

DESTINY MEDIA TECHNOLOGIES INC  
Form 10QSB  
April 14, 2005

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB**

(Mark One)

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

For the quarterly period ended February 28, 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: 0-028259

**DESTINY MEDIA TECHNOLOGIES INC.**

(Exact name of registrant as specified in its charter)

**COLORADO**

(State or other jurisdiction of  
incorporation or organization)

**84-1516745**

(IRS Employer Identification No.)

**1055 West Hastings Street, Suite 1040, Vancouver,  
British Columbia Canada V6E 2E9**

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: **(604) 609-7736**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months and (2) has been subject to the above filing requirements for the past 90 days.

Yes  No

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:  
**36,346,723 Shares of \$0.001 par value common stock outstanding as of February 28, 2005.**

Transitional small business disclosure format (check one):

Yes  No

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**PART I - FINANCIAL INFORMATION**

**Item 1. FINANCIAL STATEMENTS.**

Interim Consolidated Financial Statements  
(Expressed in United States dollars)

**DESTINY MEDIA TECHNOLOGIES INC.**

Six months ended February 28, 2005 and February 29, 2004

(Unaudited)

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**DESTINY MEDIA TECHNOLOGIES INC.**

Interim Consolidated Balance Sheets

(Expressed in United States dollars)

	February 28, 2005	August 31, 2004
	(Unaudited)	
<b>Assets</b>		
<b>Current assets:</b>		
Cash	\$ 2,151	\$ 17,523
Short-term investments	-	8,661
Accounts and other receivables, net of allowance for doubtful accounts of \$9,211 (August 31, 2004 - \$19,291)	90,545	67,484
Inventory	2,675	3,480
Prepaid expenses	4,082	18,846
<b>Total current assets</b>	<b>99,453</b>	<b>115,994</b>
Software development costs, net of accumulated amortization of \$15,708 (August 31, 2004 - \$nil)	107,256	81,857
Other assets, net of accumulated amortization of \$80,918 (August 31, 2004 - \$73,306)	2,645	5,198
Equipment, net of accumulated amortization of \$175,697 (August 31, 2004 - \$156,809)	71,351	73,572
<b>Total assets</b>	<b>\$ 280,705</b>	<b>\$ 276,621</b>
<b>Liabilities and Stockholders' Deficiency</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	\$ 332,385	\$ 440,997
Loans payable	69,240	20,564
Deferred revenue	67,867	62,305
<b>Total current liabilities</b>	<b>469,492</b>	<b>523,866</b>
Deferred leasehold inducement	67,127	73,071
Obligation for share settlement	100,000	100,000
<b>Stockholders' deficiency:</b>		
Common stock, par value \$0.001		
Authorized: 100,000,000 shares		
Issued and outstanding: 36,346,723 shares (August 31, 2004 – 35,316,098 shares)	36,349	35,318
Issued and held for settlement: 133,333 shares		
Additional paid-in capital	4,021,755	3,688,208
Deferred stock compensation	(35,563)	-
Stock issuable	4,000	25,000

Deficit	(4,284,947)	(4,088,494)
Accumulated other comprehensive loss	(97,508)	(80,348)
Total stockholders' deficiency	(355,914)	(420,316)
Total liabilities and stockholders' deficiency	\$ 280,705	\$ 276,621

See accompanying notes to interim consolidated financial statements.

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## DESTINY MEDIA TECHNOLOGIES INC.

Consolidated Statements of Operations

(Unaudited)

(Expressed in United States dollars)

	Three months ended February 28, 2005	Three months ended February 29, 2004	Six months ended February 28, 2005	Six months ended February 29, 2004
Revenue	\$ 227,602	\$ 181,031	\$ 420,425	\$ 398,623
Operating expenses:				
General and administrative	90,621	202,760	197,911	296,617
Sales and marketing	94,791	99,775	208,123	199,863
Research and development	116,417	133,655	175,485	179,968
Depreciation and amortization	17,577	7,078	30,172	13,927
	319,406	443,268	611,691	690,375
Loss before undernoted	(91,804)	(262,237)	(191,266)	(291,752)
Other earnings (expenses):				
Gain on extinguishment of debt	-	67,830	-	67,830
Interest and other income	67	5,797	67	11,426
Interest and other expense	(1,692)	(1,410)	(5,254)	(4,450)
	(1,625)	72,217	(5,187)	74,806
Loss for the period	\$ (93,429)	\$ (190,020)	\$ (196,453)	\$ (216,946)
Loss per common share,				
Basic and diluted	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)
Weighted average common shares outstanding, basic and diluted	36,225,937	35,014,709	35,946,112	34,115,476

See accompanying notes to interim consolidated financial statements.



**DESTINY MEDIA TECHNOLOGIES INC.**

Interim Consolidated Statements of Stockholders' Deficiency and Comprehensive Loss

(Expressed in United States dollars)

	Common stock		Additional	Shares	Deferred		Cumulative
	Shares	Amount	Paid-in	Issuable	stock	Deficit	translation
			capital		compensation		adjustment
Balance, August 31, 2004	35,316,098	\$ 35,318	\$ 3,688,208	\$ 25,000	\$ -	\$ (4,088,494)	\$ (80,348)
Loss for the period	-	-	-	-	-	(196,453)	-
Cumulative translation adjustment	-	-	-	-	-	-	(17,160)
Comprehensive loss	-	-	-	-	-	-	-
Common stock issued on options							
Exercised (note 6)	1,030,625	1,031	293,770	(25,000)	-	-	-
Common stock issuable on options							
exercised (note 6)	-	-	-	4,000	-	-	-
Deferred Stock compensation	-	-	39,777	-	(35,563)	-	-
Balance February 28, 2005	36,346,723	\$ 36,349	\$ 4,021,755	\$ 4,000	\$ (35,563)	\$ (4,284,947)	\$ (97,508)

See accompanying notes to interim consolidated financial statements.



**DESTINY MEDIA TECHNOLOGIES INC.**

Interim Consolidated Statements of Cash Flows

(Unaudited)

(Expressed in United States dollars)

	Six months Ended February 28, 2005	Six months Ended February 29, 2004
<b>Cash flows from operating activities:</b>		
Loss for the period	\$ (196,453)	\$ (216,946)
Items not involving cash:		
Depreciation and amortization	30,172	13,927
Shares issued for services rendered	-	80,000
Deferred lease benefit	(10,718)	-
Stock-based compensation – employees	-	865
Stock-based compensation – non-employees	4,214	56,176
Extinguishment of debt	-	67,830
Changes in non-cash working capital:		
Accounts receivable	(18,825)	79,153
Inventory	1,036	816
Short term investments	9,275	-
Prepaid expenses	16,075	(9,189)
Accounts payable and accrued liabilities	(136,905)	(287,244)
Deferred revenue	1,555	(44,385)
Net cash used in operating activities	(300,574)	(258,997)
<b>Cash flows from investing activities:</b>		
Purchase of equipment	(4,477)	(1,719)
Purchase of other assets	-	(1,094)
Software development costs	(37,290)	-
Net cash used in investing activities	(41,767)	(2,813)
<b>Cash flows from financing activities:</b>		
Net change to loans payable	47,640	9,141
Net proceeds from common stock issuable on options exercised	4,000	-
Net proceeds from issuance of common stock	269,801	270,000
Net cash provided by financing activities	321,441	279,141
Net increase in cash and cash equivalents during the period	(20,900)	17,331
Effect of foreign exchange rate changes on cash	5,528	(7,284)
Cash and cash equivalents at beginning of period	17,523	6,123
Cash and cash equivalents at end of period	\$ 2,151	\$ 16,170

## Supplementary disclosure:

Cash paid for:

Interest	\$	5,254	\$	4,450
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See accompanying notes to interim consolidated financial statements.

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## DESTINY MEDIA TECHNOLOGIES INC.

Notes to Interim Consolidated Financial Statements

(Unaudited)

(Expressed in United States dollars)

Six months ended February 28, 2005 and February 29, 2004

### 1. Organization:

Destiny Media Technologies Inc. (the "Company") was incorporated in August 1998 under the laws of the State of Colorado. The Company develops enabling technologies that allow for the distribution over the Internet of digital media files in either a streaming or digital download format. The technologies are proprietary. The Company operates out of Vancouver, BC, Canada and serves customers predominantly located in the United States and Canada.

### 2. Continuing operations:

From inception of the business, the Company has incurred cumulative losses of \$4,284,947 and at February 28, 2005 had a working capital deficiency of \$370,039. As a result, doubt exists about its ability to continue as a going concern.

These financial statements have been prepared on the going concern basis which assumes that the Company will be able to realize its assets and satisfy its liabilities and commitments in the ordinary course of business. Operations to date have been primarily financed by equity transactions. Depending on the Company's ability to continue to grow sales and related cash flows, the Company may need additional capital through public or private financings that may not be available on reasonable terms. Accordingly, the Company will require the continued support from its shareholders and creditors until it is able to generate sufficient cash flows from operations on a sustained basis.

It is management's intention to leverage the existing technology to further develop sales and to evaluate its projected expenditures relative to its available cash. There can be no assurances that the Company will be successful in generating additional cash from operations. If it is not successful in generating cash from operations, the Company will be required to reduce operations or liquidate assets. The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

### 3. Recent Accounting Pronouncement

On December 16, 2004, the Financial Accounting Standards Board (“FASB”) issued FASB statement No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)), which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. SFAS 123(R) supersedes APB Opinion NO. 24, Accounting for Stock Issued to Employees, and amends FASB

Statement No. 95, Statement of Cash Flows. Generally, the approach in SFAS 123(R) is similar to the approach described in Statement 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The Company is currently evaluating the effect of SFAS 123(R) on its consolidated financial statements.

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## DESTINY MEDIA TECHNOLOGIES INC.

Notes to Interim Consolidated Financial Statements  
(Unaudited)  
(Expressed in United States dollars)

Six months ended February 28, 2005 and February 29, 2004

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#### **4. Unaudited interim financial information:**

The financial information at February 28, 2005 and for the six month periods ended February 28, 2005 and February 29, 2004 is unaudited.

The unaudited consolidated financial statements of the Company and its subsidiaries have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles of the United States of America ("US GAAP") have been condensed or omitted pursuant to such rules and regulations. The results of operations for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year ending August 31, 2005. This Form 10-QSB should be read in conjunction with the Form 10-KSB that includes audited consolidated financial statements for the years ended August 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity and cash flows for the two years ended August 31, 2004 and 2003.

#### **5. Accounts payable and accrued liabilities:**

Accrued liabilities as at February 28, 2005 totaled \$43,781 (August 31, 2004 - \$33,648). Accounts payable includes \$164,110 of disputed items, including those outlined in note 7.

#### **6. Share capital:**

Common shares issued for cash:

During the six month period ended February 28, 2005, the Company issued 1,030,625 common shares. These shares were issued pursuant to option agreements. During the period, the company received gross proceeds of \$273,801 on the exercise of 930,625 options. As at August 31, 2004, 100,000 common shares were issuable for proceeds of \$25,000 which had been received prior to the start of the 2005 fiscal year.

Common shares issuable:

10,000 options at an exercise price of \$0.40 per share were exercised during the period and will be issued subsequent to the end of the quarter.

## DESTINY MEDIA TECHNOLOGIES INC.

Notes to Interim Consolidated Financial Statements  
(Unaudited)  
(Expressed in United States dollars)

Six months ended February 28, 2005 and February 29, 2004

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### 7. Contingencies:

A subsidiary of the Company commenced legal proceedings against Impatica.com Inc. ("Impatica") for payment of approximately \$512,500 in unpaid technology licensing fees. It is the Company's position that Impatica repudiated the licensing agreement and that the unpaid license fees totaling \$512,500 are a debt owing by Impatica to the Company.

The defendant has denied liability to the Company on the basis that the license agreement was not formalized. The defendant has filed a counterclaim against the Company seeking return of \$162,500 advanced to the Company on an alleged "good faith" agreement based on the allegation that the technology did not perform as represented. These funds were recorded as revenues earned in accordance with the Company's revenue recognition policy in fiscal 2001. At February 28, 2005 the outcome of this claim and counterclaim is not determinable. As such, no amounts have been accrued at quarter end.

On September 14, 2004, a statement of claim was filed against the Company by its former solicitor for fees of \$145,978 CDN relating to legal services provided in connection with a failed transaction in 2001 and other general corporate matters. It is the Company's position that a significant portion of the fees being sought by its former solicitor are unwarranted and that the fees should not be borne by the Company. The Company has engaged legal counsel to defend itself and has launched a counterclaim. The Writ of Summons was filed in the BC Supreme Court on September 14, 2004. As at August 31, 2004 and February 28, 2005, the company has accrued for the disputed fees and will seek all options available to extinguish this debt. Any adjustments to the amounts recognized will be recorded when determinable.

### 8. Related party transactions and balances:

Related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

- (a) During the period ended, the Company earned \$ Nil (February 29, 2004 - \$5,713) in rental revenue from space sublet to a director.
- (b) During the period ended, the Company earned \$ Nil (February 29, 2004 - \$5,713) in rental revenue from space sublet to a company in which an officer is a significant shareholder.
- (c) As at period end, loans payable included \$50,000 (August 31, 2004 - \$Nil) owing to directors and officers of the Company.

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

### FORWARD LOOKING STATEMENTS

The following discussion should be read in conjunction with the accompanying financial statements and notes thereto included within this Quarterly Report on Form 10-QSB. In addition to historical information, the information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding the Company's capital needs, business strategy and expectations. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "intend", "anticipate", "believe", "estimate", "predict", "potential" or "continue", the negative of such terms or other comparable terminology. Actual events or results may differ materially. In evaluating these statements, you should consider various factors described in this Quarterly Report, including the risk factors accompanying this Quarterly Report, and, from time to time, in other reports the Company files with the Securities and Exchange Commission. These factors may cause the Company's actual results to differ materially from any forward-looking statement. The Company disclaims any obligation to publicly update these statements, or disclose any difference between its actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

### OVERVIEW

Destiny Media Technologies Inc. (the "Company", "Destiny Media" or "we") is a holding company which owns 100% of the outstanding shares of Destiny Software Productions, Inc. Destiny Software Productions, Inc. is the operating company. The "Company", "Destiny" or "we" refers to the consolidated activities of both companies.

The company is the developer and marketer of innovative technologies which facilitate the distribution of digital media content. All four technologies discussed below are commercially mature and ready for market.

**Clipstream™** Our Clipstream™ family of software products enables our customers to deliver audio and video streaming media via the Internet without requiring the viewer to install software media players or requiring the customer to deploy server technology.

**MPE™** Our MPE™ software is an audio and video media distribution system that enables artists and other media rights owners to securely distribute their media through the Internet. All electronic content is locked to the digital fingerprint of the destination computer.

Currently the system is being used to instantly distribute individual songs from various record labels. If the songs are exported to CD, a digital watermark is invisibly embedded into the song, so the originating computer can be identified. Our system supports the distribution of music, but it may be adopted to move video, software, research reports, or other electronic media.

**RadioDestiny Broadcaster** Our RadioDestiny Broadcaster software enables our customers to broadcast a professional Internet radio station from the customer's personal computer.



Destiny Media Player Our Destiny Media Player software enables a customer to listen to MP3 music files and to listen to RadioDestiny™ Internet broadcasts on their personal computer.

All four technologies are proprietary and were developed by the company.

Clipstream™ licenses and maintenance currently represents approximately 87% of our revenues. The Radio Destiny Broadcaster and Destiny Media Player are sold online under the brand name Pirate Radio. Pirate Radio represents approximately 2.5% of our revenue. MPE™ represented approximately 10.5% of our revenues.

In October 2004, the company released an adapted version of MPE™ which facilitates the transfer of music from the recording industry to radio stations and trusted users. We have begun recognizing revenue associated with this new version of MPE™ during the first and second quarters of fiscal 2005 during the pilot phase of implementation. Management anticipates that revenues will grow significantly as the system gains acceptance by the industry.

Pirate Radio sales are also expected to continue and management is pursuing retail distribution of the Pirate Radio software.

We are a publicly traded company. Our common stock trades on the OTC Bulletin board under the symbol “DSNY” and on the Berlin exchange in Germany under the symbol “DME”.

Our corporate website is located on the Internet at <http://www.dsn.com>.

## **PLAN OF OPERATIONS**

During our fiscal year ending August 31, 2005, management will focus on the introduction of our MPE™ digital music distribution system into full time commercial use. Our MPE™ system is uniquely suited for digital delivery of music and is a market leader in the secure electronic distribution of music. We anticipate that our MPE™ technology will be integrated into third party products. We will continue to market the MPE™ digital rights management system to the recording industry.

We have entered into a 2 1/2 year license agreement with the Universal Music Group (“UMG”). UMG will use the MPE™ system to securely distribute new music tracks to radio and trusted users. Destiny receives a per transaction licensing fee each time a song is sent to radio or trusted users. We will target an increase in transactions and utilization by other labels.

Historically our largest source of revenue has been our Clipstream™ suite of products. Management believes that our Clipstream™ suite of products has significant advantages over other competitors in the industry. Through increased expenditures on sales and marketing, management anticipates an increase in revenue as awareness of our products expands. We also anticipate the launch of new versions of various products in the Clipstream™ Suite and are currently pursuing opportunities to expand the uses of our technology in association with existing technologies such as Java based cellular phones.

We will continue to sell the Pirate Radio suite online and through Amazon.com. We will also market this internet radio broadcast system to private radio networks and retail channels.



**OPERATING RESULTS****Six Months Ended February 28, 2005****OPERATING RESULTS****Revenue**

During the quarter ending February 28, 2005, revenues climbed 18% from our first quarter ending November 30, 2004. The increase is due to the realization of revenue associated with the preliminary stages of implementation of our MPE™ digital music distribution system.

Revenue associated with our Clipstream™ suite of products continues to represent the majority our sales at approximately 82% for the quarter just ended. Gross sales of Clipstream™ have remained consistent with the results of our first quarter ending November 30, 2004.

Revenue for the six months ending February 28, 2005 has increased over the same period in the prior fiscal year by approximately 5%. Sales of Clipstream™ have declined slightly over the same period last year while our MPE™ technology has resulted in the overall increase.

**Operating Expenses**

Our general and administrative expenses consist primarily of salaries and related personnel costs including overhead, professional fees, and other general corporate and office expenditures.

<b>General and administrative (unaudited)</b>	<b>February 28, 2005 (6 months)</b>	<b>February 29, 2004 (6 months)</b>	<b>\$ Change</b>
Wages and benefits	85,692	90,283	(4,591)
Consulting	1,149	3,513	(2,364)
Rent	13,166	11,387	1,779
Telecommunications	5,284	1,270	4,014
Bad debt	13,179	16,762	(3,583)
Office and miscellaneous	26,074	124,740	(98,666)
Professional fees	53,367	48,662	4,705
	197,911	296,617	(98,706)

General and administrative expenses decreased to \$197,911 for the six months ended February 28, 2005 from \$296,617 for same period in 2004. The decrease is due primarily to a one-time charge of approximately \$80,000 for corporate initiatives relating to promotional and business development activities incurred in fiscal 2004.

Telecommunications experienced a decrease in the prior year as we were able to negotiate new rates with new carriers and received one time credits on disputed charges from prior periods with our former vendors.



Sales and marketing expenses consist primarily of salaries and related personnel costs including overhead, sales commissions, advertising, promotional fees and travel costs.

<b>Sales and marketing</b> (unaudited)	<b>February</b> <b>28,</b> <b>2005</b> (6 months)	<b>February</b> <b>29,</b> <b>2004</b> (6 months)	<b>\$</b> <b>Change</b>
Wages and benefits	123,224	132,036	(8,812)
Consulting	1,149	3,513	(2,364)
Rent	13,166	11,387	1,779
Telecommunications	5,284	1,270	4,014
Meals and entertainment	1,385	2,567	(1,182)
Travel	11,871	9,974	1,897
Advertising and marketing	52,044	39,116	12,928
	208,123	199,863	8,260

Sales and marketing expenses remained relatively consistent with the same period in the prior year. The company has incurred travel expenses associated with negotiating contracts with various customers for use of our MPE™ technology and remains committed to expanding the awareness of our Clipstream™ suite of products.

Research and development costs consist primarily of salaries and related personnel costs including overhead and consulting fees with respect to product development and deployment

<b>Research and development</b> (unaudited)	<b>February</b> <b>29,</b> <b>2004</b> (6 months)	<b>February</b> <b>28,</b> <b>2003</b> (6 months)	<b>\$</b> <b>Change</b>
Wages and benefits	142,820	150,472	(7,652)
Consulting	1,915	5,855	(3,940)
Rent	21,943	18,979	2,964
Telecommunications	8,807	2,117	6,690
Repairs and maintenance	-	2,545	(2,545)
	175,485	179,968	(4,483)

Research and development expenses remained relatively consistent for the same period in the prior year.

Increases in costs associated with less favorable US dollar exchange rate are offset by the capitalization of certain development costs associated with our MPE™ technology.

**Depreciation and Amortization.** Depreciation and amortization expenses arose from equipment and other assets. Depreciation and amortization increased to \$30,172 for the six months ended February 28, 2005 as compared to \$13,927 for the six months ended February 29, 2004, an increase of \$16,245 or 116%. The increase in depreciation and amortization is due to the capitalization of development costs associated with our MPE™ technology. As this digital transmission system is ready for use and beginning to generate income we have begun depreciating the costs previously capitalized.



## **Other Income and Expenses**

In the prior year, a gain on extinguishment of debt amounted to \$67,830 for the six months ended February 29, 2004. Interest and other income amounted to \$11,426 for the six months ended February 29, 2004 compared to \$67 for the same period ended February 28, 2005. These balances consisted primarily of rental revenue realized on vacant office space sublet during the prior period. No rental revenue was realized in the period ending February 28, 2005.

## **Income (loss) from operations**

Loss from operations for the quarter ended February 28, 2005 was \$91,804 compared to \$262,237 for the same quarter ending February 29, 2004. The more favorable result was from an increase to revenues associated with our MPE™ technology while realizing a more efficient cost management.

Loss from operations for the six months ended February 28, 2005 was \$191,266 compared to a loss of \$291,752 for the same period ending February 29, 2004. As discussed above, the more favorable result can be explained by a one time charge in fiscal 2004 of approximately \$80,000 which was not required in the current year and the increase in revenue associated with our MPE™ digital music distribution system.

## **LIQUIDITY AND FINANCIAL CONDITION**

We had cash of \$2,151 as at February 28, 2005 compared to cash of \$17,523 as at August 31, 2004. We had a working capital deficiency of \$370,039 as at February 28, 2005 compared to \$407,872 as at August 31, 2004. We had a shareholders' deficiency of \$355,914 as at February 28, 2005 compared to a shareholders' deficiency of \$420,316 as at August 31, 2004.

The decrease in our working capital deficiency is primarily the result of funds made available through the exercise of options. The use of such funds is determined at the time the funds become available. If the circumstances warrant an expenditure on marketing or promotion, this cost is incurred. Otherwise these funds are used to pay down existing liabilities.

We anticipate that our deferred revenues will continue to decrease as sales for post-delivery maintenance and support packages continues to decline. We continue to recognize deferred revenue in compliance with Statement of Position No. 97-2 "Software Revenue Recognition", as referred to in the notes to our audited financial statements and as discussed below under the heading "Critical Accounting Policies". Deferred revenues reflect cash received in advance of meeting the revenue recognition criteria as described in the notes to the financial statements. Deferred revenues result if we complete sales of our software products when significant post-delivery obligations exist. In this case, revenue is deferred until we complete the post-delivery obligations

## **Cash Flows**

Net cash used in operating activities increased to \$300,574 for the six months ending February 28, 2005, compared to \$258,997 for the six months ended February 29, 2004. This increase in use of cash can be attributed to pay down of accounts payable.

## **Financing**

During the first six months of fiscal 2005, we received \$273,801 from the exercise of 930,625 options. Additionally, 100,000 shares were issued during the period which were issuable as at August 30, 2004, for a total of 1,030,625 shares issued during the quarter.

## **Going Concern**

We have incurred recurring losses from operations and we have a working capital deficiency. As a result, substantial doubt exists about the company's ability to continue as a going concern. Operations to date have been primarily financed by equity transactions. Depending on our ability to continue to grow sales

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and related cash flows, we may need additional capital through public or private financings that may not be available on reasonable terms. Accordingly, we will required the continued financial support from our shareholders and creditors until we are able to generate sufficient cash flows from operations on a sustained basis. There can be no assurances that we will be successful. If we are not, we will be required to reduce operations or liquidate assets. Our consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should we be unable to continue as a going concern. Our auditors have referred to the substantial doubt about our ability to continue as a going concern in their audit report on our financial statements included with our Annual Report on Form 10-KSB for our fiscal year ended August 31, 2004.

### **CRITICAL ACCOUNTING POLICIES**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, and make estimates and assumptions that affect our reported amounts of assets, liabilities, revenue and expenses, and the related disclosures of contingent liabilities. We base our estimates on historical experience and other assumptions that we believe are reasonable in the circumstances. Actual results may differ from these estimates.

The following critical accounting policies affect our more significant estimates and assumptions used in preparing our consolidated financial statements.

- The consolidated financial statements have been prepared on the going concern basis, which assumes the realization of assets and liquidation of liabilities in the normal course of operations. If we were not to continue as a going concern, we would likely not be able to realize on our assets at values comparable to the carrying value or the fair value estimates reflected in the balances set out in the preparation of the consolidated financial statements. There can be no assurances that we will be successful in generating additional cash from equity or other sources to be used for operations. The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.
- We recognize revenue when there is persuasive evidence of an arrangement, delivery has occurred, the fee is fixed or determinable, collection is reasonably assured, and there are no substantive performance obligations remaining. Our revenue recognition policies are in conformity with AICPA's Statement of Position No. 97-2, "Software Revenue Recognition", as amended ("SOP 97-2). We generate revenue from software arrangements involving multiple element sales arrangements. Revenue is allocated to each element of the arrangement based on the relative fair value of the elements and is recognized as each element is delivered and we have no significant remaining performance obligations. If evidence of fair value for each element does not exist, all revenue from the arrangement is recognized over the term of the arrangement.

### **ITEM 3. CONTROLS AND PROCEDURES.**

As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the "Exchange Act"), we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as August 31, 2004, being the date of our most recently completed fiscal year end. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, Steven Vestergaard.

Based on the evaluation of the effectiveness of the Company's disclosure controls and procedures by the Company's management and the advice of the Company's independent auditors, with the participation of the Company's Chief Executive Officer and the Company's Chief Financial Officer, the Company's Chief Executive Officer and the Company's Chief Financial Officer have, for the reasons noted below, concluded that, as of the end of the period covered by this report, the Company's disclosure controls and

procedures were not fully effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

The term "internal control over financial reporting" is defined as a process designed by, or under the supervision of, the registrant's principal executive and principal financial officers, or persons performing similar functions, and effected by the registrant's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the registrant's assets that could have a material effect on the financial statements.

In the course of conducting its audit of the Company's financial statements for the fiscal year ended August 31, 2004, the Company's registered independent public accounting firm, Grant Thornton LLP, determined that there were certain material weaknesses and significant deficiencies in the Company's internal controls. Grant Thornton advised the Company's management and the audit committee of the Company's board of directors, of the following matters that Grant Thornton considered being 'material weaknesses' in the Company's internal controls:

- Grant Thornton concluded that the number of internal control deficiencies over corporate governance constituted a 'material weakness'. The deficiencies noted herein surrounded the documentation of existing internal controls of our IT security policy, our disaster recovery plan and our code of conduct policy. Grant Thornton also identified deficiencies in monitoring the internal control structure, policies associated with communicating control risks and the effects of such risks on our financial reporting process to our audit committee and/or board of directors.
- Grant Thornton concluded that there was an inadequate segregation of duties with respect to revenue as incompatible tasks are performed by the same accounting personnel, and that there was a lack of an appropriate review process of revenue recognition.

At the time it advised the Company's audit committee of its above conclusions, Grant Thornton also advised the audit committee of the following 'significant deficiencies' in the Company's internal controls. To resolve these issues, in their management letter dated November 22, 2004, Grant Thornton advised the Company of the following:

- A written policy for the extension of credit should be developed and implemented with corresponding monitoring controls to test compliance.
- Our policy in respect of the write-off approval process should be documented and all write-offs filed.
- Incompatible duties associated with recording of receivables, receipt and deposit functions, financial reporting and payroll process should be segregated.
- Formal contracts for employees should be completed.
- A written policy for the extension of credit should be developed and implemented with corresponding monitoring controls to test compliance.





At the time, Grant Thornton also advised the audit committee of the following lack in the Company's internal controls to manage third party relationships:

- There is no formal process in place to monitor the performance of service organizations.
- There is not in all cases written contracts outlining the rights and obligations of the company's IT service providers.
- The company does not currently have in place procedures and processes to detect and test external intrusions to the company's computer system.

The certifications of our chief executive officer and chief financial officer attached as Exhibits 31.01 and 31.02 to this Quarterly Report on Form 10-QSB include, in paragraph 4 of such certifications, information concerning Destiny's disclosure controls and procedures and internal control over financial reporting. Such certifications should be read in conjunction with the information contained in this Item 3 for a more complete understanding of the matters covered by such certifications. The certifying officers worked to design, or caused to be designed, disclosure controls and procedures, for the purpose of ensuring that material information relating to the Company, including its consolidated subsidiaries, is made known to them by other personnel of the Company on a timely basis. These disclosure controls and procedures were designed and adopted in good faith for this purpose, but it is recognized that these procedures must be continually evaluated and can always merit further improvement. Destiny believes that any of the abovementioned deficiencies or weaknesses in the Company's internal controls identified by the Company's independent auditors do not materially affect the fairness or accuracy of the presentation of the Company's financial condition and results of operation in the Company's historical financial statements as set forth in the Company's reports previously filed with the SEC under the Securities Exchange Act of 1934.

(b) Changes in Internal Control Over Financial Reporting. SEC rules define the term "internal control over financial reporting" as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers, or persons performing similar functions, and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

During the quarter ended February 28, 2005, the Company took the following actions that may have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting:

- The Company recently hired a new Assistant Controller to expand its internal finance and accounting staff.
- The Company is in the process of reorganizing its accounting and finance operation and has put more emphasis on proper disclosures and improving its internal controls.

The following tasks represent what the Company currently believes to be the most significant remaining actions necessary to address existing material weaknesses in the Company's controls, as well as actions it has taken to date to pursue these actions:



- Review of the Company's current policies and procedures to develop processes so that incompatible duties are not performed by one individual or that there are specific compensating controls if incompatible duties cannot be avoided.
- Develop and document existing controls and develop monitoring controls to ensure compliance with Sarbanes-Oxley Section 404.

## **PART II – OTHER INFORMATION**

### **Item 1. Legal Proceedings**

The were no material developments in any of the legal proceedings to which we are a party, as disclosed in our Annual Report on Form 10-KSB for the year ended August 31, 2004, during the quarters ended November 30, 2004 or February 28, 2005.

### **Item 2. Changes in Securities and Use of Proceeds**

During our fiscal quarter ended February 28, 2005, there were no sales of securities that were not registered pursuant to the Securities Act of 1933 (the "Securities Act").

### **Item 3. Default Upon Senior Securities**

None.

### **Item 4. Submission of Matters to a Vote of Securities Holders**

No matters were submitted to a vote of securities holders during the quarter ended February 28, 2005

### **Item 5. Other Information**

The Company has engaged Ernst & Young LLP for (the "New Auditor") as its independent auditor effective on or about April 6, 2005, to act as its independent auditor for the fiscal year ending August 31, 2005. The engagement of the New Auditor was approved by the Audit Committee of the Board of Directors effective April 12, 2005. On April 12, 2005, Grant Thornton LLP (the "Former Auditor") was dismissed as its independent auditor.

The Former Auditor's report on the Company's financial statements for each of the years ended August 31, 2004 and August 31, 2003 did not contain an adverse opinion or disclaimer of opinion, nor were such reports qualified or modified as to uncertainty, audit scope or accounting principals.

In connection with the audit for the year ended August 31, 2004 and for the year ended August 31, 2003, and subsequent interim period through the date of dismissal, there were no disagreements with the former auditor on any matter of accounting principals or practices, financial statement disclosure, or auditing scope or procedure, which disagreement(s), if not resolved to the satisfaction of the Former Auditor, would have caused it to make references to the subject matter of the disagreement(s) in connection with its report on the financial statements for such years.

For the years ended August 31, 2004 and August 31, 2003 and through to April 11, 2005, there were no reportable events (as defined by Regulation S-K item 304(a)(1)(v)) except that during the 2004 audit process, our former auditor identified and reported to the Audit Committee of the Company's Board of Directors material weaknesses, significant deficiencies in, and lack of internal controls as discussed in Item 3 of Part 1 of this report.

During the two most recent fiscal years and the interim period preceding the appointment of the New Auditor, the Company has not consulted the New Auditor regarding either (i) the application of the



accounting principles to a specified transaction, either completed or contemplated; or the type of audit opinion that might be rendered on the Company's financial statements, and neither a written report nor advice was provided to the Company that the New Auditor concluded was an important factor considered by the Company in reaching a decision as to the accounting of a financial reporting issue; or ii) any matter that was either the subject of a disagreement or reportable event (as defined in Regulation S-K, item 304(a)(1)).

The Company has authorized and requested the Former Auditor respond fully to the inquiries of the New Auditor regarding the matters above.

The Company has provided the Former Auditor with a copy of the disclosures it is making herein in response to Item 304(a) of Regulation S-K. The Registrant requested that the Former Auditor furnish the Registrant with a letter addressed to the Commission stating whether it agrees with the statements made by the Registrant. The Registrant has annexed such letter hereto as an Exhibit.

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

**(a) Exhibits.**

<u>EXHIBIT NUMBER</u>	<u>DESCRIPTION</u>
<u>23.1</u>	<u>Destiny Media Consent of Independent Registered Public Accounts Firm</u>
<u>31.1</u>	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(1)</u>
<u>32.1</u>	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(1)</u>

(1) Filed as an exhibit to this Quarterly Report on Form 10-QSB

**(b) Reports on Form 8-K.**

No reports on Form 8-K were filed during the quarter ended February 28, 2005.

**SIGNATURES**

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

**DESTINY MEDIA TECHNOLOGIES INC.**

Dated: April 12, 2005.

Steven Vestergaard, Chief Executive Officer  
and Chief Financial Officer

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