

FLEXIBLE SOLUTIONS INTERNATIONAL INC
Form 10-K
March 30, 2010

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File No. 001-31540

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Nevada

91-1922863

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

615 Discovery Street
Victoria, British Columbia, Canada

V8T 5G4

(Address of Principal Executive Office)

Zip Code

Registrant's telephone number, including Area Code: (250) 477-9969
Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, \$0.001 par value

NYSE AMEX

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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As of June 30, 2009 the aggregate market value of the Company's common stock held by non-affiliates was approximately \$10,601,067 based on the closing price for shares of the Company's common stock on the NYSE AMEX for that date.

As of March 15, 2010, the Company had 13,962,567 issued and outstanding shares of common stock.

Documents incorporated by reference: None

-ii-

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K for the year ended December 31, 2009 (“Annual Report”), including the Notes to Audited 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 our actual results will be consistent with these forward-looking statements. Except as otherwise required by applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason, after the date of this Annual Report.

PART I

Item 1. Description of Business

We were incorporated as Flexible Solutions, Ltd., a British Columbia corporation on January 26, 1991. On May 12, 1998, we merged Flexible Solutions Ltd. into Flexible Solutions International, Inc., a Nevada corporation. In connection with this merger, we issued 7,000,000 shares of common stock to the former shareholders of Flexible Solutions Ltd. in exchange for all of the outstanding shares of Flexible Solutions Ltd.

In June 2004 we purchased 52 U.S. and 139 International patents, as well as a 56,780 sq. ft. manufacturing plant near Chicago, Illinois from the bankruptcy estate of Donlar Corporation ("Donlar") for \$6.15 million. The patents we acquired from Donlar relate to water-soluble chemicals ("TPAs") which prevent corrosion and scaling in water pipes used in the petroleum, chemical, utility and mining industries. TPAs are also used to enhance fertilizers and improve crop yields and as additives for household laundry detergents, consumer care products and pesticides.

We operate through two wholly-owned subsidiaries: Flexible Solutions Ltd., and NanoChem Solutions Inc. Unless otherwise indicated, all references to our business include the operations of these subsidiaries.

In November 2007, we purchased a building and 3.3 acres of land in Taber, Alberta, Canada. The price paid was CDN\$1,325,000 and was financed by cash of \$660,000 and an interest free mortgage that was paid in June 2008. The building will be renovated and operated as a fermentation facility for the production of aspartic acid, a key ingredient in TPAs. Aspartic acid made in Taber will be shipped to our plant in Illinois for finishing.

Our website is www.flexiblesolutions.com

Our Products

HEAT\$AVR®/ECO\$AVR

Our studies indicate that approximately 70% of the energy lost from a swimming pool occurs through water evaporation. HEAT\$AVR® is a chemical product for use in swimming pools and spas that forms a thin, transparent layer on the water's surface. The transparent layer slows the evaporation of water, allowing the water to retain a higher temperature for a longer period of time and thereby reducing the energy required to maintain the desired temperature of the water. We have received reports from our commercial customers documenting energy savings of between \$2,400 to \$6,000 per year when using HEAT\$AVR®.

ECO\$AVR® is a patented, disposable dispenser designed for the residential pool and spa market. ECO\$AVR® is made of molded plastic in the form of a ten-inch long colorful fish that is filled with enough HEAT\$AVR® to cover the surface of a 400 sq. ft. swimming pool for about one month. The HEAT\$AVR® solution inside the ECO\$AVR® escapes into the water and rises to the surface to form a transparent layer on the water's surface. Once the ECO\$AVR® is empty the dispenser is removed and replaced.

In outdoor pools, the HEAT\$AVR® also provides convenience compared to pool blankets. Pool blankets are plastic covers, which are cut to the size and shape of the surface of the pool or spa. Pool blankets float on the surface and, like the HEAT\$AVR®, reduce energy costs by inhibiting water

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evaporation. However, it is often inconvenient to use conventional pool blankets because a pool blanket must be removed and stored before the pool can be used. Pool blankets do not provide any energy savings when not on the pool. Conversely, HEAT\$AVR® eliminates the need to install, remove and store the blanket and works 24 hours a day. In addition, the use of HEAT\$AVR® in an indoor pool results in even greater energy savings since indoor pool locations use energy not only to heat the pool water, but also to air condition the pool environment. By slowing the transfer of heat and water vapor from the pool to the atmosphere of the pool enclosure, less energy is required to maintain a pool at the desired temperature and there is a reduced load on the air-conditioning system.

HEAT\$AVR® retails for between \$200 and \$300 per four gallon case in the United States. ECO\$AVR® has a suggested retail price of between \$11.95 and \$14.95 in the United States. We market our HEAT\$AVR® and ECO\$AVR® products to homeowners with swimming pools and spas as well as operators of swimming pools and spas in hotels, motels, schools, and municipal and private recreational facilities.

We also manufacture and sell products which automatically dispense HEAT\$AVR® into commercial size swimming pools or spas at the rate of one ounce per 400 sq. ft. of water surface per day.

We have 18 non-exclusive distributorships in Canada and the United States for the sale of bulk HEAT\$AVR® (without the ECO\$AVR® dispenser) and exclusive distributorships in Australia, Chile, Korea, Argentina, Taiwan, Romania and Weastern Europe. We support our distributors and seek additional market opportunities by annually attending the major pool industry trade shows in the United States. We also advertise in trade magazines, maintain a semi-annual newsletter that is sent to buyer associations, customers and potential customers, and maintain a website which has information about our products.

WATER\$AVR®

This product utilizes our HEAT\$AVR technology to reduce water evaporation in reservoirs, potable water storage tanks, livestock watering ponds, aqueducts, canals and irrigation ditches. WATER\$AVR may also be used for lawn and turf care and potted and bedding plants.

WATER\$AVR® is sold in granulated form and can be applied by hand, by fully automated scheduled metering, or by an automatic dispenser.

Tests have indicated that WATER\$AVR®:

- Reduces daily water evaporation as much as 54%
- Reduces monthly water evaporation as much as 37%
- Is odorless
- Has no effect on invertebrates or vertebrates
- Has no anticipated effect on any current drinking water treatment processes and
- Is biodegradable

We have one full-time employee and one part-time employee who are involved in the sales and marketing of WATER\$AVR®.

WATER\$AVR—BTI™

WATER\$AVR—BTI™ combines evaporation control with an environmentally friendly method of killing mosquito larvae during the first, second and third stages of development. Combined with our original WATER\$AVR® product, WATER\$AVR—BTI™ can be quickly and evenly spread across large and small water surfaces where larvae must go to obtain air. Tests conducted by the Entomology Department at the Louisiana State University Agricultural Center showed that the use of WATER\$AVR—BTI™ resulted in a 100% kill rate of mosquito larvae in contact with the product.

TPAs (thermal polyaspartate biopolymers)

TPAs for Oilfields. TPAs are used to reduce scale and corrosion in various “topside” water systems. They are used in place of traditional phosphate and other products when biodegradability is required by environmental regulations. We have the ability to custom manufacture TPAs depending on the specific water conditions associated with any oil well.

TPAs for the Agricultural Industry. TPAs have the ability to reduce fertilizer crystallization before, during and after application and can also prevent crystal formation between fertilizer and minerals present in the soil. Once crystallized, fertilizer and soil minerals are not bio-available to provide plant nourishment. As a result, in select conditions the use of TPAs either blended with fertilizer or applied directly to crops can increase yields significantly. TPAs are designated for crop nutrient management programs and should not be confused with crop protection and pesticides or other agricultural chemical applications. Depending on the application, TPA products are marketed under a variety of brands including Amisorb, LYNX, MAGNET, AmGro and VOLT. Markets of significance include potatoes, sugar beets, cotton, tomatoes, almonds and other high value per acre crops.

TPAs for Irrigation. The crystallization prevention ability of TPAs can also be useful in select irrigation conditions. By reducing calcium carbonate scale propagation, TPAs can prevent early plugging of drip irrigation ports, reduce maintenance costs and lengthen the life of equipment. TPAs compete with acid type scale removers, but have the advantage of a positive yield effect on the plant, as well as an easier deployment formulation with liquid fertilizers when used as part of a “fertigation” program. Our TPAs for drip irrigation scale prevention are at an early stage of commercialization and will be marketed and sold through the same channels as TPAs used by the agricultural industry.

TPAs for Detergent. In detergents, TPAs are a biodegradable substitute for poly-acrylic acid. In select markets, the use of this substitute outweighs the added cost of TPAs, which has allowed for the continued growth of this TPA product line. However, to increase penetration of this market beyond specialty detergent manufacturers, we will need to decrease the cost of this product or wait for legislative intervention regarding biodegradability of detergent components. In the meantime, we are researching various methods to reduce production costs.

TPAs for Personal Care Products. TPAs can also be used in shampoo and cosmetic products for increased hydration that improves the feel of the core product to consumers. TPA’s may also be used as an additive to toothpaste with the documented effect of reducing decay bacteria adhesion to tooth enamel and presumed reduction in total decay. We do not currently sell TPAs for use in personal care products.

Competition

HEAT\$AVR® and ECO\$AVR™

We are aware of two other companies that manufacture products that compete with HEAT\$AVR® and ECO\$AVR® and we believe our products are more effective and safer. We maintain fair pricing equal to or lower than our competitors and protect our intellectual property carefully. Our products are expected to maintain or increase market share in the competitive pool market.

HEAT\$AVR® also competes with plastic pool blanket products. However, we believe that HEAT\$AVR® is more effective and convenient than pool blankets.

WATER\$AVR®

Ultimate Products (Aust) Pty Ltd. of Australia has a product called Aquatain that directly competes with WATER\$AVR®. We believe our WATER\$AVR® product is superior for the following reasons: it is safer, much less expensive and has much better test data. Aquatain has not expended the capital to test for environmental effects on insects and other aquatic life whereas WATER\$AVR® has recognized third party environmental safety documentation.

As water conservation is an important priority throughout the world, numerous researchers are working to develop solutions that may compete with, or be superior to, WATER\$AVR.

WATER\$AVR—BTI™

Although we are not aware of any direct competition with WATER\$AVR—BTI™, the pest control industry is very large and well funded and there are a multitude of alternative methods and materials that can be used for mosquito control. We believe that we will be able to compete by providing an environmentally sensitive product which is less expensive than traditional products.

TPAs

Our TPA products have direct competition with Lanxess AG (spun out of Bayer AG), a German manufacturer of TPAs, which uses a patented process different from ours. We have cross-licensed each other's processes and either company can use either process for the term of the patents involved. We believe that Lanxess has approximately the same production capacity and product costs as we do. We believe that we can compete effectively with Lanxess by offering excellent customer service in oilfield sales, superior distributor support in the agricultural marketplace and flexibility due to our relative size. In addition, we intend to continue to seek market niches that are not the primary targets of Lanxess.

Our TPA products face indirect competition from other chemicals in every market in which we are active. For purposes of oilfield scale prevention, phosphonates, phosphates and molibdonates provide the same effect. For crop enhancement, increased fertilizer levels or reduced concentrations can serve as a substitute for TPAs. In irrigation scale control, acid washes are our prime competitor. In detergent, poly-acrylic acid is most often used due to price advantage. Notwithstanding the above, we believe our competitive advantages include:

- Biodegradability compared to competing oil field chemicals;
- Cost-effectiveness for crop enhancement compared to increased fertilizer use;
- Environmental considerations, ease of formulation and increased crop yield opportunities in irrigation scale markets; and

- Biodegradability compared to poly-acrylic acid for detergents.

Manufacturing

Our HEAT\$AVR® and ECO\$AVR® products and dispensers are made from chemicals, plastic and other materials and parts that are readily available from multiple suppliers. We have never experienced any shortage in the availability of raw materials and parts for these products and we do not have any long term supply contracts for any of these items. We manufacture these products in our plant in Taber, Alberta, Canada.

Our WATER\$AVR® products are manufactured by a third party. We are not required to purchase any minimum quantity of this product.

Our 56,780 sq. ft. facility in Peru, Illinois manufactures our TPA products. Raw materials for TPA production are sourced from various manufacturers throughout the world and we believe they are available in sufficient quantities for any increase in sales. Raw materials are, however, derived from crude oil and are subject to price fluctuations related to world oil prices.

In November 2007, we purchased a building and 3.3 acres of land in Taber, Alberta, Canada. The price paid was CDN\$1,325,000 and was financed by cash of \$660,000 and an interest free mortgage that was paid in June 2008. Once renovated, the building will operate as a fermentation facility for the production of aspartic acid, a key ingredient in TPAs. Aspartic acid made in Taber will be shipped to our plant in Illinois for finishing.

Government Regulations

HEAT\$AVR® and ECO\$AVR®

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

WATER\$AVR®

Our WATER\$AVR® product is subject to regulation in most countries, particularly for agricultural and drinking water uses. We do not anticipate that governmental regulations will be an impediment to marketing WATER\$AVR® because the components in WATER\$AVR® have historically been used in agriculture for many years for other purposes. Nevertheless, we will need to obtain approval to sell WATER\$AVR® in the United States for agricultural and drinking water uses. We have received National Sanitation Foundation approval for the use of WATER\$AVR in drinking water in the United States.

WATER\$AVR—BTI™

As a pesticide, WATER\$AVR—BTI™ was approved by the EPA for commercial sale in the United States on November 30, 2005. We began marketing this product commercially in 2006. While EPA approval applies only to registration of the product in the United States, we believe EPA approval may expedite product registration and approval processes in other parts of the world. We will apply for certification in any country where significant markets are identified.

TPAs

In the oil field and agricultural markets we have received government approval for all TPAs currently sold. In the detergent market, there are currently no regulatory requirements for use of TPAs in detergent formulations. For personal care products such as shampoo and toothpaste, there are various regulatory bodies, including the National Sanitation Foundation and the United States Food and Drug Administration, that regulate TPA use. If we begin to market our TPA products to these industries, we will need to satisfy applicable regulatory requirements.

Proprietary Rights

Our success is dependent, in part, upon our proprietary technology. We rely on a combination of patent, copyright and trade secret laws and nondisclosure agreements to protect our proprietary technology. We currently hold 56 U.S. patents and 139 International patents which expire at various dates between 2011 and 2020. We also have three U.S. patent applications pending and have applied to extend these pending patents to certain other countries where we operate. There can be no assurance that our pending patent applications will be granted or that any issued patent will be upheld as valid or prevent the development of competitive products, which may be equivalent to or superior to our products. We have not received any claims alleging infringement of the intellectual property rights of others, but there can be no assurance that we may not be subject to such claims in the future.

Research and Development

We spent \$30,078 for the year ended December 31, 2009 and \$80,381 for the year ended December 31, 2008 on research and development. This work relates primarily to the development of our water and energy conservation products, as well as new research in connection with our TPA products.

Employees

As of December 31, 2009 we had 33 employees, including one officer, twelve sales and customer support personnel, and twenty manufacturing personnel. None of our employees is represented by a labor union and we have not experienced any work stoppages to date.

Item 1A. Risk Factors

This Form 10-K contains forward-looking information based on our current expectations. Because our actual results may differ materially from any forward-looking statements made by us, this section includes a discussion of important factors that could affect our future operations and result in a decline in the market price of our common stock.

We have incurred significant operating losses since inception and may not sustain profitability in the future.

We have experienced operating losses and negative cash flow from operations and we currently have an accumulated deficit. If our revenues do not increase, our results of operations and liquidity will be materially adversely affected. If we experience slower than anticipated revenue growth or if our operating expenses exceed our expectations, we may not be profitable. Even if we become profitable in the future, we may not remain profitable.

Fluctuations in our operating results may cause our stock price to decline.

Given the nature of the markets in which we operate, we cannot reliably predict future revenues and profitability. Changes in competitive, market and economic conditions may cause us to adjust our operations. A high proportion of our costs are fixed, due in part to our sales, research and development and manufacturing costs. Thus, small declines in revenue could disproportionately affect our operating results. Factors that may affect our operating results and the market price of our common stock include:

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

Our operations are subject to seasonal fluctuation.

The use of our swimming pool products increases in summer months in most markets and results in our sales from January to June being greater than in July through December. Markets for our WATER\$AVR® product are also seasonal, dependent on the wet versus dry seasons in particular countries. We attempt to sell into a variety of countries with different seasons on both sides of the equator in order to minimize seasonality. Our TPA business is the least seasonal, however there is a small increase in the spring related to inventory building for the crop season in the United States and a small slowdown in December as oilfield customers run down stock in advance of year end, but otherwise, little seasonal variation. We believe we are able to adequately respond to these seasonal fluctuations by reducing or increasing production as needed.

Interruptions in our ability to purchase raw materials and components may adversely affect our profitability.

We purchase certain raw materials and components from third parties pursuant to purchase orders placed from time to time. Because we do not have guaranteed long-term supply arrangements with our suppliers, any material interruption in our ability to purchase necessary raw materials or components could have a material adverse effect on our business, financial condition and results of operations.

Our WATER\$AVR® product has not proven to be a revenue producing product and we may never recoup the cost associated with its development.

The marketing efforts of our WATER\$AVR® product may result in continued losses. We introduced our WATER\$AVR® product in June 2002 and, to date, we have delivered quantities for testing by potential customers, but only a few customers have ordered the product for commercial use. This product can achieve success only if it is ordered in substantial quantities by commercial customers who have determined that the water saving benefits of the product exceed the costs of purchase and deployment of the product. We can offer no assurance that we will receive sufficient orders of this product to achieve profits or cover the additional expenses incurred to manufacture and market this product. We expect to spend \$200,000 on the marketing and production of our WATER\$AVR® product in fiscal 2010.

If we do not introduce new products in a timely manner, our products could become obsolete and our operating results would suffer.

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

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

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

We are dependent upon certain customers.

Among our current customers, we have identified six that are sizable enough that the loss of any one would be significant. Any loss of one or more of these customers could result in a substantial reduction in our revenues.

Economic, political and other risks associated with international sales and operations could adversely affect our sales.

Revenues from shipments made outside of the United States accounted for approximately 83% of our revenues in the year ended December 31, 2009, 79% in the year ended December 31, 2008 and 79% in the year ended December 31, 2007. Since we sell our products worldwide, our business is subject to risks associated with doing business internationally. We anticipate that revenues from international operations will continue to represent a sizable portion of our total revenue. Accordingly, our future results could be harmed by a variety of factors, including:

- changes in foreign currency exchange rates;
- changes in a country or region's political or economic conditions, particularly in developing or emerging markets;
- longer payment cycles of foreign customers and difficulty of collecting receivables in foreign jurisdictions;
- trade protection measures and import or export licensing requirements;
- differing tax laws and changes in those laws;
- difficulty in staffing and managing widespread operations;
- differing protection of intellectual property and changes in that protection; and
- differing regulatory requirements and changes in those requirements.

We are subject to credit risk and may be subject to substantial write-offs if one or more of our significant customers default on their payment obligations to us.

We currently allow our major customers between 30 and 45 days to pay for each sale. This practice, while customary, presents an accounts receivable write-off risk in that if one or more of our significant customers defaulted on their payment obligations to us, such write-off, if substantial, would have a material adverse effect on our business and results of operations.

Our products can be hazardous if not handled, stored and used properly; litigation related to the handling, storage and safety of our products would have a material adverse effect on our business and results of operations.

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

Our failure to comply with environmental regulations may create significant environmental liabilities and force us to modify our manufacturing processes.

We are subject to various federal, state and local environmental laws, ordinances and regulations relating to the use, storage, handling and disposal of chemicals. Under such laws, we may become liable for the costs of removal or remediation of these substances that have been used by our consumers or in our operations. Such laws may impose liability without regard to whether we knew of, or caused, the release of such substances. Any failure by us to comply with present or future regulations could subject us to substantial fines, suspension of production, alteration of manufacturing processes or cessation of operations, any of which could have a material adverse effect on our business, financial condition and results of operations.

Our failure to protect our intellectual property could impair our competitive position.

While we own certain patents and trademarks, some aspects of our business cannot be protected by patents or trademarks. Accordingly, in these areas there are few legal barriers that prevent potential competitors from copying certain of our products, processes and technologies or from otherwise entering into operations in direct competition with us. In particular, we have been informed that our former exclusive agent for the sale of our products in North America is now competing with us in the swimming pool and personal spa markets. As a former distributor, they were given access to many of our sales, marketing and manufacturing techniques.

Our products may infringe on the intellectual property rights of others, and resulting claims against us could be costly and prevent us from making or selling certain products.

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

A claim for damages could materially and adversely affect our financial condition and results of operations.

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

Our ongoing success is dependent upon the continued availability of certain key employees.

Our business would be adversely affected if the services of Daniel B. O'Brien ceased to be available to us because we currently do not have any other employee with an equivalent level of expertise in and knowledge of our industry. If Mr. O'Brien no longer served as our President and Chief Executive Officer, we would have to recruit one or more new executives, with no real assurance that we would be able to engage a replacement executive with the required skills on satisfactory terms. The market for skilled employees is highly competitive, especially for employees in the fields in which we operate. While our compensation programs are intended to attract and retain qualified employees, there can be no

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assurance that we will be able to retain the services of all our key employees or a sufficient number to execute our plans, nor can there be any assurances that we will be able to continue to attract new employees as required.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We lease 4,300 sq. ft. in Victoria, British Columbia for administration and sales and research at \$5,972 per month, effective through to June 2014, as well as 7,000 sq. ft. in Bedford Park, Illinois for offices and laboratories at a cost of \$6,548 per month with a year to year lease. We own a 56,780 sq. ft. facility in Peru, Illinois which is used to manufacture our TPA line of products as well as a building and 3.3 acres of land in Taber, Alberta, Canada. Our building in Taber will be renovated and operated as a fermentation facility for the production of aspartic acid, a key ingredient in TPAs. Aspartic acid made in Taber will be shipped to Illinois for finishing as well as for manufacturing our swimming pool products. Our former manufacturing location in Calgary, AB, Canada was sublet through until the end of the lease, September 2009. Our former sales office in Richmond, BC, Canada has been sublet through the end of the lease pertaining to this location.

Item 3. Legal Proceedings.

None.

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

The annual meeting of our shareholders was held on December 28, 2009. At the meeting the following persons were re-elected as directors for the upcoming year:

| Name | Votes For | Votes Against | Votes Abstained | Broker Non-Votes |
|--------------------|-----------|---------------|-----------------|------------------|
| Daniel O'Brien | 6,459,900 | 0 | 0 | 0 |
| Dr. Robert O'Brien | 6,459,900 | 0 | 0 | 0 |
| John H. Bientjes | 6,459,900 | 0 | 0 | 0 |
| Dale Friend | 6,459,900 | 0 | 0 | 0 |
| Eric Hodges | 6,459,900 | 0 | 0 | 0 |

11

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At the meeting, the following were presented to the shareholders:

1) a proposal to ratify an option granted to John Bientjes which allows Mr. Bientjes to purchase 5,000 shares of our common stock at a price of \$2.25 per share at any time after December 31, 2009 and on or before January 1, 2014;

2) a proposal to ratify an option granted to Dale Friend which allows Mr. Friend to purchase 5,000 shares of our common stock at a price of \$2.25 per share at any time after December 31, 2009 and on or before January 1, 2014;

3) a proposal to ratify an option granted to Eric Hodges which allows Mr. Hodges to purchase 5,000 shares of our common stock at a price of \$2.25 per share at any time after December 31, 2009 and on or before January 1, 2014;

4) a proposal to ratify the selection of Cinnamon Jang Willoughby & Company as our independent registered public accountants for the year ending December 31, 2009.

The following is a tabulation of the votes cast with respect to these proposals:

| <u>Proposal</u> | <u>Votes For</u> | <u>Votes Against</u> | <u>Votes Abstained</u> | <u>Broker Non-Votes</u> |
|-----------------|------------------|----------------------|------------------------|-------------------------|
| 1 | 6,459,900 | 0 | 0 | 0 |
| 2 | 6,459,900 | 0 | 0 | 0 |
| 3 | 6,459,900 | 0 | 0 | 0 |
| 4 | 6,459,900 | 0 | 0 | 0 |

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities.

Our common stock is traded on the NYSE AMEX under the symbol "FSI". The following is the range of high and low closing prices for our common stock for the periods indicated:

| | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| <u>Year Ended December 31, 2009</u> | | |
| First Quarter | \$ 1.89 | \$ 1.01 |
| Second Quarter | 1.42 | .98 |
| Third Quarter | 1.80 | 1.20 |
| Fourth Quarter | 2.47 | 1.61 |
| | <u>High</u> | <u>Low</u> |
| <u>Year Ended December 31, 2008</u> | | |
| First Quarter | \$ 2.40 | \$ 1.30 |
| Second Quarter | 2.84 | 2.00 |
| Third Quarter | 2.50 | 1.40 |
| Fourth Quarter | 2.29 | 0.95 |

As of December 31, 2009 we had approximately 1,700 shareholders.

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

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

During the year ended December 31, 2009 we did not purchase any shares of our common stock from third parties in a private transaction or as a result of any purchase in the open market. None of our officers or directors, nor any of our principal shareholders purchased, on our behalf, any shares of our common stock from third parties either in a private transaction or as a result of purchases in the open market during the year ended December 31, 2009.

As of March 15, 2010 we had 13,962,567 outstanding shares of common stock. The following table lists additional shares of our common stock which may be issued as of March 15, 2010:

| | Number Of Shares | Note Reference |
|--|---------------------|-------------------|
| Shares issuable upon the exercise of warrants held by private investors | 490,040 | A |
| Shares issuable upon exercise of options granted to our officers, directors, employees, consultants, and third parties | 1,546,700 | B |

A. In 2007, we sold shares of our common stock in private transactions. In some cases warrants were issued as part of the financings. In connection with these private offerings we paid commissions to sales agents and also issued warrants which allow the sales agents to collectively purchase 21,970 shares of our common stock. Information concerning these warrants is shown below.

| Shares Issuable Upon Exercise Of Warrants | Issue Date | Exercise Price (1) | Expiration Date (1) |
|---|---------------|-----------------------|------------------------|
| 21,970 (2) | 5/03/07 | \$3.00 | 12/31/10 |
| 468,070 | 5/03/07 | \$3.00 | 12/31/10 |

(1) In February 2010, we lowered the exercise price of the warrants issued in 2007 to \$3.00 per share and extended the expiration date of these warrants to December 31, 2010.

(2) Sales agent warrants.

B. Options are exercisable at prices ranging from \$2.25 to \$3.85 per share. See Item 11 of this report for more information concerning these options.

Item 6. Selected Financial Data.

Not applicable.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.
Results of Operations**

We have two product lines.

The first is a chemical ("EWCP") used in swimming pools and spas. The product forms a thin, transparent layer on the water's surface. The transparent layer slows the evaporation of water, allowing the water to retain a higher temperature for a longer period of time thereby reducing the energy required to maintain the desired temperature of the water. A modified version of EWCP can also be used in reservoirs, potable water storage tanks, livestock watering pods, canals, and irrigation ditches for the purpose of reducing evaporation.

The second product, biodegradable polymers ("TPAs"), is used by the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping. TPAs can also be used to increase biodegradability in detergents and in the agriculture industry to increase crop yields by enhancing fertilizer uptake.

Material changes in our Statement of Operations for the periods presented are discussed below:

Year Ended December 31, 2009

| <u>Item</u> | <u>Increase (I) or Decrease (D)</u> | <u>Reason</u> |
|---|---|---|
| Sales - EWCP | D | Declining economic climate in major markets. |
| TPAs | D | Reduced demand in the detergent sector and lower oil extraction levels. |
| Gross profit | D | Declining sales. |
| Wages | I | Annual wage increases. |
| Administrative salaries and benefits | I | Annual wage increases. |
| Advertising and promotion | D | Selective spending. |
| Investor relations and transfer agent fee | D | One time reversal of \$80,000 as shares were cancelled. See Note 18 to the Financial Statements which are included as part of this report for more information. |
| Office and miscellaneous | I | Costs associated with the renovation of the new facility in Alberta, Canada. Once the facility is operational, these costs will be included in cost of sales. |
| Interest expense | I | Interest on AFSC loan for Taber, AB facility originated in 2009. |
| Consulting | D | More efficient allocation of staff resulted in a decrease in consulting expenses. |
| Commission | D | Decrease in sales. |

Capital Resources and Liquidity

Our material sources and <uses> of cash during the year ended December 31, 2009 were:

| | |
|---|-------------|
| Cash provided by operations | \$ 788,313 |
| Patent development | (751) |
| Equipment purchases, primarily related to our new facility in Alberta, Canada | (1,275,719) |
| Loans | 462,155 |
| Exchange rate changes | 231,626 |
| Other | 26,481 |

Our material sources and <uses> of cash during the year ended December 31, 2008 were:

| | |
|---|--------------|
| Cash (used by) operations | \$ (286,167) |
| Patent (used) development | (21,113) |
| Equipment purchases, primarily related to our new facility in Alberta, Canada | (1,491,208) |
| Loan repayments | (633,472) |
| Loans | 1,683,815 |
| Exchange rate changes | (726,402) |
| Other | 12,738 |
| Cash on hand 1/1/08 | 1,461,809 |

We are committed to minimum rental payments for property and premises aggregating approximately \$440,550 over the term of three leases, the last expiring on July 31, 2014.

Commitments in each of the next five years are as follows:

| | |
|------|------------|
| 2010 | \$ 159,639 |
| 2011 | \$ 87,611 |
| 2012 | \$ 72,478 |
| 2013 | \$ 75,417 |
| 2014 | \$ 45,406 |

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Other than as disclosed above, we do not anticipate any capital requirements for the twelve months ending December 31, 2010.

We do not have any commitments or arrangements from any person to provide us with any additional capital.

See Note 2 to the financial statements included as part of this report for a description of our significant accounting policies.

Critical Accounting Policies And Estimates

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

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

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

Recent Accounting Pronouncements

Business Combinations

In December 2007, the FASB issued SFAS 141 (revised 2007), Business Combinations (SFAS 141R). SFAS 141R significantly changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, preacquisition contingencies, transaction costs, in-process research and development, and restructuring costs. In addition, under SFAS 141R, changes in an acquired entity's deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS 141R is effective for fiscal periods beginning after December 15, 2008. We adopted SFAS 141R on July 1, 2009. This standard will change our accounting treatment for business combinations on a prospective basis.

In December 2007, the FASB issued SFAS No. 160, "No Controlling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the no controlling interest, changes in a parent's ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal periods beginning after December 15, 2008. We adopted SFAS 160 on January 1, 2009. Adoption of this standard is not expected to have a material impact on our financial position, results of operations or cash flows.

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Disclosures about Derivative Instruments and Hedging Activities (SFAS 161)

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 amends and expands the disclosure requirements of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*. It requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This statement is effective for financial statements issued for fiscal periods beginning after November 15, 2008. We adopted SFAS 161 on January 1, 2009. Adoption of this standard is not expected to have a material impact on our financial position, results of operations or cash flows.

The Hierarchy of Generally Accepted Accounting Principles (SFAS 162)

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS 162). This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in accordance with GAAP. With the issuance of this statement, the FASB concluded that the GAAP hierarchy should be directed toward the entity and not its auditor, and reside in the accounting literature established by the FASB as opposed to the American Institute of Certified Public Accountants' (AICPA) Statement on Auditing Standards No. 69, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." This statement is effective as of November 15, 2008. We evaluated the new statement and have determined that it will not have a significant impact on the determination or reporting of our financial results.

Subsequent Events (SFAS 165)

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events," which establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The pronouncement requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, whether that date represents the date the financial statements were issued or were available to be issued. SFAS 165 is effective with interim and annual financial periods ending after June 15, 2009. We adopted SFAS 160 on January 1, 2009. The adoption of SFAS 165 is not expected to have any impact on our results of operations, financial position or cash flows.

Accounting for Transfers of Financial Assets—an amendment of FASB Statement (SFAS 166)

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets—an amendment of FASB Statement" ("SFAS 166"). SFAS No. 166 is intended to establish standards of financial reporting for the transfer of assets and transferred assets to improve the relevance, representational faithfulness, and comparability. SFAS 166 was established to clarify derecognition of assets under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS No. 166 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2009. We adopted SFAS 166 on January 1, 2010.

The adoption of SFAS No. 166 is not expected to have any impact on our consolidated financial statements.

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Amendments to FASB Interpretation No. 46(R) (SFAS 167)

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS No. 167"). SFAS No. 167 eliminates the exception to consolidate a qualifying special-purpose entity, changes the approach to determining the primary beneficiary of a variable interest entity and requires companies to more frequently re-assess whether they must consolidate variable interest entities. Under the new guidance, the primary beneficiary of a variable interest entity is identified qualitatively as the enterprise that has both (a) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. SFAS No. 167 becomes effective for our fiscal 2010 year-end and interim reporting periods thereafter. We do not expect SFAS No. 167 to have a material impact on our financial statements.

FASB Accounting Standards Codification (SFAS 168)

In July 2009, the FASB issued SFAS No. 168, "FASB Accounting Standards Codification" ("SFAS 168"), as the single source of authoritative nongovernmental U.S. generally accepted accounting principles (GAAP). The Codification is effective for interim and annual periods ending after September 15, 2009. All existing accounting standards are superseded as described in SFAS 168. All other accounting literature not included in the Codification is non-authoritative. We are currently evaluating the impact of the adoption of SFAS 168 but do not expect the adoption of SFAS 168 to impact our results of operations, financial position or cash flows.

Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (APB 141)

In May 2008, the FASB issued FSP No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("FSP 14-1"). FSP 14-1 applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under FASB Statement No. 133. Convertible debt instruments within the scope of FSP 14-1 are not addressed by the existing APB 14. FSP 14-1 would require that the liability and equity components of convertible debt instruments within the scope of FSP 14-1 be separately accounted for in a manner that reflects the entity's nonconvertible debt borrowing rate. This will require an allocation of the convertible debt proceeds between the liability component and the embedded conversion option (i.e., the equity component). The difference between the principal amount of the debt and the amount of the proceeds allocated to the liability component would be reported as a debt discount and subsequently amortized to earnings over the instrument's expected life using the effective interest method. FSP APB 14-1 is effective for our fiscal year beginning January 1, 2009 and will be applied retrospectively to all periods presented. Adoption of this standard is not expected to have a material impact on our financial position, results of operations or cash flows.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Note applicable.

Item 8. Financial Statements and Supplementary Data.

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

| | Page |
|---|-------------|
| <u>Report of Independent Registered Public Accounting Firm, Meyers, Norris, Penny LLP</u> | F-1 |
| <u>Consolidated Balance Sheet as of December 31, 2009 and 2008</u> | F-2 |
| <u>Consolidated Statements of Operations for the Years Ended December 31, 2009 and 2008</u> | F-3 |
| <u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2009 and 2008</u> | F-4 |
| <u>Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2009 and 2008</u> | F-5 |
| <u>Notes to Consolidated Financial Statements</u> | F-6 |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
FLEXIBLE SOLUTIONS INTERNATIONAL, INC.:

We have audited the consolidated balance sheets of Flexible Solutions International, Inc. (the "Company") as of December 31, 2009 and 2008 and the consolidated statements of operations, stockholders' equity and cash flows for the years then ended. The consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) in the United States of America. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the consolidated results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles in the United States of America.

MEYERS NORRIS PENNY LLP

Vancouver, Canada
March 26, 2010

CHARTERED ACCOUNTANTS & BUSINESS ADVISORS
2300 – 1055 DUNSMUIR STREET VANCOUVER, BC V7X 1J1
PH. (604) 685-8408 FAX (604) 685-8594 www.mnp.ca

F-1

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.**Consolidated Balance Sheet****December 31, 2009 and 2008****(U.S. Dollars)**

| | December 31, 2009 | December 31, 2008 |
|---|----------------------|----------------------|
| Assets | | |
| Current | | |
| Cash and cash equivalents | \$ 2,126,150 | \$ 1,894,045 |
| Accounts receivable (see Note 3) | 1,544,364 | 1,642,001 |
| Inventories (see Note 4) | 2,796,307 | 3,591,112 |
| Prepaid expenses | 121,353 | 109,459 |
| | 6,588,174 | 7,236,617 |
| Property, equipment and leaseholds, net (see Note 5) | 7,314,926 | 5,882,223 |
| Patents (see Note 6) | 224,505 | 204,203 |
| Long term deposits (see Note 7) | 7,499 | 32,713 |
| Deferred tax asset (see Note 11) | 119,000 | — |
| Total Assets | \$ 14,254,104 | \$ 13,355,756 |
| Liabilities | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 597,307 | \$ 771,180 |
| Income taxes payable | 304,000 | — |
| Current portion of long term debt (see Note 8) | 74,146 | — |
| | 975,453 | 771,180 |
| Long term debt (see Note 8) | 2,211,168 | 1,546,836 |
| | 3,186,621 | 2,318,016 |
| Stockholders' Equity | | |
| Capital stock (see Note 15) | | |
| 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: | | |
| 13,962,567 (2008: 14,062,567) common shares | 13,963 | 14,063 |
| Capital in excess of par value | 16,456,903 | 16,259,614 |

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| | | |
|---|---------------|---------------|
| Other comprehensive income (see Note 10) | 331,208 | (244,788) |
| Accumulated Deficit | (5,734,591) | (4,991,149) |
| <hr/> | | |
| Total Stockholders' Equity | 11,067,483 | 11,037,740 |
| <hr/> | | |
| Total Liabilities and Stockholders' Equity | \$ 14,254,104 | \$ 13,355,756 |
| <hr/> | | |

Commitments, Contingencies and Subsequent events (See Notes 17, 18 & 19)
See Notes to Consolidated Financial Statements.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
Consolidated Statements of Operations
For the Years Ended December 31, 2009 and 2008
(U.S. Dollars)

| | Years Ended December 31, | |
|---|--------------------------|---------------|
| | 2009 | 2008 |
| Sales | \$ 9,783,496 | \$ 10,756,654 |
| Cost of sales | 6,502,446 | 6,719,114 |
| Gross profit | 3,281,050 | 4,037,540 |
| Operating Expenses | | |
| Wages | 1,381,183 | 1,270,309 |
| Administrative salaries and benefits | 391,519 | 343,352 |
| Advertising and promotion | 71,170 | 101,821 |
| Investor relations and transfer agent fee | 154,883 | 161,040 |
| Office and miscellaneous | 457,578 | 390,416 |
| Insurance | 171,638 | 218,626 |
| Interest expense | 66,068 | 18,696 |
| Rent | 230,531 | 261,430 |
| Consulting | 162,900 | 200,066 |
| Professional fees | 252,159 | 216,566 |
| Travel | 133,732 | 137,218 |
| Telecommunications | 32,526 | 34,042 |
| Shipping | 41,427 | 37,531 |
| Research | 30,078 | 80,381 |
| Commissions | 74,156 | 120,229 |
| Bad debt expense (recovery) | (695) | 3,393 |
| Currency exchange (gain) | 117,479 | (68,939) |
| Utilities | 60,176 | 11,631 |
| Loss on sale of equipment | — | 29,048 |
| Total operating expenses | 3,828,508 | 3,556,857 |
| Operating income (loss) | (547,458) | 470,683 |
| Interest income | — | 2,483 |
| Gain on settlement of lawsuit | 80,000 | — |
| Income (loss) before income tax | (467,458) | 473,166 |

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| | | |
|---|--------------|------------|
| Deferred income tax (recovery) | (119,000) | |
| Income tax | 394,983 | 68,561 |
| <hr/> | | |
| Income (loss) for the year | \$ (743,441) | \$ 404,605 |
| <hr/> | | |
| Net income (loss) per share (basic and diluted) | \$ (0.05) | \$ 0.03 |
| <hr/> | | |
| Weighted average number of common shares (basic and diluted) | 14,020,375 | 14,058,033 |
| <hr/> | | |

See Notes to Consolidated Financial Statements.

F-3

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
Consolidated Statements of Cash Flows
For Years Ended December 31, 2009 and 2008
(U.S. Dollars)

| | Years Ended December 31, | |
|--|--------------------------|--------------------|
| | 2009 | 2008 |
| Operating activities | | |
| Net income (loss) | \$ (743,441) | \$ 404,605 |
| Adjustments to reconcile net loss to net cash: | | |
| Stock compensation expense | 277,202 | 339,416 |
| Shares issued for services | — | 5,900 |
| Depreciation | 402,115 | 447,831 |
| Write down of inventory | — | 41,440 |
| Loss on sale of equipment | — | 29,048 |
| Gain on settlement of lawsuit | (80,000) | — |
| Deferred income tax | (119,000) | — |
| Changes in non-cash working capital items: | | |
| (Increase) Decrease in accounts receivable | 137,270 | (651,757) |
| (Increase) Decrease in inventories | 759,643 | (1,322,022) |
| (Increase) Decrease in prepaid expenses | (7,062) | (3,730) |
| Increase (Decrease) in accounts payable | (142,414) | 432,280 |
| Increase (Decrease) in taxes payable | 304,000 | — |
| Increase (Decrease) deferred revenue | — | (9,178) |
| Cash provided by (used in) operating activities | 788,313 | (286,167) |
| Investing activities | | |
| (Increase) Decrease in long term deposits | 26,481 | 12,738 |
| (Increase) Decrease in development of patents | (751) | (21,113) |
| (Increase) Decrease in acquisition of equipment | (1,275,719) | (1,491,208) |
| Cash provided by (used in) investing activities | (1,249,989) | (1,499,583) |
| Financing activities | | |
| Mortgage repayment | — | (633,472) |
| Proceeds from loan | 462,155 | 1,683,815 |
| Cash provided by financing activities | 462,155 | 1,050,343 |

| | | |
|---|---------|-----------|
| Effect of exchange rate changes on cash | 231,626 | (726,402) |
|---|---------|-----------|

| | | |
|---------------------------------|---------|-------------|
| Inflow (outflow) of cash | 232,105 | (1,461,809) |
|---------------------------------|---------|-------------|

| | | |
|--------------------------------------|-----------|-----------|
| Cash and cash equivalents, beginning | 1,894,045 | 3,355,854 |
|--------------------------------------|-----------|-----------|

| | | |
|--|--------------|--------------|
| Cash and cash equivalents, ending | \$ 2,126,150 | \$ 1,894,045 |
|--|--------------|--------------|

Supplemental disclosure of cash flow information:

| | | |
|-------------------------|---------|--------|
| Income taxes to be paid | 394,983 | 68,561 |
|-------------------------|---------|--------|

| | | |
|---------------|--------|--------|
| Interest paid | 66,068 | 18,696 |
|---------------|--------|--------|

See Notes to Consolidated Financial Statements.

F-4

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31, 2009 and 2008
(U.S. Dollars)

| | Shares | Par Value | Capital in Excess of Par Value | Accumulated Earnings (Deficiency) | Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|----------------------------------|-------------------|------------------|--------------------------------|-----------------------------------|-----------------------------------|----------------------------|
| Balance December 31, 2007 | 14,057,567 | \$ 14,058 | \$ 15,914,303 | \$ (5,395,754) | \$ 394,289 | \$ 10,926,895 |
| Translation adjustment | — | — | — | — | (639,077) | (639,077) |
| Net income | — | — | — | 404,605 | — | 404,605 |
| Comprehensive income | — | — | — | — | — | (234,472) |
| Shares issued: | | | | | | |
| Issue of stock for services | 5,000 | 5 | 5,895 | — | — | 5,900 |
| Stock option compensation | — | — | 339,416 | — | — | 339,416 |
| Balance December 31, 2008 | 14,062,567 | \$ 14,063 | \$ 16,259,614 | \$ (4,991,149) | \$ (244,788) | \$ 11,037,740 |
| Translation adjustment | — | — | — | — | 575,990 | 575,990 |
| Net loss | — | — | — | (743,441) | — | (743,441) |
| Comprehensive income | — | — | — | — | — | (167,451) |
| Shares issued: | | | | | | |
| Cancellation of stock | (100,000) | (100) | (79,900) | — | — | (80,000) |
| Stock option compensation | — | — | 277,195 | — | — | 277,195 |
| Balance December 31, 2009 | 13,962,567 | \$ 13,963 | \$ 16,456,909 | \$ (5,734,590) | \$ 331,202 | \$ 11,067,483 |

See Notes to Consolidated Financial Statements.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009 and 2008
(U.S. Dollars)

1. Basis of Presentation.

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

Flexible Solutions International, Inc. and its subsidiaries develop, manufacture and market specialty chemicals which slow down the evaporation of water. The company's primary product, HEAT\$AVR®, 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. Another product, WATER\$AVR®, is marketed for water conservation in irrigation canals, aquaculture, and reservoirs where its use slows down water loss due to evaporation. In addition to the water conservation products, the Company also manufactures and markets water-soluble chemicals utilizing thermal polyaspartate biopolymers (hereinafter referred to as "TPAs"), which are beta-proteins manufactured from the common biological amino acid, L-aspartic. TPAs can be formulated to prevent corrosion and scaling in water piping within the petroleum, chemical, utility and mining industries. TPAs are also used as proteins to enhance fertilizers in improving crop yields and as additives for household laundry detergents, consumer care products and pesticides.

2. Significant Accounting Policies.

These consolidated financial statements have been prepared in accordance with accounting principles generally 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) *Inventories and Cost of Sales*

The Company has four major classes of inventory: finished goods, works in progress, raw materials and supplies. In all classes, inventory is valued at the lower of cost and market. 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. Inventory costs and costs of sales include direct costs of the raw material, inbound freight charges, warehousing costs, handling costs (receiving and purchasing) and utilities and overhead expenses related to the Company's manufacturing and processing facilities.

(c) *Allowance for Doubtful Accounts*

The Company provides an allowance for doubtful accounts when management estimates collectibility to uncertain. Accounts receivable are continually reviewed to determine which, if any,

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accounts are doubtful of collection. In making the determination of the appropriate allowance amount, the Company considers current economic and industry conditions, relationships with each significant customer, overall customer credit-worthiness and historical experience.

(d) *Property, Equipment and Leaseholds.*

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

| | |
|---------------------------|-------------------------------|
| Computer hardware | 30% Declining balance |
| Automobile | 30% Declining balance |
| Trade show booth | 30% Declining balance |
| Furniture and fixtures | 20% Declining balance |
| Manufacturing equipment | 20% Declining balance |
| Office equipment | 20% Declining balance |
| Building and improvements | 10% Declining balance |
| Leasehold improvements | Straight-line over lease term |

Depreciation is recorded at half for the year the assets are first purchased. 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.

Costs capitalized on self-constructed assets classified as plant under construction, include contracted costs and supplies, but do not capitalize interest costs. The Company does not commence depreciating its plant under construction until it becomes operational.

(e) *Impairment of Long-Lived Assets.*

In accordance with FASB Codification Topic 360, "Property, Plant and Equipment (ASC 360), the Company reviews long-lived assets, including, but not limited to, property and equipment, patents and other assets, for impairment annually or whenever events or changes in circumstances indicate the carrying amounts of assets may not be recoverable. The carrying value of long-lived assets is assessed for impairment by evaluating operating performance and future undiscounted cash flows of the underlying assets. If the sum of the expected future cash flows of an asset is less than its carrying value, an impairment measurement is indicated. Impairment charges are recorded to the extent that an asset's carrying value exceeds its fair value. Accordingly, actual results could vary significantly from such estimates. There were no impairment charges during the periods presented.

(f) *Foreign Currency.*

The functional currency of one of the Company's subsidiaries is the Canadian Dollar. The translation of the Canadian Dollar to the reporting currency of the U.S. Dollar is performed for assets and liabilities using exchange rates in effect at the balance sheet date. 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 subsidiary's functional currency, Canadian Dollars, into the reporting currency, U.S. Dollars, are excluded from the determination of income (loss) and are 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 operating income (loss) if realized during the year and in comprehensive income (loss) if they remain unrealized at the end of the year.

(g) *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 to the carrier 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. To date there have been no such significant post-delivery obligations.

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.

(h) *Stock Issued in Exchange for Services.*

The Company's common stock issued in exchange for services is valued at an estimated fair market value based upon trading prices of the Company's common stock on the dates of the stock transactions. The corresponding expense of the services rendered is recognized over the period that the services are performed.

(i) *Stock-based Compensation.*

The Company recognizes compensation expense for all share-based payments, in accordance with FASB Codification Topic 718, *Compensation — Stock Compensation*, (ASC 718). Under the fair value recognition provisions of ASC 718, the Company recognizes share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award.

Shares of newly issued common stock will be issued upon exercise of stock options or vesting of restricted share units.

The fair value at grant date of stock options is estimated using the Black-Scholes-Merton option-pricing model. Compensation expense is recognized on a straight-line basis over the stock option vesting period based on the estimated number of stock options that are expected to vest.

(j) *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.

(k) *Income (loss) Per Share.*

Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding in the period. Diluted earnings (loss) per share are calculated giving effect to the potential dilution of the exercise of options and warrants.

(l) *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.

(m) *Financial Instruments.*

The fair market value of the Company's financial instruments comprising cash and cash equivalents, accounts receivable, long term deposits and accounts payable were estimated to approximate their carrying values due to immediate or short-term maturity of these financial instruments. The Company maintains cash balances at financial institutions which at times, exceed federally insured amounts. The Company has not experienced any material losses in such accounts.

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.

(n) *Fair Value of Financial Instruments*

In August 2009, an update was made to *Fair Value Measurements and Disclosures* — “*Measuring Liabilities at Fair Value.*” This update permits entities to measure the fair value of liabilities, in circumstances in which a quoted price in an active market for an identical liability is not available, using a valuation technique that uses a quoted price of an identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities when traded as assets or the income or market approach that is consistent with the principles of *Fair Value Measurements and Disclosures*. Effective upon issuance, the Company has adopted this guidance with no material impact to the Company's consolidated financial statements.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs described below, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

- Level 1 – Quoted prices in active markets for identical assets or liabilities
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The fair values of cash and cash equivalents, accounts receivable, long term deposits and accounts payable for all periods presented approximate their respective carrying amounts due to the short term nature of these financial instruments. The fair values of long term debt approximate their carrying amounts as they bear market rates of interest.

(o) *Contingencies*

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potential material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed.

(p) *Income Taxes*

Federal, state and foreign income taxes are computed at current tax rates, less tax credits. Provisions for income taxes include amounts that are currently payable, plus changes in deferred income tax assets and liabilities. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance so that the assets are recognized only to the extent that when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will be realized.

The Company records a provision for estimated additional tax and interest that may result from tax authorities disputing uncertain tax positions taken at the largest amount that is greater than 50% likely of being realized.

No provision is made for additional taxes, which would arise if the retained earnings of subsidiaries were distributed, on the basis that it is not anticipated that such distribution will be made.

(q) *Risk Management*

The Company's credit risk is primarily attributable to its account receivables. The amounts presented in the accompanying consolidated balance sheets are net of allowances for doubtful accounts, estimated by the Company's management based on prior experience and the current economic environment. The Company is exposed to credit-related losses in the event of non-performance by counterparties to the financial instruments. Credit exposure is minimized by dealing with only credit worthy counterparties. Accounts receivable for the three primary customers totals \$1,030,960 (67%) as at December 31, 2009 (2008 - \$961,931 or 60%).

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The credit risk on cash and cash equivalents is limited because the Company limits its exposure to credit loss by placing its cash and cash equivalents with major financial institutions.

The Company is not exposed to significant interest rate risk to the extent that the long term debt maintained from the foreign government agencies is subject to a fixed rate of interest.

In order to manage its exposure to foreign exchange risks, the Company is closely monitoring the fluctuations in the foreign currency exchange rates and the impact on the value of cash and cash equivalent, accounts receivable, and accounts payable.

(r) *Recent Accounting Pronouncements*

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangement* (ASU 2009-13), which amends Codification Topic 605, *Revenue Recognition*. This update provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. This update also establishes a selling price hierarchy for determining the selling price of a deliverable. ASU 2009-13 is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently evaluating the impact the adoption of the update may have on its consolidated results of operations and financial position.

In June 2009, the FASB issued ASU No. 2009-1 to FASB Codification Topic 105, *Generally Accepted Accounting Principles*, based on SFAS No. 168, *FASB Accounting Guidance Standards Codification and the Hierarchy of Generally Accepted Accounting Principles — a replacement of SFAS No. 162*. This statement establishes that the FASB Codification becomes the single official source of authoritative U.S. GAAP superseding all non-SEC accounting and reporting standards and literature. Only one level of authoritative U.S. GAAP will exist and all other literature will be considered non-authoritative. The FASB Codification became effective for interim and annual periods ending on or after September 15, 2009. The Company adopted the FASB Codification beginning in the fourth quarter of fiscal 2009. Given that the FASB Codification does not change U.S. GAAP, this statement had no impact on the Company's consolidated financial condition or results of operations. Where possible, previously disclosed FASB references have been replaced with FASB Codification references.

In June 2009, an update was made to ASC 810, *Consolidation*. This update amends previous guidance to require the Company to perform an analysis to determine whether its variable interests give it a controlling financial interest in a variable interest entity. The update is effective for annual periods beginning after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The Company is currently evaluating the impact the adoption of the update may have on its consolidated results of operations and financial position.

In May 2009, the FASB issued guidance which is included in FASB Codification Topic 855, *Subsequent Events*, (ASC 855). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The Company has evaluated subsequent events through March 30, 2010 for appropriate accounting and disclosure in accordance with this standard.

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In April 2009, the FASB issued guidance which is included in FASB Codification Topic 320, *Investments — Debt and Equity Securities*, (ASC 320). ASC 320 amended the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The Company's implementation of this standard on May 1, 2009 did not have a significant impact on its consolidated statements of operations and financial position.

3. Accounts Receivable

| | 2009 | 2008 |
|----------------------------------|---------------------|---------------------|
| Accounts receivable | \$ 1,536,005 | \$ 1,672,772 |
| Allowances for doubtful accounts | (8,359) | (30,771) |
| | <u>\$ 1,544,364</u> | <u>\$ 1,642,001</u> |

The Company has pledged \$231,676 of the above listed accounts receivable as collateral for the Flexible Solutions Ltd. loan from AFSC (see Note 8b)

4. Inventories

| | 2009 | 2008 |
|-------------------|---------------------|---------------------|
| Completed goods | \$ 1,670,485 | \$ 2,394,723 |
| Works in progress | 96,935 | 56,036 |
| Raw materials | 1,028,887 | 1,140,353 |
| | <u>\$ 2,796,307</u> | <u>\$ 3,591,112</u> |

5. Property, Equipment and Leaseholds

| | 2009 Cost | Accumulated Depreciation | 2009 Net |
|-------------------------|--------------|-----------------------------|--------------|
| Buildings | \$ 4,171,305 | \$ 1,385,381 | \$ 2,785,924 |
| Building Improvements | 1,003,156 | — | 1,003,156 |
| Computer hardware | 83,725 | 63,022 | 20,703 |
| Furniture and fixtures | 26,170 | 15,693 | 10,477 |
| Office equipment | 21,973 | 16,929 | 5,044 |
| Manufacturing equipment | 4,481,619 | 1,608,101 | 2,873,518 |
| Trailer | 26,560 | 12,000 | 14,560 |
| Technology | 129,985 | — | 129,985 |

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| | | | |
|------------------|---------------|--------------|--------------|
| Trade show booth | 8,268 | 7,088 | 1,180 |
| Truck | 11,313 | 4,582 | 6,731 |
| Land | 463,648 | — | 463,648 |
| | \$ 10,427,722 | \$ 3,112,796 | \$ 7,314,926 |

F-12

| | 2008 | Accumulated | 2008 |
|-------------------------|---------------------|---------------------|---------------------|
| | Cost | Depreciation | Net |
| Buildings | \$ 4,017,334 | \$ 1,187,408 | \$ 2,829,926 |
| Building Improvements | 502,847 | — | 502,847 |
| Computer hardware | 78,121 | 50,962 | 27,159 |
| Furniture and fixtures | 19,884 | 11,875 | 8,009 |
| Office equipment | 29,396 | 21,262 | 8,134 |
| Manufacturing equipment | 3,335,089 | 1,402,423 | 1,932,666 |
| Trailer | 23,040 | 4,996 | 18,044 |
| Leasehold improvements | 23,665 | 19,378 | 4,287 |
| Technology | 112,759 | — | 112,759 |
| Trade show booth | 7,172 | 5,709 | 1,463 |
| Truck | 9,814 | 1,472 | 8,342 |
| Land | 428,587 | — | 428,587 |
| | \$ 8,587,708 | \$ 2,705,485 | \$ 5,882,223 |

Amount of depreciation expense for 2009: \$402,115 (2008: \$447,831)

The following carrying amount of capital assets held by Flexible Solutions Ltd. has not been amortized as they are not available for commercial production purposes as of December 31, 2009:

| | 2009 Cost | 2008 Cost |
|-------------------------|---------------------|---------------------|
| Building | \$ 1,003,057 | \$ 870,125 |
| Building improvements | 1,003,156 | 502,847 |
| Manufacturing equipment | 2,184,058 | 1,105,572 |
| Technology | 129,985 | 112,759 |
| | \$ 4,320,256 | \$ 2,591,303 |

The following carrying amount of capital assets held by Flexible Solutions Ltd. serves as collateral for the AFSC loan (see Note 8b):

| | |
|-------------------------|------------|
| Land | \$ 264,555 |
| Building | 1,003,057 |
| Building improvements | 1,003,156 |
| Manufacturing equipment | 2,271,134 |
| Trailer | 14,561 |
| Truck | 6,731 |
| Trade show booth | 1,180 |

Technology 129,985

F-13

6. Patents

In fiscal 2005, the Company started the patent process for additional WATER\$AVR® products. Patents associated with these costs were granted in 2006 and they have been amortized over their legal life of 17 years.

Of the patents costs listed below, \$75,347 are not subject to amortization as at December 31, 2009, as the patents are still in the process of being approved.

| | 2009 Cost | Accumulated Amortization | 2009 Net |
|---------|----------------------|-------------------------------------|---------------------|
| Patents | \$ 252,273 | \$ 27,768 | \$ 224,505 |

| | 2008 Cost | Accumulated Amortization | 2008 Net |
|---------|----------------------|-------------------------------------|---------------------|
| Patents | \$ 218,209 | \$ 14,006 | \$ 204,203 |

Increase in 2009 cost was mainly due to currency conversion. 2009 cost in Canadian dollars - \$265,102 (2008 - \$264,244 in Canadian dollars).

Amount of depreciation for 2009: \$13,762 (2008: \$3,444).

Estimated depreciation expense over the next five years is as follows:

| | |
|------|-----------|
| 2010 | \$ 11,475 |
| 2011 | 11,475 |
| 2012 | 11,475 |
| 2013 | 11,475 |
| 2014 | 11,475 |

7. Long Term Deposits

The Company has reclassified certain security deposits to better reflect their long term nature. Long term deposits consist of damage deposits held by landlords and security deposits held by various vendors.

| | 2009 | 2008 |
|--------------------|-------------|-------------|
| Long term deposits | \$ 7,499 | \$ 32,713 |

8. Long Term Debt

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(a) Flexible Solutions Ltd. has received a non-interest bearing loan from the Department of Agriculture and Agri-Food Canada (“AAFC”). Eligible for up to \$1,000,000 Canadian funds, the Company had borrowed \$910,801 in Canadian funds (\$866,627) as of December 31, 2009, on an unsecured basis. If the full amount is drawn, the repayment schedule is as follows:

F-14

| Amount Due (in CDN funds) | Payment Due Date |
|---------------------------|------------------|
| \$200,000 | January 1, 2012 |
| \$200,000 | January 1, 2013 |
| \$200,000 | January 1, 2014 |
| \$200,000 | January 1, 2015 |
| \$200,000 | January 1, 2016 |

(b) Flexible Solutions Ltd. has also received a 5% simple interest loan from Agriculture Financial Services Corp. ("AFSC"). Eligible for up to \$2,000,000 Canadian funds, the Company had borrowed \$1,491,000 in Canadian funds (\$1,418,687 US) as of December 31, 2009. The Company is required to make interest payments until May 1, 2010 and then must pay down the principal in equal payments until May 1, 2014. The Company has pledged the assets of the Taber, AB building, including equipment, inventory and accounts receivable (see Notes 3 and 5) as collateral, as well as signed a promissory note guaranteeing the amount of the loan.

| Continuity | 2009 | 2008 |
|-----------------------------------|--------------|--------------|
| Balance, January 1 | \$ 1,546,836 | — |
| Add: Proceeds from long term debt | 462,155 | 1,546,836 |
| Effect of exchange rate | 276,323 | — |
| Balance, December 31 | \$ 2,285,314 | \$ 1,546,836 |

| Outstanding balance at: | 2009 | 2008 |
|--------------------------|--------------|--------------|
| a) Long term debt - AAFC | \$ 866,627 | \$ 316,165 |
| a) Long term debt - AFSC | 1,418,687 | 1,230,671 |
| Long-term Debt | \$ 2,285,314 | \$ 1,546,836 |
| Less: current portion | (74,146) | — |
| | \$ 2,211,168 | \$ 1,546,836 |

9. Mortgage

Pursuant to the acquisition of the plant and property in Taber, Alberta, the Company agreed to assume a mortgage of \$651,298 (\$645,167 CAD) to the vendor to satisfy the balance of the purchase price. The mortgage was paid in full in June 2008.

10. Comprehensive Income

| | <u>2009</u> | <u>2008</u> |
|--|--------------|--------------|
| Net income (loss) | \$ (743,441) | \$ 404,605 |
| Other comprehensive income | 575,990 | (639,077) |
| Comprehensive income (loss) | \$ (234,451) | \$ (234,472) |
| Basic and diluted comprehensive loss per share | (0.02) | (0.02) |

11. Income Tax

The provision for taxes on income is comprised of the following:

| | <u>2009</u> | <u>2008</u> |
|------------------------------|-------------|-------------|
| Current tax, federal | \$ 281,225 | \$ 24,802 |
| Current tax, state | 113,758 | 43,759 |
| Current tax, foreign | — | — |
| Current tax, total | 394,983 | 68,561 |
| Deferred income tax, federal | (119,000) | — |
| Deferred income tax, state | — | — |
| Deferred income tax, foreign | — | — |
| Deferred income tax, total | (119,000) | — |
| Total | \$ 275,983 | \$ 68,561 |

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Income taxes vary from the amount that would be computed by applying the estimated combined statutory income tax rate (34%) for the following reasons:

| | <u>2009</u> | <u>2008</u> |
|---|---------------------|-------------------|
| Income before taxes, domestic | \$ 947,312 | \$ 1,309,221 |
| Income before taxes, foreign | (1,414,771) | (836,054) |
| Income before taxes, total | <u>\$ (467,459)</u> | <u>\$ 473,167</u> |
| Expense (recovery) for income taxes at statutory rate (34%) | \$ (173,745) | \$ 160,877 |
| Impact of lower statutory rates on foreign subsidiary | 70,739 | 37,622 |
| Permanent difference – stock based compensation | 94,246 | 115,401 |
| Permanent difference - research | 7,696 | — |
| Non-deductible expenses | 5,877 | — |
| Miscellaneous | 315 | 587 |
| Change in valuation allowance | 270,856 | (245,927) |
| Income tax expense (recovery) | <u>\$ 275,983</u> | <u>\$ 68,560</u> |

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's deferred tax assets and deferred income tax liabilities are calculated at a 34% tax rate consisting of the following:

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|-------------|
| Non-capital loss carry forwards | \$ 1,244,644 | \$ 917,030 |
| Property and equipment | 35,235 | (35,439) |
| Deferred tax asset on alternative minimum tax | — | 8,433 |
| Valuation allowance | (1,160,879) | (890,024) |
| Net deferred tax asset (liability) | <u>\$ 119,000</u> | <u>—</u> |

The Company's carried losses for income tax purposes are \$4,297,876 (2008 - \$3,034,495), which may be carried forward to apply against future income tax, expiring between 2010 and 2029. The future tax benefit of these loss carry-forwards has been offset with a full \$4,297,876 (2008 - \$3,034,495) valuation allowance. These losses expire as follows:

| | |
|------|------------|
| 2010 | \$ 103,369 |
| 2014 | 433,389 |
| 2022 | — |
| 2025 | 5 |
| 2026 | 889,259 |
| 2027 | 798,580 |
| 2028 | 715,560 |
| 2029 | 1,351,714 |

F-17

12. EARNINGS (LOSS) PER SHARE.

| | <u>Net income (loss)</u> | <u>Shares (denominator)</u> | <u>Earnings (loss) per share amount</u> |
|-----------------------|------------------------------|---------------------------------|---|
| 2009 Basic net loss | \$ (743,441) | 14,020,375 | \$ (0.05) |
| 2008 Basic net income | \$ 404,605 | 14,058,033 | \$ 0.03 |

Options to purchase 1,546,700 shares of the Company's common stock at prices ranging from \$2.25 to \$3.85 per share were outstanding during the year ended December 31, 2009 (2008: options to purchase 1,910,700 shares of the Company's common stock at prices ranging from \$3.00 to \$4.55 per share), but were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the Company's common stock and were anti-dilutive. There were no preferred shares issued and outstanding for the years ended December 31, 2009 or 2008.

13. STOCK OPTIONS.

The Company adopted a stock option plan ("Plan"). The purpose of this Plan is to provide additional incentives to key employees, officers, directors and consultants of the Company and its subsidiaries in order to help attract and retain the best available personnel for positions of responsibility and otherwise promoting the success of the business activities. It is intended that options issued under this Plan constitute non-qualified stock options. The general terms of awards under the option plan are that 100% of the options granted will vest the year following the grant. The maximum term of options granted is 5 years.

The Company may issue stock options and stock bonuses for shares of its common stock to provide incentives to directors, key employees and other persons who contribute to the success of the Company. The exercise price of all incentive options are issued for not less than fair market value at the date of grant.

The following table summarizes the Company's stock option activity for the years ended December 31, 2009 and 2008:

| | <u>Number of shares</u> | <u>Exercise price per share</u> | <u>Weighted average exercise price</u> |
|----------------------------|-------------------------|-------------------------------------|--|
| Balance, December 31, 2007 | 1,912,440 | \$3.040 - \$4.60 | \$ 3.38 |
| Granted | 203,000 | \$3.60 | \$ 3.60 |
| Cancelled or expired | (204,740) | \$3.00 - \$4.60 | \$ 3.74 |
| | <u>1,910,700</u> | <u>\$3.00 - \$4.55</u> | <u>\$ 3.38</u> |
| Balance, December 31, 2008 | 1,910,700 | \$3.00 - \$4.55 | \$ 3.38 |
| Granted | 122,000 | \$2.25 | \$ 2.25 |
| Cancelled or expired | (486,000) | \$3.00 - \$4.55 | \$ 3.44 |
| | <u>1,546,700</u> | <u>\$2.25 - 3.85</u> | <u>\$ 3.25</u> |

In December 2004, the Financial Accounting Standards Board ("FASB") issued revised FAS No. 123(R), *Share-Based Payment*, which replaces FAS No. 123, *Accounting for Stock-Based Compensation*,

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which superseded APB Opinion No. 25, *Accounting for Stock Issued to Employees*. FAS No. 123(R) requires the cost of all share-based payment transactions to be recognized in an entity's financial statements, establishes fair value as the measurement objective and requires entities to apply a fair-value-based measurement method in accounting for share-based payment transactions. FAS No. 123(R) applies to all awards granted, modified, repurchased or cancelled after July 1, 2005, and unvested portions of previously issued and outstanding awards. The Company adopted this statement for its first quarter starting January 1, 2006 and will continue to evaluate the impact of adopting this statement.

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

| | 2009 | 2008 |
|--|---------|---------|
| Expected life – years | 5.0 | 5.0 |
| Interest rate | 1.14% | 2.27% |
| Volatility | 65% | 99% |
| Dividend yield | —% | —% |
| Weighted average fair value of options granted | \$ 1.01 | \$ 1.15 |

During the year ended December 31, 2009, the Company granted 61,000 (2008 – 41,000) stock options to consultants and has applied FAS No. 123 using the Black-Scholes option-pricing model, which resulted in additional expenses of \$61,384 (2008 - \$47,199). During the year ended December 31, 2009, employees were granted 61,000 (2008 – 162,000) stock options, which resulted in additional expenses of \$61,384 (2008 – \$48,350). Options granted in previous years resulted in additional expenses in the amount of \$59,597 for consultants and \$94,830 for employees during the year ended December 31, 2009. No stock options were exercised during this period.

14. WARRANTS

On April 14, 2005, the Company announced that it had raised \$3,375,000 pursuant to a private placement. The investors in this offering purchased 900,000 shares of the Company's common stock at a per-share price of \$3.75, together with warrants to purchase up to 900,000 additional shares of the Company's common stock. The warrants originally had a 4 year term and were exercisable at a price of \$4.50 per share.

On June 8, 2005, the Company announced that it had raised an additional \$327,750 pursuant to a private placement. An investor purchased 87,400 shares of the Company's common stock at a per share price of \$3.75, together with a warrant to purchase up to 87,400 additional shares of the Company's common stock. The warrants originally had a 4 year term and were exercisable at a price of \$4.50 per share.

In February 2009, the Company amended the warrants to a per share stock price of \$4.00 and extended the exercise term until July 31, 2009.

In May 2007 the Company closed a \$3,042,455 private placement with institutional investors. The Company sold 936,140 units at a price of \$3.25 per unit. Each unit consisted of one share of common stock and one-half warrant with a three year term and an exercise price of \$4.50 per share. The Company also issued 21,970 warrants with the same terms for investment banking services related to this transaction. See Note 19 for information concerning modifications to the terms of the warrants

The following table summarizes the Company's warrant activity for the three years ended December 30, 2009:

| | Number of shares | Exercise price per share | Weighted average exercise price |
|-------------------------------------|------------------|--------------------------|---------------------------------|
| Balance, December 31, 2007 and 2008 | 1,477,440 | \$ 4.50 | \$ 4.50 |
| Granted | — | — | — |
| Exercised | — | — | — |
| Cancelled/Expired | 987,400 | \$ 4.50 | \$ 4.50 |
| Balance, December 31, 2009 | 490,040 | \$ 4.50 | \$ 4.50 |

15. CAPITAL STOCK.

During the year ended December 31, 2009, the Company did not issue any stock. The Company cancelled 100,000 shares during the year ended December 31, 2009 (see Note 18).

During the year ended December 31, 2008, the Company issued 5,000 shares of common stock for services, recognizing an expense of \$5,900.

16. SEGMENTED, SIGNIFICANT CUSTOMER INFORMATION AND ECONOMIC DEPENDENCY.

The Company operates in two segments:

(a) Development and marketing of two lines of energy and water conservation products (as shown under the column heading “EWCP” below), which consists of a (i) liquid swimming pool blanket which saves energy and water by inhibiting evaporation from the pool surface, and (ii) food-safe powdered form of the active ingredient within the liquid blanket and which is designed to be used in still or slow moving drinking water sources.

(b) Manufacture of biodegradable polymers and chemical additives used within the petroleum, chemical, utility and mining industries to prevent corrosion and scaling in water piping (as shown under the column heading “TPA” below). These chemical additives are also manufactured for use in laundry and dish detergents, as well as in products to reduce levels of insecticides, herbicides and fungicides.

The Company’s traditional operating activities related to the production and sale of its energy conservation product line. Upon acquiring the Donlar assets, the Company formed NanoChem, which was formed as its wholly-owned subsidiary in exchange for the capital contribution necessary to purchase the Donlar assets. The assets the Company acquired from Donlar include domestic and international patents and business processes relating to the production of TPAs and other environmental products and technologies, as well as a manufacturing plant. These assets are currently used by NanoChem for its revenue-producing activities.

The accounting policies of the segments are the same as those described in Note 2, *Significant Accounting Policies*. The Company evaluates performance based on profit or loss from operations before income taxes, not including nonrecurring gains and losses and foreign exchange gains and losses.

The Company’s reportable segments are strategic business units that offer different, but synergistic products and services. They are managed separately because each business requires different technology and marketing strategies.

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Year ended December 31, 2009:

| | <u>EWCP</u> | <u>TPA</u> | <u>Total</u> |
|---------------------------------|-------------|--------------|--------------|
| Revenue | \$ 852,079 | \$ 8,931,417 | \$ 9,783,496 |
| Interest expense | 61,383 | 4,685 | 66,068 |
| Depreciation and amortization | 51,714 | 350,401 | 402,115 |
| Segment profit (loss) | (1,636,424) | 892,983 | (743,441) |
| Segment assets | 4,718,733 | 2,596,193 | 7,314,926 |
| Expenditures for segment assets | 1,236,204 | 39,515 | 1,275,719 |

Year ended December 31, 2008:

| | <u>EWCP</u> | <u>TPA</u> | <u>Total</u> |
|---------------------------------|--------------|--------------|---------------|
| Revenue | \$ 1,203,333 | \$ 9,553,321 | \$ 10,756,654 |
| Interest revenue | 2,358 | 125 | 2,483 |
| Interest expense | 14,563 | 4,133 | 18,696 |
| Depreciation and Amortization | 46,155 | 401,676 | 447,831 |
| Segment profit (loss) | (1,501,903) | 1,906,508 | 404,605 |
| Segment assets | 2,975,588 | 2,906,635 | 5,882,223 |
| Expenditures for segment assets | 1,709,979 | 36,552 | 1,746,531 |

Sales by territory are shown below:

| | <u>2009</u> | <u>2008</u> |
|--------------------------|---------------------|----------------------|
| Canada | \$ 309,502 | \$ 229,000 |
| United States and abroad | 9,473,994 | 10,527,654 |
| Total | \$ 9,783,496 | \$ 10,756,654 |

The Company's long-lived assets are located in Canada and the United States as follows:

| | <u>2009</u> | <u>2008</u> |
|---------------|--------------|--------------|
| Canada | \$ 4,943,238 | \$ 3,167,063 |
| United States | 2,596,193 | 2,909,651 |

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| | | |
|-------|--------------|--------------|
| Total | \$ 7,539,431 | \$ 6,076,714 |
|-------|--------------|--------------|

Three customers accounted for \$6,277,651 (64%) of sales made in the year (2008 - \$4,928,678 or 46%).

17. COMMITMENTS.

The Company is committed to minimum rental payments for property and premises aggregating approximately \$440,550 over the term of three leases, the last expiring on July 31, 2014.

F-21

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Future minimum lease payments in each of the next five years are as follows:

| | |
|------|------------|
| 2010 | \$ 159,639 |
| 2011 | \$ 87,611 |
| 2012 | \$ 72,478 |
| 2013 | \$ 75,417 |
| 2014 | \$ 45,406 |

18. Contingencies.

On July 23, 2004, the Company filed a lawsuit in the Circuit Court of Cook County, Illinois against Tatko Biotech Inc. ("Tatko"). The action arose from a Joint Product Development Agreement with 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 refused to collaborate on the agreement and the Company filed the lawsuit to have the court declare that Tatko was not entitled to the 100,000 shares of the Company's common stock. On January 4, 2008, the lawsuit was dismissed pursuant to an agreement by Tatko to treat the Joint Product Development Agreement as void. As a result of the dismissal of the lawsuit and the agreement of the parties, the 100,000 shares of restricted stock will be returned or cancelled.

On May 1, 2003, the Company filed a lawsuit in the Supreme Court of British Columbia, Canada, against John Wells and Equity Trust, S.A. seeking the return of 100,000 shares of the its common stock and the repayment of a \$25,000 loan which were provided to the defendants for investment banking services. The services were not performed and in the proceedings the Company sought the return of the shares and the repayment of the loan. On the date of issuance, the transaction was recorded as shares issued for services at a fair market value of \$0.80 per share. On April 30, 2009 the Supreme Court of British Columbia ruled in favor of the Company and ordered Equity Trust S.A. to return the 100,000 shares and repay the loan with interest (\$30,514US). The Company has reversed the expense recorded for the shares in the year ended December 31, 2009.

19. Subsequent Events.

Subsequent to the year ended December 31, 2009:

On January 1, 2010, the Company issued 94,000 stock options to employees and 61,000 stock options to consultants. The strike price varies from \$1.50 – 2.25 and all have a term of five years and a vesting date of December 31, 2010.

In February 2010, the Company amended the terms of 490,040 warrants that were originally granted in May 2007. The price changed from \$4.50 to \$3.00 share and the warrants will now expire on December 31, 2010

21. Comparative Figures

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

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

On January 4, 2010, Cinnamon Jang Willoughby & Company (“CJW”) resigned as our independent registered public accounting firm as CJW was merged with Meyers Norris Penny LLP, Chartered Accountants (“MNP”). Most of the professional staff of CJW continued with MNP either as employees or partners of MNP and will continue their practice with MNP. On March 19, 2010, we, through and with the approval of our Board of Directors, engaged MNP as our independent registered public accounting firm.

Prior to engaging MNP, we did not consult with MNP regarding the application of accounting principles to a specific completed or contemplated transaction or regarding the type of audit opinions that might be rendered by MNP on our financial statements, and MNP did not provide any written or oral advice that was an important factor considered by us in reaching a decision as to any such accounting, auditing or financial reporting issue.

The reports of CJW regarding our financial statements for the fiscal years ended December 31, 2008 and 2007 did not contain any adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. During the years ended December 31, 2009 and 2008, and during the period from December 31, 2009 through January 4, 2010 there were no disagreements with CJW on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of CJW would have caused it to make reference to such disagreement in its reports.

Item 9A. Controls and Procedures.

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

As of the end of the period covered by this Annual Report on Form 10-K for the year ended December 31, 2009, 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.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. As defined by the Securities and Exchange Commission, internal control over financial reporting is a process designed by, or under the supervision of our principal executive officer and principal financial officer and implemented by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements in accordance with U.S. generally accepted accounting principles.

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Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of our financial statements in accordance with U.S. generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In connection with the preparation of our annual financial statements, management has undertaken an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, or the COSO Framework. Management's assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of those controls.

Based on this evaluation, management has concluded that our internal control over financial reporting was effective as of December 31, 2009.

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.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only management's report on internal control in this annual report.

Item 9B. Other Information.

None.

Item 10. Directors, Executive Officers and Corporate Governance.

| Name | Age | Position |
|-----------------------|-----|---------------------|
| Daniel B. O'Brien | 53 | President, Director |
| John H. Bientjes | 56 | Director |
| Dr. Robert N. O'Brien | 88 | Director |
| Dale Friend | 55 | Director |
| Eric Hodges | 60 | Director |

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

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

Dr. Robert N. O'Brien has been a director since June 1998. Dr. O'Brien was a Professor of Chemistry at the University of Victoria from 1968 until 1986 at which time he was given the designation of Professor Emeritus. He held various academic positions since 1957 at the University of Alberta, the University of California at Berkley, and the University of Victoria. While teaching, Dr. O'Brien acted as a consultant and served on the British Columbia Research Council from 1968 to 1990. In 1987, Dr. O'Brien founded the Vancouver Island Advanced Technology and Research Association. Dr. O'Brien received his Bachelor of Applied Science in Chemical Engineering from the University of British Columbia in 1951; his Masters of Applied Science in Metallurgical Engineering from the University of British Columbia in 1952; his Ph.D. in Metallurgy from the University of Manchester in 1955; and was a Post Doctoral Fellow in Pure Chemistry at the University of Ottawa from 1955 through 1957. Dr. O'Brien is the father of Daniel B. O'Brien.

Dale Friend has been a director since December 2002. She has a diversified background in the area of accounting and her experience has been primarily in business, offering a wide range of accounting knowledge. Ms. Friend has worked for a number of companies in their accounting departments, including Novas Capital Corp. and DB Perks & Associates.

Eric Hodges has been a director since September 2004. Mr. Hodges is an accountant from Victoria who has over three decades of experience. He received his financial education from the University of Washington in Seattle where he played for the Huskies football program. Mr. Hodges continued playing football after college, with a successful, multiyear professional career with the British Columbia Lions of the Canadian Football League. In the past five years, Mr. Hodges has owned and operated Eric G. Hodges & Associates, a Victoria-based accounting firm with both Canadian and U.S. clientele. Mr. Hodges is extremely familiar with both Canadian and United States generally accepted accounting principles ("GAAP"), since he has clients in both countries. Furthermore, his wide range of experience with small and quickly growing companies is an asset to the board of directors.

Directors are elected annually and hold office until the next annual meeting of our stockholders and until their successors are elected and qualified. There have been no material changes to the

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procedures by which security holders may recommend nominees to our board of directors. All executive offices are chosen by the board of directors and serve at the board's discretion.

John Bientjes, Dale Friend, and Eric Hodges are independent directors as that term is defined in section 803 of the listing standards of the NYSE AMEX.

Our Audit Committee, consisting of John Bientjes, Dale Friend and Eric Hodges, all of whom are independent directors and have strong financial backgrounds, facilitates and maintains open communications with our board of directors, senior management and our independent auditors. Our Audit Committee also serves as an independent and objective party to monitor our financial reporting process and internal control system. In addition, our Audit Committee reviews and appraises the efforts of our independent auditors. Our Audit Committee meets periodically with management and our independent auditors. Mr. Bientjes meets the SEC's definition of audit committee financial expert. Each member of the Audit Committee is "independent" as that term is defined in Section 803 of the listing standards of the NYSE AMEX.

Our Compensation Committee, consisting of John Bientjes, Dale Friend and Eric Hodges, establishes salary, incentive and other forms of compensation for our Chief Executive Officer and administers our Stock Option Program. None of our officers participated in deliberations of the compensation committee concerning executive officer compensation. During the year ended December 31, 2009, no director was also an executive officer of another entity, which had one of our executive officers serving as a director of such entity or as a member of the compensation committee of such entity.

We have adopted a Code of Ethics that applies to our Chief Executive Officer, our Chief Financial Officer and our Principal Accounting Officer, as well as our other senior management and financial staff. Interested persons may also obtain a copy of our Code of Ethics from our website at www.flexiblesolutions.com.

Item 11. Executive Compensation. **Summary Compensation Table**

The following table shows in summary form the compensation earned by (i) our Chief Executive Officer and (ii) by each other executive officer who earned in excess of \$100,000 during the two fiscal years ended December 31, 2009.

| Name and Principal Position | Fiscal Year | Salary (1) | Bonus (2) | Restricted Stock Awards (3) | Options Awards (4) | All Other Annual Compensation (5) | Total |
|---------------------------------------|-------------|------------|-----------|-----------------------------|--------------------|-----------------------------------|------------|
| Daniel B. O'Brien | 2009 | \$ 177,000 | — | — | — | — | \$ 177,000 |
| President and Chief Executive Officer | 2008 | \$ 112,492 | — | — | — | — | 112,492 |

(1) The dollar value of base salary (cash and non-cash) earned.

(2) The dollar value of bonus (cash and non-cash) earned.

- (3) During the periods covered by the table, the value of the shares of restricted stock issued as compensation for services to the persons listed in the table.
- (4) The value of all stock options granted during the periods covered by the table.
- (5) All other compensation received that we could not properly report in any other column of the table.

Stock Option Program

Our Stock Option Program involves the issuance of options, from time to time, to our employees, directors, officers, consultants and advisors. Options are granted by means of individual option agreements. Each option agreement specifies the shares issuable upon the exercise of the option, the exercise price and expiration date and other terms and conditions of the option.

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

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

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

All options expire between one and five years after the date of grant and reflect exercise prices equal to the fair market value of a share of our common stock as determined by our board of directors on the date of grant. All of the options contain vesting provisions pursuant to which the options are 100% exercisable within a fixed number of months after the date of grant.

All option grants made during a fiscal year are submitted for shareholder approval at the next annual shareholder meeting. To date, our shareholders have approved all of the grants.

The following table shows the weighted average exercise price of the outstanding options granted pursuant to our Stock Option Program as of December 31, 2009, our most recently completed fiscal year.

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) |
|----------------------|---|--|---|
| | (a) | (b) | (c) |
| Stock Option Program | 1,546,700 | \$ 3.25 | Not Applicable |
| Total | 1,546,700 | \$ 3.25 | |

As of December 31, 2009 options to purchase 1,546,700 shares of our common stock were outstanding under our Stock Option Program. The exercise price of these options varies between \$2.25 and \$3.85 per share. The options expire at various dates between May 1, 2010 and January 1, 2014.

The following tables show, during the fiscal year ended December 31, 2009, the options granted to, and the options exercised and held by, the persons named below. All options were granted pursuant to our Stock Option Program.

Options Granted

| Name | Grant Date | Options Granted (#) | Exercise Price Per Share | Expiration Date |
|----------------|---------------|---------------------------|--------------------------------|--------------------|
| Daniel O'Brien | — | — | — | — |

Options Exercised

| Name | Shares Acquired On Exercise (1) | Value Realized (2) |
|----------------|---|--------------------------|
| Daniel O'Brien | — | — |

(1) The number of shares received upon exercise of options during the fiscal year ended December 31, 2009.

(2) With respect to options exercised during the fiscal year ended December 31, 2009, the dollar value of the difference between the option exercise price and the market value of the option shares purchased on the date of the exercise of the options.

| Name | Shares underlying unexercised options which are: | Exercise Price | Expiration Date |
|------|--|-------------------|--------------------|
| | | | |

| | <u>Exercisable</u> | <u>Unexercisable</u> | | |
|----------------|--------------------|----------------------|------|----------|
| Daniel O'Brien | 400,000 | — | 3.25 | 01/05/11 |
| | — | 100,000 | 3.25 | 01/05/11 |
| | | 6 | | |

Director Compensation

We reimburse directors for any expenses incurred in attending board meetings. We also compensate directors \$2,000 annually and grant our directors options to purchase shares of our common stock each year that they serve.

Our directors received the following compensation in 2009:

| Name | Paid in Cash | Stock Awards (1) | Option Awards (2) |
|-------------------|--------------|---------------------|----------------------|
| Robert N. O'Brien | — | — | — |
| John H. Bientjes | \$ 2,000 | — | \$ 5,032 |
| Dale Friend | \$ 2,000 | — | \$ 5,032 |
| Eric Hodges | \$ 2,000 | — | \$ 5,032 |

(1) The fair value of stock issued for services computed in accordance with FAS 123R on the date of grant.

(2) The fair value of options granted computed in accordance with FAS 123R on the date of grant. The terms of outstanding options granted to our directors are shown below.

| Name | Option Price | No. of Options | Expiration Date |
|-------------------|--------------|----------------|-------------------|
| Robert N. O'Brien | \$3.25 | 250,000 | January 5, 2011 |
| John H. Bientjes | \$3.25 | 5,000 | January 5, 2011 |
| John H. Bientjes | \$3.60 | 5,000 | December 18, 2012 |
| John H. Bientjes | \$3.60 | 5,000 | January 31, 2013 |
| John H. Bientjes | \$2.25 | 5,000 | January 1, 2014 |
| Dale Friend | \$3.25 | 5,000 | January 5, 2011 |
| Dale Friend | \$3.60 | 5,000 | December 18, 2012 |
| Dale Friend | \$3.60 | 5,000 | January 31, 2013 |
| Dale Friend | \$2.25 | 5,000 | January 1, 2014 |
| Eric Hodges | \$3.25 | 5,000 | January 5, 2011 |
| Eric Hodges | \$3.60 | 5,000 | December 18, 2012 |
| Eric Hodges | \$3.60 | 5,000 | January 31, 2013 |
| Eric Hodges | \$2.25 | 5,000 | January 1, 2014 |

Daniel B. O'Brien is not compensated for serving as a director.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The following table shows the beneficial ownership of our common stock as of March 10, 2009 by (i) each stockholder who is known by us to own beneficially more than five percent of our outstanding common stock, (ii) each of our officers and directors, and (iii) by all of our executive officers and directors as a group.

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| | Shares (1) | Percentage Ownership |
|---|------------|----------------------|
| Daniel B. O'Brien 2614 Queenswood Dr. Victoria, BC Canada V8N 1X5 | 5,021,900 | 36.0% |
| Dr. Robert N. O'Brien 2614 Queenswood Dr. Victoria, BC Canada V8N 1X5 | 2,025,000 | 14.5% |
| John Bientjes #1-230 West 13th Street North Vancouver, B.C. Canada V7M 1N7 | 35,000 | 0.3% |
| Dale Friend 3009 E. Kent Ave. Vancouver, BC Canada V5S 4P6 | 20,000 | 0.1% |
| Eric Hodges #110 - 4252 Commerce Circle Victoria, BC V8Z 4M2 | 20,000 | 0.1% |
| All officers and directors as a group (5 persons) | 7,121,900 | 51.0% |

(1) Includes shares which may be acquired on the exercise of the stock options, all of which were exercisable as of December 31, 2009, listed below.

| Name | No. of Options | Exercise Price | Expiration Date |
|----------------|----------------|----------------|-----------------|
| Daniel O'Brien | 100,000 | \$3.25 | January 5, 2011 |
| | 100,000 | \$3.25 | January 5, 2011 |
| | 100,000 | \$3.25 | January 5, 2011 |
| | 100,000 | \$3.25 | January 5, 2011 |

| <u>Name</u> | <u>No. of Options</u> | <u>Exercise Price</u> | <u>Expiration Date</u> |
|--------------------|-----------------------|-----------------------|------------------------|
| Dr. Robert O'Brien | 50,000 | \$3.25 | January 5, 2011 |
| | 50,000 | \$3.25 | January 5, 2011 |
| | 50,000 | \$3.25 | January 5, 2011 |
| | 50,000 | \$3.25 | January 5, 2011 |
| John Bientjes | 5,000 | \$3.25 | January 5, 2011 |
| | 5,000 | \$3.60 | December 18, 2012 |
| | 5,000 | \$3.60 | January 31, 2013 |
| | 5,000 | \$2.25 | January 1, 2014 |
| Dale Friend | 5,000 | \$3.25 | January 5, 2011 |
| | 5,000 | \$3.60 | December 18, 2012 |
| | 5,000 | \$3.60 | January 31, 2013 |
| | 5,000 | \$2.25 | January 1, 2014 |
| Eric Hodges | 5,000 | \$3.25 | January 5, 2011 |
| | 5,000 | \$3.60 | December 18, 2012 |
| | 5,000 | \$3.60 | January 31, 2013 |
| | 5,000 | \$2.25 | January 1, 2014 |

Item 13. Certain Relationships and Related Transactions, Director Independence.

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

Item 14. Principal Accountant Fees and Services.

Meyers Norris Penny LLP, Chartered Accountants ("MNP") examined our financial statements for the year ended December 31, 2009. Cinnamon Jang Willoughby & Company, now named Meyers Norris Penny LLP ("CJW"), examined our financial statements for the year ended December 31, 2008.

Audit Fees

CJW was paid \$51,596 and \$51,596 for the for the fiscal years ended December 31, 2009 and 2008, respectively, for professional services rendered in the audit of our annual financial statements and for the reviews of the financial statements included in our quarterly reports on Form 10-Q during these fiscal years.

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Audit-Related Fees

CJW was paid \$7,130 and \$7,130 for the fiscal years ended December 31, 2009 and 2008, respectively, for the audit or review of our financial statements. Since we did not engage MNP until March 2010, MNP did not bill us for any services during the year ended December 31, 2009.

Tax Fees

CJW was paid \$28,143 and \$28,143 for the fiscal years ended December 31, 2009 and 2008, respectively, for professional services rendered for the preparation and filing of our income tax returns for the fiscal years ended December 31, 2007 and 2006.

All Other Fees

CJW was paid no other fees for professional services during the fiscal years ended December 31, 2009 and 2008.

Audit Committee Pre-Approval Policies

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

During the year ended December 31, 2009 our Audit Committee approved all of the fees paid to CJW. Our Audit Committee has determined that the rendering of all other non-audit services by CJW is compatible with maintaining CJW's independence. During the year ended December 31, 2009, none of the total hours expended on our financial audit by CJW were provided by persons other than CJW's full-time permanent employees.

Item 15. Exhibits, Financial Statement Schedules.

| <u>Number</u> | <u>Description</u> |
|---------------|--|
| 3.1 | Articles of Incorporation of the Registrant. (1) |
| 3.2 | Bylaws of the Registrant. (1) |
| 21.1 | Subsidiaries. (2) |
| 23.1 | Consent of Independent Accountants. |
| 31.1 | Certification of Principal Executive Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002. |

| <u>Number</u> | <u>Description</u> |
|---------------|--|
| 31.2 | Certification of Principal Financial Officer Pursuant to §302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Principal Executive Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Principal Financial Officer Pursuant to 18 U.S.C. §1350 and §906 of the Sarbanes-Oxley Act of 2002. |
| (1) | Previously filed as an exhibit to our Registration Statement on Form 10-SB filed with the Commission on February 22, 2000, and incorporated herein by reference. |
| (2) | Previously filed as an exhibit to our Registration Statement on Form SB-2 filed with the Commission on January 22, 2003, and incorporated herein by reference. |

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: March 30, 2010.

FLEXIBLE SOLUTIONS INTERNATIONAL, INC.

By: /s/ Daniel B. O'Brien

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

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

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|---|----------------|
| /s/ Daniel B. O'Brien _____ Daniel B. O'Brien | President, Chief Executive Officer, Principal Financial and Accounting Officer and a Director | March 30, 2010 |
| /s/ John H. Bientjes _____ John H. Bientjes | Director | March 30, 2010 |
| /s/ Robert N. O'Brien _____ Robert N. O'Brien | Director | March 30, 2010 |
| /s/ Dale Friend _____ Dale Friend | Director | March 30, 2010 |
| /s/ Eric G. Hodges _____ Eric G. Hodges | Director | March 30, 2010 |