

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

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

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

(Mark one)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004.

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

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
(Name of Small Business Issuer as Specified 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)

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

Indicate by check mark whether the registrant is a shell company (as
defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

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State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: The Company had 11,831,916 shares of Common Stock, par value \$0.001 per share, outstanding as of October 29, 2004.

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

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EXPLANATORY NOTE

Flexible Solutions International, Inc. ("we," "us," and "our") is filing this Quarterly Report on Form 10-QSB/A to amend and restate in its entirety its Quarterly Report on Form 10-QSB for the fiscal quarter ended September 30, 2004, which was previously filed with the Securities and Exchange Commission on November 12, 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 Unaudited Consolidated Financial Statements contained herein.

This Form 10-QSB/A does not reflect events occurring after the filing of our Form 10-QSB on November 12, 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 report has been amended as a result of, and to reflect, the restatement, as well as to revise the disclosure of our management's discussion and analysis, unregistered sales of equity securities, and legal proceedings, as well as to generally reflect the current disclosure requirements of Form 10-QSB.

This Form 10-QSB/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-QSB/A includes 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-QSB/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.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-QSB/A for the quarter ended September 30, 2004 ("Quarterly 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 Quarterly Report.

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Item 1. Financial Statements.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
AT SEPTEMBER 30, 2004
(U.S. DOLLARS)

| | SEPTEMBER 30, 2004 AS RESTATED (NOTE 7) (UNAUDITED) | DEC AS (|
|--|---|----------------|
| | ----- | ----- |
| ASSETS | | |
| CURRENT | | |
| Cash and cash equivalents | \$ 774,324 | \$ |
| Short-term investments | 938,360 | |
| Accounts receivable | 591,524 | |
| Income tax receivable | 85,123 | |
| Loan receivable | 17,849 | |
| Inventory | 1,009,891 | |
| Prepaid expenses | 134,279 | |
| | ----- | ----- |
| | 3,551,350 | |
| PROPERTY AND EQUIPMENT INVESTMENT | 5,207,929 303,500 | |
| | ----- | ----- |
| | \$ 9,062,779 | \$ |
| | ----- | ----- |
| LIABILITIES | | |
| CURRENT | | |
| Due to shareholders | \$ -- | \$ |
| Short-term loan | 3,150,000 | |
| Accounts payable and accrued liabilities | 159,817 | |
| | ----- | ----- |
| | 3,309,817 | |
| 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 | | |
| 11,831,916 (2003: 11,794,916) common shares | 11,832 | |
| CAPITAL IN EXCESS OF PAR VALUE | 7,347,232 | |
| OTHER COMPREHENSIVE INCOME (LOSS) | -- | |
| DEFICIT | (1,606,102) | |
| | ----- | ----- |
| TOTAL STOCKHOLDER'S EQUITY | 5,752,962 | |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY | \$ 9,062,779 | \$ |
| | ----- | ----- |

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- See Notes to Unaudited Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(U.S. DOLLARS -- UNAUDITED)

| | NINE MONTHS ENDED SEPTEMBER | |
|---|-----------------------------|----------------|
| | 2004 | 2003 |
| | AS RESTATED | AS PREPARED |
| | (NOTE 7) | |
| SALES | \$ 2,411,925 | \$ 2,411,925 |
| COST OF SALES | 829,314 | 829,314 |
| GROSS PROFIT | 1,582,611 | 1,582,611 |
| OPERATING EXPENSES | | |
| Wages | 606,942 | 606,942 |
| Administrative salaries and benefits | 94,973 | 94,973 |
| Advertising and promotion | 73,258 | 73,258 |
| Investor relations and transfer agent fee | 173,164 | 173,164 |
| Office and miscellaneous | 154,053 | 154,053 |
| Insurance | 33,475 | 33,475 |
| Interest expense | 29,364 | 29,364 |
| Rent | 114,711 | 114,711 |
| Consulting | 294,109 | 294,109 |
| Professional fees | 212,146 | 212,146 |
| Travel | 79,831 | 79,831 |
| Telecommunications | 28,464 | 28,464 |
| Shipping | 21,950 | 21,950 |
| Research | 21,000 | 21,000 |
| Bad debt expense (recovery) | (797) | (797) |
| Currency exchange | 5,666 | 5,666 |
| Utilities | 46,469 | 46,469 |
| Depreciation | 359,536 | 359,536 |
| | 2,348,314 | 2,348,314 |
| INCOME (LOSS) BEFORE INTEREST INCOME AND INCOME TAX | (765,704) | (765,704) |
| INTEREST INCOME | 33,463 | 33,463 |
| INCOME (LOSS) BEFORE INCOME TAX | (732,240) | (732,240) |
| INCOME TAX (RECOVERY) | -- | -- |
| NET INCOME (LOSS) | (732,240) | (732,240) |
| DEFICIT, BEGINNING | (873,862) | (873,862) |
| DEFICIT, ENDING | \$ (1,606,102) | \$ (1,606,102) |
| NET INCOME (LOSS) PER SHARE | \$ (0.06) | \$ (0.06) |

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WEIGHTED AVERAGE NUMBER OF SHARES

11,826,345

- See Notes to Unaudited Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(U.S. DOLLARS -- UNAUDITED)

| | THREE MONTHS ENDED SEPTEMBER | |
|---|------------------------------|--------------|
| | 2004 | 2003 |
| | AS RESTATED | AS RESTATED |
| | (NOTE 7) | (NOTE 7) |
| SALES | \$ 1,376,054 | \$ 1,376,054 |
| COST OF SALES | 418,307 | 418,307 |
| GROSS PROFIT | 957,747 | 957,747 |
| OPERATING EXPENSES | | |
| Wages | 349,226 | 349,226 |
| Administrative salaries and benefits | 37,429 | 37,429 |
| Advertising and promotion | 16,466 | 16,466 |
| Investor relations and transfer agent fee | 50,539 | 50,539 |
| Office and miscellaneous | 62,099 | 62,099 |
| Insurance | 28,507 | 28,507 |
| Interest expense | 29,364 | 29,364 |
| Rent | 62,495 | 62,495 |
| Consulting | 105,293 | 105,293 |
| Professional fees | 104,432 | 104,432 |
| Travel | 30,317 | 30,317 |
| Telecommunications | 13,750 | 13,750 |
| Shipping | 11,153 | 11,153 |
| Research | 5,158 | 5,158 |
| Bad debt expense (recovery) | -- | -- |
| Currency exchange | 2,343 | 2,343 |
| Utilities | 32,271 | 32,271 |
| Depreciation | 173,989 | 173,989 |
| | 1,114,831 | 1,114,831 |
| INCOME (LOSS) BEFORE INTEREST INCOME AND INCOME TAX | (157,084) | (157,084) |
| INTEREST INCOME | 2,994 | 2,994 |
| INCOME (LOSS) BEFORE INCOME TAX | (154,090) | (154,090) |
| INCOME TAX (RECOVERY) | -- | -- |
| NET INCOME (LOSS) | (154,090) | (154,090) |

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| | | |
|-----------------------------------|----------------|----|
| DEFICIT, BEGINNING | (1,452,012) | |
| DEFICIT, ENDING | \$ (1,606,102) | \$ |
| NET INCOME (LOSS) PER SHARE | \$ (0.01) | \$ |
| WEIGHTED AVERAGE NUMBER OF SHARES | 11,831,916 | |

- See Notes to Unaudited Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(U.S. DOLLARS -- UNAUDITED)

| | NINE MONTHS ENDED SEPTEMBER 30, | |
|---|---------------------------------|------|
| | 2004 | 2003 |
| OPERATING ACTIVITIES | | |
| Net income (loss) | \$ (732,241) | \$ |
| Stock compensation expense | 206,957 | |
| Depreciation | 359,536 | |
| Changes in non-cash working capital items: | | |
| Accounts receivable | (297,286) | |
| Inventory | (796,953) | |
| Prepaid expenses | (98,177) | |
| Accounts payable | 2,174 | |
| Income tax receivable | 1,120 | |
| Decrease in due to shareholders | (7,700) | |
| Unrealized foreign exchange gain/loss | -- | |
| CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | (1,362,571) | |
| INVESTING ACTIVITIES | | |
| Acquisition of property and equipment | (5,399,876) | |
| Short-term investments | 4,095,477 | |
| Loan receivable | (264) | |
| Acquisition of investments | -- | |
| CASH USED IN INVESTING ACTIVITIES | (1,304,663) | |
| FINANCING ACTIVITIES | | |
| Subscriptions received | -- | |
| Short-term loan | 3,150,000 | |
| Proceeds from issuance of common stock | 57,500 | |

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| | | |
|---|------------|----|
| CASH PROVIDED BY FINANCING ACTIVITIES | 3,207,500 | |
| | | |
| Effect of exchange rate changes on cash | (3,022) | |
| | | |
| INFLOW (OUTFLOW) OF CASH | 537,244 | |
| Cash and cash equivalents, beginning | 237,080 | |
| | | |
| CASH AND CASH EQUIVALENTS, ENDING | \$ 774,324 | \$ |
| | | |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Income taxes paid | \$ -- | \$ |
| Interest received | 33,464 | |
| | | |

- See Notes to Unaudited Consolidated Financial Statements -

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FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED SEPTEMBER 30, 2004
(U.S. DOLLARS)

1. BASIS OF PRESENTATION.

These unaudited consolidated financial statements of Flexible Solutions International, Inc (the "Company") have been prepared in accordance with accounting principles generally accepted 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 September 30, 2004, and the consolidated results of operations and the consolidated statements of cash flows for the nine months ended September 30, 2004 and 2003. The results of operations for the three months ended September 30, 2004 are not necessarily indicative of the results to be expected for the entire fiscal year.

These consolidated financial statements include the accounts of the Company, and its wholly-owned subsidiaries Flexible Solutions, Ltd. ("Flexible Ltd."), NanoChem Solutions Inc. and WaterSavr Global Solutions Inc. All inter-company balances and transactions have been eliminated. The 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 the former shareholders of Flexible Ltd. receiving all of the shares then issued and outstanding of the Company. The transaction has been accounted for as a reverse-takeover. Flexible Ltd. is accounted for as the acquiring party and the surviving entity. As

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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 acquisition have been accounted for as if those shares had been issued upon the organization of Flexible Ltd.

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

Pursuant to a purchase agreement dated May 26, 2004, the Company acquired the assets of Donlar Corporation on June 9, 2004 and created a new company, NanoChem Solutions Inc. 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 4% to satisfy \$3,150,000 of the purchase price. This note is due June 2, 2005 and all of the former Donlar assets were pledged as security.

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The following table summarizes the estimated fair value of the assets acquired at the date of acquisition (June 9, 2004):

| | |
|--|--------------|
| Current assets | \$ 1,126,805 |
| Property and equipment | 5,023,195 |
| | 6,150,000 |
| Acquisition costs assigned to property and equipment | 314,724 |
| Total assets acquired | \$ 6,464,724 |

The acquisition costs assigned to property and equipment are all direct costs incurred by the Company to purchase the assets. These costs include due diligence fees paid to outside parties investigating and identifying the assets, legal costs directly attributable to the purchase of the assets, plus applicable transfer taxes. These costs have been assigned to the individual assets based on their proportional fair values and will be amortized based on the rates associated with the related assets.

2. SIGNIFICANT ACCOUNTING POLICIES.

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles accepted in the United States 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.

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(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.

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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 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.

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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 the Statement of Financial Accounting Standards ("FAS") No. 123 in accounting for stock issued in exchange for 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 to employees and directors using Accounting Principles Board Opinion ("APB") 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 SFAS 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.

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(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.

(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

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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.

(1) Recent Accounting Pronouncements.

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

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(iii) In November 2001, the FASB issued Emerging Issues Task Force ("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.

3. PROPERTY, EQUIPMENT AND LEASEHOLDS.

| Item | Cost | Accumulated Amortization | September 2004 Net | December 2003 Net |
|-------------------------|-----------|-----------------------------|-----------------------|----------------------|
| Computer hardware | \$ 36,371 | \$ 11,692 | \$ 24,680 | \$ 9,267 |
| Furniture and equipment | 14,278 | 3,197 | 11,080 | 3,293 |
| Office equipment | 27,339 | 9,231 | 18,108 | 15,195 |
| Manufacturing equipment | 2,037,063 | 291,093 | 1,745,970 | 133,283 |

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| | | | | |
|------------------------|--------------|------------|--------------|------------|
| Trailer | 1,763 | 577 | 1,186 | 1,518 |
| Building | 3,144,259 | 153,754 | 2,990,507 | -- |
| Leasehold improvements | 23,610 | 9,227 | 14,382 | 5,033 |
| Trade show display | 4,140 | 310 | 3,830 | -- |
| Land | 398,186 | -- | 398,186 | -- |
| Total | \$ 5,687,009 | \$ 479,081 | \$ 5,207,929 | \$ 167,589 |

4. STOCKHOLDERS' EQUITY.

(a) During prior periods, the Company granted stock options to consultants and has recognized consulting expense applying FAS No. 123 using the Black-Scholes option-pricing model, which resulted in expense of \$71,727 for the three months ended September 30, 2004.

(b) The following table summarizes the Company's stock option activity for the period:

| | Number of Shares | Exercise Price Per Share |
|-----------------------------|---------------------|--------------------------------|
| Balance, June 30, 2004 | 1,758,740 | \$ 1.00 to \$ 4.55 |
| Granted During the Period | 5,000 | \$3.60 |
| Exercised | -- | -- |
| Cancelled | 500,000 | \$2.50 to \$3.50 |
| Balance, September 30, 2004 | 1,263,740 | \$ 1.00 to \$ 4.25 |

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

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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 (at June 9, 2004):

| | |
|-----------------------------|--------------|
| Current assets | \$ 1,126,805 |
| Property and equipment | \$ 5,023,195 |
| Acquisitions costs assigned | \$ 6,150,000 |

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| | | |
|---------------------------|----|-----------|
| to property and equipment | \$ | 254,874 |
| ----- | | |
| Total assets acquired | \$ | 6,404,874 |
| ----- | | |

6. CONTINGENCIES.

(a) On November 13, 2003, Patrick Grant 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 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 Mr. Grant is not determinable.

(b) 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 return of 100,000 shares of the Company's 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, 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 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 determinable.

(c) On May 28, 2004, Sun Solar Energy Technologies, Inc. ("Sun Solar"), filed a lawsuit in the Federal Court of Canada, against the Company, Flexible Solutions, Ltd., the Company's wholly-owned subsidiary ("Flexible Ltd."), and Mr. O'Brien. Sun Solar is seeking: (a) a declaration that the trademark "Tropical Fish" is available for use by Sun Solar; (b) injunctive relief against further use of the "Tropical Fish" trademark by the Company; and (c) monetary damages exceeding \$7,000,000 for the alleged infringement by the Company, Flexible Ltd. and Mr. O'Brien of the "Tropical Fish" trademark, as well as any other "confusingly similar trademarks" or proprietary trade dresses. On August 9, 2004, the Company, Flexible Ltd. and Mr. O'Brien filed their defense and filed a counterclaim against Sun Solar. The counterclaim seeks: (x) injunctive relief against further use of the "Tropical Fish" trademark by Sun Solar; (y) a declaration that the "Tropical Fish" trademark is owned by the Company, or, in the alternative, is not distinctive and should be struck from the trademark registry; and (z) monetary damages

exceeding \$50,000. The parties have completed documentary discovery, and examinations for discovery of all parties have been scheduled for July 2005. No amounts have been recorded as receivable in the Company's consolidated financial statements and no amounts have been accrued as potential losses as the outcome of this claim is not determinable.

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(d) On July 23, 2004, the Company filed a breach of contract suit in the Circuit Court of Cook County, Illinois against Tatko Biotech Inc. ("Tatko"). The action arises out of a joint product development agreement entered into between the Company and Tatko in which the Company agreed to invest \$10,000 toward the product development venture and granted to Tatko 100,000 shares of the Company's restricted common stock. In return, Tatko granted the Company a five-year option to purchase 20% of Tatko's outstanding capital stock. Tatko has since refused to collaborate on the agreement and the Company seeks declaratory relief stating that Tatko is not entitled to the 100,000 shares of the Company's restricted common stock. The litigation is still pending at this time.

In addition, Tatko filed its own suit on September 24, 2004 in the Circuit Court of Cook County, Illinois seeking declaratory relief of its entitlement to the Company's restricted common stock.

No amounts have been recorded as receivable in the Company's consolidated financial statements and no amount has been accrued as a loss as the outcome of the claim against Tatko is not determinable.

7. 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 its 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 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, the Company expensed the entire fair value of the stock option believing that the option fully vested upon the signing of the agreement. In its 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.

To correctly account for the stock options granted to Ondeo, the stock-based compensation expense, included in consulting expenses, 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 quarter would have been nil as no sales had yet been achieved. Instead, the Company recorded a stock-based compensation expense of \$2,704,000 for the quarter.

During the three months ended March 31, 2003, Ondeo achieved the first threshold sales target, and, accordingly, the Company should have recorded a

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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 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 stock-based compensation 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 nine months ended September 30, 2004 and 2003, and the year ended December 31, 2003:

Balance sheet as at September 30, 2004 -

| | Previously Reported | Increase (Decrease) | |
|--------------------------------|------------------------|------------------------|----|
| Capital in excess of par value | \$ 7,571,032 | \$ (223,800) | \$ |
| Accumulated deficiency | (1,829,902) | 223,800 | |

Statement of operations for the nine months ended September 30, 2004 -

| | Previously Reported | Increase (Decrease) | |
|--------------------|------------------------|------------------------|----|
| Deficit, beginning | \$ (1,097,662) | \$ 223,800 | \$ |
| Deficit, ending | (1,829,902) | 223,800 | |

Statement of operations for the three months ended September 30, 2004 -

| | Previously Reported | Increase (Decrease) | |
|--------------------|------------------------|------------------------|----|
| Deficit, beginning | \$ (1,675,812) | \$ 223,800 | \$ |
| Deficit, ending | (1,829,902) | 223,800 | |

Statement of operations for the nine months ended September 30, 2003 -

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| | Previously Reported | Increase (Decrease) |
|---|------------------------|------------------------|
| Expenses | \$ 1,346,862 | \$ 54,080 |
| Income (loss) before other item and income tax | (494,584) | (54,080) |
| Income (loss) before income tax | (339,389) | (54,080) |
| Net income (loss) | (339,026) | (54,080) |
| Net income (loss) per share | (0.03) | -- |
| Deficit, beginning | (3,100,974) | 2,704,000 |
| Deficit, ending | (3,440,000) | 2,649,920 |

Statement of cash flows for the nine months ended September 30, 2003 -

| | Previously Reported | Increase (Decrease) |
|---------------------------|------------------------|------------------------|
| Net income (loss) | \$ (339,026) | \$ (54,080) |
| Stock option compensation | 68,998 | 54,080 |

Statement of operations for the three months ended September 30, 2003 -

| | Previously Reported | Increase (Decrease) |
|--------------------|------------------------|------------------------|
| Deficit, beginning | \$ (3,149,746) | \$ 2,649,920 |
| Deficit, ending | (3,440,000) | 2,649,920 |

Balance sheet as at December 31, 2003 -

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

Item 2. Management's Discussion and Analysis or Plan of Operation.

Flexible Solutions International, Inc. ("we," "us," and "our")

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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.

RESULTS OF OPERATIONS

The following analysis and discussion pertains to our results of operations for the three month and nine month periods ended September 30, 2004, as compared to the results of operations for the three month and nine month periods ended September 30, 2003, and to changes in our financial condition from December 31, 2003 to September 30, 2004.

THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003

Separate financial data for each of our operating segments is provided below. We evaluate the performance of our operating segments based on the following:

| | Three Months Ended September 30, | | | % Change 2004-2003 |
|---------------------------|----------------------------------|--------------|--------------|-----------------------|
| | 2004 | 2003 | 2002 | |
| Sales | | | | |
| Energy Segment | \$ 141,045 | \$ 40,009 | \$ 55,257 | 25 |
| Polymer Segment | \$ 1,235,009 | * | * | |
| Consolidated | \$ 1,376,054 | \$ 40,009 | \$ 55,257 | 333 |
| Gross Profit | | | | |
| Energy Segment | \$ 100,826 | \$ 5,065 | \$ 80,819 | 189 |
| Polymer Segment | \$ 856,921 | * | * | |
| Consolidated | \$ 957,747 | \$ 5,065 | \$ 80,819 | 1880 |
| SG&A | | | | |
| Energy Segment | \$ 475,315 | \$ 372,726 | \$ 101,552 | 2 |
| Polymer Segment | \$ 639,516 | * | * | |
| Consolidated | \$ 1,114,831 | \$ 372,726 | \$ 101,552 | 19 |
| Interest Income | | | | |
| Energy Segment | \$ 2,994 | \$ 50,950 | \$ 15,221 | (9 |
| Polymer Segment | -- | * | * | |
| Consolidated | \$ 2,994 | \$ 50,950 | \$ 15,221 | (9 |
| Write-down of Investments | | | | |
| Energy Segment | -- | -- | -- | -- |
| Polymer Segment | -- | * | * | |
| Consolidated | -- | -- | -- | -- |
| Net Income (Loss) | \$ (154,090) | \$ (290,254) | \$ (167,363) | (4 |

* Polymer segment data is not available as indicated. Our polymer segment was

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formed after the acquisition of certain assets of Donlar Corporation in June 2004.

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For the three months ended September 30, 2004, our Energy segment had a net loss of \$371,495, as compared to a net loss of \$290,254 for the three months ended September 30, 2003. Our NanoChem division, formed in June 2004 after our acquisition of certain assets from Donlar, had a net gain of \$217,405 for the three months ended September 30, 2004. Although swimming pool product sales were negatively impacted by the end of the swimming pool season in the Northeastern parts of the United States and Canada, and the transition from outside to inside distribution, increases in pool product sales outside of North America and a full quarter of operations from our Polymer segment resulted in revenue of \$1,376,054 for the quarter ended September 30, 2004, as compared to \$40,009 for the quarter ended September 30, 2003. Our Polymer segment had increased sales, cash flow, and revenue after only 110 days following our commencement of their activities and is starting to replace the capital expended for it. Additionally, opportunities to synergistically cross-sell the products of all divisions have already generated leads to new business, and the swimming pool division has discovered ways to help our NanoChem division increase utilization of our Peru, Illinois factory while decreasing our costs as a whole. In addition, our NanoChem sales are much less seasonal than those of our other divisions, which should lead to less volatile sales figures in future. We will attempt to reduce seasonality even further over time.

Operating expenses for our Energy segment were \$475,315 for the quarter ended September 30, 2004, an increase of 28% from \$372,725 for the quarter ended September 30, 2003. Operating expenses for our Polymer segment were \$639,516 for the quarter ended September 30, 2004, as compared to nil for the quarter ended September 30, 2003. We continued expanding our sales and marketing efforts for our WATER\$AVR(R) product line with the objective of closing the first major sales as soon as possible and with development of advanced production machinery for swimming pool products. In our Energy segment, the largest real increases from the quarter ended September 30, 2003 to the quarter ended September 30, 2004, were in the areas of wages (from \$74,786 for the quarter ended September 30, 2003 to \$106,280 for the quarter ended September 30, 2004), rent (\$11,601 for the quarter ended September 30, 2003 to \$36,760 for the quarter ended September 30, 2004), office (\$24,559 for the quarter ended September 30, 2003 to \$54,220 for the quarter ended September 30, 2004), and consulting (\$39,572 for the quarter ended September 30, 2003 to \$89,372 for the quarter ended September 30, 2004). These increases are wholly accounted for by the operating costs of our new NanoChem division and represent a permanent increase in operating costs related to the new level of sales. The decreases in travel (from \$41,611 for the quarter ended September 30, 2003 to \$18,126 for the quarter ended September 30, 2004) and advertising (from \$31,757 for the quarter ended September 30, 2003 to \$16,411 for the quarter ended September 30, 2004) are the result of better cost control in these areas, which we instituted over the past year. Professional fees increased to \$96,927 in the quarter ended September 30, 2004, as compared to \$45,270 in the quarter ended September 30, 2003. This was largely the result of the one time costs of transferring patent assets in our acquisition of the assets comprising our NanoChem division. In addition, a substantial amount of the increase in consulting fees, from \$39,572 in the quarter ended September 30, 2003 to \$105,293 in the quarter ended September 30, 2004, is the result of expensing of consultant options. We note that depreciation increased to \$173,989 in the quarter ended September 30, 2004, as compared to \$8,841 in the quarter ended September 30, 2003, as a result of the depreciable NanoChem assets acquired in June 2004.

There is no comparable data for our Polymer segment as it was recently added in June 2004.

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Our Energy segment's loss for the quarter ended September 30, 2004 was \$371,495, an increase from the loss of \$290,254 for the quarter ended September 30, 2003. This increase in loss was a result of an increase in our professional and consulting fees in connection with our acquisition of the Donlar assets. Our Polymer segment's gain for the quarter ended September 30, 2004 was \$217,405, with no data to compare to from years previous.

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The loss per share was \$0.01 for the quarter ended September 30, 2004, as compared to a loss of \$0.02 for the quarter ended September 30, 2003.

NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003

Separate financial data for each of our operating segments is provided below. We evaluate the performance of our operating segments based on the following:

| | Nine Months Ended September 30, | | | % Change 2004-2003 |
|---------------------------|---------------------------------|--------------|--------------|-----------------------|
| | 2004 | 2003 | 2002 | |
| Sales | | | | |
| Energy Segment | \$ 900,789 | \$ 1,982,571 | \$ 1,089,164 | (55) |
| Polymer Segment | \$ 1,511,136 | * | * | * |
| Consolidated | \$ 2,411,925 | \$ 1,982,571 | \$ 1,089,164 | 22 |
| Gross Profit | | | | |
| Energy Segment | \$ 458,152 | \$ 852,278 | \$ 495,123 | (46) |
| Polymer Segment | \$ 1,124,459 | * | * | * |
| Consolidated | \$ 1,582,611 | \$ 852,278 | \$ 495,123 | 86 |
| SG&A | | | | |
| Energy Segment | \$ 1,470,207 | \$ 1,400,942 | \$ 677,707 | 5 |
| Polymer Segment | \$ 878,107 | * | * | * |
| Consolidated | \$ 2,348,314 | \$ 1,400,942 | \$ 677,707 | 68 |
| Interest Income | | | | |
| Energy Segment | \$ 33,463 | \$ 155,195 | \$ 15,221 | (78) |
| Polymer Segment | -- | * | * | * |
| Consolidated | \$ 33,463 | \$ 155,195 | \$ 15,221 | (78) |
| Write-down of Investments | | | | |
| Energy Segment | -- | -- | -- | -- |
| Polymer Segment | -- | * | * | * |
| Consolidated | -- | -- | -- | -- |
| Net Income (Loss) | \$ (732,240) | \$ (393,106) | \$ (167,363) | 86 |

* Polymer segment data is not available as indicated. Our polymer segment was formed after the acquisition of certain assets of Donlar Corporation in June 2004.

Our Energy segment's sales for the nine months ended September 30, 2004 were \$900,789, as compared to \$1,982,571 for the nine months ended September 30, 2003. Our Polymer segment's sales for the nine months ended September 30, 2004

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were \$1,511,136, which accounts for sales in the period from June 10, 2004 to September 30, 2004. The swimming pool division experienced a decrease in sales as a result of taking over distribution from an outside group. The product pipeline was filled prior to the distribution change and the focus of our sales team was directed toward ensuring sales for the 2005 season and expanding sales overseas. However, twenty days of revenue in the second quarter and the full third quarter of fiscal 2004 from the Polymer segment, combined with comparable sales in the Energy segment, resulted in sales of \$2,411,925 for the nine months ended September 30, 2004, an increase of 22% from the nine months ended September 30, 2003.

Our Energy segment's operating expenses were \$1,470,207 for the nine months ended September 30, 2004, a slight increase from \$1,400,942 for the nine months ended September 30, 2003. The increase

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in operating expenses was a result of the increase in professional and consulting fees in connection with our acquisition of the Donlar assets. The loss for the nine months ended September 30, 2004 was \$1,012,055, as compared to a loss of \$393,106 for the nine months ended September 30, 2003. Of the increased loss, \$117,806 was from expensing of consultant options. Other factors contributing to the loss were:

- o The brand building, marketing and extra staffing costs in ECO\$AVR(TM) sales incurred throughout the year that were not reflected in sales because dealers that had been sold product by our discontinued distributor, Sun Solar, still had substantial "Tropical Fish" product. We believe that very little old product is on the shelves and that costs and revenue for ECO\$AVR(TM) will be better balanced in 2005.

- o Litigation costs became significant in 2004 compared to 2003 as a result of the need to protect our assets from suit. The costs are manageable, but we will make every effort to reduce these costs going forward without adversely affecting shareholder value.

Our Polymer segment's operating expenses were \$878,107 for the nine months ended September 30, 2004, as compared to nil for the nine months ended September 30, 2003. Our net income for the nine months ended September 30, 2004 was \$246,352, with no data to compare to from years previous.

The loss per share was \$0.06 for the nine months ended September 30, 2004, as compared to a loss of \$0.03 for the nine months ended September 30, 2003.

LIQUIDITY AND CAPITAL RESOURCES

We had cash on hand of \$774,324 as of September 30, 2004, as compared to \$141,435 as of September 30, 2003.

As of September 30, 2004, we had working capital of \$241,553, as compared to working capital of \$5,752,679 as of December 31, 2003. The decrease was a result of the cash used to purchase the assets comprising our NanoChem division and the costs associated with that acquisition, combined with the continuing costs of market development for our WATER\$AVR(R) product line.

We have no external sources of liquidity in the form of credit lines from banks.

We believe that our available cash will be sufficient to fund our working capital requirements through December 31, 2004. We further believe that available cash will be sufficient to implement our expansion plans. We have no

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investment banking agreements in place and there is no guarantee that we will be able to raise capital in the future should that become necessary.

RESTATEMENT OF FINANCIAL STATEMENTS

The accompanying financial statements have been restated to revise 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 our stock-based compensation expense required adjustment. In September 2002, we entered into a distribution agreement with Ondeo Nalco Company ("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

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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 compensation expense previously recorded in fiscal 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 compensation expense recorded in September 2002 has been reversed;

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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 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 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 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 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.

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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.

Item 3. 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 Securities and Exchange Commission ("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 Quarterly 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, 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 Quarterly Report indicates or results from a material weakness with respect to our disclosure controls and procedures or our internal controls over financial reporting.

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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.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

On July 23, 2004, we filed a breach of contract suit in the Circuit Court of Cook County, Illinois against Tatko Biotech Inc. ("Tatko"). The action arises out of our joint product development agreement with Tatko in which we agreed to invest \$10,000 toward the product development venture and granted to Tatko 100,000 shares of our restricted common stock. In return, Tatko granted us a five-year option to purchase 20% of Tatko's outstanding capital stock. Tatko has since refused to collaborate on the agreement and we have sought declaratory relief stating that Tatko is not entitled to the 100,000 shares of our restricted common stock. The litigation is still pending at this time. In addition, Tatko filed its own

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suit on September 24, 2004 in the Circuit Court of Cook County, Illinois seeking declaratory relief of its entitlement to our restricted common stock. No amounts have been recorded as receivable in our consolidated financial statements and no amount has been accrued as a loss as the outcome of the claim against Tatko is not determinable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following exhibits are attached hereto and filed herewith:

| NUMBER | DESCRIPTION |
|--------|--|
| ----- | ----- |
| 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. |

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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

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

