



**KELSO**  
**TECHNOLOGIES**  
**INCORPORATED**

Consolidated Interim Financial Statements

November 30, 2010 and 2009

(Unaudited – Prepared by Management)

## **KELSO TECHNOLOGIES INC.**

Consolidated Interim Financial Statements  
November 30, 2010  
(Unaudited – Prepared by Management)

<b>Index</b>	<b>Page</b>
<b>Management's Comments on Unaudited Interim Financial Statements</b>	<b>3</b>
<b>CONSOLIDATED INTERIM FINANCIAL STATEMENTS</b>	
Consolidated Balance Sheets	4
Consolidated Statements of Operations and Deficit	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Interim Financial Statements	7 – 20

### **Management's Comments on Unaudited Interim Financial Statements**

The accompanying unaudited consolidated interim financial statements of Kelso Technologies Inc. (the "Company") as at November 30, 2010 have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these interim financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

**Kelso Technologies Inc.**  
**Consolidated Balance Sheets**  
**November 30, 2010**  
**(Unaudited – Prepared by Management)**

	November 30, 2010	August 31, 2010
<b>Assets</b>		
<b>Current</b>		
Cash	\$ 481,000	\$ 284,207
Accounts receivable	124,020	142,834
HST receivable	42,622	28,933
Prepaid expenses	117,342	17,690
	<b>764,984</b>	<b>473,664</b>
<b>Patent</b> (Note 5)	<b>36,154</b>	<b>36,923</b>
	<b>\$ 801,138</b>	<b>\$ 510,587</b>
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 200,683	\$ 195,370
Due to related parties (Note 7)	89,290	111,344
Note payable (Notes 7 and 8)	70,000	75,000
Deferred revenue	339,495	0
	<b>699,468</b>	<b>381,714</b>
<b>Shareholders' Equity</b>		
<b>Capital Stock</b>		
Common shares (Note 6 (a))	10,531,150	10,369,150
<b>Contributed surplus</b> (Note 6 (e))	<b>759,225</b>	<b>718,706</b>
<b>Deficit</b>	<b>(11,188,705)</b>	<b>(10,958,983)</b>
	<b>101,670</b>	<b>128,873</b>
	<b>\$ 801,138</b>	<b>\$ 510,587</b>

Nature of Operations and Going Concern (Note 1)  
Subsequent Events (Notes 8 and 10)

Approved on behalf of the Board:

"William Troy" (signed)

\_\_\_\_\_  
William Troy, Director

"James R. Bond" (signed")

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James R. Bond, Director

See notes to consolidated financial statements

**Kelso Technologies Inc.**  
**Consolidated Statements of Operations and Deficit**  
**Three months ended November 30**  
**(Unaudited – Prepared by Management)**

	2010	2009
<b>Revenues</b>	<b>\$ 115,922</b>	<b>\$ 26,139</b>
<b>Cost of Sales</b>	<b>80,739</b>	<b>15,540</b>
<b>Gross Profit</b>	<b>35,183</b>	<b>10,599</b>
<b>Expenses</b>		
Stock-based compensation (Note 6 (c))	40,519	47,401
Management fees (Note 7)	45,345	73,882
Accounting and legal	24,028	6,849
Management salaries (Note 7)	0	45,184
Consulting and investor relations	5,096	1,706
Research and development (Note 7)	59,393	21,500
Travel	8,792	4,070
License and fees	2,751	6,874
Office and general	17,583	3,317
Automobile (Note 7)	6,576	2,251
Bank charges	1,661	1,711
Rent (Note 7)	4,256	1,500
Telephone	0	1,544
Foreign exchange (gain) loss	4,109	(13,987)
Salaries and benefits	44,027	0
Amortization of equipment and patent	769	67
	<b>264,905</b>	<b>203,869</b>
Loss before the following	<b>(229,722)</b>	<b>(193,270)</b>
Gain on settlement of debt	<b>0</b>	<b>440,620</b>
<b>Net Income (Loss) and Comprehensive Income (Loss) for Period</b>	<b>(229,722)</b>	<b>247,350</b>
<b>Deficit, Beginning of Period</b>	<b>(10,958,983)</b>	<b>(10,651,068)</b>
<b>Deficit, End of Period</b>	<b>\$ (11,188,705)</b>	<b>\$ (10,403,718)</b>
<b>Basic and Diluted Loss Per Share</b>	<b>\$ (0.01)</b>	<b>\$ (0.02)</b>
<b>Weighted Average Number of Common Shares Outstanding</b>	<b>21,804,657</b>	<b>11,738,072</b>

See notes to consolidated financial statements

**Kelso Technologies Inc.**  
**Consolidated Statements of Cash Flows**  
**Three months ended November 30**  
**(Unaudited – Prepared by Management)**

	2010	2009
<b>Operating Activities</b>		
Net gain (loss)	\$ (229,722)	\$ 247,350
Items not involving cash		
Amortization of equipment and patent	769	67
Gain on settlement of debt	0	(440,620)
Stock-based compensation	40,519	47,401
	<b>(188,434)</b>	<b>(145,802)</b>
Changes in non-cash working capital		
Accounts receivable	18,814	(13,031)
HST receivable	(13,689)	(860)
Prepaid expenses	(99,652)	(1,972)
Accounts payable and accrued liabilities	5,313	(115,932)
Due to related parties	(27,054)	66,837
Deferred revenue	339,495	0
	<b>223,227</b>	<b>(64,958)</b>
<b>Cash Used in Operating Activities</b>	<b>34,793</b>	<b>(210,760)</b>
<b>Financing Activities</b>		
Issue of common shares, net of share issue costs	162,000	211,176
Shareholder advances (repayment), net (Note 7)	0	(1,701)
<b>Cash Provided by Financing Activities</b>	<b>162,000</b>	<b>209,475</b>
<b>Inflow (Outflow) of Cash</b>	<b>196,793</b>	<b>(1,285)</b>
<b>Cash, Beginning of Period</b>	<b>284,207</b>	<b>2,521</b>
<b>Cash, End of Period</b>	<b>\$ 481,000</b>	<b>\$ 1,236</b>
<b>Supplementary Cash Flow Information</b>		
Non-cash financing activities		
Non-cash note payable (included in due to related parties)	\$ 70,000	\$ 0
Interest paid	\$ 0	\$ 0
Income taxes paid	\$ 0	\$ 0

See notes to consolidated financial statements

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**1. NATURE OF OPERATIONS AND GOING CONCERN**

Kelso Technologies Inc. (the “Company”) designs, engineers, markets, produces and distributes various proprietary pressure relief valves and manway securement systems designed to reduce the risk of environmental harm due to non-accidental events in the transportation of hazardous commodities via railroad tank cars. The Company trades on the TSX Venture Exchange (“TSX-V”) under the symbol “KLS”.

On May 13, 2010, the Company consolidated its common shares on a one new for seven old share basis. All share and per share amounts have been revised to reflect the consolidation.

These consolidated financial statements have been prepared on the basis of the going concern assumption meaning the Company will be able to realize its assets and discharge its liabilities in the normal course of operations.

The Company has experienced significant operating losses and as at November 30, 2010 has an accumulated deficit of \$11,188,705 and a working capital surplus of \$65,516.

The Company plans to generate the necessary resources to finance operations by way of a combination of sales of its products and issuance of equity securities through private placements. If the Company is unsuccessful in generating resources from one or more of the anticipated sources and is unable to replace any shortfall with resources from another source, it will not be able to meet its obligations and its operations would be materially, adversely affected.

The consolidated financial statements do not reflect adjustments to the amounts and classifications of assets and liabilities that would be necessary if the going concern assumption were not appropriate.

**2. SIGNIFICANT ACCOUNTING POLICIES**

These financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The Company's functional and reporting currency is the Canadian dollar.

(a) Basis of presentation and consolidation

The consolidated financial statements include the accounts of the Company and its integrated wholly-owned subsidiary, Kelso Technologies (USA) Inc., a Nevada, USA, Corporation. Intercompany transactions and balances have been eliminated.

(b) Research and development

Research costs are expensed as incurred. Product and technology development costs, which meet the criteria for deferral and are expected to provide future benefits with reasonable certainty, are deferred and amortized over the estimated life of the products or technology. The Company has determined that none of the development costs have met these criteria.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(c) Patent costs

Patents are capitalized and amortized on a straight-line basis over their useful lives of 13 years. The patents are tested for impairment on an annual basis or when events occur that may indicate impairment. If there are indications of impairment, the unamortized balance is charged to operations in the period.

(d) Revenue recognition

The Company recognizes revenue from the sale of valves when receipt of the shipment by the customer is confirmed and collectability is reasonably assured. The shipment originates from an outside supplier and is shipped directly to the customer. As a result, there is no inventory held at year-end.

Interest income is recognized at the stated rate over the term of the instrument.

(e) Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax basis and losses carried forward. Future tax assets and liabilities are measured using enacted or substantively 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 future tax assets and liabilities of a change in tax rates is recognized in operations in the period in which the change is enacted or substantially assured. A valuation allowance is provided against future tax assets when it is more likely than not that the tax asset will not be utilized.

(f) Foreign currency translation

The accounts of foreign operations are translated into Canadian dollars as follows:

- (i) Monetary assets and liabilities, at the rate of exchange in effect at the balance sheet date;
- (ii) Non-monetary assets and liabilities, at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
- (iii) Revenue and expense items (excluding amortization, which is translated at the same rate as the related asset), at the rate of exchange prevailing at the transaction date.

Gains and losses arising from translation of foreign currency are included in the determination of net loss.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(g) Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates include the determination of accrued liabilities, rates of amortization, collectability of accounts receivable, valuation allowance for future tax assets and assumptions used in the calculation of stock-based compensation. While management believes the estimates used are reasonable, actual results could differ from those estimates and could impact future results of operations and cash flows.

(h) Basic and diluted loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is calculated presuming the exercise of outstanding options, warrants and similar instruments. It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the year. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

Shares held in escrow, other than where their release is subject to the passage of time, are not included in the calculation of the weighted average number of common shares outstanding.

(i) Stock-based compensation

The Company accounts for stock-based compensation using a fair value based method with respect to all stock-based payments, to directors, employees and non-employees. For directors and employees, the fair value of the options is measured at the date of grant. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is completed or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable. For directors, employees and non-employees, the fair value of the options is accrued and charged to operations, with the offset credit to contributed surplus. For directors and employees the options are recognized over the vesting period, and for non-employees the options are recognized over the related service period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to capital stock. The Company does not incorporate an estimated forfeiture rate for options that will not vest but rather accounts for actual forfeitures as they occur.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(j) Issue of equity units

The Company uses the residual value method with respect to the measurement of common shares and share purchase warrants issued as private placement units. The proceeds from the issue of units is allocated between common shares and share purchase warrants on a residual value basis, wherein the fair value of the common shares is based on the market value on the date of the announcement of the placement and the balance, if any, is allocated to the attached warrants. Share issue costs are netted against share proceeds.

(k) Financial instruments

Financial instruments are classified as one of the following: held-to-maturity, loans and receivables, held-for-trading, available-for-sale or other financial liabilities. Financial assets and liabilities classified as held-for-trading are measured at fair value with gains and losses recognized in net income. Financial assets classified as held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost. Financial instruments classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) and reported in shareholders' equity. Any financial instrument may be designated as held-for-trading upon initial recognition. When a decline in the fair value of an available-for-sale financial asset has been recognized in comprehensive income, and there is objective evidence that the impairment is other than temporary, the cumulative loss that had been previously recognized in accumulated other comprehensive income is removed from accumulated other comprehensive income and recognized in net income even though the financial asset has not been de-recognized.

Transaction costs that are directly attributable to the acquisition or issue of financial instruments that are classified as other than held-for-trading, which are expensed as incurred, are included in the initial carrying value of such instruments.

The Company provides information about its financial instruments measured at fair value at one of three levels according to the relative reliability of the inputs used to estimate the fair value:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(l) Future accounting changes

(i) Business Combinations

In January 2009, the Canadian Institute of Chartered Accountants issued Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-Controlling Interests". These sections replace the former Section 1581, "Business Combinations", and Section 1600, "Consolidated Financial Statements", and establish a new section for a non-controlling interest in a subsidiary.

Sections 1582 and 1602 will require net assets, non-controlling interests and goodwill acquired in a business combination to be recorded at fair value and non-controlling interests will be reported as a component of equity. In addition, the definition of a business is expanded and is described as an integrated set of activities and assets that are capable of being managed to provide a return to investors or economic benefits to owners.

Acquisition costs are not part of the consideration and are to be expensed when incurred. Section 1601 establishes standards for the preparation of consolidated financial statements.

These new sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently.

(ii) International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS effective for fiscal years beginning on or after January 1, 2011. Therefore, the Company will be required to report using IFRS commencing with its unaudited consolidated interim financial statements for the three months ended November 30, 2011, which must include restated interim results for the prior period ended November 30, 2010 prepared on the same basis. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

**3. CAPITAL MANAGEMENT**

The Company considers its capital under management to be all components of shareholders' equity. The Company's objective in managing its capital is to maintain its ability to continue as a going concern and to further develop its business. To effectively manage the Company's capital requirements, the Company has a planning and budgeting process in place to meet its strategic goals.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**3. CAPITAL MANAGEMENT (Continued)**

The Company funds its operations through equity financing. Future financings are dependent on market conditions and there can be no assurance the Company will be able to raise funds in the future. The Company is not subject to externally imposed capital requirements.

There were no changes in the Company's approach to capital management during the year.

**4. FINANCIAL INSTRUMENTS**

The Company has designated its cash as held-for-trading, accounts receivable as loans and receivables, and accounts payable and accrued liabilities, due to related parties, note payable and shareholder advances as other liabilities.

(a) Fair value

The carrying values of cash, accounts receivable, note payable, and accounts payable and accrued liabilities approximate their fair values due to their short-term maturity. The fair values of due to related parties and shareholder advances are not provided as there is no market for such instruments.

(b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity risk is to forecast cash flows for operations and anticipated investing and financing activities. At November 30, 2010, the Company has \$481,000 of cash to settle current liabilities with the following due dates: accounts payable and accrued liabilities are due on demand, due to related party balances are due within three months, and the note payable is due within twelve months.

(c) Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company's cash is exposed to credit risk. Cash is placed with a major Canadian financial institution. The Company is also exposed to credit risk with respect to its accounts receivable. The Company assesses the credit rating of all customers and maintains provisions for potential credit losses, and any such losses to date have been within management's expectations. The Company's concentration of credit risk and maximum exposure thereto is \$481,000 in cash (August 31, 2010 – \$284,207) and \$124,020 in accounts receivable (August 31, 2010 – \$142,834).

(d) Market risk

The significant market risks to which the Company is exposed are interest rate risk, currency risk and other price risk.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**4. FINANCIAL INSTRUMENTS (Continued)**

(d) Market risk (Continued)

(i) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company's cash consists of cash held in bank accounts that earn interest at variable rates. Due to the short-term nature of this financial instrument, fluctuations in market rates of interest do not have a significant impact on the estimated fair value or future cash flows as of November 30, 2010.

(ii) Currency risk

The Company is exposed to currency risk to the extent expenditures incurred or funds received and balances maintained by the Company are denominated in US dollars. The Company does not manage currency risk through hedging or other currency management tools.

As at November 30, 2010, the Company's net exposure to foreign currency risk is as follows:

	<b>US</b>
Cash	\$ 244,097
Accounts receivable	104,031
Accounts payable and accrued liabilities	(71,289)
	<b>\$ 276,839</b>

Based on the above, assuming all other variables remain constant, a \$0.06 weakening or strengthening of the Canadian dollar against the US dollar would result in an approximately \$16,600 foreign exchange loss or gain in the statements of operations.

(iii) Other price risk

Other price risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest rate risk or currency risk. The Company is not exposed to any other price risk.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

**5. PATENT AND ROYALTY OBLIGATION**

	<b>November 30, 2010</b>			August 31, 2010	
	Cost	Accumulated Amortization	Net Book Value		
Patent	\$ 40,000	\$ 3,846	\$ 36,154	\$	36,923

The Company is obligated to pay a 5% royalty from sales of their manway securement systems. During the period ended November 30, 2010, there were no revenues from sales of the manway securement systems. The Company also holds a number of other patents, which have been fully amortized as at November 30, 2010.

**6. CAPITAL STOCK**

Authorized:

Unlimited Class A non-cumulative, preference shares without par value, of which 5,000,000 are designated Class A, convertible, voting, preference shares

Unlimited common shares without par value

Issued:

(a) Common shares

	Number of Shares	Amount
Balance, August 31, 2009	11,295,754	\$ 9,223,831
Issued during the year		
Private placements, for cash	10,482,629	1,245,508
Share issue costs (cash)	0	(100,189)
	10,482,629	1,145,319
Balance, August 31, 2010	21,778,383	\$10,369,150
Exercise of warrants, for cash at \$0.18	900,000	162,000
Balance, November 30, 2010	22,678,383	\$10,531,150

(i) On November 2, 2009, the Company completed a private placement of 1,059,029 units at a price of \$0.21 per unit for gross proceeds of \$222,396. Each unit consists of one common share and one share purchase warrant. Each whole warrant will be exercisable at \$0.35 until October 30, 2010, at \$0.70 from October 31, 2010 until October 30, 2011, at \$1.05 from October 31, 2011 until October 30, 2012, at \$2.10 from October 31, 2012 until October 30, 2013 and at \$5.25 from October 31, 2013 until October 30, 2014. The Company paid finders fees of \$11,220.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

**6. CAPITAL STOCK (Continued)**

(a) Common shares (Continued)

- (ii) On May 26, 2010, the Company completed a private placement of 8,270,000 units at a price of \$0.10 per unit for gross proceeds of \$827,000. Each unit consists of one common share and one-half of one share purchase warrant. One whole warrant will entitle the holder to purchase one additional common share at a price of \$0.18 until May 25, 2012. The Company paid \$27,200 in finders fees.
- (iii) On August 31, 2010, the Company completed a private placement of 1,153,600 units at a price of \$0.17 per unit for gross proceeds of \$196,112. Each unit consists of one common share and one-half of one share purchase warrant. One whole warrant will entitle the holder to purchase one additional common share at a price of \$0.25 until August 31, 2012. The Company paid \$14,100 in finders fees.
- (iv) The Company paid \$47,669 in cash for other fees relating to the private placements.

(b) Escrowed shares

The Company has nil common shares held in escrow.

(c) Stock options

The Company has a stock option plan (the "Plan") available to employees, directors, officers and consultants with grants under the Plan approved from time to time by the board of directors. Under the Plan, the Company is authorized to issue options to purchase an aggregate of up to 10% of the Company's issued and outstanding common shares. Each option can be exercised to acquire one common share of the Company. The exercise price for an option granted under the Plan may not be less than the market price at the date of grant less a specified discount dependent on the market price.

Options to purchase common shares have been granted to directors, employees and consultants as follows:

Exercise Price	Expiry Date	Outstanding November 30, 2010	Exercisable November 30, 2010	Outstanding November 30, 2009	Exercisable November 30, 2009
\$0.77	February 24, 2010	0	0	98,946	98,946
\$0.70	January 31, 2012	114,286	114,286	230,143	230,143
\$0.70	April 11, 2012	0	0	28,571	28,571
\$1.75	April 11, 2012	0	0	21,428	21,428
\$3.15	April 11, 2012	0	0	14,286	14,286
\$0.24	October 4, 2012	572,000	143,000	0	0
\$0.70	November 8, 2012	58,213	58,213	197,999	197,999
\$0.70	May 26, 2013	10,929	10,929	169,858	169,858
\$0.24	June 2, 2015	600,000	150,000	0	0
\$0.25	June 14, 2015	300,000	150,000	0	0
\$0.70	October 7, 2019	28,571	28,571	135,714	135,714
		1,683,999	729,999	896,945	896,945

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

**6. CAPITAL STOCK (Continued)**

(c) Stock options (Continued)

A summary of the Company's stock options as at November 30, 2010 and 2009 and changes for the years then ended is as follows:

	Number	Weighted Average Exercise Price
Outstanding and exercisable, August 31, 2009	761,231	\$0.78
Granted	1,682,661	\$0.37
Cancelled	(932,947)	\$0.76
Expired	(98,946)	\$0.77
Outstanding and exercisable, August 31, 2010	1,411,999	\$0.31
Granted	572,000	\$0.24
Cancelled	(300,000)	\$0.24
Outstanding and exercisable, November 30, 2010	1,683,999	\$0.30

During the period ended November 30, 2010, the Company granted 572,000 (2009 – 482,660) stock options to directors, officers and consultants. Of the options granted, 143,000 vested immediately and the remaining 429,000 will vest in tranches of 143,000 options every six months from the grant date.

The weighted average contractual life for the remaining options at November 30, 2010 is 3.5 years (2009 – 2.7 years).

*Stock-based compensation*

The grant date fair value of options issued in the period ended November 30, 2010 was \$137,280. Stock-based compensation of \$40,519 (2009 – \$47,401) was recognized in the period ended November 30, 2010, and \$142,549 of stock-based compensation will be recognized in future periods.

The fair value of stock options is determined by the Black-Scholes option pricing model with assumptions as follows:

	2010	2009
Risk-free interest rate (average)	2.94%	0.54%
Estimated volatility (average)	122%	201%
Expected life	6.43 years	10 years
Expected dividend yield	0	0
Grant date fair value per option	\$0.24	0

Option pricing models require the use of highly subjective estimates and assumptions including the expected stock price volatility. Changes in the underlying assumptions can materially affect the fair value estimates.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

**6. CAPITAL STOCK (Continued)**

(d) Share purchase warrants

As at November 30, 2010 and 2009, the Company has share purchase warrants outstanding entitling the holders to acquire common shares as follows:

Exercise Price	Expiry Date	Outstanding August 31, 2010	Exercised	Expired	Outstanding November 30, 2010
\$0.70	September 17, 2010*	671,710	0	671,710	0
\$0.70	July 2, 2011	1,535,154	0	0	1,535,154
\$0.70*	October 31, 2014	1,059,029	0	0	1,059,029
\$0.18	May 25, 2012	4,135,000	1,427,500	0	2,707,500
\$0.25	August 31, 2012	576,800	30,000	0	546,800
		7,977,693	1,457,500	671,710	5,848,483

Exercise Price	Expiry Date	Outstanding August 31, 2009	Issued	Expired	Outstanding November 30, 2009
\$0.35*	October 31, 2014	0	1,059,029	0	1,059,029
\$0.70	April 4, 2010	410,237	0	0	410,237
\$0.70	September 17, 2010	671,710	0	0	671,710
\$0.70	July 2, 2011	1,535,154	0	0	1,535,154
		2,617,101	1,059,029	0	3,676,130

\* Exercisable at \$0.35 until October 30, 2010, at \$0.70 from October 31, 2010 until October 30, 2011, at \$1.05 from October 31, 2011 until October 30, 2012, at \$2.10 from October 31, 2012 until October 30, 2013, and at \$5.25 from October 31, 2013 until October 30, 2014.

(e) Contributed surplus

	November 30, 2010	August 31, 2010
Balance, beginning of period	\$ 718,706	\$ 522,462
Stock-based compensation	40,519	196,244
Balance, end of period	\$ 759,225	\$ 718,706

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

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**7. RELATED PARTY TRANSACTIONS**

Related parties are directors and officers, companies controlled by the directors and officers, a company controlled by a former officer and a company whose principal is an officer of the Company.

Related party transactions not otherwise described in these financial statements are shown below. These amounts are included in the amounts shown on the statements of operations:

	<b>2010</b>	<b>2009</b>
Management fees	\$ 45,345	\$ 73,882
Management salaries	\$ 0	\$ 44,000
Research and development costs	\$ 15,131	\$ 21,500
Automobile	\$ 0	\$ 2,100
Rent	\$ 0	\$ 1,500

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

As at November 30, 2010, amounts due to related parties are as follows:

- (a) \$70,000 (2009 – \$Nil) for a note payable to a former director and officer of the Company.
- (b) \$34,676 (2009 – \$214,914) for reimbursement of expenses and consulting fees to a director and officer of the Company.
- (c) \$55,075 (2009 – \$55,075) consulting fees to a former director of the Company.

**8. NOTE PAYABLE**

The \$70,000 note payable to a former officer of the Company is unsecured and non-interest-bearing with repayment terms of a minimum rate of \$5,000 per month beginning April 16, 2010, or as soon thereafter as funds are available to the Company, and the same amount every month thereafter or sooner if funds permit. The remaining balance is due on or before June 30, 2011. Subsequent to the period end, the note payable was paid-off in its entirety.

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

**9. INCOME TAXES**

The Company has non-capital loss carry-forwards of approximately \$3,516,000 to reduce future taxable income as follows:

2014	\$	192,000
2015		708,000
2025		13,000
2026		506,000
2027		631,000
2028		710,000
2029		625,000
2030		131,000
	\$	3,516,000

The tax losses above include approximately \$14,000 that may be applied against future taxable income in the US over a 20-year period (Expiring 2025 and later).

The Company has net capital losses of \$138,019 to be applied against future net capital gains. These losses can be carried forward indefinitely.

The Company also has Canadian exploration expenditures totaling \$92,424 and Canadian development expenditures totaling \$50,500 that may be available to reduce future taxable income.

Significant components of the Company's future tax assets and liabilities, after applying enacted corporate income tax rates, are as follows:

	<b>2010</b>	<b>2009</b>
Future income tax rate	25%	26%
Non-capital loss carry-forwards	\$ 880,520	\$ 1,150,930
Book value of assets in excess of tax value	(27)	2,026
Capital loss carry-forwards	17,252	17,942
Tax value of share issue costs	23,327	5,306
Unused cumulative exploration expenses	35,731	37,160
	956,803	1,213,364
Valuation allowance for future income tax assets	(956,803)	(1,213,364)
Future income tax asset	\$ 0	\$ 0

**Kelso Technologies Inc.**  
**Notes to Consolidated Interim Financial Statements**  
**Three months ended November 30, 2010 and 2009**  
**(Unaudited – Prepared by Management)**

**9. INCOME TAXES** (Continued)

The reconciliation of income tax benefit computed at statutory rates to the reported income tax benefit is as follows:

	<b>2010</b>	<b>2009</b>
Income tax benefit computed at Canadian statutory rates	\$ 89,295	\$ 200,833
Temporary differences not recognized in year	8,582	(10,281)
Stock based compensation and other permanent differences	(59,785)	(897)
Tax effect of expired losses	(160,180)	(103,317)
Tax effect of forgiveness of debt	(109,499)	0
Other changes resulting from timing differences	16,122	1,434
Change in valuation allowance	256,561	(60,697)
Change resulting from tax rate reduction	(41,096)	(27,075)
Income tax recovery	\$ 0	\$ 0

**10. SUBSEQUENT EVENTS**

- (a) On December 7, 2010, 250,000 share purchase options were granted to current employees and consultants of the Company. Each option is exercisable at \$0.24 and expires not later than December 7, 2013. Additionally, the Company has also granted 143,000 share purchase options to two former directors and officers of the Company. Each option is exercisable at \$0.24 and expires not later than December 7, 2011.
- (b) On December 21, 2010, the Company completed a private placement of 6,938,000 units at a price of \$0.25 per unit for gross proceeds of \$1,734,500. Each unit consists of one common share and one-half of one share purchase warrant. One whole warrant will entitle the holder to purchase one additional common share at a price of \$0.35 until December 21, 2012. A finder's fee of 8% of gross proceeds will be due in the form of cash payment or shares.
- (c) 527,500 warrants were exercised at \$0.18 per share for total proceeds of \$94,950.
- (d) 30,000 warrants were exercised at \$0.25 per share for total proceeds of \$7,500.