

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended **JUNE 30, 2003**

☐ [] 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)

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

There were 22,014,362 shares of common stock, \$0.001 Par Value,
outstanding as of August 4, 2003.

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

KLEENAIR SYSTEMS, INC.

FORM 10-QSB

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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 consolidated balance sheet of KleenAir Systems, Inc. (a development stage enterprise) (the "Company") as of June 30, 2003, and the related consolidated statements of operations for three and six months, and stockholders' equity and cash flows for six months ended June 30, 2003 and 2002. We have also reviewed the cumulative statements of operations, stockholders' equity and cash flows for the period from January 1, 1995 through June 30, 2003. 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 consolidated balance sheet as of December 31, 2002, and the related statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein); and, in our report dated February 22, 2003, 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 consolidated balance sheet as of December 31, 2002 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

August 10, 2003

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

	June 30, 2003 Unaudited	December 31, 2002
ASSETS		
CURRENT ASSETS:		
Cash	\$ 9,809	\$ 76,758
Accounts receivable	14,070	12,542
Accounts receivable from related parties	98,449	50,000
Inventory-raw materials (at cost)	62,422	114,076
Notes receivable	120,000	220,000
Advances (net of allowance)	28,000	52,000
Prepaid expenses	97,486	121,542
Total Current Assets	430,236	646,918
PROPERTY AND EQUIPMENT (net)	174,295	195,620
OTHER ASSETS:		
Patent license (net)	1,589,135	1,617,380
TOTAL ASSETS	<u>\$ 2,193,666</u>	<u>\$ 2,459,918</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
CURRENT LIABILITIES:		
Accounts payable (\$77,534 and \$69,534 due to related parties, respectively)	\$ 322,038	\$ 150,176
Accrued expenses	10,702	-
Customer deposit	29,500	-
Capital lease liability	2,511	4,811
Notes payable to related parties	173,000	50,000
Advances from directors	96,584	95,850
Total Current Liabilities	634,335	300,837
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, 21,064,362 and 20,270,556 outstanding, respectively)	21,064	20,271
Additional paid-in capital	7,162,649	6,959,717
Deficit accumulated during the development stage	(5,624,382)	(4,820,907)
Total Stockholder's Equity	1,559,331	2,159,081
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	<u>\$ 2,193,666</u>	<u>\$ 2,459,918</u>

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF OPERATIONS
For Three and Six Months Ended June 30, 2003 and 2002

	Three Months		Six Months		Cumulative During Development Stage
	2003	2002	2003	2002	
REVENUES	\$ 157,705	\$ 25,212	\$ 238,063	\$ 25,212	\$ 413,086
Cost of goods sold	<u>126,719</u>	<u>15,935</u>	<u>195,315</u>	<u>15,935</u>	<u>245,776</u>
Gross Profit	<u>30,986</u>	<u>9,277</u>	<u>42,748</u>	<u>9,277</u>	<u>167,310</u>
PRODUCT DEVELOPMENT COSTS	<u>24,889</u>	<u>85,161</u>	<u>107,388</u>	<u>147,109</u>	<u>1,149,859</u>
OPERATING EXPENSES:					
Personnel costs and director fees	3,140	40,100	12,110	40,100	679,409
Consultants	120,795	65,961	199,537	111,834	2,243,467
Professional fees	38,574	27,501	69,793	32,513	465,484
Office expenses	3,701	4,969	12,670	5,623	56,033
Depreciation	12,361	8,850	24,426	13,040	86,256
Amortization of intangible assets	24,567	-	49,133	-	114,644
Advertising and promotion	48,221	52,312	99,862	97,454	311,626
Loss on cancellation of licensing agreements	-	-	-	-	19,860
Rent	23,847	18,885	47,339	26,385	161,839
Travel	22,809	23,809	61,859	45,318	261,857
Other expenses	28,996	25,837	53,506	30,819	144,127
Bad debts	-	-	100,000	-	100,000
Unknown sources prior to current ownership	-	-	-	-	151,518
Total operating expenses	<u>327,011</u>	<u>268,224</u>	<u>730,235</u>	<u>403,086</u>	<u>4,796,120</u>
(LOSS) FROM OPERATIONS	(320,914)	(344,108)	(794,875)	(540,918)	(5,778,669)
OTHER INCOME AND (EXPENSES):					
Interest income	5	2	10	3	2,525
Interest expense	(4,480)	(937)	(8,610)	(937)	(10,799)
Amortization of discount on receivables	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20,259</u>
(Loss) before income taxes	(325,389)	(345,043)	(803,475)	(541,852)	(5,766,684)
Benefit from deferred taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>397,852</u>
(Loss) Before Extraordinary Item	(325,389)	(345,043)	(803,475)	(541,852)	(5,368,832)
Extraordinary Item:					
Costs of terminated acquisition	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(255,550)</u>
Net (Loss)	<u>\$ (325,389)</u>	<u>\$ (345,043)</u>	<u>\$ (803,475)</u>	<u>\$ (541,852)</u>	<u>\$ (5,624,382)</u>
Basic and Diluted Earnings Per Share:					
(Loss) per share before extraordinary item	\$ (0.02)	\$ (0.02)	\$ (0.04)	\$ (0.03)	\$ (0.71)
(Loss) per share from extraordinary item	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.03)</u>
Net (Loss) Per Share	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>	<u>\$ (0.04)</u>	<u>\$ (0.03)</u>	<u>\$ (0.74)</u>
Weighted Average Shares Outstanding	<u>20,805,373</u>	<u>17,055,976</u>	<u>20,642,367</u>	<u>16,546,227</u>	<u>7,604,774</u>

See accompanying accountants' report and selected information.

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

	Preferred Stock		Common Stock		Additional Paid-In Capital	Unearned Compensation	Accumulated Deficit During Development Stage
	Shares	Amount	Shares	Amount			
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)
CONSOLIDATED 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)

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See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
CONSOLIDATED 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	-	-	2,804,545	2,805	1,717,195	-	-
For services	-	-	1,201,692	1,202	404,232	-	-
For Acquisition of Carbon Cloth	-	-	873,250	873	968,434	-	-
Contributed inventory	-	-	-	-	12,207	-	-
Net loss	-	-	-	-	-	-	(1,119,045)
BALANCES, 12/31/02	-	-	20,270,556	20,271	6,959,717	-	(4,820,907)
Stock issued:							
For services	-	-	793,806	793	202,932	-	-
Net loss	-	-	-	-	-	-	(803,475)
BALANCES, 06/30/03	-	\$ -	21,064,362	\$ 21,064	\$ 7,162,649	\$ -	\$ (5,624,382)

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
For Six Months Ended June 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>	<u>Cumulative During Devel- opment Stage</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss)	\$ (803,475)	\$ (541,852)	\$ (5,624,382)
Adjustments to reconcile net income/(loss) to net cash provided by operations:			
Losses prior to current ownership	-	-	151,518
Depreciation	24,427	13,040	86,257
Amortization of:			
Intangibles	49,133	-	114,644
Prepaid expenses	93,624	79,376	1,182,319
Stock issued for services	97,672	92,101	1,938,314
Stock issued for extraordinary loss	-	-	140,550
Deferred income taxes	-	-	(397,852)
Bad debts	100,000	-	100,000
Changes in operating assets and liabilities:			
Accounts and note receivable	(25,977)	(180,862)	(118,122)
Advances to consultants	-	-	20,000
Inventory	51,654	(11,166)	(39,884)
Prepaid expenses	(8,068)	(59,540)	(255,068)
Accounts payable and accrued expenses	227,117	(64,877)	281,149
Customer deposit	29,500	-	29,500
NET CASH USED BY OPERATING ACTIVITIES	<u>(164,393)</u>	<u>(673,780)</u>	<u>(2,391,057)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Property and equipment	(3,102)	(103,102)	(250,859)
Patent licensing costs	(20,888)	(72,017)	(152,376)
Business acquisition	-	-	(44,820)
Notes receivable	-	-	(220,000)
NET CASH USED IN INVESTING ACTIVITIES	<u>(23,990)</u>	<u>(175,119)</u>	<u>(668,055)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuing stock	-	900,000	2,794,459
Additional capital contributions	-	-	2,367
Capital lease obligation	-	(1,431)	7,765
Payments on capital lease	(2,300)	-	(5,254)
Proceeds from loans from related parties	123,000	-	173,000
Advances from directors	734	-	96,584
NET CASH PROVIDED BY FINANCING ACTIVITIES	<u>121,434</u>	<u>898,569</u>	<u>3,068,921</u>
NET INCREASE/(DECREASE) IN CASH	(66,949)	49,670	9,809
CASH AT BEGINNING OF YEAR	<u>76,758</u>	<u>33,479</u>	<u>-</u>
CASH AT END OF PERIOD	<u><u>\$ 9,809</u></u>	<u><u>\$ 83,149</u></u>	<u><u>\$ 9,809</u></u>

SUPPLEMENTAL DISCLOSURES

See Note 4.

See accompanying accountants' report and selected information.

KLEENAIR SYSTEMS, INC.
(A Development Stage Enterprise)
SELECTED INFORMATION FOR CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2003
(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, 2002. 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 financial statements included in Item 1 of Part 1. Operating results for the six-month period ended June 30, 2003, are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

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 2003 and 2002 was \$12,065 and \$4,190, respectively.

Office furniture and equipment	\$ 61,496
Test vehicles	28,028
Analysis equipment	161,461
Leasehold improvements	<u>11,682</u>
	262,667
Accumulated depreciation	<u>(88,372)</u>
Net property & equipment	<u>\$ 174,295</u>

NOTE 3: PREPAID EXPENSES AND AMORTIZATION

The Company frequently prepays 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. These amortized costs were included in "Advertising and promotion," although this is not necessarily true for the cumulative amounts presented. Amortization totaled \$93,624 and \$79,376 in the six months ended June 30, 2003 and 2002, respectively.

NOTE 4: SUPPLEMENTAL CASH FLOW DISCLOSURES

The following table sets forth supplemental cash flow disclosures.

	<u>2003</u>	<u>2002</u>	<u>Cumulative During Devel- opment Stage</u>
Cash payments for:			
Interest	\$ 4,074	\$ 937	\$ 6,263
Income taxes	-	-	-

	<u>2003</u>	<u>2002</u>	<u>Cumulative During Devel- opment Stage</u>
Non-cash investing and financing transactions:			
Stock issued for:			
Compensation and directors fees	\$ -	\$ 40,100	\$ 819,560
Services and prepaid services	106,053	142,751	1,796,810
Equipment	-	-	8,300
Patent licensing	-	1,255,410	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
Acquisition of Carbon Cloth Technologies, Inc.	-	-	981,514
Uncompleted business acquisition	-	-	87,500

NOTE 5: STOCK TRANSACTIONS

During the first quarter of 2003, the Company issued 100,000 restricted shares valued at \$30,750 for financial consulting services. Another 115,000 unrestricted S-8 shares valued at \$35,475 were issued to consultants for business promotion and financial consulting services. The Company also issued 96,223 unrestricted S-8 shares valued at \$27,899 for research and development services and sales promotion.

During the second quarter of 2003, the Company issued 82,500 restricted shares and 50,000 S-8 shares valued at \$24,413 for an agreement regarding release of certain patent licensing. A total of 171,151 S-8 shares valued at \$40,635 were issued for business promotion and consulting services. Another 178,932 S-8 shares were issued as compensation for legal services billed at \$44,553.

NOTE 6: NOTES RECEIVABLE

During the first quarter of 2002, the Company lent \$120,000 to a licensee. During the third quarter of 2002, the Company lent another \$100,000 to this licensee. These loans were collateralized by stock of the Company held by the licensee. During the fourth quarter of 2002, the licensee assigned the \$120,000 loan along with the underlying collateral to a consultant for the Company. In March 2003, a final settlement of a dispute and lawsuit between the entities resulted in the forgiveness of the \$100,000 loan. This debt forgiveness has been recorded as "Bad debts."

NOTE 7: ACCOUNTS RECEIVABLE FROM RELATED PARTIES

This balance consists of three elements as presented below. KleenAir Systems International LTD. (KASI) is partially owned by the Company and controlled by the Company's President. Nox Masters LTD. is wholly owned by KASI. The \$53,449 represents sales of particulate traps and NoxMaster™ systems for resale and installation on British vehicles. The \$45,000 is billings for equipment and support services during the testing phases leading to approval of the systems in the U.K.

KleenAir Systems International LTD.	\$ 53,449
KleenAir Systems LTD.	<u>45,000</u>
Total	<u>\$ 98,449</u>

NOTE 8: NOTE PAYABLE TO RELATED PARTIES

During the first and second quarters of 2003, officers and entities related to them loaned the Company \$90,000 and \$33,000, respectively. These loans bear interest at 7% compounded monthly and are due on demand.

NOTE 9: SUBSEQUENT EVENTS

During July 2003, the Company has authorized 100,000 S-8 shares for a consultant for financial representation and advisory services with another potential 100,000 shares, based on performance. Another 40,000 S-8 shares have been approved as compensation for a consultant for management services. Additionally, 850,000 restricted shares have been authorized as director fees for 2003 and 500,000 restricted shares have been sold.

The Company has additional orders for significant sales of particulate traps and NOxMaster™ systems from its U.K. affiliate, who is reselling them to a distributor. The Company also is in the midst of an series of orders to provide its CarbonGuard™ system, which has been designated a "single-source product" for retrofitting city buses in New York.

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 1986, the Company filed an S-18 and registered certain stock. From 1989 through 1993, the Company underwent a series of name changes in order to explore various business opportunities. However, none of the business opportunities was successfully completed.

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 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., and changed to its current name.

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. The Company owns U.S. Patent # 5,224,346 Engine NOx Reduction System issued in 1993, U.S. Patent # 5,609,026 Engine NOx Reduction issued in 1997. In 1999 the Company was issued a third patent on Ammonia Injection in NOx Control, U.S. Patent # 5,992,141. 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.

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. A license for this technology has been sold to Ecologic, LLC for China, India and California.

The Company occupies 10,000 square foot R & D facilities at 1711 Langley, Irvine, CA 92614. The Company has 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 has completed the final phase of its London Taxi Program funded by a U.K. government grant and been advised that KleenAir is now approved for the Clean-Up Register of the Energy Savings Trust for all light duty applications. Test systems have been installed on a Dennis refuse collection truck and a Mercedes-Benz Sprinter 16 passenger bus operated by the Borough of Hounslow in London. An Energy savings Trust grant has been awarded for a test and evaluation program on both these vehicles. Final emissions tests were conducted on the Sprinter and application has been made to have it included for medium duty vehicles on the Clean-Up Register. Patent awards have now been confirmed for several European countries including the U.K., Germany, France, Italy, Spain and Sweden, and anticipated soon for Japan, Brazil, and China.

Distribution arrangements have been concluded through the Company's U.K. affiliate with Dinex A/S of Denmark and Dinex Exhaust Systems Ltd of the U.K. for the KleenAir product line. Dinex specializes in after-market sales of particulate filters, silencers and exhaust system components for medium and heavy-duty diesel-powered vehicles. Initial orders for \$150,000 have been delivered to Dinex and a further \$500,000 worth of orders are in the process of being shipped during the third quarter. Additional significant orders are anticipated in the coming months.

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 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..

The Company has now received approval from CARB for its applications for Retrofit Verification for heavy-duty vehicles on its NOxMaster™ NOx reduction system. It has also received approval from EPA to proceed with an application for certification of the combination package of its Oxidizing Particulate Trap (OPT) with the NOxMaster™ for both high particulate reduction as well as high NOx reduction.

The Company's wholly owned subsidiary, Carbon Cloth Technologies, Inc. (Carbon Cloth), of Malibu, California, is a manufacturer of automotive thermal management systems. Carbon Cloth has several years of experience developing thermal solutions for such motorsports industry leaders as Ferrari, Mercedes-Benz and Penske, that has enabled development of the CarbonGuard™, a significant addition to the battle on pollution. It has applied for patents in automotive thermal management systems. At present the CarbonGuard™ is used to enhance the effectiveness

of particulate filters. These filters need to maintain 300 degrees centigrade for 30% of a vehicle's operating time otherwise the filters clog and create backpressure. Wherever particulate filters are currently installed, estimated to be at least 30,000 units at present, the CarbonGuard™ can improve performance and save maintenance expense. Filter technology has come to prominence recently as both the Environmental Protection Agency (EPA) and the California Air Resource Board (CARB) have determined that particulates from vehicle emissions are a serious public health problem.

Carbon Cloth has recently received an order of nearly \$200,000 from Johnson Matthey, Inc. These systems are intended as retrofits on 600 New York City Transit Buses to help improve performance of particulate filters being installed. The CarbonGuard™ is already 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 has been selected as a sole source product for this application. A further several hundred buses are anticipated to be upgraded with the CarbonGuard™. It is expected that this product will generate meaningful revenues during the balance of this year and make a significant contribution toward covering the Company's overhead expenses. Negotiations are being held with a number of automotive OEM manufacturers to incorporate our CarbonGuard™ for a variety of thermal management applications.

The acquisition agreement with ServoTech Engineering Inc. did not close as anticipated in February. Discussions are ongoing as to the nature of the future relationship. In the meantime, the Company is continuing its sales activities on behalf of the SOBRIS™ system under an agency agreement signed last July. ServoTech is a licensee of Ford Motor Company on SCR injection technology. Its SOBRIS™ product is under test and evaluation by a number of automotive manufacturers in the U.S. and Europe. Dr. Hamid Servati, President of Servotech and a director of the Company, has purchased an additional 500,000 shares of restricted common stock from the Company. This increases his holdings to 1,250,000 shares. The Company and Servotech continue to negotiate a more permanent relationship between the two entities.

Once production and sales begin, the Company anticipates employing initially 15 to 20 employees, primarily in management, technical and administrative capacities. 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.

Item 3: Controls and Procedures

- (a) Within the 90-day period prior to the date of this report, the Corporation carried out an evaluation, under the supervision and with the participation of the Company's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Corporation's disclosure controls and procedures are effective

in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in the Corporation's Exchange Act filings.

- (b) There have been no significant changes in the Corporation's internal controls or in other factors which could significantly affect its internal controls subsequent to the date the Corporation carried out its evaluation.

PART II - OTHER INFORMATION

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

Exhibit 23 -- Accountants' consent to incorporation by reference

Exhibit 99.1 -- Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Reports on Form 8-K — None

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: August 14, 2003

/s/ LIONEL SIMONS

By: Lionel Simons, President,
Secretary, Principal Accounting Officer, &
Principal Financial Officer

CERTIFICATION

I, Lionel Simons President and Chief Financial Officer certify that:

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

Date: August 14, 2003

/s/ LIONEL SIMONS

Lionel Simons
President and
Chief Financial Officer