

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended.....May 31, 2010
OR

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

For the transition period from.....to.....

AURA SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

95-4106894

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

1310 E. Grand Ave.

El Segundo, California 90245

(Address of principal executive offices)

Registrant's telephone number, including area code: **(310) 643-5300**

Former name, former address and former fiscal year, if changed since last report:

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Act).

Large Accelerated Filer
Non-accelerated filer

Accelerated Filer
Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

**APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

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

Class	Outstanding June 30, 2010
Common Stock, par value \$0.0001 per share	54,344,575 shares

AURA SYSTEMS, INC. AND SUBSIDIARY

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AURA SYSTEMS, INC. AND SUBSIDIARY

QUARTER ENDED MAY 31, 2010

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The consolidated financial statements included herein have been prepared by Aura Systems, Inc., (the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). As contemplated by the SEC under Rule 10-01 of Regulation S-X, the accompanying consolidated financial statements and footnotes have been condensed and therefore do not contain all disclosures required by accounting principles generally accepted in the United States of America. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the year ended February 28, 2010 as filed with the SEC (file number 000-17249).

AURA SYSTEMS, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	<u>May 31, 2010</u>	<u>February 28, 2010</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,903	\$ 45,294
Accounts receivable, net of allowance for doubtful accounts of \$50,000 at May 31 and February 28, 2010, respectively	423,324	313,671
Inventory - current	1,500,000	1,500,000
Other current assets	269,941	241,749
Total current assets	<u>2,208,168</u>	<u>2,100,714</u>
Property, plant, and equipment, net	520,891	557,838
Inventory, non-current, net of allowance for obsolete inventory of \$2,467,459 and \$2,212,626 at May 31 and February 28, 2010, respectively	2,138,521	2,140,194
Total assets	<u>\$ 4,867,580</u>	<u>\$ 4,798,746</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	\$ 1,173,332	\$ 1,130,276
Notes payable	490,000	547,500
Notes payable- related party, net of debt discount of \$23,400 at May 31, 2010	6,536,600	5,150,000
Accrued expenses	2,566,805	2,221,759
Customer advances	334,477	411,616
Total current liabilities	<u>11,101,214</u>	<u>9,461,151</u>
Convertible note payable	500,000	500,000
Total liabilities	<u>11,601,214</u>	<u>9,961,151</u>
Commitments		
Stockholders' deficit :		
Common stock, \$0.0001 par value; 75,000,000 shares authorized at May 31 and February 28, 2010; 54,344,575 and 52,689,061 issued and outstanding at May 31 and February 28, 2010	5,434	5,268
Additional paid-in capital	376,146,801	374,890,469
Accumulated deficit	<u>(382,885,869)</u>	<u>(380,058,142)</u>
Total stockholders' deficit	<u>(6,733,634)</u>	<u>(5,162,405)</u>
Total liabilities and stockholders' deficit	<u>\$ 4,867,580</u>	<u>\$ 4,798,746</u>

See accompanying notes to these un-audited condensed consolidated financial statements.

AURA SYSTEMS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

THREE MONTHS ENDED MAY 31, 2010 AND 2009

(Un-audited)

	May 31	
	2010	2009
Net Revenues	\$ 587,988	\$ 632,695
Cost of goods sold	<u>300,134</u>	<u>301,092</u>
Gross Profit	287,854	331,603
Expenses		
Engineering, research and development expenses	461,690	509,132
Selling, general and administrative	2,328,464	1,789,695
Stock Option expense	<u>43,565</u>	<u>83,506</u>
Total costs and expenses	2,833,719	2,382,333
Loss from operations	<u>(2,545,865)</u>	<u>(2,050,730)</u>
Other (income) and expense		
Interest expense, net	220,526	100,404
Loss on settlement of debt	57,032	22,750
Other income, net	<u>4,303</u>	<u>(2,775)</u>
Total other (income) expense	<u>281,861</u>	<u>78,673</u>
Net Loss	<u>\$ (2,827,726)</u>	<u>\$ (2,171,109)</u>
Total basic and diluted loss per share	<u>(0.05)</u>	<u>\$ (0.05)</u>
Weighted average shares used to compute basic and diluted loss per share	<u>53,312,554</u>	<u>46,641,265</u>

See accompanying notes to these un-audited condensed consolidated financial statements.

AURA SYSTEMS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MAY 31, 2010 AND 2009
(Un-audited)

	2010	2009
Cash flow from operating activities:		
Net Loss	\$ (2,827,726)	\$ (2,171,109)
Adjustments to reconcile Net loss to net cash used in operating activities		
Depreciation Expense	46,545	24,465
Loss on settlement of debt	57,032	22,750
Beneficial conversion	48,600	-
Stock issued for services	488,000	-
Amortization of debt discount	-	18,956
Stock options and warrants expense	43,565	83,506
(Increase) decrease in:		
Accounts receivable	(109,653)	42,450
Inventory	1,673	61,090
Other current assets and deposit	(28,192)	(63,406)
Increase (decrease) in:		
Accounts payable, customer deposit and accrued expenses	328,439	371,758
Net cash used in operations	<u>(1,951,717)</u>	<u>(1,609,540)</u>
Investing activities:		
Acquisition of plant and equipment	<u>(9,599)</u>	<u>(108,685)</u>
Net cash used by investing activities	(9,599)	(108,685)
Financing activities:		
Issuance of common stock	470,925	465,000
Proceeds from notes payable, net	1,460,000	892,500
Exercise of warrants	<u>-</u>	<u>94,428</u>
Net cash provided by financing activities:	<u>1,930,925</u>	<u>1,451,928</u>
Net increase (decrease) in cash & cash equivalents	(30,391)	(266,297)
Cash and cash equivalents at beginning of period	<u>45,294</u>	<u>317,256</u>
Cash and cash equivalents at end of period	<u>\$ 14,903</u>	<u>\$ 50,959</u>
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ -	\$ 8,761
Income taxes	\$ -	\$ -

Un-audited supplemental disclosure of non-cash investing and financing activities:

During the quarter ended May 31, 2010, \$124,978 of notes payable and accrued interest was converted into 235,000 shares of common stock. We also issued 20,000 shares of our Common Stock in satisfaction of \$20,000 in accounts payable.

See accompanying notes to these un-audited condensed consolidated financial statements.

AURA SYSTEMS, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010

(Un-audited)

1) Basis of Presentation

The condensed consolidated financial statements include the accounts of Aura Systems, Inc. and subsidiary ("the Company"). All inter-company balances and inter-company transactions have been eliminated.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments (which include normal recurring adjustments) and reclassifications for comparability necessary to present fairly the financial position of Aura Systems, Inc. and subsidiaries at May 31, 2010 and the results of its operations for the three months ended May 31, 2010 and 2009.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

2) Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Aura and our inactive subsidiary, Aura Realty, Inc. Significant inter-company amounts and transactions have been eliminated in consolidation.

Revenue Recognition

The Company's revenue recognition policies are in compliance with Staff accounting bulletin (SAB) 104. Sales revenue is recognized at the date of shipment to customers when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collect-ability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as unearned revenue.

We recognize revenue for product sales upon shipment and when title is transferred to the customer. When Aura performs the installation of the product, revenue and cost of sales are recognized when the installation is complete. We have in the past earned a portion of our revenues from license fees and recorded those fees as income when we fulfilled our obligations under the particular agreement.

Terms of our sales generally provide for Shipment from our facilities to customers FOB point of shipment. Title passes to customers at the time the products leave our warehouse.

The Company does not offer a general right of return on any of its sales and considers all sales as final. However, if a customer determines that a different system configuration would better suit their application, we will allow them to exchange the system and bill them the incremental cost, or credit them if there is a decrease in the system cost. While some sales are for evaluative purposes, they are still considered final sales. The customers' evaluation is for them to determine if there is a benefit to them to outfit additional vehicles in their fleets.

The only potential post delivery obligation the Company might have is for the installation of the unit. However, the unit is typically delivered at the time of installation, and the billing is done when the installation is complete. Any discounts that are offered are done as a reduction of the invoiced amount at the time of billing. The Company does not utilize bill and hold. The Company does provide customers with a warranty; however, due to the low sales volume to date, the amount has not been material and is expensed as incurred.

Cash and Cash Equivalents

Cash and equivalents include cash on hand and cash in time deposits, certificates of deposit and all highly liquid debt instruments with original maturities of three months or less. We maintain cash deposits at a bank located in California. Deposits at this bank are insured by the Federal Deposit Insurance Corporation up to \$250,000. We have not experienced any losses in such accounts and believe we are not exposed to any significant risk on cash and cash equivalents.

Accounts Receivable

The Company grants credit to its customers generally in the form of short-term trade accounts receivable. Accounts receivable are stated at the amount that management expects to collect from outstanding balances. When appropriate, management provides for probable un-collectible amounts through an allowance for doubtful accounts. Management primarily determines the allowance based on the aging of accounts receivable balances, historical write-off experience, customer concentrations, customer creditworthiness and current industry and economic trends. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to accounts receivable.

Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market, on a standard cost basis. We review the components of inventory on a regular basis for excess or obsolete inventory based on estimated future usage and sales. As further described in Note 3, due to continuing lower than projected sales, we are holding inventories in excess of what we expect to sell in the next fiscal year. As of May 31 and February 28, 2010, \$2,138,521, and \$2,140,194, respectively, of inventories have been classified as long-term assets.

Property, Plant, and Equipment

Property, plant, and equipment, including leasehold improvements, are recorded at cost, less accumulated depreciation and amortization. Depreciation is provided using the straight-line method over the estimated useful lives of the respective assets as follows:

Machinery and equipment	5 to 10 years
Furniture and fixtures	7 years

Improvements to leased property are amortized over the lesser of the life of the lease or the life of the improvements. Maintenance and minor replacements are charged to expense as incurred. Gains and losses on disposals are included in the results of operations.

Income Taxes

We account for income taxes in accordance with FASB ASC 740, "Income Taxes". Under FASB ASC 740, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial statement reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The provision for income taxes represents the tax expense for the period, if any, and the change during the period in deferred tax assets and liabilities.

We have significant income tax net operating losses; however, due to the uncertainty of the realize-ability of the related deferred tax asset and other deferred tax assets, a valuation allowance equal to the amount of deferred tax assets has been established at February 28, 2010 and 2009.

FASB ASC 740 also provides criteria for the recognition, measurement, presentation and disclosure of uncertain tax positions. A tax benefit from an uncertain position may be recognized only if it is "more likely than not" that the position is sustainable based on its technical merit.

Estimates

The preparation of financial statements requires management to make estimates and assumptions 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Going Concern

The accompanying financial statements have been prepared on a going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the financial statements, during the three month periods ended May 31, 2010 and 2009, the Company incurred losses of \$2,827,726 and \$2,171,109, respectively and had negative cash flows from operating activities of \$1,951,717 and \$1,609,540, respectively, during the three month periods ended May 31, 2010 and 2009.

If the Company is unable to generate profits or continue to obtain financing for its working capital requirements, it may have to curtail its business sharply or cease business altogether.

The financial statements do not include any adjustments relating to the recoverability and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to retain its current financing, to obtain additional financing, and ultimately to attain profitability. Our independent auditors, in their report on the Company's financial statements for the year ended February 28, 2010 expressed substantial doubt about the Company's ability to continue as a going concern.

Recently Issued Accounting Pronouncements

In March 2010, the Financial Accounting Standards Board ("FASB") issued guidance related to revenue recognition for multiple element deliverables which eliminates the requirement that all undelivered elements must have objective and reliable evidence of fair value before a company can recognize the portion of the consideration that is attributable to items that already have been delivered. Under the new guidance, the relative selling price method is required to be used in allocating consideration between deliverables and the residual value method will no longer be permitted. This guidance is effective prospectively for revenue arrangements entered into or materially modified in 2011 although early adoption is permitted. A company may elect, but will not be required, to adopt the amendments retrospectively for all prior periods. The Company is currently evaluating this guidance and has not yet determined the impact, if any, that it will have on the consolidated financial statements.

In June 2009, the FASB issued new guidance which is now part of ASC 105-10, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles". ASC 105-10 (formerly Statement of Financial Accounting Standards No. 168), establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. ASC 105-10 is effective for interim and annual periods ending after September 15, 2009. The adoption of ASC 105-10 did not have a material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-01- Accounting for Distributions to Shareholders with Components of Stock and Cash. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The adoption of this ASU did not have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification. The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments

also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51." If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In February 2010, FASB issued ASU No. 2010-9 – Amendments to Certain Recognition and Disclosure Requirements. This update addresses certain implementation issues related to an entity's requirement to perform and disclose subsequent-events procedures, removes the requirement that public companies disclose the date of their financial statements in both issued and revised financial statements. According to the FASB, the revised statements include those that have been changed to correct an error or conform to a retrospective application of U.S. GAAP. The amendment is effective for interim and annual reporting periods in fiscal year ending after June 15, 2010. The Company does not expect the adoption of this ASU to have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued ASC 855 (previously SFAS No. 165, "Subsequent Events"), which establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before the financial statements are issued or available to be issued. It is effective for interim and annual periods ending after June 15, 2009. There was no material impact upon the adoption of this standard on the Company's consolidated financial statements.

In June 2009, the FASB issued ASC 860 (previously SFAS No. 166, "Accounting for Transfers of Financial Assets"), which requires additional information regarding transfers of financial assets, including securitization transactions, and where companies have continuing exposure to the risks related to transferred financial assets. SFAS 166 eliminates the concept of a "qualifying special-purpose entity," changes the requirements for de-recognizing financial assets, and requires additional disclosures. SFAS 166 is effective for fiscal years beginning after November 15, 2009. There was no material impact upon the adoption of this standard on the Company's consolidated financial statements.

In June 2009, the FASB issued ASC 810 (previously SFAS No. 167) for determining whether to consolidate a variable interest entity. These amended standards eliminate a mandatory quantitative approach to determine whether a variable interest gives the entity a controlling financial interest in a variable interest entity in favor of a qualitatively focused analysis, and require an ongoing reassessment of whether an entity is the primary beneficiary. These amended standards are effective for us beginning in the first quarter of fiscal year 2010 and we are currently evaluating the impact that adoption will have on our consolidated financial statements.

In August 2009, the FASB issued Accounting Standards Update (“ASU”) 2009-05, which amends ASC Topic 820, Measuring Liabilities at Fair Value, which provides additional guidance on the measurement of liabilities at fair value. These amended standards clarify that in circumstances in which a quoted price in an active market for the identical liability is not available, we are required to use the quoted price of the identical liability when traded as an asset, quoted prices for similar liabilities, or quoted prices for similar liabilities when traded as assets. If these quoted prices are not available, we are required to use another valuation technique, such as an income approach or a market approach. These amended standards became effective for us beginning in the fourth quarter of fiscal year 2009 and have not had a significant impact on our consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the prior period financial statements to conform to the 2010 presentation.

3) Inventories

Inventories, stated at the lower of cost (first in, first out) or market, consist of the following:

	May 31, 2010	February 28, 2010
Raw materials	\$ 2,320,254	\$ 2,626,206
Finished goods	3,485,726	3,226,614
Reserved for potential product obsolescence	<u>(2,030,959)</u>	<u>(2,076,018)</u>
	3,775,021	3,776,802
Non-current portion	(2,138,521)	(2,140,194)
Discount on long term inventory	<u>(136,500)</u>	<u>(136,608)</u>
Current portion	<u>\$ 1,500,000</u>	<u>\$ 1,500,000</u>

Inventories consist primarily of components and completed units for the Company's AuraGen product.

We do not expect to realize all of our inventories within the 12-month period ending May 31, 2011. Because of this, we have assessed the net realizability of these assets, the proper classification of the inventory, and the potential obsolescence of inventory. The net inventories as of May 31 and February 28, 2010, which are not expected to be realized within a 12-month period, have been reclassified as long term. We have also recorded a reserve for obsolescence of \$2,030,959 and \$2,076,018 at May 31 and February 28, 2010, respectively.

4) Property, Plant & Equipment

Property, plant, and equipment at May 31, 2010 and February 28, 2010 consisted of the following:

	<u>May 31,</u> <u>2010</u>	<u>February</u> <u>28, 2010</u>
Machinery and equipment	\$ 1,060,519	\$ 1,060,519
Furniture and fixtures	1,499,699	1,493,293
Leasehold Improvements	<u>485,080</u>	<u>481,887</u>
	3,045,298	3,035,699
Less accumulated depreciation and amortization	<u>2,524,407</u>	<u>2,477,861</u>
Property, plant and equipment, net	<u>\$ 520,891</u>	<u>\$ 557,838</u>

Depreciation and amortization expense was \$46,545 and \$24,465, for the three month periods ended May 31, 2010, and 2009.

5) Accrued expenses

Accrued expenses at May 31, 2010 and February 28, 2010 consisted of the following:

	<u>May 31,</u> <u>2010</u>	<u>February</u> <u>28, 2010</u>
Accrued payroll and related expenses	\$ 1,889,981	\$ 1,716,279
Accrued interest	624,205	494,830
Other	<u>29,219</u>	<u>10,650</u>
Total	<u>\$ 2,543,405</u>	<u>\$ 2,221,759</u>

6) Notes Payable and Other Liabilities

Notes payable at May 31, 2010 and February 28, 2010 consisted of the following:

	<u>May 31, 2010</u>	<u>February 28, 2010</u>
Demand notes payable (a)	\$ 100,000	\$ 90,000
Convertible notes payable (b)	<u>890,000</u>	<u>957,500</u>
	990,000	1,047,500
Less: Current portion	<u>490,000</u>	<u>547,500</u>
Long-term portion	<u>\$ 500,000</u>	<u>\$ 500,000</u>

(a) At May 31, 2010 consists of two unsecured demand notes payable of \$50,000 each, with interest at an annual rate of 10%, on which \$1,768 in interest was accrued during the period ended May 31, 2010. At February 28, 2010 consists of one unsecured demand note payable of \$50,000, with interest at an annual rate of 10%, on which \$5,229 in interest was accrued during the year ended February 28, 2010, and one unsecured demand

note with an original balance of \$140,000, an additional \$50,000 loaned during July 2009, and a remaining balance of \$40,000.

(b) Consists of an unsecured convertible note payable totaling \$500,000, bearing interest at a rate of 7%, due in 2013. The note is convertible into our common stock at a price of \$3 per share. The Company accrued interest of \$8,761 on the note during the period ended May 31, 2010. Also consists of four unsecured convertible notes entered into during the second quarter of fiscal 2010 totaling \$390,000. The notes carry an interest rate of 10%, are for a term of 180 days, and are convertible into common stock of the company at \$0.75 per share. The company accrued interest of \$9,786 on the notes during the period ended May 31, 2010. At February 28, 2010 this also included \$67,500 in 10% demand notes payable that were converted into Common Stock of the Company during the quarter ended May 31, 2010. Except for the \$500,000 note due in 2013, these notes are past due and therefore due on demand.

Future maturities of notes payable at May 31, 2010 are as follows:

Year Ending February 28,	
2011	\$ 490,000
2012	-
2013	500,000
Total	<u>\$ 990,000</u>

7) Notes Payable- Related Party

At February 28, 2010 the balance consists of \$5,150,000 unsecured notes payable to a member of our Board of Directors, payable on demand, bearing interest at a rate of 10% per annum. During the three month period ended May 31, 2010, the Company received additional financing of \$1,050,000 from the related party, also at an interest rate of 10%, and \$138,301 accrued and unpaid interest for the period was included in accrued expenses. Also consists of a \$360,000 unsecured convertible note payable to our CEO entered into in March 2010, less a debt discount of \$23,400. The note is for 120 days, carries an interest rate of 10% and is convertible into shares of our common stock at a price of \$0.75 per share. During the period ended May 31, 2010, we accrued \$7,930 in interest on the note.

8) Capital

During the quarter ended May 31, 2010, we issued 757,130 shares of Common Stock for cash consideration of \$470,925. We also issued 235,000 shares of Common Stock for the conversion of \$124,978 of notes payable and accrued interest. We also issued 643,384 shares of Common Stock for services valued at \$468,000.

During the quarter ended May 31, 2009, we issued 582,916 shares of Common Stock for cash consideration of \$335,000. We issued 165,000 shares for a subscription receivable of \$90,000, which was received in June, 2009. We also received \$ 130,000 for 216,666 shares issued in June 2009. We also issued 94,428 shares of common Stock upon the exercise of 94,428 warrants, for cash consideration of \$94,428, and issued 58,333 shares of Common Stock for the conversion of \$35,000 of notes payable.

Employee Stock Options

In September 2006, our Board of Directors adopted the 2006 Employee Stock Option Plan. Activity in this plan is as follows:

	2006 Plan		
	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Number of Options
Outstanding, February 28, 2010	\$1.50		6,283,500
Issued	\$1.50		224,000
Cancelled	\$1.50		(3,000)
Outstanding, May 31, 2010	\$1.50		6,504,500

The exercise prices for the options outstanding at May 31, 2010, and information relating to these options is as follows:

Range of Exercise Price	Options Outstanding		Exercisable Options			
	Number	Weighted Average Remaining Life	Weighted Average Exercise Price	Weighted Average Remaining Life	Number	Weighted Average Exercise Price
\$1.50	6,504,500	3.98 years	\$ 1.50	3.95 years	6,230,745	\$ 1.50

Warrants

Activity in issued and outstanding warrants is as follows:

	Number of Shares	Exercise Prices
Outstanding, February 28, 2010	6,612,793	\$0.75-4.00
Issued	350,642	\$1.50
Outstanding, May 31, 2010	6,963,435	\$0.75-4.00

The exercise prices for the warrants outstanding at May 31, 2010, and information relating to these warrants is as follows:

Range of Exercise Prices	Stock Warrants Outstanding	Stock Warrants Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price of Warrants Outstanding	Weighted-Average Exercise Price of Warrants Exercisable	Intrinsic Value
\$1.50	350,642	350,642	93 months	\$1.50	\$1.50	\$0.00
\$0.75-1.25	1,354,710	1,354,710	50 months	\$1.25	\$1.25	\$0.00
\$1.50	1,900,000	1,900,000	49 months	\$1.50	\$1.50	\$0.00
\$2.00-\$3.00	1,934,991	1,934,991	9 months	\$2.44	\$2.49	\$0.00
\$3.50	805,589	805,589	19 months	\$3.50	\$3.50	\$0.00
\$4.00	617,503	617,503	8 months	\$4.00	\$4.00	\$0.00
	<u>6,963,435</u>	<u>6,963,435</u>				

9) Segment Information

We are a United States based company providing advanced technology products to various industries. The principal markets for our products are North America, Europe, and Asia. All of our operating long-lived assets are located in the United States. We operate in one segment.

Total net revenues from customer geographical segments are as follows for the three month periods ended May 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
United States	\$ 393,802	\$ 612,291
Canada	81,339	4,493
Asia	99,000	0
Europe	6,347	15,911
Other	<u>7,500</u>	<u>-</u>
Total	<u>\$ 587,988</u>	<u>\$ 632,695</u>

10) Significant Customers

In the three months ended May 31, 2010, we sold AuraGen related products to three significant customers whose sales comprised 29%, 17% and 13% of net sales, respectively. These customers are not related to or affiliated with us. In the three months ended May 31, 2009, we sold AuraGen related products to two significant customers whose sales comprised 64% and 14% of net sales, respectively. These customers are not related to or affiliated with us.

At May 31, 2010, we held accounts receivable from these customers for totaling 37%, 1% and 15%, respectively, of net accounts receivable. At May 31, 2009, we held accounts receivable from these customers for totaling 52% and 19%, respectively, of net accounts receivable.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This Report contains forward-looking statements within the meaning of the federal securities laws. Statements other than statements of historical fact included in this Report, including the statements under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations," regarding future events or prospects are forward-looking statements. The words "approximates," "believes," "expects," "anticipates," "estimates," "intends," "plans" "would "should," "may," or other similar expressions in this Report, as well as other statements regarding matters that are not historical fact, constitute forward-looking statements. We caution investors that any forward-looking statements presented in this Report are based on the beliefs of, assumptions made by, and information currently available to, us. Such statements are based on assumptions and the actual outcome will be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance and some will inevitably prove to be incorrect. As a result, our actual future results may differ from our expectations, and those differences may be material. Accordingly, investors should use caution in relying on forward-looking statements to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include the following:

- Our ability to generate positive cash flow from operations;
 - Our ability to obtain additional financing to fund our operations;
 - Our business development and operating development; and
 - Our expectations of growth in demand for our products.
-

- For further information regarding these and other risks and uncertainties, we refer you to Part I, Item 1A of our Form 10-K for the fiscal year ended February 28, 2009.

We do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise except to the extent required by law. You should interpret all subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf as being expressly qualified by the cautionary statements in this Report. As a result, you should not place undue reliance on these forward-looking statements.

Overview

We design, assemble and sell the AuraGen®, our patented mobile power generator that uses the engine of a vehicle to generate power. The AuraGen® delivers on-location, plug-in electricity for any end use, including industrial, commercial, recreational and military applications. We began commercializing the AuraGen® in late 1999. To date, AuraGen® units have been sold in numerous industries, including recreational, utilities, telecommunications, emergency/rescue, public works, catering, oil and gas, transportation, government and the military.

We have not yet achieved a level of AuraGen® sales sufficient to generate positive cash flow. Accordingly, we have depended on repeated infusions of cash in order to maintain liquidity as we have sought to develop sales.

Our financial statements included in this report have been prepared on the assumption that we will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, as a result of our losses from operations, there is substantial doubt about our ability to continue as a going concern. . Our independent auditors, in their report on the Company's financial statements for the year ended February 28, 2010 expressed substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amount and classification of liabilities that may result from our possible inability to continue as a going concern.

Our ability to continue as a going concern is dependent upon the successful achievement of profitable operations, and the ability to generate sufficient cash from operations and obtain financing resources to meet our obligations. There is no assurance that such efforts will be successful.

Our current level of sales reflects our efforts to introduce a new product into the marketplace. Many purchases of the product are being made for evaluation purposes. We seek to achieve profitable operations by obtaining market acceptance of the AuraGen® as a competitive - if not superior - product providing mobile power, thereby causing sales to increase dramatically to levels which support a profitable operation. There can be no assurance that this success will be achieved.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements requires management to make estimates and disclosures on the date of the financial statements. On an on-going basis, we evaluate our estimates, including, but not limited to, those related to revenue recognition. We use authoritative pronouncements, historical experience and other assumptions as the basis for making judgments. Actual results could differ from those estimates. We believe that the following critical accounting policies affect our more significant judgments and estimates in the preparation of our consolidated financial statements.

Revenue Recognition

We are required to make judgments based on historical experience and future expectations, as to the reliability of shipments made to our customers. These judgments are required to assess the propriety of the

recognition of revenue based on Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition," and related guidance. Because sales are currently in limited volume and many sales are for evaluative purposes, we have not booked a general reserve for returns. We will consider an appropriate level of reserve for product returns when our sales increase to commercial levels.

Inventory Valuation and Classification

Inventories consist primarily of components and completed units for our AuraGen® product. Inventories are valued at the lower of cost (first-in, first-out) or market. Provision is made for estimated amounts of current inventories that will ultimately become obsolete due to changes in the product itself or vehicle engine types that go out of production. Due to continuing lower than projected sales, we are holding inventories in excess of what we expect to sell in the next fiscal year. The net inventories which are not expected to be realized within a 12-month period based on current sales forecasts have been reclassified as long term. Management believes that existing inventories can, and will, be sold in the future without significant costs to upgrade it to current models and that the valuation of the inventories, classified both as current and long-term assets, accurately reflects the realizable values of these assets. The AuraGen® product being sold currently is not technologically different from those in inventory. Existing finished goods inventories can be upgraded to the current model with only a small amount of materials and manpower. We make these assessments based on the following factors: i) existing orders, ii) age of the inventory, iii) historical experience and iv) our expectations as to future sales. If expected sales volumes do not materialize, there would be a material impact on our financial statements.

Valuation of Long-Lived Assets

Long-lived assets, consisting primarily of property and equipment, and patents and trademarks, comprise a portion of our total assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying values may not be recoverable. Recoverability of assets is measured by a comparison of the carrying value of an asset to the future net cash flows expected to be generated by those assets. Net cash flows are estimated based on expectations as to the realize-ability of the asset. Factors that could trigger a review include significant changes in the manner of an asset's use or our overall strategy.

Specific asset categories are treated as follows:

Accounts Receivable: We record an allowance for doubtful accounts based on our expectation of collect-ability of current and past due accounts receivable.

Property, Plant and Equipment: We depreciate our property and equipment over various useful lives ranging from five to ten years. Adjustments are made as warranted when market conditions and values indicate that the current value of an asset is less than its net book value.

When we determine that an asset is impaired, we measure any such impairment by discounting an asset's realizable value to the present using a discount rate appropriate to the perceived risk in realizing such value. When we determine that an impaired asset has no foreseeable realizable value, we write such asset down to zero.

Results of Operations

First Quarter FY 2011 compared to First Quarter FY 2010

Net revenues for the three months ended May 31, 2010 (the "First Quarter FY2011") decreased \$44,707 to \$587,988, from \$632,695 in the three months ended May 31, 2009 (the "First Quarter FY 2010"), a decrease of 7%. At the relatively low level of sales currently generated by the Company, net revenue can fluctuate substantially quarter to quarter based upon the timing of when orders come in and shipments are made.

Cost of goods decreased to \$300,134 in the First Quarter FY 2011, from \$301,092 in the First Quarter FY 2010, as a result of the decrease in net revenues.

Engineering, research and development expenses decreased \$47,442 (9%) to \$461,690 in the First Quarter FY2011 from \$509,132 in the First Quarter FY 2010. The decrease was due primarily to the downsizing of the facility in Georgia.

Selling, general and administrative expenses increased \$538,769 (30%) to \$2,328,464 in the First Quarter FY 2011 from \$1,789,695 in the First Quarter FY 2010. The increase is primarily due to non-cash charges of approximately \$490,000 for stock issued for the payment of services relating to marketing and investor relations, and stock issued as a finders fee to an individual relating to previous private placements.

Net interest expense in the First Quarter FY 2011 increased \$120,022 to \$220,526 from \$100,404 in the First Quarter FY 2010. The increase is primarily attributable to the increased interest expense associated with the loans from a member of our Board, partially offset by a decrease in other loans that were converted into our common stock in the fourth quarter of the prior fiscal year. The loans from our board member totaled \$6.2 million as of May 31, 2010, compared to \$2.5 million at May 31, 2009, and carry an interest rate of 10%.

Our net loss for the First Quarter FY 2011 increased \$656,617 (28%) to \$2,827,726 from \$2,171,109 in the First Quarter FY 2010 primarily as a result of the non-cash charges noted above and the increased interest expense coupled with the decrease in gross margin resulting from the decrease in net revenues.

Liquidity and Capital Resources

We had cash of approximately \$15,000 and \$45,000 at May 31, 2010, and February 28, 2010, respectively. We had a working capital deficit at May 31, 2010, and February 28, 2010 of \$(8,893,046) and \$(7,360,437), respectively. The working capital deficit includes demand notes payable to a board member of \$6,200,000 and \$5,150,000 at May 31 and February 28, 2010, respectively, and a 120 day convertible note payable to our CEO of \$360,000 at May 31, 2010. At May 31, 2010, we had accounts receivable, net of allowance for doubtful accounts, of \$423,324 compared to \$313,671 at February 28, 2010.

Net cash used in operations for the quarter ended May 31, 2010, was \$1,951,717, an increase of approximately \$360,000 from the comparable quarter in the prior fiscal year. Net cash provided by financing activities during the quarter ended May 31, 2010, was \$1,930,925, resulting primarily from net proceeds from notes payable of \$1,460,000, along with proceeds from the sale of Common Stock totaling approximately \$470,000.

We paid \$9,599 for acquisitions of property and equipment in the First Quarter FY2011 compared to \$108,685 for acquisitions of property and equipment in the First Quarter FY2010. The acquisitions in the prior year were primarily leasehold improvements to our new facility.

Accrued expenses at May 31, 2010, increased approximately \$322,000 from the February 28, 2010 balance. The increase is primarily due to an increase in payroll and payroll related expenses of approximately \$170,000 resulting from the deferral of salaries by several members of senior management, until such time as cash flow allows these amounts to be paid, and an increase in accrued interest on our outstanding notes payable of approximately \$150,000.

Net proceeds from the issuance of debt totaled \$1,460,000 in the First Quarter FY 2011, compared with \$892,500 in the First Quarter FY 2010. Included in the debt proceeds of \$1,460,000 in the first quarter of FY2011 is a total of \$1,050,000 from a member of our Board and \$360,000 from our CEO. Subsequent to the end of the first quarter of FY 2011, the board member loaned the Company an additional \$850,000 under the same terms and conditions as the previous loans. As of June 30, 2010, the total amount owing this board member is \$7,050,000 plus accrued interest of approximately \$591,500. If the Board member were to demand repayment, we do not currently have the resources to make the payment.

The Company had a deficit in shareholders' equity at May 31, 2010 of \$6,733,634, compared to \$5,162,405 at February 28, 2010. The deficit includes \$8,316,291 of non-cash expenses resulting from charges for stock option and warrant expense for fiscal years 2008, 2009, 2010, and the first quarter of fiscal 2011.

Since 2002 substantially all of our revenues from operations have been derived from sales of the AuraGen®. The cash flow generated from our operations to date has not been sufficient to fund our working capital needs, and we cannot predict when operating cash flow will be sufficient to fund working capital needs.

In the past, in order to maintain liquidity we have relied upon external sources of financing, principally equity financing and private indebtedness. We have no bank line of credit and require additional debt or equity financing to fund ongoing operations. The issuance of additional shares of equity in connection with any such financing could dilute the interests of our existing stockholders, and such dilution could be substantial. If we cannot raise needed funds, we would also be forced to make further substantial reductions in our operating expenses, which could adversely affect our ability to implement our current business plan and ultimately our viability as a company.

Capital Transactions

During the quarter ended May 31, 2010, we issued 757,130 shares of Common Stock for cash consideration of \$470,925. We also issued 235,000 shares of Common Stock for the conversion of \$124,978 of notes payable and accrued interest. We also issued 643,384 shares of Common Stock for services valued at \$468,000.

During the quarter ended May 31, 2009, we issued 747,916 shares of Common Stock for cash consideration of \$500,000. We also issued 94,428 shares of common Stock upon the exercise of 94,428 warrants, for cash consideration of \$94,428, and issued 58,333 shares of Common Stock for the conversion of \$35,000 of notes payable.

ITEM 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit, is recorded, processed, summarized and reported, within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms, and such information is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosures. Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures and have concluded, as of May 31, 2010, that they were effective.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during our fiscal quarter ended May 31, 2010, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II - OTHER INFORMATION

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

During the quarter ended May 31, 2010, we issued 757,130 shares of Common Stock for cash consideration of \$470,925. We also issued 235,000 shares of Common Stock for the conversion of \$124,978 of two notes payable and accrued interest. We also issued 643,384 shares of Common Stock for services valued at \$468,000. We also entered into a 120 day Convertible Note Payable with our CEO for \$360,000, which is convertible into our Common Stock at a price of \$0.75 per share.

All of the sales of unregistered securities are believed to be exempt from registration pursuant to Section 4(2) of the Securities Act of 1933 as these offerings were a private placement to a limited number of qualified investors without public solicitation or advertising.

ITEM 6. Exhibits

- 10.1 Convertible note payable dated March 12, 2010, by and between Melvin Gagerman and the Company.
- 31.1 Certifications pursuant to Rule 13a-14 under the Securities Exchange Act of 1934.
- 31.2 Certifications pursuant to Rule 13a-14 under the Securities Exchange Act of 1934.
- 32.1 Certification of CEO and CFO Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to § 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AURA SYSTEMS, INC.

(Registrant)

Date: July 16, 2010

By: /s/ Melvin Gagerman

Melvin Gagerman

Chief Financial Officer

(Principal Financial and Accounting Officer)

and Duly Authorized Officer)