

Edgar Filing: Flooring Zone Inc - Form 10QSB

Flooring Zone Inc  
Form 10QSB  
October 04, 2006

United States  
Securities and Exchange Commission  
Washington, DC 20549

FORM 10-QSB

Quarterly Report Under Section 13 or 15(d) of  
the Securities Exchange Act of 1934

For the Quarter Ended  
June 30, 2006

Commission File Number  
333-119234

THE FLOORING ZONE, INC.

-----  
(Exact name of registrant as specified in its charter)

NEVADA

-----  
(State or other jurisdiction of incorporation or organization)

20-0019425

-----  
(I.R.S. Employer Identification No.)

3219 Glynn Avenue, Brunswick, Georgia 31520

-----  
(Address of principal executive offices)

(912) 264-0505

-----  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12 (b) of the Act: None.

Securities registered pursuant to section 12(g) of the Exchange Act: Common,  
\$0.001 par value

Check whether the Issuer filed all reports required to be filed by section 13 or  
15(d) of the Exchange Act during the past 12 months (or for such shorter period  
that the registrant was required to file such report(s), Yes  No

Check whether the Issuer has been subject to such filing requirements for the  
past 90 days. Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in  
Rule 12b-2 of the Exchange Act. Yes  No

As of September 12, 2006 we had 19,569,750 shares of our \$0.001 par value,  
common stock outstanding.

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FORM 10-QSB  
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The Flooring Zone, Inc.  
 Condensed Consolidated Balance Sheet  
 June 30, 2006  
 (Unaudited)

ASSETS

Current assets:

Cash	\$
Accounts receivable, net	1
Inventory	4
Prepaid expense	-----

Total current assets

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Property & equipment, net	2
Other assets:	
Intangible assets, net	
Deposits	-----
Total other assets	-----
TOTAL ASSETS	\$ 7 =====

See accompanying notes to financial statements

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The Flooring Zone, Inc.  
Condensed Consolidated Balance Sheet-[continued]  
June 30, 2006  
(Unaudited)

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:	
Accounts payable	\$ 2
Line of credit-related party	1,5
Customer deposits	
Accrued liabilities	
Current portion long-term debt	----- 1
Total current liabilities	2,0
Long-term liabilities:	
Note payable-related party	
Long-term debt	4
Current portion long-term debt	----- (1)
Total long-term liabilities	4

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Total liabilities	2,4
Stockholders' deficit:	
Preferred Stock, 10,000,000 shares authorized \$.001 par value value: No shares issued and outstanding	
Common stock, 100,000,000 shares authorized \$.001 par value; 19,569,750 shares issued and outstanding	
Additional paid in capital	6
Accumulated deficit	(2,3)
	-----
Total stockholders' deficit	(1,6)
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 7
	=====

See accompanying notes to financial statements

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The Flooring Zone, Inc.  
Condensed Consolidated Statements of  
Operations For the three month and six month periods  
ended June 30, 2006 and 2005  
(Unaudited)

	Three months ended June 30,		Six months
	2006	2005	2006
	-----	-----	-----
Revenues:			
Sales	\$ 774,111	\$ 926,128	\$ 1,395,5
Licensing Fees	0	0	
	-----	-----	-----
Net revenues	774,111	926,128	1,395,5
Less cost of sales	607,384	608,283	1,104,0
	-----	-----	-----
Gross profit	166,727	317,845	291,4
General and administrative expenses	186,044	294,308	378,1
	-----	-----	-----
Net income (loss) from operations	(19,317)	23,537	(86,6

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Other income (expense):

Interest expense	(56,536)	(23,039)	(87,2
	-----	-----	-----
Total other income (expense)	(56,536)	(23,039)	(87,2
	-----	-----	-----
Net income (loss) before taxes	(75,853)	498	(173,9
Income taxes	-	-	
	-----	-----	-----
Net income (loss)	\$ (75,853)	\$ 498	\$ (173,9
	=====	=====	=====
Income (loss) per share-basic and diluted	\$ (0.01)	\$ 0.00	\$ (0.
	=====	=====	=====
Weighted average shares outstanding - basic and diluted	35,403,083	38,522,145	36,986,4
	=====	=====	=====

See accompanying notes to financial statements

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The Flooring Zone, Inc.  
Condensed Consolidated Statements of Cash Flows  
For the six month periods ended June 30, 2006 and 2005  
(Unaudited)

	6/30/2006
	-----
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income (loss)	\$ (173,989)
Adjustments to reconcile net income (loss) to net cash used in operating activities:	
Depreciation and amortization	11,914
Decrease (increase) in accounts receivable	(10,780)
Decrease (increase) in inventories	(172,557)
Decrease (increase) in prepaid expenses	-
Increase (decrease) in accounts payable	(8,422)
Increase (decrease) in accrued liabilities	(7,592)
Increase (decrease) in customer deposits	(44,789)

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	-----
Net cash used in operating activities	(406,215)
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property and equipment	-
Purchase of intangible assets	-
	-----
Net cash used in investing activities	-
CASH FLOWS FROM FINANCING ACTIVITIES	
Net borrowing (payments) on line of credit-related party	390,101
Net borrowing (payments) on long term debt	(46,400)
Proceeds from the issuance of common stock	-
	-----
Net cash provided by financing activities	343,701
	-----
NET INCREASE IN CASH	(62,514)
CASH AT BEGINNING OF PERIOD	64,282
	-----
CASH AT END OF PERIOD	\$ 1,768
	=====
SUPPLEMENTAL DISCLOSURES	
Cash paid for interest	\$ 87,347
Cash paid for income taxes	-

See accompanying notes to financial statements

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The Flooring Zone, Inc.  
Notes to Condensed Consolidated Financial Statements  
June 30, 2006

Note 1 ORGANIZATION AND INTERIM FINANCIAL STATEMENTS

Organization - The Flooring Zone, Inc. (the "Company") is a corporation organized under the laws of the State of Nevada on May 5, 2003. The company's business operations provide for full-service retail floor covering products and services.

Interim financial statements - The accompanying condensed consolidated financial statements are unaudited and have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information

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and footnotes required by accounting principles for complete financial statements generally accepted in the United States of America. In the opinion of management, the accompanying consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of our financial position as of June 30, 2006. There has not been any change in the significant accounting policies of The Flooring Zone, Inc. for the periods presented. The results of operations for the three months and six months ended June 30, 2006 and 2005 are not necessarily indicative of the results for a full-year period. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2005 filed with the Securities and Exchange Commission (the "SEC").

Stock based compensation- On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, "Share-Based Payment," using the modified prospective method. However, for the three and six months ended June 30, 2006, the Company's results of operations do not reflect any compensation expense because the Company had no new stock options granted under its stock incentive plans during the first six months of fiscal year 2006 and no previous stock option grants which vested during the first six months of fiscal year 2006.

Prior to the first quarter of fiscal year 2006, the Company accounted for its stock-based employee compensation arrangements in accordance with the provisions and related interpretations of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Had compensation cost for stock-based compensation been determined consistent with SFAS No. 123R, the net loss and net loss per share for the six months ended June 30, 2005 would have been adjusted to the following pro forma amounts:

		6/30/2005
		-----
Net income, as reported	\$	10,166
Compensation cost under fair value-based accounting method, net of tax		-
		-----
Net income, pro forma		10,166
Net income per share-basic and diluted:		
As reported	\$	0.00
Pro forma	\$	0.00

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The Flooring Zone, Inc.  
Notes to Condensed Consolidated Financial Statements  
June 30, 2006  
(Unaudited)

Note 2 INVENTORY

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Inventories are stated at lower of cost or market and consist of the following:

	6/30/06
	-----
Flooring material	403,164
	-----
Total \$	403,164
	=====

### Note 3 GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the financial statements, the Company has an accumulated deficit of \$2,345,276, and a negative working capital of \$1,475,287. These factors raise substantial doubt about the Company's ability to continue as a going concern.

Management plans include obtaining additional debt financing to cover the shortfalls in revenue and allowing the Company to begin purchasing inventory at a discount, and making changes in operations to reduce expenses. The Company may also seek additional equity financing through the sale of its shares, although the Company currently has no commitments for additional equity financing and there is no guarantee that the Company can obtain equity financing on acceptable terms or at all. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### Note 4 COMMON STOCK

In November 2005, Jimmy Lee resigned as the Company's President, CEO and director. Mr. Lee returned his 19,000,000 shares of the Company's common stock. In return the Company agreed to remove his name from all debt and personal guarantees. In June 2006 the Company did remove Mr. Lee's name from all debt of the Company and canceled the stock certificates.

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

This discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and capital resources during the three and six months ended June 30, 2006 and 2005. This discussion should be read in conjunction with the financial statements and financial statement footnotes included in this registration statement.

#### Forward-Looking Statements

Certain statements of our expectations contained herein, including, but not limited to statements regarding sales growth, new stores, increases in comparable store sales, commodity price inflation and deflation, and capital expenditures constitute "forward-looking statements." Such statements are based

on currently available operating, financial and competitive information and are



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subject to various risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations. These risks and uncertainties include but are not limited to, fluctuations in and the overall condition of the U.S. economy, stability of costs and availability of sourcing channels, conditions affecting new store development, our ability to implement new technologies and processes, our ability to attract, train, and retain highly-qualified associates, unanticipated weather conditions and the impact of competition and regulatory and litigation matters. Undue reliance should not be placed on such forward-looking statements, as such statements speak only as of the date on which they are made.

### General

The Flooring Zone, Inc. is a Nevada corporation organized on May 5, 2003, to operate full service retail floorcovering stores. We have a wholly-owned subsidiary, The Flooring Zone of Georgia, Inc. The Georgia corporation was formed in 2000, by the founders of The Flooring Zone, Inc., and was established to develop our business concept in the retail floorcovering industry. Through our subsidiary we operate two retail stores. We have stores in Brunswick, Georgia and Yulee, Florida. We also maintain administrative offices and warehouse facilities in Brunswick, Georgia.

### Results of Operations

Comparison of the three months ended June 30, 2006 and 2005.

During the three months ended June 30, 2006, we realized net loss of \$75,853 compared to a net income of \$498 during the three months ended June 30, 2005.

### Revenues

We generate revenue primarily from the sale of flooring products. We sell flooring products to two groups - retail customers and contractors. Retail customers generally pay higher prices for product than contractors. Historically, about 60% to 70% of our product sales have been to retail customers. In the current fiscal year we believe we are experiencing a shift in our traditional customer mix. To date this year, contractors have accounted for approximately 50% of our product sales. We believe this shift in our customer mix is, at least, partially due to Mr. Carroll taking a more active role in the day-to-day operations of the Company following his appointment as CEO. Mr. Carroll has been involved in the construction industry in Georgia for a number of years and we believe the increase in product sales to contractors has resulted from his relationships in the industry. While we realize smaller margins on products sold to contractors, we believe such decreases in net revenue are being partially offset by decreases in other expenses, including advertising and display costs. Contractors, unlike most retail customers, represent routine repeat business. Contractors buy product often and in larger quantities than do retail customers. As our customer mix shifts to a higher percentage of contractor sales we have and may continue to decrease our advertising and display expenses as we decrease our need to constantly drive new retail customers to our stores.

During the three months ended June 30, 2006 average retail product prices were fairly constant, although we increased prices for supplies such as carpet pad, glue, etc., approximately 10% higher as compared to the same quarter

of 2005. Despite higher retail prices for supplies, overall we realized a 16% decrease in revenue from product sales. This decrease in revenue from product

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sales in the three months ended June 30, 2006 is primarily the result of the closing of our St. Mary's store. As discussed above, another contributing factor to our decreased revenue from sales is the shift in our customer mix because contractors typically pay lower prices for product than do retail customers. We expect that revenue from product sales will continue to be lower throughout the rest of the 2006 fiscal year as compared to the 2005 fiscal year because of the closing of the St. Mary's store.

### Gross Profit

Our gross profit is directly affected by our costs of sales. Cost of sales includes all direct costs of floor coverings, materials used in installation and installation labor. As with revenues, our cost of sales and gross profit are directly affected by changes in the percentage of products sold to retail customers versus contractors. As discussed above, the prices we can charge contractors are lower than the prices we can charge retail customers therefore, our profit margin on product sales to retail customers is greater. Moreover, we often realize profit from providing installation services to retail customers. Conversely, contractors typically use their own subcontractors to install the floor covering products they purchase. These subcontractors provide the materials used in installation and the installation labor.

Gross profit during the second fiscal quarter of 2006, was \$166,727, a 47% decrease from the \$317,845 gross profit realized during the second fiscal quarter of 2005. As discussed above, during the three months ended June 30, 2006 we realized a 16% decrease in net revenue. While cost of sales remained nearly unchanged during the second quarter 2006 compared to the second quarter 2005. As a result of decreased revenue and increasing prices we pay for product, cost of products sold, cost of sales as a percentage of net revenues increased from 66% during the second quarter 2005 to 78% during the second quarter 2006. During the quarter we also revisited certain previously completed jobs to perform repair work that was performed at our expense, which resulted in an increase to our costs of product sold, with no corresponding increase to revenue. Due to rising fuel costs, the cost of installation supplies and floor padding increased. We also paid surcharges on all shipments, which further increased cost of sales for the period.

For the reasons detailed above, as our customer mix continues to shift to a higher percentage of contractors, we anticipate cost of sales will continue to represent a higher percentage of net revenues than it has historically. As discussed above, however, we believe this decrease in margins can be at least partially offset by decreases in other expenses.

### General and Administrative Expenses

General and administrative expenses for the three months ended June 30, 2006, decreased \$108,264, or 37% to \$186,044 compared to the three months ended June 30, 2005. As a percentage of sales revenue general and administrative expenses decrease to 24% during the quarter ended June 30, 2006, compared to 32%

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during the quarter ended June, 30, 2005. During the three months ended June 30, 2006 and 2005, general and administrative costs consisted of:

	Three Months Ended	
	June 30, 2006	June 30, 2005
	-----	-----
Salaries & benefits costs	\$ 68,716	\$ 120,265
Advertising & display costs	5,575	28,086

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Occupancy costs & utilities	69,856	73,872
Legal & accounting costs	15,507	8,308
Other	26,390	63,777
	-----	-----
	\$ 186,044	\$ 294,308
	=====	=====

The 43% reduction in salaries and benefits costs in the three months ended June 30, 2006 compared to the same three month period 2005 is the result of a reduction in our work force. This reduction in our work force resulted from the closing of our St. Mary's store and a reduction in our retails sales and accounts payable departments. In anticipation of expansion, we had hired more retail sales and accounts payable personnel than we needed to operate our current locations. With the decision not to expand at the current time, we laid off several persons. We do not expect significant additional changes salaries and benefits throughout the balance of 2006.

During the quarter ended June 30, 2006, advertising and display costs decreased by 80% compared to the same period of 2005. As explained above, this decrease is primarily attributable to the closing of our St. Mary's store. We anticipate the advertising and display costs will continue at lower rates during the balance of the 2006 fiscal year as a result of closing of the St. Mary's store and as a result of reduced marketing costs as we focus more attention on product sales to contractors rather than retail buyers

Occupancy costs and utilities during the second quarter 2006 compared to the same quarter 2005, decreased 5% as a result of the closing of the St. Mary's store. We had an increase in waste services because in previous periods we shared these costs with a neighbor. This arrangement no longer exists. We expect these costs to remain constant in the upcoming quarters.

Legal and accounting costs increased 86% during the three months ended June 30, 2006 compared to the three months ended June 30, 2005. We anticipate legal and accounting costs to continue at levels consistent with or higher than the second quarter 2006 as we begin to incur legal and accounting costs in connection with our ongoing public reporting obligations.

Other costs decreased 58% during the quarter ended June 30, 2006 as compared to the quarter ending June 30, 2005 as we continued our efforts to control expenses. We anticipate other costs will to remain fairly constant in upcoming quarters.

### Net Income

For the reasons discussed above, our net loss in the second quarter 2006 was \$75,853 compared to a net income of \$498 in the second quarter 2005. We expect that net loss will decrease in upcoming quarters.

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For the six months ended June 30, 2006 and 2005

We incurred a net loss of \$173,989 through the six months ended June 30, 2006, compared to net income of \$10,166 during the six months ended June 30, 2005.

### Revenues

During the first six months of fiscal 2006 average retail product prices were fairly constant, although we increased prices for supplies such as carpet pad, glue, etc., approximately 10% higher as compared to the same period

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of 2005. Despite higher retail prices for supplies, overall we have realized a 22% decrease in revenue from product sales. This decrease in revenue from product sales in the first two quarters of 2006 is primarily the result of the closing of our St. Mary's store. As discussed above, another contributing factor to our decreased revenue from sales is the shift in our customer mix because contractors typically pay lower prices for product than do retail customers. We expect that revenue from product sales will continue to be lower throughout the rest of the 2006 fiscal year as compared to the 2005 fiscal year because of the closing of the St. Mary's store.

### Gross Profit

Gross profit during the first six months of 2006 was \$291,483, 58% lower than the \$696,486 gross profits realized during the first six months of 2005. During the first six months of 2006, we realized a 22% decrease in net revenue. We also realized a 1% increase in cost of sales during the first six months of 2006 compared to the first six months of 2005. As a result of decreased revenue and increased cost of products sold, cost of sales as a percentage of net revenues increased from 61% during the first six months of 2005 to 79% during the first six months of 2006. During the first six months of 2006 we also revisited certain previously completed jobs to perform repair work that was performed at our expense, which resulted in an increase to our costs of product sold, with no corresponding increase to revenue.

For the reasons detailed above, as our customer mix continues to shift to a higher percentage of contractors, we anticipate cost of sales will continue to represent a higher percentage of net revenues than it has historically. Also, we have experienced increases in costs of sales due to an increase in costs of installation supplies and floor padding that fluctuates with the price of fuel. As discussed above, however, we believe this decrease in margins can be at least partially offset by decreases in other expenses.

### General and Administrative Expenses

General and administrative expenses for the six months ended June 30, 2006, decreased \$264,375, or 41% to \$378,180 compared to the six months ended June 30, 2005, and as a percentage of sales revenue it decreased to 27% during the six months ended June 30, 2006 as compared to 36% for the first six months

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ended June 30, 2005. During the six months ended June 30, 2006 and 2005, general and administrative costs consisted of:

	Six Months Ended	
	June 30, 2006	June 30, 2005
	-----	-----
Salaries & benefits costs	\$ 146,491	\$ 250,146
Advertising & display costs	16,006	49,436
Occupancy costs & utilities	133,969	150,992
Legal & accounting costs	24,505	35,808
Other	57,209	156,173
	-----	-----
	\$ 378,180	\$ 642,555
	=====	=====

The 41% reduction in salaries and benefits costs in the six months ended June 30, 2006 compared to 2005 is the result of a reduction in our work force. This reduction in our work force resulted from the closing of our St. Mary's store and a reduction in our retail sales and accounts payable

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departments. In anticipation of expansion, we had hired more retail sales and accounts payable personnel than we needed to operate our current locations. With the decision not to expand at the current time, we laid off several persons. We do not expect significant additional changes salaries and benefits throughout the balance of 2006.

During the six months ended June 30, 2006 we decreased our advertising and display costs by 67% compared to the same period of 2005. As explained above, this decrease is primarily attributable to the closing of our St. Mary's store and a reduction in advertising as our traditional customer mix continues to shift to focus more attention on product sales to contractors rather than retail buyers.

Occupancy costs and utilities during the six months ended June 30, 2006 compared to the same period of 2005, decreased by 11% as a result of the closing of the St. Mary's store. We expect these costs to remain relatively constant in the upcoming quarters.

Legal and accounting costs decreased 32% to \$24,505 during the six month period ended June 30, 2006 compared to the six month period ended June 30, 2005. We believe this decrease in legal and accounting costs is more an issue of timing than a reflection of any long-term reduction in legal and accounting costs and we expect legal and accounting costs to continue at levels consistent with or higher than the amounts incurred during the prior fiscal year.

Other costs decreased 63% to \$57,209 during the six month period ended June 30, 2006 compared to the six month period ended June 30, 2005 as we continued our efforts to control expenses. We anticipate other costs will to remain fairly constant in upcoming quarters.

### Net Income

For the reasons disclosed above, during the six months ended June 30, 2006 we realized a net loss of \$173,989 compared to net income \$10,166 during the first six months of 2004. While we expect net losses to decrease in upcoming quarters, we do expect to continue to realize net losses through the balance of the current fiscal year.

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### Liquidity and Capital Resources

Our capital resources have consisted of revenues from operations, funds raised through the sale of our common stock and debt. During the fourth quarter 2005 we completed a public offering of our securities pursuant to an effective SB-2 registration statement. The funds raised in the SB-2 have since been used to fund our operations. As shown in our financial statements, we have an accumulated deficit of \$2,345,276, and negative working capital of \$1,475,287. These factors raise substantial doubt about our ability to continue as a going concern.

We have been working to obtain additional debt financing to cover the shortfalls in revenue and to allow us to begin purchasing inventory at a discount. As noted above, we have also been making changes in operations to reduce expenses. We may also seek additional equity financing through the sale of our shares, although we currently have no commitments for additional equity financing and there is no guarantee that we can obtain equity financing on acceptable terms or at all.

During the first six months of 2006 and 2005 cash was primarily used to fund operations. See below for additional discussion and analysis of cash flow.

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	Six Months Ended	
	June 30, 2006	June 30, 2005
	-----	-----
Net cash used in operating activities	\$ (406,215)	\$ (155,042)
Net cash used in investing activities	-	\$ (6,748)
Net cash provided by financing activities	\$ 343,701	\$ 166,424
	-----	-----
	\$ (62,514)	\$ 4,634
	=====	=====

### NET INCREASE (DECREASE) IN CASH

As discussed herein, during the six months ended June 30, 2006 compared to the six months ended June 30, 2005 product sales decreased leading to a reduction in net income of \$10,166 to a net loss of \$173,989. In addition to the reduction in cash from operating activities resulting from the net loss of \$173,989, we also realized an increase in accounts receivable and decreases in accounts payable, accrued liabilities and customer deposits.

We used \$0 net cash in investing activities to acquire equipment during the first six months of 2006, compared to \$6,748 during the first six months of 2005.

Net cash provided from financing activities was \$343,701 during the six months ended June 30, 2006 compared to \$166,424 during the six months ended June 30, 2005, a 107% increase. During the six months ended June 30, 2006 we repaid \$46,400 in long term debt compared to \$70,676 during the first six months of 2005. It is important to note that during the first six months of 2005 most of the cash provided from financing activities came from the sale of our equity securities. By contrast, during the six months ended June 30, 2006, cash flow from financing activities was the result of borrowing on a line of credit extended by a related party.

At June 30, 2006 and 2005, we had cash on hand of \$1,768 and \$94,726, respectively.

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### Summary of Material Contractual Commitments

The following table lists our significant commitments as of June 30, 2005.

Contractual Commitments	Total	Payments Due by Fiscal Year			
		2005	2006	2007	2008
	-----	-----	-----	-----	-----
Line of Credit-Related Party	1,595,825	1,595,825	-	-	
Note Payable-Related Party	79,761	28,388	51,373		
Notes Payable	474,277	22,737	47,344	50,575	353,177
Capital Leases	13,493	4,674	8,819		
Operating Leases	688,005	73,289	149,338	152,170	155,208
	-----	-----	-----	-----	-----
TOTAL	\$2,851,361	\$1,724,913	\$256,874	\$202,745	\$508,360
	=====	=====	=====	=====	=====

### Off-Balance Sheet Financing Arrangements

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As of June 30, 2005 and 2004, we had no off-balance sheet financing arrangements.

### Critical Accounting Policies

#### Revenue Recognition

We recognize revenues in accordance with the Securities and Exchange Commission, Staff Accounting Bulletin (SAB) number 104, "Revenue Recognition in Financial Statements." SAB 104 clarifies application of U. S. generally accepted accounting principles to revenue transactions. Accordingly, revenue is recognized when an order has been received, the price is fixed and determinable, the order is shipped and installed, collection is reasonably assured and we have no significant obligations remaining. Licensing fees are royalties paid to us for licensing the use of the name The Flooring Zone. The royalties range from 1-2% of the licensee's commercial sales volume.

We record accounts receivable for sales which have been delivered but for which money has not been collected. An allowance for doubtful accounts is provided for accounts deemed potentially uncollectible based on analysis and aging of accounts. For customer purchases or deposits paid in advance, we record a liability until products are shipped or installed.

#### Merchandise Inventory

We record inventory at the lower of cost or market, cost being determined on a first-in, first-out method. We do not believe our merchandise inventories are subject to significant risk of obsolescence in the near-term, and we have the ability to adjust purchasing practices based on anticipated sales trends and general economic conditions.

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#### Vendor Funds

We receive funds from vendors in the normal course of business for purchase-volume-related rebates. Our accounting treatment for these vendor-provided funds is consistent with Emerging Issues Task Force (EITF) 02-16 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received From a Vendor." Under EITF 02-16, purchase volume rebates should be treated as a reduction of inventory cost, unless they represent a reimbursement of specific, incremental and identifiable costs incurred by the customer to sell the vendor's product. The purchase volume rebates that we receive do not meet the specific, incremental and identifiable criteria in EITF 02-16. Therefore, they are treated as a reduction in the cost of inventory and we recognize these funds as a reduction of cost of sales when the inventory is sold.

#### Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123R, Share-based Payment. This standard is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R requires the measurement of the cost of employee services received in exchange for an award of the entity's equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render service. The Company adopted SFAS No. 123R on January 1, 2006, which requires stock-based compensation expense to

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be recognized against earnings for the portion of outstanding unvested awards, based on the grant date fair value of those awards calculated using a Black-Scholes pricing model under SFAS 123 for pro forma disclosure. The Company is currently evaluating to what extent the entity's equity instruments will be used in the future for employees services and the transition provisions of this standard; therefore, the impact to the Company's financial statements of the adoption of SFAS No. 123R cannot be predicted with certainty.

### Item 3. Controls and Procedures

Our principal executive officers and our principal financial officer (the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Such officers have concluded (based upon their evaluations of these controls and procedures as of the end of the period covered by this report) that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by it in this report is accumulated and communicated to management, including the Certifying Officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officers have also indicated that there were no significant changes in the Company's internal controls over financial reporting or other factors that could significantly affect such controls subsequent to the date of their evaluation, and there were no significant deficiencies and material weaknesses.

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Management, including the Certifying Officers, does not expect that the Company's disclosure controls or its internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any systems of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of these inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

## PART II - OTHER INFORMATION

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

No instruments defining the rights of the holders of any class of registered securities have been materially modified, limited or qualified during the quarter ended June 30, 2006.

During the quarter, we sold no shares that were not registered under the Securities Act of 1933.

### Item 6. Exhibits



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Exhibits. The following exhibits are included as part of this report:

- Exhibit 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.1 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.2 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

THE FLOORING ZONE, INC.

October 2, 2006

/s/ Michael Carroll

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Michael Carroll, Chief Executive Officer

October 2, 2006

/s/ Michael Carroll

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Michael Carroll, Chief Financial Officer

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