

U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended **MARCH 31, 2002**

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

Commission file number 33-3362-D

KLEENAIR SYSTEMS, INC.

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

State of Nevada

(State or other jurisdiction of
incorporation or organization)

87-0431043

(I.R.S. Employer
Identification #)

1711 Langley Avenue, Irvine CA 92614

(Address of principal executive offices)

(949) 955-3492

(Registrant's telephone number)

There were 16,425,162 shares of common stock, \$0.001 Par Value,
outstanding as of April 15, 2002.

Transitional Small Business Disclosure Format (check one); Yes ☐ No ☒

PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

REPORT ON REVIEW BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors,
KleenAir Systems, Inc.
Irvine, CA

We have reviewed the accompanying balance sheet of KleenAir Systems, Inc. (a development stage enterprise) (the "Company") as of March 31, 2002, and the related statements of operations, stockholders' equity, and cash flows for the three months ended March 31, 2002 and 2001. We have also reviewed the cumulative statements of operations, stockholders' equity and cash flows for the period from January 1, 1995 through March 31, 2002. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical review procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the balance sheet as of December 31, 2001, and the related statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein); and, in our report dated April 9, 2002, we expressed an opinion on those financial statements that was qualified based on the Company's ability to continue as a going concern. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2000 is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ Robert Early & Company
ROBERT EARLY & COMPANY, P.C.
Abilene, Texas

May 16, 2002

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
BALANCE SHEETS

	March 31, 2002 <u>Unaudited</u>	December 31, 2001 <u></u>
ASSETS		
CURRENT ASSETS:		
Cash	\$ 624,092	\$ 33,479
Accounts receivable	1,600	1,600
Note receivable	120,000	-
Prepaid expenses	<u>139,714</u>	<u>119,862</u>
Total Current Assets	885,406	154,941
 PROPERTY AND EQUIPMENT (net)	 63,999	 55,237
 OTHER ASSETS:		
Patent license	<u>161,858</u>	<u>152,781</u>
 TOTAL ASSETS	 <u>\$ 1,111,263</u>	 <u>\$ 362,959</u>
 LIABILITIES AND STOCKHOLDER'S EQUITY		
CURRENT LIABILITIES:		
Accounts payable (\$71,615 and \$74,899 due to related parties, respectively)	\$ 107,997	\$ 95,931
Advances from directors	<u>95,850</u>	<u>95,850</u>
 Total Current Liabilities	 <u>203,847</u>	 <u>191,781</u>
 STOCKHOLDERS' EQUITY:		
Preferred stock, series A, \$.001 par value (10,000,000 shares authorized, none outstanding)		
Common stock, \$.001 par value (50,000,000 shares authorized, 16,425,162 and 15,391,069 outstanding, respectively)	16,425	15,391
Additional paid-in capital	4,789,662	3,857,649
Deficit accumulated during the development stage	<u>(3,898,671)</u>	<u>(3,701,862)</u>
 Total Stockholder's Equity	 <u>907,416</u>	 <u>171,178</u>
 TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	 <u>\$ 1,111,263</u>	 <u>\$ 362,959</u>

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
STATEMENTS OF OPERATIONS
For Three Months Ended March 31, 2002 and 2001

	2002	2001	Cumulative During Devel- opment Stage
REVENUES:			
Sale of product license	\$ -	50,000	\$ 119,188
Services	-	3,000	4,600
Total Revenues	<u>-</u>	<u>53,000</u>	<u>123,788</u>
PRODUCT DEVELOPMENT COSTS	<u>61,948</u>	<u>29,968</u>	<u>766,646</u>
OPERATING EXPENSES:			
Personnel costs and director fees	-	-	582,602
Consultants	45,873	-	1,650,618
Professional fees	5,012	1,207	238,427
Office expenses	654	-	26,279
Depreciation	4,190	3,710	32,441
Advertising and promotion	45,142	89,063	199,354
Loss on cancellation of licensing agreements	-	-	19,860
Rent	7,500	7,500	58,750
Other expenses	26,491	14,940	150,674
Unknown sources prior to current ownership	-	-	151,518
Total operating expenses	<u>134,862</u>	<u>116,420</u>	<u>3,110,523</u>
(LOSS) FROM OPERATIONS	(196,810)	(93,388)	(3,753,381)
OTHER INCOME AND (EXPENSES):			
Interest income	1	49	2,501
Amortization of discount on receivables	<u>-</u>	<u>-</u>	<u>20,259</u>
(Loss) Before Extraordinary Item	(196,809)	(93,339)	(3,730,621)
Extraordinary Item:			
Costs of terminated acquisition	<u>-</u>	<u>-</u>	<u>(168,050)</u>
Net (Loss)	<u>\$ (196,809)</u>	<u>\$ (93,339)</u>	<u>\$ (3,898,671)</u>
Basic earnings per share:			
(Loss) Per Share Before Extraordinary Item	\$ (0.01)	\$ (0.01)	\$ (0.67)
(Loss) Per Share From Extraordinary Item	-	-	(0.03)
Net (Loss) Per Share	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.70)</u>
Weighted Average Shares Outstanding	<u>16,030,815</u>	<u>12,579,082</u>	<u>5,603,639</u>

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional</u>	<u>Unearned</u>	<u>Accumulated</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Paid-In</u>	<u>Compensation</u>	<u>Deficit During</u>
					<u>Capital</u>		<u>Development</u>
							<u>Stage</u>
BALANCES, 1/1/95	-	\$ -	74,132	\$ 74	\$ 151,444	\$ -	\$ (151,518)
Stock issued for cash	-	-	27,334	27	66,982	-	-
For adjustment	-	-	534	1	-	-	-
For consulting services	-	-	86,148	86	279,439	-	-
For professional services	-	-	4,666	5	12,745	-	-
For purchase of patent rights	933,334	934	60,000	60	13,905	-	-
For directors' compensation	-	-	4,000	4	22,496	-	-
For officers' compensation	33,334	33	9,334	9	194,958	-	-
Other contributed capital	-	-	-	-	2,367	-	-
Options compensation	-	-	-	-	70,313	(152,016)	-
Net loss	-	-	-	-	-	-	(329,289)
BALANCES, 12/31/95	966,668	967	266,148	266	814,649	(152,016)	(480,807)
Stock issued for services	13,332	13	24,666	25	201,837	(78,750)	-
For officers' compensation	33,332	33	-	-	15,592	(15,625)	-
For aborted acquisition	-	-	40,000	40	140,510	-	-
Exercise of options	-	-	75,000	75	112,424	-	-
Conversion to common	(318,666)	(319)	318,666	319	-	-	-
Net Loss	-	-	-	-	-	187,346	(716,511)
BALANCES, 12/31/96	694,666	694	724,480	725	1,285,012	(59,045)	(1,197,318)
Stock issued for cash	-	-	120,000	120	14,880	-	-
For officers' compensation	33,334	33	-	-	3,842	(3,875)	-
Conversion to common	(100,000)	(100)	100,000	100	-	-	-
Net loss	-	-	-	-	-	37,979	(55,438)
BALANCES, 12/31/97	628,000	627	944,480	945	1,303,734	(24,941)	(1,252,756)

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See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY

(Continued from previous page)

	Preferred Stock		Common Stock		Additional	Unearned	Accumulated
	Shares	Amount	Shares	Amount	Paid-In Capital	Compensation	Deficit During Development Stage
Stock issued for cash	-	-	800,000	800	199,200	-	-
For services	-	-	2,120,000	2,120	92,255	-	-
For officer/director services	-	-	320,000	320	59,680	-	-
For diesel license	-	-	2,000,000	2,000	60,500	-	-
Conversion to common	(403,334)	(403)	403,334	403	-	-	-
Net loss	-	-	-	-	-	24,941	(305,561)
BALANCES, 12/31/98	224,666	224	6,587,814	6,588	1,715,369	-	(1,558,317)
Stock issued for cash	-	-	146,800	147	35,653	-	-
For services	-	-	1,103,334	1,103	247,179	-	-
For equipment	-	-	33,200	33	8,267	-	-
For officer/director services	-	-	1,425,000	1,425	408,808	-	-
Conversion to common	(61,334)	(61)	61,334	61	-	-	-
Net loss	-	-	-	-	-	-	(802,722)
BALANCES, 12/31/99	163,332	163	9,357,482	9,357	2,415,276	-	(2,361,039)
Stock issued for cash	-	-	1,414,000	1,414	357,336	-	-
For services	-	-	1,642,666	1,643	600,024	-	-
As promotion	-	-	1,600	2	3,199	-	-
Conversion to common	(163,332)	(163)	163,334	163	-	-	-
Net loss	-	-	-	-	-	-	(717,012)
BALANCES, 12/31/00	-	-	12,579,082	12,579	3,375,835	-	(3,078,051)

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY

(Continued from previous page)

	Preferred Stock		Common Stock		Additional	Unearned	Accumulated
	Shares	Amount	Shares	Amount	Paid-In Capital	Compen- sation	Deficit During Development Stage
Stock issued for cash	-	-	195,000	195	104,805	-	-
For services	-	-	1,749,487	1,749	293,087	-	-
For officer/director services	-	-	850,000	850	77,690	-	-
For rent	-	-	17,500	18	6,232	-	-
Net loss	-	-	-	-	-	-	(623,811)
BALANCES, 12/31/01	-	-	15,391,069	15,391	3,857,649	-	(3,701,862)
Stock issued for cash	-	-	1,000,000	1,000	899,000	-	-
For services	-	-	34,093	34	33,013	-	-
Net loss	-	-	-	-	-	-	(196,809)
BALANCES, 03/31/02	-	\$ -	16,425,162	\$ 16,425	\$ 4,789,662	\$ -	\$ (3,898,671)

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
STATEMENTS OF CASH FLOWS
For Three Months Ended March 31, 2002 and 2001

	<u>2001</u>	<u>2000</u>	<u>Cumulative During Devel- opment Stage</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss)	\$ (196,809)	\$ (93,339)	\$ (3,898,671)
Adjustments to reconcile net income/(loss) to net cash provided by operations:			
Losses prior to current ownership	-	-	151,518
Depreciation	4,190	3,710	32,441
Amortization of:			
Prepaid expenses	39,688	89,063	707,846
Deferred services	-	-	250,267
Stock issued for services	33,047	-	1,594,005
Stock issued for extraordinary loss	-	-	140,550
Changes in operating assets and liabilities:			
Accounts and note receivable	(120,000)	10,380	(121,600)
Advances to consultants	-	-	20,000
Prepaid expenses	(59,540)	-	(260,340)
Trade accounts payable	12,066	(21,225)	107,997
NET CASH USED BY OPERATING ACTIVITIES	<u>(287,358)</u>	<u>(11,411)</u>	<u>(1,275,987)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Property and equipment	(12,952)	(1,428)	(88,139)
Patent licensing costs	(9,077)	(2,298)	(84,458)
NET CASH USED IN INVESTING ACTIVITIES	<u>(22,029)</u>	<u>(3,726)</u>	<u>(172,597)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuing stock	900,000	-	1,974,459
Additional capital contributions	-	-	2,367
Advances from directors	-	-	95,850
NET CASH PROVIDED BY FINANCING ACTIVITIES	<u>900,000</u>	<u>-</u>	<u>2,072,676</u>
NET INCREASE/(DECREASE) IN CASH	590,613	(15,137)	624,092
CASH AT BEGINNING OF YEAR	<u>33,479</u>	<u>24,365</u>	<u>-</u>
CASH AT END OF PERIOD	<u><u>\$ 624,092</u></u>	<u><u>\$ 9,228</u></u>	<u><u>\$ 624,092</u></u>
SUPPLEMENTAL DISCLOSURES:			
Cash payments for:			
Interest	\$ -	\$ -	\$ -
Income taxes	-	-	-
Non-cash investing and financing transactions:			
Stock issued for:			
Compensation and directors fees	-	-	648,108
Services and prepaid services	33,047	-	1,498,782
Equipment	-	-	8,300
Patent licensing	-	-	14,900
Repurchase of U.S. diesel license	-	-	62,500
Acquisition of National Diversified Telecom, Inc.	-	-	140,550
Sale of marketing licenses for notes receivable	-	-	1,736,558

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Enterprise)
SELECTED INFORMATION FOR FINANCIAL STATEMENTS
March 31, 2002
(Unaudited)

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions of Regulation S-B. They do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, except as disclosed herein, there has been no material change in the information included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2001. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The report of Robert Early & Company, P.C. commenting on their review accompanies the condensed financial statements included in Item 1 of Part 1. Operating results for the three-month period ended March 31, 2002, are not necessarily indicative of the results that may be expected for the year ending December 31, 2002.

NOTE 2: PROPERTY AND EQUIPMENT

The Company has purchased testing equipment, test vehicles, and office equipment and furniture as presented in the following table. Depreciation expense for the first quarter of 2002 and 2001 was \$4,190 and \$3,710, respectively.

Office furniture and equipment	\$ 10,369
Test vehicle	5,750
Analysis equipment	<u>80,322</u>
	96,441
Accumulated depreciation	<u>(32,442)</u>
Net property & equipment	<u>\$ 63,999</u>

NOTE 3: PREPAID EXPENSES AND AMORTIZATION

The Company frequently prepaids for services to be rendered either in cash or by stock issuance. These transactions are recorded as prepaid expenses and amortized over the period covered by the agreement. During the current periods presented, these amortization costs have been included in advertising and promotion, although this is not necessarily true for the cumulative amounts presented. Amortization totaled \$39,688 and \$89,063 in the three months ended March 31, 2002 and 2001, respectively.

NOTE 4: SALE OF LICENSE

During the first quarter of 2001, the Company sold certain marketing licenses regarding patents to its new carburetor to Ecologic, LLC for \$50,000.

NOTE 5: STOCK TRANSACTIONS

During the first quarter of 2002, the Company issued a total of 14,093 restricted shares valued at \$10,697 for research and development services and sales promotion. Another 20,000 unrestricted S-8 shares valued at \$22,350 were issued to a consultant for business promotion. The Company also sold 1,000,000 shares for \$900,000 pursuant to a private placement.

NOTE 6: NOTE RECEIVABLE

During the first quarter of 2002, the Company lent \$120,000 to a licensee. This loan is expected to be repaid during the second quarter.

NOTE 7: SUBSEQUENT EVENTS

During April 2002, the Company completed negotiations to acquire Carbon Cloth Technologies, Inc., a California corporation ("CCT"). CCT is a manufacturer of automotive thermal management systems. Its Carbon Guard(TM) product is currently installed on a number of New York City Transit Authority buses as enhancements for the operating efficiency of particulate traps. It is expected that this product will generate meaningful revenues during the balance of this year and make a significant contribution to the Company's overhead expense. It is also expected that there will be a synergy of sales from the combination of presentations for the Company's emission control device and CCT's products.

CCT began sales of its products during the fourth quarter of 2001. Prior to that time, it had spent several years developing and testing its products for racing applications before porting its products to commercial uses.

The Company is issuing a total of 1,000,000 shares for this acquisition. Out of this total, 166250 shares are to be issued pursuant to employment and consulting agreements.

This acquisition was reported on a Form 8-K dated April 30, 2002 and filed on May 14, 2002. As stated in that filing, financial statements and pro forma combined financial information will be presented in an amendment filed on or before July 15, 2002.

Item 2. Management's Discussion and Plan of Operation

The Company was incorporated under the laws of the State of Nevada on February 4, 1986, under the name of Covington Capital Corporation.

In April, 1995, under the name Investment and Consulting International, Inc., the Company acquired a patent for a proprietary device, designed to neutralize nitrogen oxide in automobile emissions, from a separate company which was then known as KleenAir Systems, Inc. Simultaneously with the acquisition of the patent, the Company acquired the right to use the corporate name KleenAir Systems, Inc.

Since acquiring the patent in 1995, the Company has been a developmental stage company and has worked towards the completion of the development and testing of the NOxMaster® technology. This technology is protected by the following patents which are owned by the Company: US Patent # 5,224,346 issued in 1993, US Patent # 5,609,026 issued in 1997 and, US Patent # 5,992,141 issued in 1999.

The Company has applied for and maintained patent protection under the Patent Cooperation Treaty (PCT) to protect its intellectual property in a variety of countries that are significant producers of automotive products. Patent awards have now been confirmed for the following countries in Europe: the UK, Germany, France, Italy, Spain, and Sweden. Further patent awards for Japan, Brazil and China are expected soon.

The Company has applied for additional patents related to its NOxMaster® technology and in addition has applied for a patent on a new emission control device, the Sonic Flow Carburetor, which atomizes fuel on gasoline powered engines, enhancing operating efficiency and reducing emissions.

The Company has recently leased new 10,000 square foot R & D facilities at 1711 Langley, Irvine, CA 92614. The Company has also acquired a new chassis dynamometer in addition to its engine dynamometer to cope with increasing levels of R & D engine and device testing programs as it prepares for commercializing its technology.

The Company is in the final phase of its London Taxi Testing Program funded by a U.K. government grant. This in-service test involving four London taxicabs started in January 2002 and is expected to be completed in September 2002.

Test systems have also been installed on a Dennis refuse collection truck and a Mercedes-Benz Sprinter 16 passenger bus, both operated by the Borough of Hounslow in London. A U.K. government grant has also been awarded for a test and evaluation program on both these vehicles.

NOxMaster® systems have also been ordered by four other London Boroughs for test and evaluation and are expected to be installed by the end of June 2002 on both refuse collection trucks and buses.

U.S. testing continues of the NOxMaster® Diesel Catalytic Converter together with its NOxMaster® Ammonia Injection System to present an integrated system for the elimination of emissions from diesel powered mobile sources.

The Company's technology was successfully tested by the City of Houston along with a number of competing technologies with the results being published in February 2002. A level of 82% NOx reduction and 92% particulate reduction was achieved. The tests were conducted by the Company for its licensee Extengine Transport Systems under the brand name ADEC.

The Company has received an EO certification from the California Air Resources Board (CARB) for off-road and stationary engine applications, which will enable it to commence sales of its products in California. EO certification for on-road applications is expected shortly.

The Company is preparing to meet CARB and EPA Retrofit Verification requirements for heavy-duty vehicles on its NOxMaster® NOx reduction system. It will also seek certification of the combination package of its Oxidizing Particulate Trap (OPT) with the NOxMaster® for high particulate reduction as well as high NOx reduction.

The Company has acquired Carbon Cloth Technologies, Inc. ("CCT"), of Malibu, California. CCT is a manufacturer

of automotive thermal management systems which technology is complementary to the Company's existing technology. Its Carbon Guard™ is currently installed on a number of New York City Transit Authority buses as enhancements for the operating efficiency of its installed base of particulate traps. It is expected that this product will generate meaningful revenues during the balance of this year and make a significant contribution to the Company's overhead expense.

The Company is actively seeking sources of funding for its operating capital requirements both to complete its test and evaluation programs and to support initial sales and production.

The Company is negotiating potential licensing and other commercial arrangements with certain international companies in the automotive industry, subject to completion of satisfactory test and evaluation programs.

Disclosure Regarding Forward-Looking Statements

Where this Form 10-QSB includes "forward-looking" statements within the meaning of Section 27A and Section 21E of the Securities Act, the Company desires to take advantage of the "safe harbor" provisions thereof. Therefore, the Company is including this statement for the express purpose of availing itself of the protections of such safe harbor provisions with respect to all of such forward-looking statements. The forward-looking statements in this Form 10-QSB reflect the Company's current views with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ from those anticipated. These risks include, but are not limited to, economic conditions, changes in environmental regulations, the market for venture capital, etc. In this Form 10-QSB, the words "anticipates," "believes," "expects," "intends," "future" and similar expressions identify forward-looking statements. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that may arise after the date hereof. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by this section.

PART II - OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.

Exhibit 23 --- Consent to incorporation by reference

Report on Form 8-K --- A Form 8-K dated April 30, 2002 reported that the Registrant had completed negotiations and signed an agreement to acquire Carbon Cloth Technologies, Inc. (a California Corporation) effective April 30, 2002. Financial statements for Carbon Cloth and pro forma combined financial information are to be filed with an amendment to the Form 8-K.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KLEENAIR SYSTEMS, INC.

Date: May 17, 2002

/s/ LIONEL SIMONS
By: Lionel Simons, President,
Secretary, Principal Accounting Officer, &
Principal Financial Officer