

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

**FORM 10QSB**

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

For the quarterly period ended **June 30th 2004**

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

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

Commission file number \_\_\_\_\_

**FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

(Exact name of small business issuer as specified in its charter)

NEVADA

(State or other jurisdiction of incorporation or organization)

91-1922863

(IRS Employer Identification No.)

2614 Queenswood Dr. Victoria BC Canada V8N 1X5

(Address of principal executive offices)

( 250 ) 477 - 9969

( Issuer's telephone number)

(Former name, former address and former fiscal year if changed since last report)

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

Check whether the registrant filed all documents and reports required to be filed by Section 12,13 or 15(d)  
of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes[ ] No[ ]

**APPLICABLE ONLY TO CORPORATE ISSUERS**

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest  
practicable date: Common stock \$.001 par value 11,831,916 shares as of June 30<sup>th</sup> 2004.

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

## PART 1 - FINANCIAL INFORMATION

### Item 1. FINANCIAL STATEMENTS.

Attached hereto and incorporated herein by reference.

### Item 2. MANAGER'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following information contains certain forward looking statements that anticipate future trends or events. These statements are based on certain assumptions that may prove to be erroneous and are subject to certain risks including but not limited to the risks of increased competition in the Company's industry and other risks detailed in the Company's Securities and Exchange Commission filings. Accordingly, actual results may differ, possibly materially, from the predictions contained herein.

During the three months ended June 30<sup>th</sup> 2004, the Company experienced a net loss of \$327,289 as compared to a loss of \$230,076 for the three months ended June 30<sup>th</sup> 2003. The loss resulted from the following: a continued loss from operations including wages, travel and overhead in our WaterSavr division required by the world wide sales effort, start up expenses for the new Ecosavr marketing office in Richmond BC, and a very large increase in depreciation (\$175,596 vs \$8,116) resulting from the acquisition of depreciable assets from the bankruptcy estate of Donlar Corp on June 9<sup>th</sup> 2004. Our gross profit increased from 38.3% to 80.8%. The ratio was positively affected by the increased efficiency in our Calgary factory, the increase in revenue per unit sold resulting from taking over the distribution of the Ecosavr residential product and the addition of some low cost sales from the new NanoChem division. Total sales in the swimming pool division were less than the previous year as a result of excess product in the retail pipeline from product purchased in first quarter 2004 and last quarter 2003 by our ex-distributor working its way through the retail channels. Management believes that this product is now in the hands of end users and residential sales will soon return to higher levels and at twice the price per unit realized in 2003.

#### RESULTS OF OPERATIONS

The following analysis and discussion pertains to the Company's results of operations for the three month and six month periods ended June 30<sup>th</sup> 2004 compared to the results of operations for the three month and six month periods ended June 30<sup>th</sup> 2003, and to changes in the Company's financial condition from December 31<sup>st</sup> 2003 to June 30<sup>th</sup> 2004.

#### THREE MONTHS ENDED June 30<sup>th</sup> 2004 and 2003

For the second quarter of the current fiscal year ending June 30<sup>th</sup> 2004, sales were \$547,761 compared to \$661,296 for the same quarter of the previous year. The small decrease in sales was a direct result of a one time switch in our residential pool division from sales through external distribution to internal distribution by our own employees. The previous distributor, Sunsolar Energy Technologies, whose contract ended on February 29<sup>th</sup> 2004, preordered significant quantities of product in anticipation of the lapse of the contract and that purchase prevented us from realizing the dollar value of sales normally expected in 2<sup>nd</sup> quarter. Sales from our newly formed NanoChem division mitigated this somewhat and management expects that unit sales in residential pool products will return to historical levels in 3<sup>rd</sup> quarter 2004.

Operating expenses were \$797,316 for the second quarter, up from \$561,113. Wages decreased from \$195,202 to \$143,246 as a result of reorganization and efficiency increases in the Watersavr division. There were also reductions in travel from 44,235 down to 25,938, in telecom from 15,838 down to 9,014 and in professional fees down from 104,810 to 71,206 as we gained better control of marketing costs in our Watersavr division. On the other hand, our costs for consulting rose to 114,138 from 30,719, advertising rose to 49,062 from 13,094 as we became responsible for distribution of Ecosavr, and

depreciation soared from 8,116 to 175,595 resulting from acquisition of depreciable assets for cash from the estate of Donlar Corp.

The net loss of \$327,289 for the quarter represents an increase over second quarter last year when the net loss was \$230,076. The increased loss can be attributed to the depreciation of assets acquired from the estate of Donlar Corp. The loss per share was \$0.03 for the three months ended June 30<sup>th</sup> 2004 compared to \$0.02 for the three months ended June 30<sup>th</sup> 2003.

#### SIX MONTHS ENDED June 30<sup>th</sup> 2004

Sales in the six months ended June 30<sup>th</sup> 2004 were \$1,035,871 compared to \$1,942,562 for the six months ended June 30<sup>th</sup> 2003. The large decrease in sales was due to the following factors. In the comparable period of 2003, there were sales of \$473,000 in the Watersavr division that were not repeated this year because the distributor responsible was unable to meet contractual quotas and was terminated. The residential pool product distributor whose contract ended on Feb 29<sup>th</sup> 2004 preordered large amounts of product in 4<sup>th</sup> quarter 2003 for sale in the first 6 months of 2004. Our obligation to produce as requested shifted revenue backwards into 2003 from 2004 first half. Finally, acquisition of the assets of Donlar Corp (renamed NanoChem Solutions Inc.) was not complete until June 9<sup>th</sup> and therefore only a small portion of the sales for the quarter and half were consolidated with those of Flexible Solutions.

Operating expenses for the Company were \$1,233,484 for the six months ended June 30<sup>th</sup> 2004 up from \$974,107 for the six months ended June 30<sup>th</sup> 2003. The increase in operating expense is a result of increased depreciation, advertising, consulting fees, investor relations, research and development and expansion of sales and marketing for commercial pool products and water conservation products.

The net loss for the six months ended June 30<sup>th</sup> 2004 was \$578,150 compared to a net loss of \$49,295 for the six months ended June 30<sup>th</sup> 2003. The loss was due to reduced sales in the Watersavr and swimming pool divisions combined with the reduced interest income resulting from using capital to purchase assets and the large increase in depreciation resulting from substituting depreciable assets for cash. Cost of goods sold decreased to 39.7% from 56.4% as our pool products factory increased efficiency and our price per unit rose. The loss per share was \$0.05 for the six-month period ended June 30<sup>th</sup> 2004 compared to \$0.00 for the six-month period ended June 30<sup>th</sup> 2003.

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#### LIQUIDITY AND CAPITAL RESOURCES

As of June 30<sup>th</sup> 2004 the Company had working capital of \$297,772, which represented a decrease of \$5,464,907 as compared to the working capital of December 31<sup>st</sup> 2003. The decrease was entirely related to the purchase of assets from the bankruptcy estate of Donlar that closed on June 9<sup>th</sup>. We used \$3,000,000 in cash from our working capital and signed a promissory note for a further \$3,150,000 that is set against current assets because it has a term of less than one year as of this report. The note is due June 9<sup>th</sup> 2005.

The Company has no external sources of liquidity in the form of credit lines from banks.

Management believes that its available cash will be sufficient to fund the Company's working capital requirements through December 31<sup>st</sup> 2004. Management further believes that available cash will be sufficient to implement the Company's expansion plans. No investment banking agreements are in place and there is no guarantee that the Company will be able to raise capital in the future should that become necessary.

#### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS:**

The Company does not have any derivative financial instruments as of June 30<sup>th</sup> 2004. However, the Company is exposed to interest rate risk.

The Company's interest income and expense are most sensitive to changes in the general level of U.S. and Canadian interest rates. In this regard, changes in U.S. and Canadian interest rates affect the interest paid on the Company's cash equivalents as well as the interest paid on debt.

#### FOREIGN CURRENCY RISK

The Company operates in both the United States and Canada. Therefore, the Company's business and financial condition is sensitive to currency exchange rates or any other restriction imposed on its currency.

### Part II - OTHER INFORMATION

Item 1. Legal proceedings – On July 27<sup>th</sup> 2004, Sunsolar Energy Technologies of St. Laurent Quebec filed suit in the Federal Court of Canada against Flexible Solutions Ltd., Flexible Solutions International Inc., and Daniel O'Brien alleging trademark infringement and seeking up to \$7,000,000 Canadian in damages and costs. The Company considers the complaint frivolous, has filed a statement of defense, is considering a countersuit and will defend itself vigorously.

Item 2. Changes in Securities –12,000 common shares were issued during the quarter.

Item 3. Default upon Senior Securities - None

Item 4. Submission of Matters to a Vote of Securities Holders – On May 26<sup>th</sup> the annual general meeting of shareholders was held in Victoria BC. The results are as follow.

- Mr. Dan O'Brien, Mr. Robert O'Brien, Ms. Dale Friend, Mr. John Bientjes and Mr. Eric Hodges were confirmed as directors for the following year.
- Cinnamon Jang Willoughby were confirmed as Auditor for the year ending Dec 31 2004
- Stock option compensation to directors and insiders was approved

Item 5. Other Information - None

Item 6.(a) Exhibits

31 Certifications Pursuant to Section 302 of the Sarbanes- Oxley Act of 2002

32 Certifications Pursuant to Section 906 of the Sarbanes- Oxley Act of 2002

Item 6.(b) Reports on Form 8-K – July 26<sup>th</sup> 2004, June 1<sup>st</sup> 2004, May 18<sup>th</sup> 2004, May 18<sup>th</sup> 2004

### SIGNATURES

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

FLEXIBLE SOLUTIONS INTERNATIONAL INC.  
(Registrant)

Dated: August 13<sup>th</sup> 2004

/s/ Dan O'Brien, President and Director

EXHIBIT 31.1

I, Dan O'Brien, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Flexible Solutions International Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 13<sup>th</sup>, 2004

/s/Dan O'Brien  
Dan O'Brien, CEO

EXHIBIT 31.2

I, Fred Kupel, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Flexible Solutions International Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 13<sup>th</sup>, 2004

/s/ Fred Kupel  
Fred Kupel, CFO

EXHIBIT 32.1

CERTIFICATION PURSUANT TO  
18 U.S.C. 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of Flexible Solutions International Inc. on form 10-Q for the period ended June 30<sup>th</sup> 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Dan O'Brien, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to section 906 of the Sarbanes -Oxley Act of 2002, that **[based on my knowledge]**:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Dan O'Brien  
Dan O'Brien  
CEO, Aug 13<sup>th</sup> 2004

EXHIBIT 32.2

CERTIFICATION PURSUANT TO  
18 U.S.C. 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of Flexible Solutions International Inc. (the Company) on form 10-Q for the period ended June 30<sup>th</sup> 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Dan O'Brien, Chief Financial Officer of the Company, certify pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that **[based on my knowledge]**:

1. The Report fully complies with the requirements of Section 13(a) or 15(b) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly represents, in all material respects, the financial condition and results of operations of the Company.

/s/ Fred Kupel  
Fred Kupel  
CFO, Aug 13<sup>th</sup> 2004

**FLEXIBLE SOLUTIONS INTERNATIONAL INC.****Consolidated Balance Sheets****June 30, 2004****(Unaudited - U.S. Dollars)**

	<b>June 30 2004</b>	<b>December 31 2003</b>
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 738,337	\$ 237,080
Short term investments	1,334,649	5,033,837
Accounts receivable	533,220	294,238
Income tax receivable	84,003	86,243
Loan receivable	17,540	17,585
Inventory	841,398	212,938
Prepaid expenses	69,820	36,101
	3,618,967	5,918,022
<b>Property and equipment</b>	<b>5,252,053</b>	<b>167,589</b>
<b>Investment</b>	<b>303,500</b>	<b>303,500</b>
	\$ 9,174,520	\$ 6,389,111
<b>Liabilities</b>		
<b>Current</b>		
Due to shareholders	-	7,700
Short term loan	3,150,000	
Accounts payable and accrued liabilities	189,195	\$ 157,643
	3,339,195	165,343
<b>Stockholders' Equity</b>		
<b>Capital stock</b>		
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		
11,831,916 (2003: 11,794,916) common	11,832	11,794
<b>Capital in excess of par Value</b>	<b>7,499,305</b>	<b>7,306,613</b>
<b>Other comprehensive income (loss)</b>	<b>-</b>	<b>3,023</b>
<b>Deficit</b>	<b>(1,675,812)</b>	<b>(1,097,662)</b>
<b>Total Stockholder's Equity</b>	<b>5,835,325</b>	<b>6,223,768</b>
<b>Total Liabilities and Stockholder's Equi</b>	<b>\$ 9,174,520</b>	<b>\$ 6,389,111</b>

**FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

Consolidated Statements of Operations  
Six Months Ended June 30, 2004 and 2003  
(Unaudited - U.S. Dollars)

	Six Months Ended June 30	
	2004	2003
<b>Sales</b>	\$ 1,035,871	\$ 1,942,562
<b>Cost of sales</b>	411,007	1,095,902
<b>Gross profit</b>	624,864	846,660
<b>Operating Expenses</b>		
Wages	257,716	333,872
Administrative salaries and benefits	57,544	39,475
Advertising and promotion	56,792	29,158
Investor relations and transfer agent fee	122,625	68,667
Office and miscellaneous	96,922	34,775
Rent	52,216	37,522
Consulting	188,816	82,651
Professional fees	107,714	127,873
Travel	49,514	78,419
Telecommunications	14,714	24,600
Shipping	10,797	8,278
Research	15,842	19,704
Bad debt expense (recovery)	(797)	-
Currency exchange	3,324	62,959
Utilities	14,198	10,227
Depreciation	185,547	15,927
	1,233,484	974,107
<b>Income (loss) before interest income and income tax</b>	(608,620)	(127,447)
<b>Interest income</b>	30,470	104,246
<b>Income (loss) before income tax</b>	(578,150)	(23,201)
<b>Income tax (recovery)</b>		26,094
<b>Net income (loss)</b>	(578,150)	(49,295)
<b>Deficit, beginning</b>	(1,097,662)	(3,100,974)
<b>Deficit, ending</b>	\$ (1,675,812)	\$ (3,150,269)
<b>Net income (loss) per share</b>	(0.05)	(0.00)
<b>Weighted average number of shares</b>	11,819,916	11,677,988

**FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

Consolidated Statements of Operations  
Three Months Ended June 30, 2004 and 2003  
(Unaudited - U.S. Dollars)

	Three Months Ended June 30	
	2004	2003
<b>Sales</b>	\$ 547,761	\$ 661,296
<b>Cost of sales</b>	105,088	408,835
<b>Gross profit</b>	442,673	252,461
<b>Operating Expenses</b>		
Wages	143,246	195,202
Administrative salaries and benefits	32,697	21,833
Advertising and promotion	49,062	13,094
Investor relations and transfer agent fee	57,947	35,547
Office and miscellaneous	62,332	4,817
Rent	30,867	23,124
Consulting	114,138	30,719
Professional fees	71,206	104,810
Travel	25,938	44,235
Telecommunications	9,014	15,838
Shipping	7,655	4,586
Research	6,681	2,173
Bad debt expense (recovery)	(797)	-
Currency exchange	2,902	46,792
Utilities	8,833	10,227
Depreciation	175,595	8,116
	797,316	561,113
<b>Income (loss) before interest income and inc</b>	(354,643)	(308,652)
<b>Interest income</b>	27,354	53,978
<b>Income (loss) before income tax</b>	(327,289)	(254,674)
<b>Income tax (recovery)</b>		(24,598)
<b>Net income (loss)</b>	(327,289)	(230,076)
<b>Deficit, beginning</b>	(1,348,523)	(2,920,193)
<b>Deficit, ending</b>	\$ (1,675,812)	\$ (3,150,269)
<b>Net income (loss) per share</b>	(0.03)	(0.02)
<b>Weighted average number of shares</b>	11,819,916	11,709,916

**FLEXIBLE SOLUTIONS INTERNATIONAL INC.**  
**Consolidated Statements of Cash Flows**  
**For The Six Months Ended June 30, 2004 and 2003**  
**(Unaudited - U.S. Dollars)**

	<b>Six Months Ended June 30</b>	
	<b>2004</b>	<b>2003</b>
<b>Operating activities</b>		
Net income (loss)	\$ (578,150)	\$ (49,297)
Stock compensation expense	135,230	56,591
Depreciation	185,547	15,927
Changes in non-cash working capital items:		
Accounts receivable	(238,982)	(490,487)
Inventory	(628,460)	57,589
Prepaid expenses	(33,719)	(14,124)
Accounts payable	31,552	10,777
Income tax receivable	2,240	87,024
Decrease in due to shareholders	(7,700)	-
Unrealized foreign exchange gain/loss	-	-
<b>Cash provided by (used in) operating activities</b>	<b>(1,132,442)</b>	<b>(326,000)</b>
<b>Investing activities</b>		
Acquisition of property and equipment	(5,270,011)	(41,799)
Short-term investments	3,699,188	(91,071)
Loan receivable	45	(1,827)
Acquisition of investments	-	(271,000)
<b>Cash used in investing activities</b>	<b>(1,570,778)</b>	<b>(405,697)</b>
<b>Financing activity</b>		
Subscriptions received	-	(4,560)
Short term loan	3,150,000	
Proceeds from issuance of common stock	57,500	325,319
<b>Cash provided by financing activities</b>	<b>3,207,500</b>	<b>320,759</b>
Effect of exchange rate changes on cash	(3,023)	94,933
<b>Inflow (outflow) of cash</b>	<b>501,257</b>	<b>(316,005)</b>
Cash and cash equivalents, beginning of period	237,080	556,789
<b>Cash and cash equivalents, end of period</b>	<b>\$ 738,337</b>	<b>\$ 240,784</b>
<b>Supplemental disclosure of cash flow information:</b>		
Income taxes paid	\$ -	\$ 78,378
Interest received	\$ 30,470	\$ 104,246

# **FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

## **Notes to Consolidated Financial Statements**

**Periods Ended June 30**

**(U.S. Dollars)**

**(Unaudited)**

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### **1. BASIS OF PRESENTATION**

These unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information. These financial statements are condensed and do not include all disclosures required for annual financial statements. The organization and business of the Company, accounting policies followed by the Company and other information are contained in the notes to the Company's audited consolidated financial statements filed as part of the Company's December 31, 2003 Annual Report on Form 10-KSB. This quarterly report should be read in conjunction with such annual report.

In the opinion of the Company's management, these consolidated financial statements reflect all adjustments necessary to present fairly the Company's consolidated financial position at June 30, 2004 and the consolidated results of operations and the consolidated statements of cash flows for the six months ended June 30, 2004 and 2003. The results of operations for the three months ended June 30, 2004 are not necessarily indicative of the results to be expected for the entire fiscal year.

### **2. SIGNIFIGANT 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 -**

Inventory is valued at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

#### **c) Property, Equipment and Leaseholds -**

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

Computer hardware	30% Declining balance
Furniture and fixtures	20% Declining balance
Manufacturing equipment	20% Declining balance
Office equipment	20% Declining balance
Trailer	30% Declining balance
Building	10% 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.

## **FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

**Notes to Consolidated Financial Statements**

**Periods Ended June 30**

**(U.S. Dollars)**

**(Unaudited)**

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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.

e) Revenue Recognition -

Revenue from product sales is recognized at the time the product is shipped since title and risk of losses is transferred to purchaser upon delivery to the carrier. Shipments are made F.O.B. shipping point. 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 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 APB Opinion No. 25 and related interpretations in accounting for its employee stock option plans. Compensation expense is recorded when options are granted to management at discounts to market.

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.

## **FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

### **Notes to Consolidated Financial Statements**

**Periods Ended June 30**

**(U.S. Dollars)**

**(Unaudited)**

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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 of America 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.

l) Recent Accounting Pronouncements -

i) In June 2001, the Financial Accounting Standards Board (FASB) issued FAS 142, Goodwill and Other Intangible Assets. Under FAS 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 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 142 effective January 1, 2002. Application of the non-amortization provisions of FAS 142 for goodwill did not have any impact on its financial reporting

ii) In October 2001, the FASB issued Statement of Financial Accounting Standards for FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." FAS 144 addresses significant issues relating to the implementation of FAS 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 121 for long-lived assets to be disposed of by sale, whether such assets are or are not deemed to be a business. FAS 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 financial statements.

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 the financial statements

## FLEXIBLE SOLUTIONS INTERNATIONAL INC.

Notes to Consolidated Financial Statements

Periods Ended June 30

(U.S. Dollars)

(Unaudited)

### 3. PROPERTY, EQUIPMENT AND LEASEHOLDS AT JUNE 30

	Cost	Accumulated Amortization	2004 Net	2003 Net
Computer hardware	\$ 33,587	\$ 9,576	\$ 24,011	\$ 7,365
Furniture and equipment	12,278	2,583	9695	3,268
Office equipment	25,745	8,210	17,535	19,875
Manufacturing equipment	1,996,107	197,738	1,798,369	117,344
Trailer	1,740	475	1,265	-
Building	3,082,956	77,074	3,005,882	-
Leasehold improvements	12,918	8,046	4,873	6,585
Land	390,422	-	390,422	-
	<u>\$ 5,555,754</u>	<u>\$ 303,701</u>	<u>\$ 5,252,053</u>	<u>\$ 154,438</u>

### 4. STOCKHOLDERS' EQUITY

- (a) During the prior periods, the Company granted stock options to consultants and have recognized consulting expense applying SFAS 123 using the Black-Scholes option pricing model which resulted in expense of \$68,295 for the three months ended June 30, 2004.
- (b) The following table summarizes the Company's stock option activity for the period:

	2004		
	Number of Shares	Exercise Price Per Share	Weighted Average Exercise Price
Balance, March 31, 2004	1,669,000	\$ 1.20 to \$ 4.55	\$ 3.18
Granted During the Period	77,000	\$4.25 to \$4.55	4.37
Exercised	(12,000)	\$ (1.00 to \$ 1.50)	(1.42)
Balance, June 30, 2004	1,734,000	\$ 1.00 to \$ 4.25	\$ 3.06

## **FLEXIBLE SOLUTIONS INTERNATIONAL INC.**

**Notes to Consolidated Financial Statements**

**Periods Ended June 30**

**(U.S. Dollars)**

**(Unaudited)**

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### **5. ACQUISITION OF ASSETS OF DONLAR CORPORATION**

Pursuant to a purchase agreement dated May 26, 2004, the company acquired the assets of Donlar Corporation on June 9, 2004.

The purchase price of the transaction was \$6,150,000 with consideration being a combination of cash and debt. Under the purchase agreement and as part of the consideration, the company issued a promissory note bearing interest at the prime rate to the vendor to satisfy \$3,150,000 of the purchase price.

The following table summarizes the estimated fair value of the assets acquired at the date of acquisition:

As at June 9, 2004:

Current assets	\$ 1,126,805
Property and equipment	5,023,195
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	\$ 6,150,000
Acquisitions costs assigned to property and equipment	219,475
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Total assets acquired	\$ 6,369,475

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### **6. CONTIGENCIES**

- a) The company has been named as a plaintiff in a lawsuit filed in the state of Illinois by a former employee. In November 2003, an ex-employee, Patrick Grant filed suit against Flexible Solutions in Cook County Circuit Court, Cook County IL, claiming wrongful dismissal and seeking return of options rights or cash. The company believes these allegations are without merit and intends to vigorously defend against them.
- b) The company is plaintiff in a lawsuit demanding return of the share certificate of 100,000 shares of stock originally given to the defended as payment in advance for services. The services for which the advance was given were never performed or given to the company, and the company therefore received no consideration or value for such advance. Return of the share certificate for 100,000 shares was demanded within ten (10) days, namely August 22, 2001, however, to date remains unreturned.

On date of issue, January 4, 2001, the share transaction was recorded as shares issued for services at fair market value, a value of \$0.80 per share.