SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended December 31, 1996

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 No. 0-18492

DIGITAL SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

New Jersey	22-1899798
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
4041 Hadley Road, South Plainfield, NJ	07080
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (908) 561-1200

Former name, former address and former fiscal year, if changed since last report.

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

Yes /X/ No / /

19,091,187 shares of Common Stock, par value $.001 per share, were outstanding as of February 7, 1997.

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
FORM 10-Q

December 31, 1996

Table of Contents

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 1996 (Unaudited)	SEPTEMBER 30, 1996
ASSETS		
CURRENT ASSETS		
Cash	$ -	$ -
Restricted Cash (Note 3)	811,000	1,155,000
Accounts receivable, net of allowance	7,825,000	6,338,000
Notes due from officers	76,000	136,000
Other current assets	507,000	189,000
Total current assets	9,219,000	7,818,000
EQUIPMENT AND IMPROVEMENTS		
Equipment	2,883,000	2,883,000
Leasehold improvements	180,000	180,000
	3,063,000	3,063,000
Accumulated depreciation and amortization	2,285,000	2,226,000
	778,000	837,000
DEFERRED TAX ASSET	760,000	760,000
GOODWILL, net of amortization	4,716,000	4,780,000
OTHER ASSETS	550,000	605,000
TOTAL ASSETS	$ 16,023,000	$ 14,800,000

The accompanying notes to the consolidated financial statements are an integral part of these consolidated financial statements.

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31 1996 (Unaudited)	SEPTEMBER 30, 1996
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	$ 3,017,000	$ 2,907,000
Current portion of long-term debt	131,000	88,000
Accounts payable	1,669,000	1,620,000
Accrued expenses and other current liabilities	3,559,000	2,917,000
Total current liabilities	8,376,000	7,532,000
LONG-TERM DEBT	64,000	100,000
Total Liabilities	8,440,000	7,632,000
COMMITMENTS AND CONTINGENCIES (Note 3)		
SHAREHOLDERS' EQUITY		
Common Stock, $.001 par value; authorized 40,000,000 shares; issued and outstanding 19,079,669 and 18,786,609 at December 31, 1996 and September 30, 1996, respectively	19,000	19,000
Additional paid-in capital	13,071,000	12,857,000
Accumulated deficit	(5,507,000)	(5,708,000)
Total shareholders' equity	7,583,000	7,168,000
TOTAL LIABILITIES AND EQUITY	$ 16,023,000	$ 14,800,000

The accompanying notes to the consolidated financial statements are an integral part of these consolidated financial statements.

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	FOR THE THREE MONTHS ENDED DECEMBER 31,	
	1996	1995
OPERATING REVENUES	$ 30,885,000	$ 23,090,000
DIRECT OPERATING EXPENSES	28,370,000	20,916,000
Gross profit	2,515,000	2,174,000
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,061,000	1,619,000
DEPRECIATION AND AMORTIZATION	179,000	139,000
Income from operations	275,000	416,000
OTHER INCOME (EXPENSE)		
Interest and other income	17,000	58,000
Interest expense	(91,000	(82,000)
	(74,000	(24,000)
Income before tax	201,000	392,000
INCOME TAX EXPENSE	-	-
NET INCOME	$ 201,000	$ 392,000
NET INCOME PER COMMON SHARE	$ 0.01	$ 0.03
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	20,097,204	14,280,774

The accompanying notes to the consolidated financial statements are an integral part of these consolidated financial statements.

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	FOR THE THREE MONTHS ENDED DECEMBER 31, 1996	FOR THE THREE MONTHS ENDED DECEMBER 31, 1995
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 201,000	$ 392,000
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	179,000	140,000
Provision for doubtful accounts	13,000	82,000
Amortization of rent deferral	--	(7,000)
Changes in operating assets and liabilities:		
Accounts receivable	(1,500,000)	(463,000)
Other current assets	(318,000)	(203,000)
Notes due from officers	60,000	--
Accounts payable, accrued expenses and other current liabilities	733,000	(166,000)
Net cash used in operating activities	(632,000)	(225,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of equipment and improvements	--	(28,000)
Net cash used in investing activities	--	(28,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Repayments) proceeds from borrowings on revolving line of credit - net	110,000	(70,000)
Repayments of long-term debt	(36,000)	(16,000)
(Repayments) proceeds from subordinated bridge loan		(250,000)
Proceeds from reduction of required Letters of Credit	344,000	
Proceeds from issuance of common stock and exercise of common stock options and warrants - net	214,000	835,000
Net cash provided by financing activities	632,000	499,000
Net increase in cash and cash equivalents	--	246,000
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	--	20,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ --	$ 266,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 80,868	$ 97,000

The accompanying notes to the consolidated financial statements are an integral part of these consolidated financial statements.

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) ORGANIZATION AND BUSINESS

Digital Solutions, Inc. (the Company) was incorporated under the laws of the State of New Jersey on November 25, 1969. The Company, with its subsidiaries, provides a broad spectrum of human resource services including Professional Employer Organization (PEO) services, payroll processing, human resource administration and placement of temporary and permanent employees.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements included herein have been prepared by the registrant, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the registrant believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's latest annual report on Form 10-K. This financial information reflects, in the opinion of management, all adjustments necessary to present fairly the results for the interim periods. The results of operations for such interim periods are not necessarily indicative of the results for the full year.

The accompanying consolidated financial statements include those of DSI, a New Jersey Corporation and its wholly-owned subsidiaries; DSI Contract Staffing, DSI Staff ConnXions, Staff ConnXions - Northeast, Inc., Digital Insurance Services, Inc., DSI Staff ConnXions of Mississippi, DSI Staff ConnXions - Southwest, MLB Medical Staffing, Inc., Ram Technical Services, Inc. and DSI Staff Rx, Inc. The results of operations of acquired companies have been included in the consolidated financial statements from the date of acquisition. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

Revenue Policy

The Company recognizes revenue in connection with its PEO business and its temporary placement service program when the services have been provided. The corresponding cost of providing those services are reflected as direct operating expenses. Payroll services, commissions and other fees for administrative services are recognized as revenue as the related service is provided.

Equipment and Improvements

Equipment and improvements are stated at cost. Depreciation and amortization are provided using straight-line and accelerated methods over the estimated useful asset lives (3 to 5 years) and the shorter of the lease term or estimated useful life for leasehold improvements.

Goodwill

Goodwill represents the excess of the cost of companies acquired over the fair value of their net assets at dates of acquisition and is being amortized on a straight line basis over 20 years for substantially all of the Company's acquisitions.

Earnings Per Common Share

Earnings per common share are based upon the weighted average number of shares outstanding as well as the dilutive effect of stock options and warrants. The dilutive effect of stock options and warrants was to increase the weighted average number of shares outstanding by 1,133,046 shares for the quarter ended December 31, 1996

Statements of Cash Flows

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

(3) COMMITMENTS AND CONTINGENCIES

In connection with the Company's workers compensation insurance policy, the insurance company develops reserve factors on each claim that may or may not materialize after the claim is fully investigated. Generally Accepted Accounting Principles require that all incurred, but not paid claims, as well as an estimate for claims incurred, but not reported (IBNR), be accrued on the balance sheet as a current liability, although a portion of the claims may not be paid in the following 12 months. As of December 31, 1996 and September 30, 1996, this accrual amounted to $790,000 and $630,000, respectively. During the three months ended December 31, 1996 and 1995, the Company recognized approximately $345,000 and $380,000, respectively, as its share of premiums collected in excess of claims and fees paid and established reserves.

The Company has outstanding letters of credit amounting to $1,266,000 as of December 31, 1996. The letters of credit are required to collateralize unpaid claims in connection with the workers compensation insurance policy and can only be drawn upon by the beneficiary if the Company does not perform according to the terms of the related agreement. The Company has collateralized these letters of credit by maintaining compensating restricted cash balances of $810,000 and utilizing $455,000 of amounts available under its line of credit.

(4) SHAREHOLDERS' EQUITY

During the first quarter of fiscal 1997, $214,000 was raised from the exercise of stock options and warrants.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Certain statements contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "1995 Reform Act"). Digital Solutions, Inc. (the "Company") desires to avail itself of certain "safe harbor provisions of the 1995 Reform Act and is therefore including this special note to enable the Company to do so. Forward-looking statements included in this Memorandum involve known and unknown risks, uncertainties, and other factors which could cause the Company's actual results, performance (financial or operating) or achievements to differ from the future results, performance (financial or operating) achievements expressed or implied by such forward looking statements. Such future results are based upon management's best estimates based upon current conditions and the most recent results of operations. These risks include, but are not limited to risks associated with the Company's recent losses (prior to the December 31, 1996 quarter), the Company's ongoing need for a new credit facility, need for additional capital, risks of recently consummated acquisitions as well as future acquisitions, effects of competition and technological changes and dependence upon key personnel.

The Company's operating revenues for the three months ended December 31, 1996 and 1995 were $30,885,000 and $23,090,000, respectively, which represents an increase of $7,795,000 or 34%. This increase is due to the efforts of the internal sales force to continually bring in new business which accounted for all the increase. PEO services accounted for $7,047,000 or 90% of the increase in new billings.

Direct Operating Expenses were $28,370,000 for the three months ended December 31, 1996 and $20,916,000 for the comparable period last year, representing an increase of $7,454,000 or 36%. In the quarter ended December 31, 1995 profits from workers' compensation were recorded as a reduction in selling, general and administrative ("SG&A"), whereas in the quarter ended December 31, 1996 these profits were recorded as a reduction of direct operating expenses. After adjusting direct operating expenses in the quarter ended December 31, 1995 to account for workers' compensation profits in the same manner as done in the quarter ended December 31, 1996, direct operating expenses for the quarter ended December 31, 1996 increased $ 7,834,000 or 38% over the comparable period last year. This increase represents the corresponding higher costs associated with the increase in revenue and a greater mix of PEO business.

Gross Profit was $2,515,000 and $2,174,000 for the quarters ended December 31, 1996 and 1995, respectively, or an increase of $341,000 or 16%. After adjusting the quarter ended December 31, 1995 for the change in accounting for the workers' compensation profits as mentioned above, gross profit for this period was $ 2,554,000 or essentially the same as the quarter ended December 31, 1996. Gross profit, as a percent of revenue, was 8.1% for the quarter ended December 31, 1996 and 11.1% for the same period last year after the workers' compensation adjustment. This reduction in gross profit percent reflects the company's continued drive towards PEO services which have a lower margin as a percentage of revenue than payroll services or contract services, but which adds more dollars of gross profit per client than these other services.

Selling, general and administrative ("SG&A") costs were $2,061,000 for the quarter ended December 31, 1996 and $1,619,000 for the quarter ended December 31, 1995 or an increase of $442,000 or 27%. After adjusting the quarter ended December 31, 1995 for the change in accounting for workers' compensation profits as mentioned above, SG&A for the quarter ended December 31, 1996 increased $ 62,000 or 3.1% over the comparable period last year. This small increase reflects management's efforts to continue to control SG&A expenses.

Net income for the three months ended December 31, 1996 and 1995 was $201,000 and $392,000 respectively. This decrease in net income is attributed to a change in accounting for medical costs which resulted in a $ 65,000 higher charge against earnings in the first quarter of fiscal 1997; an anticipated and desired loss of some business in the Southwest from the first quarter of fiscal 1996 which accounted for approximately $ 51,000 in gross profit (desired loss due to subsequent workers' compensation exposure or credit difficulties); increased depreciation and amortization charges of $ 40,000 to reflect the increased write-offs established in fiscal 1996; and $ 35,000 less in workers' compensation profits.

Liquidity and Capital Resources

The Company's working capital as of December 31, 1996 amounted to $843,000 or a ratio of 1.10 to one versus $286,000 as of December 31, 1995 or 1.04 to one. This improvement includes capital contributions through the exercise of options and warrants of $214,000 plus a $344,000 contribution from the reduction in the amount of cash required to collateralize the Company's workers' compensation program (see below).

In February 1995, the Company entered into a one year revolving line facility (the "Line") with a bank which was subsequently extended on four occasions and modified. Each loan extension has been for limited periods of time. Under the terms of the current agreement, the Company may borrow up to the lesser of $3,500,000 (including letters of credit), or 75% of eligible accounts receivable, as defined. The Company is obligated to make monthly payments of interest on the outstanding amounts at the bank's floating base rate plus two and one-half percent (10.75% at December 31, 1996).

The Line is collateralized by substantially all of the Company's accounts receivable. However, the line has matured and the Company is presently unable to borrow any further under the line. The Company is presently negotiating with the bank to develop mutually agreeable terms and conditions in response to the Company's request for extending the line. The bank has proposed certain minimum weekly payments by the Company of $10,000. While the Company believes it will be able to negotiate terms and renew the line, in the event that this does not occur, the Company is pursuing other financing alternatives.

In addressing the capital needs of the Company, management is presently in negotiation with a potential lender to provide a line of credit to replace the matured line. As currently being discussed, this facility will be secured by substantially all assets of the Company and will be available based on a percentage of eligible receivables. Management believes that this facility, if obtained, will be sufficient to cover its cash needs for the foreseeable future. There can be no assurance that the Company will be successful in its efforts to obtain a new line of credit.

In December 1996, due to favorable trends in losses in its workers' compensation program, the Company's carrier reduced its letter of credit requirement from $1,600,000 to $1,150,000 which resulted in $450,000 of additional cash available. Of this availability, $344,000 has been added to working capital during the quarter ended December 31, 1996.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

In October 1995, the Company entered into a note and finance agreement with LNB Investment Corporation (LNB) providing for the loan to the Company of up to $3,000,000. The loan was for a term of 15 months and was to be secured by shares of the Company's common stock having a market value of no less than four times the outstanding balance of the loan. LNB agreed not to sell or otherwise liquidate the shares unless the Company were to default under the loan agreement and failed to cure such default after notice. A total of 7,500,000 shares to be pledged as collateral were registered under a registration statement filed under the Securities Act of 1933, as amended.

The Company issued 1,783,334 shares in the name of LNB and delivered the shares to a depository to secure the first portion of the loan of $1,000,000. In January 1996, the Company determined that the shares pledged as collateral had been transferred and sold in violation of the loan and finance agreement. As a result, the financing agreement was terminated and never funded. Through the efforts of the Company, 1,258,334 of these shares were recovered and the Company received proceeds of $229,000 for a portion of the 525,000 shares not recovered.

In March 1996, the Company commenced action against LNB, Donaldson, Lufkin & Jenrette Securities Corporation and other individuals to recover damages on account of the wrongful sale of the Company's common stock. The Company seeks to recover 525,000 shares which were not returned and damages against all of the defendants. The Company is currently engaged in discovery proceedings in the action.

At December 31, 1996 the Company is involved in various other legal proceedings incurred in the normal course of business. In the opinion of management and its counsel, none of these proceedings would have a material effect, if adversely decided, on the consolidated financial position or results of operations of the Company.

Item 5. Other information

On October 9, 1996 the Company announced it had signed a letter of intent to acquire the assets of a Texas PEO company. The acquisition was subject to due diligence, negotiation and execution of a final agreement, which is ongoing. No assurance can be given that the accquisition will be consummated.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits - None

(b) Reports on Form 8-K

none filed during the quarter ended December 31, 1996.

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.

DIGITAL SOLUTIONS, INC.
(Registrant)

/s/ George J. Eklund

George J. Eklund
Chief Executive Officer

/s/ Donald T. Kelly

Donald T. Kelly
Chief Financial Officer

Date: February 14, 1997

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