QSOUND

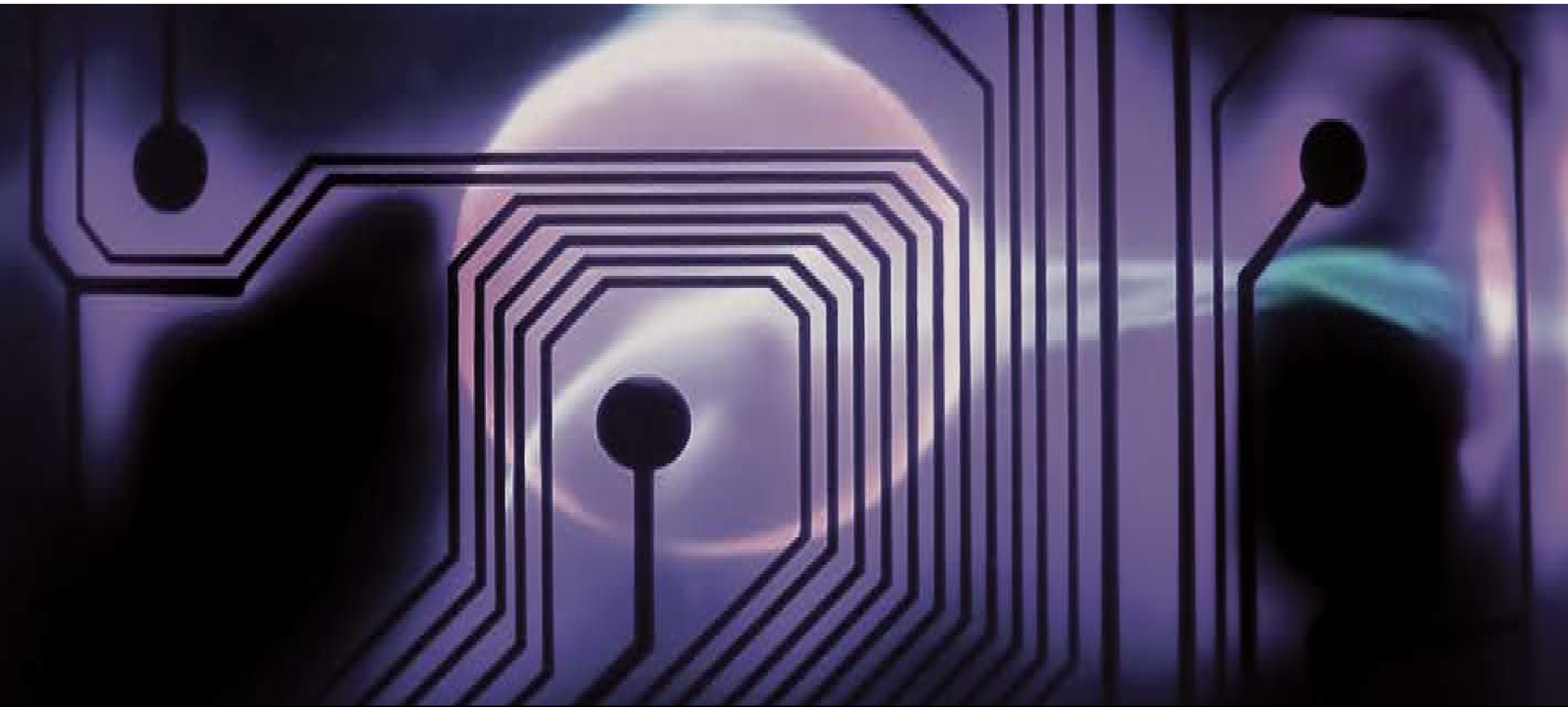
Third Quarter Report 2007

digital audio

innovation

new partnerships

expanding markets



QSoundLabs

powered by microQ®

Contents

Management's Discussion and Analysis..........................3
Consolidated Balance Sheets..9
Consolidated Statements of Operations.........................10
Consolidated Statements of Cash Flows.........................11
Notes to Consolidated Financial Statements..................12
Corporate Information..19

Management's Discussion and Analysis

Three and nine month periods ended September 30, 2007

This Management Discussion and Analysis ("MD&A") dated November 7th, 2007 should be read in conjunction with the unaudited interim consolidated financial statements for the three and nine month periods ended September 30, 2007 and the audited consolidated financial statements, notes and MD&A thereto of QSound Labs, Inc. ("QSound" or the "Company") for the year ended December 31, 2006. This additional information, together with the Annual Report on Form 20-F, can be found on SEDAR, EDGAR and the Company's website at www.qsound.com.

The interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and are stated in United States dollars. This discussion provides management's analysis of the Company's historical financial and operating performance based on information currently available and provides estimates of the Company's future financial and operating performance based on information currently available. Actual results will vary from estimates and the variances may be significant.

Forward looking statements

This discussion includes certain forward-looking statements that are based upon current expectations, which involve risks and uncertainties associated with our business and the economic environment in which the business operates. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. For example, the words anticipate, believe, plan, estimate, expect, intend, should and similar expressions are intended to identify forward-looking statements. Should one or more of the risks and uncertainties materialize or should the underlying assumptions prove incorrect, actual results or events may differ materially from current expectations. Please refer to the Risks identified within the Annual Report on Form 20-F. The Company does not intend, and disclaims any obligation, to update or revise any forward looking statements whether as a result of new information, future events or otherwise.

Overview

QSound is a world leader in the development, marketing and distribution of audio enhancement and audio synthesis technologies, and audio software engines. The Company has developed proprietary audio solutions that include virtual surround sound, positional audio and stereo enhancement for mobile devices, consumer electronics, PC/multimedia, and Internet markets. The Company's cutting-edge audio technologies create rich 3D audio environments allowing consumers to enjoy stereo surround sound from two, four and up to 7.1 speaker systems.

QSound's subsidiaries QCommerce Inc. and QTelNet Inc., provide e-commerce solutions for small and medium sized businesses and Voice Over IP solutions respectively.

Financial overview

Revenue:

	Three months ended September 30				Nine months ended September 30			
	2007	%	2006	%	2007	%	2006	%
Up front license fees	-	-%	38,900	12%	251,600	12%	688,249	47%
Royalties and recurring license fees	618,131	92%	223,406	65%	1,639,399	79%	530,828	37%
Audio product sales	20,613	3%	25,806	8%	76,379	4%	73,315	5%
E-commerce product sales	33,550	5%	41,668	12%	104,665	5%	124,789	9%
Telephony product sales	-	-%	11,907	3%	2,641	-%	28,444	2%
	672,294	100%	341,687	100%	2,074,684	100%	1,445,625	100%

Royalty and recurring license fee revenue for the three months ended September 30, 2007 increased 177% to $618,131 from $223,406 for the three months ended September 30, 2006. This increase reflects continuing growth in recurring royalty revenue from its microQ technology, with licensees continuing to see increasing levels of product sales. For the nine months ended September 30, 2007 and 2006 royalty and recurring license fee revenue was $1,639,399 and $530,828 respectively, an increase of 209%. The nine month increase reflects the increasing level of product sales with microQ embedded technology together with the Company's focus in securing annual license fees with certain strategic partners. QSound expects royalty revenue growth to continue quarter over quarter, however, due to revenue recognition criteria there will be quarterly fluctuations in the level of recurring license fees but anticipated growth on an annual basis. Both growth of royalties and recurring license fees being indicative of the Company's strategic focus of continuing to grow recurring revenues from licensing its microQ technology.

Up front license fees for the three months ended September 30, 2007 and 2006 were $- and $38,900 respectively, a decrease of 100%. For the nine months ended September 30, 2007 up front license fee revenue decreased 63% to $251,600 from $688,249 in the corresponding period in 2006. As the focus continues to be to build a more stable base of recurring revenue the influence on the Company's total revenue by large up front license or engineering fees that may have been negotiated within license agreements will be less marked, although QSound will continue to negotiate these into its license agreements.

Total product sales have declined 32% to $54,163 for the three months to September 30, 2007 from $79,381 in 2006. For the nine months ended September 30, 2007 and 2006 revenues were $183,685 and $226,548 respectively, a decrease of 19%. Both the three and nine month declines seen in 2007 are attributable to falling levels of sales within the e-commerce and telephony segments. The increase in audio product sales has resulted from higher levels of chip sales during the nine months to September 30, 2007.

Expenses:

	Three months ended September 30				Nine months ended September 30			
	2007	%	2006	%	2007	%	2006	%
Marketing	302,253	35%	274,602	33%	1,036,081	39%	771,312	29%
Operations	36,490	4%	35,427	4%	103,395	4%	105,237	4%
Product engineering	200,063	23%	199,682	24%	548,062	20%	629,196	24%
Administration	264,405	31%	234,079	28%	846,670	31%	719,600	28%
Foreign exchange loss	915	-%	(8,343)	(1%)	1,106	-%	564	-%
Amortization	55,690	7%	100,303	12%	166,315	6%	382,443	15%
	859,816	100%	835,750	100%	2,701,629	100%	2,608,352	100%

Expenses for the three months ended September 30, 2007 and 2006 were $859,816 and $835,750 respectively, an increase of 3%. Expenses for the nine months ended September 30, 2007 were $2,701,629 as compared to $2,608,352 in 2006, an increase of 4%. These small movements have occurred as the Company continues to experience increasing cost levels due to the strengthening of the Canadian dollar against the United States dollar.

For the three months ended September 30, 2007, marketing expenses were $302,253, as compared to $274,602 in 2006. This 10% increase was primarily due to an increase in compensation expense of $62,000 relating to higher payroll expenses relating to new employees hired during the latter part of 2006 and a $7,000 increase in consultant costs, being offset by a $36,000 decrease in stock based compensation. For the nine months ended September 30, 2007 marketing expenses increased by $264,769 or 34%, to $1,036,081 as compared to $771,312 in 2006 with the increase as a result of the same factors as described above.

Operations expenses have remained constant at $36,490 for the three months ended September 30, 2007 compared to $35,427 for the same period in 2006. For the nine months ended September 30, 2007 operations expenses decreased by 2% to $103,395 from $105,237 in 2006. This slight decline in expenditure is reflective of lower levels of support required for the E-commerce segment of the business in 2007.

For the three months ended September 30, 2007, product engineering expenses have remained constant at $200,063 as compared to $199,682 for the same period in 2006. For the nine months ended September 30, 2007 and 2006 product engineering expenses were $548,062 and $629,196 respectively, a decrease of 13%, primarily as a result of a $68,000 decrease in payroll costs together with a $30,000 decrease in stock based compensation.

Administration expenses have increased 13% to $264,405 for the three months ended September 30, 2007 from $234,079 for the same period in 2006. This increase is attributable to an increase in audit fees of $20,000 as the Company now undergoes a review of its interim financial statements due to the increasing complexity of both Canadian and U.S. accounting standards, and an increase in compensation expense of $21,000. This increase in costs was negated by the successful recovery of a doubtful account amounting to $8,000 which had been provided for in 2006. For the nine months ended September 30, 2007 administration expenses were $846,670 as compared to $719,600 for the same period in 2006. The 18% increase being primarily due to a $75,000 increase in audit fees and a $51,000 increase in compensation expense.

Amortization for the three months ended September 30, 2007 decreased 44% to $55,690 from $100,303 in 2006, and for the nine months ended September 30, 2007 decreased 57% to $166,315 from $382,443 in 2006. The decreases occurring as a result of the impairment charge on property and equipment which occurred during 2006.

Interest income:

Interest income was $16,168 and $59,812 in the three and nine months ended September 30, 2007 compared to $23,722 and $55,998 for the same periods in 2006. The decrease in the three month period is resultant from lower levels of surplus cash balances being invested due to the cash requirements of the Company's operating activities. The Company expects interest income to continue to decrease in the short term due to cash balances being used for operating activities and the expected decrease in US interest rates.

Interest on convertible notes and accretion expense:

Interest on convertible notes has remained constant for the three months ended September 30, 2007 at $20,794 compared to the same period in 2006, and for the nine months ended September 30, 2007 has increased 52% to $61,705 from $40,541 in 2006. The increase for the nine months ended September 30, 2007 is as expected and results from the issuance of the convertible notes on March 27, 2006. The Company expects interest on convertible notes to decrease in the short term due to expectations of falling US interest rates.

Accretion expense for the three months ended September 30, 2007 increased 29% to $19,208 from $14,866 in the corresponding period in 2006, and for the nine months ended September 30, 2007 increased 90% to $57,305 from $30,217. Both increases are due to using the Effective Interest Rate within the accretion calculation.

Summary of quarterly results

The following table sets out certain operating results and balance sheet items of the Company for the past eight quarters:

	2007			2006				2005
	Sept 30	Jun 30	Mar 31	Dec 31	Sept 30	Jun 30	Mar 31	Dec 31
Revenue	672,294	796,030	606,360	543,405	341,687	430,168	673,770	403,015
Net loss	(234,544)	(158,179)	(396,728)	(509,781)	(533,020)	(491,072)	(200,351)	(475,223)
Loss per share	(0.02)	(0.02)	(0.04)	(0.05)	(0.06)	(0.06)	(0.02)	(0.06)
Total cash	1,507,956	1,832,503	1,824,038	2,316,476	2,307,783	2,464,122	2,223,655	1,222,729
Total assets	3,251,976	3,363,809	3,531,771	3,534,885	4,041,512	4,202,713	4,411,921	3,002,315
Total debt	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	–

Financial condition

QSound has historically financed its operations through the issuance of common shares and debt. As at September 30, 2007, the Company had cash and cash equivalents totaling $1,507,956 compared to $2,316,476 as at December 31, 2006. The Company had convertible notes amounting to $1,000,000 outstanding at September 30, 2007 and December 31, 2006.

For the three months ended September 30, 2007 cash used in operating activities was $375,770 compared to $191,548 for the three months ended September 30, 2006. For the nine months ended September 30, 2007 and 2006 cash used in operating activities was $980,682 and $635,043 respectively. The movements in each of the reported periods have resulted from the changes in non cash working capital balances with these being influenced by movements in accounts receivable, and in 2006 the movements in deferred revenues.

For the three months ended September 30, 2007 and 2006 cash provided from financing activities was $59,644 and $43,820 respectively. Cash provided from financing activities in these periods resulted from the exercise of stock options. For the nine months ended September 30, 2007 and 2006 cash provided by financing activities was $156,499 and $1,781,782 respectively. The large movement is attributable to 500,000 warrants being exercised for $520,000 and the issuance of $1,000,000 convertible notes during the nine months ended September 30, 2006.

For the three months ended September 30, 2007 and 2006 cash used in investing activities was $8,421 and $8,611 respectively. For the nine months ended September 30, 2007 cash provided from investing activities was $15,663 compared to cash used in investing of $61,685 for the nine months ended September 30, 2006. Cash provided from investing activities resulted primarily from receipt of $36,000 of the outstanding Note Receivable and receipt of $586 from the Sale of Property and Equipment, offset by investment in Property and Equipment of $13,912 and Intangible Assets of $7,011. Cash used in investing activities in the nine months ended September 30, 2006 resulted primarily from $39,500 expended on Deferred Development Costs, $22,547 expended on Intangible Assets and $26,080 expended on Property and Equipment, being offset by receipt of $26,442 of the outstanding Note Receivable.

The Company continues to take steps to ensure that its technology is current and up to date and will endeavor to maintain this through continuing research and development, and protecting its technology through the registration of trademarks and patents.

Management believes that the Company’s current cash and anticipated cash flow from operations will be sufficient to meet its working capital and capital expenditure requirements for the foreseeable future.

Critical accounting estimates and policies

The preparation of the consolidated financial statements requires the Company to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. The Company evaluates its estimates on an ongoing basis, based on historical experience and other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions and conditions.

Stock-based compensation

The Company uses the fair value based method of accounting for stock options. Determination of the amounts of stock-based compensation is based on the assumption of stock volatility, interest rates, forfeitures and the term of the option. Such assumptions by their nature are subject to measurement uncertainty.

Revenue recognition

QSound generates revenue from sale of licenses for software products, royalties, and engineering fees. The Company recognizes revenue, when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery of the software product has occurred or the services have been performed, the price is fixed or determinable, customer acceptance has been received, and collection is reasonably assured. When software sales arrangements contain multiple elements, the Company allocates revenue to each element of accounting based on vendor specific objective evidence of fair value. In the absence of fair value for a delivered element, the Company allocates revenue to the undelivered items based on their fair value with the residual amount allocated to the delivered elements. Where the fair value of an undelivered element cannot be determined, the Company would defer revenue for the delivered elements until the undelivered elements are delivered.

Software license fees, royalties, and engineering fees collected on projects in advance of revenue being recognized are recorded as deferred revenue.

The Company also generates revenue from the sale of other products. Revenue from other product sales is recognized when products are shipped pursuant to sales arrangements with customers (when title passes), collectibility is reasonably assured, and the Company has no further obligations relating to the product.

Changes in accounting policies

Financial Instruments: Effective January 1, 2007, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1530, Comprehensive Income; Section 3855, Financial Instruments – Recognition and Measurement; and Section 3861, Financial Instruments – Disclosure and Presentation. These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide requirements for the recognition and measurement of financial instruments. Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with generally accepted accounting principles.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Under the new standards, policies followed for periods prior to the effective date generally are not reversed, and therefore the comparative figures have not been restated. The adoption of these Handbook Sections had no impact on opening deficit.

Under Section 3855, financial instruments must be classified into one of these five categories: held-for-trading, held to maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held to maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net earnings; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net earnings.

Upon adoption of these new standards, the Company designated its cash as held-for-trading, which is measured at fair value. Accounts receivable and the note receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities, and convertible notes are classified as other financial liabilities, which are measured at amortized cost. The Company had neither available for sale, nor held to maturity instruments during the three and nine months ended September 30, 2007.

The Company had no “other comprehensive income or loss” transactions during the three and nine months ended September 30, 2007 and no opening or closing balances for accumulated other comprehensive income or loss.

Internal controls over financial reporting

The Chief Executive Officer and the Chief Financial Officer of QSound are responsible for designing a system of internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with Canadian GAAP. The Company has assessed the design of its internal control over financial reporting and has identified the following material weakness:

- Due to the limited number of staff at QSound, it is not feasible to achieve complete segregation of duties.

This weakness could result in more than a remote likelihood that a material misstatement would not be prevented or detected. While management of QSound have in place mitigating factors, namely the CEO and CFO being actively involved in the Company’s operational and financial activities, a system of internal controls can provide only reasonable, not absolute, assurance that the objectives of the control system are met, no matter how well conceived or operated.

Risks

There have been no material changes to the disclosures set forth in Part I, Item 3D in the Company’s Annual Report on Form 20-F for the year ended December 31, 2006.

Consolidated Balance Sheets

September 30, 2007 and December 31, 2006 (unaudited)

(Expressed in United States dollars)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,507,956	$ 2,316,476
Accounts receivable (net) and accrued revenue	852,175	316,298
Note receivable	27,046	6,000
Inventory	18,478	19,422
Deposits and prepaid expenses	231,282	60,933
	2,636,937	2,719,129
Note receivable	–	55,325
Property and equipment	284,676	348,280
Deferred development costs	254,963	313,800
Intangible assets	75,400	98,351
	$ 3,251,976	$ 3,534,885
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$ 303,496	$ 268,439
Deferred revenue	87,852	45,572
	391,348	314,011
Convertible notes	447,166	389,862
Shareholders' equity		
Share capital (note 3)	47,449,047	47,208,942
Warrants	1,027,114	1,027,114
Contributed surplus (note 4)	2,713,252	2,581,456
Deficit	(48,775,951)	(47,986,500)
	2,413,462	2,831,012
	$ 3,251,976	$ 3,534,885

See accompanying notes to consolidated financial statements

Consolidated Statements of Operations, Comprehensive Loss and Deficit

(unaudited)

(Expressed in United States dollars)

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
		(note 9)		(note 9)
REVENUE				
Royalties, licenses and engineering fees	$ 618,131	$ 262,307	$ 1,890,999	$ 1,219,078
Product sales	54,163	79,380	183,685	226,547
	672,294	341,687	2,074,684	1,445,625
Cost of product sales	15,167	8,065	71,337	12,888
	657,127	333,622	2,003,347	1,432,737
EXPENSES				
Marketing	302,253	274,602	1,036,081	771,312
Operations	36,490	35,427	103,395	105,237
Product engineering	200,063	199,682	548,062	629,196
Administration	264,405	234,079	846,670	719,600
Foreign exchange loss	915	(8,343)	1,106	564
Amortization	55,690	100,303	166,315	382,443
	859,816	835,750	2,701,629	2,608,352
Loss before other items	(202,689)	(502,128)	(698,282)	(1,175,615)
OTHER ITEMS				
Interest income	16,168	23,722	59,812	55,998
Interest on convertible notes	(20,794)	(20,794)	(61,705)	(40,541)
Accretion expense	(19,208)	(14,866)	(57,305)	(30,217)
Gain on sale of property and equipment	–	–	586	–
	(23,834)	(11,938)	(58,612)	(14,760)
Loss before taxes	(226,523)	(514,066)	(756,894)	(1,190,375)
Foreign withholding tax	(8,021)	(18,954)	(32,557)	(34,068)
Net loss and comprehensive loss for period (note 2)	(234,544)	(533,020)	(789,451)	(1,224,443)
Deficit, beginning of period	(48,541,407)	(46,943,699)	(47,986,500)	(46,252,276)
Deficit, end of period	$ (48,775,951)	$ (47,476,719)	$ (48,775,951)	$ (47,476,719)
Loss per common share (basic and diluted)	$ (0.02)	$ (0.06)	$ (0.08)	$ (0.13)

See accompanying notes to consolidated financial statements

Consolidated Statements of Cash Flows

(unaudited)

(Expressed in United States dollars)

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
		(note 9)		(note 9)
Cash provided by (used in):				
OPERATIONS				
Loss for the period	$ (234,544)	$ (533,020)	$ (789,451)	$ (1,224,443)
Items not requiring (providing) cash:				
Amortization	55,690	100,303	166,315	382,443
Stock based compensation	45,906	86,501	215,402	316,137
Accretion expense	19,208	14,866	57,305	30,217
Gain on sale of property and equipment	–	–	(586)	–
Other	(355)	(728)	(1,722)	(3,687)
Changes in non-cash working capital balances (note 6(b))	(261,675)	140,530	(627,945)	(135,710)
	(375,770)	(191,548)	(980,682)	(635,043)
FINANCING				
Issuance of common shares (net)	59,644	43,820	156,499	781,782
Proceeds on issuance of convertible notes	–	–	–	1,000,000
	59,644	43,820	156,499	1,781,782
INVESTMENTS				
Note receivable	–	–	36,000	26,442
Purchase of property and equipment	(4,545)	(2,070)	(13,912)	(26,080)
Deferred development costs	–	–	–	(39,500)
Purchase of intangible assets	(3,876)	(6,541)	(7,011)	(22,547)
Proceeds from sale of property and equipment	–	–	586	–
	(8,421)	(8,611)	15,663	(61,685)
(Decrease) increase in cash and cash equivalents	(324,547)	(156,339)	(808,520)	1,085,054
Cash and cash equivalents, beginning of period	1,832,503	2,464,122	2,316,476	1,222,729
Cash and cash equivalents, end of period	1,507,956	2,307,783	1,507,956	2,307,783

Supplementary Information (note 6(c))

Notes to Consolidated Financial Statements

For the three and nine months ended September 30, 2007 and 2006 (unaudited)

(Expressed in United States dollars)

1. Financial statement presentation

QSound Labs, Inc.("QSound" or the "Company"), a public company organized under the laws of the Province of Alberta, Canada, is an audio technology company which develops proprietary audio solutions, including virtual surround sound, positional audio and stereo enhancement for mobile devices, consumer electronics, PC/multimedia and Internet markets. Its subsidiaries QCommerce Inc. and QTelNet Inc. provide e-commerce solutions for small and medium sized businesses and Voice Over IP solutions respectively.

These interim consolidated financial statements are presented in accordance with Canadian generally accepted accounting principles. These accounting policies and methods of computation are described in the notes to the audited consolidated financial statements for the year ended December 31, 2006. Accordingly, these interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2006. The disclosures herein are incremental to those included in the annual financial statements and certain disclosures which are required to be included in the notes to the annual financial statements have been condensed or omitted.

Use of estimates:

The timely preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

2. Significant new accounting policies:

Effective January 1, 2007, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1530, Comprehensive Income; Section 3855, Financial Instruments – Recognition and Measurement; and Section 3861, Financial Instruments – Disclosure and Presentation. Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events from non-owner sources.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Under the new standards, policies followed for periods prior to the effective date generally are not reversed, and therefore the comparative figures have not been restated.

Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount, requiring fair value or cost-based measures under different circumstances. Under 3855, financial instruments must be classified into one of these five categories: held-for-trading, held to maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held to maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net earnings; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net earnings.

Under adoption of these new standards, the Company designated its cash as held-for-trading, which is measured at fair value. Accounts receivable and the note receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities, and convertible notes are classified as other financial liabilities, which are measured at amortized cost. The Company had neither available for sale, nor held to maturity instruments during the three and nine months ended September 30, 2007.

The Company had no “other comprehensive income or loss” transactions during the three and nine months ended September 30, 2007 and no opening or closing balances for accumulated other comprehensive income or loss.

3. Share capital:

Authorized:
The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of first and second preferred shares. No preferred shares are outstanding.

Common shares issued and outstanding:

	Number of Shares		Consideration
Balance December 31, 2006	9,375,585	$	47,208,942
Issued upon exercise of options (note 5(b))	76,700		243,374
Share awards (note 5(a))	1,600		6,712
Share issue costs	–		(9,981)
Balance September 30, 2007	9,453,885	$	47,449,047

4. Contributed surplus:

Balance December 31, 2006	$	2,581,456
Stock based compensation		208,690
Options exercised		(76,894)
Balance September 30, 2007	$	2,713,252

5. Stock based compensation plans:

(a) Under the Equity Compensation Plan for officers, employees and consultants of the Company, approved by shareholders at the Annual and Special Meeting on April 27, 2007, the Company awarded 1,600 vested shares to various employees during July 2007. In the three and nine months ended September 30, 2007, $6,712 was charged to earnings in respect of these awards, based on the fair value at the date of issuance.

(b) A summary of the Company's outstanding stock options at September 30, 2007 and activity during the period is presented below:

	Number of Shares		Weighted average exercise price
Balance December 31, 2006	981,700	$	1.99
Granted	30,000		4.65
Exercised	(76,700)		2.17
Cancelled or expired	(45,000)		4.45
Balance September 30, 2007	890,000	$	1.94

5. Stock based compensation plans (continued):

All stock options granted have expiry dates between 2007 and 2015. Of the 30,000 stock options granted, 15,000 vest in 2007 and 15,000 vest in 2008.

The following table summarizes the information about stock options outstanding at September 30, 2007:

	Options Outstanding				Options Exercisable		
Range of Exercise Prices	**Number Outstanding**	**Weighted-Average Remaining Term (Years)**		**Weighted-Average Exercise Price**	**Number Exercisable**		**Weighted Average Exercise Price**
$ 0.47 to 1.65	531,500	3.21	$	0.99	531,500	$	0.99
2.05 to 2.40	188,500	4.68		2.24	98,500		2.09
3.50 to 3.57	35,000	1.71		3.54	35,000		3.54
4.20 to 5.33	135,000	3.56		4.85	82,500		4.83
	890,000	3.52	$	1.94	747,500	$	1.68

A non cash expense for the three and nine months ended September 30, 2007 of $39,194 and $208,690 (2006: $86,501 and $316,137) respectively was charged to earnings, reflecting the fair value of stock options vested during the period, with a corresponding increase to contributed surplus.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

	2007	**2006**
Risk free interest rate	4.79%	4.87%
Expected option life (years)	2 years	1.67 years
Expected volatility	45.47%	64.78%

The weighted average fair value at the date of grant of options granted for the three and nine months ended September 30, 2007 was $1.66 (2006: $2.09 and $1.65 respectively).

6. Supplementary information:

(a) Per share amounts
The following table summarizes the common shares used in the per share calculations:

	Three months ended		Nine months ended	
	September 30, 2007	**September 30, 2006**	**September 30, 2007**	**September 30, 2006**
Weighted average common shares outstanding (basic and diluted)	9,428,333	9,308,656	9,408,708	9,090,276

(b) Net change in non-cash working capital

	Three months ended				Nine months ended			
		September 30, 2007		**September 30, 2006**		**September 30, 2007**		**September 30, 2006**
Accounts receivable	$	(138,928)	$	(111,101)	$	(535,877)	$	(236,085)
Inventory		141		5,730		944		(3,724)
Deposits and prepaid expenses		(120,842)		19,270		(170,349)		(31,404)
Accounts payable and accrued liabilities		62,630		19,706		35,057		(64,815)
Deferred revenue		(64,676)		206,925		42,280		200,318
	$	(261,675)	$	140,530	$	(627,945)	$	(135,710)

(c) Cash flow information

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Interest received in cash	$ 20,741	$ 7,813	$ 71,788	$ 49,784
Interest paid in cash	$ –	$ 19,747	$ 41,137	$ 19,747
Taxes paid in cash	$ 8,021	$ 18,954	$ 32,557	$ 34,068

7. Segmented information:

The Company has three operating segments consisting of Audio Products ("Audio"), E-Commerce Products ("E-Commerce"), and Voice Over Internet Protocol Products ("Telephony"). Audio involves the development and marketing of sound enhancement technology for use in various industries. E-Commerce involves the development and marketing of internet business services. Telephony involves the development and marketing of telecommunication over internet equipment and software.

Three months ended September 30, 2007	**Audio**	**E-Commerce**	**Telephony**	**Total**
Revenue	$ 638,744	$ 33,550	$ –	$ 672,294
Amortization	49,390	3,824	2,476	55,690
Loss before other items	(163,325)	(26,200)	(13,164)	(202,689)
Interest income	16,168	–	–	16,168
Segment assets	3,102,577	97,381	52,018	3,251,976
Expenditures for property and equipment	4,545	–	–	4,545
Expenditures for intangible assets	3,876	–	–	3,876
September 30, 2006				
Revenue	$ 288,113	$ 41,668	$ 11,906	$ 341,687
Amortization	29,748	7,137	63,418	100,303
Loss before other items	(407,778)	(22,729)	(71,621)	(502,128)
Interest income	22,587	–	1,135	23,722
Segment assets	3,710,645	94,306	236,561	4,041,512
Expenditures for property and equipment	2,070	–	–	2,070
Expenditures for intangible assets	6,541	–	–	6,541

Nine months ended September 30, 2007	**Audio**	**E-Commerce**	**Telephony**	**Total**
Revenue	$ 1,967,378	$ 104,665	$ 2,641	$ 2,074,684
Amortization	147,414	11,472	7,429	166,315
Loss before other items	(589,586)	(69,131)	(39,565)	(698,282)
Interest income	58,276	5	1,531	59,812
Expenditures for property and equipment	13,912	–	–	13,912
Expenditures for intangible assets	7,011	–	–	7,011
September 30, 2006				
Revenue	$ 1,292,394	$ 124,789	$ 28,442	$ 1,445,625
Amortization	170,780	21,410	190,253	382,443
Loss before other items	(890,818)	(62,554)	(222,243)	(1,175,615)
Interest income	52,956	–	3,042	55,998
Expenditures for property and equipment	25,764	316	–	26,080
Deferred development costs	39,500	–	–	39,500
Expenditures for intangible assets	22,547	–	–	22,547

7. Segmented information (continued):

Geographic revenue information	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Canada	$ 75,446	$ –	$ 145,835	$ 10,847
United States	501,640	242,855	1,542,120	566,700
Asia	79,433	98,016	361,554	859,362
Europe	13,775	–	18,775	–
Other	2,000	816	6,400	8,716
	$ 672,294	$ 341,687	$ 2,074,684	$ 1,445,625

During the three and nine months ended September 30, 2007 two and four customers respectively within the Audio segment contributed 57% and 65% of the total revenues, each providing greater than 10% of total revenues. In the three and nine months ended September 30, 2006, two customers within the Audio segment contributed 44% and 46% of the total revenues, each providing greater than 10% of total revenues.

8. Financial instruments:

The Company's financial instruments consist of cash, accounts receivable, note receivable, accounts payable and accrued liabilities, and convertible notes. The fair values of these recognized financial instruments, excluding the convertible notes, approximate their carrying amounts due to the short term maturity of these instruments. At September 30, 2007 the fair value of the convertible notes amounted to $762,178, whilst the carrying value is $447,166. The carrying value will be accreted to the face value of $1,000,000 over the term of the loan. During the three and nine months ended September 30, 2007 $19,208 and $57,305 respectively (2006: $14,866 and $30,217) has been charged as accretion expense.

9. Accounting change:

As part of the year end close and audit process, the Company changed the accounting for the convertible notes and corrected the fair value measurement of stock options, resulting in the accretion expense and stock based compensation expense for the three and nine months ended September 30, 2006 being adjusted. The net effect to the loss for three and nine months ended September 30, 2006 is to increase the previously reported losses of $524,093 and $1,115,915, by $8,927 and $108,528, to $533,020 and $1,224,443, respectively.

10. United States accounting principles:

(a) Statements of operations, comprehensive income and deficit

The effect on the loss for the three and nine months ended September 30, 2007 and 2006 of the differences between Canadian and United States generally accepted accounting principles is summarized as follows:

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Net loss under Canadian GAAP	$ (234,544)	$ (533,020)	$ (789,451)	$ (1,224,443)
Amortization of deferred development costs	5,055	–	15,164	20,218
Accretion of debt discount	10,847	10,658	32,423	21,667
Net loss under US GAAP	(218,642)	(522,362)	(741,864)	(1,182,558)
Loss per share (basic and diluted)	$ (0.02)	$ (0.06)	$ (0.08)	$ (0.13)

(b) Balance sheet

The effect on the consolidated balance sheet at September 30, 2007 of the difference between Canadian and United States generally accepted accounting principles is as follows:

September 30, 2007	As reported in accordance with Canadian GAAP	Differences	Under US GAAP
Current assets	$ 2,636,937	–	$ 2,636,937
Property and equipment	284,676	–	284,676
Deferred development costs	254,963	(45,489)	209,474
Intangible assets	75,400	–	75,400
	$ 3,251,976	(45,489)	$ 3,206,487
Current liabilities	$ 391,348	–	$ 391,348
Convertible notes	447,166	(337,336)	109,830
Shareholder's equity:			
Common shares	47,449,047	202,058	47,651,105
Warrants	1,027,114	–	1,027,114
Contributed Surplus	2,713,252	272,582	2,985,834
Deficit	(48,775,951)	(182,793)	(48,958,744)
	$ 3,251,976	(45,489)	$ 3,206,487

(c) Recent accounting pronouncements

Under the Securities and Exchange Commission's (SEC) Staff Accounting Bulletin no. 74 (SAB 74), the Company is required to disclose certain information related to recently issued accounting standards. SAB 74 requires that when a new accounting standard has been issued but not yet adopted, the registrant should discuss the effect that the new standard will have on the registrant's financial statements when adopted. The SAB 74 disclosure requirement applies not only to the U.S. GAAP information presented by foreign registrants, but also to the GAAP used to prepare the primary financial statements included in SEC filings.

US GAAP pronouncements:

(i) SFAS 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value within GAAP and expands disclosures about fair value measurements. This is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years.

(ii) SFAS 159, *The Fair Value Option for Financial Assets and Liabilities*. This statement permits entities to choose to measure financial instruments and other certain items at fair value that are not currently required to be measured at fair value. This is effective for fiscal years beginning after November 15, 2007.

Canadian GAAP pronouncements:

(i) CICA Handbook Section 1535, *Capital Disclosures* establishes standards for disclosing information about an entity's capital and how it is managed. It requires the disclosure of information about an entity's objectives, policies and processes for managing capital. This Section is effective for annual periods beginning on or after October 1, 2007 and will be adopted by the Company for its 2008 fiscal year.

10. United States accounting principles (continued):

(ii) CICA Handbook Section 3862, *Financial Instruments – Disclosures* and Section 3863, *Financial Instruments – Presentations*. Section 3862 requires entities to provide disclosures in their financial statements that enable the user to evaluate the significance of financial instruments on the entity's financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains and circumstances in which financial assets and liabilities are offset. These Sections are effective for annual and interim periods beginning on or after October 1, 2007 and will be adopted by the Company for its 2008 fiscal year.

(iii) CICA Handbook Section 3031, Inventories, replaces Section 3030, and requires that entities measure inventory at the lower of cost and net realizable value, and provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. This section is effective for annual and interim periods beginning on or after January 1, 2008 and will be adopted by the Company for its 2008 fiscal year.

The Company has reviewed and assessed the impact of these statements and determined that adoption of the statements will not have a material impact on the Company's financial statements.

Corporate Information

Directors

David Gallagher
M. Patty Chakour
Tony Stelliga
Doug Balfour

Stock Exchange, Stock Symbol

NASDAQ Capital Market,
QSND

Patent Counsel

Fulbright & Jaworski
2800, 2200 Ross Avenue
Dallas, TX 75201

Auditors

KPMG LLP
2700, 205 5 Ave SW
Calgary, AB T2P 4B9

Bankers

The Royal Bank of Canada
335 - 8th Avenue SW
Calgary, AB T2P 1C9

Bank of America
333 South Beaudry Avenue
Los Angeles, CA 90017

Wells Fargo
420 Montgomery St
San Francisco, CA 94104

Transfer Agent

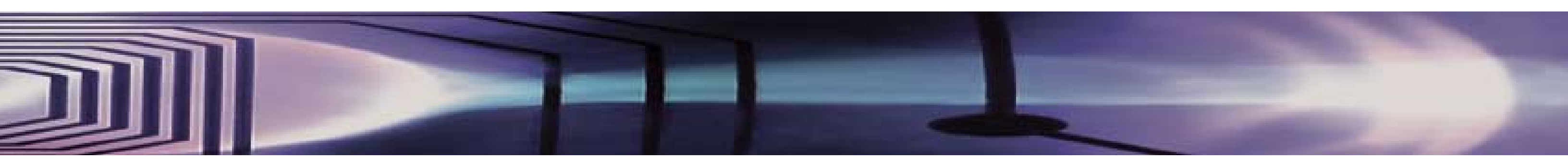
Computershare Investor Services
600, 530 - 8th Avenue SW
Calgary, AB T2P 3S8

Subsidiaries

QCommerce Inc.
www.qcommerce.com
QTelNet
www.qtelnet.com

QSound Labs, Inc.

400, 3115 - 12th Street NE
Calgary, AB Canada T2E 7J2
Tel: +1-403-291-2492
www.qsound.com



QSound Labs, Inc.

400 - 3115 - 12th Street NE
Calgary AB Canada T2E 7J2

Tel: +1-403-291-2492
Fax: +1-403-250-1521

Email: info@qsound.com

www.qsound.com

Printed in Canada