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FLEXIBLE SOLUTIONS INTERNATIONAL INC  
Form 10KSB/A  
December 06, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-KSB/A  
(AMENDMENT NO. 2)

(Mark one)

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003.

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

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

Commission File Number 000-29649

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.  
(Name of Small Business Issuer in Its Charter)

NEVADA  
(State of Incorporation)

91-1922863  
(IRS Employer Identification No.)

615 DISCOVERY STREET  
VICTORIA, BRITISH COLUMBIA, CANADA  
(Address of Principal Executive Offices)

V8T 5G4  
(Zip Code)

(250) 477-9969  
(Issuer's Telephone Number, Including Area Code)

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NONE  
(Securities registered pursuant to Section 12(b) of the Exchange Act)

COMMON STOCK, \$0.001 PAR VALUE  
(Securities registered pursuant to Section 12(g) of the Exchange Act)

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Check whether the 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 registrant was required to file such reports), and (2)  
has been subject to such filing requirements for the past 90 days. Yes  No

Check if there is no disclosure of delinquent filers in response to  
Item 405 of Regulation S-B is not contained in this form, and no disclosure will  
be contained, to the best of the registrant's knowledge, in definitive proxy or  
information statements incorporated by reference in Part III of this Form 10-KSB  
or any amendment to this Form 10-KSB.

Indicate by check mark whether the registrant is a shell company (as

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defined in Rule 12b-2 of the Exchange Act). Yes  No

State issuer's revenues for its most recent fiscal year: \$2,321,120.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity, as of a specified date within the past 60 days. As of March 19, 2004, the aggregate market value of the Company's common stock held by non-affiliates was approximately \$27,225,440 based on the closing price for shares of the registrant's common stock on the American Stock Exchange for that date.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of March 19, 2004, there were 11,794,916 shares of the Company's Common Stock outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

No documents are incorporated by reference.

Transitional Small Business Disclosure Format (check one): Yes  No

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.  
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FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003

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EXPLANATORY NOTE  
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Flexible Solutions International, Inc. ("we," "us," and "our") is filing this Annual Report on Form 10-KSB/A to amend and restate in its entirety its Annual Report on Form 10-KSB for the fiscal year ended December 31, 2003, which was previously filed with the Securities and Exchange Commission on March 29, 2004.

In October 2005, while completing a registration statement for securities issued in the second quarter of 2005, we determined that certain disclosures made in connection with our stock-based compensation expense required adjustment. As such, on October 5, 2005, upon the recommendation of our management, our board of directors and its audit committee, and our independent accountants, we determined to restate our consolidated financial statements for each of the periods ended since September 30, 2002, including each of the years ended December 31, 2002 through 2004, and for both of the quarters in the six months ended June 30, 2005 (the "Restated Periods").

In accordance with this determination to restate the Restated Periods, we revised the disclosures for stock-based compensation expense as required under Emerging Issues Task Force ("EITF") No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services; EITF No. 00-18, Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees; and EITF No. 01-9, Accounting for Consideration Given by a Vendor to a Customer. In particular, we adjusted the stock-based compensation expense in our financial statements and notes thereto recorded in connection with our grant of an option to purchase 2,000,000 shares of our common stock in September 2002 pursuant to the terms of a product distribution agreement. Additional information on this restatement and its effects on our financial condition and results of operations can be found in our Notes to Consolidated Financial Statements contained herein.

This Form 10-KSB/A does not reflect events occurring after the filing of our Form 10-KSB on March 29, 2004 or modify any of the disclosures contained therein, or in the accompanying financial statements and notes thereto, in any way other than by the amendments identified above and as set forth herein. Notwithstanding the above, and for the convenience of the reader, this entire

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report has been amended as a result of, and to reflect, the restatement, as well as to revise the disclosure of our description of business, legal proceedings, management's discussion and analysis, as well as our risk factors, change in accountants, unregistered sales of equity securities, directors and executive officers, and principal accountant fees and services, as well as to generally reflect the current disclosure requirements of Form 10-KSB.

This Form 10-KSB/A should be read in conjunction with our periodic filings made with the Securities and Exchange Commission subsequent to the date of their original filings, including any amendments to those filings. In addition, in accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, and certain other rules, this Form 10-KSB/A includes an updated Auditor's Report and Consent of Independent Registered Public Accounting Firm and updated certifications from our Chief Executive Officer and Chief Financial Officer.

We are presently unaware of any evidence that the restatements described above are due to any material noncompliance by us, as a result of misconduct, with any financial reporting requirement under the federal securities laws. Our audit committee of the board of directors is working with our management and our accountants to assure that we are taking the appropriate approach to resolving the issues related to the restatements, as well as any further issues that may be identified during the course of its review. The filing of this Form 10-KSB/A shall not be deemed an admission that the original filing, when made, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

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### CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-KSB/A for the year ended December 31, 2003 ("Annual Report"), including the Notes to Unaudited Consolidated Financial Statements, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, those statements relating to development of new products, our financial condition, our ability to increase distribution of our products, integration of businesses we acquire, and disposition of any of our current business. Forward-looking statements can be identified by the use of forward-looking terminology, such as "may," "will," "should," "expect," "anticipate," "estimate," "continue," "plans," "intends," or other similar terminology. These forward-looking statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is anticipated or forecasted in these forward-looking statements due to numerous factors, including, but not limited to, our ability to generate or obtain sufficient working capital to continue our operations, changes in demand for our products, the timing of customer orders and deliveries, and the impact of competitive products and pricing. In addition, such statements could be affected by general industry and market conditions and growth rates, and general domestic and international economic conditions.

Although we believe that the expectations reflected in these forward-looking statements are reasonable and achievable, such statements involve risks and uncertainties and no assurance can be given that the actual results will be consistent with these forward-looking statements. Except as otherwise required by Federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason, after the date of this Annual Report.

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PART I

Item 1. Description of Business.

OUR COMPANY

Flexible Solutions International, Inc. ("we," "us," and "our") develops, manufactures and markets specialty chemicals which slow down the evaporation of water. Our initial product, HEAT\$AVR(R), is marketed for use in swimming pools and spas where its use, by slowing the evaporation of water, allows the water to retain a higher temperature for a longer period of time and thereby reduces the energy required to maintain the desired temperature of the water in the pool. Our newest product, WATER\$AVR(R), is marketed for water conservation in irrigation canals, aquaculture, and reservoirs where its use slows down water loss due to evaporation. We also make and sell dispensers which automate the deployment of our chemical products.

We were incorporated as Flexible Solutions, Ltd. (referred to hereinafter as "Flexible Ltd."), a British Columbia corporation, on January 26, 1991. On May 12, 1998, we merged Flexible Ltd. with and into Flexible Solutions International, Inc., a Nevada corporation, and, in exchange for all of the outstanding shares of Flexible Ltd., we issued 7,000,000 shares of common stock, which represented all of our then-issued and then-outstanding shares, to the former shareholders of Flexible Ltd. Flexible Ltd. is now our wholly-owned subsidiary. At the time of our merger with Flexible Ltd., we had no other business and were incorporated solely in order to acquire Flexible Ltd. The merger facilitated the establishment of a public trading market for our common stock. Trading in our common stock commenced on October 12, 1999, through the OTC Bulletin Board under the trading symbol "FXSO". Since November 2002, our common stock has traded on the American Stock Exchange under the trading symbol "FSI". Since the merger, we have been expanding our distribution network and working to complete the development of our WATER\$AVR(R) product.

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### OUR SUBSIDIARIES

We are the parent holding company of Flexible Ltd. and WaterSavr Global Solutions Inc. (hereinafter referred to as "WaterSavr").

Flexible Solutions, Ltd.

Flexible Ltd., a British Columbia corporation, was organized to develop and market swimming pool chemical products designed to reduce heat loss. HEAT\$AVR(R) is Flexible Ltd.'s principal product. For further information on this product, see "Our Products" below.

WaterSavr Global Solutions Inc.

In 2002, we established WaterSavr Global Solutions, Inc. to concentrate on the marketing of our WATER\$AVR(R) product. WATER\$AVR(R) is a patented powder that, when deployed onto a water surface of any size, will significantly reduce evaporation. For further information on our WATER\$AVR(R) products, see "Our Products" below.

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### OUR PRODUCTS

#### HEAT\$AVR

Our principal product consists of our HEAT\$AVR(R) branded chemical solutions. HEAT\$AVR(R) is a chemical product for use in swimming pools and personal spas that forms a thin, transparent layer on the water's surface that reduces water evaporation and heat loss. We market the HEAT\$AVR(R) product as a cost-effective and convenient way to save on the cost of energy required to heat pools and spas. Our studies indicate that approximately 70% of the energy lost from a swimming pool occurs through water evaporation. By using our HEAT\$AVR(R) product, we can minimize that heat loss and save our customers money on their pool and spa energy needs. In addition, the product is not visible on the pool surface and it cannot be seen, felt or tasted by swimmers. After a swimmer stops disturbing the pool water, the product reforms to a complete layer on the pool surface.

We completed the development of our HEAT\$AVR(R) product and introduced it to the commercial marketplace in 1998, achieving initial sales of \$84,252 that year. Since that time, we have expanded our marketing of the HEAT\$AVR(R) product to include the residential marketplace. We found that by designing the HEAT\$AVR(R) product to be "residential-friendly," we could increase sales.

We market HEAT\$AVR(R) to the residential marketplace primarily in the form of our "Tropical Fish" dispenser. Each Tropical Fish dispenser is made of molded plastic in the form of a ten-inch long colorful Tropical Fish that is filled with enough HEAT\$AVR(R) solution to cover the surface of a 400 square-foot swimming pool for about one month. The Tropical Fish is deployed by snipping the fin and tossing the fish into the pool where it submerges to the bottom of the pool. Water pressure causes the HEAT\$AVR(R) liquid inside to escape into the water where it rises to the surface and forms an invisible layer on the surface of the water.

In outdoor swimming pools, our HEAT\$AVR(R) product can provide savings on pool heating costs and provides convenience of use when compared to pool blankets. Pool blankets are plastic covers, which are cut to the size and shape of the surface of the pool or spa. They float on the surface and perform the same function as our HEAT\$AVR(R) product: reducing energy cost by inhibiting water evaporation. Pool personnel often find it inconvenient to use conventional

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pool blankets because a pool blanket must be removed and stored prior to entering the pool and provides no energy savings when not on the pool. Conversely, our HEAT\$AVR(R) product eliminates the necessity of installing, removing and storing the blanket and works 24 hours a day. We believe that the ease of use provided by HEAT\$AVR(R) results in more consistent pool and spa usage. In addition, the use of HEAT\$AVR(R) in an indoor pool results in even greater energy savings. Indoor pool locations use energy not only to heat the pool water, but also to air condition the pool environment. By slowing the transfer of heat and water vapor from the pool to the atmosphere of the pool enclosure, less energy is required to maintain a pool at the desired temperature and there is a reduced load on the air-conditioning system because less is heat transferred from the pool water to the surrounding air and less water vapor will have to be removed from the air to maintain the required comfort level.

### Marketing and Sales

We market our HEAT\$AVR(R) product to both residential and commercial markets, consisting of individual homeowners with swimming pools and personal spas and commercial consumers consisting of operators of swimming pools and personal spas located in hotels, motels, schools, and municipal and private recreational facilities.

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Our HEAT\$AVR(R) and Tropical Fish products are sold in Canada and the United States by our exclusive distributor, Sun Solar Energy Technologies ("Sun Solar"), and in Australia by Hydro-Flexible Solutions Pty. We also sell HEAT\$AVR(R) directly into the United States to both wholesale and retail accounts. We have approximately 259 active customers. In the year ended December 31, 2003, Sun Solar represented approximately 73% of our total sales.

We also have nonexclusive distributors in Canada and the United States for HEAT\$AVR(R) (without the Tropical Fish) and exclusive distributors in Australia, Korea and Great Britain. We support our distributors and seek additional market opportunities by attending the major pool industry trade shows in the United States yearly. We advertise in trade magazines and directly to buyer associations. We also maintain an internet presence with a website containing information about our products. In addition, we publish a semi-annual newsletter that is distributed by us to approximately 5,000 customers and potential customers.

### Our Agreement With Sun Solar Energy Technologies

In February 1998, we entered into a distributorship agreement with Sun Solar, which grants Sun Solar an exclusive distributorship for our Tropical Fish product in the United States and Canada. In order to maintain the exclusivity of such distribution, Sun Solar must order and pay for at least 860,000 units in the year ending February 29, 2004. Such exclusive agreement terminates on February 29, 2004. We have agreed to give Sun Solar a right of first refusal in the event we propose to sell Flexible Ltd. If such subsidiary is sold we must require the purchaser to fulfill the exclusive distribution contract with Sun Solar and Sun Solar can veto the proposed sale to an entity which it reasonably believes may have an intent to discontinue manufacture of our Tropical Fish product. The agreement also provides that Sun Solar will sell its veto for a reasonable premium arrived at a price mutually agreed upon with a mediator. The agreement also grants Flexible the right of first refusal if Sun Solar proposes to sell its exclusive distributorship. If such distributorship is sold, Sun Solar's sales performance minimums are required to be binding on the new owner. The agreement also provides that if such exclusive distribution rights are sold by Sun Solar, the buyer must advance to us \$1.00 for each Tropical Fish which must be bought in the year of sale to maintain the distribution agreement exclusivity, which payment will be credited to future orders of Tropical Fish at

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the rate of \$1.00 per fish as the orders are made. In connection with this agreement, we have also agreed to offer distribution rights on new swimming pool products to Sun Solar in the United States and Canada if it is in compliance with its sales performance requirements. There can be no assurance that our exclusive distributorship with Sun Solar will be renewed past its current expiration on February 29, 2004. We grant Sun Solar 45 days to pay for product ordered after shipment.

### WATER\$AVR(R)

We introduced our WATER\$AVR(R) product in June 2002. This product utilizes our core technology to reduce water evaporation. We market it as a water conservation product for use where water is standing or gently flowing and the need for water conservation can justify the cost of purchase and deployment of the product. We believe that our WATER\$AVR(R) product may find a market for use in the following markets: reservoirs, potable water storage, aqueducts and canals, agricultural irrigation, flood water crops, lawn and turf care, potted and bedding plants, stock watering ponds, and mining.

WATER\$AVR(R) is sold in granulated form and can be provided in shaker containers holding 3/4 lbs. or in 50 lbs. weatherproof bags. WATER\$AVR(R) can be applied in various ways from hand dispersal to fully automated scheduled metering, and we also offer an automatic dispenser for WATER\$AVR(R) to automate deployment of the product.

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We anticipate our initial market for WATER\$AVR(R) will be in India, Spain, Australia and the United States. We have provided quantities of the product for testing in these countries and, if successful, we anticipate that substantial orders may be received. We also anticipate marketing WATER\$AVR(R) to both developed and drought stricken countries to address water conservation concerns. In this regard, we are seeking to establish strategic relationships with companies in the water processing industry who have marketing and manufacturing operations in countries with water conservation concerns. We have two full-time employees and two other employees more than fifty percent assigned to establishing sales channels throughout the world for WATER\$AVR(R).

In September 2002, we granted Ondeo Nalco Company ("Ondeo") the following distribution rights:

|   |  |
|---|--|
| -----                                   | -----  |
| Exclusive Market                        | Countries  |
| -----                                   | -----  |
| Market                                  | Canada and USA   |
| Municipal mineral and mining            | All, except India, Pakistan,<br>Bangladesh, Sri Lanka, Nepal, Bhutan,<br>Mauritania, Malaysia and Singapore. |
| -----                                   | -----  |
| Non-Exclusive Market (1)                | Countries  |
| -----                                   | -----  |
| All except agriculture and large retail | All, except India, Pakistan,<br>Bangladesh, Sri Lanka, Nepal, Bhutan,<br>Mauritania, Malaysia and Singapore. |
| -----                                   | -----  |

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(1) The exclusive markets granted to Ondeo convert to non-exclusive if Ondeo is unable to meet the sales thresholds.

Upon entering into the distribution agreement with Ondeo, we also granted Ondeo an option to purchase 1,000,000 shares of our common stock at



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\$4.25 per share, which vests immediately, and an additional option to purchase 1,000,000 shares at \$5.50 per share, which option vests upon the satisfaction of certain sales targets.

Ondeo was successful in satisfying the sales thresholds until September 30, 2003, at which time it missed a milestone payment. As a result, the exclusive rights reverted to non-exclusive and the option grants were cancelled and accounted for as cancelled in the year 2003.

Ondeo continues to distribute WATER\$AVR(R) on a non-exclusive basis and to manufacture WATER\$AVR(R) in accordance with our manufacturing agreement that is separate from distribution.

### COMPETITION

#### HEAT\$AVR(R)

We are aware of only one other company that manufactures a chemical evaporation reduction product that competes with our HEAT\$AVR(R) product. This other product has had limited sales to date and does not have the convenience factor of our Tropical Fish dispenser.

As mentioned above, HEAT\$AVR(R) also competes against plastic pool blanket products. We compete against pool blankets on the basis of convenience of use of HEAT\$AVR(R) versus the inconvenience of deploying and storing pool blankets. Pool owners and operators may also decide that evaporation control products are not needed for their pools.

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#### WATER\$AVR(R)

Aegis Chemical Industries Ltd. of India directly competes with our WATER\$AVR(R) product. We believe our WATER\$AVR(R) product is superior for the following reasons:

- o Easier Application. WATER\$AVR(R) may be deployed directly to the water surface by hand or machine. Our competition requires premixing to dilute the product to usable strength, followed by extensive pumping.
- o Cost. In order to achieve comparable water savings levels, other products would cost more than the WATER\$AVR(R) product.

Water conservation is an important priority throughout the world, and numerous researchers in industry and academia are seeking to develop solutions that may compete with, or be superior to our products. Climate changes that relieve water shortage conditions or a technological breakthrough in water desalination could reduce the need for water conservation products.

Specialty chemicals are a highly competitive industry with many multi-national firms with large research and development operations. There are a number of firms which develop and market chemical products for the pool and spa industry. Therefore, we can expect competition to arise at any time.

### MANUFACTURING

Our HEAT\$AVR(R) products and dispensers are made from chemicals, plastic and other materials and parts that are readily available from multiple suppliers. We have never experienced any shortage in the availability of raw materials and parts for our products and we do not have any long term supply

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contracts for any such items. We manufacture our products in an approximately 11,000 sq. ft. plant in Calgary, Alberta, Canada.

Our WATER\$AVR(R) products are manufactured under contract with Ondeo under a five-year agreement effective as of April 2002, with a five-year extension available. We are not required to purchase any minimum quantity of such product.

### GOVERNMENTAL REGULATIONS

#### HEAT\$AVR(R)

Chemical products for use in swimming pools are covered by a variety of governmental regulations in the countries where we sell our products. These regulations cover such matters as packaging, labeling, and product safety. We believe our products are in compliance with such regulations.

#### WATER\$AVR(R)

Our WATER\$AVR(R) product is subject to additional regulation in most countries, particularly for agricultural and drinking water uses. As we continue to develop this product, and prior to its full-scale commercial roll-out, we will address these issues on a country-by-country basis. We do not anticipate that governmental regulations will be an impediment to marketing our WATER\$AVR(R) product because the ingredients have historically been used in agriculture for many years for other purposes. Nevertheless, we will need to obtain approval to sell WATER\$AVR(R) in the United States for agricultural or drinking water users. To date, we have already applied for and received National Sanitation Foundation approval for drinking water in the United States.

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### PROPRIETARY RIGHTS

Our success and ability to compete is dependent, in part, upon our proprietary technology. We rely on a combination of patent, copyright and trade secret laws and nondisclosure agreements to protect our proprietary technology. We currently hold three United States patents and are seeking to extend these patents to certain other countries. We also have seven United States patent applications pending. There can be no assurance that our pending patent applications will be granted or that any issued patent will be upheld as valid or prevent the development of competitive products, which may be equivalent to or superior to our products. We have not received any claims alleging infringement of the intellectual property rights of others, but there can be no assurance that we may not be subject to such claims in the future.

### RESEARCH AND DEVELOPMENT

During the last two fiscal years, we have spent approximately \$70,138 on research and development activities. This work relates primarily to the development of our water and energy conservation products.

### EMPLOYEES

As of December 31, 2003, we employed 20 persons, including one officer, nine sales and customer support employees, and eleven employees in our manufacturing department. None of our employees is represented by a labor union and we have experienced no work stoppages to date.

Item 2. Description of Property.

Our Chief Executive Officer provides use of space in his residence to

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conduct his administrative duties and we do not reimburse him for such use. We rent 1,400 sq. ft. of sales and marketing space in Victoria, British Columbia at a cost of \$1,050 a month. This lease is effective through October 2006. We lease an 11,000 sq. ft. building in Calgary, Alberta at a cost of \$3,150 per month for the manufacture of our products. This lease is effective through September 2006. Subsequent to year end, we leased 1,900 sq. ft. in Richmond, British Columbia as additional space for sales and customer support at a cost of \$1,640 per month. This lease is effective through January 2007. We also lease an additional 2,000 sq. ft. of research space in Victoria, British Columbia at a cost of \$1,171 per month. This lease is effective through October 2005.

### Item 3. Legal Proceedings.

On May 1, 2003, we filed a lawsuit in the Supreme Court of British Columbia, Canada, against John Wells and Equity Trust, S.A. seeking return of 100,000 shares of our common stock and repayment of a \$25,000 loan, which were provided to defendants for investment banking services consisting of securing a \$5 million loan and a \$25 million stock offering. Such services were not performed and in the proceeding, we seek return of such shares after defendant's failure to both return the shares voluntarily and repay the note. On May 7, 2003, we obtained an injunction freezing the transfer of the shares. The proceeding is still in a discovery phase. On the date of issuance, the share transaction was recorded as shares issued for services at fair market value, a value of \$0.80 per share. No amounts have been recorded as receivable in the Company's consolidated financial statements as the outcome of this claim is not yet determinable.

On November 13, 2003, an ex-employee, Patrick Grant, filed a lawsuit in the Circuit Court of Cook County, Illinois against us, WaterSavr, and our Chief Executive Officer, Daniel B. O'Brien. The

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plaintiff claims damages for breach of contract, tortious interference with an agreement and various wrongful discharge claims. The plaintiff seeks monetary damages in excess of \$1,020,000 for the breach of contract and tortious interference claims and unspecified compensatory and punitive damages in the wrongful discharge claims. We consider the case to be without merit and are planning to dispute the matter vigorously. In addition, we intend to file counterclaims against the plaintiff for failure to repay financial obligations owed to us of almost \$40,000, as well as unspecified damages arising out of plaintiff's disclosure of confidential information to a client during his employment at WaterSavr. No amounts have been recorded as receivable and no accrual has been made for any loss in our consolidated financial statements as the outcome of the claim filed by Mr. Grant is not yet determinable.

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

There were no matters submitted to a vote of our shareholders in the quarter ended December 31, 2003.

## PART II

### Item 5. Market for Common Equity and Related Stockholder Matters.

Our common stock began trading on the American Stock Exchange under the symbol FSI on November 19, 2002. Prior to that, our stock traded on the over-the-counter market and was quoted on the NASD Electronic Bulletin Board.

The following is the range of high and low closing sales or bid prices for our common stock for the periods indicated:

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|                              |                | HIGH   | LOW    |
|------------------------------|----------------|--------|--------|
| YEAR ENDED DECEMBER 31, 2003 | First Quarter  | \$3.40 | \$2.25 |
|                              | Second Quarter | 3.40   | 2.39   |
|                              | Third Quarter  | 3.60   | 2.90   |
|                              | Fourth Quarter | 5.35   | 3.00   |
| YEAR ENDED DECEMBER 31, 2002 | First Quarter  | 3.57   | 1.30   |
|                              | Second Quarter | 4.10   | 2.50   |
|                              | Third Quarter  | 3.85   | 1.95   |
|                              | Fourth Quarter | 3.85   | 2.77   |

Prices since November 19, 2002 represent high and low prices on the American Stock Exchange. Prices prior to November 19, 2002 represent inter-dealer quotations which do not include retail mark-ups, markdowns, or commissions, and do not necessarily represent actual transactions. As of December 31, 2003, we had 23 record holders of our common stock. Such shares are owned by an estimated 582 beneficial owners.

Our common stock also trades on the Frankfurt stock market under the symbol FXT.

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### DIVIDEND POLICY

We have not paid any dividends on our common stock, and it is not anticipated that any dividends will be paid in the foreseeable future. Our board of directors intends to follow a policy of retaining earnings, if any, to finance our growth. The declaration and payment of dividends in the future will be determined by the board of directors in light of conditions then existing, including our earnings, financial condition, capital requirements and other factors.

### EQUITY COMPENSATION PLAN INFORMATION

The following table contains certain information relating to outstanding options to purchase the Company's common stock granted pursuant to individual compensation arrangements as of December 31, 2003, the Company's most recently completed fiscal year.

|  | NO. OF SECURITIES TO BE<br>ISSUED UPON EXERCISE OF<br>OUTSTANDING OPTIONS,<br>WARRANTS AND RIGHTS | WEIGHTED-AVERAGE<br>EXERCISE PRICE OF<br>OUTSTANDING OPTIONS,<br>WARRANTS AND RIGHTS | NO. OF<br>AVAILAB<br>UNDER<br>PLANS<br>REFL |
|--|---|--|---|
|  | (a)   | (b)  |   |
| Equity compensation plans approved by security holders (1) | --  | --   |   |
| Equity compensation plans not approved by                  |   |  |   |

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|                      |           |        |
|----------------------|-----------|--------|
| security holders (2) | 1,699,000 | \$2.84 |
|                      |           |        |
| TOTAL                | 1,699,000 | \$2.84 |
|                      |           |        |

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(1) We have not granted any shares to purchase our common stock pursuant to equity compensation plans that have been approved by our shareholders.

(2) (a) Consists of non-qualified options to purchase our common stock that have been granted pursuant to individual compensation arrangements and not pursuant to any equity compensation plan. All of the grants made during our fiscal year are submitted for shareholder approval at such fiscal year's annual shareholder meeting and, to date, our shareholders have approved all of the grants.

(b) If the grantee is an employee, and if he or she ceases to be employed by us, the grantee may, during the 30-day period following termination of employment, exercise the option to the extent that the option was exercisable on the date of termination. In the case of death or disability, the grantee (or his or her administrator) has twelve months from the date of death or disability to exercise the option to the extent that the option was exercisable on the date of death or disability.

(c) The options are subject to adjustment by reason of a recapitalization, reclassification, stock split, combination of shares, dividend or other distribution payable in capital stock. Upon a merger, liquidation, dissolution or other consolidation, we shall provide each grantee with one-months' prior written notice informing the grantee that he or she may exercise the option in full (to the extent it has not been previously exercised) within such one-month period. Following such date, the options shall be terminated.

(d) The options may not be transferred, assigned, pledged or hypothecated in any way (except by will or the laws of descent) and are not subject to execution, attachment or similar process.

(e) All of the options granted have terms of between one and six years from and after the date of grant and reflect exercise prices equal to the fair market value of a share of our common stock as determined by our board of directors on the date of grant thereof.

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### Item 6. Management's Discussion and Analysis or Plan of Operation

Our operating activities are related primarily to manufacturing and marketing our swimming pool chemical products. In June 2002, we introduced a fresh water evaporation control chemical product called WATER\$AVR(R), which has recorded sales of just over \$500,000 in 2003. This figure represents approximately 22% of our sales and 20% of our total revenue.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Securities and Exchange Commission ("SEC") has recently issued Financial Reporting Release ("FRR") No. 60, Cautionary Advice Regarding Disclosure About Critical Accounting Policies, suggesting companies provide additional disclosure and commentary on those accounting policies considered most critical. A critical accounting policy is one that is both important to the portrayal of our financial condition and results, and requires management's most difficult, subjective or complex judgments. Typically, the circumstances that make these judgments difficult, subjective and/or complex have to do with the need to make estimates about the effect of matters that are inherently uncertain. We believe the accounting policies below represent our critical accounting policies as contemplated by FRR No 60 (see Note 3 of the Notes to Consolidated Financial Statements for a detailed discussion on the application of these and other accounting policies):

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Allowances for Product Returns. We grant certain of our customers the right to return product which they are unable to sell. Upon sale, we evaluate the need to record a provision for product returns based on our historical experience, economic trends and changes in customer demand.

Allowances for Doubtful Accounts Receivable. We evaluate our accounts receivable to determine if they will ultimately be collected. This evaluation includes significant judgments and estimates, including an analysis of receivables aging and a review of large accounts. If, for example, the financial condition of our customers deteriorates resulting in an impairment of their ability to pay or a pattern of late payment develops, allowances may be required.

Provisions for Inventory Obsolescence. We may need to record a provision for estimated obsolescence and shrinkage of inventory. Our estimates would consider the cost of inventory, the estimated market value, the shelf life of the inventory and our historical experience. If there are changes to these estimates, provisions for inventory obsolescence may be necessary.

### RESULTS OF OPERATIONS

Year ended December 31, 2003 and 2002

Sales for the year ended December 31, 2003 were \$2,321,120, as compared to \$1,112,192 for the year ended December 31, 2002, an increase of \$1,208,928, or 109%. Our sales increase was primarily the result of increased sales in residential swimming pool products, increased sales in the commercial swimming pool division, and the fiscal 2003 sales attributed to our WATER\$AVR(R) product. In addition, we increased the price of our residential swimming pool product by 12.5% in the third quarter of fiscal 2003.

For the year ended December 31, 2003, our overall gross profit margin on product sales decreased to 41.3%, as compared to 47.7% for the year ended December 31, 2002. This decrease was primarily due to higher costs for employees, travel and product awareness efforts at our WaterSavr division in Illinois. There were also extra costs related to the labor and material inputs for our swimming pool products as a result of the significant rise of the Canadian Dollar versus the United States Dollar.

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We incurred operating expenses for the year ended December 31, 2003 of \$1,664,146, as compared to operating expenses of \$997,899 in the year ended December 31, 2002. In the year ended December 31, 2003, we increased sales and marketing costs in connection with our WATER\$AVR(R) product and this was reflected in increased wages, office, rent, telecommunications and travel expenses. We also incurred increased professional fees in fiscal 2002 primarily due to increased legal and accounting expenses and specific consultants directed at increasing WATER\$AVR(R) sales as quickly as possible in countries outside the United States. Depreciation expense was \$37,712 for the year ended December 31, 2003, as compared to \$24,683 for the year ended December 31, 2002, which reflects depreciation for additional property and equipment added in the year ended December 31, 2003. Our expenses to increase investor awareness were significantly more than in the year ended December 31, 2002 and this resulted in an increase in investor relations and transfer agent fees in the year ended December 31, 2003. We also had a credit of \$31,955 in the year ended December 31, 2003 for currency exchange, as compared to an expense of \$19,180 for such item in the year ended December 31, 2002.

Our income tax provision for the year ended December 31, 2003 reflected a benefit of \$25,892, an increase over the income tax benefit of \$21,456 for the

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year ended December 31, 2002. In the year ended December 31, 2003, we had interest income of \$203,310, as compared to interest income of \$67,228 for the year ended December 31, 2002.

We incurred a net loss of \$476,888 in fiscal 2003, as compared to a net loss of \$378,445 in fiscal 2002.

Year Ended December 31, 2002 and 2001

Revenue decreased to \$1,112,192 for the year ended December 31, 2002, as compared to \$1,334,273 in the year ended December 31, 2001, as a result of seasonal weather issues that caused a shortening of the pool season in the eastern United States and Canada. There were no price changes in the period and product mix did not shift significantly. Tropical Fish was responsible for approximately 94% of sales during the period.

Operating expenses for the year ended December 31, 2002 were \$997,899, as compared to \$806,020 in the year ended December 31, 2001. Cash expense increased due to increased production levels and to further introduction of our WATER\$AVR(R) product. In the year ended December 31, 2002, we increased sales and marketing costs in connection with our WATER\$AVR product and this was reflected in increased wages, office, rent, telephone and travel expenses. We also incurred increased professional fees in the year ended December 31, 2002 due to increased legal and accounting expenses. Depreciation expense was \$24,683 for the year ended December 31, 2002, as compared to \$18,910 for the year ended December 31, 2001, which reflects greater depreciation for additional property and equipment added in fiscal 2002. We also undertook efforts to better organize our investor awareness program, which resulted in a decrease in investor relations and transfer agent fees in the year ended December 31, 2002, as compared to 2001.

We incurred a net loss of \$378,445 in the year ended December 31, 2002, as compared to a net loss of \$233,955 in the year ended December 31, 2001.

### LIQUIDITY AND CAPITAL RESOURCES

We sold 1,828,600 shares of common stock to investors in the year ended December 31, 2002 for net proceeds of \$5,750,000. During the year ended December 31, 2003, we consumed \$369,542 of this capital while introducing and building awareness of our new WATER\$AVR(R) product. We believe we have sufficient capital to support our business and operations for at least the next 12 months. We

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anticipate utilizing approximately \$1 million in the next twelve months in an attempt to increase the sales of our products by adding sales and marketing professionals, increasing advertising and promotion expenses, improving our products, developing additional uses for our core technology, and in preparing and filing additional patent applications. There can be no assurance that such expenditures will result in a significant increase in sales of our products.

### SEASONALITY

Our operations are subject to seasonal fluctuation. Use of our products increases in summer months in most markets and results in our sales from January to June being greater than in July through November. Additionally, cooler summer weather patterns lead to lower sales volume, particularly of our Tropical Fish product, which is geared to residential pools, due to a shorter swimming season, while warmer weather results in increased sales volume due to a longer swimming season. We believe we are able to adequately respond to these seasonal fluctuations by reducing or increasing production as needed.

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### RESTATED FINANCIAL STATEMENTS

The accompanying financial statements have been restated to correct certain stock-based compensation expense. In October 2005, while completing a registration statement for securities issued in the second quarter of 2005, we determined that certain disclosures made in connection with stock-based compensation expense required adjustment. In September 2002, we entered into a distribution agreement with Ondeo whereby Ondeo agreed to serve as the exclusive distributor of our WATER\$AVR(R) products for so long as Ondeo maintained a certain threshold sales level as defined in the agreement. As consideration for signing the agreement, Ondeo was granted an option to purchase 2,000,000 shares of our common stock. Half of the option for one million shares was exercisable immediately at an exercise price of \$4.25 for each common share. The remaining half of the option for 1,000,000 shares was exercisable after certain threshold sales targets were achieved at a price of \$5.50 for each common share.

In determining the stock-based compensation expense for the nine months ended September 30, 2002, we expensed the entire fair value of the stock option believing that the option fully vested upon the signing of the agreement. In our October 2005 review, however, we determined that: (i) first, as stated above, half of the option to purchase 1,000,000 shares of common stock did not vest and was not exercisable until the threshold sales target had been met, which would not be until five years after the signing of the distribution agreement; and (ii) second, we did not consider Emerging Issues Task Force ("EITF") No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services; EITF No. 00-18, Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees; and EITF No. 01-9, Accounting for Consideration Given by a Vendor to a Customer.

During the three months ended March 31, 2003, Ondeo achieved the first threshold sales target, and accordingly, we should have recorded a corresponding stock-based compensation expense of \$54,080. However, since the entire stock-based compensation expense had been recorded in the September 30, 2002 interim financial statements and in the year ended December 31, 2002, we did not record any additional stock-based compensation expense as a result of the attained first threshold level.

In the fourth quarter of the year ended December 31, 2003, we determined that Ondeo was not going to attain the minimum sales targets stipulated in the agreement. Consequently, the agreement and corresponding stock option was cancelled. We accounted for the cancellation of the stock option in accordance with Statement of Financial Accounting Standard No. 123 similar to a forfeiture of stock options and reversed \$2,480,200 of the stock-based compensation expense previously recorded in fiscal

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2002. Had we accounted for the cancellation of the stock option correctly, we would have reversed the amended stock-based compensation expense of \$54,080 that was recorded in the first quarter ended March 31, 2003.

In light of the above, the net effect of the adjustments to the financial statements is as follows:

1. Approximately \$2,704,000 in stock-based compensation expense recorded in September 2002 has been reversed;

2. Approximately \$54,080 in stock-based compensation expense has been recorded in the quarter ended March 31, 2003, as Ondeo met the first sales



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threshold under the agreement;

3. Approximately \$54,080 in stock-based compensation expense has been reversed in the year ended December 31, 2003, as Ondeo failed to meet subsequent sales thresholds under the agreement, resulting in the cancellation of the stock option;

4. As stated above, we previously recorded a stock-based compensation expense of \$2,704,000 in December 2002. As a result of canceling the stock option, we previously recorded a recovery of \$2,480,000 of stock-based compensation expense at December 31, 2003. This \$2,480,000 recovery has been reversed, in conjunction with the reversal of \$2,704,000 in stock-based compensation expense originally recorded; and

5. For the periods ended March 31, 2004 to June 30, 2005, the net effect of these adjustments is to decrease capital in excess of par value by approximately \$223,800 and increase retained earnings by approximately \$223,800.

We are presently unaware of any evidence that the restatements described above are due to any material noncompliance by us, as a result of misconduct, with any financial reporting requirement under the federal securities laws. Our audit committee of the board of directors is working with our management and our accountants to assure that we are taking the appropriate approach to resolving the issues related to the restatements, as well as any further issues that may be identified during the course of its review.

### RISKS RELATED TO OUR BUSINESS

WE HAVE A LIMITED OPERATING HISTORY UPON WHICH TO EVALUATE OUR POTENTIAL FOR FUTURE SUCCESS.

Although we were incorporated in 1991, we have been operating in our present form only since May 1998. To date, we have generated limited revenues from the sale of our products and do not expect to generate significant revenues until we sell a significantly larger number of our products. Accordingly, we have only a limited operating history upon which you can base an evaluation of our business and prospects. The likelihood of our success must be considered in light of the risks and uncertainties frequently encountered by middle stage companies like ours in an evolving market. If we are unsuccessful in addressing these risks and uncertainties, our business will be materially harmed.

WE HAVE INCURRED SIGNIFICANT OPERATING LOSSES SINCE INCEPTION AND MAY NOT SUSTAIN PROFITABILITY IN THE FUTURE.

We have experienced operating losses and negative cash flow from operations since our inception and we currently have an accumulated deficit. To the extent that our revenues do not increase, our results of operations and liquidity will be materially adversely affected. If we experience slower than anticipated

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revenue growth or if our operating expenses exceed our expectations, we may not achieve profitability. Even if we achieve profitability in the future, we may not be able to sustain it.

FLUCTUATIONS IN OUR OPERATING RESULTS MAY CAUSE OUR STOCK PRICE TO DECLINE.

Given the nature of the markets in which we participate, we cannot reliably predict future revenues and profitability. Changes in competitive,

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market and economic conditions may cause us to adjust our operations. A high proportion of our costs are fixed, due in part to our sales, research and development and manufacturing costs. Thus, small declines in revenue could disproportionately affect our operating results. Factors that may affect our operating results and the market price of our common stock include:

- o demand for and market acceptance of our products;
- o competitive pressures resulting in lower selling prices;
- o adverse changes in the level of economic activity in regions in which we do business;
- o adverse changes in industries, such as swimming pool construction, on which we are particularly dependent;
- o changes in the portions of our revenue represented by various products and customers;
- o delays or problems in the introduction of new products;
- o the announcement or introduction of new products, services or technological innovations by our competitors;
- o variations in our product mix;
- o the timing and amount of our expenditures in anticipation of future sales;
- o increased costs of raw materials or supplies; and
- o changes in the volume or timing of product orders.

WE HAVE NOT PAID, AND DO NOT EXPECT TO PAY, DIVIDENDS ON OUR COMMON STOCK.

We have not paid any dividends on our common stock since our inception and do not intend to pay any dividends to our common shareholders in the foreseeable future. We intend to reinvest any earnings in the development and expansion of our business.

OUR OPERATIONS ARE SUBJECT TO SEASONAL FLUCTUATION.

The use of our swimming pool products increases in summer months in most markets and results in our sales from January to June being greater than in July through December. Markets for our WATER\$AVR(R) product are also seasonal, dependent on the wet versus dry seasons in particular countries. We attempt to sell into a variety of countries with different seasons on both sides of the equator in order to minimize seasonality. We believe we are able to adequately respond to these seasonal fluctuations by reducing or increasing production as needed.

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INTERRUPTIONS IN OUR ABILITY TO PURCHASE RAW MATERIALS AND COMPONENTS MAY ADVERSELY AFFECT OUR PROFITABILITY.

We purchase certain raw materials and components from third parties pursuant to purchase orders placed from time to time. Because we do not have guaranteed long-term supply arrangements with our suppliers, any material interruption in our ability to purchase necessary raw materials or components

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could have a material adverse effect on our business, financial condition and results of operations.

IF WE DO NOT INTRODUCE NEW PRODUCTS IN A TIMELY MANNER, OUR PRODUCTS COULD BECOME OBSOLETE AND OUR OPERATING RESULTS WOULD SUFFER.

Without the timely introduction of new products and enhancements, our products could become obsolete over time, in which case our revenue and operating results would suffer. The success of our new product offerings will depend upon several factors, including our ability to:

- o accurately anticipate customer needs;
- o innovate and develop new products and applications;
- o successfully commercialize new products in a timely manner;
- o price our products competitively and manufacture and deliver our products in sufficient volumes and on time; and
- o differentiate our products from our competitors' products.

In developing any new product, we may be required to make a substantial investment before we can determine the commercial viability of the new product. If we fail to accurately foresee our customers' needs and future activities, we may invest heavily in research and development of products that do not lead to significant revenues.

OUR PRODUCTS CAN BE HAZARDOUS IF NOT HANDLED, STORED AND USED PROPERLY; LITIGATION RELATED TO THE HANDLING, STORAGE AND SAFETY OF OUR PRODUCTS WOULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS AND RESULTS OF OPERATIONS.

Some of our products are flammable and must be stored properly to avoid fire risk. Additionally, some of our products may cause irritation to a person's eyes if they are exposed to the concentrated product. Although we label our products to warn of such risks, our sales could be reduced if our products were to be viewed as being dangerous to use or if they are implicated in causing personal injury or property damage. We are not currently aware of any circumstances in which our products have caused harm or property damage to consumers. Nevertheless, litigation regarding the handling, storage and safety of our products would have a material adverse effect on our business and results of operations.

OUR FAILURE TO COMPLY WITH ENVIRONMENTAL REGULATIONS MAY CREATE SIGNIFICANT ENVIRONMENTAL LIABILITIES AND FORCE US TO MODIFY OUR MANUFACTURING PROCESSES.

We are subject to various federal, state and local environmental laws, ordinances and regulations relating to the use, storage, handling and disposal of certain of our chemical substances. Under such laws, we may become liable for the costs of removal or remediation of these substances that have been used by our consumers or in our operations. Such laws may impose liability without regard to whether we knew of, or caused, the release of such substances. Any failure by us to comply with present or future regulations could subject us to the imposition of substantial fines, suspension of production, alteration of

manufacturing processes, or cessation of operations, any of which could have a material adverse effect on our business, financial condition, and results of operations.

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OUR FAILURE TO PROTECT OUR INTELLECTUAL PROPERTY COULD IMPAIR OUR COMPETITIVE POSITION.

While we own certain patents and trademarks, some aspects of our business cannot be protected by patents or trademarks. Accordingly, in these areas there are few legal barriers that prevent potential competitors from copying certain of our products, processes and technologies or from otherwise entering into operations in direct competition with us.

OUR PRODUCTS MAY INFRINGE ON THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS, AND RESULTING CLAIMS AGAINST US COULD BE COSTLY AND PREVENT US FROM MAKING OR SELLING CERTAIN PRODUCTS.

Third parties may seek to claim that our products and operations infringe their patent or other intellectual property rights. We may incur significant expense in any legal proceedings to protect our proprietary rights or to defend infringement claims by third parties. In addition, claims of third parties against us could result in awards of substantial damages or court orders that could effectively prevent us from making, using or selling our products in the United States or abroad.

A CLAIM FOR DAMAGES COULD MATERIALLY AND ADVERSELY AFFECT OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Our business exposes us to potential product liability risks, particularly with respect to our consumer swimming pool and personal spa products. There are many factors beyond our control that could lead to liability claims, including the failure of our products to work properly and the chance that consumers will use our products incorrectly or for purposes for which they were not intended. There can be no assurance that the amount of product liability insurance that we carry will be sufficient to protect us from product liability claims. A product liability claim in excess of the amount of insurance we carry could have a material adverse effect on our business, financial condition and results of operations.

OUR ONGOING SUCCESS IS DEPENDENT UPON THE CONTINUED AVAILABILITY OF CERTAIN KEY EMPLOYEES.

Our business would be adversely affected if the services of Daniel B. O'Brien ceased to be available to us because we currently do not have any other employee with an equivalent level of expertise in and knowledge of our industry. If Mr. O'Brien no longer served as our Chief Executive Officer, we would have to recruit one or more new executives, with no real assurance that we would be able to engage a replacement executive with the required skills on satisfactory terms. The market for skilled employees is highly competitive, especially for employees in the fields in which we operate. While our compensation programs are intended to attract and retain the employees required for it to be successful, there can be no assurance that we will be able to retain the services of all of our key employees or a sufficient number to execute on our plans, nor can there be any assurances that we will be able to continue to attract new employees as required. Mr. O'Brien does not have an employment contract with us. We have key-man life insurance policy in the amount of CDN \$400,000 on Mr. O'Brien.

OUR REVENUES WOULD BE SUBSTANTIALLY REDUCED IF WE LOST THE MAJOR CUSTOMER THAT ACCOUNTS FOR A SUBSTANTIAL AMOUNT OF OUR SALES.

Our exclusive United States and Canadian distributor of our HEAT\$AVR(R) product packaged in our Tropical Fish dispenser accounted for 73% of our sales revenues in fiscal 2003 and 94% of our sales revenues in fiscal 2002. Although we have an agreement with such firm which is described above, this agreement does not require the distributor to purchase any minimum amount of our products, nor does it

prevent it from handling competing products. If our distributor reduced its purchase or ceased to purchase our products, we would likely suffer substantial reduction in our sales and would have to make alternative arrangements to distribute our Tropical Fish product in the United States and Canada. There can be no assurance that we would be able to replace the services of this distributor on satisfactory terms. Subsequent to the year ended December 31, 2003, on February 29, 2004, the distribution contract with Sun Solar ended and was not renegotiated. We have decided to retain responsibility for distribution internally and have hired new, experienced staff to execute worldwide distribution from our Richmond, British Columbia office. Sun Solar ordered sufficient product through the winter to ensure that retail merchants have stock on hand for the start of the summer season. We will be responsible for restocking during the summer and all sales in the future.

WE ARE SUBJECT TO CREDIT RISK AND MAY BE SUBJECT TO SUBSTANTIAL WRITE-OFFS IF ONE OR MORE OF OUR SIGNIFICANT CUSTOMERS DEFAULT ON THEIR PAYMENT OBLIGATIONS TO US.

We currently allow our major customers between 30 and 45 days to pay for each shipment of product we make to them. This practice, while customary, presents an accounts receivable write-off risk in that if one or more of our significant customers defaulted on their payment obligations to us, such write-off, if substantial, would have a material adverse effect on our business and results of operations. While we have exposure to this type of risk, we are no longer subject to the concentrated credit risk that we were previously subject to because of our relationship with Sun Solar. In addition, while our exposure to a bad debts and write-offs credit risk may increase as we service a larger number of customers in the swimming pool and personal spa and water evaporation industries, the effect of any such bad debts and write-offs will be minimized as a result of the increase in the numbers of our customers and overall revenues.

THE RECENT INTRODUCTION OF OUR WATER\$AVR(R) PRODUCT LINE MAY RESULT IN LOSSES.

We introduced our WATER\$AVR(R) product in fiscal 2002. We have delivered quantities for testing by potential customers, but only one customer has ordered the product for commercial use. This product can achieve success only if it is ordered in substantial quantities by commercial customers who have determined that the water saving benefits of the product exceed the costs of purchase and deployment of the product. We cannot assure that we will receive sufficient orders of this product to achieve profits or cover the additional expenses incurred to manufacture and market this product. We expect to incur \$800,000 in development, marketing and manufacture of our WATER\$AVR(R) product line in fiscal 2004.

Item 7. Financial Statements.

Our consolidated financial statements and notes thereto appear on pages F-1 to F-18 of this Annual Report.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC. AND SUBSIDIARIES  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Chartered Accountants, Cinnamon Jang Willoughby & Company  
Report of Independent Chartered Accountants, Pannell Kerr Forster  
Consolidated Balance Sheets as of December 31, 2003  
Consolidated Statements of Operations for the Year Ended December 31, 2003  
Consolidated Statements of Stockholders' Equity for the Year Ended December 31, 2003  
Consolidated Statements of Cash Flows for the Year Ended December 31, 2003  
Notes to Consolidated Financial Statements

REPORT OF INDEPENDENT CHARTERED ACCOUNTANTS

To the board of directors and stockholders of Flexible Solutions International, Inc.:

We have audited the consolidated balance sheet of Flexible Solutions International, Inc. as at December 31, 2003 and the consolidated statements of operations, stockholders' equity and cash flows for the year then ended. The consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion the consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles in the United States of America.

As described in note 2 to the consolidated financial statements, the accompanying consolidated financial statements of Flexible Solutions International, Inc. as of December 31, 2003 and for the year then ended have been restated.

On March 15, 2004 (September 30, 2005 as to the effects of the restatements described in note 2) we reported separately to the shareholders of Flexible Solutions International, Inc. on consolidated financial statements for the same period, audited in accordance with auditing standards generally accepted in the United States of America and prepared in accordance with accounting principles generally accepted in the United States of America.

The financial statements as at December 31, 2002 and 2001 and for the years then ended were audited by another firm of chartered accountants who expressed an opinion without reservation on those statements in their report dated March 12, 2003.

Cinnamon Jang Willoughby & Company  
Chartered Accountants

Burnaby, British Columbia  
March 15, 2004 (September 30, 2005 as to the effects of the restatements described in note 2)

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To the board of directors and stockholders of FLEXIBLE SOLUTIONS INTERNATIONAL, INC.:

We have audited the accompanying consolidated balance sheets of Flexible Solutions International, Inc. as of December 31, 2002 and 2001 and the consolidated statements of operations, stockholders' equity and cash flows for each of the years ended December 31, 2002, 2001 and 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the years ended December 31, 2002, 2001 and 2000 in conformity with accounting principles generally accepted in the United States of America.

As described in note 2 to the consolidated financial statements, the accompanying consolidated financial statements of Flexible Solutions International, Inc. as of December 31, 2002 and for the year then ended have been restated.

On March 12, 2003 (September 30, 2005 as to the effects of the restatements described in note 2), we reported separately to the shareholders of Flexible Solutions International, Inc. on consolidated financial statements for the same period, audited in accordance with auditing standards generally accepted in the United States of America and prepared in accordance with accounting principles generally accepted in the United States of America.

Pannell Kerr Forster,  
Chartered Accountants

Vancouver, Canada  
March 12, 2003 (September 30, 2005 as to the effects of the restatements described in note 2)

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEETS  
AT DECEMBER 31, 2003  
(U.S. DOLLARS)

ASSETS

December 31,  
2003  
As Restated  
(Note 2)

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CURRENT

|                                 |    |           |
|---------------------------------|----|-----------|
| Cash and cash equivalents       | \$ | 237,080   |
| Short-term investments (Note 5) |    | 5,033,837 |
| Accounts receivable             |    | 294,238   |
| Income taxes recoverable        |    | 86,243    |
| Loan receivable (Note 6)        |    | 17,585    |
| Inventory                       |    | 212,938   |
| Prepaid expenses (Note 7)       |    | 36,101    |
|                                 |    | -----     |
|                                 |    | 5,918,022 |

|   |  |         |
|---|--|---------|
| PROPERTY, EQUIPMENT AND LEASEHOLDS (NOTE 8) |  | 167,589 |
| INVESTMENTS (NOTE 9)                        |  | 303,500 |
|   |  | -----   |

\$ 6,389,111

LIABILITIES

Current:

|  |    |         |
|--|----|---------|
| Accounts payable and accrued liabilities | \$ | 157,643 |
| Due to shareholders                      |    | 7,700   |
|  |    | -----   |

165,343

STOCKHOLDERS' EQUITY

Capital Stock

Authorized

50,000,000 Common shares with a par value of \$0.001 each

1,000,000 Preferred shares with a par value of \$0.01 each

Issued and outstanding

11,794,916 (2002: 11,570,916) common shares (Note 14)

11,794

CAPITAL IN EXCESS OF PAR VALUE 7,082,813

SHARE SUBSCRIPTION RECEIVABLE --

OTHER COMPREHENSIVE INCOME (LOSS) 7,094,607

DEFICIT

3,023

873,862

COMMITMENTS (NOTE 16) 6,223,768

CONTINGENCIES (NOTE 17) \$ 6,389,111

- See Notes to Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE YEAR ENDED DECEMBER 31, 2003  
(U.S. DOLLARS)

|               | Year Ended December |              |
|---------------|---------------------|--------------|
|               | 2003                | 2002         |
|               | As Restated         | As Restated  |
|               | (Note 2)            | (Note 2)     |
|               | -----               | -----        |
| SALES         | \$ 2,321,120        | \$ 1,112,192 |
| COST OF SALES | 1,363,064           | 581,422      |

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|  |              |              |
|--|--------------|--------------|
| GROSS PROFIT                               | 958,056      | 530,770      |
| OPERATING EXPENSES                         |              |              |
| Administrative salaries and benefits       | 80,999       | 45,312       |
| Advertising and promotion                  | 63,871       | 45,000       |
| Bad debts                                  | 24,747       | 230          |
| Commission                                 | --           | --           |
| Consulting (recovery)                      | 197,918      | 86,445       |
| Currency exchange (gain) loss              | (31,955)     | 19,180       |
| Depreciation                               | 37,712       | 24,683       |
| Investor relations and transfer agent fee  | 173,268      | 96,954       |
| Office and miscellaneous                   | 83,854       | 77,703       |
| Professional fees                          | 190,638      | 53,548       |
| Rent                                       | 70,538       | 61,126       |
| Research and development                   | 67,615       | 2,523        |
| Shipping                                   | 19,203       | 10,771       |
| Telecommunications                         | 41,445       | 9,326        |
| Travel                                     | 150,116      | 50,213       |
| Utilities                                  | 17,246       | --           |
| Wages                                      | 476,931      | 414,885      |
|  | 1,664,146    | 997,899      |
|  | -----        | -----        |
| INCOME (LOSS) BEFORE OTHER INCOME          | (706,090)    | (467,129)    |
| OTHER INCOME                               |              |              |
| Interest                                   | 203,310      | 67,228       |
| Gain on disposal of property and equipment | --           | --           |
|  | -----        | -----        |
|  | 203,310      | 67,228       |
| INCOME (LOSS) BEFORE INCOME TAXES          | (502,780)    | (399,901)    |
| INCOME TAXES (RECOVERY)                    | (25,892)     | (21,456)     |
|  | -----        | -----        |
| NET INCOME (LOSS)                          | \$ (476,888) | \$ (378,445) |
| NET INCOME (LOSS) PER SHARE (NOTE 12)      | \$ (0.04)    | \$ (0.04)    |
|  | -----        | -----        |
| WEIGHTED AVERAGE NUMBER OF SHARES          | 11,734,880   | 10,555,754   |
|  | -----        | -----        |

- See Notes to Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2003  
(U.S. DOLLARS)

|                           | Shares       | Par Value | Capital in Excess of Par Value As Restated Note 2) | Share Subscription Receivable | Oth Compre Income |
|---------------------------|--------------|-----------|--|-------------------------------|-------------------|
|                           | -----        | -----     | -----  | -----                         | -----             |
| Balance December 31, 2001 | \$ 9,272,816 | \$ 9,272  | \$ 563,713   | \$ --                         | \$ (              |
| Shares issued:            |              |           |  |                               |                   |

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|                                    |            |        |           |          |
|------------------------------------|------------|--------|-----------|----------|
| For cash                           |            |        |           |          |
| Private placement                  | 1,828,600  | 1,829  | 5,998,271 | --       |
| Exercise of stock options          | 439,500    | 439    | 150,686   | --       |
| For services                       | 30,000     | 30     | 44,370    | --       |
| Share issue costs                  | --         | --     | (250,000) | --       |
| Share subscription                 | --         | --     | --        | (33,000) |
| Payment of subscription receivable |            |        |           | 16,783   |
| Stock option compensation          | --         | --     | 117,608   | --       |
| Translation adjustment             | --         | --     | --        | --       |
| Net loss                           | --         | --     | --        | --       |
| -----                              |            |        |           |          |
| Comprehensive income               |            |        |           |          |
| Balance December 31, 2002          | 11,570,916 | 11,570 | 6,624,648 | (16,217) |
| Shares issued:                     |            |        |           |          |
| Exercise of stock options          | 124,000    | 124    | 64,695    | --       |
| For investment                     | 100,000    | 100    | 270,900   | --       |
| Payment of subscription receivable | --         | --     | --        | 16,217   |
| Stock option compensation reversal | --         | --     | 122,570   | --       |
| Translation adjustment             | --         | --     | --        | --       |
| Net income                         | --         | --     | --        | --       |
| -----                              |            |        |           |          |
| Comprehensive income               |            |        |           |          |
| Balance December 31, 2003          | 11,794,916 | 11,794 | 7,082,813 | --       |
| -----                              |            |        |           |          |

- See Notes to Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2003  
(U.S. DOLLARS)

|  | Year Ended December 31, |              |
|--|-------------------------|--------------|
|  | 2003                    | 2002         |
|  | As Restated             | As Restated  |
|  | (Note 2)                | (Note 2)     |
|  | -----                   | -----        |
| Operating activities:                      |                         |              |
| Net income (loss)                          | \$ (476,888)            | \$ (378,445) |
| Adjustments for                            |                         |              |
| Depreciation                               | 37,712                  | 24,683       |
| Stock compensation expense                 | 122,570                 | 117,608      |
| Gain on disposal of property and equipment | --                      | --           |
| Non-cash services                          | --                      | 44,400       |
|  | -----                   | -----        |
| Changes in non-cash working capital        | (316,606)               | (191,754)    |
| Accounts receivable                        | (239,016)               | (8,848)      |
| Income tax recoverable                     | 31,771                  | (136,122)    |
| Inventory                                  | (9,108)                 | (22,132)     |
| Prepaid expenses                           | 51,220                  | (28,030)     |
| Accounts payable and accrued liabilities   | 104,497                 | 32,554       |

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|   |            |             |
|---|------------|-------------|
| Unrealized foreign exchange (gain) loss                   | --         | 627         |
| Increase in amounts due to shareholders                   | 7,700      | --          |
| Cash flows from (used in) operating activities            | (369,542)  | (353,705)   |
| <hr/>   |            |             |
| Investing activities                                      |            |             |
| Acquisition (disposal) short-term investments             | 28,658     | (5,062,495) |
| Loan receivable   | (7,503)    | (566)       |
| Acquisition of property and equipment                     | (76,735)   | (80,496)    |
| Acquisition of investments                                | --         | (32,500)    |
| Note receivable   | --         | 9,225       |
| Cash flows (used in) investing activities                 | (55,580)   | (5,166,832) |
| <hr/>   |            |             |
| Financing activities                                      |            |             |
| Proceeds from issuance of common shares                   | 64,819     | 5,868,225   |
| Subscriptions received                                    | 16,217     | 16,783      |
| Cash flows from financing activities                      | 81,036     | 5,885,008   |
| Effect of exchange rate changes on cash                   | 24,377     | 1,861       |
| Net increase (decrease) in cash                           | (319,709)  | 366,332     |
| Cash and cash equivalents, beginning                      | 556,789    | 190,457     |
| Cash and cash equivalents, ending                         | \$ 237,080 | \$ 556,789  |
| <hr/>   |            |             |
| Supplemental disclosure of cash flow information:         |            |             |
| Additional information                                    |            |             |
| Interest  | \$ 203,310 | \$ 67,228   |
| Income taxes  | 60,351     | 115,472     |
| Non-cash transactions                                     |            |             |
| Issue of common stock for investment<br>(2002 - services) | 271,000    | 44,400      |
| Sale of trailer - exchange for rent                       | --         | --          |
| <hr/>   |            |             |

- See Notes to Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2003  
(U.S. DOLLARS)

1. BASIS OF PRESENTATION.

These consolidated financial statements include the accounts of Flexible Solutions International, Inc. (the "Company"), and its wholly-owned subsidiaries Flexible Solutions, Ltd. ("Flexible Ltd.") and WaterSavr Global Solutions Inc. All inter-company balances and transactions have been eliminated. The parent company was incorporated May 12, 1998 in the State of Nevada and had no operations until June 30, 1998 as described below.

On June 30, 1998, the Company completed the acquisition of all of the shares of Flexible Ltd. The acquisition was effected through the issuance of 7,000,000 shares of common stock by the Company with former shareholders of the subsidiary receiving all of the total shares then issued and outstanding. The transaction has been accounted for as a reverse-takeover.

Flexible Ltd. is accounted for as the acquiring party and the surviving entity. As Flexible Ltd. is the accounting survivor, the consolidated financial statements presented for all periods are those of Flexible Ltd. The shares issued by the Company pursuant to the 1998 acquisition have been accounted for as if those shares had been issued upon the organization of Flexible Ltd.

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On May 2, 2002, the Company established WaterSavr Global Solutions Inc. through the issuance of 100 shares of common stock.

### 2. RESTATEMENTS AS A RESULT OF CORRECTING STOCK COMPENSATION EXPENSE.

In October 2005, while completing a registration statement for securities issued in the second quarter of 2005, the Company determined that certain disclosures made in connection with stock-based compensation expense required adjustment. In September 2002, the Company entered into a distribution agreement with Ondeo Nalco Company ("Ondeo") whereby Ondeo agreed to serve as the exclusive distributor of the Company's WATER\$AVR(R) products for so long as Ondeo maintained a certain threshold sales level as defined in the agreement. As consideration for signing the agreement, Ondeo was granted an option to purchase 2,000,000 shares of the Company's common stock. Half of the option for 1,000,000 shares was exercisable immediately at an exercise price of \$4.25 for each common share. The remaining half of the option for 1,000,000 shares was exercisable after certain threshold sales targets were achieved at a price of \$5.50 for each common share.

In determining the stock-based compensation expense for the nine months ended September 30, 2002, the Company's expensed the entire fair value of the stock option believing that the option fully vested upon the signing of the agreement. In the Company's October 2005 review, however, the Company determined that: (i) first, as stated above, half of the option to purchase 1,000,000 shares of common stock did not vest and was not exercisable until the threshold sales target had been met, which would not be until five years after the signing of the distribution agreement; and (ii) second, the Company did not consider Emerging Issues Task Force ("EITF") No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services; EITF No. 00-18, Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees; and EITF No. 01-9, Accounting for Consideration Given by a Vendor to a Customer.

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To correctly account for the stock options granted to Ondeo, the stock-based compensation expense, included in consulting expense, should have been measured at the date the performance obligation was complete and then recognized on a rational and systematic manner in relation to the sales achieved by Ondeo. Had the Company correctly accounted for these stock options, stock-based compensation expense for the year would have been nil as no sales had yet been achieved. Instead, the Company recorded stock-based compensation expense of \$2,704,000 for the year.

During the three months ended March 31, 2003, Ondeo achieved the first threshold sales target, and, accordingly, the Company should have recorded a corresponding stock-based compensation expense of \$54,080. However, since the entire stock-based compensation expense had been recorded in the September 30, 2002 interim financial statements and in the year ended December 31, 2002, the Company did not record any additional stock-based compensation expense as a result of the attained first threshold level.

In the fourth quarter of the year ended December 31, 2003, it was determined that Ondeo was not going to attain the minimum sales targets stipulated in the exclusive distributorship agreement. Consequently the exclusive distributorship agreement and corresponding stock options were cancelled. The Company accounted for the cancellation of the stock options in accordance with Statement of Financial Accounting Standards ("FAS") No. 123 similar to a forfeiture of stock options and reversed \$2,480,200 of the stock compensation expense previously recorded in 2002. Had the Company accounted for the cancellation of the stock options correctly, it would have reversed the

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stock-based compensation of expense of \$54,080 that was recorded in the first quarter ended March 31, 2003.

The following presents the effect on the Company's previously issued financial statements for the years ended December 31, 2003 and 2002:

Balance sheet as at December 31, 2003 -

|                                | Previously<br>Reported | Increase<br>(Decrease) |
|--------------------------------|------------------------|------------------------|
| Capital in excess of par value | \$ 7,306,613           | \$ (223,800)           |
| Accumulated deficiency         | (1,097,662)            | 223,800                |

Statement of operations for the year ended December 31, 2003 -

|                                   | Previously<br>Reported | Increase<br>(Decrease) |
|-----------------------------------|------------------------|------------------------|
| Expenses                          | \$ (816,054)           | \$ 2,480,200           |
| Income (Loss) before other item   | 1,774,110              | (2,480,200)            |
| Income (Loss) before income taxes | 1,977,420              | (2,480,200)            |
| Net Income (Loss)                 | 2,003,312              | (2,480,200)            |
| Net Income (Loss) per share       | 0.17                   | (0.21)                 |

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Statement of cash flow for the year ended December 31, 2003 -

|                           | Previously<br>Reported | Increase<br>(Decrease) |
|---------------------------|------------------------|------------------------|
| Net Income (Loss)         | \$ 2,003,312           | \$ (2,480,200)         |
| Stock option compensation | (2,357,630)            | 2,480,200              |

Balance sheet as at December 31, 2002 -

|                                | Previously<br>Reported | Increase<br>(Decrease) |
|--------------------------------|------------------------|------------------------|
| Capital in excess of par value | \$ 9,328,648           | \$ (2,704,000)         |
| Accumulated deficiency         | (3,100,974)            | 2,704,000              |

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Statement of operations for the year ended December 31, 2002 -

|                                   | Previously<br>Reported | Increase<br>(Decrease) |
|-----------------------------------|------------------------|------------------------|
| Expenses                          | \$ 3,701,899           | \$ (2,704,000)         |
| Income (Loss) before other item   | (3,171,129)            | 2,704,000              |
| Income (Loss) before income taxes | (3,103,901)            | 2,704,000              |
| Net Income (Loss)                 | (3,082,445)            | 2,704,000              |
| Net Income (Loss) per share       | (0.29)                 | 2,704,000              |

Statement of cash flows for the year ended December 31, 2002 -

|                           | Previously<br>Reported | Increase<br>(Decrease) |
|---------------------------|------------------------|------------------------|
| Net Income (Loss)         | \$ (3,082,445)         | \$ 2,704,000           |
| Stock option compensation | 2,821,608              | (2,704,000)            |

### 3. COMPARATIVE FIGURES.

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

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### 4. SIGNIFICANT ACCOUNTING POLICIES.

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles accepted in the United States of America applicable to a going concern and reflect the policies outlined below.

#### (a) Cash and Cash Equivalents.

The Company considers all highly liquid investments purchased with an original or remaining maturity of less than three months at the date of purchase to be cash equivalents. Cash and cash equivalents are maintained with several financial institutions.

#### (b) Inventory and Cost of Sales.

Inventory is valued at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis. Cost of sales includes all expenditures incurred in bringing the goods to the point of sale. Inventorial costs and costs of sales include direct costs of the raw material, inbound freight charges, warehousing costs, handling costs (receiving and purchasing) and utilities and overhead expenses related to the Company's manufacturing and processing facilities.

#### (c) Property, Equipment and Leaseholds.

The following assets are recorded at cost and depreciated using the following methods using the following annual rates:

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|                         |                               |
|-------------------------|-------------------------------|
| Computer hardware       | 30% Declining balance         |
| Furniture and fixtures  | 20% Declining balance         |
| Manufacturing equipment | 20% Declining balance         |
| Office equipment        | 20% Declining balance         |
| Leasehold improvements  | Straight-line over lease term |

Property and equipment are written down to net realizable value when management determines there has been a change in circumstances which indicates its carrying amount may not be recoverable. No write-downs have been necessary to date.

(d) Foreign Currency.

The functional currency of the Company is the Canadian Dollar. The translation of the Canadian Dollar to the reporting currency of the U.S. Dollar is performed for current assets and current liabilities using exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated using rates prevailing at the time of the acquisition of the assets or assumption of the liabilities. Revenue and expense transactions are translated using average exchange rates prevailing during the year. Translation adjustments arising on conversion of the financial statements from the Company's functional currency, Canadian Dollars, into the reporting currency, U.S. Dollars, are excluded from the determination of income and disclosed as other comprehensive income (loss) in stockholders' equity.

Foreign exchange gains and losses relating to transactions not denominated in the applicable local currency are included in income if realized during the year and in comprehensive income if they remain unrealized at the end of the year.

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(e) Revenue Recognition.

Revenue from product sales is recognized at the time the product is shipped since title and risk of loss is transferred to the purchaser upon delivery to the carrier. Shipments are made F.O.B. shipping point. The Company recognizes revenue when there is persuasive evidence of an arrangement, delivery has occurred, the fee is fixed or determinable, collectibility is reasonably assured, and there are no significant remaining performance obligations. When significant post-delivery obligations exist, revenue is deferred until such obligations are fulfilled.

Provisions are made at the time the related revenue is recognized for estimated product returns. Since the Company's inception, product returns have been insignificant; therefore no provision has been established for estimated product returns.

(f) Stock Issued in Exchange for Services.

The valuation of the Company's common stock issued in exchange for services is valued at an estimated fair market value as determined by officers and directors of the Company based upon trading prices of the Company's common stock on the dates of the stock transactions.

(g) Stock-based Compensation.

The Company applies the fair value based method of accounting prescribed by FAS No. 123 in accounting for stock issued in exchange for



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services to consultants and non-employees.

FAS No. 123 encourages, but does not require, companies to record compensation cost for stock-based compensation plans to employees at fair value. The Company has chosen to account for stock-based compensation plans to employees and directors using Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees. Accordingly, compensation cost for stock options for employees is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee is required to pay for the stock.

The Company adopts the disclosure provisions of FAS No. 123 for stock options granted to employees and directors. The Company discloses on a supplemental basis, the pro-forma effect of accounting for stock options awarded to employees and directors, as if the fair value based method had been applied, using the Black-Scholes option-pricing model.

### (h) Comprehensive Income.

Other comprehensive income refers to revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income, but are excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity. The Company's other comprehensive income is primarily comprised of unrealized foreign exchange gains and losses.

### (i) Income (Loss) Per Share.

Income (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares outstanding. Diluted loss per share is computed by giving effect to all potential dilutive options that were outstanding during the year. For the year ending December 31, 2003, 2002 and 2001, all outstanding options were anti-dilutive.

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### (j) Use of Estimates.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect 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 reporting period. Actual results could differ from those estimates and would impact the results of operations and cash flows.

### (k) Financial Instruments.

The fair market value of the Company's financial instruments comprising cash, short-term investment, accounts receivable, income tax recoverable, loan receivable, accounts payable and accrued liabilities and amounts due to shareholders were estimated to approximate their carrying values due to immediate or short-term maturity of these financial instruments.

The Company is exposed to foreign exchange and interest rate risk to the extent that market value rate fluctuations materially differ from financial assets and liabilities subject to fixed long-term rates.

### (m) Recent Accounting Pronouncements.

(i) In June 2001, the Financial Accounting Standards Board

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("FASB") issued FAS No. 142, Goodwill and Other Intangible Assets. Under FAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed at least annually for impairment. The amortization provisions of FAS No. 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets acquired prior to July 1, 2001, the Company adopted FAS No. 142 effective January 1, 2002. Application of the non-amortization provisions of FAS No. 142 for goodwill did not have any impact on the Company's financial reporting.

(ii) In October 2001, the FASB issued FAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. FAS No. 144 addresses significant issues relating to the implementation of FAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and develops a single accounting model, based on the framework established in FAS No. 121 for long-lived assets to be disposed of by sale, whether such assets are or are not deemed to be a business. FAS No. 144 also modifies the accounting and disclosure rules for discontinued operations. The standard was adopted on January 1, 2002 and did not have any impact on the Company's financial statements.

(iii) In November 2001, the FASB issued EITF Issue No. 01-14, Income Statement Characterization of Reimbursements Received for "Out of Pocket" Expenses Incurred. This guidance requires companies to recognize the recovery of reimbursable expenses such as travel costs on service contracts as revenue. These costs are not to be netted as a reduction of cost. This guidance was implemented January 1, 2002. The Company does not expect this guidance to have a material impact on its financial statements.

### 5. SHORT-TERM INVESTMENT.

Short-term investment consists of a certificate of deposit bearing interest at 4.03% and maturing September 11, 2005. The Company will incur a penalty if principle is withdrawn before the maturity date. The amount of the penalty equals one-half of the remaining days in the term daily compounded interest on the total amount withdrawn. If the accrued interest is less than the calculated penalty at the time of withdrawal, the difference between the penalty and the accrued interest will be deducted from the principal.

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### 6. LOAN RECEIVABLE.

|                                  | 2003      | 2002      |
|----------------------------------|-----------|-----------|
| 5% loan receivable due on demand | \$ 17,585 | \$ 10,082 |

### 7. PREPAID EXPENSES.

|                                  | 2003      | 2002      |
|----------------------------------|-----------|-----------|
| Deposits for materials purchases | \$ --     | \$ 13,578 |
| Security deposit and prepaids    | 36,101    | 73,743    |
|                                  | \$ 36,101 | \$ 87,321 |

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8. PROPERTY, EQUIPMENT AND LEASEHOLDS.

|                         | Cost       | Accumulated<br>Amortization | 2003<br>Net |
|-------------------------|------------|-----------------------------|-------------|
| Computer hardware       | \$ 15,983  | \$ 6,716                    | \$ 9,267    |
| Furniture and fixtures  | 5,126      | 1,833                       | 3,293       |
| Office equipment        | 22,061     | 6,866                       | 15,195      |
| Manufacturing equipment | 232,108    | 98,825                      | 133,283     |
| Trailer                 | 1,786      | 268                         | 1,518       |
| Leasehold improvements  | 12,279     | 7,246                       | 5,033       |
|                         | \$ 289,343 | \$121,754                   | \$167,589   |

9. INVESTMENTS.

|  | 2003       | 2002      |
|--|------------|-----------|
| Ideal Business Solutions India Pty. Ltd. | \$ 32,500  | \$ 32,500 |
| Tatko Inc.                               | 271,000    | --        |
|  | \$ 303,500 | \$ 32,500 |

The Company's purchase of 2,700 shares (or 10% of the total outstanding) of Ideal Business Solutions India Pty. Ltd. has been recorded at cost.

On May 31, 2003, the Company acquired an option to purchase a 20% interest in the outstanding shares of Tatko Inc. ("Tatko") for consideration of the issuance of 100,000 shares of its common stock. The option to purchase the shares of Tatko expires on May 31, 2008. The cost of the investment has been accounted for based on the fair market value of the Company's common stock on May 31, 2003.

10. COMPREHENSIVE INCOME (LOSS).

|                            | 2003<br>As Restated<br>(Note 2) | 2002<br>As Restated<br>(Note 2) |
|----------------------------|---------------------------------|---------------------------------|
| Net income (loss)          | \$ (476,888)                    | \$ (378,445)                    |
| Other comprehensive income | 24,377                          | 2,488                           |
|                            | \$ (452,511)                    | \$ (375,957)                    |

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11. INCOME TAX.

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Total income tax expense differs from the amounts computed by applying the combined Canadian federal and provincial statutory rate of 36% to income before income taxes. The income to which this is applied is as follows:

|   | 2003<br>As Restated<br>(Note 2) | 2002<br>As Restated<br>(Note 2) |
|---|---------------------------------|---------------------------------|
| Income (loss) before income tax per entity    | \$ (170,369)                    | \$ (162,021)                    |
| Flexible Solutions International, Inc.        | 16,616                          | (56,264)                        |
| Flexible Solutions, Ltd.                      | (349,027)                       | (181,616)                       |
| WaterSavr Global Solutions Inc.               |                                 |                                 |
| Consolidated income (loss) before income tax  | (502,780)                       | (399,901)                       |
| Permanent difference                          |                                 |                                 |
| Stock option benefit                          | 122,570                         | 117,608                         |
| Other   |                                 |                                 |
| Stock issued for services                     | --                              | 44,400                          |
| Miscellaneous                                 | --                              | --                              |
| <b>Taxable income (loss) for tax purposes</b> | <b>\$ (380,210)</b>             | <b>\$ (237,893)</b>             |

Application of the federal and provincial statutory rate results in the following:

|  | 2003                | 2002                |
|--|---------------------|---------------------|
| Expected tax expense (recovery) at statutory rates             |                     |                     |
| From Canadian operations                                       | \$ (25,892)         | \$ (21,456)         |
| From U.S. operations   | (110,984)           | (84,691)            |
| Decrease resulting from manufacturing and processing deduction | --                  | --                  |
| Other  | --                  | --                  |
| <b>Income tax expense (recovery)</b>                           | <b>\$ (136,876)</b> | <b>\$ (106,147)</b> |

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's deferred tax liability calculated at a 35% tax rate consists of the following:

|   | 2003       |
|---|------------|
| Non-capital loss carry-forwards               | \$ 226,931 |
| Book over tax value of property and equipment | (17,063)   |

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|                     |           |
|---------------------|-----------|
| Valuation allowance | (209,868) |
|                     | -----     |
|                     | \$ --     |

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The Company's losses for income tax purposes are \$648,375 (2002 - \$268,165), which may be carried forward to apply against future income tax, expiring between 2010 and 2023. The future tax benefit of these loss carry-forwards has been offset with a full valuation allowance. These losses expire as follows:

|      |           |
|------|-----------|
| 2010 | \$ 79,113 |
| 2018 | 16,858    |
| 2019 | 13,414    |
| 2022 | 237,893   |
| 2023 | 301,097   |

12. NET INCOME (LOSS) PER SHARE.

|                       | Net Income (Loss)<br>(Numerator)<br>As Restated<br>(Note 2) | Shares<br>(Denominator)<br>As Restated<br>(Note 2) |
|-----------------------|---|--|
|                       | -----   | -----  |
| 2003 basic net income | \$ (476,888)  | 11,734,88  |
| 2002 basic net loss   | \$ (378,445)  | 10,555,75  |
| 2001 basic net loss   | \$ (233,955)  | 9,247,94   |

There were no preferred shares issued and outstanding for the years ended December 31, 2003, 2002 or 2001. The 2002 denominator excludes 3,671,800 shares that may be issued upon exercise of options as to do so would have been anti-dilutive for the 2002 per share loss.

13. STOCK OPTIONS.

The Company may issue stock options and stock bonuses for shares of its common stock to provide incentives to directors, key employees and other persons who contribute to the success of the Company. The exercise price for incentive options (which may be granted to employees of the Company or its subsidiaries) is not less than the fair market value of the stock at the date of the grant, and the exercise price for non-qualified options (which may be granted to non-employees of the Company) is not less than 80% of the fair market value on the date of the grant. The fair market value is defined by the most recent closing sale price reported by the American Stock Exchange.

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The following table summarizes the Company's stock option activity for the years ended December 31, 2003 and 2002:

|                            | Number of<br>Shares | Exercise Price<br>Per Share |
|----------------------------|---------------------|-----------------------------|
| Balance, December 31, 2001 | 1,888,500           | \$0.25 - \$3.50             |
| Granted                    | 2,222,800           | \$1.50 - \$5.50             |
| Exercised                  | (439,500)           | \$0.25 - \$1.50             |
| Balance, December 31, 2002 | 3,671,800           | \$0.25 - \$5.50             |
| Granted                    | 256,000             | \$3.60 - \$4.25             |
| Exercised                  | (124,000)           | \$0.25 - \$2.28             |
| Expired                    | (2,109,800)         | \$0.25 - \$5.50             |
| Balance, December 31, 2003 | 1,694,000           | \$1.00 - \$4.25             |

The Company applies APB Opinion No. 25 and related interpretations in accounting for its stock options granted to employees, and accordingly, compensation expense of nil (2002 - \$85,000) was recognized as wages expense. Had compensation expense been determined as provided in FAS No. 123 using the Black-Scholes option-pricing model, the pro forma effect on the Company's net income (loss) and per share amounts would be as follows:

|  | 2003<br>As Restated<br>(Note 2) | 2002<br>As Restated<br>(Note 2) |
|--|---------------------------------|---------------------------------|
| Net income (loss), as reported           | \$ (476,888)                    | \$ (378,445)                    |
| Net income (loss), pro forma             | (557,767)                       | (1,000,296)                     |
| Net income (loss) per share, as reported | (0.04)                          | (0.04)                          |
| Net income (loss) per share, pro forma   | (0.05)                          | (0.09)                          |

The fair value of each option grant is calculated using the following weighted average assumptions:

|                       | 2003   | 2002   |
|-----------------------|--------|--------|
| Expected life - years | 5.00   | 5.00   |
| Interest rate         | 2.87%  | 3.00%  |
| Volatility            | 49.00% | 72.30% |
| Dividend yield        | --%    | --%    |

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During the year ended December 31, 2003, the Company granted 205,000 (2002 - 2,097,000) stock options to consultants and has applied FAS No. 123 using the Black-Scholes option-pricing model, which resulted in additional consulting expense of \$122,570 (2002 - \$117,608). During the year ended December 31, 2003, the Company cancelled 2,000,000 stock options to consultants pursuant to the terms of the contract.

### 14. CAPITAL STOCK.

During the year ended December 31, 2003, the Company: (i) issued 100,000 shares of common stock valued at \$271,000 to acquire an option to purchase a 20% interest in Tatko (see Note 8); and (ii)

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issued 124,000 shares of common stock at prices ranging from \$0.25 to \$2.28 per share upon exercise of stock options.

During the year ended December 31, 2002, the Company: (i) completed two private placements whereby 400,000 shares of common stock were issued at prices ranging from \$0.25 to \$1.50 per share upon exercise of stock options; (ii) issued 439,500 shares of common stock at prices ranging from \$0.25 to \$1.50 per share upon exercise of stock options; and (iii) issued 30,000 shares of common stock at a price of \$1.48 per share to an officer in lieu of six months of salary.

### 15. SEGMENTED, SIGNIFICANT CUSTOMER INFORMATION AND ECONOMIC DEPENDENCY.

The Company operates in a single segment, involving the development and marketing of two lines of energy and water conservation products, which consists of a (i) liquid swimming pool blanket which saves energy and water by storing evaporation from the pool surface, and (ii) food-safe powdered form of the active ingredient within the liquid blanket and is designed to be used in still or slow moving drinking water sources.

The Company's sales in the United States and abroad amounted to 28% (2002 - 4%) of its total sales. The remainder was earned in Canada.

All of the Company's long-lived assets are located in Canada.

The Company had two major customers, Sun Solar and Ondeo, which comprised 97% of total sales for the year ended December 31, 2003 (2002 - 95%). The Company is exposed to concentrated credit risk with respect to its trade receivables from Sun Solar. It seeks to keep this risk to a minimum by granting only 45 days credit terms to the customer.

### 16. COMMITMENTS.

The Company is committed to minimum rental payments for property and premises aggregating approximately \$201,482 over the term of a lease expiring September 30, 2006.

Commitments in each of the next three years are approximately as follows:

|       |          |
|-------|----------|
| ----- | -----    |
| 2004  | \$73,266 |
| 2005  | 73,266   |
| 2006  | 54,950   |
| ----- | -----    |

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### 17. CONTINGENCIES.

On May 1, 2003, the Company filed a lawsuit in the Supreme Court of British Columbia, Canada, against John Wells and Equity Trust, S.A. seeking the return of 100,000 shares of the Company's common stock and the repayment of a \$25,000 loan, which were provided to defendants for investment banking services consisting of securing a \$5 million loan and a \$25 million stock offering. Such services were not performed and in the proceeding the Company seeks return of such shares after defendant's failure to both return the shares voluntarily and repay the note. On May 7, 2003, the Company obtained an injunction freezing the transfer of the shares. The proceeding is still in a discovery phase.

On November 13, 2003, Patrick Grant, an ex-employee, filed a lawsuit in the Circuit Court of Cook County, Illinois against the Company, WaterSavr Global Solutions Inc. ("WGS"), the wholly-owned subsidiary of the Company, and Daniel B. O'Brien, the Company's Chief Executive Officer. The

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plaintiff claims damages for breach of contract, tortious interference with an agreement and various wrongful discharge claims. The plaintiff seeks monetary damages in excess of \$1,020,000 for the breach of contract and tortious interference claims and unspecified compensatory and punitive damages in the wrongful discharge claims. The Company considers the case without merit and is planning to dispute the matter vigorously. In addition, the Company intends to file counterclaims against the plaintiff for failure to repay financial obligations owed to the Company of almost \$40,000, as well as unspecified damages arising out of the plaintiff's disclosure of confidential information to a client during his employment at WGS. No amounts have been recorded as receivable and no accrual has been made for any loss in the Company's consolidated financial statements as the outcome of the claim filed by the plaintiff is not determinable.



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Item 8. Changes in and Disagreements With Accountants On Accounting and Financial Disclosure.

Effective April 2003, we engaged Cinnamon Jang Willoughby & Company, Certified Public Accountants, to serve as the principal accountant to audit our financial statements for the fiscal year ending December 31, 2003. Pannell Kerr Forster ("PKF"), our former accountant, continued to serve as the principal accountant to audit our financial statements for the fiscal year ended December 31, 2002, through the completion of that audit and the date of our Annual Report on Form 10-K for that period, as well as through the three months ended March 31, 2003 and the date of our Quarterly Report on Form 10-QSB for that period. The change in our principal accountant was approved by the Audit Committee.

During the fiscal years ended December 31, 2001 and December 31, 2002 and the period from December 31, 2002 to the date of the filing with the SEC of our Quarterly Report on Form 10-QSB for the three months ended March 31, 2003, we did not have any disagreements, as defined in Item 304(a)(1)(iv) of Regulation S-B under the Securities Exchange Act of 1934, as amended, with PKF, whether or not resolved, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to PKF's satisfaction, would have caused it to make reference to the subject matter of the disagreements in connection with its report.

Item 8A. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports to the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide a reasonable level of assurance of reaching our desired disclosure control objectives.

As of the end of the period covered by this Annual Report, we carried out an evaluation, under the supervision and with the participation of management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation,

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our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us (including our consolidated subsidiaries) that is required to be included in our periodic reports.

The prior accounting treatment of our stock-based compensation expense was done in consultation and in accordance with the advice of our independent accountants. Accordingly, management does not believe that this restatement of our Annual Report indicates or results from a material weakness with respect to our disclosure controls and procedures or our internal controls over financial reporting.

### Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Item 8B. Other Information.

None.

### PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance With Section 16(A) of the Exchange Act.

#### DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth our directors and officers and their respective ages and positions:

| Name                  | Age | Position                                     |
|-----------------------|-----|--|
| Daniel B. O'Brien     | 47  | President, Chief Executive Officer, Director |
| John H. Bientjes      | 51  | Director                                     |
| Dr. Robert N. O'Brien | 82  | Director                                     |
| Dale Friend           | 47  | Director                                     |

Daniel B. O'Brien has served as the President and Chief Executive Officer, as well as a director, of our company since June 1998. He has been involved in the swimming pool industry since 1990, when he founded our subsidiary, Flexible Ltd., which was purchased by us in 1998. From 1990 to 1998, Mr. O'Brien was also a teacher at Brentwood College where he was in charge of outdoor education.

John H. Bientjes has been a member of our board of directors since February 2000. Since 1984, Mr. Bientjes has served as the manager of the Commercial Aquatic Supplies Division of D.B. Perks & Associates, Ltd., located in Vancouver, British Columbia, a company that markets supplies and equipment to commercial swimming pools which are primarily owned by municipalities. Mr. Bientjes was graduated in 1976 from Simon Fraser University in Vancouver, British Columbia with a Bachelor of Arts Degree in Economics and Commerce.

Dr. Robert N. O'Brien has been a member of our board of directors since June 1998. Dr. O'Brien was a Professor of Chemistry at the University of

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Victoria from 1968 until 1986 at which time he was given the designation of Professor Emeritus. He held various academic positions since 1957 at the University of Alberta, the University of California at Berkley, and the University of Victoria. While teaching, Dr. O'Brien acted as a consultant and served on the British Columbia Research Council from 1968 to 1990. In 1987, Dr. O'Brien founded the Vancouver Island Advanced Technology and Research Association. Dr. O'Brien received his Bachelor of Applied Science in Chemical Engineering from the University of British Columbia in 1951; his Masters of Applied Science in Metallurgical Engineering from the University of British Columbia in 1952; his Ph.D. in Metallurgy from the University of Manchester in 1955; and was a Post Doctoral Fellow in Pure Chemistry at the University of Ottawa from 1955 through 1957. Dr. Robert N. O'Brien and Daniel B. O'Brien are father and son.

Dale Friend was elected a director in December 2002. She was a Senior Trust Analyst for Alderwoods Group, a company engaged in funeral and mortuary services, from August 2002 to February 2003. She also served as an Advanced Accountant for such firm from 1999 to August 2002. From 1979 to 1998, Ms. Friend was with Telus in various accounting, auditing and financial planning positions.

Directors are elected annually and hold office until the next annual meeting of our stockholders and until their successors are elected and qualified. We reimburse directors for any expenses incurred in

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attending board of directors meetings. There have been no material changes to the procedures by which security holders may recommend nominees to our board of directors.

### BOARD COMMITTEES

Our board of directors has established an Audit Committee and a Compensation Committee.

#### Audit Committee

Our Audit Committee, consisting of John Bientjes and Dale Friend, both of whom are independent directors and have strong financial backgrounds, facilitates and maintains open communications among our board of directors, our Audit Committee, senior management and our independent auditors. Our Audit Committee also serves as an independent and objective party to monitor our financial reporting process and internal control system. In addition, our Audit Committee reviews and appraises the efforts of our independent auditors. Our Audit Committee meets periodically with management and our independent auditors. The Audit Committee held four meetings in fiscal 2003 and all members participated. Our board of directors has determined that Mr. Bientjes meets the SEC's definition of audit committee financial expert. Both of the members of the Audit Committee are "independent," as such term is used in Item 7(d)(3)(iv) of Schedule 14A under the Securities Exchange Act of 1934, as amended.

#### Compensation Committee

Our Compensation Committee, consisting of Dr. Robert O'Brien and John Bientjes, establishes salary, incentive and other forms of compensation for our Chief Executive Officer, and administers our stock option programs. Our Compensation Committee meets periodically with management and our independent auditors. The Compensation Committee did not hold any meetings in fiscal 2003.

### CODE OF ETHICS

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Between the year ended December 31, 2003 and July 2005, we had not adopted a written Code of Ethics applicable to our senior management and senior financial staff. However, effective as of August 2005, our board of directors has adopted a Code of Ethics that applies to our Chief Executive Officer, our Chief Financial Officer and our Principal Accounting Officer, as well as to the other senior management and senior financial staff of our company. Our Code of Ethics complies with the requirements imposed by the Sarbanes-Oxley Act of 2002 and the rules and regulations issued thereunder for codes of ethics applicable to such officers. Our board of directors has reviewed and will continue to evaluate its role and responsibilities with respect to the new legislative and other requirements of the SEC. Interested persons can obtain a copy of our Code of Ethics, without charge and upon request, by writing to: Investor Relations, c/o Flexible Solutions International, Inc. 615 Discovery St., Victoria, British Columbia, V8T 5G4, CANADA. Interested persons may also obtain a copy of our Code of Ethics by printing it from the "Investor Info--Insider Trading Reports" page of our website, at <http://www.flexiblesolutions.com>.

### SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely upon a review of our records, we are not aware of any of our officers, directors or beneficial owners of more than 10% of our securities that failed to timely file one or more reports disclosing beneficial ownership of our securities as required under Section 16(a) of the Securities Exchange Act of 1934, as amended, during the fiscal year ended December 31, 2003.

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Item 10. Executive Compensation.

#### SUMMARY COMPENSATION TABLE

The following table sets forth certain information about the compensation paid or accrued to the person who was our Chief Executive Officer (the "named executive officer") during the fiscal year ended December 31, 2003.

| NAME AND<br>PRINCIPAL POSITION                             | YEAR | ANNUAL COMPENSATION |       |                                 | LONG TERM COMPEN              |   |
|--|------|---------------------|-------|---------------------------------|-------------------------------|---|
|  |      | SALARY              | BONUS | OTHER<br>ANNUAL<br>COMPENSATION | AWARDS                        |   |
|  |      |                     |       |                                 | RESTRICTED<br>STOCK<br>AWARDS | SECURITIES<br>UNDERLYING<br>OPTION/<br>SARS |
|  |      | (\$)                | (\$)  | (\$)                            | (\$)                          | (#)   |
| Daniel B. O'Brien<br>President, Chief<br>Executive Officer | 2003 | \$40,000            | --    | --                              | --                            | 20,000                                      |
|  | 2002 | \$40,000            | --    | --                              | --                            | 50,000                                      |
|  | 2001 | \$18,500            | --    | --                              | --                            | 100,000                                     |

#### OPTION/SAR GRANTS IN LAST FISCAL YEAR (INDIVIDUAL GRANTS)

The following table provides certain information about the stock options granted to the named executive officer for the year ended December 31, 2003.

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| NAME              | NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED (#) | PERCENT OF TOTAL OPTIONS / SARS GRANTED TO EMPLOYEES IN FISCAL YEAR | EXERCISE BASE PRICE (\$/SHARE) |
|-------------------|---|---|--------------------------------|
| Daniel B. O'Brien | 20,000 shares                                       | 15.3%   | \$3.60                         |

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION/SAR VALUES

The following table sets forth certain information about stock options exercised in fiscal 2003 and the value of unexercised stock options held as of December 31, 2003 by the named executive officer.

| NAME              | SHARES ACQUIRED ON EXERCISE (#) | VALUE REALIZED (\$) | NUMBER OF UNEXERCISED OPTIONS AT FY-END (#) |               | VALUE IN OPTION |
|-------------------|---------------------------------|---------------------|---|---------------|-----------------|
|                   |                                 |                     | EXERCISABLE                                 | UNEXERCISABLE | EXERCISABLE     |
| Daniel B. O'Brien |                                 |                     | 150,000                                     | 20,000        | \$391,500       |

COMPENSATION OF DIRECTORS

We have agreed to issue to our non-employee directors options to purchase 5,000 shares of our common stock annually for serving as a director. However, Dr. Robert N. O'Brien will not receive director options in any year in which he receives options for other services. We currently pay Dr. O'Brien additional options for assisting in research and development and patent prosecution. The amount of such options are determined annually by the Board of Directors with Dr. O'Brien abstaining from the

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vote on such matter. In fiscal 2003, Dr. O'Brien received the following options for such services and he did not receive director options:

| OPTION PRICE | NO. OF OPTIONS | EXPIRATION DATE   |
|--------------|----------------|-------------------|
| \$3.60       | 20,000         | December 31, 2008 |

Our outside directors received the following options in fiscal 2003:

| NAME             | OPTION PRICE | NO. OF OPTIONS | EXPIRATION DATE   |
|------------------|--------------|----------------|-------------------|
| John H. Bientjes | \$3.60       | 5,000          | December 31, 2008 |



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| Name<br>-----      | No. of Options<br>----- | Exercise Price<br>----- | Ex<br>--- |
|--------------------|-------------------------|-------------------------|-----------|
| Daniel O'Brien     | 100,000                 | \$1.40                  | Dec       |
|                    | 50,000                  | \$4.25                  | Dec       |
| Dr. Robert O'Brien | 50,000                  | \$1.40                  | Dec       |
|                    | 25,000                  | \$4.25                  | Dec       |
| John Bientjes      | 5,000                   | \$4.25                  | Dec       |
| Dale Friend        | 5,000                   | \$4.25                  | Dec       |

The total does not include the following shares which may be acquired on the exercise of stock options which are not exercisable until December 31, 2004.

| Name<br>-----      | No. of Options<br>----- | Exercise Price<br>----- | Ex<br>--- |
|--------------------|-------------------------|-------------------------|-----------|
| Daniel O'Brien     | 20,000                  | \$3.60                  | Dec       |
| John Bientjes      | 5,000                   | \$3.60                  | Dec       |
| Dr. Robert O'Brien | 20,000                  | \$3.60                  | Dec       |
| Dale Friend        | 5,000                   | \$3.60                  | Dec       |

(4) Address for this shareholder is Suite 3450, South Tower, Royal Bank Plaza, Toronto, Ontario, M5J 2J2, CANADA.

Item 12. Certain Relationships and Related Transactions.

Our director, Dr. Robert N. O'Brien, developed our substantially all of products and has assigned his patent rights to such products to us. We have no agreement with Dr. O'Brien requiring him to conduct any research and development activities for us, but we anticipate that any future inventions which may be of interest to us will continue to be assigned to us by Dr. O'Brien, although he has no legal obligation to do so. Dr. O'Brien does not receive any salary or royalties from us for any research and development activities, although our board of directors does consider such activities undertaken by Dr. O'Brien when it grants stock options to Dr. O'Brien. Dr. O'Brien is a member of our board of directors, but abstains from all proceedings of the board concerning his stock option grants. See Item 10 above for further information. Dr. O'Brien is the father of our Chief Executive Officer, Daniel B. O'Brien.

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Item 13. Exhibits.

| Number<br>----- | Description<br>-----  |
|-----------------|---|
| 3.1             | Articles of Incorporation of the Registrant. (1)                              |
| 3.2             | Bylaws of the Registrant. (1)   |
| 4.1             | Option Granting Plan for the Term December 31, 2002 to December 31, 2003. (2) |

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- 10.1 Distribution Agreement dated June 1, 1998 between Flexible Solutions, Ltd. and Heliocol Canada Ltd. (now known as Sun Solar Energy Technologies). (1)
- 10.2 Global Supply and License Agreement between Registrant and Ondeo Nalco Company. (3)
- 10.3 Exclusive Distribution Agreement effective September 1, 2002 with Ondeo Nalco Company. (3)
- 21.1 Subsidiaries. (4)
- 23.1 Consent of Independent Accountants.\*
- 23.2 Consent of Independent Accountants.\*
- 31.1 Certification of Principal Executive Officer Pursuant to ss.302 of the Sarbanes-Oxley Act of 2002.\*
- 31.2 Certification of Principal Financial Officer Pursuant to ss.302 of the Sarbanes-Oxley Act of 2002.\*
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. ss.1350 and ss.906 of the Sarbanes-Oxley Act of 2002.\*
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. ss.1350 and ss.906 of the Sarbanes-Oxley Act of 2002.\*

-----  
\* Filed herewith.

- (1) Previously filed as an exhibit to the Company's Registration Statement on Form 10-SB filed with the Commission on February 22, 2000, and incorporated herein by reference.
- (2) Previously filed as an exhibit to the Company's Form 10-KSB for the year ended December 31, 2003 filed with the Commission on March 29, 2004, and incorporated herein by reference.
- (3) Previously filed as an exhibit to the Company's Registration Statement on Form SB-2 filed with the Commission on March 5, 2003, and incorporated herein by reference.
- (4) Previously filed as an exhibit to the Company's Registration Statement on Form SB-2 filed with the Commission on January 22, 2003, and incorporated herein by reference.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

Cinnamon Jang Willoughby & Company, Certified Public Accountants ("CJW"), are our independent auditors and have examined our financial statements for the fiscal year ended December 31, 2003. Pannell Kerr Forster, Certified Public Accountants ("PKF"), were our independent auditors for the fiscal year ended December 31, 2002.

#### AUDIT FEES AND TAX FEES

CJW was paid aggregate audit fees of \$19,293.00 for the fiscal year ended December 31, 2003, for professional services rendered for the audit of our annual financial statements and for the reviews of the financial statements included in our quarterly reports on Form 10-QSB during this fiscal year, and aggregate tax fees of \$1,400.00 for professional services rendered for tax compliance, tax advice and tax planning, including calculation and filing of income tax returns for the fiscal year ended December 31, 2003.

PKF was paid aggregate audit and tax fees of \$14,966 for the fiscal year ended December 31, 2002, for professional services rendered for the audit of our annual financial statements and for the reviews of the financial statements included in our quarterly reports on Form 10-QSB during this fiscal year, as well as for professional services rendered for tax compliance, tax advice and tax planning, including calculation and filing of income tax returns for the fiscal year ended December 31, 2002.



AUDIT-RELATED FEES

Neither CJW nor PKF was paid any additional fees for either of the fiscal years ended December 31, 2003 or December 31, 2002, respectively, for assurance and related services reasonably related to the performance of the audit or review of our financial statements.

OTHER FEES

Neither CJW nor PKF was paid any other fees for professional services during the fiscal years ended December 31, 2003 or December 31, 2002, respectively.

AUDIT COMMITTEE PRE-APPROVAL POLICIES

Rules adopted by the SEC in order to implement requirements of the Sarbanes-Oxley Act of 2002 require public company audit committees to pre-approve audit and non-audit services. Effective as of December 2002, our Audit Committee has adopted a policy for the pre-approval of all audit, audit-related and tax services, and permissible non-audit services provided by our independent auditors. The policy provides for an annual review of an audit plan and budget for the upcoming annual financial statement audit, and entering into an engagement letter with the independent auditors covering the scope of the audit and the fees to be paid. The Audit Committee may also from time-to-time review and approve in advance other specific audit, audit-related, tax or permissible non-audit services. In addition, the Audit Committee may from time-to-time give pre-approval for audit services, audit-related services, tax services or other non-audit services by setting forth such pre-approved services on a schedule containing a description of, budget for, and time period for such pre-approved services. The policies require the Audit Committee to be informed of each service, and the policies do not include any delegation of the Audit Committee's responsibilities to management. The Audit Committee may delegate pre-approval authority to one or more of its members. The member to whom such authority is delegated will report any pre-approval decisions to the Audit Committee at its next scheduled meeting.

During the year ended December 31, 2003, the Audit Committee approved 100% of the total fees that were paid to CJW. The Audit Committee has determined that the rendering of all other non-audit services by CJW is compatible with maintaining CJW's independence. During the year ended December 31, 2003, none of the total hours expended on our financial audit by CJW were provided by persons other than CJW's full-time permanent employees.

SIGNATURES

In accordance with the requirements of Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: December 5, 2005.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

By: /s/ DANIEL B. O'BRIEN

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-----  
Name: Daniel B. O'Brien  
Title: President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

| Signature   | Title   | Date             |
|---|---|------------------|
| /s/ DANIEL B. O'BRIEN<br>-----<br>Daniel B. O'Brien | President and Chief Executive Officer (principal executive officer), Interim Chief Financial Officer (principal accounting officer), Director | December 5, 2005 |
| -----<br>John H. Bientjes                           | Director  |                  |
| /s/ ROBERT N. O'BRIEN<br>-----<br>Robert N. O'Brien | Director  | December 5, 2005 |
| /s/ DALE FRIEND<br>-----<br>Dale Friend             | Director  | December 5, 2005 |
| /s/ ERIC G. HODGES<br>-----<br>Eric G. Hodges       | Director  | December 5, 2005 |