photorealistic content. In addition, the user, while seated, is tracked in 360 degrees. The multisensory system incorporates off-the-shelf computer equipment, gyroscopic head-tracking, stereo sound, wind simulation, and smell. The system comes standard for one user.

Competition

Competition within each of our markets is intense.

There are several large competitors in the general field of high-tech simulation. For instance, the January 7, 2002 edition of Forbes magazine contains a feature story on L3 Communications, Inc., a company purportedly doing in excess of $5 billion in business with the United States government in this market. L3 has so far focused on other types of simulators (such as aircraft motion simulators) and to-date we have never directly competed against L3, and may never compete with them regarding our IVR simulators. Other companies have made essentially the same single-screen style simulator for the past 15 years or longer.

As our virtual reality experiences are usually custom applications, and we deal primarily with advertising agencies, or directly with the client, it is difficult to quantify the competition. Sometimes companies are able to penetrate one or two particular high-tech promotions. With over 13 years in the marketplace, we currently are not aware of any other virtual reality-based advertising/promotion company with similar products similar to ours.

Some general competitors within the virtual reality industry that promote substitute and similar technologies are as follows:

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Advanced Interactive Systems, Inc. (AIS)--has been a provider of interactive simulation systems designed to provide training for law enforcement, military, and security agencies since 1993. Its line of products uses primarily video production in judgmental training scenarios. AIS also markets to anti-terrorist and other special application training facilities for military and special operations groups. Its systems have historically used only single screen technology.

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Cubic Defense Applications performing in a wide range of industries, including military simulation, Cubic currently produces a product (EST-2000) which was developed several years ago as mainly a marksmanship training system, with limited immersive combat training capabilities. Due to its size and corporate strength, Cubic could become a formidable competitor if it chose to focus on firearms training.

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Firearms Training Systems, Inc. (FATS)--claims to have over 4,000 training systems installed worldwide by military, law enforcement, and commercial customers. FATS is a full service training/simulation company that also uses video scenarios with single-screen technology. FATS also produces other types of simulators and recoil weapons. AIS, Cubic and FATS products are similar in many respects, although FATS has been in the market longer.

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IES Interactive Training, Inc. (IES)--a supplier of basic simulation equipment to law enforcement. Having fielded several hundred single screen systems in the law enforcement marketplace, it is mainly focused on the law enforcement marketplace.

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Straylight--has focused on the use of virtual reality in the promotions and conventions market. .

Our recent patent applications may hamper or halt potential plans by our competitors to enter the multi-screen simulator industry to compete with our IVR simulator.

The above summaries of competition are by no means exhaustive, since these industries are fluid and, at times, rapidly expanding.

Marketing

Marketing within the training/simulation market is conducted primarily through trade shows, trade journal advertisements, search engine strategies, and one-on-one demonstrations. We recently completed and publicly unveiled the IVR HD™ series of law enforcement-focused advanced training simulators at the Trexpo West trade show in March of 2004, and we publicly unveiled the military-oriented IVR 4G™ fourth generation warfare simulators at the I/ITSEC trade show in December of 2004. We have demonstrated the IVR simulators to high-level officers in the United States military, the Department of Defense, as well as to municipal, state, and federal agencies both domestically and internationally. In addition to our 25 announced sales to foreign governmental agencies, we have also sold 11 systems to domestic military and law enforcement agencies, and we have been advised that our IVR simulators are in the budgeting stages for branches of the United States Armed Forces, municipal and state law enforcement agencies, and several foreign governments. Of the 36 IVR™ systems we have sold, 12 have been fully installed, two have been shipped and are awaiting installation, and the remainder are contracted for future delivery.

Marketing within the advertising/promotional market is conducted primarily by web-based search engine strategies and by the face-to-face sales efforts of our vice-president of advertising and promotion. Our Immersa-Dome demonstration unit uses high-definition content from our projects for Pennzoil, Buick, Red Baron® Pizza, Chevrolet, and the U.S. Army. Marketing within this industry is conducted primarily by one-on-one appointments and demonstrations of our technology to agencies and qualified corporations. We also attend industry tradeshows to generate leads and to garner further market exposure.

Employees

At March 15, 2006, we employed 15 people. None of our employees are members of a union, and we consider relations with our employees to be satisfactory.

Trademarks/Patents

We have obtained a patent for our Universe Control Board™, and various federal trademarks. We have also filed for federal registration of our "Immersive Virtual Reality™" and "IVR™" trademarks.

On December 20, 2005, we successfully registered our claim on the trademark Immersa-Dome® from the United States Patent and Trademark Office.

On March 15, 2004, we applied for a patent on our IVR™ series of advanced training simulators, seeking a patent for our "multiple screen simulation system and method for situational response training.

On May 3, 2004, we announced that we had obtained an exclusive license to the patented technology behind the Immersa-Dome.

On December 3, 2004, in advance of industry demonstration at the industry-leading Interservice/Industry Training and Simulation Education Conference in Orlando, Florida, we submitted three separate provisional patent applications for innovations in the field of firearms training. These included: 1) the Threat-Fire™ Belt, 2) our Hybrid-CGI™ software, and 3) a "drop-in" kit and magazine for wireless recoil in real weapons.

First, the Threat-Fire Belt permits the simulator's instructor to deliver an electric "stun" to the trainee, simulating the sensation of being shot, thus enhancing the multi-directional experience associated with our IVR simulators.

Second, the Hybrid-CGI software integrates "green-screen" video, panoramic images, computer-generated images, and 3-D sound. Green-screen filming is the technique of filming actors and other visual elements in the foreground against an evenly-colored green background, and subsequently extracting the actors and other visual elements and placing them onto a new panoramic background specifically suited to the user s needs and locale. Hybrid-CGI software decreases both cost and time of scenario production, and provides more scenario options to the end user than traditional production methods.

Third, the "drop-in" kit and magazine is non-permanent, and delivers wireless recoil to a real weapon. The magazine is refillable, and the aiming laser features hyper-accurate collinear placement for both immersive combat training and marksmanship qualification. Use of untethered training weaponry is highly desirable in firearms simulators.

On November 22, 2005, the provisional patent applications filed in 2004 for the Threat-Fire™ belt and Hybrid-CGI™ software were upgraded to full patent applications, submitted to the United States Patent and Trademark Office, and are currently awaiting patent office action.

In December of 2005, we decided to not proceed with a full patent application of the provisional application originally filed on December 3, 2004, relating to the "drop-in" kit and magazine recoil design, due to significant design improvements incorporated since the preparation of the original provisional patent application.

There can be no assurance that patents or trademarks will issue on these applications, or that, if issued, they will be sufficiently broad to provide meaningful protection.

Item 2. Description of Property

Our executive offices are located in Arlington, Texas, at the offices of Jones & Cannon, P.C. See "Certain Relationships and Related Transactions." Jones & Cannon, P.C. began charging us $1,500 per month for our office space on June 15, 2000, but to date only $9,000 has been paid, all in 2002. There is no assurance that these offices will remain sufficient for our use, or that the nature of this relationship will continue.

Our production offices are located in Phoenix, Arizona, in an office building owned by Ferris Holdings, L.L.C. See Certain Relationships and Related Transactions. Ferris Holdings has charged us $7,772.00 per month for our office space since August of 2000. We have a 25 1/2-year lease with Ferris Holdings.

Item 3. Legal Proceedings

On February 6, 2004, suit was filed against us in County Court at Law No. 4 of Harris County, Texas, in cause number 810288, styled *Barbara Nedry v. VirTra Systems, Inc.*, seeking payment of the principal sum of $6,000, plus accrued interest, in equipment leases allegedly entered into by Ms. Nedry with the former Ferris Productions, Inc. in 2001. We have contested the allegations. The case is currently in the pre-trial discovery phase.

On May 13, 2004, suit was filed against us in the federal district court of South Carolina, in cause number 04CP402455, styled *Garland and Leota Slagle v. VirTra Systems, Inc.*, seeking payment of the principal sum of $90,000, plus accrued interest, in equipment leases allegedly entered into by the Slagles with the former Ferris Productions, Inc. in 2001. We have contested the allegations. The parties are currently in settlement discussions.

On December 30, 2004, suit was filed against us in the federal district court of North Carolina, in cause number 4:04-CV-199-H2, styled *Edward and Linda Strickland v. VirTra Systems, Inc.*, seeking payment in the principal sum of $72,000, plus accrued interest, in equipment leases allegedly entered into by Mr. Strickland with the former Ferris Productions, Inc. 2001. We contested the allegations. In February of 2006, we entered into an agreed judgment in the amount of $85,000, with a contractual provision in the judgment that there would be no collection activity on the judgment prior to February of 2007.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the last quarter of the period covered by this report.

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Market Information`

Our common stock is quoted under the symbol "VTSI" on the OTC Electronic Bulletin Board. The following table sets forth the high and low bid prices for shares of our common stock for the periods noted, as reported by the OTC Electronic Bulletin Board. Quotations reflect inter dealer prices, without retail markup, mark down, or commission, and may not represent actual transactions.

		BID PRICES	
YEAR	PERIOD	HIGH	LOW
2003			
	First Quarter	$0.14	$0.09
	Second Quarter	0.15	0.06
	Third Quarter	0.29	0.07
	Fourth Quarter	0.47	0.21
2004			
	First Quarter	0.35	0.20
	Second Quarter	0.43	0.24
	Third Quarter	0.42	0.28
	Fourth Quarter	0.46	0.28
2005			
	First Quarter	0.43	0.22
	Second Quarter	0.30	0.13
	Third Quarter	0.24	0.11
	Fourth Quarter	0.20	0.10

As of April 12, 2006, the reported bid price for our common stock was $0.088 per share.

Shareholders

As of March 15, 2006, we had 67,331,801 shares of common stock outstanding, held by 203 shareholders of record.

Dividends

We have not paid cash dividends on our common stock in the past and we do not anticipate doing so in the foreseeable future.

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains certain forward-looking statements that are subject to business and economic risks and uncertainties, and our actual results could differ materially from those forward-looking statements. The following discussion regarding our financial statements should be read in conjunction with the financial statements and notes to those financial statements.

Overview

Our principal business began in 1993 with the organization of Ferris Productions, Inc. Ferris designed, developed, distributed, and operated virtual reality products for the entertainment, simulation, promotion, and education markets. In September of 2001, Ferris merged into GameCom, Inc., a publicly held Texas company whose principal business at the time was the development and marketing of an internet-enabled video game system. We subsequently adopted our present name.

Prior to the merger of Ferris and GameCom, both companies had incurred substantial debt, much of which was eliminated in December of 2004 in a debt for equity conversion. However, there can be no assurances that we will be able to successfully implement our expansion plans. As we enter the training/simulation market, we face all of the risks, expenses, and difficulties frequently encountered in connection with the expansion and development of a new business, difficulties in maintaining delivery schedules if and when volume increases, the need to develop support arrangements for systems at widely-dispersed physical locations, and the need to control operating and general and administrative expenses.

In October of 2005, we announced our intention to acquire three electronic manufacturing services companies: Chrysalis Manufacturing d/b/a Altatron EMS; Dynalyst Manufacturing Corporation; and Suntech, Inc.

In December of 2005, we executed a definitive agreement with Virtra Merger Corporation to acquire three private electronics manufacturing service firms: Altatron International, Inc.; Chrysalis Manufacturing Corporation d/b/a Altatron EMS; and Dynalyst Manufacturing Corporation. Under the terms of the definitive agreement, we would acquire the three companies in a stock-for-stock merger transaction. We are currently in the due diligence phase, and there can be no assurance that the merger will be consummated.

Critical Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

Restatements

Restatements of 2005 information previously reported were made. See Note 12 for

details.

Revenue Recognition

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

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

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

Stock-Based Compensation

We account for our stock compensation arrangements under the provisions of Accounting Principles Board (APB) No. 25 Accounting for Stock Issued to Employees. We provide disclosure in accordance with the disclosure-only provisions of Statement of Financial Accounting Standard (SFAS) No. 123R Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure . Effective January 1, 2006, we adopted FAS 123R using the modified prospective transition method as defined. Under the modified prospective method we will record compensation cost prospectively for the unvested portion as of January 1, 2006, of previously issued and outstanding awards over the remaining vesting period of such awards.

Derivative Financial Instruments

We do not use derivative instruments to hedge exposures to cash flow, market, or

foreign currency risks.

Derivative financial instruments are initially measured at their fair value. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at it fair value and is then re−valued at each reporting date, with changes in the fair value reported as charges or credits to income. For option−based derivative financial instruments, we use the Black−Scholes model to value the derivative instruments. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is reassessed at the end of each

reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non−current based on whether or not net−cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

Results of Operations

Fiscal year ended December 31, 2005 compared to fiscal year ended December 31, 2004.

Total revenue for the year ended December 31, 2005 was $977,358, compared to total revenue of $1,328,180 for the year ended December 31, 2004. This decrease of $350,822, or 26%, resulted primarily the timing of several IVR™ simulator sales which were delivered in the spring of 2006.

Cost of sales and services decreased $196,689, or 23%, to $663,376, for the year ended December 31, 2005, from $860,065 for the year ended December 31, 2004. This decrease is relatively proportionate to the change in revenue.

General and administrative expenses decreased by $859,107, or 31%, to $1,961,543 for the year ended December 31, 2005, from $2,820,650 for the year ended December 31, 2004. The decrease is primarily due to no incentive compensation being granted to senior management in 2005 while approximately $600,000 was granted in 2004. In addition, we accrued $280,000 for the potential settlement of the Legg Mason lawsuit in 2004, and there was no similar expense in 2005. In fact, the lawsuit was settled for a $50,000 cash payment in 2005, and we accordingly recorded a gain on settlement of $230,000.

Interest expense and finance charges increased to $1,321,211 for the twelve months ended December 31, 2005, a 37.9% increase over the $957,912 reported for the same period in 2004. Of this amount, $375,885 resulted from

charges relating to the expense of debt discount upon conversion of convertible debentures referred to in Note 12 to the financial statements.

During 2004, we presented an exchange offer to the holders of certain of our notes payable and obligations under product financing arrangements, whereby the debtholders were allowed to convert their principal and accrued interest to our common stock under one of three options. Under Option A, the debtholder could receive common stock equal to 0.6 shares per dollar of principal amount he or she was owed, and was not required to lock up any of the shares he or she received in the exchange. Under Option B, each debtholder could receive common stock equal to 0.9 shares per dollar of principal amount he or she was owed, but could not sell any of the shares for a period of six months, after which the shares could be sold in six equal monthly installments. During the years ended December 31, 2005 and 2004, we issued 393,400 and 5,303,258 shares, respectively, of our common stock in exchange for the following: (i) $0 and $183,500 in principal and $0 and $49,069 of accrued interest, respectively, on our notes payable, (ii) $0 and $615,531 in principal and $0 and $155,475 of accrued interest, respectively, on our notes payable to stockholders, and (iii) $159,782 and $5,792,176 of principal and interest, respectively, outstanding on our obligations under product financing arrangements. As a result of this debt exchange, we recorded $221,720 and $4,621,415 of forgiveness of debt income in the statement of operations for the years ended December 31, 2005 and 2004, respectively.

In addition to the forgiveness of debt income resulting from the debt exchange agreements, we also wrote off various notes payable and certain other notes payable to stockholders that were settled through a lawsuit settlement. Included in forgiveness of debt income in the statement of operations for the year ended December 31, 2005 and 2004 is $294,500 and $301,085, respectively, related to these settlements.

Liquidity and Plan of Operations

As of December 31, 2005, our liquidity position was extremely precarious. We had current liabilities of $5,308,155, including $494,372 in obligations remaining under the lease financing for the old Ferris Productions virtual reality systems, $2,560,481 in accounts payable and accrued liabilities, and short-term notes payable of $1,095,899, some of which were either demand indebtedness or were payable at an earlier date and were in default. As of December 31, 2005, there was only $185,668 in current assets available to meet those liabilities.

To date we have met our capital requirements by acquiring needed equipment under the Ferris Productions non-cancelable leasing arrangements, through capital contributions, loans from principal shareholders and officers, certain private placement offerings, and through our convertible debentures and equity line financing with Dutchess Private Equities Fund, L.P.

For the year ended December 31, 2005, our net loss was $1,668,270. After taking into account the non-cash items included in that loss, our cash requirements for operations were approximately $1,400,000. In addition, we made capital expenditures of $14,536, and repaid notes and certain advances in the amount of $475,791. To cover these cash requirements, we issued convertible debentures for $1,250,000, received proceeds from the issuance of notes payable and other advances of $405,640, and issued 246,352 shares of our common stock for net cash proceeds of $76,143.

The opinion of our independent auditor for the year ended December 31, 2005 expressed substantial doubt as to our ability to continue as a going concern. We will need substantial additional capital or new lucrative custom application projects to become profitable. In July of 2002, we entered into a financial contract with Dutchess Private Equities Fund, L.P. Under this arrangement, Dutchess is to purchase under an equity line up to $5 million of our common stock over a two-year period. The number of shares we may sell to Dutchess is based upon the trading volume of our stock. Dutchess and several other investors also participated in a private placement of $450,000 in convertible debentures, which has been repaid in full. In February of 2005, we entered into a new financial contract with Dutchess, under which Dutchess is to purchase under a new equity line up to $6 million of our common shares, similar to the 2002 agreement, which will soon be expiring. Additionally, during 2005 we completed two private placements with Dutchess for $1,250,000 in convertible debentures. Based on recent increases in the stock's trading volume following our entry into the training/simulation market, management believes that this equity line will allow us to continue our operations for at least the next 12 months.

Item 7. Financial Statements

VIRTRA SYSTEMS, INC.

TABLE OF CONTENTS

	Pages(s)
Report of Independent Registered Public Accounting Firm	14
Financial Statements:	
Balance Sheet as of December 31, 2005	16
Statement of Operations for the years ended December 31, 2005 and 2004	17
Statement of Cash Flows for the years ended December 31, 2005 and 2004	18
Statement of Stockholders Deficit for the years ended December 31, 2005 and 2004	20
Notes to Financial Statements	21

HAM,

LANGSTON &

BREZINA, L.L.P.

Certified Public Accountants

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

VirTra Systems, Inc.

We have audited the accompanying balance sheet of VirTra Systems, Inc. (the Company) as of December 31, 2005, and the related statements of operations, stockholders deficit and cash flows for the years ended December 31, 2005 and 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VirTra Systems, Inc. as of December 31, 2005, and the results of its operations and its cash flows for the years

ended December 31, 2005 and 2004 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations and at December 31, 2005 is in a negative working capital position and a stockholders deficit position. These factors raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 3 to the financial statements, in 2004 the Company changed its method of accounting for variable interest entities.

As discussed in Note 12 to the financial statements, the Company has restated its financial statements as of and for the year ended December 31, 2005 to correct errors in its accounting for convertible notes payable and related warrants to purchase common stock.

/s/ Ham Langston & Brezina, L.L.P.

Houston, Texas

April 17, 2006, except for note 12 which is August 17, 2007

15

VIRTRA SYSTEMS, INC.

BALANCE SHEET

December 31, 2005

		December 31, 2005
ASSETS		
Cash and cash equivalents	$	764
Accounts receivable		184,904
Costs and estimated earnings in excess of billings on uncompleted contracts		-
Total current assets		185,668
Property and equipment, net		951,630
Capitalized development cost, net		130,815
Total non-current assets		1,082,445
TOTAL ASSETS	$	1,268,113
LIABILITIES AND STOCKHOLDERS' DEFICIT		
LIABILITIES		
Notes payable	$	1,095,899
Obligations under product financing arrangements		494,372
Convertible debentures, net of discount of $613,286		160,760
Derivative liability		692,848
Accounts payable		1,232,779
Accrued liabilities		1,327,702
Advanced held on deposit		183,650
Billings in excess of costs and estimated earnings on uncompleted contracts		84,650
Payable to related party		35,495
Total current liabilities		5,308,155
Redeemable common stock		1,859
Total non-current liabilities		1,859
Total liabilities	$	5,310,014
SHAREHOLDERS' DEFICIT		
Common stock, $.005 par value, 100,000,000 shares authorized, 65,983,600 shares issued and outstanding		329,918

Additional paid in capital		9,050,267
Accumulated deficit		(13,422,086)
Total shareholders' deficit		(4,041,901)
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIT	$	1,268,113

See accompanying notes to financial statements.

VIRTRA SYSTEMS, INC.

STATEMENT OF OPERATIONS

for the years ended December 31, 2005 and 2004

		2005		2004
REVENUE				
Custom applications:				
Training/simulation	$	714,435	$	986,816
Advertising/promotion		167,969		296,864
Other revenue		94,954		44,500
Total Revenues		977,358		1,328,180
Cost of sales and services		663,376		860,065
Gross margin		313,982		468,115
OPERATING EXPENSES				
Gain on legal settlement		(230,000)		-
General and administrative expenses		2,137,469		2,820,650
Loss from operations		(1,593,487)		(2,352,535)
OTHER INCOME AND EXPENSE ITEMS:				
Forgiveness of debt income		516,220		4,922,500
Interest income		66		16
Interest expense and finance charges		(1,321,211)		(957,912)
Gain on embedded derivative liability		708,184		-
Other income		21,958		500
Total other income and expense items		(74,783)		3,965,104
Net income/(loss) before accounting change		(1,668,270)		1,612,569
Cumulative effect of accounting change		-		(46,478)
Net income/(loss)		(1,668,270)		1,566,091

Weighted average shares outstanding basic		62,221,809		51,675,342
Weighted average shares outstanding - fully diluted		62,221,809		52,450,576
Basic net income/(loss) per share:				
Net income/(loss) per share before accounting change	$	(0.03)	$	0.03
Cumulative effect of accounting change		-		-
Net income/(loss) per share	$	(0.03)	$	0.03
Fully diluted net income/(loss) per share:				
Net income/(loss) per share before accounting change	$	(0.03)	$	0.03
Cumulative effect of accounting change		-		-
Net income/(loss) per share	$	(0.03)	$	0.03

See accompanying notes to financial statements.

17

VIRTRA SYSTEMS, INC.

STATEMENT OF CASH FLOWS

for the years ended December 31, 2005 and 2004

	2005	**2004**
Cash flows from operating activities:		
Net income/(loss)	(1,668,270)	1,566,091
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	163,231	100,465
Accrued cost of product financing arrangements and amortization of debt issuance costs	-	656,019
Cumulative effect of accounting change	-	46,478
Forgiveness of debt income	(516,220)	(4,922,500)
Gain on sale of assets	(18,000)	(500)
Derivative liability gain	(708,184)	-
Expense related to derivative liability	215,504	-
Bad debt expense	175,926	148,821
Common stock and options issued for services	155,720	633,900
Gain on settlement of litigation	(230,000)	-
Amortization of debt discount	572,242	-
Changes in operating assets and liabilities:		
Accounts receivable and other	(175,474)	80,423
Billings in excess of costs and estimated earnings	(39,446)	24,770
Accounts payable	224,190	219,360
Accrued liabilities and other	373,722	568,590
Product finance obligations	55,974	-
Net cash used in operating activities	(1,419,085)	(878,083)
Cash flows from investing activities:		
Capital expenditures	(14,536)	(83,754)
Proceeds from sale of assets	18,000	500

Increase in capitalized development costs	-	(196,223)
Common stock redeemed	(173)	(339)
Net cash provided by/(used in) investing activities	3,291	(279,816)
Cash flows from financing activities:		
Proceeds from issuance of notes payable and other advances	405,640	277,500
Proceeds from issuance of common stock	76,143	1,238,421
Payments on notes payable and other advances	(475,791)	(278,326)
Proceeds from convertible debentures	1,250,000	-
Net cash provided by financing activities	1,255,992	1,237,595
Increase (decrease) in cash and cash equivalents	(159,802)	79,696
Cash and cash equivalents, beginning of year	160,566	80,870
Cash and cash equivalents, end of year	764	160,566

Supplemental disclosure of cash flow information:		
Cash paid for interest expense	90,473	36,407
Cash paid for income taxes	-	-
Non-cash investing and financing activity		
Common stock issued upon conversion of debentures	475,954	-
Common stock issued as settlement of accounts payable	-	-
Addition to note payable for late payment penalty	-	48,526
Common stock issued in exchange for notes payable, obligations under product financing arrangements and accrued interest payable	159,782	2,174,336
Cancellation of redeemable common stock	-	83

See accompanying notes to financial statements.

VIRTRA SYSTEMS, INC.

STATEMENTS OF STOCKHOLDERS DEFICIT

for the years ended December 31, 2005 and 2004

	Common Stock				
	Shares	**Amount**	**Additional Paid In Capital**	**Accum. Deficit**	**Total**
Balance at December 31, 2003	48,568,628	242,843	4,174,747	(13,319,907)	(8,902,317)
Common stock issued for services	2,030,000	10,150	619,750	-	629,900
Common stock issued as settlement of accounts payable	225,000	1,125	47,131	-	48,256
Common stock issued for cash	4,294,707	21,474	1,216,947	-	1,238,421
Common stock issued in debt exchange	5,303,258	26,516	2,147,820	-	2,174,336
Effect of stock options vesting	-	-	4,000		4,000
Cancellation of redeemable common stock	16,559	83	-	-	83
Net income				1,566,091	1,566,091
Balance at December 31, 2004	60,438,152	302,191	8,210,395	(11,753,816)	(3,241,230)
Common stock issued for services	394,334	1,971	113,498	-	115,469
Common stock issued for cash	246,352	1,232	74,911	-	76,143
Common stock issued upon conversion of	393,400	1,967	157,815	-	159,782

obligations under financing arrangements					
Stock warrants issued for services	-	-	40,251	-	40,251
Common stock issued upon conversion of debentures	4,511,362	22,557	453,397	-	475,954
Net loss	-	-	-	(1,668,270)	(1,668,270)
Balance at December 31, 2005	65,983,600	329,918	9,050,267	(13,422,086)	(4,041,901)

See accompanying notes to financial statements.

VIRTRA SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS

1.

Background and Summary of Significant Accounting Policies

Background

GameCom, Inc. (GameCom), a Texas corporation, was founded in 1996. Effective September 21, 2001 GameCom merged with Ferris Productions, Inc. (Ferris) (together the Company) and the Company changed its name to VirTra Systems, Inc. (VirTra). The Company is headquartered in Arlington, Texas, with a production facility located in Phoenix, Arizona. The Company develops, manufactures and operates technically advanced personal computer and non-personal computer based products including virtual reality (VR) products for the training/simulation and advertising/promotion markets.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

Restatements

Restatements of 2005 information previously reported were made. See Note 12 for

details.

Revenue Recognition

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

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

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

Concentrations of Credit Risk

Financial instruments which subject the Company to concentrations of credit risk include cash and cash equivalents and accounts receivable.

The Company maintains its cash in well known banks selected based upon management s assessment of the banks financial stability. Balances periodically exceed the $100,000 federal depository insurance limit; however, the Company has not experienced any losses on deposits.

Accounts receivable generally arise from sales of equipment and services to various companies throughout the world. Collateral is generally not required for credit granted. During the years ended December 31, 2005 and 2004 the Company had three customers representing 36% and 85% of its custom application revenue, respectively. Included in accounts receivable at December 31, 2005 is $58,404 or 32% due from one of these three customers.

Cash Equivalents

For purposes of reporting cash flows, the Company considers all short-term investments with an original maturity of three months or less to be cash equivalents.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, which range from three to seven years. Expenditures for major renewals and betterments that extend the original estimated economic useful lives of the applicable assets are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts, and any gain or loss is included in operations.

Capitalized Development Costs

Capitalized development costs consist of direct costs incurred in developing proprietary technology exclusively used in its products and costs incurred in obtaining a patent on such technology. The intangible assets are being amortized on a straight-line basis over a five-year period. As of December 31, 2005, accumulated amortization of these intangible assets is $65,408. During the years ended December 31, 2005 and 2004, the Company recorded amortization expense of $65,408 and $0, respectively. During the year ended December 31, 2005 the Company did not capitalize any additional development costs.

Debt Issuance Costs

Debt issuance costs are deferred and recognized, using the interest method, over the term of the related debt.

Shipping and Delivery Costs

The cost of shipping and delivery is charged directly to cost of sales and service at the time of shipment.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred income taxes are recorded to reflect the tax consequences on future years of temporary differences between the tax basis of assets and liabilities and their financial amounts at year-end. The Company provides a valuation allowance to reduce deferred tax assets to their net realizable value.

Income (Loss) Per Share

Basic income (loss) per share is computed on the basis of the weighted average number of shares of common stock outstanding during each period. Diluted income (loss) per share is calculated by adjusting the outstanding shares by common equivalent shares from common stock options and warrants.

Stock-Based Compensation

The Company accounts for its stock compensation arrangements under the provisions of Accounting Principles Board (APB) No. 25 Accounting for Stock Issued to Employees . The Company provides

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disclosure in accordance with the disclosure-only provisions of Statement of Financial Accounting Standard (SFAS) No. 123 Accounting for Stock-Based Compensation . Under APB 25, because the exercise price of the Company s employee stock options is greater than or equals the market price of the underlying stock on the date of grant, no compensation expense has been recognized.

Proforma information regarding net income and earnings per share is required by Statement 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model, with the following weighted average assumptions for 2004: risk free interest rate of 4%; no dividend yield; weighted average volatility factor of the expected market price of the Company s common stock of 71%; and a weighted average expected life of the options and warrants of 1 to 5 years. For purposes of proforma disclosures, the estimated fair value of the options is included in expense at the date of issuance, as required by Statement 123. There were no stock options or warrants granted to employees during 2005. The Company s proforma information is as follows:

	2005	2004
Net income (loss) before accounting change as reported	$(1,668,270)	$1,612,569
Net income (loss) before accounting change proforma	$(1,668,270)	$ 837,769
Basic income (loss) per share-as reported	$ (0.03)	$ 0.03
Basic income (loss) per share-proforma	$ (0.03)	$ 0.02
Diluted income (loss) per share-as reported	$ (0.03)	$ 0.03
Diluted income (loss) per share-proforma	$ (0.03)	$ 0.02

The Black-Scholes option valuation model was developed for use in estimating fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Impairment of Long-Lived Assets

In the event that facts and circumstances indicate that the carrying value of a long-lived asset, including associated intangibles, may be impaired, an evaluation of recoverability is performed by comparing the estimated future undiscounted cash flows associated with the asset or the asset s estimated fair value to the asset s carrying amount to determine if a write-down to market value or discounted cash flow is required.

Fair Value of Financial Instruments

The Company includes fair value information in the notes to financial statements when the fair value of its financial instruments is different from the book value. When the book value approximates fair value, no additional disclosure is made.

Reclassification

Certain amounts reported in the prior period financial statements have been reclassified to the current period presentation.

Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks. Derivative financial instruments are initially measured at their fair value. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at it fair value and is then re−valued at each reporting date, with changes in the fair value reported as charges or credits to income. For option−based derivative financial instruments, the Company uses the Black−Scholes model to value the derivative instruments. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is reassessed at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non−current based on whether or not net−cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

Recently Issued Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities . In December 2003, the FASB issued a revision to FIN 46 (FIN 46R). FIN 46R clarifies the application of ARB No. 51, Consolidated Financial Statements , to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support provided by any parties, including the equity holders. FIN 46R requires the consolidation of these entities, known as variable interest entities, by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity s expected losses, receive a majority of the entity s expected residual returns, or both. Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies that are small business issuers to the end of the first reporting period ending after December 15, 2004, except that all public companies must, at a minimum, apply the unmodified provisions of the Interpretation to entities that were previously considered special-purpose entities in practice and under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003. FIN 46R requires entities to either (a) record the effects prospectively with a cumulative effect adjustment as of the date on which FIN 46R is first applied, or (b) restate previously issued financial statements for the years with a cumulative effect adjustment as of the beginning of the first year being restated. The Company did not have any special purpose entities but does have an entity that qualifies as a variable interest entity under FIN 46R (See Note 3).

In December 2004, FASB issued SFAS No. 123R, Share Based Payments . The statement requires public companies to measure the cost of employee services in exchange for an award of equity instruments to be based on the grant-date fair value of the award as determined by using an option-pricing model. This statement eliminates the alternative to use APB No. 25 s intrinsic value method of accounting that was provided in Statement No. 123 as originally issued.

The statement also clarifies and expands Statement No. 123 s guidance in several areas, including measuring fair value, classifying an award as equity or as a liability, and attributing compensation cost to reporting periods. For entities that file as a small business issuer, the effective date of this statement is the beginning of the first interim or annual reporting period that begins after December 15, 2005. The Company adopted SFAS No. 123R effective January 1, 2006, using the modified prospective method. This method applies the fair value based method to new awards and to awards modified, repurchased or cancelled after the required effective date. Also, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the service is rendered on or after the required effective date. Any options issued subsequent to January 1, 2006 will be accounted for under SFAS No. 123R.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs . The new Statement amends ARB No. 43, Chapter 4, Inventory Pricing , to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. This Statement requires that those items be recognized as current period charges and requires that allocation of fixed production overhead to the cost of

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conversion be based on the normal capacity of the production facilities. This Statement is effective for fiscal years beginning after June 15, 2005. The adoption of this statement on January 1, 2006, did not have a material impact on the Company s financial condition or results of operations.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets - An Amendment of APB Opinion No. 29 . SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is to be applied prospectively for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of this statement on January 1, 2006, did not have a material impact on the Company s financial condition or results of operations.

In May 2005, the FASB issued SFAS no. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 . In addition to replacing APB Opinion No. 20 and FASB Statement No. 3, it changes the requirements for the accounting for and reporting a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This Statement is effective for fiscal years beginning after December 15, 2005. The adoption of this statement on January 1, 2006 did not have a material impact on the Company s financial position or results of operations.

2.

Going Concern Considerations

During the years ended December 31, 2005 and 2004, the Company has defaulted on its notes payable and obligations under product financing arrangements, has continued to accumulate payables to its vendors and has experienced negative financial results as follows:

	2005	2004
Net income (loss)	($1,668,270)	$1,566,091
Negative cash flows from operations	($1,419,085)	$(878,083)

Negative working capital	($5,122,487)	$(4,470,338)
Accumulated deficit	($13,422,086)	$(11,753,816)
Stockholders deficit	($4,041,901)	$(3,241,230)

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

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

The Company is also attempting to raise funds through debt and/or equity offerings. If successful, these additional funds would be used to pay down debt and for working capital purposes.

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

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

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

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

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

3.

Accounting Change

On December 31, 2004, the Company adopted FASB Interpretation No. 46R (FIN 46R), Consolidation of Variable Interest Entities (Revised) . This accounting change added assets and liabilities to the balance sheet as of that date resulting from the consolidation of Ferris Holdings, L.L.C., which was previously not included in the financial statements. Ferris Holdings, L.L.C. is an entity 100% owned by an officer/director of the Company. This entity s only asset is the land and building in Phoenix, Arizona that is currently leased by the Company. Since the Company also guarantees performance on the entities debt related to this property, the Company has an implicit variable interest in this entity. This accounting change resulted in $827,263 of additional property and equipment, net of accumulated depreciation, a $67,885 reduction in note receivable from a related party, and $805,856 of additional notes payable, but did not require an adjustment to earnings and is not expected to affect future earnings or cash flows. The accounting change did result in a loss of $(46,478), which is reported as a Cumulative effect of accounting change in the accompanying statement of operations.

4.

Accounts Receivable

Accounts receivable consist primarily of amounts due from certain companies for the purchase of equipment and services. An allowance for doubtful accounts is provided, when appropriate, based on past experience and other factors which, in management s judgment, deserve current recognition in estimating probable bad debts. Such factors include circumstances with respect to specific accounts receivable, growth and composition of accounts receivable, the relationship of the allowance for doubtful accounts to accounts receivable and current economic conditions. As of December 31, 2005 all accounts receivable are considered collectible and the allowance for doubtful accounts is $0.

5.

Custom Application Contracts

Costs, estimated earnings and billings on uncompleted custom application contracts at December 31, 2005 are summarized below.

Costs incurred on uncompleted contracts	$ 164,269
Estimated earnings	195,865
	360,134
Billings to date	(268,858)
	$ 91,276

These amounts are included in the accompanying balance sheet under the following captions:

Costs and estimated earnings in excess of billings on uncompleted contracts	$ 91,276

Billings in excess of costs and estimated earnings on uncompleted contracts	$ -

6.

Property and Equipment

Property and equipment consisted of the following at December 31, 2005:

Land	$ 140,000
Building	774,705
Computer equipment	330,222
Office furniture and equipment	196,413
	1,441,340
Less: accumulated depreciation	(489,710)
Property and equipment, net	$ 951,630

Depreciation expense for the years ended December 31, 2005 and 2004 was $97,823 and $82,332, respectively.

7.

Notes Payable

Notes payable consist of the following at December 31, 2005:

Note payable to a bank, bearing interest at 7.75% per year and due in monthly payments of $8,520 including interest, through May 31, 2006, at which time the monthly payment amount will increase as agreed upon with the bank at that time. This note is collateralized by land and a building.	$773,933
Notes payable to a bank, bearing interest at 7.5% per year and due in monthly payments of $9,750, including interest, through May 31, 2006, at which time the monthly payment amount will increase as agreed upon with the bank at that time. These notes are collateralized by certain equipment, licensing rights and by the personal guarantees of officers/stockholders of the Company.	255,466
Notes payable to third party entities and individuals, who did not elect to exchange the debt for common stock (See Note 9), bearing interest at a stated rate of 10% payable semi- annually with principal due three years after issuance of the note, which ranged from October 2001 to March 2002. These notes are not collateralized. In connection with the funding of these notes, the former Ferris issued a total of 412,500 shares of its common stock as equity attachments to the note holders and to pay debt issuance costs. Accordingly, the actual weighted average interest rate on these notes, including the effect of the issuance of common stock and the payment of debt issuance costs, was approximately 16%. No interest or principal has been paid on these notes during the year ended December 31, 2005.	66,500
Total notes payable	$1,095,899

Certain notes payable to banks contain various financial and non-financial covenants, which require the Company, among other things, to maintain certain levels of stockholders equity and to comply with certain financial ratios. The Company was in violation of these covenants as of December 31, 2005 and the banks could demand full payment of all principal and interest.

27

8.

Obligations Under Product Financing Arrangements

In financing the production of its arcade equipment, the Company had entered into agreements whereby an entity or individual advanced funds to the Company to produce specific arcade equipment. Under this arrangement, the Company had agreed to make monthly payments for a specified amount for three years, with an automatic renewal for an additional three years unless cancelled in writing, from the origination date as specified in the agreement. In addition, the entity or individual advancing the funds had the right to exercise a buy-out whereby the Company has 180 days to repay the obligation upon exercise of the buy-out. Interest is payable monthly at an annual rate of approximately 16%.

In connection with these financing arrangements, the Company had incurred debt issuance costs of approximately 21% of the total obligation. These costs were amortized over a three year period using the interest method resulting in an effective annual interest rate of approximately 29% on these obligations.

As of December 31, 2005, the Company was in default on its remaining obligations under the product financing arrangements (See Note 9) totaling $494,372, which included accrued interest. The Company has not made any interest payments on these obligations since September 2001 and has received notices from various individuals and entities demanding buyouts of these obligations.

9.

Debt Exchange Agreement

During 2004, the Company presented an exchange offer to the holders of certain of its notes payable and obligations under product financing arrangements whereby the debt holders were allowed to convert the principal and accrued interest related to its debt to common stock of the Company under one of three options. Under Option A, the debt holder could receive common stock equal to 0.6 shares per dollar of principal amount he or she was owed, and was not required to lock up any of the shares he or she receives in the exchange. Under Option B, each debt holder could receive common stock equal to 0.9 shares per dollar of principal amount he or she was owed, but could not sell any of

the shares for a period of six months, after which the shares could be sold in six equal monthly installments. Under Option C, each debt holder could receive common stock equal to 1.2 shares per dollar of principal amount he or she was owed, but could not sell any of the shares for a period of one year, after which the shares could be sold in six equal monthly installments. During the years ended December 31, 2005 and 2004, the Company issued 393,400 and 5,303,258 shares of its common stock in exchange for the following: (i) $0 and $183,500 in principal and $0 and $49,069 of accrued interest, respectively on its notes payable (ii) $0 and $615,531 in principal and $0 and $155,475 of accrued interest, respectively on its notes payable to stockholders and (iii) $159,782 and $5,792,176 of principal and interest, respectively, outstanding on its obligations under product financing arrangements. As a result of this debt exchange, the Company recorded $221,720 and $4,621,415 of forgiveness of debt income in the statement of operations for the years ended December 31, 2005 and 2004, respectively.

10.

Forgiveness of Debt

In addition to the forgiveness of debt income resulting from the Debt Exchange Agreement (See Note 9), the Company also wrote off various notes payable and certain other notes payable to stockholders that were settled through a lawsuit settlement. Included in forgiveness of debt income in the statement of operations for the year ended December 31, 2005 and 2004 is $294,500 and $301,085, respectively, related to these settlements.

11.

Accrued Liabilities

Included in accrued liabilities as of December 31, 2005 is as follows:

Accrued payroll tax, including penalties and interest	$ 810,188
Accrued property tax	55,133
Accrued interest payable	322,279
Deferred revenue	97,095
Accrued commissions payable	33,258
Other	9,749
	$1,327,702

12. Convertible Debentures

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

In addition the Company issued to the holders of the convertible debentures warrants to purchase 750,000 and 500,000 shares of the Company s common stock (See Note 15).

Based on the guidance in SFAS 133 and EITF 00-19, the Company concluded that these instruments were required to be accounted for as derivatives. SFAS 133 and EITF 00-19 require the Company to bifurcate and separately account for the conversion features of the convertible debentures and warrants issued as

embedded derivatives.

Pursuant to SFAS 133, the Company bifurcated the conversion feature from the debentures because the conversion price is not fixed and the debentures are not convertible into a fixed number of shares. Accordingly, the embedded derivative must be bifurcated and accounted for separately.

Furthermore, the Company concluded that the exercise price and the number of shares to be issued under the warrants are not fixed. Therefore, exercise of these warrants and these debentures might result in issuing an indeterminate number of shares, and it cannot be concluded that the Company has a sufficient number of authorized shares to settle these warrants. As such, the warrants were accounted for as derivative instrument liabilities. The Company is required to record the fair value of the conversion features and the warrants on its balance sheet at fair value with changes in the values of these derivatives reflected in the statement of operations as "Gain (loss) on embedded derivative liability." The derivative liabilities were not previously classified as such in the Company's historical financial statements. In order to reflect these changes, the Company is concurrently restating its financial statements for the year ended December 31, 2005 and 2006.

The impact of the application of SFAS No. 133 and EITF 00-19 on the balance sheet as of December 31, 2005 is as follows:

	Liability Amount
Convertible debentures, face amount	774,046
Unamortized discount of conversion feature	(613,286)
Embedded derivative liability - warrants	692,848

Total	853,608

The impact on statements of operations for this restatement for the year ended December 31, 2005 is as follows:

	As previously reported	Adjustments		Restated 12/31/2005
Interest Expense	(939,813)	381,398	(a)	(1,321,211)
Gain on embedded derivative liability	-	(708,184)	(b)	(708,184)
Net Loss	$(1,995,056)	(326,786)		$(1,668,270)
EPS	$(0.03)	-		$(0.03)

(a)To adjust interest expense for discount amortization associated with the bifurcation of the embedded derivatives.

(b) To record the fair value of derivatives from inception through December 31, 2005 net of bifurcation.

13.

Income Taxes

The Company has incurred losses since its inception and, therefore, has not been subject to federal income taxes. As of December 31, 2005, the Company had net operating loss (NOL) carryforwards for income tax purposes of approximately $11,375,000 which expire in various tax years through 2025. Under the provisions of Section 382 of the Internal Revenue Code the ownership change in the Company that resulted from the merger of the Company could severely limit the Company s ability to utilize its NOL carryforward to reduce future taxable income and related tax liabilities. Additionally, because United States tax laws limit the time during which NOL carryforwards may be applied against future taxable income, the Company may be unable to take full advantage of its NOL for federal income tax purposes should the Company generate taxable income.

The composition of deferred tax assets and liabilities and the related tax effects at December 31, 2005 are as follows:

Deferred tax assets:	
Net operating losses	$3,868,243
Intangible assets	18,493
Valuation allowance	(3,863,327)
Total deferred tax assets	23,409
Deferred tax liabilities:	
Property and equipment	(23,409)
Total deferred tax liability	(23,409)
Net deferred tax asset (liability)	$ -

30

The difference between the income tax benefit in the accompanying statement of operations and the amount that would result if the U.S. Federal statutory rate of 34% were applied to pre-tax loss for the years ended December 31, 2005 and 2004 is as follows:

	2005		2004	
	Amount	%	Amount	%
Provision (benefit) for income tax at federal statutory rate	$(567,211)	(34.0)	$ 548,273	34.0
Increase (decrease) in valuation allowance	562,758	33.7	(860,556)	(53.4)
Non-deductible interest and financing costs	27,050	1.6		-
Non-deductible compensation expense	52,945	3.2	215,526	13.4
Non-deductible lawsuit (gain) loss	(78,200)	(4.7)	95,200	5.9
Other	2,658	0.2	1,557	0.1
	$ -	0.0	$ -	0.0

14.

Redeemable Common Stock

In 1997 the Company entered into an agreement to redeem 1,505,399 shares of common stock from certain stockholders at par value of $.005 per share with the consideration for such redemption to be paid pro-rata to such stockholders by March 31, 1998. During 2000 the Company and stockholders released 727,108 shares of common stock from the redemption requirement and 287,531 shares were redeemed. During 2004 the Company released an additional 16,559 shares of common stock from the redemption requirement and 67,743 shares of common stock were redeemed. During 2005, the Company redeemed 34,624 shares of common stock. As of December 31, 2005, 371,834 shares remain to be redeemed at the option of the Company.

15.

Stock Options and Warrants

The Company periodically issues incentive stock options to key employees, officers, directors and outside consultants to provide additional incentives to promote the success of the Company s business and to enhance the ability to attract and retain the services of qualified persons.

In September 2001 the Company s stockholders amended the 2000 Incentive Stock Option Plan (the Plan). The stockholders have authorized 6,000,000 shares for the Plan and options granted under the Plan may be either incentive stock options or non-statutory stock options subject to certain restrictions as specified in the Plan. During the years ended December 31, 2005 and 2004, no options have been granted to employees under this Plan. As of December 31, 2005, options to purchase 100,000 shares of common stock are outstanding under the Plan.

Effective September 1, 2003, the Company granted stock options to purchase 1,000,000 shares of common stock at $0.10 per share to an employee. Options to purchase 200,000 shares are considered vested and exercisable upon the employee generating $600,000 of revenue for the Company during the first year of employment. Options to purchase 300,000 shares are considered vested and exercisable upon the employee generating $1,200,000 of revenue for the Company during the second year of employment. Options to purchase 500,000 shares are considered vested and exercisable upon the employee generating $1,500,000 of revenue for the Company during the third year of employment. These options expire at the end of each respective year if the revenue amounts are not achieved. As of December 31, 2004 options to purchase 200,000 shares of common stock became vested and exercisable resulting in compensation expense of $4,000. As of December 31, 2005 options to purchase 300,000 shares of common stock expired as the revenue target was not met. These options expire five years from the date they become vested.

Effective November 1, 2004, the Company granted options to purchase 4,000,000 shares of common stock to its CEO. These options become vested and exercisable as follows: (i) 2,000,000 shares at an exercise price of $0.31 per share upon 85% conversion of debt to equity related to the Debt Exchange Agreement (See Note 9); (ii) 1,000,000 shares at an exercise price of $0.31 per share upon the Company s first profitable quarter; and (iii) 1,000,000 shares at an exercise price of $0.005 per share upon the Company achieving positive stockholders equity. As of December 31, 2004, options to purchase 3,000,000 shares of common stock at an exercise price of $0.31 per share, which approximated fair value at the grant date, became vested and exercisable. During the year ended December 31, 2005 no additional options became vested and exercisable. These options expire on October 31, 2009.

Effective November 1, 2004, the Company granted options to purchase 1,000,000 shares of common stock to its President with an exercise price of $0.31 per share, which approximated fair market value at the grant date. These options became vested and exercisable upon the Company s first profitable quarter. As of December 31, 2004, these options were fully vested and exercisable and expire on October 31, 2009.

A summary of the Company s stock option activity and related information for the years ended December 31, 2005 and 2004 follows:

	Number of Shares Under Options	Weighted-Average Exercise Price
Outstanding December 31, 2003	4,173,000	$0.12
Granted	5,000,000	$0.25
Exercised	-	-
Forfeited/cancelled	(3,073,000)	$0.005
Outstanding December 31, 2004	6,100,000	$0.22
Granted	-	-
Exercised	-	-
Forfeited/cancelled	(300,000)	$0.10
Outstanding December 31, 2005	5,800,000	$0.23
Exercisable December 31, 2005	4,300,000	$0.30

Following is a summary of outstanding stock options at December 31, 2005:

Number of Shares	Vested	Expiration Date	Weighted Average Exercise Price
100,000	100,000	2012	$0.21
700,000	200,000	2009	$0.10
1,000,000	-	2009	$0.005
4,000,000	4,000,000	2009	$0.31
5,800,000	4,300,000		

In July 2002, the Company entered into an agreement for up to a maximum $5,000,000 sale of its common stock to Dutchess Private Equities Fund, LP (Dutchess). Under this investment agreement the Company has the right to issue a put notice to Dutchess to purchase the Company s common stock. Put notices cannot be issued more frequently than every seven days. The required purchase price is equal to 92% of

the average of the four lowest closing bid prices of the common stock during the five-day period immediately following the issuance of the put notice. Each individual put notice is subject to a maximum amount equal to 175% of the daily average volume of the common stock for the 40 trading days before the issuance of the put notice multiplied by the average of the closing bid prices of the common stock for the three trading days immediately preceding the put notice date. Regardless of the amount stated in a put notice, the maximum amount that Dutchess is required to purchase is the lesser of the amount stated in the put notice or an amount equal to 20% of the aggregate trading volume of the common stock during the five days immediately following the date of the put notice times 92% of the average of the four lowest closing bid prices of the common stock during this five-day period. During the year ended December 31, 2005 and 2004 the Company received $76,142 and $1,238,421, respectively of net proceeds from the issuance of 246,352 and 4,294,707 shares, respectively, of its common stock related to this agreement.

In February 2005, the Company entered into a new investment agreement with Dutchess for up to a maximum $6,000,000 sale of its common stock. Under this investment agreement the Company has the right to issue a put notice to Dutchess to purchase the Company s common stock. Put notices cannot be issued more frequently than every seven days. The required purchase price is equal to 92% of the average of the four lowest closing bid prices of the common stock during the five-day period immediately following the issuance of the put notice. Each individual put notice is subject to a maximum amount equal to 175% of the daily average volume of the common stock for the 40 trading days before the issuance of the put notice multiplied by the average of the closing bid prices of the common stock for the three trading days immediately preceding the put notice date. Regardless of the amount stated in a put notice, the maximum amount that Dutchess is required to purchase is the lesser of the amount stated in the put notice or an amount equal to 20% of the aggregate trading volume of the common stock during the five days immediately following the date of the put notice times 92% of the average of the four lowest closing bid prices of the common stock during this five-day period. During the year ended December 31, 2005, no shares of common stock were issued under this agreement. For the accounting treatment of this investment agreement, see Note 12.

A summary of the Company s stock warrant activity and related information is as follows:

	Number of Shares	**Weighted Average Exercise Price**
Outstanding at December 31, 2003	996,703	$0.38
Granted	-	-

Exercised	-	-
Forfeited	-	-
Outstanding at December 31, 2004	996,703	$0.38
Granted	1,750,000	$0.29
Exercised	-	-
Forfeited	-	-
Outstanding at December 31, 2005	2,746,703	$0.29

In connection with the issuance of Convertible Debentures in 2005 (see note 12) the Company issued stock warrants to purchase 500,000 shares of the Company s common stock at $0.33, 250,000 shares of the Company s common stock at the lowest market price five days prior to funding and 500,000 shares of the Company s common stock at $0.19 per share. These warrants are exercisable over a 5 year period.

During August of 2005, the Company issued stock warrants to a consultant to purchase 500,000 shares of the Company s common stock at prices ranging from $0.25 to $0.40 per share. These warrants vest upon grant and are exercisable over a three-year period. Using the Black-Scholes Option Pricing Model with the following assumptions: (i) volatility of 101%, and (ii) interest rate of 4.37%, the value of the warrants were estimated to be $20,429 which was recorded as selling, general and administrative expense in the statement of operations for the year ended December 31, 2005.

16.

Net Income (Loss) Per Share

Basic earnings per share is calculated using the weighted average shares of common stock outstanding during the periods. Diluted earnings per share is calculated using the weighted average number of common and potentially dilutive common shares outstanding during the period, using the as-if converted method for convertible preferred stock, convertible secured debentures and convertible secured promissory notes, and the treasury stock method for options and warrants.

For the year ended December 31, 2004, potentially dilutive securities, which consist of warrants to purchase 500,000 shares of common stock at an exercise price of $0.71 per share were not included in the computation of diluted net income per share because such inclusion would be antidilutive. For the year ended December 31, 2005, all of the outstanding stock options and warrants were not included in the computation of diluted net income (loss) per share since such inclusion would be antidilutive.

The following table sets for the computation of basic and diluted net income (loss) per share for the years ended December 31, 2005 and 2004:

	2005	2004
Numerator:		
Net income (loss) before accounting change	$(1,668,270)	$1,612,569
Denominator:		
Denominator for basic calculation weighted average shares	62,221,809	51,675,342

Dilutive common stock equivalents:		
Stock options	-	341,246
Stock warrants	-	433,988
Denominator for diluted calculation weighted average shares	62,221,809	52,450,576
Net income (loss) per share:		
Basic net income (loss) per share	$ (0.03)	$ 0.03
Diluted net income (loss) per share	$ (0.03)	$ 0.03

17.

Commitments and Contingencies

Lease Obligations

The Company rents office space in Arlington, Texas on a month-to-month basis at $1,500 per month from an officer and stockholder of the Company. No payments were made during the years ended December 31, 2005 and 2004. Included in accounts payable at December 31, 2005 is $75,750 owed to the officer and stockholder for this rent. Included in the statement of operations for the years ended December 31, 2005 and 2004 is rent expense of $18,000 each year related to this lease.

Employment Contract

Effective September 1, 2003, the Company entered into a contract with an employee whereby the employee is to receive a base salary and a four percent cash commission on all sales originated by the employee. In addition, the employee is entitled to receive options to purchase 1,000,000 shares of the Company s common stock with an exercise price of $0.10 per share, if certain sales targets are achieved for each of the next three years. If the sales targets are not achieved, the stock options will not be exercisable. As of December 31, 2004 the sales target in the first year was achieved, therefore, options to purchase 200,000 shares of common stock became exercisable. During December 31, 2005 the sales target in the second year was not achieved, therefore, options to purchase 300,000 shares of common stock were cancelled (See Note 15).

Litigation

On May 8, 2003, the Company filed a declaratory judgment lawsuit in the 348th state district court of Tarrant County, Texas against Legg Mason Wood Walker Incorporated and the Depository & Clearing Corporation. In this suit, the Company refers to the district court s prior ruling that the Company s cancellation of shares of the common stock formerly in the name of William E. K. Hathaway II c/o Olympic Holdings, L.L.C. was proper, and in this suit the Company seeks a further judicial determination that Hathaway s subsequent endorsement of his certificate to these companies was ineffective, as the certificate was no longer genuine and could not be registered, and, further due to other alleged irregularities, resulting in the Company having no liability to these companies. The Company subsequently dismissed Depository & Clearing Corporation from the lawsuit without prejudice. On July 2, 2003, Legg Mason counterclaimed against the Company for $277,855, representing the costs Legg Mason endured when required to purchase 700,000 shares of the Company s stock on the open market to cover its short position resulting from the Company s transfer agent s confiscation of the certificate originally issued to Mr. Hathaway. On March 16, 2005, the court granted Legg Mason s motion for summary judgment, and entered judgment in favor of Legg Mason against the Company for $277,855. As of December 31, 2004 the Company had recorded $280,000 in accrued liabilities related to this case. During 2005 this lawsuit was settled for a $50,000 cash payment and the Company recorded a gain on settlement related of this case of $230,000.

The Company is also involved in litigation related to its delinquent repayment of certain of its obligations under product financing arrangements, notes payable to stockholder and accounts payable to vendors. Management believes that such litigation will not have a material impact on the Company s financial position, results of operations or cash flows as the amounts owed to these individuals and entities have been accrued in the accompanying balance sheet.

The Company is currently a party to certain other litigation arising in the normal course of business. Management believes that such litigation will not have a material impact on the Company s financial position, results of operations or cash flows.

18.

Related Party Transactions

During November 2004, the Company issued 1,000,000 shares of common stock to its CEO and 1,000,000 shares of common stock to a member of its board of directors for services provided to the Company during 2004. Based on the fair market value of the common stock at the date of issuance, the Company recorded $620,000 of compensation expense in its statement of operations for the year ended December 31, 2004.

Included in accounts payable in the December 31, 2005 balance sheet is $403,898 and $75,750 payable to a firm which is owned by an officer/stockholder of the Company for legal services and office rent, respectively (See Note 17).

19.

Subsequent Events

On January 10, 2006 the Company entered into an agreement to merge with a newly-formed entity, Virtra Merger Corporation, which in anticipation of the merger, is to acquire Altatron International, Inc., Chrysalis Manufacturing Corporation and Dynalist Manufacturing.

The Companies are currently in the due diligence phase, however, there can be no assurance that the acquisition will be consummated.

20.

Restatement

The Company has restated its annual financial statements from amounts previously reported on December 31, 2005. The Company previously recorded the convertible features of its debt as a beneficial conversion feature and reflected such discount as a reduction in the debt. The Company has determined that certain financial instruments issued by the Company contain features that require the Company to account for these features as derivative instruments. Accordingly, the debentures and associated warrants have been accounted for as derivative instrument liabilities rather than as equity. Additionally, the embedded conversion features of the debentures and warrants related to the debt have been bifurcated from the debt and accounted for separately as derivative instrument liabilities. Note 12 was amended to disclose the derivative instrument liabilities and provide information on subsequent changes.

The Company is required to record the fair value of the conversion features and the warrants on the balance sheet at fair value with changes in the values of these derivatives reflected in the statement of operations as "Gain (loss) on derivative instrument liabilities." The effect of the (non-cash) changes related to accounting separately for these derivative instrument liabilities and modifying the estimated volatility, on the statement of operations for the year ended December 31, 2005 was a decrease in the net loss attributable to common

shareholders of $326,786. This restatement had no material impact on net loss per share available to common shareholders.

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

Not applicable.

Item 8A. Controls and Procedures.

Based upon the accounting error which is the subject of this restated 10-KSB/A, our chief executive officer and chief financial officer has concluded that our disclosure controls and procedures are not effective to ensure that material information relating to our company is made known to management, including the chief executive officer and chief financial officer, particularly during the period when our periodic reports are being prepared, and that our internal controls are effective to provide reasonable assurance that our financial statements are fairly presented in conformity with generally accepted accounting principles.

In accord with SEC requirements, the chief executive officer and chief financial officer notes that, since the date of his evaluation to the date of this annual report, there have been no significant changes in internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

Item 8B.

Other Information.

N/A

PART III

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

The following table sets forth the names and ages of our current directors and executive officers, the principal offices and positions held by each person, and the date such person became our director or executive officer.

Name	Age	Positions	Date became director or executive officer
L. Kelly Jones	52	chief executive officer and chairman of the board of directors	March 26, 1997
Bob Ferris	34	president and director	September 21, 2001
J. David Rogers	52	chief financial officer	March 14, 2006
L. Andrew Wells	37	director	September 21, 2001
Kimberly Biggs	39	secretary and treasurer	March 26, 1997

The members of our board of directors are elected annually and hold office until their successors are elected and qualified. Our officers are chosen by and serve at the pleasure of its board of directors. Some of the officers and directors have positions of responsibility with other businesses and will devote only such time as they believe necessary on our business.

There are no family relationships between any of the directors and executive officers, other than Messrs. Ferris and Wells being brothers-in-law. There was no arrangement or understanding between any executive officer and any other person pursuant to which any person was selected as an executive officer.

We do not have a separate audit committee.

L. Kelly Jones has since 1980 been a member of the law firm Jones & Cannon, a firm which he founded and which provides legal services to us. Mr. Jones is certified in the area of commercial real estate law by the Texas Board of Legal Specialization and is the author of an article, "Texas Mechanics' and Materialmen's Lien Laws: A Guide Through the Maze," which appeared in the Texas Bar Journal in March of 1985. Mr. Jones' areas of practice include corporate, construction, real estate, municipal law, and commercial litigation. Mr. Jones served from 1985 through 1989 on the Arlington City Council, and on the Stephen F. Austin State University Board of Regents from 1987 through 1993, where he was chairman from 1991 through 1993. He holds a juris doctorate degree from the University of Texas and a bachelor of arts degree in political science from Stephen F. Austin State University.

Bob Ferris became our president in September of 2001. He previously had been the president of the former Ferris Productions, Inc. since he founded that company in 1993. Mr. Ferris attended the United States Air Force Academy with a major in management. He received a degree in systems engineering from the University of Arizona.

J. David Rogers became our chief finacial officer in March of 2006. Since 2005, he has served as vice-president of corporate finance for CapNet Securities Corporation, a Houston-based NASD broker/dealer and investment bank. In addition to his executive responsibilities, he is a member of the corporate transactions team which focuses on fee-for-service professional services relating to due diligence and capital formation. From January of 2004, Mr. Rogers previously served as an analyst for CapNet Securities, and, prior to that, for The Dorato Group, which was then an affiliated company of CapNet Securities. In July, 2002, he joined Institutional Capital Management, Inc. in its fixed income department. From 1998 through 2001, Mr. Rogers was with The Tribo Companies, Houston based group of independent oil and gas exploration and production companies. He was the assistant controller of Tri-Union Development Corporation and its subsidiary, and Controller of the other companies in the group. Mr. Rogers, 52, served earlier in his career in operating and staff management positions for divisions of Dresser Industries, NL Industries and The Hughes Tool Company. He holds bachelor of science and masters in business administration degrees from Southern Methodist University, and NASD licenses 7 (general securities), and 63.

L. Andrew Wells since January 1, 2003, has served as president of CapNet Securities Corporation, a Houston-based NASD broker/dealer and investment bank. In addition to his executive responsibilities, he is a member of the corporate transactions team which focuses on fee-for-service professional services relating to due diligence and capital formation. In that role, he also acts as a facilitator assisting companies in dealing with commercial lenders, venture firms, private equity funds, mezzanine and subordinated debt funds, SBICs, angel investors, and non-financial institutions seeking strategic investment or merger partners. Previously, Mr. Wells served as managing partner of CenterPoint Partners, LLC, a Houston-based corporate finance advisory firm formed in January of 2002. CenterPoint is an amalgamation of the former Strategic Securities, Inc. and some other Houston-based regional investment banking groups advisory divisions. From 1997 until 2002, he was the principal of Strategic Securities, Inc., a Houston-based merchant banking firm which he founded in 1997. From June 2000 until March of 2001, Mr. Wells also served on an interim bases as chief financial officer of U. S. Operators, Inc., a San Antonio-based call center which was reorganizing under Chapter 11 of the bankruptcy code. Prior to 1997, Mr. Wells was employed by a regional NASD broker/dealer in Houston, Texas. He holds a bachelor of science degree from Stephen F. Austin State University and NASD licenses 7 (general securities), 63, 65 (registered investment advisor), and 24 (securities principal).

Kimberly Biggs has for the last 16 years been legal administrator of the Arlington law firm of Jones & Cannon (which provides legal services for us) as legal administrator, a position which she holds to this date.

Major General Perry V. Dalby (retired), age 62, has served on our advisory board of directors since January of 2005. In December of 2000, General Dalby assumed command of the 75th Division (training support), and mobilized the division in support of the global war on terrorism in January, 2003. Previously, in 1983, General Dalby was assigned to the 75th Maneuver Area Command, and subsequently assumed command as chief of the Battle Simulation Center, Combat Arms Branch, and as the assistant deputy commander for the 75th Division (Exercise). General Dalby retired from the U.S. Army in May of 2004. General Dalby s 37 years of military service were highlighted by the Distinguished Service Medal, Legion of Merit, Distinguished Flying Cross, Bronze Star (two clusters), and the Purple Heart.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16 of the Securities Exchange Act of 1934, as amended ("Section 16"), requires that reports of beneficial ownership of capital stock and changes in such ownership be filed with the Securities and Exchange Commission (the "SEC") by Section 16 "reporting persons," including directors, certain officers, holders of more than 10% of the outstanding common stock and certain trusts of which reporting persons are trustees. We are required to disclose in this annual report on Form 10-K each reporting person whom we know to have failed to file any required reports under Section 16 on a timely basis during the fiscal year ended December 31, 2005 or prior fiscal years.

Code of Ethics

We have not adopted a code of ethics for our principal executive officer and senior financial officers. The board of directors intends to hold these officers to the highest ethical standards in their conduct of our business, but it does not believe that for a small company like ours formal exhortations to that effect are effective or contribute to that objective. The board of directors also believes that publishing a laundry list of specific prohibitions would be counter-productive, as it would detract from the board of director's objective by encouraging the attitude that all conduct not specifically prohibited is permitted.

Significant Employees

In addition to the officers and directors identified above, the following employees play a significant role in our operations.

Michael Kitchen, age 32, is currently our executive vice-president of training and simulation sales. Mr. Kitchen is responsible for all aspects of our regional, national, and international sales campaigns within the training/simulation market. He is a graduate of The University of Colorado, earning a B.A. degree in economics, with an emphasis in international marketing. Before joining our company, Mr. Kitchen was vice-president of international sales for Interactive Training, Inc. (IES).

Tom Milks, age 44, serves as our vice-president of advertising and promotion sales. Previously, Mr. Milks ran the North American operations office of Virtuality, a virtual reality company. Before joining our company, he was the Western United States sales director for BitFlash, a graphic technology company, based in Ottawa, Ontario, Canada.

Jack Nickel, age 44, became or director of training in February of 2006. Mr. Nickel is retired from the Air Force; he was a member of the 1st Combat Camera Squadron out of Charleston Air Force Base in South Carolina, has seen combat in Iraq, Afghanistan, and Somalia, and has flown in 21 aerial combat sorties, With 24 years of military service and combat experience, Mr. Nickel has been decorated with medals and commendations, including the Air Force Meritorious Service Medal and Air Medal. Mr. Nickel is a graduate of the Air Force NCO academy at Elmendorf AFB, Alaska, in 2000, and the Air Force Senior NCO academy, in Charleston, South Carolina, in 2003. In 2004, Mr. Nickel received his associate of science degree in audio/visual media production from the community college of the Air Force, and his associate of arts degree in general transfer studies from the University of Phoenix.

Steve Haag, age 46, serves as our vice-president of investor relations. Mr. Haag received his bachelors degree in psychology, with a minor in organizational behavior, from Webster University in 1993, and his masters degree in education from the University of Missouri-St. Louis in 1995. Before joining us, he was employed at Connect Computer Group, Inc., the firm which was largely responsible for the development of our kiosk and computer systems.

Matt Burlend, age 32, serves as vice-president of production and senior engineer. Prior to his employment with the former Ferris Productions, Mr. Burlend was employed from 1996 until 1999 at Panduit Corporation, a designer of automated production equipment, as a machine design engineer. Mr. Burlend holds a mechanical engineering degree from Olivet Nazarene University.

Zane Horton, age 28, serves as senior software engineer. He previously had been service manager of the former Ferris Productions, Inc. since he started with that company in 2000. Before joining VirTra Systems, he was employed as an IT technician with Camelback Research Associates, maintaining large-format databases, e-mail

servers, and performed software development using visual BASIC programming. Mr. Horton received his bachelor of science degree in computer information systems from Devry Institute of Technology.

Jason Englebright, age 33, has served as our director of product services since 2005. Prior to his employment with VirTra Systems, Mr. Englebright served ten years in the United States Air Force, where he qualified as expert marksman, and served as both a tactical operations member and instructor, and as non-commissioned officer-in-charge of the Combat Arms (CATM) section at Buckley AFB. Mr. Englebright received his associate of science degree in criminal justice from the Community College of the Air Force in 2005.

Item 10. Executive Compensation

Summary Compensation Table

This summary compensation table shows certain compensation information for services rendered in all capacities during each of the prior three fiscal years.

Name and Principal Position	Year	Salary	Bonus	Other Annual Compensation	Restricted Stock Awards	Securities Underlying Options/SARs
L. Kelly Jones, chief executive officer and chairman of the board of directors	2005	$180,000	-	-	--	-
	2004	$105,000	-	-	$310,000	$0.00 (1)
	2003	$20,000	-	-	-	-
	2005	$120,000	-	-	-	-

Bob Ferris, president and director						
	2004	$90,000		-	-	$0.00 (2)
	2003	$60,000	-	-	-	-
L. Andrew Wells, director	2005	-	-	-	--	-
	2004	-	-	-	$310,000	
	2003	-	-	-	-	
Kimberly Biggs, secretary and treasurer	2005	$26,250	-	-		
	2004	$30,000	-	-	-	
	2003	$16,500	-	-	-	
						$0.00 (3)
Michael Kitchen, executive vice-president of training and simulation sales	2005	$129,000	-	-		-
	2004	$99,000	-	-	-	$4000 (4)
	2003	$33,000	-	-	-	

(1) These options, incentive in nature, provide that Mr. Jones may purchase (i) 2,000,000 common shares at a strike price of $0.31, subject to the condition precedent that we successfully convert 85% of our leaseholder/shareholder promissory note indebtedness to equity upon terms acceptable to our board of directors, (ii) 1,000,000 common shares at a strike price of $0.31, subject to the condition precedent that the we experience our first profitable quarter, and (iii) 1,000,000 common shares at par value, subject to the condition precedent that the company experience a

positive shareholders equity, such options to vest ratably in the four successive quarters after such event. These incentive stock options were granted to Mr. Jones by our board of directors (Mr. Jones abstaining) on November 1, 2004. The options contained in subparagraphs (i) and (ii) vested as of December 31, 2004.

(2) These options, incentive in nature, provide that Mr. Ferris may purchase 1,000,000 common shares at a strike price of $0,31, subject to the condition precedent that we experience our first profitable quarter. These incentive options were granted to Mr. Ferris by our board of directors (Mr. Ferris abstaining) on November 1, 2004. The options vested as of December 31, 2004.

(3) These options were issued under the 2000 Incentive Stock Option Plan, discussed below.

(4) These options, incentive in nature and executed in connection with his employment contract, provide that Mr. Kitchen may purchase 1,000,000 common shares over a three-year period at a strike price of $0.10, subject to certain sales goals being achieved over that time period. As of December 31, 2004, options to purchase 200,000 shares of common stock became vested and exercisable, These options expire five years from the date they become vested.

2000 Incentive Stock Option Plan

In February, 2000, the board of directors adopted, and a majority of the shareholders approved, our 2000 Incentive Stock Option Plan, subject to approval of shareholders at the next annual meeting. The purpose of the plan is to enable us to attract, retain and motivate key employees who are important to the success and growth of our business, and to create a long-term mutuality of interest between our shareholders and those key employees by granting them options to purchase our common stock. Options granted under the plan may be either incentive stock options or non-statutory options. The plan is to be administered either directly by the board, or by a committee consisting of two or more outside directors (the **"Committee"**). Under the plan, options may be granted to our key employees. The option price is to be fixed by the Committee at the time the option is granted. If the option is intended to be an incentive stock option, the purchase price is to be not less than 100% of the fair market value of the common stock at the time the option is granted, or, if the person to whom the option is granted is the owner of 10% or more of our common stock, 110% of such fair market value. The Committee is to specify when and on what terms the options granted to key employees are to become exercisable. However, no option may be exercisable after the expiration of ten years from the date of grant or five years from the date of grant in the case of incentive stock options granted to a holder of ten percent or more of our common stock. In the case of incentive stock options, the aggregate fair market value of the shares with respect to which the options are exercisable for the first time during any calendar year may not exceed $100,000 unless this limitation has ceased to be in effect under Section 422 of the Internal Revenue code. If there is a change of control of our company, all outstanding options become immediately exercisable in full. In the event of an employee's death, or following the employee's retirement at or after age 65 or before age 65 with the consent of the Committee, outstanding options may be exercised for a period of one year from the applicable date of death or

retirement. If the employee's employment is terminated for reasons other than death or retirement, the options remain exercisable for a period of three months after such termination unless termination was for cause, in which case all outstanding options are immediately canceled. 1,500,000 shares of common stock have been initially authorized for issuance under the plan. Under the plan, eligible individuals may, at the discretion of the Committee, be granted options to purchase shares of common stock. However, no eligible individuals may be granted options for more than 500,000 shares in any calendar year. The option price and number of shares covered by an option will be adjusted proportionately in the event of a stock split, stock dividend, etc., and the Committee is authorized to make other adjustments to take into consideration any other event which it determines to be appropriate to avoid distortion of the operation of the plan. In the event of a merger or consolidation, option holders will be entitled to acquire the number and class of shares of the surviving corporation which they would have been entitled to receive after the merger or consolidation if they had been the holders of the number of shares covered by the options. If we are not the surviving entity in a merger and consolidation, the Committee may in its discretion terminate all outstanding options, and in that event option holders will have 20 days from the time they received notice of termination to exercise all their outstanding options. The plan terminates ten years from its effective date unless terminated earlier by the board of directors or the shareholders. Proceeds of the sale of shares subject to options under the plan are to be added to our general funds and used for its general corporate purposes.

On September 21, 2001, our shareholders approved the 2000 Incentive Stock Option Plan, and increased the shares authorized for the plan from 1,500,000 to 6,000,000.

In May of 2002, options for 150,000 shares under the plan, at an option price of $0.21, were granted to our corporate secretary and our then-current vice-president of operations. The former vice-president of operations has exercised his options.

In February of 2005, options for 1,700,000 shares under the plan, at an option price of $0.30, were granted to our vice-president of production and senior engineer; our vice-president of advertising/promotion; our vice-president of investor relations; our director of training; our corporate secretary; our senior engineer; our senior graphics designer; our videographer; and our graphic artist.

Compensation of Directors

No director receives or has received any compensation from us for serving on the board of directors.

Item 11. Security Ownership of Certain Beneficial Owners and Management

The following table shows, as of March 15, 2006, information about equity securities we believe to be owned of record or beneficially by

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each of our directors;

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each person who owns beneficially more than 5% of any class of our outstanding equity securities; and

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all of our directors and executive officers as a group.

Shareholders' Name and Address	Number of Shares Owned	Percent
L. Kelly Jones 440 North Center Arlington, Texas 76011	7,088,752 (1)	10.1% (2)
Bob Ferris 1941 South Brighton Circle Mesa, Arizona 85208	6,060,240 (3)	8.9% (2)
L. Andrew Wells 1011 Compass Cove Circle Spring, Texas 77379	3,530,120	5.2% (2)
Kimberly Biggs 2414 Green Willow Court Arlington, Texas 76001	42,460	*
all officers and directors as a group (4 persons)	16,721,572 (1)(2)	24.2% (2)

* less than 1%.

(1) includes incentive conditional options to purchase 3,000,000 shares of our common stock for $930,000, which are exercisable within 60 days.

(2) based on 67,331,801 shares outstanding.

(3) includes incentive conditional options to purchase 1,000,000 shares of our common stock for $310,000, which are exercisable within 60 days.

The beneficial owners of securities listed above have sole investment and voting power with respect to such shares. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of stock subject to options or warrants currently exercisable, or exercisable within 60 days, are deemed outstanding for purposes of computing the percentage of the person holding such options or warrants, but are not deemed outstanding for purposes of computing the percentage of any other person.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of stock subject to options or warrants currently exercisable, or exercisable within 60 days, are deemed outstanding for purposes of computing the percentage of the person holding such options or warrants, but are not deemed outstanding for purposes of computing the percentage of any other person.

Item 12. Certain Relationships and Related Transactions

Mr. Jones, our chief executive officer, is also president of Jones & Cannon, a Texas professional corporation, which has provided legal services to us and which may continue to provide legal services to us in the future, and which rents our executive offices to us. We currently owe Jones & Cannon more than $403,898 for legal services rendered. Jones & Cannon had also been providing the limited amount of executive office space and clerical and other services we require, at the rate of $1500 per month, and we currently owe Jones & Cannon $90,750 in past due rent.

Mr. Ferris, our president, is the owner of Ferris Holdings, L.L.C., which is the landlord on the lease for our engineering, technical, and production facilities in Phoenix, Arizona. On December 31, 2004, we adopted FASB Interpretation No. 46R (FIN 46R), Consolidation of Variable Interest Entities (Revised) . This accounting change added assets and liabilities to the balance sheet as of that date resulting from the consolidation of Ferris Holdings, L.L.C., into our financial statements. Ferris Holdings, L.L.C. is an entity 100% owned by Mr. Ferris, and the entity s only asset is the land and building in Phoenix, Arizona, which we currently lease, Since we also guarantee the debt related to this property, we have an implicit variable interest in this entity. This accounting change resulted in $827,263 of additional property and equipment, net of accumulated depreciation, a $67,885 reduction in note receivable from a related party, and $805,856 of additional notes payable, but did not require an adjustment to earnings and is not expected to affect future earnings or cash flows. The accounting change did result in a loss of $(46,478), which is reported as a Cumulative effect of accounting change in the accompanying statement of operations.

In December, 1997, we agreed to redeem at par value an aggregate of 1,505,399 shares of the common stock held by the ten former shareholders of First Brewery of Dallas, Inc., a company we acquired in April, 1997. The aggregate redemption price was $7,527.02. That redemption was to have occurred no later than March 31, 1998. However, we did not have sufficient funds to honor this commitment and are currently in default under the agreement as to a few of these shareholders. Mr. Jones and Ms. Biggs were among those whose shares were to have been redeemed. In February, 2000, we and Mr. Jones agreed that the shares that were to have been redeemed from Mr. Jones would not be redeemed. In September of 2004, we and Ms. Biggs agreed that the shares that were to have been redeemed from Ms. Biggs would not be redeemed. In February, 2002, we completed the redemption of 287,531 of these shares from one shareholder, and those shares when received were canceled. In December, 2004, and January, 2005, we completed the redemption of 67,743 and 34,624 of these shares from two shareholders. Demand has been made upon the remaining four shareholders for 371,834 shares.

During the period from July, 1997 through May, 1998 Mr. Jones, our chairman of the board and chief executive officer, lent us an aggregate of $90,000 for use as operating capital. Of this amount, $65,000 was subsequently eliminated when Mr. Jones accepted in full satisfaction of that debt certain equipment securing bank debt which Mr. Jones had guaranteed, leaving a balance of $25,000.00. This indebtedness was evidenced by an unsecured demand promissory note at an annual interest rate of 12 % per annum. During the period from November, 2000 through December, 2001, Mr. Jones lent us an aggregate of $81,000 for use as operating capital, for a total indebtedness of $106,000. This $81,000 indebtedness was evidenced by unsecured promissory notes without interest. All of this

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indebtedness was converted to 151,200 common shares, contractually locked up until as long as June of 2006, as part of our debt conversion plan approved on December 13, 2004.

Item 13. Exhibits

N/A

Item 14. Principal Accountant Fees and Services.

Audit fees.

The aggregate fees billed for each of the last two fiscal years for professional services rendered by our principal accountant for the audit of our annual financial statements and review of financial statements included in our Forms 10-QSB were $50,000 and $50,000 for each of the fiscal years ended December 31, 2004 and 2005, respectively.

Audit-Related Fees

N/A

Tax Fees

$3,000 per year.

All Other Fees

N/A

Pre-approval Policies and Procedures

All engagements of our auditors are approved by the board of directors before the accountant is engaged to render audit or non-audit services.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VIRTRA SYSTEMS, INC.

(Registrant)

By:

Perry V. Dalby, chief executive officer

Dated August 15, 2007

Pursuant to the requirements of the Securities Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
____	Chief Executive Officer, Chief Financial Officer and Director	

Perry V. Dalby

President and Director

Bob Ferris

Director

H. Frank Stanley

Thomas Cloud Director

45