Combining diesel and natural gas for clear cost efficiency

Annual report and financial Statements
31 December 2007

	Page
Highlights	2
Group Overview	3
Chairman's Statement	4
Chief Executive's Review	5
Business and Financial Review	8
Board of Directors	10
Directors' Report	12
Report on Directors' Remuneration	15
Statement of Directors' Responsibilities	17
Corporate Governance Statements	18
Independent Auditor's Report to the Members of Clean Air Power Limited	20
Consolidated Income Statement	21
Consolidated Balance Sheet	22
Company Balance Sheet	23
Consolidated Cash Flow Statement	24
Company Cash Flow Statement	25
Consolidated Statement of Changes in Equity	26
Company Statement of Changes in Equity	27
Notes to the Consolidated Financial Statements	28
Corporate Information	50

Genesis Vehicle System completed for Robert Wiseman Dairies in December 2007

2007 Highlights

- 16% increase in Group revenue to £4.70m, up from £4.07m in 2006.
- 74% increase in revenue from core Dual-Fuel™ technology to £3.04m, up from £1.74m in 2006.
- Gross profit increased by 15% to £2.03m, up from £1.76m in 2006.
- Net loss reduced by £0.83m to £2.90m (2006: £3.73m).
- Development of demonstration Dual-Fuel™ vehicle in cooperation with Volvo.
- Establishment of Australian subsidiary operation delivered 153% revenue increase within the region.
- Commencement of delivery of £1.50m vehicle system order in Australia for Mitchell Corp Pty Ltd.
- Follow up £0.90m order placed by Mitchells for delivery in 2008.
- £0.30m Wiseman Dairies order for Genesis vehicle system in the UK demonstrates increased momentum.
- Order book in January 2008 stood at £2.70m, equating to 57% of 2007 Group revenue.
- Financing package worth up to £5.00m agreed in April 2008.

Clean Air Power is pioneering the move towards using natural gas as a fuel for heavy goods vehicles by developing its patented technologies. These technologies allow an existing diesel engine to operate on a combination of diesel and natural gas with minimal change required to the base engine.

The solutions provided by Clean Air Power maintain diesel engine performance and efficiency while delivering significant fuel cost savings along with a marked reduction in carbon emissions.

In the last quarter of 2007 the sales momentum for Clean Air Power's Dual-Fuel™ products increased with the commencement of deliveries from two major orders, one in the UK and one in Australia. The Company is very encouraged by this improved traction for its core product range and plans to build on this progress in 2008.

Gas is introduced to the engine using our patented injectors allowing the diesel engine to burn up to 85% natural gas in place of diesel. Natural gas is a cheaper and cleaner fuel than diesel, therefore replacing diesel with gas leads to cost and emissions reductions. The Clean Air Power Dual-Fuel™ vehicles can run on 100% diesel at any time if gas is not available, representing a considerable advantage over spark ignited natural gas engines. This 'diesel fallback' feature is an important benefit of the Company's technology as it provides a level of reassurance for conservative operators who are considering adopting alternative technologies for their fleets.

The Clean Air Power Dual-Fuel™ technology is proven in that around 1,600 vehicles have already been fitted with the Dual-Fuel™ products worldwide. Some of these vehicles have completed more than a million miles and some have been running for more than seven years.

Initially founded in the USA in 1991, around £40m has been invested in developing the technology with the result that 63 patents are currently held or pending.

The holding company of the Group is based in Bermuda with operational subsidiaries in the UK, the USA and Australia. The Group was admitted to the AIM market of the London Stock Exchange in February 2006.

UK Production, R&D and Administration centre, Leyland, Lancashire

The main objectives for the management team are twofold;

i) to market the technology to major engine or truck manufacturers with a view to reaching a cooperation agreement.

ii) to adapt the technology in order that it may be applied to a larger range of heavy duty vehicles thereby increasing the potential market

The Group is actively selling its technology in the UK and Australia and significant progress has been made during the year in both of those markets, Clean Air Power plans to develop new products to meet the latest emissions regulations. The Group also plans to significantly develop its sales volumes and potential markets further by entering into a commercial agreement whereby its technology is adopted by an engine or truck manufacturer.

In addition to its core Dual-Fuel™ products the Group has two other valuable business divisions contributing both to the year on year growth in sales and margin.

- The Components division delivers innovative components that enable automotive and truck manufacturers to build spark ignited, natural gas vehicles that meet worldwide emissions regulations. Companies such as Volvo and Mercedes Benz are currently manufacturing engines with Clean Air Power's components, including hydraulic valves, gas injectors and coalescing filters. All components are certified by the EU standard ECE R 110. Global volumes of these natural gas engines are currently relatively low compared with gasoline or diesel engines, but growth rates are high and increasing further, driven by the environmental benefits of these cleaner engines.
- The Emissions Reduction division in the USA specialises in regulating engine emissions for large static diesel engines. New and more stringent legislation is driving the development and application of exhaust after-treatment in all areas where these static internal combustion engines operate. It is extremely unlikely that developments in base-engine technology will meet these regulations, thus indicating a future need for the type of solutions that the Group currently provides.

In the UK the Group has an administration centre in High Wycombe and an engineering and production facility in Leyland. In the USA Clean Air Power has a research and development and production facility in San Diego, California along with an Emissions Reduction facility in Houston, Texas. The Australian operation is mainly based in Perth.

Clean Air Power's technology delivers proven reductions in carbon emissions along with very significant fuel cost savings to truck operators. The past year has seen increases in fuel costs and ever more focus on the need to reduce carbon emissions. As such Clean Air Power is perfectly positioned to assist major corporations and governments to deliver on their environmental commitments while at the same time reducing operator's transport overheads.

Overview

This year has seen a material increase in sales momentum for our flagship Dual-Fuel™ technology and some exciting developments in our discussions with manufacturers.

Outlook

The sales growth generated during the last quarter of 2007 has been very encouraging and sales in the first quarter of 2008 continue to be strong. We have significantly strengthened our Australian team throughout 2007 and early 2008. We believe that this demonstration of commitment to the market has been well received and will help us build on the sales increase delivered in Australia during 2007.

The Company plans to continue to market its existing Dual-Fuel™ solutions in the UK and Australia in the coming year. In 2008 Clean Air Power plans to develop a Dual-Fuel™ solution for the UK and European market that can be fitted to a Euro V emissions compliant vehicle, a vehicle which has to meet the latest EU Emissions Regulations. Additionally in late 2008, the Company plans to launch a US04 emissions compliant product for Australia. Development of these products is already underway.

In November 2007 the Company announced that significant progress had been made with a major manufacturer concerning possible adoption of Clean Air Power's Dual-Fuel™ technology into their engines. These discussions are ongoing and the Company believes that the flexible nature of its technology offers potential solutions for a range of vehicles including heavy duty trucks, mid range trucks, buses but also for generators and, in theory, any diesel engine application.

In January 2008 Clean Air Power won a £0.50m order for our emissions division based in Houston, Texas and the Company's overall order book was strong, with orders of £2.70m being received in January 2008.

In early March 2008 Clean Air Power produced completed another Dual-Fuel™ demonstration vehicle for the Volvo Group. A 13 litre heavy duty Mack truck was converted and exhibited by Volvo Group at WIREC 2008 (Washington International Renewable Energy Conference). Mack Trucks Inc. is owned by Volvo Group.

In April 2008 the Company agreed a financing package to provide up to £5.00m gross proceeds for the Company between April 2008 and June 2009. Endeavor, Capital Management LLC, a longstanding and major shareholder in the Company, currently holding 18.5% of the Company's shares, has conditionally agreed to provide up to £4.65m of the new funds. The remaining funds will be provided by another institutional investor which has agreed to invest approximately £0.25m and the Company's management which is investing a further £0.10m. The funds raised will be used to further advance in-house product development, provide working capital to support existing operations and to provide resources for potential manufacturer cooperation activity.

Volvo FM9 converted in co-operation with Volvo Group in May 2007.

Looking ahead the company aims to be able to finalise a cooperation agreement with a major manufacturer during the coming year. Discussions are currently ongoing, and although progress has been somewhat slow in formalising such an agreement, we are encouraged by the recent progress that has been made to date.

In 2007 Clean Air Power increased revenues by 16% and reduced net loss by 22% thanks to a growth in sales of the company's Dual-Fuel™ products. The last quarter of 2007 saw a considerable acceleration in sales in both the UK and Australia. Most importantly, significant progress has been made as a result of our marketing efforts with a view to reaching a cooperation agreement with a major manufacturer.

We believe that our progress with manufacturers has been driven by the commercial success in 2007 of our Dual-Fuel™ vehicle technology. **Sales from our Dual-Fuel™ vehicle division increased by 74% to £3.04m in 2007 compared with £1.74m in 2006.**

The success of 2007 could not have been achieved without the dedication and commitment of all my colleagues in Clean Air Power. On behalf of myself and the whole board I would like to thank them for those efforts and look forward to continued success in 2008 and beyond.

The Group is ideally placed to take advantage of two significant and high profile global issues, increasing fossil fuel cost and growing concern over harmful emissions and CO_2. The Clean Air Power technology delivers a marked improvement in both of these areas and has already been proven on over 1,600 trucks worldwide.

Clean Air Power has 3 commercial divisions; Dual-Fuel™ vehicles systems, Components and Emissions Reduction systems.

Dual-Fuel™ vehicles systems

The core technology of the Group gives rise to Clean Air Power's patented Dual-Fuel™ system which allows a heavy duty diesel truck engine to run on a combination of both diesel and natural gas, thereby generating significant reductions in NOx, particulate and CO_2 emissions as well as generating cost savings for the operator.

2007 was a very successful year for this division with sales increasing by 74%.

The technology is currently available in two main variants; the interfaced product currently marketed in Australia and the Genesis product marketed in Europe.

Mitchell Corp Pty Ltd trucks being converted to Dual-Fuel™ in Melbourne, Australia

Interfaced vehicle system

In this solution Clean Air Power's technology is interfaced with the manufacturer's electronic engine management system. It requires the cooperation of the manufacturer and maximises the benefits in terms of carbon emissions and fuel cost savings. The current product offering is certified to EPA 02 and it can be fitted as an after-market solution to vehicles in the Australian and South American markets along with a number of developing countries.

In order to access the important US and European markets with an interfaced product Clean Air Power will need to produce a new variant of this product which complies with the latest engine emission regulations. The current strategy envisages this new product being delivered under a cooperation agreement with a major manufacturer although potentially the company could develop and market its own engine to address opportunities in these key markets.

Demand for the solution is growing, driven by the desire to reduce greenhouse emissions and the fuel cost savings available to operators. In the last quarter of 2007, 31 units were sold. During 2007 a further order from Mitchell Corp Pty Ltd in Australia for £0.90m followed their 2006 order for £1.50m bringing their total order to 70 vehicle systems.

Genesis vehicle system

The 'Genesis' system was developed specifically to be a retro fitted product which can be installed without the need for formal cooperation of the engine manufacturers. The solution does not interface directly with the vehicles own engine management system and the emissions and fuel savings are therefore lower than would be expected on a fully interfaced system, but still considerable. However, the demonstrated reductions in carbon emissions and fuel costs have proved the product to be commercially attractive.

To date Clean Air Power has developed the Genesis solution for both DAF and Mercedes Euro III vehicles. Clean Air Power is targeting major supermarket chains, logistics companies, parcel carriers and local authorities for its 'Genesis' product. We believe these types of organisation will appreciate the financial benefits of converting their vehicles to gas whilst also understanding that they will be reducing emissions of CO_2. Following an initial purchase of two vehicles, the Company was very pleased to receive an order for 20 units worth £0.30m from Robert Wiseman Dairies, one of the country's leading dairy product suppliers. These 22 vehicles are expected to generate fuel savings of £220,000 per year and around 260 tonnes of CO_2 per annum for Robert Wiseman Dairies.

Genesis Vehicle Systems production facility, Leyland, UK.

We also believe that there are opportunities in Europe where certain markets have more mature natural gas infrastructures or more beneficial natural gas versus diesel price differentials. Our target markets include Germany, Italy, the Netherlands and Sweden.

In 2008 Clean Air Power continues to sell the Euro III Genesis solution. The Company is in the process of developing a Genesis solution that can be fitted to Euro V emission compliant trucks and plans for its implementation in 2008 are in place.

Genesis was initially viewed as a transitional product for the Group. Its objective was to bring the benefits of Dual-Fuel™ to operators in a current market situation where none of the major truck manufacturers offer a Dual-Fuel™ solution. Once the operators began to enjoy the financial and environmental benefits of running vehicles on Dual-Fuel™, the Clean Air Power strategy foresaw two outcomes; an increased demand for further Dual-Fuel™ trucks from operators, and; a demonstration of real market demand to assist Clean Air Power in its negotiations with truck manufacturers.

Having achieved its initial objective of attracting the attention of major manufacturers the Genesis product continues to offer strong potential as a useful revenue generator. In the UK and European markets it can continue to produce revenue in advance of anticipated future revenues resulting from a manufacturer cooperation agreement. Importantly there is considerable potential to sell variants of the Genesis product into markets in developing countries for a number of years to come.

OEM Developments

Our main strategic goal is to work with vehicle and engine manufacturers to reach an agreement whereby the Dual-Fuel™ technology is incorporated on their vehicle as a standard option and develop it further with their full cooperation. In this way the benefits of our technology can be maximised. The Group has been actively pursuing this route to market with a number of such organisations.

The strategy has involved encouraging the engine manufacturers to adopt our technology in partnership with a combination of interested parties. Truck operators, environmental bodies and governments would all benefit from the widespread adoption of our Dual-Fuel™ technology. By demonstrating the benefits of our technology to these parties we have been able to enlist their support in building a compelling proposition for manufacturers.

Volvo FM9 demonstration vehicle, converted in May 2007.

Some Clean Air Power Dual-Fuel™ vehicles have run for seven years and others have completed more than a million miles running on Dual-Fuel™ systems.

An important and exciting event in 2007 was the development of a Dual-Fuel™ demonstration vehicle in conjunction with the Volvo Group. Volvo is one of a number of manufacturers with whom Clean Air Power had been holding preliminary discussions. The heavy duty Euro V diesel truck uses an improved version of Clean Air Power's Genesis retrofit technology installed onto a Volvo 9 litre diesel engine. This was developed without direct access to the ECU software, but uses Controller Area Network (CAN) communication protocol that was jointly developed to more closely integrate the Dual-Fuel™ controls with the truck's existing systems.

The Volvo demonstration truck was displayed by the Volvo Group in a presentation in Stockholm before going on to a similar demonstration in Brussels and trade shows in northern Europe.

Clean Air Power believes that its technology could provide Volvo, and other manufacturers, with solutions applicable to a number of different types of vehicles on a global basis. The Volvo Group truck brands include Renault, Mack, Nissan Diesel and Volvo. In addition to trucks the Volvo Group product range includes marine applications, buses and construction equipment.

Clean Air Power has submitted proposals to Volvo for the further development and commercialisation of its technology. The Company understands the decision making lead times involved in such discussions with manufacturers but remains optimistic that the proven environmental and economic benefits of its technology will prove compelling.

In early March 2008 Clean Air Power produced completed another Dual-Fuel™ demonstration vehicle for the Volvo Group. A 13 litre heavy duty Mack truck was converted and exhibited by Volvo Group at WIREC 2008 (Washington International Renewable Energy Conference). Mack Trucks Inc. is owned by Volvo Group.

Components Division

Clean Air Power manufactures a number of the components that are used in the Group's Dual-Fuel™ technology. The Group also sells these components for spark ignited gas engines and certain other applications. Global demand for these engines is increasing as part of the overall shift towards alternative fuels. With sales mainly in Europe and the USA, strong margins and a customer base including international OEMs, this is an important supplement to the overall Clean Air Power business.

Manufacturing and Research & Development Operations, San Diego, California.

2007 sales grew from £1.43m in 2006 to £1.48m. In 2007 marketing efforts have been increased for this division and we expect to strengthen marketing activity further in 2008 in order to improve awareness of our product offering. This business tends to operate with long initial order lead times but thereafter receives regular ongoing revenues once customers have specified one of our products into their engines. Repeat orders can then be expected, often for the life of the vehicles. Late 2007 saw increased interest in this product area with new business being gained which is expected to continue into 2008. Growth in the Components division will also coincide with anticipated growth of the Group's Dual-Fuel™ vehicle conversion sales.

Emissions Reduction Division

This area of our business provides solutions to very large stationary diesel engines such as those used in pumping stations. Our current market is mainly in the USA and we provide a solution whereby the emissions from large stationary diesel engines are reduced, using Selective Catalytic Reduction technology and diesel particulate filtering, usually in response to the requirements of local legislation.

The business is mainly project based with a few large scale contracts generating the majority of the revenue, although a strategy is in place to develop revenue from smaller, more regular contracts.

2007 was a rather lean year for the division with sales of £0.19m being 79% below the 2006 level of £0.90m. This reduction was due to a single large project being delivered in 2006 but no similar type of project being available in 2007. However, in January 2008 Clean Air Power announced a £0.50m order for this division due to be delivered in the first half of the year.

The Group has had a good year in terms of progress with manufacturers regarding future revenues, and has also seen strong current year revenue growth from its existing Dual-Fuel™ products. During the year, Group revenue was 16% higher than the previous year at £4.70m (2006: £4.07m). This growth in revenue was generated principally by Dual-Fuel™ vehicle conversions in Australia.

The Group's financial and non financial highlights of the year were as follows:

	2007	2006	Change
	£'000	£'000	%
Group Revenue	4,704	4,072	+16%
Total Operating Loss before Exceptional and Non Cash Items *	(2,540)	(2,630)	-3%
Shareholders Funds	3,741	6,471	-42%
Cash and Cash Equivalents	1,814	5,617	-68%
Net Current Assets	2,749	5,929	-54%
Loss per Share	10.8p	14.8p	+27%
Average no of employees	59	51	+16%
Staff Turnover %	18.6	13.7	+4.9%
No of Installations	31	11	+182%

* Exceptional items and Non Cash Items include - depreciation, amortisation and share-based payments.

The increase in Group revenue relates mainly to improvements in the Vehicle Conversions segment with turnover of £3.04m (2006: £1.74m). The Vehicle Conversions increase was largely due to the increased number of operations in Australia on Dual-Fuel™.

Total operating loss before exceptional and non cash items improved by £0.09m (3%).

Shareholders funds decreased in 2007 mostly due to the Company making a loss of £2.90m during the period.

Net current assets for the year ended 31 December 2007 were £2.75m (2006: Net current assets £5.93m). This decrease is mainly due to the 2007 cash reduction of £3.80m.

Loss per share improved by 27%, this was mainly due to the Group reducing the loss for the period by £0.83m.

The average number of employees increased as the business expanded into Australia, to support the launch of the Genesis Dual-Fuel™ product.

Staff turnover increased by 4.9%.

Number of installations increased to 31 (2006: 11) units in the year. This improvement relates to the increased activity in the Australian subsidiary.

Revenue

Revenue for the Group showed strong growth as a result of increased Dual-Fuel™ vehicle conversions in Australia. This is most encouraging since the growth from our core flagship Dual-Fuel™ vehicle division increased by 74% to £3.04m in 2007 compared with £1.74m in 2006. Revenue from the Emissions Reduction segment was less than expected down by £0.71m. This was mainly due to the timing of contracts. 2008 has already seen an improvement with a major contract awarded for £0.50m.

Gross Profit and Cost of Sales

The gross profit margin for the Group for the year was 43% (2006: 43%) and the actual gross profit increased by 15% to £2.03m (2006: £1.76m). This was principally as a result of the growth in revenue generated by vehicle conversions.

Administration Costs

Administration costs were £4.93m (2006: £4.69m), which included in the incorporation of Clean Air Power Pty Ltd in Australia and the costs associated with the personnel of the entity. Staff costs increased as a result of additional investment in engineering personnel to further develop our product offering.

Share-based Payments

The share-based payments charges for the Group were £0.16 million (2006: £0.76 million).

Group Loss

The operating loss for the Group decreased by £0.62m to £3.07 (2006: £3.69m).

Taxation

Due to continued losses the Group reports no tax charge for 2007 (2006: nil).

Dividend

The directors do not recommend a dividend in respect of the current financial year (2006: nil) and no interim dividend was paid (2006: nil).

Balance Sheet and Liquidity

Explanations of the most significant items in the Balance Sheet during the year are as follows:

Intangible Assets

Intangible assets are carried at £0.72m (2006: £0.43m). This reflects product development costs capitalised in accordance with IAS 38 'Intangible Assets'. Intangible assets are tested annually for impairment and no impairment adjustment was required for the year ended 31 December 2007.

Trade and Other Receivables

The value of trade and other receivables increased by £0.48m to £1.64m in 2007 compared to the same date last year principally due to higher revenues, particularly in the last quarter of 2007.

Cash Flows

Cash and cash equivalents reduced by £3.80m to £1.81m (2006: £5.62m) during the year primarily due to trading losses and capital expenditure. Further analysis of this movement is included in the consolidated cash flow statement on page 24.

Trade and Other Payables

The value of trade and other payables has increased by £0.62m to £1.75m at 31 December compared to the same date in 2006. The increase is as a result of the increased purchases required to support higher sales activity levels in late 2007 and early 2008.

Treasury Policy and Financial Risk

The Group's treasury operation is managed within formally defined policies which are reviewed by the Board. The Group finances its activities with cash and overnight deposits. Other financial assets and liabilities, such as trade receivables and trade payables, arise directly from the Group's operating activities.

Surplus funds of the Group are invested through the use of short-term deposits with the objective of maximising fixed interest rate returns whilst still providing the flexibility to fund on-going operations when required. It is not the Group's policy to engage in speculative activity or to use complex financial instruments.

Key Performance Indicators

Financial

The Group uses the following primary measures to assess its performance and propositions.

- Revenue
  - o Revenue and revenue growth are used for internal performance analysis and by investors to assess progress against projections in the market.
- Operating Result
  - o Operating result and profitability trends are used for internal performance analysis and by investors to assess progress against projections in the market.
- Earnings per share
  - o Earnings per share is calculated as basic earnings per share from continuing operations.
- Cash
  - o Cash and cash equivalent balances are used for internal performance analysis and by investors to assess progress against projections in the market.

Non-financial

- No. of vehicle installations
  - o The Group's main activity is to market its technology with a view to it being installed on customer vehicles. The number of vehicle installations, and associated trends, is therefore a very important measure of progress.
- Staff Turnover
  - o Clean Air Power values its staff very highly and recognises that the success of the Group is largely due to the dedication and knowledge of its employees. Staff turnover is therefore regularly monitored.

International Financial Reporting Standards (IFRS)

The Group's conversion to IFRS was communicated to shareholders in the 2006 financial statements. These financial statements also include an explanation of the significant changes made and reconciliations from our previously published UK GAAP information. As previously advised, the change in reporting regime has not changed the fundamentals of the Group's businesses and actions required of management to maintain and improve shareholder value.

Rodney Westhead

Non-Executive Chairman

Rodney joined as a Director of Clean Air Power in January 2006 and was the Chairman of Carter & Carter plc, the Chairman of the AEA Technology Audit Committee and the Senior Non-Executive Director of Mouchelparkman plc. During his career in the British automotive industry, Rodney served as the Group Chief Executive of Ricardo plc, where he was responsible for managing a global range of companies engaged in automotive strategic and technology consulting. Rodney led the Group in strategic acquisitions of companies in the UK and Europe and established offices throughout the world. Ricardo is the largest automotive consultancy company in Europe with approximately £150million in annual turnover. Prior to serving as Chief Executive, Rodney served as the Group Finance Director. Rodney Westhead was a partner in Grant Thornton and had served as Managing Partner of the London office.

John Pettitt

President and Chief Executive

John joined Clean Air Power in August 2005 as part of the Group's focus on the world truck market. John has over twenty five years' senior level experience in General Management, Sales & Marketing within the business-to-business services sector. A successful track record of business development has been built on recruiting and developing strong management teams at all levels and providing clear direction and leadership. His career started with Thomson Yellow Pages and Thomson Directories reaching the position of Sales Controller with a staff of 350. Leaving Thomson after 13 years, he joined Lex Service plc as Sales Director of Lex Vehicle Leasing and helped that company grow from 15,000 to 50,000 vehicles in five years becoming the UK's leading vehicle leasing company. He left to become Managing Director of Fraikin Limited, the UK division of Europe's largest independent truck leasing business. After roles with TLS Truck Rental and Iveco-Ford Truck Limited, he rejoined Lex Service and remained there for five years before joining Clean Air Power. His last role was managing Lex Transfleet Airside Solutions, a company employing over 400 staff and maintaining 6,500 pieces of equipment and vehicles for British Airways at four UK airports.

Peter Rowse

Financial Director

Peter joined Clean Air Power in January 2006. Previously he served as Chief Financial Officer of DeLonghi America, Inc., the USA subsidiary of the Italian appliance company, where he was responsible for finance, IT management and development, human resource functions, and logistics. Peter was integrally involved in all commercial areas and strategic planning and was instrumental in the company's turnaround. Peter led several initiatives at DeLonghi to improve internal controls and played an active role in managing relationships with Canadian and Mexican operations. Peter also served as Controller, and later, Finance Director of DeLonghi Limited in the UK. During his tenure, the company grew revenue from £5 million to £50 million GBP. Prior to DeLonghi, he held financial and management accounting roles at Alexon Group plc and TNT Express Europe (UK) Limited. Peter is FCMA qualified.

Larry Wilson

Non-Executive Director

Larry joined as a Director in January 2006 and previously had been a Director of Clean Air Power Inc. since 2001. Prior to joining the board Larry worked for 43 years for Caterpillar, Inc. The past four years were in the earthmoving division with the remaining 39 in the engine division. He became Product Development Manager, responsible for all new engine products from 50-7,000 hp. During this period his organisation developed and introduced the 1.1 litre, 1.7 litre, 3500 & 3600 series engines. He then became the Strategy Planning Manager for Electric Power. Larry graduated from Rose Polytechnic Institute, Terre Haute, Indiana, with a BSME in 1959 and Bradley University, Peoria, Illinois, with an MBA in 1973. He spent eight years in active and reserve military duty in the Corps of Engineers.

Dr. Ulrich Wöhr

Non-Executive Director, Chairman of the Audit Committee

Ulrich joined as a Director in September 2006 and is currently Chairman of the Supervisory Board of BERU Aktiengesellschaft in Ludwigsburg, Germany, Deputy Chairman of the Supervisory Board of EAN European Avionics Navigationssysteme GmbH & Co. KG, Weilderstadt, Germany and advisor to several large and medium sized non listed and privately held companies, as well as shareholder and partner in the family owned Otto Wöhr GmbH, Friolzheim, a leading and worldwide supplier of mechanical and automatic car parking devices. During his career in the German industry, he served inter alia for almost 20 years as CEO/CFO of VDO Adolf Schindling AG, an important worldwide operating partner of the automotive industry.

Thereafter he was CFO of the then troubled Metallgesellschaft AG, Frankfurt am Main, followed by the CEO function in GEA AG Bochum, a company acquired by Metallgesellschaft AG in 1999. He retired in the year 2000 and from 2002 to 2004 he was responsible for the restructuring of Bundesdruckerei GmbH, Berlin, a former privatised German government printing body.

Hans Folkesson

Non-Executive Director

Hans joined as a Director in September 2006 and has 32 years experience in the automotive industry. He started his career with SAAB-SCANIA 1974 as a body-engineer and then held a number of positions within R&D and manufacturing engineering. After 18 years at Saab, Hans became Director for Research and Development at Skoda/VW in Mlada Boleslav Czechoslovakia. He led the first phase of product integration with the VW Group, including the development of the first generation Octavia based on the VW A4-platform. In 1995 Hans joined Volvo Trucks as Senior Vice President R&D, Purchasing and Quality and from 2000 was Senior Vice President for R&D at Volvo Cars, a subsidiary of Ford Motor Company.

Hans has a licentiate of engineering at Chalmers University of Technology and is a member of the Royal Swedish Academy of Engineering Sciences.

Bernard Lord

Non-Executive Director

Bernard Lord joined as a Director in July 2007 is a solicitor and lives in Fredericton, New Brunswick, Canada. Since completing his second term as Premier of the Province of New Brunswick in October 2006, he has joined the leading Canadian law firm McCarthy Tetrault LLP as Senior Counsel. His interest in transportation was evident during his tenure as premier, during which time major investment in infrastructure of the road network of New Brunswick was made.

His commitment to the environment was demonstrated by the creation of Efficiency New Brunswick, an agency dedicated to the reduction of energy consumption and costs, and improving the environment.

He holds a bachelor's degree in social science with a major in Economics, a bachelor's degree in common law from the Universite de Moncton and honorary doctorate degrees from the Universite de Moncton and St. Thomas University. He was elected four times as the MLA for Moncton East.

Financial statements

The Directors present their annual report and Group financial statements for the year ended 31 December 2007.

Principal Activities and review of the business

Clean Air Power continues to develop and market Dual-Fuel™ solutions to power heavy goods vehicles. In addition the Group sells specialised components used in the automotive industry and emissions reduction solutions for large stationary diesel engines.

The Group results are set out in the Consolidated Income Statement on page 21 and are explained in the Business and Financial Review on pages 8 to 9. A review of the Group's business and future development in contained in the Chairman's Statement on page 4 and the Chief Executive's Review on pages 5 to 7.

Results and dividends

The results of the Group are set out on page 23. The retained loss for the year is £2.90m (2006: £3.73m).

The Directors do not recommend the payment of a dividend in respect of the current financial year (2006: nil) and no interim dividend was paid (2006: nil).

Employment

The Group recognises and places considerable value on, the contribution made by all employees to the development of the Group and the achievement of its goals. The Group seeks to keep all its employees informed on matters affecting them as employees and affecting the Group as a whole.

Applications for employment by disabled persons are always fully considered, bearing in mind aptitudes of the applicants concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment within the Group continues and that appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible be identical with that of other employees.

Substantial shareholders

On 31 December 2007 the following persons had reported an interest of 3% or more in the issued ordinary share capital of the Group.

	No. of shares	Percentage of issued Ordinary Share Capital
Enertech Capital Partners	7,116,103	26.4%
HSBC Client Holdings Nominee (UK) Limited	4,968,942	18.5%
Royal Bank of Canada	3,392,459	12.6%
T. Hoare Nominees Limited	2,511,309	9.3%
Vidacos Nominees Limited	2,225,000	8.3%

No other person has reported an interest of 3% or more in the issued ordinary share capital.

Directors and Directors' Interests

The names and brief biographical details of Directors at the date of this report are set out on page 10 & 11.

Creditor Payment Policy

It is the Group's policy to settle terms of payment with suppliers when agreeing the terms of the transaction, to ensure suppliers are aware of these and abide by them. Normally, suppliers will be advised as soon as practicable of a dispute and payment will be made of that part of the invoice not in dispute unless good reason exists. Total creditor days for the period ending 31 December 2007 was 41days (2006: 43 days).

Donations

The Group made no political or charitable donations in the year (2006: £nil).

Risks and Uncertainties

The following factors may affect the Group's operating results, financial condition and/or the trading price of the Company's shares. The risk factors below are those the Directors believe are potentially significant but this should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties related to an investment in the Group.

Manufacturer Cooperation

The Group's current 'Genesis' technology for the UK and European Markets operates on vehicles complying with Euro III emissions technology. The Group has developed these solutions with very little cooperation from manufacturers. The judgement of the Group is that cooperation would be required from an engine manufacturer in order for the Group to develop its technology to maximise the potential reductions in emissions and fuel costs on today's newer generation vehicles. A manufacturer cooperation agreement would also be expected to provide additional comfort for customers along with additional sales and after sales resource.

In general the company's strategy assumes that the majority of medium and long term product development will take place in cooperation with a manufacturer. If the Group was not able to obtain such an agreement then its ability to generate sales from its Dual-Fuel™ technology would be significantly affected in the majority of its markets.

In House Product Development

The lifecycle of the current 'Genesis' Euro III product variant will end during 2008 for the UK market. The company intends to develop a Genesis product suitable to be fitted to Euro V vehicles during 2008. This should have a much longer commercial life but delays or technical barriers to completion of this product could affect future sales. Also a risk remains that, even assuming the Euro V version is successfully developed, some interested operators may prefer to wait until an OEM version is available with better economics and emissions levels. A similar issue exists within the Australian market where vehicles registered after 1 January 2008 will need to be certified to US EPA 04 and an internal solution is currently being developed.

Adaptation of the Core Technology

While the core technology has now been fitted to around 1,600 vehicles across the world a number of new product variants are in the process of development. Each new variant requires the adaptation of the core technology to each specific engine platform. If such adaptations are not able to be completed in line with the timing anticipated in Group plans then the ability to meet sales expectations could be adversely affected.

Gas Supply

The natural gas infrastructure across the world is much less developed than for existing road fuels. The Company is aware of a numbers of potential suppliers keen to enter the market. However, they may not wish to enter the market until there is an agreement with a major manufacturer. This issue also highlights one benefit of the Company's technology; if gas is not available for any reason the vehicles can operate on 100% diesel without any problem.

Regulatory Framework

The Group's products fall within a number of heavily regulated areas. In order to prosper the Group's technological solutions must keep pace with the increasingly stringent emissions legislation. Should the levels of taxation of diesel be reduced or the level of taxation on natural gas be increased in target markets then the financial benefits available to the Group's customers could be diminished. In this case demand for the products could be affected.

Competition/Intellectual Property

In the majority of markets the Group experiences relatively low levels of competition mainly due to the degree of technological development and patents that apply to the Group technology. The demand to reduce fuel costs and carbon emissions is attracting new players to the market. Competition is certainly increasing with some competitors making progress. Should they succeed in entering these markets and gaining commercial traction, with or without infringing the patents, then such competitive pressure could affect the ability of the Group to achieve sales and satisfactory margins.

Additional Capital Requirements

The Directors believe that, based on the current level of cash and the agreed new funding, additional funding may not be required. However, if the working capital needs exceed expectations or for some reason the agreed new funding was not received in line with the contracted terms then the Group may need to raise additional capital from equity or debt sources.

Employees

The relatively small size of the Group, 59 employees, does create risk in that key knowledge of certain aspects of the business is concentrated in a relatively small number of employees. Recruitment and training plans are in place to mitigate this risk.

Trading Risks

The trading performance of the Group could be affected by a number of factors outside its control, including currency risk. A significant proportion of the Group's activities will take place in the USA or Australia and there is the potential for exchange rates variances to impact on the profitability of the Group. In attempt to offset some of its exposure the Group maintains funds in different currencies to match its expected cash requirements.

Research and Development

The Group continues to undertake research and development to ensure a supply of future products. Where possible, new technology is patented and the Group currently holds 63 patents held and pending.

Future Developments

The Directors aim to maintain the management policies which have resulted in the Group's growth in 2007. They consider the best possibilities for growth in 2008 to be from sales of the Dual-Fuel™ technology in Australia and the UK and from global sales of components.

Financial Instruments

The Group's objectives and polices in respect of financial instruments are disclosed in Note 23 in the financial statements.

Disclosure of Information to the Auditors

So far as each person who was a Director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow Directors and the Group's auditor, each Director has taken all the steps that he is obliged to take as a Director in order to made himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditors

A resolution proposing the re-appointment of Ernst & Young LLP as auditors of the Company will be put to the forthcoming annual general meeting.

Signed on behalf of the board of Directors
Peter Rowse, Director, 8 April 2008

Introduction

The members of the Group's remuneration Committee are Rodney Westhead, Larry Wilson and Hans Gunnar Folkesson.

The Remuneration Committee is responsible for considering and making recommendations to the Board on:

- The Company's general policy on executive and senior management remuneration.
- The specific remuneration packages for executive directors of the Company, including basic salary, performance-based incentives, pensions and other benefits; and
- The design and operation of the Company's share schemes.

The remuneration of each executive director is determined on behalf of the Board by the Remuneration Committee. The remuneration of the non-executive directors is determined by the executive directors.

Remuneration Policy

Remuneration packages aim to attract, retain and motivate high calibre managers and reward individual performance. On appointment and periodically thereafter the Committee benchmarks the executive remuneration packages against appropriate comparators. The reward structure comprises the following elements:

Basic Salary and Benefits

In accordance with the remuneration policy outlined above, the salaries of the executive directors are reviewed annually. Consideration is also taken of an executive director's experience, responsibilities and performance. Performance is assessed both from an individual and business perspective.

Benefits in kind comprise of private medical insurance benefits for John Pettitt and Peter Rowse. Cash in lieu of a benefit in kind is in respect of a car allowance for both John Pettitt and Peter Rowse.

Pensions

The Company does not have a contributory pension scheme. All pension payments are paid directly into the directors' personal pension plans.

Fees

The fees of the non-executive directors are determined by the executive directors.

Performance Related Bonus

This is based on a fixed formula which is determined at the beginning of each financial year by the Remuneration Committee. The formula measures specified personal objectives and measures the Group's performance to specified targets principally relating to earnings before interest and tax. The amount of bonus is dependent on the level of performance achieved. John Pettitt was awarded £30,000 and Peter Rowse was awarded £15,000.

Share Option Schemes

Clean Air Power Ltd has operated Share Option Schemes since February 2006 under which executive directors, managers and staff of the Company are granted options over shares in Clean Air Power Ltd at prevailing market prices at the date of the grant.

Under the Executive Share Option Schemes, options are granted to executive directors and employees at the discretion of the Remuneration Committee and on the basis of their performance. Options are granted at the full market value of the Company's shares at the time of the grant and are exercisable between one year and ten years from the date of the grant.

Further information on the options issued to the Executive Directors is detailed below.

At 31 December 2007, the price of the Company's shares quoted on the AIM of the London Stock Exchange was 19.75p and the highest and lowest prices during the year ended 31 December 2007 were 71.50p and 19.75p respectively.

Service Contracts

The service contract and letters of appointment of the directors include the following terms:

Executive Directors	Date of Contract	Unexpired Term (months) or Rolling Contract	Notice Period (months)
John Pettitt	01.08.05	Rolling	12
Peter Rowse	01.01.06	Rolling	6
Non-Executive Directors			
Rodney Westhead	11.01.06	*	-
Larry Wilson	11.01.06	*	-
Hans Folkesson	15.09.06	*	-
Ulrich Wöhr	14.09.06	*	-
Bernard Lord	04.07.07	*	-

* Contracts for service initially for three years with an annual review thereafter.

There are no special provisions for compensation in the event of loss of office.

Directors' Remuneration

	Salary/ Fees	Consultancy	Annual Bonus	Benefits	Total 2007	Total 2006	Pension 2007	Pension 2006
Executive Directors:	**£**	**£**	**£**	**£**	**£**	£	**£**	£
John Pettitt	**165,000**	**–**	**30,000**	**14,590**	**209,590**	175,448	**14,850**	14,475
Peter Rowse	**102,500**	**–**	**15,000**	**9.898**	**127,398**	101,563	**6,150**	5,700
Non Executive Directors:								
Rodney Westhead	**42,000**	**–**	**–**	**–**	**42,000**	40,923	**–**	–
Hans Folkesson	**3,395**	**29,702**	**–**	**–**	**33,097**	4,947	**–**	≠–
Dr Ulrich Wöhr	**18,113**	**–**	**–**	**–**	**18,113**	4,208	**–**	–
Larry Wilson	**12,000**	**–**	**–**	**–**	**12,000**	12,000	**–**	–
Bernard Lord	**8,586**	**–**	**–**	**–**	**8,586**	–	**–**	–
(appointed 4 July 2007)								
Scott Ungerer	**–**	**–**	**–**	**–**	**–**	9,000	**–**	–
(resigned 26 September 2006)								
Wally Hunter (resigned 16 October 2006)	**–**	**–**	**–**	**–**	**–**	9,516	**–**	–
Total	**351,594**	**29,702**	**45,000**	**24,488**	**450,784**	357,605	**21,000**	20,175

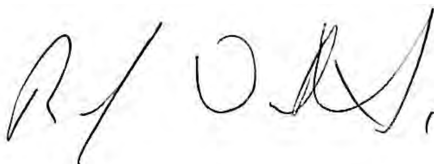
Directors' Interests

Set out below are the beneficial interests of the directors and their families in the share capital of the Company at the beginning and end of the year.

	Number of ordinary shares			
	Shares		**Options**	
	31.12.2007	01.01.2007 or later appointment	**31.12.2007**	01.01.2007 or later appointment
John Pettitt	35,000	10,000	1,441,791	1,441,791
Peter Rowse	5,000	–	241,168	192,239
Rodney Westhead	25,104	5,000	–	–
Hans Folkesson	20,000	–	–	–
Dr Ulrich Wöhr	–	–	–	–
Larry Wilson	–	–	–	–
Bernard Lord (appointed 4 July 2007)	–	–	–	–

Directors' Interests in the Group's Share Option Schemes

	At 1 January 2007	**Granted during the year**	**At 31 December 2007**	**Date of grant**	**Exercise price**	**Date first exercisable**	**Expiry date**
John Pettitt	1,441,791		1,441,791	27 Feb 2006	$0.98	27 Feb 2007	27 Feb 2017
Peter Rowse	48,060		48,060	28 Feb 2006	100p	28 Feb 2007	28 Feb 2017
Peter Rowse	36,045		36,045	28 Feb 2006	100p	1 March 2007	28 Feb 2017
Peter Rowse	36,045		36,045	28 Feb 2006	100p	1 June 2007	28 Feb 2017
Peter Rowse	36,045		36,045	28 Feb 2006	100p	1 September 2007	28 Feb 2017
Peter Rowse	36,044		36,044	28 Feb 2006	100p	1 December 2007	28 Feb 2017
Peter Rowse	–	48,929	48,929	13 Apr 2007	28.5p	13 March 2010	13 Mar 2017



Signed on behalf of the board of Directors
Rodney Westhead, April 2008

The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The Directors are required to prepare Group financial statements for each financial year which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those Group financial statements the Directors are required to:

- select suitable accounting policies in accordance with IAS 8: 'Accounting Policies, Changes in Accounting Estimates and Errors' and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- state that the Group has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors' are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Corporate governance , in general terms, is the way in which a Company is controlled and directed and, in particular is concerned with the role of the Board of Directors, how the Board and committees of the Board operate, and accountability within a Company.

The Company's shares are listed on the Alternative Investment Market (AIM) of the London Stock Exchange. The Company is subject to the AIM Admission Rules of the London Stock Exchange and is consequently not required to comply with best practice corporate governance provisions contained within Section 1 of the revised Combined Code (July 2003) ("Combined Code") appending to the Listing Rules of the Financial Services Authority. However, the Directors believe good corporate governance is essential. Having considered the provisions of the Combined Code, the Directors set out below the principles of the Combined Code and how the Company has applied those principles. The current size of the Company means that full compliance with the provisions of the Combined Code is not practical or cost effective. However, in areas where the Board of Directors believe that the provisions set out in the Combined Code are paramount to corporate governance, procedures for compliance have been established.

The Board

The Board of Directors is usually structured such that it includes a balance of Executive and Non-Executive Directors. As at 31 December 2007, the Board compromised one Non–Executive Chairman, four Non-Executive Directors and two Executive Directors including the Chief Executive Officer. The Executive Directors and the Non-Executive Directors bring a wide range of business expertise to the Board's discussions and decision making. The Board of Directors has put in place an organisational structure with clearly defined responsibilities and delegation of authority. Biographical details of all the Directors are set out on page 10 and 11.

The Board considers that the Non-Executive Chairman and three of the Non-Executives are independent of management. One of the Non-Executive Directors provides consultancy services relating to corporate development for which he is rewarded on a time spent basis.

The full board meets formally at least four times each year to consider all matters of significance for the Company as they arise, as well as matters reserved specifically for their consideration. These matters include development of business strategy and policy, the review and approval of operating budgets and monitoring business performance against objectives, the approval of significant financing and capital expenditure programmes, the approval of interim and annual financial statements and consideration of matters relating to internal control. The board is supplied in a timely manner with all relevant information to assist in the discharge of its duties.

All the Directors have access to the advice and services of the Company Secretary who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with.

Senior management meet on a regular basis and discuss all major issues affecting the Company which do not require Board discussion or approval by other Board Committees. It is the Company's policy to appoint Non-Executive Directors for specified terms, subject to re-election. All Directors are subject to re-election by shareholders at the first opportunity after their initial appointment, and to re-election thereafter in accordance with the Company's By-laws.

Remuneration Committee

The Remuneration Committee seeks to ensure that its policies on remuneration are such that the Company is able to attract and retain high calibre executives, and those executives are rewarded in a way consistent with the interest of shareholders. Remuneration and incentive packages are awarded according to the individual's performance, experience and responsibility.

The Remuneration Committee comprises three Non-Executive Directors and is chaired by Mr Rodney Westhead. The Executive Directors attend meetings of the Committee by invitation. The Committee meets at least annually and is responsible for making recommendations to the Board on the remuneration policy of the Executive Directors and senior staff, and for determining salaries, incentive payments and longer term incentives in the form of share options. Shareholders would be invited to approve any new long-term incentive schemes which might give rise to a significant dilution in their equity. The Remuneration of the Non-Executive Directors is set by the Executive Directors ensuring that no Director is responsible for the determination of his own remuneration.

In determining the level of remuneration, individual performance and competitiveness within the sector is considered when setting or reviewing the remuneration package of Executive Directors. Details of the Directors emoluments are disclosed at Note 9 to the financial statements.

Nomination Committee

The Nomination Committee comprises three Non-Executive Directors and is chaired by Mr Rodney Westhead. Its role is to ensure that appropriate procedures are in place for the nomination and selection of candidates for appointment to the board, having regard for the balance and the structure of the board. In appropriate cases, recruitment consultants are used to assist the process. The Committee also makes recommendations to the board regarding the re-election of Directors, succession planning and Board composition.

Accountability and Audit

All the Directors are equally accountable under the law for the proper stewardship of the Company's affairs. The Board acts in a way which allows all Directors to bring their independent judgement to bear on issues of strategy, performance, resources, including key appointments and standard of conduct.

Audit Committee

The Audit Committee comprises three Non-Executive Directors and is chaired by Dr Ulrich Wöhr. The Committee will review the Company's interim and annual financial statements before submission to the Board for approval. The committee will also review regular reports from management and the external auditors on accounting and internal control matters. Where appropriate, the committee will monitor the progress of action taken in relation to such matters. The audit committee will also recommend the appointment of and review the fees of the external auditors.

Internal Control

The Board of Detectors is responsible for ensuring that the Company maintains an adequate system of risk management and internal control. Due to the relatively small size of the Company, the processes it has employed to identify, evaluate and manage significant business risk have been informal, and have depended upon close business involvement of senior management, including the Executive Directors in all aspects of the Company's operations.

The Company maintains an adequate system of risk management and internal control, and an internal control environment which, in the opinion of the Directors, is appropriate for the Company's size and complexity. These controls include a budgeting process with an annual operating budget approved by the Board of Directors, a comprehensive financial reporting system, comparing actual results to budget (with variations to budget being thoroughly investigated with corrective action taken by the Directors as appropriate), the provision of monthly management accounts, annual budgets and forecasts, and operational limits on the delegation of financial authority.

Full management accounts are normally issued within twelve working days following the month end. Full financial forecast updates are produced bi-annually and the Company reports to shareholders bi-annually.

The Company does not currently have an internal audit function. The Board believes that this is appropriate given the current size of the Company.

Relations with Shareholders

The Company seeks to maintain and enhance its good relationship with its shareholders. This is achieved through the provision of interim and annual reports; through meeting with shareholders and presentations to them in general meetings and after major Company announcements; by responses to individual enquiries; and through the Company's website, www.cleanairpower.com. The Annual General Meeting is the primary opportunity to meet individual shareholders, to make presentations to them, to encourage their participation through questions and to talk informally to them after the formal proceedings. Separate resolutions are proposed at the Annual General Meeting on each substantially separate issue. The board is always ready, where practicable, to enter into dialogue with institutional and individual shareholders based on mutual understanding of objectives.

Going Concern

After making enquires, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

We have audited the group and parent company financial statements (the "financial statements") of Clean Air Power Limited for the year ended 31 December 2007 which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Consolidated and Company Cash Flow Statements, the Consolidated and Company Statement of Changes in Equity and the related notes 1 to 29. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body. Our audit work has been undertaken so that we might state to the company's members those matters we are required under International Standards on Auditing to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRSs as adopted by the European Union.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Highlights, Group Overview, Chairman's Statement, Chief Executive's Review, Business and Financial Review, Directors' Report and Corporate Governance Statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

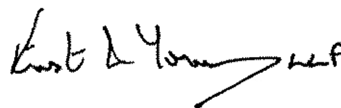
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2007 and of its loss for the year then ended; and
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the parent company's affairs as at 31 December 2007.



Ernst & Young LLP, Manchester, 8 April 2008

For the year ended 31 December 2007

	Notes	**Year ended 31 December 2007**	Year ended 31 December 2006
		£'000	£'000
Revenue	3	**4,704**	4,072
Cost of Sales		**(2,677)**	(2,314)
Gross profit		**2,027**	1,758
Administrative expenses		**(4,933)**	(4,689)
Share-based payments charge	25	**(161)**	(759)
Operating loss		**(3,067)**	(3,690)
Reorganisation expenses		**–**	(196)
Loss on ordinary activities before net finance revenue and taxation		**(3,067)**	(3,886)
Finance revenue	6	**171**	274
Finance costs	7	**(4)**	(117)
Loss on ordinary activities before taxation		**(2,900)**	(3,729)
Tax expense	10	–	–
Loss for the financial period		(2,900)	(3,729)
Basic and diluted loss per share	11	**10.8p**	14.8p

All items dealt with in arriving at operating loss above relate to continuing operations

At 31 December 2007

	Notes	31 December 2007	31 December 2006
		£'000	£'000
Assets			
Non-current assets			
Plant and equipment	12	**284**	116
Intangible assets	13	**715**	426
		999	542
Current assets			
Inventories	16	**1,488**	1,090
Trade and other receivables	17	**1,635**	1,159
Cash and cash equivalents	18	**1,814**	5,617
		4,937	7,866
TOTAL ASSETS		**5.936**	8,408
Equity and liabilities			
Equity attributable to equity holders of the parent			
Ordinary share capital share capital		**15**	15
Accumulated loss		**(39,151)**	(36,412)
Other reserves		**33,504**	33,410
Share premium		**8,982**	8,982
Translation reserve		**391**	476
Total equity		**3,741**	6,471
Non-current liabilities			
Other payables	22	**7**	–
		7	–
Current liabilities			
Trade and other payables	20	**1,750**	1,130
Provisions	21	**438**	807
		2,188	1,937
TOTAL LIABILITIES		**2,195**	1,937
TOTAL EQUITY AND LIABILITIES		**5,936**	8,408

The financial statements were approved by the Board of Directors on 8 April 2008 and were signed on its behalf by:

Director

At 31 December 2007

	Notes	31 December 2007	31 December 2006
		£'000	£'000
Assets			
Non-current assets			
Investments	14	**320**	320
Other financial assets	15	**9,361**	10,094
		9,681	10,414
TOTAL ASSETS		**9,681**	10,414
Equity and liabilities			
Equity attributable to equity holders of the parent			
Ordinary share capital		**15**	15
Share premium		**8,982**	8,982
Accumulated profit		**684**	223
Total equity		**9,681**	9,220
Current liabilities			
Trade and other payables	20	**–**	1,194
		–	1,194
TOTAL LIABILITIES		**–**	1,194
TOTAL EQUITY AND LIABILITIES		**9,681**	10,414

The financial statements were approved by the Board of Directors on 8 April 2008 and were signed on its behalf by:

Director

For the year ended 31 December 2007

Consolidated cash flow statement	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Cash flows from operating activities		
Loss before taxation	**2,900**	(3,729)
Adjustments for:		
Net finance income	**(167)**	(157)
Depreciation of plant and equipment	**55**	161
Amortisation of intangibles	**311**	140
Share-based payments	**161**	759
Increase in trade and other receivables	**(334)**	(496)
Increase/(decrease) in trade and other payables	**503**	(465)
Increase in inventories	**(398)**	(95)
Decrease in provisions	**(369)**	(45)
Other non-cash movements	**12**	6
Net cash outflow from operating activities	**(3,126)**	(3,921)
Investing activities		
Interest received	**171**	274
Sale of plant and equipment	**–**	2
Payments to acquire plant and equipment	**(226)**	(94)
Payments to acquire intangible assets	**(600)**	(535)
Net cash outflow from investing activities	**(655)**	(353)
Financing activities		
Interest paid	**(4)**	(78)
Proceeds from the issue of ordinary share capital	**–**	10,587
Share issue costs	**–**	(1,599)
Payment of loan notes	**–**	(182)
Net cash (outflow)/inflow from financing activities	**(4)**	8,728
Net (decrease)/increase in cash and cash equivalents	**(3,785)**	4,454
Net foreign exchange differences	**(18)**	–
Cash and cash equivalents at 1 January	**5,617**	1,163
Cash and cash equivalents at 31 December	1,814	5,617

For the year ended 31 December 2007

Company cash flow statement	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Cash flows from operating activities		
Profit before taxation	**461**	223
Adjustments for:		
Net finance income	**(457)**	(320)
Decrease/Increase) in other financial assets	**1,194**	(10,094)
Increase/(decrease) in payables	**(1,194)**	1,194
Reorganisation costs	**–**	196
Other non-cash movements	**(4)**	(187)
Net cash outflow from operating activities	**–**	(8,988)
Financing activities		
Proceeds from the issue of ordinary share capital	**–**	10,587
Share issue costs	**–**	(1,599)
Net cash/inflow from financing activities	**–**	(8,988)
Net increase in cash and cash equivalents	**–**	–
Cash and cash equivalents 1 January	**–**	–
Cash and cash equivalents at 31 December	–	–

For the year ended 31 December 2007

	Issued capital	Share premium	Translation reserve	Other reserves	Retained earnings	Total equity
	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 January 2006	**7**	**–**	**–**	**26,734**	**(33,442)**	**(6,701)**
Translation movements	–	–	476	–	–	476
Total income and expense for the year recognised directly in equity	–	–	476	–	–	476
Loss for the year	–	–	–	-	(3,729)	(3,729)
Total income and expense for the year	–	–	476	-	(3,729)	(3,253)
Share-based payments	–	–	–	–	759	759
On cancellation of shares and loan notes	–	–	–	6,997	–	6,997
On issue of new shares	8	10,581	–	(321)	–	10,268
Share insurance costs	–	(1,599)	–	–	–	(1,599)
Balance at 31 December 2006	**15**	**8,982**	**476**	**33,410**	**(36,412)**	**6,471**
Translation movements	–	–	**(85)**	–	–	**(85)**
Foreign Exchange movements	–	-	–	**94**	–	**94**
Total income and expense for the year recognised directly in equity	–	–	**(85)**	**94**	–	**9**
Loss for the year	–	–	–	–	**(2,900)**	**(2,900)**
Total income and expense for the year	–	–	**(85)**	**94**	**(2,900)**	**(2,891)**
Share-based payments	–	–	–	–	**161**	**161**
Balance at 31 December 2007	**15**	**8,982**	**391**	**33,504**	**(39,151)**	**3,741**

For the year ended 31 December 2007

	Issued capital	Share premium	Retained earnings	Total equity
	£'000	£'000	£'000	£'000
Balance at 1 January 2006	**7**	**–**	**–**	**7**
Profit for the year	–	–	223	223
Total income and expense for the year	–	–	223	223
On issue of new shares	8	10,581	–	10,589
Share insurance costs	–	(1,599)	–	(1,599)
Balance at 31 December 2006	**15**	**8,982**	**223**	**9,220**
Profit for the year	–	–	**461**	**461**
Balance at 31 December 2007	**15**	**8,982**	**684**	**9,681**

1. AUTHORISATION OF FINANCIAL STATEMENTS AND STATEMENT OF COMPLIANCE WITH IFRSs

The Group and Company financial statements of Clean Air Power Limited for the year ended 31 December 2007 were authorised for issue by the Board of Directors on 8 April 2008 and the balance sheets were signed on the Board's behalf by Peter Rowse. Clean Air Power Limited is a public limited company incorporated in Bermuda whose shares are publicly traded.

The Group and Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 December 2007.

Information relating to the reorganisation of the Group on 27 February 2006 can be found in the 31 December 2006 financial statements.

All of the revenue and profits and operating assets relate to the Group's principal business activities, being vehicle conversion sales, sales of components and an emissions reduction business. Revenue is stated net of value added tax.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis.

This is the first year in which the Group has prepared its financial statements under IFRS and the comparatives have been restated from UK Generally Accepted Accounting Practice (UK GAAP) to comply with IFRS. The Group issued its interim consolidated financial reports in September 2007 incorporating its interim IFRS financial statements for 2007 along with the reconciliations to IFRS from the previously published UK GAAP financial statements. Reconciliations to IFRS from the previously published UK GAAP financial statements can be found in note 29.

The accounting policies that follow set out those policies that apply in preparing the financial statements for the year ended 31 December 2007. The company and the Group have applied the same policies throughout the year.

The Group and Company financial statements are presented in Sterling and all values are rounded to the nearest thousand pounds (£'000) except where otherwise indicated.

Basis of consolidation

The Group financial statements consolidate the financial statements of Clean Air Power Limited and its subsidiary undertakings drawn up to 31 December each year.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group, and deconsolidated from the date that control ceases. The financial statements of subsidiaries used in the preparation of the consolidated financial statements are prepared for the same reporting period of the parent Company and are based on consistent accounting policies.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated, including unrealised profits or losses.

Changes in accounting policies

The Group has early adopted the following IFRS standard. Adoption of this standard did not have any effect on the financial performance or position of the Group. The standard did however give rise to additional disclosures including revisions to accounting policies.

- IFRS 8 Operating Segments

The principle effect of this change is as follows:

IFRS 8 Operating Segments

This standard requires disclosure of information about the Group's operating segments and replaced the requirement to determine primary (business) and secondary (geographical) segments of the Group. The Group determined that the operating segments were the same as the business segments previously identified under IAS 14 Segment Reporting. Additional disclosures about each of these segments are shown in Note 3, including revised comparative information.

New standards and interpretations not applied

IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements.

International Accounting Standards (IAS/IFRS)		**Effective date**
IFRS 2	Amendment to IFRS 2 Vesting Conditions and Cancellations	1 January 2009
IFRS 3	Business Combinations (revised January 2008)	1 July 2009
IAS 1	Presentation of Financial Statements (revised September 2007)	1 January 2009
IAS 23	Borrowing Costs (revised March 2007)	1 January 2009
IAS 27	Consolidated and Separate Financial Statements (revised January 2008)	1 July 2009
International Financial Reporting Interpretations Committee (IFRIC)		
IFRIC 12	Service Concession Arrangements	1 January 2008
IFRIC 13	Customer Loyalty Plans	1 July 2008
IFRIC 14 IAS 19 –	The Limit on a Defined Benefit Asset Minimum Funding Requirement and their Interaction	1 January 2008

The amendment to IFRS 2 restricts the definition of vesting conditions to include only service conditions (requiring a specified period of service to be completed) and performance conditions (requiring the other party to achieve a personal goal or contribute to achieving a corporate target). All other features are not vesting conditions, and whereas a failure to achieve such a condition was previously regarded as a forfeiture (giving rise to a reversal of amounts previously charged to profit) it must be reflected in the grant date fair value of the award and treated as a cancellation, which results in either an acceleration of the expected charge, or a continuation over the remaining vesting period, depending on whether the condition is under control of the entity or the counterparty. The amendment is mandatory for periods beginning on or after 1 January 2009 and the Group is currently assessing its impact on the financial statements although it is not expected to be material.

The Group does not anticipate early adopting the revised IFRS 3 and so will apply it prospectively to all business combinations on or after 1 July 2009. Whilst it is not possible to estimate the outcome of adoption, the key features of the revised IFRS 3 include a requirement for acquisition-related costs to be expensed and not included in the purchase price; and for contingent consideration to be recognised at fair value on the acquisition date (with subsequent changes recognised in the income statement and not as a change to goodwill). The standard also changes the treatment of non-controlling interests (formerly minority interests) with an option to recognise these at full fair value as at the acquisition date and a requirement for previously held non-controlling interests to be fair valued as at the date control is obtained, with gains and losses recognised in the income statement.

IFRS 8: Operating Segments requires disclosure based on information presented to the Board. This is not expected to change the business segments about which information is given. We do not expect to have customers that individually account for more than 10% of total revenues.

While the revised IAS 1 will have no impact on the measurement of the Group's results or net assets it is likely to result in certain changes in the presentation of the Group's financial statements from 2009 onwards.

IAS 23 has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use. As the Group already chooses to capitalise such interest there will be no impact on adoption.

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

Plant and Equipment

Plant and equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the expected useful life of the asset using the following rates:

Plant and equipment – 3 - 5 years

The carrying values of plant and equipment are reviewed for impairment either annually, or when events or changes in circumstances indicate the carrying value may not be recoverable (whichever is earlier).

If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount.

An item of plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Residual values and estimated remaining lives are reviewed annually.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost includes all costs incurred in bringing each product to its present location and condition on a moving weighted average cost basis. Net realisable value is the estimated selling price in the ordinary course of business, less any further costs expected to be incurred to completion and disposal.

Work in Progress

Work in progress is the cost of direct materials and labour.

Operating Leases

Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Foreign Currency

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the income statement, except for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in profit or loss.

The assets and liabilities of foreign operations are translated into sterling at the rate of exchange ruling at the balance sheet date. Income and expenses are translated at weighted average exchange rates for the year. The resulting exchange differences are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Intangible Assets

Research and Development Costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the ability of resources to complete and the availability to measure reliably the expenditure during the development. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure capitalised is amortised over the period of expected future sales from the related project.

- Development expenditure – 18 months to 5 years.

Computer Software

Computer software is carried at cost less accumulated amortisation. Computer software has a finite life with no residual value and is amortised on a straight line basis over the expected useful life as follows:

- Computer software – 3 years.

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. In addition, the carrying value of capitalised development expenditure is reviewed for impairment annually before being brought into use.

Cash and Cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity date of three months or less.

Investments

Investments in subsidiary undertakings are stated at cost less any provision for any impairment that the Directors consider necessary.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Deferred Income Taxes

Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred income tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax relating to items recognised directly in equity is recognised in equity and not in profit or loss.

Pensions

The Group contributes on behalf of its employees to individual personal defined contribution plans. The contributions made by the Group are recognised as an expense in the period they fall due.

Share-based Payment Transactions

The cost of equity settled transactions with employees is measured by reference to the fair value at the date on which they are granted. The fair value is determined by an external valuer using an appropriate pricing model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company ('market conditions'), if applicable.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions number of equity instruments that will ultimately vest or in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately. Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value being treated as an expense in the income statement.

Trade and Other Receivables

Trade receivables, which generally have 30 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable, bad debts are written off when identified.

Interest Bearing Loans and Borrowables

All loans and borrowings are initially recorded at fair value net of issue costs associated with the borrowing.

Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis and charged to the Income Statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled during the period in which they arise.

Trade Payables

Trade payables are not interest bearing and are stated at their nominal value.

Financial liabilities and equity instruments

Financial liabilities and equity instruments are all instruments that are issued by the Group as a means of raising finance, including shares, loan notes, debentures, debt instruments and options and warrants that give the holder the right to subscribe for or obtain financial liabilities and equity instruments. An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. All equity instruments are included in shareholders' funds. The finance costs incurred in respect of an equity instrument are charged directly to the income statement. Other instruments are classified as financial liabilities if they contain a contractual obligation to transfer economic benefits.

Borrowing Costs

Borrowing costs are recognised as an expense when incurred.

Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, VAT and other sales taxes or duty. The following criteria must also be met before revenue is recognised.

Sale of Goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on despatch of the goods.

Interest Income

Revenue is recognised as interest accrues using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to its net carrying amount.

Critical Accounting Policies, Judgements and Estimates

The preparation of financial statements requires management to make estimates and assumptions that effect the amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for revenues and expenses during the year.

The nature of estimation means that actual outcomes could differ from those estimates. Key sources of estimation uncertainty and critical accounting judgements are as follows:

Deferred Taxation

In the preparation of the financial statements, the Group estimates the income taxes in each of the taxing jurisdictions in which the Group operates as well as any deferred taxes based on temporary differences. Deferred tax assets relating to tax loss carry-forwards and temporary differences are recognised in those cases when future taxable income is expected to permit the recovery of those tax assets. Changes in assumptions in the projections of future taxable income as well as changes in tax rates could result in significant differences in the valuation of deferred taxes.

Intangible Assets

Development costs are capitalised in accordance with the accounting policy. Initial capitalisation of costs is based on management's judgement that technology and economical feasibility is confirmed, usually when project development has reached a defined milestone. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

Provisions

The Group recognises a provision for liabilities associated with vehicle and parts warranty. The Group has made assumptions in relation to historical claims and the expected cost of claims. In relation to future claims, the Group has made assumptions based on the warranty expiry dates and the history of previous claims.

Share-based payments

The estimation of share-based payment costs requires the selection of an appropriate valuation model, consideration as to the inputs necessary for the valuation chosen and the estimation of the number of awards that will ultimately vest, inputs which arise from judgements relating to the continuing participation of employees.

3. SEGMENT INFORMATION

Revenue by business segment

For management purposes the Group is organised into business units based on their products and services, and has three reportable

Operating segments as follows:

The vehicle conversions segment allows a standard diesel engine to operate on natural gas without any major changes to the engine.

The components segment designs and delivers innovative hydraulic valves and natural gas injector components for natural gas engines that enable automotive and truck manufactures to build low-emission gasoline, natural gas and diesel vehicles that meet worldwide emissions regulations.

The emissions reduction segment offers emissions reduction solutions that reduce regulated engine emissions by post combustion after-treatment of an engine's exhaust gasses.

	Year ended 31 December 2007 £'000				
	Vehicle Conversions	**Components**	**Emissions Reduction**	**Adjustments and eliminations**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Revenue					
Third party	3,039	1,476	189	–	4,704
Inter-segment	986	91	–	(1,077)	–
Total revenue	4,025	1,567	189	(1,077)	4,704
Results					
Depreciation and amortisations	(321)	(34)	(11)	–	(366)
Segment (loss)/profit	(3,139)	85	(260)	414	(2,900)
Assets					
Capital expenditure	746	75	5	–	826
Operating assets	4,207	729	143	(142)	4,937
Provisions	421	18	40	(41)	438
Operating liabilities	1,873	280	76	(41)	2,188

1. Inter-segment revenues are eliminated on consolidation.
2. Capital expenditure consists of additions to plant and equipment and intangible assets.
3. Revenue from one customer amounted to £1,270,080 (2006: nil), arising from sales related to the vehicle conversions segment.
4. Adjustments and eliminations relate to consolidation eliminations and Holding Company items.

	Year ended 31 December 2006 £'000				
	Vehicle Conversions	**Components**	**Emissions Reduction**	**Adjustments and eliminations**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Revenue					
Third party	1,744	1,427	901	–	4,072
Inter-segment	–	86	–	(86)	–
Total revenue	1,744	1,513	901	(86)	4,072
Results					
Depreciation and amortisation	(175)	(79)	(47)	–	(301)
Segment (loss)/profit	(3,215)	(433)	(472)	391	(3,729)
Assets					
Capital expenditure	596	21	12	–	629
Operating assets	6,671	790	428	(23)	7,866
Provisions	739	24	44	–	807
Operating liabilities	1,432	298	207	–	1,937

1. Inter-segment revenues are eliminated on consolidation.
2. Capital expenditure consists of additions to plant and equipment and intangible assets.
3. Adjustments and eliminations relate to consolidation eliminations and Holding Company items.

3. SEGMENT INFORMATION cont.

Geographical information

	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Revenues from external customers		
UK	**947**	537
USA	**1,195**	2,323
Australia	**1,705**	674
Rest of Europe	**658**	529
Rest of World	**199**	9
	4,704	4,072

The revenue is based on the location of the customer.

4. OPERATING LOSS

Loss on ordinary activities before taxation is stated after charging:

	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Inventory expensed in the period	**2,211**	1,725
Depreciation of property, plant and equipment	**55**	161
Amortisation of capitalised development expenditure	**311**	140
Gain from disposal of fixed assets	**–**	2
Reorganisation expenses	**–**	196
Foreign exchange differences	**(18)**	43
Operating lease rentals		
- Other	**56**	45
- Land and buildings	**324**	229
Research and development expensed to income statement	**659**	668

5. AUDITORS' REMUNERATION

	2007	2006
	£'000	£'000
Audit of the financial statements	**52**	47
Other fees to auditors – other services	**41**	24
	93	71

The 2007 other services relate to the IFRS conversion, interim costs and other technical advice. 2006 other services relate to interim audit costs and other technical advice.

6. FINANCE REVENUE

	2007	2006
	£'000	£'000
Bank interest receivable	**171**	274

7. FINANCE COSTS

	2007	2006
	£'000	£'000
Other interest payable	**4**	117

In 2006 other interest payable mainly related to loan notes payable.

8. EMPLOYEE BENEFITS EXPENSE

The average monthly number of employees of the Group during the period, including executive Directors, was as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
	Number	Number
Operational	**37**	31
Administrative	**22**	20
	59	51

Staff costs for all employees, including executive Directors, consist of:

	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Wages and salaries	**2,363**	2,118
Social security costs	**238**	210
Other pension costs	**102**	34
Expense of share-based payments	**161**	759
	2,864	3,121

The Group operates money purchase (defined contribution) pension schemes. The assets of these schemes are held separately from those of the Group in independently administered funds. The pension cost for the period represents contributions payable by the Group to these funds and amounted to £100,767 (31 December 2006: £34,000). Unpaid pension costs at the year end amounted to £10,239 (2006: £16,121).

9. DIRECTORS' EMOLUMENTS

	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Emoluments:		
Remuneration for management/non executive services	**421**	354
Consultancy paid to Non-Executive Director	**30**	4
Defined contribution pension payments	**21**	20
	472	378

At the year end, there were £3,226 unpaid pension contributions (2006: £12,015).

	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Highest paid Director:		
Emoluments	**210**	175
Defined contribution pension payments	**15**	14
	225	189

Pension contributions were made to personal plans of two of the executive Directors (2006: two).

Disclosures of Directors' remuneration, share options and pension contributions are on pages 15 and 16 within the Remuneration report and form part of these audited financial statements.

10. TAXATION

Analysis of charge in the year	Year ended 31 December 2007	Year ended 31 December 2006
	£'000	£'000
Corporation tax at 30%	**–**	–
Adjustment in respect of prior years	**–**	–
Deferred tax	**–**	–
	–	–

Reconcilliation of tax charge	2007	2007	2007	2006
	£'000	**%**	£'000	%
(Loss) on ordinary activities before tax	**(2,900)**	**100**	(3,729)	100
Tax at 30% thereon	**(870)**	**30**	(1,119)	30
Tax effect of expenses that are not deductible in determining taxable profit	**152**	**(5)**	499	(13)
Losses arising in the year not recognised in deferred tax	**729**	**(25)**	851	(23)
Movement in temporary differences not recognised in deferred tax	**(3)**	**–**	(164)	4
Effect of different tax rates of group companies operating in other jurisdictions	**(8)**	**–**	(67)	2
Current tax for the period	**–**	**–**	–	–

Deferred tax not provided

A deferred tax asset has not been recognised in relation to the following as there is insufficient evidence that the asset will be recovered.

	Plant and equipment	Tax losses	Short term temporary differences	Total
	£'000	£'000	£'000	£'000
As at 1 January 2007	57	11,395	1,160	12,612
Current year movement	(38)	437	(540)	(141)
Prior year movement	(1)	(185)	(43)	(229)
Balance at 31 December 2006	**18**	**11,647**	**577**	**12,242**

At the balance sheet date the Group has an unprovided deferred tax asset in relation to unused tax losses of £11.6m (2006: £11.4m) available to offset against future profits, no deferred tax asset has been recognised in respect of these losses due to the unpredictability of future profit streams.

At the balance sheet date, the aggregate amount of temporary differences for which deferred tax assets have not been recognised is £0.6m (2006: £1.2m). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of all temporary differences and it is probable that such differences will not reverse in the foreseeable future.

Prior year movements mainly relate to adjustments made to tax losses before the submission of tax returns to local tax authorities.

Unrecognised tax losses carried forward against certain future overseas corporation tax liabilities have the following expiration dates.

	2007	2006
	£'000	£'000
2006	**–**	800
2007	**900**	1,000
2008	**–**	–
2009	**600**	600
2010	**700**	800
2011	**500**	600
2012 and later	**35,700**	38,900
Available indefinitely	**7,700**	4,700
Unrecognised tax losses available to carry forward	**46,100**	47,400
Amount of tax losses recognised in the deferred tax asset	**–**	–
Total tax losses available to carry forward	**46,100**	47,400

11. LOSS PER SHARE

Basic

Basic loss per share is calculated by dividing net loss for the year attributable to equity holders of the parent by the weighted average number of Common Shares in issue during the year.

	2007	2006
Loss for the period (£'000)	**(2,900)**	(3,729)
Weighted average number of shares	**26,905,479**	25,134,312
Basic and diluted loss per share	**(10.8p)**	(14.8p)

The loss for the period and the weighted average number of ordinary shares for calculating the diluted earnings per share for the period to 31 December 2007 are identical to those used for the basic earnings per share. This is because the outstanding share options would have the effect of reducing the loss per ordinary share and would therefore not be dilutive.

12. PLANT AND EQUIPMENT – GROUP

	Plant and equipment	Total
Cost	**£'000**	**£'000**
At January 1 2006	**898**	**898**
Additions	94	94
Disposals	(10)	(10)
Exchange Differences	(103)	(103)
At 31 December 2006	**879**	**879**
Additions	**226**	**226**
Disposals	**(1)**	**(1)**
Exchange Differences	**(10)**	**(10)**
At 31 December 2007	**1,094**	**1,094**
Depreciation		
At January 1 2006	**693**	**693**
Depreciation charge for the year	161	161
Disposals	(9)	(9)
Exchange Differences	(82)	(82)
At 31 December 2006	**763**	**763**
Charge for the period	**55**	**55**
Disposals	**(1)**	**(1)**
Exchange Differences	**(7)**	**(7)**
At 31 December 2007	**810**	**810**
Net book value		
At 31 December 2007	**284**	**284**
At 31 December 2006	116	116
At 1 January 2006	205	205

The carrying value of plant and equipment held under finance leases and hire purchase contracts at 31 December 2007 was £9,900 (2006: nil).

13. INTANGIBLE ASSETS – GROUP

	Capitalised development expenditure	Software	Total
Cost	**£'000**	**£'000**	**£'000**
At January 1 2006	–	**373**	**373**
Additions	516	19	535
Exchange Differences	–	(46)	(46)
At 31 December 2006	**516**	**346**	**862**
Additions	**594**	**6**	**600**
Exchange Differences	–	**(3)**	**(3)**
At 31 December 2007	**1,110**	**349**	**1,459**
Amortisation			
At January 1 2006	–	**337**	**337**
Charge for the period	108	32	140
Exchange Differences	–	(41)	(41)
At 31 December 2006	**108**	**328**	**436**
Charge for the period	**303**	**8**	**311**
Exchange Differences	–	**(3)**	**(3)**
At 31 December 2007	**411**	**333**	**744**
Net book value			
At 31 December 2007	**699**	**16**	**715**
At 31 December 2006	408	18	426
At 1 January 2006	–	36	36

Capitalised development expenditure mostly relates to the Groups Dual-Fuel™ products.

The most important 2007 additions (£249,283) relate to the Engine Management System (EMS) project, the carrying value at the end of the year was £384,756. The project is still ongoing and therefore related amortisation has not commenced.

14. INVESTMENTS – COMPANY

	Subsidiary undertaking
Cost and net book value	**£'000**
At 1 January 2007	320
Additions	–
At 31 December 2007	**320**

The following unlisted subsidiary undertakings at the end of the period have all been included in the consolidated accounts.

Name	Country of Registration	Proportion of voting rights and ordinary share capital	Nature of business
Clean Air Power Limited	England and Wales	100%	Vehicle Conversions and Product Support
Clean Air Power Inc	USA	100%	Vehicle Conversion, Emissions Reduction and Product Support
Clean Air Power Pty Ltd	Australia	100%	Vehicle Conversions and Product Support

15. OTHER FINANCIAL ASSETS (NON-CURRENT) – COMPANY

	2007	2006
	£'000	£'000
Amounts owed by subsidiary undertakings	**9,361**	10,094

	2007	2006
	£'000	£'000
Amounts due from 1 January 2009 with an option to extend this deadline.	**9,361**	10,094

16. INVENTORIES – GROUP

	2007	2006
	£'000	£'000
Raw materials	**1,400**	902
Work in progress	**13**	58
Finished goods	**75**	130
	1,488	1,090

There is no significant difference between the replacement value of stock and the amount at which it is stated in the financial statements. During 2007 the amount of inventories write down is £46,053.

17. TRADE AND OTHER RECEIVABLES (CURRENT) – GROUP

	2007		2006	
	Group	**Company**	Group	Company
	£'000	**£'000**	£'000	£'000
Trade receivables	**1,384**	–	946	–
Prepayments and accrued income	**232**	–	104	–
VAT receivables	–	–	35	–
Other non-trade receivables	**19**	–	74	–
	1,635	–	1,159	–

Trade receivables are non-interest bearing and are generally on 30 day terms, apart from vehicle conversions which are settled on collection of the vehicle conversion.

As at 31 December 2007, trade receivables at nominal value of £63,000 (2006: £88,000) were impaired and fully provided for. Movements in the provision for impairment of receivables were as follows:

	Total
	£'000
As at 1 January 2007	88
Charges for the year	5
Unused amounts reversed	(30)
As at 31 December 2007	63

As at 31 December, the ageing analysis of trade receivables is as follows:

	Total	**<30 days**	**30-60 days**	**61-90 days**	**91-120 days**	**>120 days**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
2007	**1,384**	**891**	**423**	**70**	**–**	**–**
2006	946	388	524	34	–	–

18. CASH AND CASH EQUIVALENTS – GROUP

	2007	2006
	£'000	£'000
Cash at bank and on hand		
Sterling	**429**	3,281
US Dollar	**890**	2,336
Australian Dollar	**495**	–
	1,814	5,617

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates.

19. EQUITY SHARE CAPITAL

	2007	2006
	£'000	£'000
Authorised		
60,000,000 (31 December 2006: 60,000,000 Common Shares of US$0.001) Common Shares of US$0.001 each	**34**	34
Allotted, called up and fully paid		
26,905,479 (31 December 2006: 26,905,479 Common Shares of US$0.001 each) Common Shares of US$0.001each	**15**	15
	15	15

20. TRADE AND OTHER PAYABLES (CURRENT) – GROUP AND COMPANY

	Year ended 31 December 2007		Year ended 31 December 2006	
	Group	**Company**	Group	Company
	£'000	**£'000**	£'000	£'000
Trade payables	**535**	**–**	460	–
Deferred income	**172**	**–**	–	–
Taxation and social security	**115**	**–**	40	–
Other payables	**–**	**–**	34	–
Accruals	**926**	**–**	596	–
Obligations under finance lease	**2**	**–**	–	–
Amounts owed to subsidiary undertakings	**–**	**–**	–	1,194
	1,750	**–**	1,130	1,194

Terms and conditions of the above financial liabilities:
“ Trade payables are non-interest bearing and normally settled on 30 day terms.
” For terms and conditions relating to related parties, refer to Note 26.

21. PROVISIONS – GROUP

	Other provisions	**Engine maintenance provisions**	**Total**
	£'000	**£'000**	**£'000**
At 1 January 2007	68	739	807
Additional provisions in year	**–**	**131**	**131**
Utilisation of provisions	**(30)**	**(212)**	**(242)**
Unused amounts reversed	**–**	**(268)**	**(268)**
Exchange differences	**1**	**9**	**10**
At 31 December 2007	**39**	**399**	**438**

The engine maintenance provisions relate to warranties given by the Group in respect to products sold. The warranty period in most cases is 12 months or 250,000 miles, whichever comes first. In certain cases, the customer may negotiate a period longer than 12 months. This expenditure arises at different times over the life of the product and is expected to be fully utilised within one year.

Other provisions relate to provisions for onerous leases and future obligations and are expected to be fully utilised within one year.

Utilisation of provisions mainly in Engine maintenance relate to claims within warranty period.

Unused amounts reversed relate to vehicles which are no longer in warranty.

22. OTHER PAYABLES (NON CURRENT) – GROUP

	Year ended 31 December 2007		Year ended 31 December 2006	
	Group	**Company**	Group	Company
	£'000	**£'000**	£'000	£'000
Obligations under finance lease	**7**	**–**	–	–

23. FINANCIAL INSTRUMENTS

In the normal course of business, the Group uses certain financial instruments including cash, equity rights and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these instruments is to provide finance for the Group's operations. The main risks arising from the Group's financial instruments are market price risk, liquidity risk, foreign currency risk and interest rate risk. The Group's policies and objectives in each of these areas are noted below.

Treasury Policies and Financial Risk
Surplus funds are intended to support the Group and Company's short-term working capital requirements. These funds are invested through the use of overnight deposits and the policy is to maximise fixed interest returns as well as provide the flexibility required to fund on-going operations. It is not the Group's policy to invest in financial derivatives.

Market Price Risk
The Group's main exposure to market risk is currency risk due to the different countries it operates in. It constantly monitors these risks by analysing interest rates and exchange rates in the different markets.

Liquidity Risk
The Group seeks to manage financial risk, and in particular liquidity risk, ensuring that sufficient liquidity is available to meet foreseeable requirements and to invest surplus cash in low risk overnight deposits with reputable institutions.

Foreign Currency Risk
Foreign currency is mitigated wherever possible by matching the currency that purchases are made with receipts from debtors denominated in that currency. The Group hedges its foreign currency position by operating non-sterling currency bank accounts. This policy is regularly reviewed.

23. FINANCIAL INSTRUMENTS cont.

The table below shows the Group's currency exposures that give rise to net currency gains and losses recognised in the profit and loss account.

As at 31 December 2007, these currency exposures are as follows:

Functional currency of Group operations	Net foreign currency monetary assets		
	AUS Dollar	**US Dollar**	**Total**
	£'000	**£'000**	**£'000**
2007			
Sterling	**495**	**890**	**1,385**
Total	**495**	**890**	**1,385**
2006			
Sterling	–	1,965	1,965
Total	–	1,965	1,965

Interest Rate Risk
The Group finances its operations through cash reserves and issuance of shares. The interest rate policy depends on economic and market conditions. Surplus cash deposits are held on overnight deposit with a view to maximising the return on surplus funds.

Interest rate risk profile of financial assets
The interest rate profile of the interest bearing financial assets (only cash and cash equivalents) of the Group at 31 December 2007 is as follows:

	Floating rate financial assets	**Total**
	£'000	**£'000**
2007		
Sterling	**429**	**429**
US Dollar	**890**	**890**
AUS Dollar	**495**	**495**
	1,814	**1,814**
2006		
Sterling	3,293	3,293
US Dollar	2,324	2,324
AUS Dollar	–	–
	5,617	5,617

Fair Values of financial instruments
In the opinion of the Directors, the book value of the financial instruments is not materially different from their fair values. The book value of the financial assets is considered equal to their fair value because of the short maturity period.

Credit risk
The Group trades only with recognised, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.
Of the total balance of £1,384,000 in trade debtors, 56% relates to one customer, a significant trade debtor in the Australian Company. Based on current knowledge, the Group is not aware of any financial problems that could impact the Group.

Borrowing facilities
The Group has no borrowing facilities available to it at 31 December 2007 (2006: nil).

24. COMMITMENTS AND CONTINGENCIES

Operating lease commitments – Group as lessee

The Group has entered into commercial leases on certain properties, motor vehicles and items of equipment. The leases have an average life of between 3 and 5 years. There are no restrictions on the Group by entering into these leases.

Operating leases

The future minimum rentals payable under non-cancellable operating leases at 31 December 2007 are as follows:

		2007	2006
		£'000	£'000
Land and buildings	– Less than 1 year	299	128
	– After 1 year but no more than 5 years	655	243
	– More than 5 years	289	–
		1,243	371
Plant & Machinery	– Less than 1 year	29	13
	– After 1 year but no more than 5 years	37	21
		66	34
Vehicles	– Less than 1 year	24	17
	– After 1 year but no more than 5 years	30	12
		54	29

No operating leases have any escalation clauses or purchase options attached to the lease.

Finance lease and hire purchase commitments

The Group has entered into a hire purchase contract for one item of equipment. Future minimum lease payments under hire purchase contracts together with the present value of the net minimum lease payments are as follows:

	2007 Minimum payments	2007 Present value of payments	2006 Minimum payments	2006 Present value of payments
	£'000	£'000	£'000	£'000
Within one year	3	3	–	–
After one year but no more than five years	8	6	–	–
Total minimum lease payments	11	9	–	–
Less amounts representing finance charges	(2)	–	–	–
Present value of minimum lease payments	9	9	–	–

25. SHARE-BASED PAYMENTS

The Group operates an Incentive Plan under which employees of the Group are granted options to subscribe for new ordinary shares of the Company. Options are exercisable at a price equal to the average quoted market price of the Company's shares at the date of the grant. Options are forfeited if the employee leaves the Group before the options vest. The contractual life of each option granted is ten years and the vesting conditions relate only to the service periods of employees (non-market related). The vesting period is between one and three years. There are no market related performance conditions attached to the options.

The Group recognised total expenses of £161,211 (2006: £759,137) related to equity-settled share-based payments transactions during the year, of which £150,413 (2006: £715,077) has been expensed in Clean Air Power Limited UK, £10,545 (2006: £44,060) has been expensed in Clean Air Power Inc and £253 (2006: £nil) has been expensed in Clean Air Power Pty Ltd.

The fair value of the options is estimated at the grant date using Black-Scholes pricing model, taking into account the terms and conditions upon which the instruments were granted.

Details of the share options granted during the year and the exercise price of these options are as follows:

	Number of options	Exercise price
13 April 2007	236,809	£0.285
13 June 2007	28,900	£0.295

Movements in share options granted post 28 February 2006 and outstanding at the balance sheet date, together with weighted average exercise price were as follows:

	2007 Number of shares	2007 Weighted average exercise price (£)	2006 Number of shares	2006 Weighted average exercise price (£)
Outstanding at the beginning of the year	2,691,995	0.70	–	–
Granted during the year	265,709	0.29	2,908,634	0.73
Forfeited during the year	(34,081)	0.95	(216,639)	0.98
Exercised during the year	–	–	–	–
Outstanding at the end of the year	2,923,623	0.66	2,691,995	0.70
Exercisable at the end of the year	2,629,057	0.70	–	–

25. SHARE-BASED PAYMENTS cont.

The estimated fair value of the options granted is as follows:

	£'000
27 February 2006	821,918
28 February 2006	89,379
23 June 2006	3,440
18 September 2006	1,390
13 April 2007	24,981
13 June 2007	3,092
	944,200

The weighted average remaining contractual life for the share options outstanding as at 31 December 2007 is 9.2 years (2006: 10.2 years).

The weighted average fair value of options granted during the year was £0.11 (2006: £0.34).

The range of exercise prices for options outstanding at the year end was £0.285 - £1.00 (2006: £0.52 - £1.00).

The following table lists inputs to the model used for the years ended 31 December 2007 and 31 December 2006.

	2007	2006
Expected volatility (%)	**45.00**	15.71
Expected life (months)	**36**	13
Risk free rate (%)	**5.39**	4.73
Expected dividends	**Nil**	Nil
Model used	**Black-Scholes**	Black-Scholes

Expected volatility was determined by reference to the volatility of comparable listed companies on the AIM Market. The Group has a unique product and therefore market volatility could not be considered as a reliable basis for estimating future volatility. The expected life used in the model is a weighted average based on the vesting period of the options.

26. RELATED PARTY DISCLOSURES

The financial statements include the financial statements of Clean Air Power Limited (Bermuda) and the subsidiaries in the following table:

Name	**Country of incorporation**	**% equity interest**	
		2007	2006
Clean Air Power Inc.	United States	**100**	100
Clean Air Power Limited	England and Wales	**100**	100
Clean Air Pty Ltd	Australia	**100**	100

Clean Air Power Limited (Bermuda) is the ultimate parent of the Group. Transactions and balances with group entities are eliminated in the consolidated financial statements.

During the year Clean Air Power Inc. sold £91,109 (2006: £86,000) of vehicle components to Clean Air Power Limited (UK).

During the year Clean Air Power Inc. sold £985,830 (2006: £nil) of vehicle components to Clean Air Power Pty Ltd.

The following table provides the total amount of transactions, which have been entered into with related parties for the relevant financial year.

	Amounts owed to related parties 2007 £'000				
	Clean Air Power Limited (Bermuda)	**Clean Air Power Limited**	**Clean Air Power Inc.**	**Clean Air Power Pty Ltd**	**Total**
Amounts owed by related parties					
Clean Air Power Limited (Bermuda)	**–**	**9,361**	**–**	**–**	**9,361**
Clean Air Power Limited	**(9,361)**	**–**	**(2,508)**	**598**	**(11,271)**
Clean Air Power Inc.	**–**	**2,508**	**–**	**1,012**	**3,520**
Clean Air Power Pty Ltd	**–**	**(598)**	**(1,012)**	**–**	**(1,610)**
Total	**(9,361)**	**11,271**	**(3,520)**	**1,610**	**–**

	Amounts owed to related parties 2006 £'000				
	Clean Air Power Limited (Bermuda)	Clean Air Power Limited	Clean Air Power Inc.	Clean Air Power Pty Ltd	Total
Amounts owed by related parties					
Clean Air Power Limited (Bermuda)	–	10,094	(1,194)	–	8,900
Clean Air Power Limited	(10,094)	–	(1,970)	–	(12,064)
Clean Air Power Inc.	1,194	1,970	–	–	3,164
Clean Air Power Pty Ltd	–	–	–	–	–
Total	(8,900)	12,064	(3,164)	–	–

26. RELATED PARTY TRANSACTIONS cont.

Compensation of key management personnel

	2007	2006
	£'000	£'000
Short-term employee benefits	435	358
Pension	26	25
Share-based payments	149	698
	610	1,081

Details of the directors' interests are included in the Directors' Remuneration Report on pages 15 & 16.

Transactions with related parties

The Group receives consultancy services from Hans Gunnar Folkesson, a Non-Executive Director of Clean Air Power (Bermuda) Limited and Gary Ireson, the Director of Clean Air Power Pty Ltd.

The following table provides the total amount of transactions, which have been entered into with related parties for the relevant financial year.

Hans Gunnar Folkesson	2007	2006
	£'000	£'000
Services received from related parties	30	4
Amounts owed to related parties	3	–

Gary Ireson	2007	2006
	£'000	£'000
Services received from related parties	28	–
Amounts owed to related parties	4	–

27. DESCRIPTION OF RESERVES

Issued Capital
The balance classified as share capital includes the total net proceeds on issue of the Company's equity share capital, comprising of $0.001 ordinary shares.

Share Premium
The balance on the share premium reserve represents the fair value of the consideration given in excess of the nominal value of the ordinary shares issued in an acquisition made by the issue of shares.

Translation Reserve
The translation reserve contains all foreign exchange differences arising from the translation of the Group's net investment in overseas subsidiaries.

Other Reserves
Other reserves mainly relates to the additional paid in capital following the reorganisation of the Group in 2006. This amount is the excess of par paid by the original investors of Clean Air Power Inc.

28. EVENTS AFTER THE BALANCE SHEET

On 7 April 2008 the Company's shareholders at a Special General Meeting approved a private financing package with Endeavor Capital Management LLC and certain other investors to provide additional funds for the Company.

Financing details

The financing package will provide proceeds of up to around £5.0m for the Company between April 2008 and June 2009. Endeavor, a longstanding and major shareholder in the Company, currently holding 18.5% of the Company's shares, has conditionally agreed to provide up to £4.65m of the new funds. The remaining funds will be provided by another institutional investor which has agreed to invest approximately £0.25m and the Company's management which is investing a further £0.10m.

The funds will be received in six tranches. The first three tranches will be; £1m on or before 30 April 2008; £0.5m on 30 June 2008; and £0.5m on 30 September 2008.

The remainder of the financing package will be available to the Company through the exercise of call and put options to be granted to Endeavor and the Company respectively. The second three tranches will each be for £1m and will (if exercised) be received between 1 October 2008 and 30 June 2009 under a mutual call/put option.

Endeavor's obligations will become absolute subject to the closing of certain investment funds. If Endeavor's obligation under the put option does not become absolute on or before 30 June 2008, Endeavor shall on or before 15 December 2008, subscribe for such number of Common Shares as have an aggregate value of approximately £500,000.

For every two common shares subscribed for pursuant to the financing package, the Company will issue a warrant for the purchase of one additional common share, exercisable within three years, with an exercise price at a 40% premium to the issue price.

Endeavor is required to participate in each of the six tranches of the financing package, with the other institutional investor and management only investing in the first tranche. Depending on the movement in the share price prior to the closing of each tranche, and the exercise of the latter three tranches, Endeavor may acquire a majority interest in the Company.

The Company Bye-laws incorporate by reference various provisions of the City Code, including Rule 9 of the City Code. However, this requirement may be waived by an independent vote at a meeting of the Company shareholders and, consequently, a resolution, with regards to acquisition of Common Shares by Endeavor or its Affiliates, was passed at a Special General Meeting.

Endeavor currently holds 18.5% of the issued share capital, and is therefore a related party under the AIM rules.

29. TRANSITION TO IFRS

For the year ended 31 December 2006, the Group prepared its financial statements in accordance with United Kingdom generally accepted accounting practice (UK GAAP). These financial statements, for the year ended 31 December 2007 are the first the Group is required to prepare in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

Accordingly, the Group has prepared financial statements that comply with the standards applicable for periods beginning on or after 1 January 2006 and the significant accounting policies meeting those requirements are described in note 2. In preparing these financial statements, the Group has started from an opening balance sheet as at 1 January 2006, the Group's date of transition to IFRS, and made those changes in accounting policies and other restatements required by IFRS 1 for the first-time adoption of IFRS. This note explains the principle adjustments made by the Group in restating its UK GAAP balance sheet as at 1 January 2006 and its previously published UK GAAP financial statements for the year ended 31 December 2006.

First Time Adoption of IFRS

The Group's financial statements for the year ended 31 December 2007 will be the first annual financial statements that comply with IFRS. This financial information has been prepared as described in Note 2. The Group has applied IFRS 1 in preparing this consolidated financial information.

Clean Air Power Limited's transition date is 1 January 2006. The Group prepared its opening IFRS balance sheet at that date. The reporting date of these consolidated financial statements is 31 December 2007.

Exemptions from Full Retrospective Application Elected by the Group

IFRS 3 'Business Combinations'

The Group has applied the business combinations exemption in IFRS 1. It has not restated business combinations that took place prior to the 1 January 2006 transition date.

IAS 21 'Foreign exchange differences'

The Group has elected not to calculate the cumulative translation differences on the net assets of foreign subsidiaries held in reserve at the date of transition. The reserve is therefore reset to zero at the 1 January 2006 transition date.

Reconciliations between IFRS and UK GAAP

The following reconciliations provide a quantification of the effect of the transition to IFRS. The first three reconciliations provide an overview of the impact on equity of the transition at 1 January 2006 and 31 December 2006. The following reconciliation provides details of the impact of the transition on net income for the period ended 31 December 2006.

- summary of equity
- equity at 1 January 2006
- equity at 31 December 2006
- net income for the year ended 31 December 2006

The above reconciliations have been presented for the Group and Company.

The transition to IFRS has no effect on the cash flows of the Group but there are certain presentational differences in the cash flow statement under IFRS and UK GAAP.

29.1 GROUP SUMMARY OF EQUITY

	1 January 2006	31 December 2006
	£'000	£'000
Total equity under UK GAAP	(6,701)	6,471
Total equity under IFRS	(6,701)	6,471

29.2 GROUP RECONCILIATION OF EQUITY AT 1 JANUARY 2006

	Notes	UK GAAP	Effect of transition to IFRS	**IFRS**
		£'000	£'000	**£'000**
Assets				
Non-current assets				
Property, plant and equipment	29.2(a)	241	(36)	**205**
Intangible assets	29.2(a)	–	36	**36**
		241	**–**	**241**
Current assets				
Inventories		998	**–**	**998**
Trade and other receivables		663	**–**	**663**
Cash and cash equivalents		1,163	**–**	**1,163**
		2,824	**–**	**2,824**
TOTAL ASSETS		3,065	**–**	**3,065**
Equity and liabilities Equity attributable to equity holders of the parent				
Ordinary share capital		7	–	**7**
Accumulated loss		(33,442)	–	**(33,442)**
Other reserves		26,734	–	**26,734**
Total equity		(6,701)		**(6,701)**
Non-current liabilities				
Preference shares		3,498	–	**3,948**
Notes payable		144	–	**144**
		3,642	**–**	**3,642**
Current liabilities				
Trade and other payables		1,953	**–**	**1,953**
Notes payable		3,319	**–**	**3,319**
Provisions		852	**–**	**852**
		6,124	**–**	**6,124**
TOTAL LIABILITIES		9,766	**–**	**9,766**
TOTAL EQUITY AND LIABILITIES		3,065	**–**	**3,065**

Explanation of the effect of the transition to IFRS
29.2(a) Under UK GAAP, computer software was capitalised and reported within property, plant and equipment. Under IFRS computer software is reported as an intangible asset.

29.3 GROUP RECONCILIATION OF EQUITY AT 31 DECEMBER 2006

	Notes	UK GAAP	Effect of transition to IFRS	**IFRS**
		£'000	£'000	**£'000**
Assets				
Non-current assets				
Property, plant and equipment	29.3(a)	134	(18)	**116**
Intangible assets	29.3(a)	408	18	**426**
		542	–	**542**
Current assets				
Inventories		1,090	–	**1,090**
Trade and other receivables		1,159	–	**1,159**
Cash and cash equivalents		5,617	–	**5,617**
		7,866	–	**7,866**
TOTAL ASSETS		8,408	–	**8,408**
Equity and liabilities Equity attributable to equity holders of the parent				
Ordinary share capital		15	–	**15**
Accumulated loss		(36,412)	–	**(36,412)**
Other reserves	29.3(b)	33,886	(476)	**33,410**
Share premium		8,982	–	**8,982**
Translation reserve	29.3(b)	–	476	**476**
Total equity		6,471		**6,471**
Current liabilities				
Trade and other payables		1,130	–	**1,130**
Provisions		807	–	**807**
		1,937	–	**1,937**
TOTAL LIABILITIES		1,937	–	**1,937**
TOTAL EQUITY AND LIABILITIES		8,408	–	**8,408**

Explanation of the effect of the transition to IFRS

29.3(a) Under UK GAAP, computer software was capitalised and reported within property, plant and equipment. Under IFRS computer software is reported as an intangible asset.

29.3(b) Under UK GAAP, translation movements were reported within other reserves. Under IFRS translation movements are reported as a separate component of equity.

29.4 GROUP RECONCILIATION OF NET INCOME FOR YEAR ENDED 31 DECEMBER 2006

	UK GAAP	Effect of transition to IFRS	**IFRS**
	£'000	£'000	**£'000**
Revenue	4,072	–	**4,072**
Cost of Sales	(2,314)	–	**(2,314)**
Gross Profit	1,758	–	**1,758**
Administrative expenses	(4,689)	–	**(4,689)**
Share-based payments charge	(759)	–	**(759)**
Group operating loss	(3,690)	–	**(3,690)**
Reorganisation expenses	(196)	–	**(196)**
Loss before finance costs	(3,886)	–	**(3,886)**
Finance costs	(117)	–	**(117)**
Finance income	274	–	**274**
Loss before taxation	(3,279)	–	**(3,729)**
Taxation	–	–	**–**
Loss for the period	(3,729)	–	**(3,729)**

29.5 COMPANY SUMMARY OF EQUITY

	1 January 2006	31 December 2006
	£'000	£'000
Total equity under UK GAAP	7	9,220
Total equity under IFRS	7	9,220

29.6 COMPANY RECONCILIATION OF EQUITY AT 1 JANUARY 2006

	UK GAAP	Effect of transition to IFRS	**IFRS**
	£'000	£'000	**£'000**
Current assets			
Trade and other receivables	7	–	**7**
	7	–	**7**
TOTAL ASSETS	7	–	**7**
Equity and liabilities			
Equity attributable to equity holders of the parent			
Ordinary share capital	7	–	**7**
Total equity	7	–	**7**
TOTAL EQUITY AND LIABILITIES	7	–	**7**

29.7 COMPANY RECONCILIATION OF EQUITY AT 31 DECEMBER 2006

	Notes	UK GAAP	Effect of transition to IFRS	**IFRS**
		£'000	£'000	**£'000**
Assets				
Non-current assets				
Investments		320	–	**320**
Other financial assets		10,094		**10,094**
		10,414	–	**10,414**
TOTAL ASSETS		10,414	–	**10,414**
Equity and liabilities				
Equity attributable to equity holders of the parent				
Ordinary share capital		15	–	**15**
Accumulated profit		223	–	**223**
Share premium		8,982	–	**8,982**
Total equity		9,220	–	**9,220**
Current liabilities				
Trade and other payables		1,194	–	**1,194**
		1,194	–	**1,194**
TOTAL LIABILITIES		1,194	–	**1,194**
TOTAL EQUITY AND LIABILITIES		10,414	–	**10,414**

29.8 COMPANY RECONCILIATION OF NET INCOME FOR YEAR ENDED 31 DECEMBER 2006

	UK GAAP	Effect of transition to IFRS	**IFRS**
	£'000	£'000	**£'000**
Revenue		–	**–**
Cost of sales	–	–	**–**
Gross profit	–	–	**–**
Administrative expenses	99	–	**99**
Company operating profit	99	–	**99**
Reorganisation expenses	(196)	–	**(196)**
Loss before finance costs	(97)	–	**(97)**
Finance income	320	–	**320**
Loss before taxation	223	–	**223**
Taxation	–	–	**–**
Profit for the period	223	–	**223**

Directors

Non-Executive Chairman – Rodney Westhead + # “
President & Chief Executive – John Pettitt
Financial Director – Peter Rowse
Non-Executive Director – Larry Wilson * + # “
Non-Executive Director – Dr Ulrich Wöhr (appointed 14 September 2006) * “
Non-Executive Director – Hans Gunnar Folkesson (appointed 18 September 2006) * + #
Non-Executive Director – Bernard Lord (appointed 4 July 2007) “

* Member of the Audit Committee + Member of the Remuneration Committee
# Member of the Nomination Committee “ Independent

Secretary

Evelou Mosley (appointed 1 January 2008)
Elaine Colmet (resigned 31 December 2007) (appointed 3 January 2006)

Registered Office

Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

Auditors

Ernst & Young LLP
100 Barbirolli Square
Manchester
M2 3EY

Solicitors

Berwin Leighton Paisner LLP
Adelaide House
London Bridge
London
EC4R 9HA

Nominated Advisor and Stockbrokers

Canaccord Adams
7th Floor, Cardinal Place
80 Victoria Street
London
SW1E 5JL

Registrars and Transfer Office

Capita IRG (Offshore) Limited
Victoria Chambers, Liberation Square
1/3 The Esplanade
St Helier
Jersey

Principal Banker

Royal Bank of Scotland
8 South Parade
Nottingham
NG1 2JS

Financial Public Relations

Buchanan Communications
45 Moorfields
London
EC2Y 9AE

8 Lancaster Court, Coronation Road, Cressex Business Park
High Wycombe Bucks HP12 3TD United Kingdom