HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES

<u>REVIEWED CONSOLIDATED FINANCIAL STATEMENTS</u>

September 30, 2017

HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES

Table of Contents

HYDROGEN ENGINE CENTER AND SUBSIDIARIES
Consolidated Balance Sheet
September 30, 2017

Assets

	2017
Current assets	
Cash	$ 7,623
Due from related party	11,774
Inventories	297,409
Total current assets	316,806
Property and equipment, net of depreciation	951,606
Other assets	
Intangible assets, net of amortization	261,234
Total other assets	261,234
Total assets	$ 1,529,646

Liabilities and Stockholders' Equity (Deficit)

	2017
Current liabilities	
Accounts payable and related taxes	$ 46,375
Accrued liabilities	12,062
Accrued officers wages	788,862
Customer deposits	30,000
Accrued interest	593,332
Iowa Department of Economic Development court judgment payable	688,186
Druek judgment payable	107,379
Note payable - City of Algona	53,112
Notes payable - Algona Area Economic Development Commission	233,624
Current portion, notes payable	736,840
Total current liabilities	3,289,772
Stockholders' Equity (Deficit)	
Common stock, $0.001 par value; 100,000,000 shares authorized; 50,580,471 issued and outstanding	50,580
Additional paid in capital	21,919,528
Accumulated other comprehensive income	1,651
Retained deficit	(23,731,885)
Total stockholders' equity (deficit)	(1,760,126)
Total liabilities and stockholders' deficit	$ 1,529,646

See report of independent registered public accounting firm.

HYDROGEN ENGINE CENTER AND SUBSIDIARIES
Consolidated Statement of Earnings (Loss)
For the Nine Months Ended September 30, 2017

	2017
Sales	$ 26,664
Cost of goods sold	10,187
Gross profit	16,477
Operating expenses	
Compensation expense	
(including stock compensation of $214,812)	532,039
Professional services	154,798
Occupancy expenses	71,478
Operations expense	221,515
Depreciation and amortization	82,207
Total operating expenses	1,062,037
Loss from operations	(1,045,560)
Other income (expense):	
Interest income	29
Other income	2,437
Rental income	6,750
Interest expense	(76,387)
Gain on sale of fixed assets	264
Total other income (expenses)	(66,907)
Loss before income taxes	(1,112,467)
Net loss	$ (1,112,467)
Basic and diluted loss per share of common stock	$ (0.02)

See report of independent registered public accounting firm.

HYRDOGEN ENERGY CENTER, INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Stockholders' Equity (Deficit)
For the Nine Months Ended September 30, 2017

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Deficit	Total Stockholders' Deficit
Balance at December 31, 2016	$ 49,085	$ 21,347,652	$ 1,651	$ (22,619,418)	$ (1,221,030)
Net loss	-	-	-	(1,112,467)	(1,112,467)
Other comprehensive income	-	-	-	-	-
Stock options expensed	-	214,812	-	-	214,812
Exercise of stock options (380,952 shares)	381	79,619			80,000
Purchase of common stock (1,114,236 shares)	1,114	277,445	-	-	278,559
Balance at September 30, 2017	$ 50,580	$ 21,919,528	$ 1,651	$ (23,731,885)	$ (1,760,126)

See report of independent registered public accounting firm.

HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES
Consolidated Statement of Cash Flows
For the Nine Months Ended September 30, 2017

	2017
Cash flows from operating activities:	
Net loss	$ (1,112,467)
Adjustments to reconcile net loss to net cash	
used in operating activities:	
Depreciation and amortization	82,207
Gain on sale of fixed assets	(264)
Stock option compensation	214,812
Non cash expenses exchanged for paid in capital	116,559
Interest income	(29)
Decrease (increase) in:	
Inventory	31,775
Increase (decrease) in:	
Accounts payable	34,982
Accrued liabilities	1,954
Accrued officers' wages	59,135
Accrued interest	40,194
IDED and Druek judgment payables	18,002
Net cash used in operating activities	(513,140)
Cash flows from investing activities:	
Proceeds from sale of fixed assets	5,800
Interest income	29
Net cash provided by investing activities	5,829
Cash flows from financing activities:	
Net (decrease) increase in borrowings and capital leases	(177)
Issuance of common stock	1,495
Increase in additional paid in capital	240,505
Net cash provided by financing activities	241,823
Net increase (decrease) in cash	(265,488)
Cash at beginning of year	273,111
Cash at end of year	$ 7,623
Supplemental disclosures of cash flow information:	
Cash paid during the year for:	
Income taxes	$ -
Interest on notes payable	$ 18,237

Non-cash investing and financing activities:

See report of independent registered public accounting firm.

NOTE 1 – NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Hydrogen Engine Center, Inc. (the “Company”, “We”) is a Nevada corporation with headquarters and operations located in East Tennessee. The Company is listed on the Over the Counter market under the Pink Slip Symbol HYEG.

The Company has been building hydrogen fueled engines since 2003. In 2004 the Company added engine controls and then combined these two technologies to build generator sets. Hydrogen Engine Center (HEC) was developed with the objective of producing distributive power, for industrial clients, fueled by alternative fuels, such as hydrogen, natural gas, anhydrous ammonia, methanol, propane, syn-gas, landfill gas and other alternative fuels.

The Company expects to market its products and transact business globally.

Principles of Consolidation - The consolidated financial statements include the accounts of Hydrogen Engine Center, Inc. and its wholly owned subsidiaries HEC-IOWA, Inc. and HEC-TINA, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

Revenue and Expense Recognition – Hydrogen Engine Center, Inc. and Subsidiaries (The “Company”) recognize revenues and expenses for both financial reporting and income tax reporting purposes in accordance with the accrual method of accounting. For custom manufactured items, any customer deposits are reflected in the balance sheet and costs related to the manufacturing are included in work in process inventory. Once the item is completed and shipped, deposits and corresponding work in process costs are recognized in the statement of income.

Cash and Cash Equivalents – For purposes of the consolidated statement of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. The company has no cash equivalents at the consolidated balance sheet date.

Inventories – Inventory consists mainly of parts, components and work in progress on fully equipped modular units, engines and generator sets. Capitalized costs associated with work in progress inventory include parts and components used, direct labor and outside services. Due to the very limited amount of production work performed, the Company did not capitalize fixed production overhead items into work in progress. Inventory is recorded at the lower of cost or market under the first-in, first-out (FIFO) method.

Property and Equipment – Property and equipment are recorded at cost less accumulated depreciation. The Company has a capitalization policy which requires capitalization of items with a cost of $2,000 or greater and an estimated useful life of three years or more. Items that do not meet that criteria are expensed. Depreciation for financial reporting purposes is computed using the straight-line method and for tax reporting purposes is computed using straight-line and accelerated methods. Repairs and maintenance costs are expensed unless the repair significantly extends the useful life of the asset it is related to. In such cases, the repair cost will be capitalized and depreciated over the extended useful life.

Estimated useful lives by category are as follows:

Building	39-40 years
Building rennovations	39-40 years
Leasehold improvements	39-40 years
Vehicles	5 years
Furniture and equipment	5-7 years

NOTE 1 – NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes – Income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of property and equipment, inventories, investments, intangibles and deferred compensation for financial and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes also are recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future federal income taxes. Current and deferred income taxes are presented for each individual entity in the consolidated statement of earnings and are based upon actual income or loss generated by those entities and the temporary timing differences that are unique to each. In accordance with current accounting standards, tax years 2010, 2011, 2012, 2013, 2014, 2015 and 2016 are currently open for examination from Federal and state taxing authorities.

Use of Estimates - In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the statement of condition dates and revenues and expenses for the periods shown. Actual results could differ from the estimates and assumptions used in the consolidated financial statements. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of foreclosed real estate, and deferred tax assets.

Shipping and Handling – Common carrier cost for products received are included in cost of goods sold. The Company provides its own truck fleet for the delivery of product to customers. These costs are included in operating expenses. Freight cost is billed to the customer for products delivered.

Accounts Receivable – Payment terms on accounts receivable are ordinarily net ten days from invoice. The Company performs credit evaluations on customers and typically does not require collateral from its customers. Advanced deposits for custom projects may be required depending on the customer. An allowance for doubtful accounts is based upon an analysis of aged accounts receivable for current collectability and historical trends. Management periodically reviews this allowance and adjustments are made as necessary. Accounts deemed uncollectible are charged off against income in the period when that determination is made. Currently, the Company does not have any accounts receivable as of September 30, 2017 and, therefore, has not established an allowance for doubtful accounts.

Employee Stock Compensation Plan - Generally accepted accounting principles in the United States of America Codification Section 718 requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on a grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period which an employee is required to provide service in exchange for the award – the requisite service period.

The Company has determined the estimated fair value of stock options at grant date using the Black-Scholes option-pricing model based on market data as of February 21, 2017, The expected dividend yield of 0.0% and expected volatility ranges from 80.34% - 223.06% were used to model the values. The risk-free rate of return ranges from 0.17% - 1.98%, which was based on the yield of a U.S. Treasury note with a term of ten years. The expected life of the stock options ranges from 5.50 - 6.50 years depending upon vesting period.

Research and Development Costs – The Company incurs costs associated with research and development activities related to the design and building of a hydrogen fuel engine. Research and development costs are expensed in the period they are incurred.

NOTE 2 – EARNINGS (LOSS) PER SHARE

Earnings (loss) per common share have been computed based on dividing net earnings (loss) by the weighted-average number of shares of common stock outstanding. Diluted earnings (loss) per common share, which would include the effect of vested stock options have not been presented since the vested shares would be anti-dilutive in a situation where the Company is generating a loss. Earnings (loss) per common share are presented on the consolidated statement of earnings (loss).

NOTE 3 – RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, FASB issued ASU 2016-02, Leases (Topic 842). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. The new guidance will be effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period and is applied retrospectively. Early adoption is permitted. We are currently in the process of assessing the impact the adoption of this guidance will have on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers" (Topic 606) (ASU 2014-09), which supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition", and most industry-specific guidance. ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The amendments in ASU 2014-09 will be applied using one of two retrospective methods.

Subsequently, the FASB has issued the following standards related to ASU 2014-09: ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (ASU 2016-08); ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing (ASU 2016-10); and ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (ASU 2016-12). The Company must adopt ASU 2016-08, ASU 2016-10 and ASU 2016-12 with ASU 2014-09 (collectively, the new revenue standards). The effective date will be the first quarter of our fiscal year ended March 31, 2018. We have not determined the potential effects on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09), which simplified certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification on the statement of cash flows. ASU 2016-09 will be effective for the Company beginning in its first quarter of 2018. The Company is currently evaluating the impact of adopting ASU 2016-09 on its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01), which updates certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 will be effective for the Company beginning in its first quarter of 2019. The Company does not believe the adoption of ASU 2016-01 will have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13), which modifies the measurement of expected credit losses of certain financial instruments. ASU 2016-13 will be effective for the Company beginning in its first quarter of 2021 and early adoption is permitted. The Company does not believe the adoption of ASU 2016-13 will have a material impact on its consolidated financial statements.

There are several other new accounting pronouncements issued or proposed by the FASB. Each of these pronouncements, as applicable, has been or will be adopted by the Company. Management does not believe any of these accounting pronouncements has had or will have a material impact on the Company's consolidated financial position or operating results.

NOTE 4 - STOCK COMPENSATION PLAN

The Company maintains stock-based benefit plans under which certain employees and directors are eligible to receive restricted stock grants or options. Under the 2015 Stock-Based Benefit Plan, the maximum number of 8,000,000 shares may be issued through the exercise of stock options. The exercise price of each option equals the market price of the Company's stock on the date of grant and an option's maximum contractual term is ten years.

Restricted stock grants aggregating 2,000,000 shares and having a fair value of $506,000 were awarded through September 30, 2017. 800,000 shares vest immediately and restrictions on the remaining 1,200,000 shares awarded lapse in annual increments over three years. The fair value as of the grant date of the restricted stock grants is charged to expense as the restrictions lapse. Total stock compensation expense for all grants vesting through September 30, 2017 was $214,812.

Information pertaining to options outstanding at September 30:

	2017	
	Shares	**Weighted-average exercise price**
Outstanding at beginning of period	4,828,000	$ 0.123
Granted during the 9 month period	2,200,000	$ 0.210
Options exercised	(800,000)	$ 0.210
Options forfeited	(613,000)	$ -
Outstanding at end of year	5,615,000	$ 0.166
Options exercisable at September 30, 2017	3,411,250	$ 0.114

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable**	**Weighted Average Exercise Price**
$0.11	4,000,000	6.50	$ 0.110	1,600,000	$ 0.110
$0.11 - $0.17	410,000	8.07	$ 0.167	910,000	$ 0.117
$0.20 - $0.215	5,000	8.80	$ 0.200	901,250	$ 0.117
$0.21	1,200,000	9.56	$ 0.210		

NOTE 5 - INVENTORY

Inventory consists of the following at September 30:

	2017
Parts and components	$ 8,000
WIP-electrolyzers	237,409
Gensets	52,000
	$ 297,409

NOTE 6 – PROPERTY AND EQUIPMENT, NET

Property and equipment at September 30 are summarized as follows:

	2017
Land and land improvements	$ 25,000
Building	600,250
Building rennovations	31,233
Leasehold improvements	56,843
Vehicles	1,650
Furniture and equipment	485,179
	1,200,155
Less: accumulated depreciation	(248,549)
	$ 951,606

Depreciation expense for the nine months ended September 30, 2017 is $67,180.

NOTE 7 - INTANGIBLE ASSETS

In accordance with the terms of the stock warrant agreement between the Company and a shareholder dated January 27, 2015, the shareholder agreed to exchange certain assets for the right to purchase stock under the warrant agreements. The warrant agreements are discussed in more detail in Note 5. Included in the assets which were exchanged were intangible assets with amortizable lives ranging from fifteen to seventeen years on a straight-line basis. At September 30, net intangible assets include the following:

	2017
Patents	$ 120,000
Technical knowledge	194,665
	314,665
less: Accumulated amortization	(53,431)
Intangibles, net of amortization	$ 261,234

For the nine months ended September 30, 2017, amortization expense associated with intangible assets was $15,027.

NOTE 7 - INTANGIBLE ASSETS (Continued)

Future amortization of intangibles is as follows:

3 months ending 2017	$ 5,009
2018	20,036
2019	20,036
2020	20,036
2021	20,036
Thereafter	176,081
	$ 261,234

NOTE 8 – NOTES PAYABLE

The Company, through its subsidiaries, have the following notes payable:

The Company has a note payable with Iowa State Bank. The original loan amount was $250,000 with interest at 9% per annum. The note matured on March 1, 2010 and is secured by inventory. The outstanding balance on this loan at September 30, 2017 is $221,215. The Company is in default on this note payable and the balances are included in current portion of notes payable on the consolidated balance sheet. Interest continues to accrue on this note payable and is reflected in accrued interest payable.

During the year ending December 31, 2016, the Company purchased building and land in exchange for cash and an interest only mortgage note payable with a financial institution. The original amount of the loan was $531,250 and carries an interest rate of 4.50% per annum. The note requires monthly interest payments on the outstanding balance, with all outstanding principal and interest due at maturity. The note matures August 2018 and contains a provision to convert to an amortizing loan over a fixed term. The Company expects the loan will convert to a fixed term note upon maturity in 2018. The outstanding balance on this note at September 30, 2017 is $515,625 and is included in current portion of notes payable.

The Company has a note payable to the City of Algona dating back to 2005. The note required quarterly payments of $5,000 beginning January 1, 2006 and was a zero interest, ten year, partially forgivable loan provided the Company created and retained a specific amount of new, full time positions for five years. Since the Company did not meet the jobs created requirements, the loan is accruing interest at 10% per annum. Due to the Company's inability to make quarterly payments as required, the loan is in default and is due according to the original terms. The loan was collateralized by real estate. Accrued interest on this loan is included in accrued interest payable. The outstanding balance on this loan at September 30, 2017 is $53,113.

The Company has a note payable to the Algona Area Economic Development Corporation dating back to 2005. The note required quarterly payments of $2,500 beginning January 1, 2006 and ending July 2017. The note payable was a partially forgivable loan, carrying an interest rate of 8% per annum with a ten-year term provided the Company created and retained a specific amount of new, full time positions for five years. Since the Company did not meet the jobs created requirements, the loan is accruing interest at 8% per annum. Due to the Company's inability to make quarterly payments as required, the loan is in default and is due according to the original terms. The loan was collateralized by real estate. Accrued interest on this loan is included in accrued interest payable. The outstanding balance on this loan at September 30, 2017 is $146,124.

NOTE 8 – NOTES PAYABLE (CONTINUED)

The Company assumed a second note payable to the Algona Area Economic Development Corporation for the purchase of real estate. The note required quarterly payments of $2,500 beginning January 1, 2006 with the final payment in July 2017. The note carries an interest rate of 10%. Due to the Company's inability to make quarterly payments as required, the loan is in default and is due according to the original terms. The loan was collateralized by real estate. Accrued interest on this loan is included in accrued interest payable. The outstanding balance on this loan September 30, 2017 is $87,500.

NOTE 9 – JUDGMENTS PAYABLE

The Iowa Department of Economic Development judgment payable results from a default provision contained in two separate economic development loans (Community Economic Betterment Account (CEBA) and Physical Infrastructure Assistance Program (PIAP) in 2005. The Company's Iowa subsidiary was in default of the CEBA note agreement for failure to create the required number jobs by the project completion date of July 30, 2010. The PIAP note had a cross default provision related to the CEBA note, thereby making the Company in default of both note agreements. Interest on both notes payable accrued at 6% per annum from the disbursement date of December 1, 2005 through the default date of April 10, 2010. Per diem interest continues to accrue from the date of default in the amounts of $41.10 for the CEBA note payable and $24.66 for the PIAP note payable. The judgment payable presented on the balance sheet includes the original note payable balances ($400,000 in total), plus all accrued interest and applicable attorney fees from the date of disbursement through the date of the balance sheets presented.

On April 7, 2017, the Iowa District Court in and for Kossuth County entered a summary judgment against the Company related to a note payable to an individual (Druek). The judgment is for $93,221.17 plus interest at 9% from April 5, 2011 through April 7, 2017 plus $22.98 per diem interest thereafter until paid in full and attorney fees in the amount of $14,157.20. Per diem interest through September 30, 2017 is included in accrued interest at September 30, 2017.

NOTE 10 – ADDITIONAL PAID IN CAPITAL

Additional paid in capital at September 30 is composed of the following:

	2017
Common stock transactions	$ 20,263,602
Issuance of stock warrants	580,000
Stock warrant extensions	720,000
Vested stock options	355,926
Total	$ 21,919,528

NOTE 11 – OPERATING LEASES

The Company's corporate facilities are located in Greeneville, Tennessee and are leased through November 15, 2017. The Company is not expected to renew the lease and will be moving into another facility the Company owns. The monthly lease payment is $4,500. Lease expense incurred for the nine months ended September 30, 2017 is $36,000.

The Company has entered into a month to month agreement with an unrelated company to sublease a portion of the corporate facilities and will continue this sublease in the new facility. This agreement calls for lease payments of $750 per month. Rental income related to this sublease for the nine months ended September 30, 2017 is $6,750.

NOTE 12 – RELATED PARTY TRANSACTIONS

During prior years, the Company paid some expenses on behalf of a shareholder and Board of Directors member, with a provision the individual would reimburse the Company. These amounts are reflected in the balance sheet as "Due from Related Party".

NOTE 13 – INCOME TAXES

Due to continuing operating losses, there is no current provision for income taxes recorded in the financial statements.

The components of the net deferred tax asset at September 30, 2017 are summarized as follows:

	2017
Deferred tax liabilities:	
Depreciation	$ (83,814)
	$ (83,814)
Deferred tax assets:	
Inventory	$ 164,557
NOL carryforward	6,846,232
Stock option compensation	137,031
Accrued officers compensation	303,712
Accrued interest	131,948
Tax credit carryforward	178,154
Gross deferred tax assets	7,761,634
Net deferred tax assets	7,677,820
less: valuation allowance	(7,677,820)
Net deferred tax asset	$ -

The Company has cumulative Federal net operating loss carryforwards of approximately $17,800,000 as of September 30, 2017 which are used to offset future taxable income. Federal net operating losses may be carried forward twenty years from the year they were incurred. Unused losses expire after the carryforward period. The Company's net operating losses at September 30, 2017 expire beginning in 2023 through 2037. The Company has a Federal general business credit carryforward of $178,154. Internal Revenue Code allows the unused portion of the credit to be carried forward for twenty years. This credit will begin expiring in 2025.

Management assesses the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred over the company's history. On the basis of this analysis, management believes that it is more likely than not that the company will not be able to utilize all of its deferred tax assets. Therefore, a full valuation allowance against deferred tax assets has been set up.

Uncertain tax positions must be recorded in accordance with ASC 740 on the basis of a two-step process in which management determines it is more likely than not that the tax position will be sustained on the basis of the technical merits of the position. Then, for tax position that meet the more likely than not threshold, the company must recognize the largest amount of tax benefit that is more than 50% likely to be realized upon ultimate settlement with tax authorities. Management has evaluated all tax positions and determined there are no uncertain tax positions taken.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company is subject to various claims and litigation arising out of patent disputes and various other claims. Because litigation is subject to many uncertainties and the outcome of individual litigated matters is not predictable with assurance, it is reasonably possible that some of the legal actions and claims could be filed and decided as unfavorable to the Company. Although the amount of ultimate liabilities with respect to such matters cannot be ascertained, management believes that any resulting liability should not materially affect the financial position of the Company.

NOTE 15 – FAIR VALUE DISCLOSURES

Fair Value Disclosures – Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Generally accepted accounting principles in the United States of America ("GAAP") establishes a hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of input may be used to measure fair value as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Due to their short-term nature, the carrying value of the Company's accounts receivables, inventory, accounts payable, accrued liabilities and notes payable approximate fair value. The fair value of the Company's borrowings, if recalculated based on current interest rates, would not significantly differ from the recorded amounts. All other financial instruments are based upon Level 3 inputs, which represent management's assumptions about fair value. The Company has no other assets or liabilities that it chooses or that are required to be reported at fair value.

NOTE 16 – CONCENTRATIONS OF CREDIT RISK

Deposits are held in financial institutions in the United States and, at times, deposit balances may exceed federally insured limits. The Company has never experienced any losses related to these balances. FDIC insurance covers up to $250,000 per depositor at each financial institution, and the Company's cash balances may exceed federally insured limits.

NOTE 17 – GOING CONCERN

We have not achieved profitability in any quarter since our formation and we will continue to incur net losses until we can produce sufficient revenue to cover our costs. As of September 30, 2017, we had an accumulated deficit of approximately $23.7 million. We anticipate that we will continue to incur losses until we can produce and sell our products on a large-scale and cost-effective basis. Our losses resulted from costs incurred in connection with our research and development expenses and from general and administrative costs associated with our operations. We cannot guarantee when we will operate profitably, if ever.

In order to achieve profitability, among other factors, management must successfully execute our planned path to profitability. If we are unable to successfully take these steps, we may never operate profitably, and, even if we do achieve profitability, we may be unable to sustain or increase our profitability in the future. We do not have enough cash to fund our operations to profitability and if we are unable to secure additional capital, we may be required to seek strategic alternatives, including but not limited to a potential business combination or a sale of our company or our business, or reduce and/or cease our operations.

Our auditors, Rodefer Moss & Co, PLLC have indicated in their report on the Company's financial statements for the fiscal year ended December 31, 2016 that conditions exist that raise substantial doubt about our ability to continue as a going concern due to our recurring losses from operations and substantial decline in our working capital. A "going concern" opinion could impair our ability to finance our operations through the sale of equity, incurring debt, or other financing alternatives. Our ability to continue as a going concern will depend upon the availability and terms of future funding, ability to sell and manufacture product, improved operating margins and our ability to profitably meet our after-sale service and commitments with customers. If we are unable to achieve these goals, our business would be jeopardized, and the Company may not be able to continue. If we ceased operations, it is likely that all of our investors would lose their investment.

In order to continue operations through the second quarter of 2018, management plans to sell the majority of parts and components inventory, the sale of real estate and the exercise of additional stock options and purchase of shares of stock by two shareholders. For the long term, management is exploring a variety of opportunities to obtain additional capital, including advanced conversations with investors and a potential private placement. There is no assurance that we will be able to raise the necessary capital or that the capital, if available, will be available on terms that will be acceptable to us.

If adequate funds are not available or are not available on acceptable terms, our ability to fund our operations, take advantage of opportunities, develop products and technologies, and otherwise respond to competitive pressures could be significantly delayed or limited, and we may need to downsize or halt our operations. If we are not able to obtain the needed financing in a timely fashion, our ability to achieve profitability will be materially impaired.