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 March 31, 1998

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)
300 Atrium Drive, Somerset, NJ	08873
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (732) 748-1700

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 / /

19,298,010 shares of Common Stock, par value $.001 per share, were outstanding as of May 13, 1998.

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
FORM 10-Q

March 31, 1998

Table of Contents

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	MARCH 31, 1998 (unaudited)	SEPTEMBER 30, 1997
ASSETS		
CURRENT ASSETS		
Cash	$ 1,244,000	$ 841,000
Restricted Cash	738,000	738,000
Accounts receivable, net of allowance	5,300,000	5,820,000
Other current assets	962,000	402,000
Total current assets	8,244,000	7,801,000
EQUIPMENT AND IMPROVEMENTS		
Equipment	3,319,000	3,170,000
Leasehold improvements	49,000	47,000
	3,368,000	3,217,000
Accumulated depreciation and amortization	2,460,000	2,310,000
	908,000	907,000
DEFERRED TAX ASSET	380,000	760,000
GOODWILL, net of amortization	4,220,000	4,344,000
OTHER ASSETS	279,000	351,000
TOTAL ASSETS	$14,031,000	$14,163,000

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

DIGITAL SOLUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	MARCH 31, 1998 (unaudited)	SEPTEMBER 30, 1997
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	$ --	$ 2,697,000
Current portion of long-term debt	569,000	113,000
Accounts payable	2,281,000	2,254,000
Accrued expenses and other current liabilities	3,357,000	4,138,000
Total current liabilities	6,207,000	9,202,000
LONG-TERM DEBT	1,998,000	89,000
Total Liabilities	8,205,000	9,291,000
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
Common Stock, $.001 par value; authorized 40,000,000 shares; issued and outstanding 19,298,010 and 19,141,760 at March 31, 1998 and September 30, 1997, respectively	19,000	19,000
Additional paid-in capital	13,643,000	13,393,000
Accumulated deficit	(7,836,000)	(8,540,000)
Total shareholders' equity	5,826,000	4,872,000
TOTAL LIABILITIES AND EQUITY	$ 14,031,000	$ 14,163,000

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

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

	FOR THE THREE MONTHS MARCH 31, 1998	1997
REVENUES	$ 32,575,000	$ 30,225,000
DIRECT EXPENSES	30,346,000	28,633,000
Gross profit	2,229,000	1,592,000
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	1,761,000	4,307,000
DEPRECIATION AND AMORTIZATION	170,000	438,000
Income (loss) from operations	298,000	(3,153,000)
OTHER INCOME (EXPENSE)		
Interest and other income	11,000	16,000
Interest expense	(105,000)	(105,000)
	(94,000)	(89,000)
Income (loss) before tax	204,000	(3,242,000)
INCOME TAX	--	--
NET INCOME (LOSS)	$ 204,000	$ (3,242,000)
BASIC EARNINGS (LOSS) PER COMMON SHARE	$ 0.01	$ (0.17)
WEIGHTED AVERAGE SHARES OUTSTANDING	19,298,010	19,085,036
DILUTED EARNINGS (LOSS) PER COMMON SHARE	$ 0.01	$ (0.17)
DILUTED SHARES OUTSTANDING	19,618,273	19,085,036

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

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

	FOR THE SIX MONTHS MARCH 31,	
	1998	1997
REVENUES	$ 66,237,000	$ 61,110,000
DIRECT EXPENSES	61,406,000	57,003,000
Gross profit	4,831,000	4,107,000
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	3,618,000	6,368,000
DEPRECIATION AND AMORTIZATION	339,000	617,000
Income (loss) from operations	874,000	(2,878,000)
OTHER INCOME (EXPENSE)		
Interest and other income	23,000	33,000
Interest expense	(193,000)	(196,000)
	(170,000)	(163,000)
Income (loss) before tax	704,000	(3,041,000)
INCOME TAX	--	--
NET INCOME (LOSS)	$ 704,000	$ (3,041,000)
BASIC EARNINGS (LOSS) PER COMMON SHARE	$ 0.04	$ (0.16)
WEIGHTED AVERAGE SHARES OUTSTANDING	19,234,889	19,021,425
DILUTED EARNINGS (LOSS) PER COMMON SHARE	$ 0.04	$ (0.16)
DILUTED SHARES OUTSTANDING	19,572,183	19,021,425

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

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

	FOR THE SIX MONTHS MARCH 31, 1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 704,000	$(3,041,000)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	339,000	617,000
Provision for doubtful accounts	35,000	1,052,000
Other non cash items	--	1,148,000
Changes in operating assets and liabilities:		
Accounts receivable	485,000	(1,698,000)
Other current assets	(173,000)	(254,000)
Notes due from officers	--	136,000
Accounts payable, accrued expenses and other current liabilities	(754,000)	2,142,000
Net cash provided by operating activities	636,000	102,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of equipment and improvements	(151,000)	(105,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings on revolving line of credit	--	410,000
Repayments on revolving line of credit	(260,000)	(360,000)
Payments under capital lease obligations	(72,000)	(44,000)
Proceeds from reduction of required Letters of Credit	--	417,000
Proceeds from issuance of common stock and exercise of common stock options and warrants - net	250,000	229,000
Net cash (used in) provided by financing activities	(82,000)	652,000
Net increase in cash	403,000	649,000
CASH AT BEGINNING OF PERIOD	841,000	--
CASH AT END OF PERIOD	$ 1,244,000	$ 649,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 181,000	$ 183,000

The accompanying notes to the consolidated financial statements are an integral part of these consolidated 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. These consolidated financial statements should 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., DSI Staff ConnXions - Southwest, 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.

Earnings Per Common Share

In March 1997, the Financial Accounting Standards Board issued Statement on Financial Accounting Standards Number 128, "Earnings Per Share" (FAS No. 128). FAS 128 requires the presentation of basic earnings per share and diluted earnings per share for all periods presented. "Basic earnings per share" represents net income divided by the weighted average shares outstanding. "Diluted earnings per share" represents net income divided by weighted average shares outstanding adjusted for the incremental dilution of outstanding stock options and awards.

A reconciliation of weighted average number of common shares outstanding to weighted average common shares outstanding assuming dilution is as follows:

	Three Months Ended March 31, 1998	Three Months Ended March 31, 1997	Six Months Ended March 31, 1998	Six Months Ended March 31, 1997
Weighted average number of common shares	19,298,010	19,085,036	19,234,889	19,021,425
Dilutive share equivalents of outstanding stock options	320,263	--	337,294	--
Weighted average number of common shares assuming dilution	19,618,273	19,085,036	19,572,183	19,021,425

Stock options outstanding at March 31, 1998 to purchase 599,479 shares of common stock were not included in the computation of earnings per share assuming dilution because the options' exercise prices were greater than the average price of the common shares.

(3) COMMITMENTS AND CONTINGENCIES

In connection with the Company's former workers' compensation insurance policy which expired on April 1, 1997, the insurance company developed 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 March 31, 1998, this accrual amounted to $361,000. On April 1, 1997, the Company entered into a workers' compensation policy with a new carrier. During the six months ended March 31, 1998 and 1997, the Company recognized approximately $508,000 and $517,000, respectively, as its share of premiums collected from customers covered by these policies in excess of claims and fees paid.

The Company has outstanding letters of credit amounting to $1,193,000 as of March 31, 1998. The letters of credit are required to collateralize unpaid claims in connection with the Company's former 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 $738,000 and utilizing $455,000 of amounts available under its line of credit. The Company's current policy does not require a letter of credit because the Company funds the estimated loss reserves on a monthly basis.

(4) SHAREHOLDERS' EQUITY

During the first six months of fiscal 1998, $250,000 was received from an equity investment by the Company directors and executive officers, as well as from a former director, to be used for general corporate purposes.

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 report 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 risks of future acquisitions, effects of competition and technological changes and dependence upon key personnel.

The Company's revenues for the three months ended March 31, 1998 and 1997 were $32,575,000 and $30,225,000, respectively, which represents an increase of $2,350,000 or 7.8%. For the six months ended March 31, 1998 and 1997, the Company's revenues were $66,237,000 and $61,110,000, respectively, which represents an increase of $5,127,000 or 8.4%. This increase is due to the efforts of the internal sales force to continually bring in new business which accounted for all of the increase. Revenues for the first six months ended March 31, 1997 include approximately $8,000,000 in revenue from two contracts completed in the third quarter of fiscal 1997. Excluding these contracts, revenues for the first six months of fiscal 1998 increased 25% over the comparable prior year period.

Direct expenses were $30,346,000 for the three months ended March 31, 1998 and $28,633,000 for the comparable period last year, representing an increase of $1,713,000 or 6.0%. The quarter ended March 31, 1997, included adjustments amounting to $678,000 primarily related to a revised methodology in evaluating workers' compensation reserves. In addition, the second quarter ended March 31, 1997 also included an expense for underbilled/excess charges for medical expenses in the amount of $206,000. After adjusting for these charges, direct costs increased $2,597,000 or 9.4%. As a percentage of revenue, and on an adjusted basis, direct expenses for the three months ended March 31, 1998 and 1997 were 93.2% and 91.8%, respectively. These increases represent the corresponding higher costs associated with the increase in PEO business. For the six months ended March 31, 1998 and 1997, direct costs increased $4,403,000 or 7.7%, from $57,003,000 to $61,406,000, respectively. For the first six months of fiscal 1997 direct costs included $284,000 in underbilled/excess charges for medical expenses. After reflecting the adjustments previously discussed and these medical expenses, direct costs increased $5,365,000 or 9.6%. As a percentage of revenue, and on an adjusted basis, direct costs for the six months ended March 31, 1998 and 1997 were 92.7% and 91.7%, respectively. These increases were attributed to the same reasons previously discussed.

Gross profits were $2,229,000 and $1,592,000 for the quarters ended March 31, 1998 and 1997, respectively, or an increase of $637,000. After reflecting the above mentioned items in the second quarter of 1997, gross profit for that period was $2,476,000. Gross profits, as a percentage of revenue, were 6.8% and 8.2% for the quarters ended March 31, 1998 and 1997, respectively, after reflecting the items previously discussed. For the six months ended March 31, 1998 and 1997, gross profits increased to $4,831,000 from $4,107,000, respectively. After reflecting the previously discussed items, gross profit for the six months ended 1997 was $5,069,000. As a percentage of revenue, gross profits for the six months ended March 31, 1998 and 1997 were 7.3% and 8.3%, respectively, after reflecting for the items previously discussed. The decrease in gross profits as a percentage of revenue is attributed to an increase in the percentage of PEO business which has a lower margin.

SG&A costs for the quarters ended March 31, 1998 and 1997 were $1,761,000 and $4,307,000, respectively, representing a decrease of $2,546,000 or 59.1%. Included in the second quarter 1997 SG&A costs were $1,973,000 of items including $1,002,000 to increase the Company's bad debt reserve, $300,000 to absorb miscellaneous charges, $124,000 to correct unrecorded 1996 expenses, $102,000 to establish a vacation pay accrual, $81,000 to change supplies accounting, $93,000 to establish a reserve for severance costs and $271,000 for various other miscellaneous items. The need to substantially increase the Company's bad debt reserve became evident after January, 1997 when previously current clients became seriously delinquent. The Company is currently filing legal claims to recover some of these amounts. Excluding these items, SG&A in fiscal 1998 decreased by $573,000 or 24.5%. This decrease was largely attributable to the reduction in overhead costs implemented in the fourth fiscal quarter of 1997. For the six months ended March 31, 1998 and 1997 SG&A decreased from $6,368,000 to $3,618,000, respectively. Included in the six months ended March 31, 1997 SG&A costs were the same items as discussed above as well as a first quarter severance charge of $51,000. After reflecting these items, SG&A decreased by $726,000 or 16.7% which was attributable to the reasons previously discussed.

Depreciation and amortization for the quarters ended March 31, 1998 and 1997 decreased to $170,000 from $438,000, respectively, or $268,000. The decrease was attributable to the writing off of all intangible assets of Digital Insurance Services, Inc. in the quarter ended March 31, 1997 as a result of management's decision to abandon these assets since it was decided not to remain in the insurance business. For the six month period ended March 31, 1998 and 1997, depreciation and amortization decreased from $617,000 to $339,000, respectively, or $278,000. The decrease was attributable to the same reason as explained above.

Net income for the quarter ended March 31, 1998 was $204,000 versus a net loss of $3,242,000 for the similar period in 1997. This increase of $3,446,000 is attributed to the $3.1 million adjustments previously discussed and the overhead reductions implemented in the fourth fiscal quarter of 1997. For the six months ended March 31, 1998 the Company reported net income of $704,000 versus a loss of $3,041,000 in the similar period of 1997 or an increase of $3,745,000. This increase is attributable to the same reasons as reported above.

Liquidity and Capital Resources

The Company's working capital position as of March 31, 1998 was $2,037,000 versus a working capital deficit of ($1,401,000) as of September 30, 1997. The improved working capital position is attributable to the continued earnings improvement of the Company and the successful refinancing of the Company's short term borrowings, as discussed below, to a long term credit facility. At March 31, 1998, the Company had cash of $1,244,000, restricted cash of $738,000 and accounts receivable of $5,300,000.

In February 1995, the Company entered into a one year revolving credit line facility (the "Line") with a bank which was subsequently extended and amended on seven occasions. At September 30, 1997 and March 31, 1998, the total amount outstanding on the Line was $2,697,000 and $2,437,000, respectively. On April 29, 1998, the Company was successful in replacing the former credit facility with a new long term credit facility from FINOVA Capital Corporation totaling $4.5 million. The credit facility includes a three year term loan for $2.5 million, with a five year amortization, at prime + 3% (currently 11.5%) and a $2 million revolving line of credit secured by certain accounts receivable of the Company at prime + 1% (currently 9.5%). Taking various fees into consideration and assuming the Company continuously fully utilizes the revolver, the effective rate of interest on the total borrowings is approximately 16.1%. The balance sheet as of March 31, 1998 reflects the categorization of the bank debt between short-term and long-term due to the new financing. The short-term portion reflects the next twelve months of principal payments due Finova starting June 1, 1998. The long-term portion reflects the balance of the bank debt owed as of March 31, 1998.

Inflation and changing prices have not had a material effect on the Company's net revenues and results of operations in the last three fiscal years, as the Company has been able to modify its prices to respond to inflation and changing prices.

Year 2000 Issue

The year 2000 issue is the programming of computer systems to recognize the values "00" in a date field as the year 2000 and not the year 1900. The Company began steps in 1997 to reasonably ensure that the software it utilizes will be year 2000 compliant. The Company is utilizing internal staff and external sources to make its information technology/computer systems year 2000 compliant. The Company believes that with modifications to existing software and conversions to new software, the year 2000 issue will not pose significant operational problems.

Statement of Financial Accounting Standards

In June, 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"), which establishes standards for reporting and displaying comprehensive income and its components. The components of comprehensive income refer to revenues, expenses, gains and losses that are excluded from net income under current accounting standards, including unrecognized foreign currency translation items, minimum pension liability adjustments and unrealized gains and losses on certain investments in debt and equity securities. SFAS 130 requires that all items that are recognized under accounting standards as components of comprehensive income be reported in a financial statement displayed in equal prominence with the other financial statements; the total of other comprehensive income for a period is required to be transferred to a component of equity that is separately displayed in a statement of financial position at the end of an accounting period. SFAS 130 is effective for both interim and annual periods beginning after fiscal December 15, 1997, at which time the Company will adopt the provisions. The Company does not expect SFAS 130 to have a material effect on reported results.

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). SFAS 131 establishes standards for the way public enterprises are to report information about operating segments in interim financial statements and requires the reporting of selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas and major customers. SFAS 131 is effective for periods beginning after fiscal December 15, 1997, at which time the Company will adopt the provisions. The Company does not expect SFAS 131 to have a material effect on reported results.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

At March 31, 1998 the Company is involved in various other legal proceedings incurred in the normal course of business. In the second fiscal quarter ended March 31, 1998, the Company commenced legal actions to pursue the collection of past due accounts receivable balances. 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 Events

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits - None

(b) Reports on Form 8-K

none filed during the quarter ended March 31, 1998.

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/ Donald W. Kappauf

Donald W. Kappauf
Chief Executive Officer

/s/ Donald T. Kelly

Donald T. Kelly
Chief Financial Officer

Date: May 13, 1998

3-MOS
SEP-30-1998
JAN-01-1998
MAR-31-1998
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5,888,000
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8,244,000
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AMOUNT REPORTED ACTUALLY REFLECTS EPS-BASIC NOT EPS-PRIMARY.