VIRTRA SYSTEMS INC
Form 10QSB/A
December 08, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended September 30, 2006

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 CityWest Blvd., Suite 300, Houston, Texas	77042
(Address of principal executive offices)	(Zip Code)

(832) 242-1100

(Registrant's telephone number, including area code)

Check whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES |X| NO |_|

As of November 10, 2006, the Registrant had outstanding 91,482,599 shares of common stock, par value $.005 per share.

Note: This amendment corrects our statement of cash flows for the nine months ended September 30, 2005, and adds Item 2 to Part II.

PART I. FINANCIAL INFORMATION

Item 1.

Financial Statements.

VIRTRA SYSTEMS, INC.

BALANCE SHEET

September 30, 2006 and December 31, 2005

ASSETS	**September 30, 2006**	**December 31, 2005**
Current assets:		
Cash and cash equivalents	$ 20,650	$ 764
Accounts receivable	184,539	184,904
Costs in Excess of Billing	192,829	-
Total current assets	398,018	185,668
Property and equipment, net	121,706	951,630
Capitalized development cost, net	81,765	130,815
Other Assets	49,926	-
Total assets	$ 651,415	$ 1,268,113
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Notes payable	$ 4,716	$ 1,095,899
Obligations under product financing arrangements	437,213	494,372
Convertible debentures, net of discounts of $312,228 and $299,170	99,249	474,876
Accounts payable	925,249	1,232,779
Accrued liabilities	1,983,222	1,327,702
Advances held on deposit	4,650	183,650
Billings in excess of costs and estimated earnings on uncompleted contracts	-	84,650
Payable to related party	82,252	35,495
Total current liabilities	$3,536,551	4,929,423
Redeemable common stock, 371,834 shares at $.005 par value	1,859	1,859

Total liabilities	3,538,410	4,931,282
Commitments and contingencies		
Stockholders deficit:		
Common stock, $.005 par value, 100,000,000 shares authorized, 90,597,461 and 65,983,600 shares issued and outstanding as of September 30, 2006 and December 31, 2005, respectively	452,987	329,918
Common stock committed	130,000	-
Additional paid-in capital	10,693,024	9,755,785
Accumulated deficit	(14,163,005)	(13,748,872)
Total stockholders deficit	(2,886,994)	(3,663,169)
Total liabilities and stockholders deficit	$ 651,416	$ 1,268,113

See accompanying notes to financial statements.

VIRTRA SYSTEMS, INC.

STATEMENT OF OPERATIONS

For the three months and nine months ended September 30, 2006 and 2005

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Revenue:				
Custom applications:				
Training/simulation	$ 27,533	$ 225,474	$ 809,187	$ 457,883
Advertising/promotion	438,518	38,547	448,043	167,969
Other revenue	(3,130)	15,598	(1,403)	74,851
Total revenue	462,921	279,619	1,255,827	700,703
Cost of sales and services	178,573	126,218	461,681	446,159
Gross margin	284,348	153,401	794,146	254,544
General and administrative expenses	561,870	593,539	1,430,549	1,332,612
Net loss from operations	(277,522)	(440,138)	(636,443)	(1,078,068)
Other income (expenses):				
Interest Income		50	72	57
Interest expense and finance cost	(281,054)	(105,679)	(510,258)	(571,496)
Gain on sale of fixed assets	519,073	-	519,073	18,000
Forgiveness of debt	212,782	516,220	212,782	
Other income			600	516,220
Total other income (expenses)	450,873	410,591	222,269	(37,219)
Net income	$ 173,351	$ (29,547)	$ (414,133)	$(1,115,287)

Weighted average shares outstanding	88,237,504	62,283,330	88,237,504	61,326,894
Basic and diluted net loss per common share	$ (0.00)	$ (0.00)	$ (0.00)	$ (0.02)

See accompanying notes to financial statements.

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VIRTRA SYSTEMS, INC.

STATEMENT OF CASH FLOWS

for the nine months ended September 30, 2006 and 2005

	Nine months Ended September 30, 2006	2005
Cash flows from operating activities:		
Net income (loss)	$ (414,133)	$ (1,115,287)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	103,817	122,110
Amortization of deferred debt costs	76,607	
Amortization of BCF and discount	(13,058)	
Bad Debt Expense	31,805	-
Forgiveness of debt	(212,782)	(516,220)
Gain on sale of PP&E	(519,073)	(18,000)
Stock warrants issued as financing costs	-	139,225
Effect of beneficial conversion feature	-	150,000
Stock issued as compensation for services	30,216	155,001
Increase in operating assets	(309,795)	(202,905)
Increase (decrease) in accounts payable and accrued expenses	513,545	
Net cash used in operating activities	(712,851)	(1,286,076)
Cash flows from investing activities:		
Capital expenditures	(11,906)	(5,845)
Proceeds from sale of PP&E	106,689	18,000
Net cash used in investing activities	94,783	12,155
Cash flows from financing activities:		
Proceeds from convertible debentures	-	1,250,000
Proceeds from issuance of notes payable and other advances	108,298	20,640
Payments on notes payable and other advances	(70,128)	(214,915)
Proceeds from common stock committed to be issued	599,784	76,142
Net cash provided by financing activities	637,954	1,131,867

Net increase (decrease) in cash and cash equivalents	19,886	(142,054)
Cash and cash equivalents at beginning of period	764	160,556
Cash and cash equivalents at end of period	$ 20,650	$ 18,512
Non-cash investing and financing activities:		
Interest paid	$ -	$ 44,620
Common stock issued upon conversion of debentures		$ 262,060
Income taxes paid	$ -	$ -
Common stock issued upon conversion of debentures	$ 182,604	$ 159,080

See accompanying notes to financial statements.

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VIRTRA SYSTEMS, INC.

STATEMENTS OF STOCKHOLDERS DEFICIT

for the nine months ended September 30, 2006

	Common Stock Shares	Common Stock Amount	Common Stock Committed	Additional Paid-In Capital	Accumulated Deficit	Total
Balance at December 31, 2005	65,983,600	$329,918	$ -	$9,755,785	($13,748,872)	($3,663,169)
Other common stock issued for cash	15,583,741	77,919		521,865		599,784
Common stock issued upon conversion of debentures	8,425,800	42,129		388,179		430,308
Common Stock Issued for Services	604,320	3,022		27,194		30,216
Common stock committed for issuance			130,000	-	-	130,000
Net loss	-	-	-	-	$ (414,133)	$ (414,133)
Balance at September 30, 2006	90,597,461	$ 452,987	$ 130,000	$ 10,693,024	($14,163,005)	($2,886,994)

See accompanying notes to financial statements.

VIRTRA SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS

1. **Basis of Presentation**

The accompanying unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the U.S. Securities and Exchange Commission, and should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2005. They do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the financial statements for the year ended December 31, 2005 included in the Company s Form 10-KSB filed with the Securities and Exchange Commission. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been included. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the respective full year.

2. **Use of Estimates**

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

3. **Acquisitions**

On January 10, 2006 the Company entered into an agreement to merge with a newly-formed entity, Virtra Merger Corporation, which in anticipation of the merger, is to acquire Altatron International, Inc., Chrysalis Manufacturing Corporation and Dynalyst Manufacturing. However, the Company s stock price declined significantly, making the acquisition much more expensive than originally estimated. Both companies are still interested in the business combination but there can be no assurance that the acquisition will be consummated.

4. **Convertible Debentures**

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

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

In accordance with generally accepted accounting principles, in the event the conversion price on debentures is less than the Company s stock price on the date of issuance, the difference is considered to be a beneficial conversion feature and is amortized as interest expense over the period from the date of issuance to the earlier of the conversion date or the stated maturity date. The Company has calculated the aggregate beneficial conversion feature of these convertible debentures to be $398,677 on the $750,000 debentures and $140,760 on the $500,000 debentures.

During the quarter ended September 30, 2006, the Company recognized $106143 in interest expense related to the accretion of the debt discount and beneficial conversion features recorded on these convertible debentures including the portion of the debentures that converted. As of September 30, 2006, the remaining balance of the debt discount and beneficial conversion features was $312,228.

5. <u>Stock Options and Warrants</u>

Effective January 1, 2006, the Company adopted the Statement of Financial Accounting Standards No. 123 (Revised), Share-Based Payments (SFAS 123R) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. The Company adopted SFAS 123R using the modified prospective method, therefore, the prior period financial statements will not reflect any restated amounts. The Company estimates that there is no additional stock based compensation expense related to outstanding options to be recorded during the quarter ended September 30, 2006. The outstanding stock options as of September 30, 2006, are based on certain performance criteria and vest upon the occurrence of an event. Therefore, the Company used an estimate of when the event will occur to determine which options will ultimately vest and if expense should be recorded.

The Company periodically issues incentive stock options to key employees, officers, directors and outside consultants to provide additional incentives to promote the success of the Company s business and to enhance the ability to attract and retain the services of qualified persons. There were no stock options issued during the nine months ended September 30, 2006.

A summary of the Company s stock option activity and related information for the nine months ended September 30, 2006 and the year ended December 31, 2005 follows:

	Number of	Weighted-Average

		Shares Under Options	Exercise Price
Outstanding	December 31, 2004	6,100,000	$0.22
Granted		-	-
Exercised		-	-
Forfeited		300,000	$0.10
Outstanding	December 31, 2005	5,800,000	$0.23
Granted		-	-
Exercised		-	-
Forfeited		1,000,000	-

Outstanding	September 30, 2006	4,800,000	$0.23
Exercisable	September 30, 2006	3,300,000	$0.30

Following is a summary of outstanding stock options at September 30, 2006:

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
3,000,000	3000,000	2009	$0.31
4,800,000	3,300,000		

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

		Number of Shares	Weighted-Average Exercise Price
Outstanding	December 31, 2004	996,703	$0.38
Granted		1,750,000	$0.29
Exercised		-	
Forfeited		-	
Outstanding	December 31, 2005	2,746,703	$0.29
Granted		-	
Exercised		-	

Forfeited		-	
Outstanding	September 30, 2006	2,746,703	$0.29

6. Going Concern Considerations

During the nine months ended September 30, 2006 and 2005, 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:

	2006	2005
Net loss for the nine months ended September 30	$ (414,133)	$ (1,115,287)
Negative cash flows from operations	$ (172,057)	$ (1,286,076)
Negative working capital	$ (3,138,533)	$ (4,527,986)

Accumulated deficit	$(14,163,005)	$(12,869,103)
Stockholders deficit	$ (2,886,994)	$ (3,415,009)

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.

7. Subsequent Event

As of September 30, 2006, the Company had $893,903 accrued for various payroll tax liabilities. In May 2006, the Company received notices from the IRS of tax liens that have been filed related to these accrued amounts, and their intent to levy.

8. Committed Common Stock

The company sold the land and building in Phoenix on September 15, 2006. Gross proceeds from the sale were $1,210,430. After sales related expenses and tax payments, there were $1,054,695 to apply to our loan balance with Arizona Bank. The real estate was the security for the loan.

After applying the proceeds, there remained $263,340 in principal and interest outstanding. The bank agreed to accept $130,000 worth of common stock in full satisfaction of this remaining principal and interest. The Company is approaching its limit of authorized capital and is obligated to Dutchess Advisors to continue servicing the debt through conversions. The bank agreed to wait for its common stock to be issued until the shareholders have voted on the increase in authorized capital.

The exchange of debt for equity, along with the forgiveness of unpaid rent by Ferris Holdings in the amount of $76,442 resulted in income from the forgiveness of debt in the amount of $212,782.

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

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

Business Overview

Our principal business began in 1993 with the organization of Ferris Productions, Inc. Ferris designed, developed, distributed, and operated virtual reality products for the entertainment, simulation, promotion, and education markets. Virtual reality is a generic term associated with computer systems that create a real-time visual/audio/haptic (touch and feel) experience. Virtual reality immerses participants into a three-dimensional real-time synthetic environment generated or controlled by one (or several) computer(s). In September of 2001, Ferris merged into GameCom, Inc., a publicly-held Texas company whose principal business at the time was the development and marketing of an Internet-enabled video game system. Our historic areas of application have included the entertainment/amusement, advertising/promotion, and training/simulation markets. We effectively left the entertainment/amusement market in the spring of 2003 in order to more fully focus on the advertising/promotional and training/simulation markets.

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

We maintain our corporate office at 2500 CityWest Blvd., Suite 300, Houston, Texas 77042, and our telephone number is (832) 242-1100. We also maintain engineering, technical, and production offices, and a demonstration facility, at 1406 West 14th Street, Suite #101, Tempe, Arizona 85281, with a phone number of (480) 968-1488.

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

Critical Accounting Policies and Estimates

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

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

Revenue Recognition

Revenue from custom application contracts are recognized on a percentage-of-completion basis, measured by the percentage of costs incurred to date to 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.

Results of Operations

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

The Company enjoyed a 65.6% increase in revenues to $462,921 compared to the same quarter of last year. VirTra Systems took orders for and began delivery on significant projects for a civilian contractor for the United States Navy (Immersadomes) and IVRs for the U.S. Marine Corps. The Company s gross profit was $284,348, up $130,947 from last year. As a per cent of sales it dipped to 53.6% from 54.9%.

General and administrative expenses declined 5.3% to $561,870; an drop of $31,669. Included in that change are nearly $73,000 were represented by one time charges for commissions on the sale of the company s real estate in Phoenix. Despite the non-repeating item, the company s operating loss narrowed to $277,522, an improvement from a loss of $440,138 in the third quarter of 2005.

Interest expense rose to $281,054 from $105,679 in the prior year period, due largely to a $99,026 charge taken when reconciling the debentures to their capitalized debt discount. The Company s share price has dropped significantly since the convertible debentures and the debt discount amortization were booked. More shares are being converted than originally envisioned when the discount amortization schedule was established and an adjustment was necessary to reflect the difference.

During the third quarter, the Company sold its real estate in Phoenix and moved our production facility into leased space. We also sold some old obsolete equipment and parts from earlier editions of our products before moving. The net gain on sale of assets was $519,073 with all but $19,100 of it coming from the building. VirTra Systems anticipated a monthly cost savings of no less than $9,000 by eliminating the real estate and building and substituting it with leased premises.

For some time, the Company had been in default on the bank loans secured by the real estate and some old equipment. Through negotiations we were able to favorably reduce the amount owed the bank and the amount owed a related party for unpaid rent, and recording $212,782 income from the forgiveness of debt.

Net profit for the three months ending September 30, 2006 was $173,351 compared to a net loss of $29,547 in the same quarter of 2005. Both periods recorded gains from the forgiveness of debt in the financial results. Eliminating those gains, VirTra Systems would have shown a net loss of $39,431 in the third quarter of 2006 compared to a net loss of $545,767 for the third quarter of 2005.

Nine months Ended September 30, 2006 Compared to Nine months Ended September 30, 2005

The Company narrowed its net loss by over 62.8% compared to the nine months ending September 30, 2005 primarily from increased revenues and higher margins on products and services sold.

Revenues from our Immersadome product line achieved new highs with jobs awarded from Case Western University and a civilian contractor to the United States Navy. The Case-Western project was originally conceived as an advertising/promotion application for the Company s Immersadome products. However in a very innovative fashion, the speech pathology application turned out to be an application for the Company s flagship IVR technology; the first of its kind outside the military and law enforcement arenas, and an opportunity for VirTra Systems to exploit applications in the medical services field. Total revenue for the quarter was $1,255,827, an increase of 79.2% from the first nine months of last year. The Company s gross margin rose to 63.2% from last year s 36.3% for the same period.

General and administrative expense $97,937, or 7.4% to $1,430,549 for the nine months ended September 30, 2006. As mentioned earlier, nearly $73,000 of that increment was a non-recurring expense associated with the sale of the real estate in Phoenix. The Company maintains tight controls on personnel additions and has become less reliant upon outside consulting, legal and other professional fees. Overall interest expense and finance charges fell to $510,258 for the nine months ended September 30, 2006, compared to $571,496 for the corresponding period of 2005. Week by week we decrease the principal balance owed on our convertible debentures, and thus interest on the outstanding balance. The result of improved margins and comparatively flat expenses resulted in a loss from operation of $636,443 compared to $1,078,068 in the first nine months of 2005.

VirTra Systems had other income of $222,269 in the first nine months of this year, compared to a loss of $37,219. The gain on the sale of assets and income from debt forgiveness totaled $731,855. Overall, the company recorded a net loss of $414,133 from the year earlier loss of $1,115,287.

Liquidity and Plan of Operations

As of September 30, 2006, our liquidity position was extremely precarious. We had current liabilities of $3,536,551, including $437,213 in unconverted obligations under the lease financing for the old Ferris Productions virtual reality systems, $925,249 in accounts payable, and accrued liabilities of $1,983,222. As of September 30, 2006, there was only $309,018. of current assets available to meet those liabilities.

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

For the nine months ended September 30, 2006, our net loss was $414,133. After taking into account the non-cash items included in that loss, our cash requirements for operations were $712,851. In addition, we made capital expenditures of $11,906 and repaid notes in the amount of $70,128. To cover these cash requirements, the company sold additional common stock to raise $599,784, used a portion of the proceeds of sale of its Phoenix production facility and borrowed $108,298. We began the third quarter with a new Immersa-Dome order from the Navy, to be built for August delivery. We ended the quarter with work in progress for the United States Marine Corps, and we have firm orders in hand for deliveries to Ti Training, Lonexi (Mexico), Raytheon, Raytheon, the United States Marshall Service and further work with the Marines.

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. Despite expense reductions that the Company is presently initiating, we will need substantial additional capital or new lucrative custom application projects to become profitable. In 2005, we completed two private placements with Dutchess for $1,250,000 in convertible debentures. Management believes that a continuation of sales growth, purchase order financing to sustain the production and additional sales of common stock will carry the Company through the next twelve months.

Item 3. Controls and Procedures

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

There have been no significant changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the period from March 17, 2006 through August 21, 2006, we sold an aggregate of 15,583,741 shares of our common stock to a total of 19 accredited investors. Of those shares, 604,320 shares were issued for consulting services, and the remaining shares were issued for cash totaling $630,000. The purchasers of these shares represented that they were acquiring the shares for investment, and appropriate restrictions were placed on resale of the shares. The shares were issued in reliance upon the private offering exemption contained in section 4(2) of the Act and the accredited investor exemption contained in section 4(6) of the Act.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

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

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

SIGNATURES

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

VIRTRA SYSTEMS, INC.

Date: December 8, 2006

/s/ Perry V. Dalby
Perry V. Dalby
Chief Executive Officer