

Edgar Filing: DIVERSIFIED SECURITY SOLUTIONS INC - Form 10QSB

DIVERSIFIED SECURITY SOLUTIONS INC  
Form 10QSB  
August 14, 2003

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES AND EXCHANGE  
ACT OF 1934

For the quarterly period ended June 30, 2003

OR

TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES AND EXCHANGE  
ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 05-62411

Diversified Security Solutions, Inc.  
(Name of small business issuer as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	22-3690168 (I.R.S. Employer Identification No.)
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280 Midland Avenue  
Saddle Brook, New Jersey 07663  
(address of principal executive offices) (Zip Code)

Issuer's Telephone number, including area code: (201) 794-6500

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

Yes  No

Number of shares outstanding of the issuer's Common Stock:

Class:	Outstanding at June 30, 2003
Common stock, \$.01 par value	5,138,357

Diversified Security Solutions, Inc. and Subsidiaries

INDEX

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Page  
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Part I	Financial Information	
Item 1.	Financial Statements	
	Consolidated Balance Sheets as of June 30, 2003 (Unaudited) and December 31, 2002	1
	Consolidated Statements of Operations for the six and three-months ended June 30, 2003 (Unaudited).	2
	Consolidated Statements of Cash Flows for the six-months ended June 30, 2003 (Unaudited) and June 30, 2002 (Unaudited)	3
	Notes to Financial Statements	4-7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	7-9
Item 3.	Controls and Procedures	9
Part II	Other Information	
Item 1.	Legal Proceedings	10
Item 2.	Change in Securities	10
Item 3.	Defaults Upon Senior Securities	10
Item 4.	Submission of Matters to a Vote of Security Holders	10
Item 5.	Other Information	10
Item 6.	Exhibits and Reports on Form 8-K	10
	SIGNATURES	11

DIVERSIFIED SECURITY SOLUTIONS, INC.  
CONSOLIDATED BALANCE SHEETS

June 30, 2003  
Unaudited  
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ASSETS		
Current assets:		
Cash and cash equivalents		\$ 3,567,181
Accounts receivable - net of allowance for doubtful accounts of \$100,000 and \$100,000		5,289,420
Note receivable		500,000
Inventory		1,794,821
Costs and profit in excess of billings		170,907

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Refundable and prepaid income taxes	689,902
Deferred tax assets	510,000
Other current assets	422,536
	-----
Total current assets	12,944,767
Property and equipment, net of accumulated depreciation of \$1,231,325 and \$1,070,718	1,231,074
Computer software product cost - net of accumulated amortization of \$499,472 and \$479,472	194,620
Goodwill	1,846,733
Intangible assets - net of accumulated amortization of \$121,579 and \$63,356	1,447,237
Other assets	119,356
	-----
	\$17,783,787
	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
Current liabilities:	
Accounts payable	\$ 1,200,540
Accrued expenses	949,277
Billings in excess of cost	294,159
Deferred tax liability	97,000
Long-term debt current portion	174,620
Capitalized lease obligations, current portion	9,594
Customer deposits held	7,488
	-----
Total current liabilities	2,732,678
	-----
Capitalized lease obligations, less current portion	1,853
Long-term debt, less current portion	2,425,139
Deferred tax liability	182,000
	-----
Total liabilities	5,341,670
	-----
Stockholders' Equity:	
Preferred stock, \$.01 par value; 2,000,000 shares authorized; no shares issued	
Common stock, \$.01 par value; 10,000,000 shares authorized; 5,138,357 shares outstanding	51,384
Additional paid-in capital	13,150,681
Accumulated deficit and retained earnings	(759,948)
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Total stockholders' equity	12,442,117
	-----
	\$17,783,787
	=====

The accompanying notes are an integral part of the statements

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DIVERSIFIED SECURITY SOLUTIONS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2003	2002	2003	2002
Sales	\$ 7,226,421	\$ 7,394,016	\$ 3,520,718	\$ 4,214,632
Cost of Sales	5,604,699	4,266,639	2,950,163	2,375,295
Gross profit	1,621,722	3,127,377	570,555	1,839,337
Operating expenses				
Selling, general and administrative	4,385,578	2,935,706	2,212,438	1,722,740
Operating (loss) income	(2,763,856)	191,671	(1,641,883)	116,597
Interest income	(6,733)	(38,467)	(1,193)	(9,471)
Interest expense	51,114	78,809	24,391	39,962
(Loss) income before income taxes	(2,808,237)	151,329	(1,665,081)	86,106
(Provision) benefit for income taxes	1,179,000	(65,000)	699,000	(39,000)
Net (loss) income	\$ (1,629,237)	\$ 86,329	\$ (966,081)	\$ 47,106
Basic and diluted (loss) earnings per common share:				
Basic (loss) earnings per common share	\$ (0.32)	\$ 0.02	\$ (0.19)	\$ 0.01
Weighted average common shares	5,138,357	4,725,000	5,138,357	4,725,000
Diluted (loss) earnings per common share	\$ (0.32)	\$ 0.02	\$ (0.19)	\$ 0.01
Weighted average diluted shares	5,138,357	4,800,000	5,138,357	4,800,000

The accompanying notes are an integral part of these statements

DIVERSIFIED SECURITY SOLUTIONS, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS

Six Months Ended  
June 30,

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	2003	2002
Cash flows from operating activities:		
Net (loss) income	(1,931,237)	\$ 86,3
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Amortization of stock based compensation		10,4
Depreciation and amortization	238,830	176,9
Deferred taxes	(349,000)	
Changes in operating assets and liabilities:		
Accounts receivable	974,575	(836,2
Inventory	375,178	(859,6
Costs and profits in excess of cost	539,418	(7,6
Refundable and prepaid incomes taxes	(684,011)	(249,2
Other assets	158,275	(210,1
Accounts payable	(266,897)	(515,2
Accrued expenses	(122,297)	(120,9
Billings in excess of cost	170,289	(78,8
Customer deposits held	(147,577)	404,0
Cash used in operating activities	(1,044,454)	(2,200,3
Cash flows from investing activities:		
Proceeds of securities held to maturity		399,2
Purchase of property and equipment	(185,369)	(368,9
Cash (used in) provided by investing activities	(185,369)	30,2
Cash flows from financing activities		
Net payments of revolving bank line	326,298	(488,3
Capitalized lease obligation payments	(1,566)	(2,4
Repayment of other notes	--	(38,6
Cash provided by (used in) financing activities	324,733	(529,4
Decrease in cash and cash equivalents	(905,090)	(2,699,5
Cash and cash equivalents - beginning of period	4,472,271	8,914,4
Cash and cash equivalents - end of period	\$ 3,567,181	\$ 6,214,9

The accompanying notes are integral part of the statements

Supplemental Cash Flow Information:

Cash paid during the period for:

Income taxes	\$ 183,875	\$ 149,9
Interest	\$ 50,827	\$ 78,8

Supplemental Schedule of Non-Cash Investing and Financing Activities:

During 2003, the Company financed equipment for \$38,632.

In May 2003, the Company accrued \$56,376 of goodwill in connection with the acquisition of HBE-CA (See note 5)

The accompanying notes are an integral part of these financial statements

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## DIVERSIFIED SECURITY SOLUTIONS, INC. AND SUBSIDIARIES NOTES TO FINANCIAL STATEMENTS

### 1. Basis of Presentation

Diversified Security Solutions, Inc., the ("Company") and its subsidiaries, are systems integrators providing design, installation and support services for a wide variety of security, communications and control systems. The Company specializes in turnkey systems that integrate many different technologies. Systems are customized to meet the specific needs of its customers. In addition, we manufacture and assemble CCTV equipment and provide security-consulting services to our clients. The Company markets nationwide with an emphasis in the New York, Dallas, Phoenix and Southern California metropolitan areas. Customers are primarily medium and large commercial and government agencies.

The Company's headquarters and manufacturing facility is located in Saddle Brook, New Jersey. Sales and service facilities are located near Dallas, Texas, Phoenix, Arizona and Fullerton, California.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States of America for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three and six - month periods ended June 30, 2003, are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company's Annual Report on Form 10-KSB for the fiscal period ended December 31, 2002

### 2. Net (Loss) Income Per Common Share

Basic net (loss) income per share of common stock is calculated by dividing net (loss) income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance or potential common shares that may be issued by the Company relating to outstanding stock options and warrants.

### 3. Stock Based Compensation

On January 1, 2003, the Company adopted the fair recognition value provisions of FASB No. 123, "Accounting for Stock Based Compensation," which was amended by FASB No. 148. Under the prospective method of adoption selected by the Company, stock based compensation cost will be recognized using the fair value method for all awards, granted, modified or settled on or after the effective date. There were no stock options issued during the three and six-months ended June 30, 2003 and there were stock options issued during the three and six-months ended June 30, 2003.

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Based upon the fair value method to measure compensation expense, the Company's proforma effects for the three and six-months ended June 30, 2003 is as follows:

	Three-Months Ended June 30, (Unaudited)		Six-Months Ended June 30, (Unaudited)	
	2003	2002	2003	2002
Net (loss) income, as reported	\$ (966,081)	\$ 47,106	\$ (1,629,237)	\$ 86,329
Stock - based employee compensation expense included in reported net (loss) income, net of related tax expense	0	0	0	0
Total stock-based employee compensation expense determined under fair valued based, net of related tax effects		(8,489)		(8,489)
Pro forma net (loss) income	\$ (966,081)	\$ 38,617	\$ (1,629,237)	\$ 77,840
 (Loss) earning per share:				
Basic- as reported	\$ (0.19)	\$ 0.01	\$ (0.32)	\$ 0.02
Basic- as pro forma	\$ (0.19)	\$ 0.01	\$ (0.32)	\$ 0.02
Diluted - as reported	\$ (0.19)	\$ 0.01	\$ (0.32)	\$ 0.02
Diluted - as proforma	\$ (0.19)	\$ 0.01	\$ (0.32)	\$ 0.02

5

#### 4. Employee Benefit Plan

Effective January 1, 2003, the Company sponsored a 401-K and a discretionary profit sharing plan (the "Plan".) The Company matches up to three percent of qualifying employees' compensation contribution to the Plan. The Company's contributions to the employees' account vests equally over three years and the employee contribution to their own account vests immediately.

#### 5. Commitments

On May 17, 2002, the Company purchased all of the issued and outstanding shares of Henry Bros. Electronic, Inc. formerly Photo Scan Systems, Inc. ("HBE-CA") from Secure Alarm Systems, Inc. ("Secure Alarm"). The purchase price

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for the issued and outstanding, shares of PhotoScan was \$600,000 of which \$200,000 was paid in cash and balance was paid by issuing 51,249 shares of the Company restricted common stock. The purchase agreement provides that in the event that the average closing price of our common stock for the ten trading days immediately prior to May 16, 2003 is less than approximately \$7.805 per share, the Company will pay in cash Secure Alarm an amount equal to the difference between \$400,000 and the 51,249 shares multiplied by such average closing price. In May 2003, the Company accrued an obligation of \$56,375 to the owner of Secure Alarm.

On August 13, 2002, the Company acquired all of the issues and outstanding common stock of National Safe of California, Inc. ("National Safe"). The purchase price of the acquisition was \$2,000,000, which was paid by issuing an aggregate of 283,566 shares. The Stock Purchase Agreement provides that in the event that the average closing price of the Company's common stock for the ten trading days immediately prior to August 12, 2003 ("the Reference Date") is less than \$7.053 per share, the Company can within 10 days of the Reference Date, either purchase 212,675 of the Shares of \$1,500,000 (subject to certain adjustments detailed in the Stock Purchase Agreement) or pay the seller an amount equal to the difference between (i) \$1,500,000 and (ii) 212,675 (subject to certain adjustments detailed in the Stock Purchase Agreement) multiplied by such average closing price.

Any adjustment resulting from the above transaction(s) is a purchase price adjustment and will be recorded as goodwill.

### 6. Related Party Transactions

A corporation of which a director was an officer was paid consulting fees in amount of \$12,400 and \$30,900 for the three and six - months ended June 30, 2003, respectively.

### Critical Accounting Policies

Disclosure of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements of the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002. Some of these policies require management to make estimates and assumptions that may affect the reported amounts in the Company's financial statement.

### Recent Accounting Pronouncements

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation--Transition and Disclosure," which amends SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. In addition, SFAS No. 148 improves the timeliness of those disclosures by requiring that this information be included in interim as well as annual financial statements. SFAS No. 148 is effective for fiscal years ending after December 15, 2002. The effects of adopting SFAS No. 148 did not impact on the Company's financial position or results of operations.



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### Forward Looking Statements

When used in this discussion, the words "believes", "anticipates", "contemplated", "expects", or similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, the ability to control costs and expenses, significant variations in recognized revenue due to customer caused delays in installations, cancellations of contracts by our customers, and general economic conditions which could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company undertakes no obligation to publicly release the results of any revisions to those forward looking statements that may be made to reflect events or circumstances after this date or to reflect the occurrence of unanticipated events.

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

#### Results of Operations

Six - Months ended June 30, 2003 and June 30, 2002

Sales - Sales for the six-month ended June 30, 2003 was \$7,226,421 representing a decrease of 2.3% or \$167,595 as compared to June 30, 2002 or \$7,394,016. Sales declined in our core business of \$ 2,237,126 for the six - months ended June 30, 2003 as compared to June 30, 2002. Sales for the six-months ended June 30, 2003 as compared to June 30, 2002 included \$2,039,531 from three acquisitions made by the Company. HBE-CA's operations were included in operations since June 2002. National Safe and Henry Bros. Electronics, LLC formerly Corporate Security Integration (" HBE-AZ") operations began in the third quarter 2002. Sales decreased in our core business due to the overall economy and more competitors in the market place.

Cost of Sales - Cost of sales for the six-months ended June 30, 2003 was \$5,604,699 as compared to \$4,266,639 for the six - months ended June 30, 2002. This was an increase of \$1,338,060 or 31.3% as compared to the six-months ended June 30, 2003. For the six -months ended June 30, 2003, the gross profit margin was 22.4% as compared to 42.3% for the six months ended June 30, 2002. We attribute the increase in our cost of sales to our having to charge less for our services due to increased competition.

7

Selling, General and Administrative Expenses - Selling, general and administrative expenses increased to \$4,385,578 for the six-months ended June 30, 2003 as compared to \$2,935,706 for the six-months ended June 30, 2002 . This increase of 49.4% or \$1,449,872 is primarily attributed to the additional cost associated with our West Coast offices of \$1,377,190.

Interest Income - Interest income for the six-months months ended June 30, 2003 was \$6, 733 as compared to \$38,467 for six months ended June 30, 2002. The decrease of \$31,734 was due to having less cash to invest.

Interest Expense. Interest expense for the six-months months ended June 30, 2003

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was \$51,114 as compared to \$78,809 for the six-months ended June 30, 2002. Interest expense decreased by \$27,695 is attributed to having an average lower debt balance of \$2,424,987 for the six-months ended June 30, 2003 as compared to \$ 2,681,547 for the six months ended June 30, 2002 and lower interest rates on our loans by a full basis point for the six-month ended June 30, 2003 as compared to June 30, 2002

Net (Loss) Income - As a result of the factors noted above, for the six-months ended June 30, 2003, our net loss was \$1,692,237, as compared to net income of \$86,329, for the six-months ended June 30, 2002. This resulted in basic loss per share of \$0.32 on weighted average common shares outstanding of 5,138,357 for the six-months ended June 30, 2003 as compared to basic earnings per share of \$0.02 on weighted average common shares outstanding of 4,725,000 for the six-months ended June 30, 2002.

### Three - Months ended June 30, 2003 and June 30, 2002

Sales - Sales for the three-month ended June 30, 2003 was \$3,520,718 representing a decrease of 16.5% or \$693,914 as compared to June 30, 2002 or \$4,214,632. Sales declined in our core business of \$ 1,779,406 for the three - months ended June 30, 2003 as compared to June 30, 2002. Sales for the three - months ended June 30, 2003 as compared to June 30, 2002 included \$1,085,492 from three acquisitions made by the Company. HBE-CA's operations were included in operations since June 2002. National Safe and HBE-AZ's operations began in the third quarter 2002. Sales decreased in our core business due to the overall economy and more competitors in the market place.

Cost of Sales - Cost of sales for the three-months ended June 30, 2003 was \$2,950,163 as compared to \$2,375,295 for the three-months ended June 30, 2002. This was an increase of \$574,868 or 24.2% as compared to the three-months ended June 30, 2002. For the three-months ended June 30, 2003, the gross profit margin was 16.2% as compared to 43.6% for the three-months ended June 30, 2002. We attribute the increase in our cost of sales to our having to charge less for our services due to increased competition.

Selling, General and Administrative Expenses - Selling, general and administrative expenses increased to \$2,212,439 for the three-months ended June 30, 2003 as compared to \$1,722,740 for the three-months ended June 30, 2002. This increase of 28.4. % or \$489,699 is primarily attributed to the costs incurred with the operating expenses of the west coast offices for the three-months ended June 30, 2003 of \$577,960.

8

Interest Income - Interest income for the three-months months ended June 30, 2003 was \$1,193 as compared to \$9,471 for three- months ended June 30, 2002. The decrease of \$8,278 was due to having less cash to invest.

Interest Expense - Interest expense for the three-months months ended June 30, 2003 was \$24,391 as compared to \$39,962 for the three-months ended June 30, 2002. Interest expense decreased by \$15,571 is attributed to having an average lower debt balance of \$2,403,738 for the three -months ended June 30, 2003 as compared to \$2,673,557 and lower interest rates on our loans by a full basis point for the three-months ended June 30, 2003 as compared to the three-months ended June 30, 2003.

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Net (Loss) Income. As a result of the factors noted above, for the three-months ended June 30, 2003, our net loss was \$966,081 as compared to net income of \$47,106 for the three-months ended June 30, 2002. This resulted in basic loss per share of \$0.19 on weighted average common shares outstanding of 5,138,357 for the three months ended June 30, 2003 as compared to basic earnings per share of \$0.01 on weighted average common shares outstanding of 4,725,000 for the three-months ended June 30, 2002.

### Liquidity and Capital Resources

As of June 30, 2003, we had cash and cash equivalents of \$3,567,181. We have a loan facility of \$4,500,000 with Hudson United Bank and have certain debt maturing from November 2004 through May 2005. The amount available under the credit facility was \$1,913,069 as of June 30, 2003. Our working capital was \$10,552,385 as of June 30, 2003.

During the six-months ended June 30, 2003, net cash used in operations was \$1,044,454 and we purchased property and equipment of \$185,369. In addition, there was net cash provided by investing activities resulting from net borrowings of \$324,733.

Our capital requirements have grown substantially as a result of the growth of our operations and staffing since our public offering. We believe that our current cash and available lines of credit should be sufficient to meet our capital requirements for the next twelve-months. The company is in the process of seeking capital.

### Item 3. Controls and Procedures

#### (a) Evaluation of disclosure controls and procedures

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

9

(a) As used herein, "disclosure controls and procedures" means controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure

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(b) Changes in internal controls.

There have been no significant changes in the Company's internal controls or, to its knowledge, in other factors that could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

### Part II - Other Information

#### Item 1. Legal Proceedings

In May 2003, Henry Bros. Electronics, Inc., a wholly owned subsidiary of the Company, commenced an action in the Superior Court located in Orange County, California, seeking a preliminary injunction against National Systems Integration, Inc. (formerly known as Intellisec). This matter has since been settled.

#### Item 2. Changes in Securities

Not applicable

#### Item 3. Defaults Upon Senior Securities

Not applicable

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

Not applicable

#### Item 5. Other Information

Not applicable

#### Item 6. Exhibits and Report on Form 8-K

10

#### (a) Exhibits

Number	Description
-----	-----
31(1)	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(2)	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) The issuer filed no reports on Form 8-K during the second quarter of 2003

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In accordance with 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

SIGNATURE

Date: August 14, 2003

/s/ JAMES E. HENRY

-----  
James E. Henry  
Chairman, Chief Executive Officer  
and Director

Date: August 14, 2003

/s/ LOUIS MASSAD

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Louis Massad  
Vice President, Treasurer, Chief  
Financial Officer and Director

11

STATEMENT OF DIFFERENCES

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The section symbol shall be expressed as..... 'SS'