

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.....August 31, 2013
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 October 10, 2013
Common Stock, par value \$0.0001 per share	88,414,499 shares

AURA SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS
AURA SYSTEMS, INC.
CONDENSED BALANCE SHEETS
(Unaudited)**

	August 31, 2013	February 28, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 31,785	\$ 89,196
Accounts receivable, net of allowance for doubtful accounts of \$50,000 at August 31, 2013 and February 28, 2013	536,020	279,551
Inventory - current	1,000,000	1,000,000
Other current assets	226,571	235,034
Total current assets	1,794,376	1,603,780
Deposits	61,944	61,944
Property, plant, and equipment, net	15,940	40,470
Inventory, non-current, net of allowance for obsolete inventory of \$1,247,959 and \$1,341,650 at August 31, 2013 and February 28, 2013, respectively	1,177,051	1,384,142
Total assets	\$ 3,049,311	\$ 3,090,336
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	\$ 944,053	\$ 1,202,382
Accrued expenses	2,169,623	1,601,740
Customer advances	23,864	12,598
Notes payable	948,990	3,004,990
Convertible notes payable, net of discount	2,155,628	503,509
Notes payable and accrued interest- related party	18,040,465	17,265,466
Total current liabilities	24,282,623	23,590,684
Convertible note payable, net of discount	1,142,769	1,097,938
Convertible note payable and accrued interest-related party, net of discount	1,882,678	-
Total liabilities	27,308,070	24,688,623
Commitments and contingencies		
Stockholders' deficit:		
Common stock, \$0.0001 par value; 150,000,000 shares authorized at August 31, 2013 and February 28, 2013; 88,414,499 and 76,604,573 issued and outstanding at August 31, 2013 and February 28, 2013, respectively	8,841	7,660
Additional paid-in capital	402,998,426	398,949,767
Accumulated deficit	(427,266,026)	(420,555,713)
Total stockholders' deficit	(24,258,759)	(21,598,286)
Total liabilities and stockholders' deficit	\$ 3,049,311	\$ 3,090,336

See accompanying notes to these unaudited condensed financial statements.

AURA SYSTEMS, INC.
CONDENSED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED AUGUST 31, 2013 AND 2012
(Unaudited)

	Three Months		Six Months	
	2013	2012	2013	2012
Net Revenues	\$ 615,389	\$ 303,904	\$ 1,423,915	\$ 1,071,472
Cost of goods sold	<u>311,735</u>	<u>106,915</u>	<u>631,955</u>	<u>460,026</u>
Gross Profit	303,654	196,989	791,960	611,446
Expenses				
Engineering, research and development expenses	304,902	380,201	703,700	696,692
Selling, general and administrative expenses	<u>2,274,255</u>	<u>2,227,156</u>	<u>4,839,425</u>	<u>4,527,458</u>
Total costs and expenses	<u>2,579,157</u>	<u>2,607,357</u>	<u>5,543,125</u>	<u>5,224,150</u>
Loss from operations	<u>(2,275,503)</u>	<u>(2,410,368)</u>	<u>(4,751,165)</u>	<u>(4,612,704)</u>
Other (income) and expense				
Interest expense, net	1,455,568	944,198	2,171,866	1,825,095
Other (income) expense, net	<u>-</u>	<u>(6,666)</u>	<u>(212,717)</u>	<u>(8,166)</u>
Total other (income) expense	<u>1,455,568</u>	<u>937,532</u>	<u>1,959,149</u>	<u>1,816,929</u>
Net Loss	<u>\$ (3,731,071)</u>	<u>\$ (3,347,900)</u>	<u>\$ (6,710,314)</u>	<u>\$ (6,429,633)</u>
Total basic and diluted loss per share	<u>\$ (0.04)</u>	<u>\$ (0.05)</u>	<u>\$ (0.08)</u>	<u>\$ (0.09)</u>
Weighted average shares used to compute basic and diluted income (loss) per share	<u>84,722,108</u>	<u>72,345,446</u>	<u>81,121,697</u>	<u>72,199,221</u>

*Weighted average number of shares used to compute basic and diluted loss per share is the same since the effect of the dilutive securities is anti-dilutive.

See accompanying notes to these unaudited condensed financial statements.

AURA SYSTEMS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED AUGUST 31, 2013 AND 2012
(Unaudited)

	2013	2012
Cash flow from operating activities:		
Net Loss	\$(6,710,314)	\$(6,429,633)
Adjustments to reconcile Net loss to net cash used in operating activities		
Depreciation Expense	24,530	90,527
Bad debt expense	-	(4,227)
Amortization of debt discount	455,860	1,196,025
Gain on settlement of debt	(203,110)	-
Stock issued for services	889,726	266,000
Fair market value of warrants issued for services	333,559	-
Provision for inventory obsolescence	(93,691)	(142,068)
Amortization of prepaid shares	-	268,206
Fair market value of stock options granted	215,014	131,707
(Increase) decrease in:		
Accounts receivable	(256,469)	680,748
Inventory	300,782	187,942
Other current assets and deposit	8,463	(289,410)
Increase (decrease) in:		
Accounts payable, customer deposit and accrued expenses	1,116,789	1,151,548
Net cash used in operations	(3,918,861)	(2,892,635)
Financing activities:		
Issuance of common stock	-	152,000
Proceeds from notes payable	535,000	1,455,000
Payments on notes payable	(120,000)	-
Proceeds from convertible notes payable	1,170,700	-
Payments on convertible notes payable	(306,250)	(1,531,250)
Proceeds from notes payable-related party, net	2,582,000	2,850,000
Net cash provided by financing activities:	3,861,450	2,925,750
Net increase (decrease) in cash & cash equivalents	(57,411)	33,115
Cash and cash equivalents at beginning of period	89,196	6,260
Cash and cash equivalents at end of period	\$ 31,785	\$ 39,375
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ 106,842	-
Income taxes	-	-

Unaudited supplemental disclosure of non-cash investing and financing activities:

During the six months ended August 31, 2013, \$1,330,112 of notes payable and accrued interest were converted into 2,660,225 shares of common stock, 1,833,333 shares of common stock and 916,666 7-year warrants to purchase our stock with an exercise price of \$0.75 were issued to re-price a prior issuance of stock in December 2012, and 4,254,250 shares of common stock were issued in exchange for the cancellation of warrants to purchase 5,005,000 shares of common stock at an exercise price of \$0.75 per share which would have expired on September 22, 2016.

See accompanying notes to these unaudited condensed financial statements.

AURA SYSTEMS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - ACCOUNTING POLICIES

Accounting principles

In the opinion of management, the accompanying balance sheets and related interim statements of income and comprehensive income, and cash flows include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Company's 2013 Form 10-K filed on June 12, 2013 with the U.S. Securities and Exchange Commission.

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.

Recently Issued Accounting Pronouncements

Accounting Standards Update No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists: An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. For example, an entity should not evaluate whether the deferred tax asset expires before the statute of limitations on the tax position or whether the deferred tax asset may be used prior to the unrecognized tax benefit being settled. The amendments in this Update do not require new recurring disclosures. ASU Topic No. 2013 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

Accounting Standards Update No. 2013-05, Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity: This ASU addresses the accounting for the cumulative translation adjustment when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. ASU Topic No. 2013-05 is effective for our fiscal year 2014, although early adoption is permitted. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In March 2013, the FASB issued guidance on a parent's accounting for the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had

resided. The new guidance will be effective for the Company beginning July 1, 2014. The adoption of this standard is not expected to have a material impact on the Company's financial statements.

In February 2013, the FASB issued ASU No. 2013-02, which amends the authoritative accounting guidance under ASC Topic 220 *Comprehensive Income*. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The amendments in this update are effective prospectively for reporting periods beginning after December 15, 2013. Early adoption is permitted. Adoption of this update is not expected to have a material effect on the Company's consolidated results of operations or financial condition.

Reclassifications

Certain reclassifications have been made to the comparative financial statements to conform to the current period presentation.

NOTE 2 – GOING CONCERN

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. During the six months ended August 31, 2013 and August 31, 2012, the Company incurred losses of \$6,710,314 and \$6,429,633, respectively and had negative cash flows from operating activities of \$3,918,861 and \$2,892,635, respectively.

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

Substantial additional capital resources will be required to fund continuing expenditures related to our research, development, manufacturing and business development activities. 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.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that could result from the outcome of this uncertainty.

NOTE 3 – INVENTORIES

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

	August 31, 2013	February 28, 2013
Raw materials	\$ 1,777,109	\$ 1,888,831
Finished goods	1,647,901	1,836,960
	<u>3,425,010</u>	<u>3,725,791</u>
Reserve for potential product obsolescence	(1,172,828)	(1,253,300)
Discount on long term inventory	(75,131)	(88,350)
	<u>(1,247,959)</u>	<u>(1,341,650)</u>

Non-current portion	2,177,051 (1,177,051)	2,384,141 (1,384,141)
Current portion	<u>\$ 1,000,000</u>	<u>\$ 1,000,000</u>

We assessed the net realize-ability and the related potential obsolescence of inventory. In accordance with this assessment, management has recorded a reserve of \$1,172,828 and \$1,253,300 as of August 31, 2013 and February 28, 2013, respectively. Management has also recorded a discount on long term inventory of \$75,131 and \$88,350 as of August 31, 2013 and February 28, 2013, respectively.

NOTE 4 – OTHER CURRENT ASSETS

Other assets of \$226,571 and \$235,034 are primarily comprised of vendor advances of \$206,253 and \$181,910 as of August 31, 2013 and February 28, 2013.

NOTE 5 – PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consisted of the following:

	August 31, 2013	February 28, 2013
Machinery and equipment	\$ 964,111	\$ 964,111
Furniture and fixtures	163,302	163,302
Leasehold improvements	485,080	485,080
	<u>1,612,493</u>	<u>1,612,493</u>
Less accumulated depreciation	(1,596,553)	(1,572,023)
Property, plant and equipment, net	<u>\$ 15,940</u>	<u>\$ 40,470</u>

Depreciation expense was \$24,531 and \$90,527 for the six months ended August 31, 2013 and August 31, 2012, respectively.

NOTE 6 – NOTES PAYABLE

Notes payable consisted of the following:

	August 31, 2013	February 28, 2013
Demand notes payable, at 10% and 16%	\$ 948,990	\$ 3,004,990
Convertible Promissory Note dated August 10, 2012, due August 10, 2017, convertible into shares of our common stock at a price of \$0.76 per share. The note carries an interest rate of 7% with interest only payments due on the 10 th of each month with the principal payment due on the maturity date.	755,128	724,056
Convertible Promissory Note dated October 2, 2012, due October 2, 2017, convertible into shares of our common stock at a price of \$0.76 per share. The note carries an interest rate of 7% with interest only payments due on the 2 nd of each month with the principal payment due on the maturity date.	387,641	373,882
Convertible Promissory Note dated November 2, 2012, due January 4, 2013, convertible into shares of our common stock at a price of \$0.76 per share. The note carries an interest rate of 7% with interest only payments due on the 2 nd of each month with the principal	-	350,000

payment due on the maturity date.

Senior secured convertible note dated September 23, 2011, due March 23, 2013, with 12 monthly payments commencing April 23, 2012 of \$306,250 per month. The notes have a stated interest rate of 0%, with prepaid interest of \$175,000. Balance net of Beneficial Conversion Feature	-	153,508
Senior secured convertible notes dated May 7, 2013, due June 15, 2013, convertible into shares of our common stock at a price of \$0.75 per share. The notes carry an interest rate of 12% with interest due on the last day of the month. If the note is not repaid by the due date, the interest rate increases to 16%.	1,882,678	-
Senior secured convertible notes dated June 20, 2013, due June 20, 2014, convertible into shares of our common stock at a price of \$0.75 per share. The notes carry an interest rate of 16% with interest due on the last day of the month. If the note is not repaid by the due date, the interest rate increases to 16%.	274,102	-
	<u>4,248,539</u>	<u>4,606,436</u>
Less: Current portion	<u>\$ 3,105,771</u>	<u>\$ 3,508,498</u>
Long-term portion	<u>\$ 1,142,768</u>	<u>\$ 1,097,938</u>

CONVERTIBLE DEBT

On September 23, 2011, Aura Systems, Inc. entered into a purchase agreement to sell convertible notes with a total principal value of \$3,675,000 and warrants to purchase shares of common stock to an investment fund managed by MDB Capital Group. The notes have a 1.5 year maturity date and are convertible into shares of common stock at the initial conversion price of \$0.75 per share. The warrants entitle the investors to acquire 4,900,000 and 490,000 shares and have an initial exercise price of \$1 and \$0.75 per share, respectively, and have a 5 year term. The proceeds of Convertible note were assigned between warrants and convertible note per ASC 470-20. The company recorded \$175,000 as a discount (prepaid interest), \$1,006,482 as capitalized financing cost and a discount of \$1,790,482 on shares to be issued upon conversion of the note into equity. This discount (prepaid interest), capitalized finance cost and discount will be amortized over the life of the note. The notes were repaid in full in March 2013 and the Company then entered into an exchange agreement with the note holders whereby the outstanding warrants held by the investors, which carried an exercise price of \$0.75 per share and would expire on September 22, 2016, were exchanged for our Common Stock at a ratio of 0.85 shares of common stock for each warrant outstanding.

On May 7, 2013, the Company transferred 4 notes payable with a total principal value of \$1,000,000 together with accrued interest, and consulting fees to a senior secured convertible note with a principal value of \$1,087,000 (“new note”) and warrants to Kenmont Capital Partners (the “holder”). The new note has a 1 year maturity date and is convertible into shares of common stock at the conversion price of \$0.75 per share, provided, that the Conversion Price shall automatically be reset to \$0.50 per share on June 15, 2013 if a Qualified Financing has not occurred on or prior to that date. The warrants entitle the holder to acquire 1,449,333 shares and have an initial exercise price of \$0.75 per share, and have a 7 year term. The Company recorded \$342,020 as a discount, which will be amortized over the life of the note.

On May 7, 2013, the Company transferred 2 note payables with a total principal value of \$550,000 together with accrued interest to a senior secured convertible note with a principal value of \$558,700 (“new note”) and warrants to LPD Investments, Ltd. (the “holder”). The new note has a 1 year maturity date and is convertible into shares of common stock at the conversion price of \$0.75 per share, provided, that the Conversion Price shall automatically be reset to \$0.50 per share on June 15, 2013 if a Qualified Financing has not occurred on or prior to that date. The warrants entitle the holder to acquire 744,933 shares and have an initial exercise price of \$0.75 per share, and have a 7 year term. The Company recorded \$175,793 as a discount, which will be amortized over the life of the note.

On May 7, 2013, the Company entered into an agreement with an individual (the “holder”) for the sale of \$750,000 of secured convertible note payable (the “Note”) and warrants to the holder. The Note has a 1 year maturity date and is convertible into shares of common stock at the conversion price of \$0.75 per share, provided, that the Conversion Price shall automatically be reset to \$0.50 per share on June 15, 2013 if a Qualified Financing has not occurred on or prior to that date. The warrants entitle the holder to acquire 1,000,000 shares and have an initial exercise price of \$0.75 per share, and have a 7 year term. The Company recorded \$235,985 as a discount, which will be amortized over the life of the note.

On June 20, 2013, the Company entered into an agreement with four individuals (the “holders”) for the sale of \$325,000 of secured convertible notes payable (the “Notes”) and warrants to the holders. The Notes have a 1 year maturity date and are convertible into shares of common stock at the conversion price of \$0.50 per share. If the Company receives no less than \$5,000,000 in aggregate gross proceeds from the sale of equity securities of the Company in one or series of related transactions after June 20, 2013 (“the Qualified Financing”), the Company shall deliver to each Holder a written offer to issue and sell to or exchange with such Holder such number of securities as is equal to the quotient of (x) the conversion balance of the Note divided by (y) 100% of the purchase price of the primary securities offered to investors pursuant to the Qualified Financing. The warrants entitle the holders to acquire 433,334 shares and have an initial exercise price of \$0.75 per share, and have a 7 year term. The Company recorded \$63,622 as a discount, which will be amortized over the life of the notes.

On August 19, 2013, the Company entered into an agreement with a member of its Board of Directors for the sale of \$2,500,000 of convertible notes payable (the “Notes”) and warrants to the holder. The notes carry a base interest rate of 9.5%, have a 4 year maturity date and are convertible into shares of common stock at the conversion price of \$0.50 per share. The warrants entitle the holder to acquire 5,000,000 shares and have an initial exercise price of \$0.75 per share and have a 7 year term. The Company recorded \$667,118 as a discount, which will be amortized over the life of the note.

Future maturities of notes payable at August 31, 2013 are as follows:

Year Ending February 28,	
2014	\$ -
2015	-
2016	-
2017	3,025,447
Total	<u>\$3,025,447</u>

CONVERTIBLE PROMISSORY NOTES

At February 28, 2013, the three other convertible promissory note payable amounted to \$1,447,938, net of discounts of \$402,063. The convertible notes (the “Notes”) bear interest at 7% per annum, and are convertible into common stock of the Company at \$0.76 per share (as well as variable conversion rates as described below). The notes are due on August 10, 2017, October 2, 2017, and January 4, 2013 and are unsecured. On May 7, 2013, the note due on January 4, 2013 was converted into a portion of the note due June 15, 2013, which carries an interest rate of 12%.

7% Convertible Promissory Notes:

On August 10, 2012 the Company entered into an agreement with the individual (the “holder”) for the sale of \$1,000,000 of unsecured Convertible Promissory Note (the “Note”) to the holder. The Convertible Promissory Note balance together with all accrued interest thereon shall be due and payable on August 10, 2017 and the annual interest rate is 7% per annum and is due to be repaid 5 years from the closing date. The Note holder will receive interest on the unpaid principal amount payable monthly in arrears on the tenth day of each calendar month commencing September 10, 2012. Interest shall be computed on the actual number of days elapsed over a 360-day year. The Holder has the right from and after the Date of Issuance, and until any time until the Convertible promissory note is fully paid, to convert any outstanding and unpaid principal portion of the Convertible promissory note into shares of Common Stock. The company recorded \$310,723 as a debt discount, which will be amortized over the life of the note.

On October 2, 2012 the Company entered into an agreement with the individual (the “holder”) for the sale of \$500,000 of unsecured Convertible Promissory Note (the “Note”) to the holder. The Convertible Promissory Note balance together with all accrued interest thereon shall be due and payable on October 2, 2017 and the annual interest rate is 7% per annum and is due to be repaid 5 years from the closing date. The Note holder will receive interest on the unpaid principal amount payable monthly in arrears on the second day of each calendar month commencing November 2, 2012. Interest shall be computed on the actual number of days elapsed over a 360-day year. The Holder has the right from and after the Date of Issuance, and until any time until the Convertible promissory note is fully paid, to convert any outstanding and unpaid principal portion of the Convertible promissory note into shares of Common Stock. The company recorded \$137,583 as a debt discount, which will be amortized over the life of the note.

On November 2, 2012 the Company entered into an agreement with the individual (the “holder”) for the sale of \$350,000 of unsecured Convertible Promissory Note (the “Note”) to the holder. The Convertible Promissory Note balance together with all accrued interest thereon shall be due and payable on January 4, 2013 and the annual interest rate is 7% per annum and is due to be repaid 2 months from the closing date. The Note holder will receive interest on the unpaid principal amount payable monthly in arrears on the second day of each calendar month commencing December 2, 2012. Interest shall be computed on the actual number of days elapsed over a 360-day year. The Holder has the right from and after the Date of Issuance, and until any time until the Convertible promissory note is fully paid, to convert any outstanding and unpaid principal portion of the Convertible promissory note into shares of Common Stock. On May 7, 2013, this note was converted into a portion of the note due June 15, 2013, which carries an interest rate of 12%.

The Convertible Notes have a variable conversion price. If, at any time while the Notes remain outstanding, the Company issues or sells any Convertible Securities and the lowest price per share for which one share of Common Stock is issuable upon the conversion, exercise or exchange thereof is less than the then Conversion Price of the Notes (such lower price, the "Dilutive Price"), then the Conversion Price of these Notes shall be adjusted to reflect such Dilutive Price. Such adjustment shall be made upon the issuance or sale of the Convertible Security bearing a dilutive price. In the event of default for the Notes, the amount of principal and interest not paid when due becomes immediately due and payable.

NOTE 7 - ACCRUED EXPENSES

Accrued expenses consisted of the following:

	<u>August 31, 2013</u>	<u>February 28, 2013</u>
Accrued payroll and related expenses	\$ 2,046,623	\$ 1,564,496
Accrued interest	117,210	30,867
Other	5,790	6,377
Total	<u>\$ 2,169,623</u>	<u>\$ 1,601,740</u>

Accrued payroll and related expenses consisted primarily of salaries accrued but not paid to certain employees. As of August 31, 2013 and February 28, 2013, these amounts total \$1,352,640 and \$927,984, respectively. Also included in this amount is accrued vacation expense of \$464,999 and \$411,667 at August 31, 2013 and February 28, 2013, respectively.

NOTE 8–SHAREHOLDERS’ EQUITY

Common Stock

During the six months ended August 31, 2013, \$1,330,112 of notes payable and accrued interest were converted into 2,660,225 shares of common stock, 595,451 shares of common stock were issued for services and expenses related to the notes valued at \$297,726, 1,833,333 shares of common stock were issued to re-price a prior issuance of stock in December 2012, 1,266,667 shares valued at \$304,000 and 1,000,000 warrants valued at \$133,424 were issued as a settlement for failure to repay a \$500,000 note when due, 700,000 shares valued at \$168,000 and 700,000 warrants valued at \$93,397 were issued as consideration for issuing a letter of credit for \$350,000 on Aura’s behalf, 500,000

shares valued at \$120,000 and 800,000 warrants valued at \$106,739 were issued to an individual as consideration for joining Aura's Board of Directors and 4,254,250 shares of common stock were issued in exchange for the cancellation of warrants to purchase 5,005,000 shares of common stock at an exercise price of \$0.75 per share which would have expired on September 22, 2016.

During the six months ended August 31, 2012, we issued 350,000 shares of Common Stock for services rendered valued at \$266,000, 200,000 shares of common stock for consideration of \$152,000, and 206,941 shares upon conversion of \$157,276 of notes payable and accrued interest.

Employee Stock Options

During the six months ended August 31, 2013 we granted 233,333 options as a performance bonus to our Vice-President of sales and 7,000 options to other employees.

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, 2013	\$0.75-\$1.00	\$0.00	8,548,000
Cancelled	-	-	-
Granted	\$0.75	\$0.00	240,333
Outstanding, August 31, 2013	\$0.75-\$1.00	\$0.00	8,788,333

The exercise prices for the options outstanding at August 31, 2013, and information relating to these options is as follows:

Options Outstanding			Exercisable Options			
Range of Exercise Price	Number	Weighted Average Remaining Life	Weighted Average Exercise Price	Weighted Average Remaining Life	Number	Weighted Average Exercise Price
\$0.75-\$1.00	8,788,333	6.40 years	\$ 0.79	6.50 years	8,421,666	\$ 0.79

Warrants

Activity in issued and outstanding warrants is as follows:

	Number of Shares	Exercise Prices
Outstanding, February 28, 2013	38,783,290	\$0.75-\$3.00
Granted	12,262,096	\$0.75
Cancelled	(5,005,000)	\$0.75
Outstanding, August 31, 2013	46,040,386	\$0.75-\$3.00

The exercise prices for the warrants outstanding at August 31, 2013, and information relating to these warrants is as follows:

Weighted-	Weighted-
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Range of Exercise Prices	Stock Warrants Outstanding	Stock Warrants Exercisable	Weighted-Average Remaining Contractual Life	Average Exercise Price of Warrants Outstanding	Average Exercise Price of Warrants Exercisable	Intrinsic Value
\$0.75	8,893,334	8,893,334	83 months	\$0.75	\$0.75	\$0.00
\$0.75	3,368,762	3,368,762	80 months	\$0.75	\$0.75	\$0.00
\$0.75-\$1.00	8,756,942	8,756,942	71 months	\$0.81	\$0.81	\$0.00
\$1.00-\$1.25	1,220,000	1,220,000	37 months	\$1.03	\$1.03	\$0.00
\$1.00	16,722,787	16,722,787	36 months	\$1.00	\$1.00	\$0.00
\$1.50	155,000	155,000	31 months	\$1.50	\$1.50	\$0.00
\$0.75-1.50	1,109,198	1,109,198	28 months	\$1.17	\$1.17	\$0.00
\$1.50	156,000	156,000	24 months	\$1.50	\$1.50	\$0.00
\$1.50	704,000	704,000	23 months	\$1.50	\$1.50	\$0.00
\$1.50	350,642	350,642	20 months	\$1.50	\$1.50	\$0.00
\$0.75-\$2.00	58,000	58,000	16 months	\$1.78	\$1.78	\$0.00
\$2.00	725,721	725,721	13 months	\$2.00	\$2.00	\$0.00
\$0.75-2.00	3,650,000	3,650,000	10 months	\$1.03	\$1.03	\$0.00
\$3.00	170,000	170,000	3 months	\$3.00	\$3.00	\$0.00
	<u>46,040,386</u>	<u>46,040,386</u>				

NOTE 9 –INCOME TAXES

Our effective tax rates were approximately 0.0% for the six months ended August 31, 2013 and 2012. Our effective tax rate was lower than the U.S. federal statutory rate primarily due to the fact that we record a full valuation allowance against our deferred tax assets, which is primarily comprised of net operating losses.

NOTE 10 - 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 six months ended August 31, 2013 and 2012:

	2013	2012
United States	\$ 1,150,137	\$ 753,315
Canada	78,961	31,366
Europe	24,218	63,316
Asia	161,849	187,031
Other	8,750	36,444
Total	<u>\$ 1,423,915</u>	<u>\$ 1,071,472</u>

NOTE 11 – SIGNIFICANT CUSTOMERS

Concentration Risk

In the six months ended August 31, 2013, we sold AuraGen related products to five significant customers whose sales comprised 27.5%, 16.1%, 10.8%, 9.8% and 8.8% of net sales, respectively. Net accounts receivable from these customers at August 31, 2013 were \$111,575, \$194,250, \$22,076, \$32,618 and \$5,134 respectively. These customers are not related to or affiliated with us. In the six months ended August 31, 2012, we sold AuraGen related

products to four significant customers whose sales comprised 25%, 15%, 8% and 8% of net sales, respectively. Net accounts receivable from these customers at August 31, 2012 were \$50,242, \$0, \$11,227 and \$0 respectively. These customers are not related to or affiliated with us.

NOTE 12 – RELATED PARTIES TRANSACTIONS

At August 31, 2013, the balance in Notes Payable and accrued interest-related party, current, includes \$13,819,960 of unsecured notes payable plus accrued interest of \$4,135,220 to a member of our Board of Directors, payable on demand, bearing interest at a rate of 10% per annum. During the six months ended August 31, 2013 and August 31, 2012, interest amounting to \$689,714 and \$604,091 respectively, was incurred on these notes. The balance also includes \$82,000 of unsecured notes payable plus accrued interest of \$3,284 to our CEO pursuant to a demand note entered into on April 5, 2013. At August 31, 2013, the balance in Convertible note payable and accrued interest-related party, long term, includes \$1,838,822 of secured notes payable net of discounts of \$661,178 plus accrued interest of \$43,857 to another member of our Board of Directors. The Company also issued the following stock and warrants to this board member: 1,833,333 shares of our common stock and 916,666 7 year warrants with an exercise price of \$0.75 as a re-pricing of a previous issuance made in December 2012, 1,266,667 shares of our common stock and 1,000,000 7 year warrants with an exercise price of \$0.75 for failure to repay a \$500,000 note when due, 700,000 shares of our common stock and 700,000 7 year warrants with an exercise price of \$0.75 for issuing a \$350,000 letter of credit on Aura's behalf, 500,000 shares of our common stock and 800,000 7 year warrants with an exercise price of \$0.75 for joining Aura's Board of Directors, and 5,000,000 7 year warrants attached to the \$2,500,000 convertible note which includes the unpaid \$500,000 note referred to above.

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, 2013.

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 a prime mover such as 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 and sold our first commercial units in late 2000 and early 2001. 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, 2013 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. Until recently, many purchases of the product were for evaluation purposes. Recently we started to receive repeat orders for larger quantities as different organizations are integrating our products into their vehicles. We seek to achieve profitable operations by obtaining market acceptance of the AuraGen[®] as a competitive - if not superior - product providing mobile power anywhere anytime. 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. 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 current use. 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 August 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 collectability 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

Six months ended August 31, 2013 compared to six months ended August 31, 2012

Net revenues for the six months ended August 31, 2013 (the "Six months FY2014") increased \$352,443 to \$1,423,915 from \$1,071,472 in the six months ended August 31, 2012 (the "Six months FY2013"), an increase of 33%. The increase is primarily attributable to increased sales to three existing customers and sales to a customer to whom there were no sales in the prior year period. These customers are ongoing customers, but do not order on a regular basis. Our customers typically order on an as needed basis and therefore our sales can fluctuate substantially between periods based on our customers' needs at a given time.

Cost of goods increased \$171,929 (37%) to \$631,955 in the Six months FY2014 from \$460,026 in the Six months FY2013. The increase in cost of goods is a result of the increase in sales for the period combined with the differences in gross margins between the 8kW and 5kW systems.

Engineering, research and development expenses increased \$7,008 (1%) to \$703,700 in the Six months FY2014 from \$696,692 in the Six months FY 2013. In the past, we have reduced our expenditures in this area due our financial situation and due to reduced efforts in developments of new configurations. We intend to increase our expenditures in this area in the near future.

Selling, general and administrative expense increased \$311,967 (7%) to \$4,839,425 in the Six months FY2014 from \$4,527,458 in the Six months FY2013. The increase is primarily attributable to non-cash charges of approximately \$226,739 for stock and warrants issued for directors' fees and an increase in consulting fees of approximately \$170,000, partially offset by a decrease in marketing expenses of approximately \$70,000 and a decrease in legal expense of approximately \$50,000.

Net interest expense in the Six months FY2014 increased \$346,771 (19%) to \$2,171,866 from \$1,825,095 in the Six months FY2013 as a result of our increased debt levels, and the non-cash amortization of the debt discount, warrant expense and beneficial conversion feature on the notes payable entered into in the current fiscal year partially offset by the decrease in the amortization of the debt discount on the financing completed in the third quarter of FY2012, which was fully repaid in the first quarter of the current fiscal year.

Our net loss for the Six months FY2014 increased \$280,681 to \$6,710,314 from \$6,429,633 in the Six months FY2013.

Three months ended August 31, 2013 compared to three months ended August 31, 2012

Net revenues for the three months ended August 31, 2012 (the "Second Quarter FY2013") increased \$311,485 to \$615,389 from \$303,904 in the three months ended August 31, 2012 (the "Second Quarter FY2013"), an increase of 102%. The increase is primarily attributable to increased sales to two existing customers and sales to a customer to whom there were no sales in the prior year period. These customers are ongoing customers, but do not order on a regular basis.

Cost of goods increased \$204,820 (192%) to \$311,735 in the Second Quarter FY2014 from \$106,915 in the Second Quarter FY2013. The increase in cost of goods is primarily a result of the increase in sales, combined with the differences in gross margins between the 8kW and 5kW systems.

Engineering, research and development expenses decreased \$75,299 (20%) to \$304,902 in the Second Quarter FY2014 from \$380,201 in the Second Quarter FY 2013. These expenses have decreased substantially in prior periods, but are expected to increase in future periods.

Selling, general and administrative expense increased \$47,099 (2%) to \$2,274,255 in the Second Quarter FY2014 from \$2,227,156 in the Second Quarter FY2013.

Net interest expense in the Second Quarter FY2014 increased \$511,370 (54%) to \$1,455,568 from \$944,198 in the Second Quarter FY2013 as a result of our increased debt levels, and the non-cash amortization of the debt discount, warrant expense and beneficial conversion feature on the notes payable entered into in the current fiscal year partially offset by the decrease in the amortization of the debt discount on the financing completed in the third quarter of FY2012, which was fully repaid in the first quarter of the current fiscal year.

Our net loss for the Second Quarter FY2014 increased \$383,171 to \$3,731,071 from \$3,347,900 in the Second Quarter FY2013.

Liquidity and Capital Resources

We had cash of approximately \$32,000 and \$89,000 as of August 31, 2013, and February 28, 2013, respectively. We had a working capital deficit at August 31, 2013, and February 28, 2013 of \$22,488,247 and \$21,986,904, respectively. The working capital deficit includes notes payable and accrued interest to related parties of \$18,040,465 and \$17,265,466 as of August 31 and February 28, 2013, respectively. As of August 31, 2013, we

had accounts receivable, net of allowance for doubtful accounts, of \$536,020 compared to \$279,551 as of February 28, 2013.

Net cash used in operations for the six months ended August 31, 2013, was \$3,918,861, an increase of \$1,026,226 from the comparable period in the prior fiscal year. Net cash provided by financing activities during the six months ended August 31, 2013, was \$3,861,450, resulting from net proceeds from notes payable.

There were no acquisitions of property and equipment in the six months FY 2014 or the six months FY 2013.

Accrued expenses as of August 31, 2013 increased \$567,883 to \$2,169,623 from \$1,601,740 as of February 28, 2013. Approximately \$1,353,000 of accrued expenses is salaries accrued but unpaid to certain employees and ex-employees due to a lack of resources, and approximately \$465,000 is accrued but unused vacation time earned by employees.

Net proceeds from the issuance of debt totaled \$3,861,450 in the six months FY 2014, compared with \$2,925,750 in the six months FY 2013. Net debt proceeds of \$82,000 in the six months of FY2014 were from our CEO, and debt repayments totaling \$306,250 were made on the \$3.5 million financing completed in the third quarter fiscal 2012. As of September 30, 2013, the total amount owing a board member is \$13,819,960 plus accrued interest of approximately \$4,250,000. If the board member were to demand repayment, we do not currently have the resources to make the payment. We also had net proceeds of \$2,500,000 from another board member in the six months of FY2014 from a convertible note we entered into. The total amount owing this board member at September 30, 2013 is \$1,846,682 net of unamortized discount of \$653,318, plus accrued interest of approximately \$64,000.

The Company had a deficit of \$24,258,759 in shareholders' equity as of August 31, 2013, compared to \$21,598,286 as of February 28, 2013. The deficit includes approximately \$16.1 million of non-cash expenses resulting from charges for stock option and warrant expense for fiscal years 2008 through the first nine months of fiscal year 2013.

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 six months ended August 31, 2013, \$1,330,112 of notes payable and accrued interest were converted into 2,660,225 shares of common stock, 595,451 shares of common stock were issued for services and expenses related to the notes valued at \$297,726, 1,833,333 shares of common stock were issued to re-price a prior issuance of stock in December 2012, 1,266,667 shares valued at \$304,000 and 1,000,000 warrants valued at \$133,424 were issued as a settlement for failure to repay a \$500,000 note when due, 700,000 shares valued at \$168,000 and 700,000 warrants valued at \$93,397 were issued as consideration for issuing a letter of credit for \$350,000 on Aura's behalf, 500,000 shares valued at \$120,000 and 800,000 warrants valued at \$106,739 were issued to an individual as consideration for joining Aura's Board of Directors and 4,254,250 shares of common stock were issued in exchange for the cancellation of warrants to purchase 5,005,000 shares of common stock at an exercise price of \$0.75 per share which would have expired on September 22, 2016.

During the six months ended August 31, 2012, we issued 350,000 shares of Common Stock for services rendered valued at \$266,000, 200,000 shares of common stock for consideration of \$152,000, and 206,941 shares upon conversion of \$157,276 of notes payable and accrued interest.

Inventories

Inventories consist primarily of components and completed units of the Company's AuraGen[®] product.

Early in our AuraGen[®] program, we determined it was most cost-effective to outsource production of components and subassemblies to volume-oriented manufacturers, rather than produce these parts in house. As a result of this decision, and based on then anticipated sales, we purchased, prior to fiscal 2001, a substantial inventory of components at volume prices. Since sales did not meet such expectations, we have been selling product from this inventory for several years. Management has analyzed its inventories based on its current business plan, current potential orders for future delivery, and pending proposals with prospective customers and has determined that we do not expect to realize all of its inventories within the next year. The net inventories as of May 31 and February 28, 2013, which are not expected to be realized within a 12-month period have been reclassified as long term.

Most of our inventory consists of a variety of (i) metallic, mechanical components, and (ii) electrical components including metallic chassis to hold the assembled electrical systems. The vast majority of mechanical components are not aged and most of the electrical components are also not aged. The components that are aged are related to the prime mover/Generator interface that may not be in demand any longer.

Currently, we offer and ship three different basic models of systems; (i) a 5 kW based systems, (ii) an 8.5 kW based system and (iii) a 16 kW based systems (two 8.5 kW systems configured in tandem back-to-back). Each of these systems can be configured with different options such as 110 VAC only, 220 VAC only, 24 VDC only, 12 VDC only and AC/DC combinations of the same or different voltages. In addition, the system can be configured with single phase, split phase or three-phase output.

A number of the mechanical components are common to all three of the above configurations, while others are very specific. For example, the stators and rotors for the 5 kW systems are different from the 8.5 kW systems, but the housings are the same. Similarly, the electrical components consist of some parts that are geared for a specific configuration while others are generic and can be used for all of the configurations. The electrical chassis are also interchangeable between the 5 kW and 8.5 kW configurations. Due to the nature and mix of the product being sold, frequently, the 5 kW electrical systems are upgraded to 8.5 kW systems by replacing some components.

From the above description one can understand that the inventory consists of numerous components and subassemblies but not finished systems; therefore each system that is sold and shipped to a customer is built from some components that are in inventory and others that need to be purchased to be able to configure the required system.

Currently, most of the product being shipped consists of 8.5 kW systems. These systems are built by using existing inventory subassemblies and parts, including some that can be used for both 5 kW and 8.5 kW systems, and additional parts that are purchased to provide the required configuration. Typically such systems are built using approximately 20 to 25 percent of existing inventory and approximately 75% of additional parts that are purchased.

However, most of the systems currently being sold to the Korean military consist of 5 kW systems. They have been purchasing approximately 100 systems per year and have indicated to us that they will continue to do so for the next five years. To date we have shipped over 500 such systems (in this case 100% of the rotors and stators are used from existing inventory and over 50% of the electrical parts are also from inventory).

In addition to the above, we constantly see demand for different and unique configurations that require the purchase of additional parts.

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 August 31, 2013, 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 August 31, 2013, which 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 six months ended August 31, 2013, \$1,330,112 of notes payable and accrued interest were converted into 2,660,225 shares of common stock, 595,451 shares of common stock were issued for services and expenses related to the notes valued at \$297,726, 1,833,333 shares of common stock were issued to re-price a prior issuance of stock in December 2012, 1,266,667 shares valued at \$304,000 were issued as a settlement for failure to repay a \$500,000 note when due, 700,000 shares valued at \$168,000 were issued as consideration for issuing a letter of credit for \$350,000 on Aura's behalf, 500,000 shares valued at \$120,000 were issued to an individual as consideration for joining Aura's Board of Directors and 4,254,250 shares of common stock were issued in exchange for the cancellation of warrants to purchase 5,005,000 shares of common stock at an exercise price of \$0.75 per share which would have expired on September 22, 2016.

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

- 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.

- 101.INS XBRL Instance Document
- 101.SCH XBRL Schema Document
- 101.CAL XBRL Calculation Linkbase Document
- 101.LAB Label Linkbase Document
- 101.PRE Presentation Linkbase Document

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: October 21, 2013

By: /s/ Melvin Gagerman

Melvin Gagerman

Chief Financial Officer

(Principal Financial and Accounting Officer
and Duly Authorized Officer)