HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES

AUDIT REPORT

December 31, 2016 and 2015

HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES

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• Certified Public Accountants
• Business Advisors

p: 865.583.0091
f: 865.583.0560
w: rodefermoss.com
608 Mabry Hood Road
Knoxville, TN 37932

RODEFER MOSS & CO, PLLC

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Hydrogen Engine Center, Inc.
Greeneville, Tennessee

We have audited the accompanying consolidated balance sheets of Hydrogen Engine Center, Inc. and Subsidiaries (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of earnings, changes in stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2016. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 19 to the consolidated financial statements, the Company has not achieved profitability in any quarter since its formation, and may continue to incur net losses, which raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters also are described in Note 19. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Rodefer Moss & Co, PLLC

/s/ Rodefer Moss & Co, PLLC
Knoxville, Tennessee
November 14, 2017

HYDROGEN ENGINE CENTER AND SUBSIDIARIES
Consolidated Balance Sheets
December 31, 2016 and 2015

Assets

	2016	2015
Current assets		
Cash	$ 273,111	$ 70,894
Due from related party	11,774	3,864
Inventories	329,183	6,317
Total current assets	614,068	81,075
Property and equipment, net of depreciation	1,024,322	427,266
Other assets		
Intangible assets, net of amortization	276,262	296,298
Total other assets	276,262	296,298
Total assets	$ 1,914,652	$ 804,639

Liabilities and Stockholders' Equity

	2016	2015
Current liabilities		
Accounts payable and related taxes	$ 11,393	$ 4,500
Accrued liabilities	10,108	16,356
Accrued officers wages	729,727	662,612
Customer deposits	30,000	-
Accrued interest	553,138	498,451
Iowa Department of Economic Development court judgment payable	670,184	646,181
Druek note payable	107,379	107,379
Note payable - City of Algona	53,112	53,112
Notes payable - Algona Area Economic Development Commission	233,624	233,624
Current portion, notes payable	737,017	222,967
Total current liabilities	3,135,682	2,445,182
Stockholders' Equity		
Common stock, $.001 par value; 100,000,000 shares suthorized; 49,085,283 and 36,314,016 issued and outstanding	49,085	36,314
Additional paid in capital	21,347,652	19,378,893
Accumulated other comprehensive income	1,651	1,651
Retained deficit	(22,619,418)	(21,057,401)
Total stockholders' equity (deficit)	(1,221,030)	(1,640,543)
Total liabilities and stockholders' equity (deficit)	$ 1,914,652	$ 804,639

The accompanying notes are an integral part of these consolidated financial statements.

HYDROGEN ENGINE CENTER AND SUBSIDIARIES
Consolidated Statements of Earnings
For the Years Ended December 31, 2016 and 2015

	2016	2015
Operating expenses		
Compensation expense		
(including stock compensation of $84,294 and $80,000)	516,392	359,079
Professional services	203,210	177,544
Occupancy expenses	93,372	89,581
Operations expense	284,655	234,802
Depreciation and amortization	96,002	80,480
Total operating expenses	1,193,631	941,486
Loss from operations	(1,193,631)	(941,486)
Other income (expense):		
Interest income	206	23
Other income (expense)	10,632	9,929
Rental income	7,500	6,000
Interest expense	(86,724)	(107,679)
Stock warrant extension expense	(300,000)	(420,000)
Debt forgiveness loss on foreclosure	-	(476,230)
Total other income (expenses)	(368,386)	(987,957)
Loss before income taxes	(1,562,017)	(1,929,443)
Net loss	$ (1,562,017)	$ (1,929,443)
Loss per share of common stock	$ (0.03)	$ (0.05)

The accompanying notes are an integral part of these consolidated financial statements.

HYRDOGEN ENERGY CENTER, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2016 and 2015

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Deficit	Total Stockholders' Deficit
Balance at December 31, 2014	$ 32,722	$ 17,576,079	$ 1,651	$(19,127,958)	$ (1,517,506)
Net loss	-	-	-	(1,929,443)	(1,929,443)
Other comprehensive income	-	-	-	-	-
Paid in capital in exchange for stock warrants		580,000			580,000
Paid in capital for stock warrant extension		420,000			420,000
Stock options expensed		80,000			80,000
Purchase of common stock (3,592,448 shares)	3,592	722,814	-	-	726,406
Balance at December 31, 2015	36,314	19,378,893	1,651	(21,057,401)	(1,640,543)
Net loss	-	-	-	(1,562,017)	(1,562,017)
Other comprehensive income	-	-	-	-	-
Paid in capital for stock warrant extension		300,000			300,000
Stock options expensed	-	84,295	-	-	84,295
Purchase of common stock (12,771,267 shares)	12,771	1,584,464	-	-	1,597,235
Balance at December 31, 2016	$ 49,085	$ 21,347,652	$ 1,651	$ (22,619,418)	$ (1,221,030)

The accompanying notes are an integral part of these consolidated financial statements.

HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Net loss	$ (1,562,017)	$ (1,929,443)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	96,002	80,480
Debt forgiveness loss on foreclosure	-	476,230
Stock option compensation	84,294	80,000
Stock warrant extension expenses	300,000	420,000
Non cash expenses exchanged for paid in capital	384,895	188,071
Interest income	(206)	(23)
Decrease (increase) in:		
Trade accounts and notes receivable	-	10,661
Inventory	(322,866)	3,904
Due from related party	(7,910)	(3,864)
Increase (decrease) in:		
Accounts payable	6,893	(52,282)
Accrued liabilities	(6,248)	14,388
Accrued officers' wages	67,115	86,178
Accrued interest	54,687	88,742
IDED and Druek judgment payables	24,002	24,002
Customer deposits	30,000	-
Net cash used in operating activities	(851,359)	(512,956)
Cash flows from investing activities:		
Purchase of fixed assets	(136,170)	(51,480)
Interest income	206	23
Net cash used in investing activities	(135,964)	(51,457)
Cash flows from financing activities:		
Net (decrease) increase in borrowings and capital leases	(17,200)	(829)
Issuance of common stock	12,771	3,592
Increase in additional paid in capital	1,193,969	393,408
Net cash provided by financing activities	1,189,540	396,171
Net increase (decrease) in cash	202,217	(168,242)
Cash at beginning of year	70,894	239,136
Cash at end of year	$ 273,111	$ 70,894

The accompanying notes are an integral part of these consolidated financial statements.

HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Continued)

	2016	2015
Cash paid during the year for:		
Income taxes	$ -	$ -
Interest on notes payable	$ 6,043	$ -

Non-cash investing and financing activities:

For the year ended December 31, 2015,additional paid in capital for stock warrants exchanged for $265,335 in fixed assets and $314,665 in intangible assets.

For the year ended December 31, 2015, bank foreclosure on real estate resulted in a decrease in property and equipment cost of $1,863,950, accumulated deprecation of $587,846, notes payable of $527,347 and accrued interest of $125,679.

For the year ended December 31, 2015, write off of old property and equipment resulted in a decrease in cost and accumulated deprecation of $684,932.

For the year ended December 31, 2015, property and equipment in the amount of $141,335 was exchanged for paid in capital.

For the year ended December 31, 2016, property and equipment in the amount of $5,660 was exchanged for paid in capital.

For the year ended December 31, 2016, a building in the amount of $531,250 was exchanged for a note payable.

The accompanying notes are an integral part of these consolidated financial statements.

HYDROGEN ENGINE CENTER, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2016 and 2015

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

The common stock of 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

During the year ended December 31, 2015, a financial institution foreclosed on a building and real estate located in Iowa. The foreclosure procedures resulted in a loss on debt forgiveness of $476,230. This loss is presented as a separate line item in the "Other Income (Expense) section of the consolidated statement of earnings.

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 and 2015 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 shown as a separate line item 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 collectibility 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 December 31, 2016 and 2015 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 a non-public 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 December 31, 2016 and 2015, 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 PER SHARE

Earnings per common share have been computed based on dividing net earnings by the weighted-average number of shares of common stock outstanding. Diluted earnings 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 per common share are presented on the consolidated statement of earnings.

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 6,000,000 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 408,000 and 420,000 shares and having a fair value of $70,700 and $93,840 were awarded in 2016 and 2015, respectively. Restrictions on the 480,000 and 420,000 shares awarded in 2016 and 2015, respectively, lapse in annual increments over four years. Restrictions on the additional 20,000 awarded in 2015 lapse twelve months from the date of the grant. Restrictions on the grants awarded in 2014 lapse in annual increments over five years. The market value as of the grant date of the restricted stock grants is charged to expense as the restrictions lapse. Compensation expense for grants vesting in 2016 and 2015 was $84,294 and $80,000 respectively.

Information pertaining to options outstanding at December 31, 2016:

	2016		2015	
	Shares	Weighted-average exercise price	Shares	Weighted-average exercise price
Outstanding at beginning of period	4,420,000	$ 0.115	4,000,000	$ 0.110
Granted during the 12 month period	408,000	$ 0.200	420,000	$ 0.167
Options exercised	-	$ -	-	$ -
Options forfeited	-	$ -	-	$ -
Outstanding at end of year	4,828,000	$ 0.123	4,420,000	$ 0.115
Options exercisable at end of year	920,000	$ 0.127	800,000	$ 0.110

	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	7.25	$ 0.120	800,000	$ 0.12
$0.11 - $0.17	420,000	8.71	$ 0.167	920,000	$ 0.127
.$20-.$215	408,000	9.49	$ 0.200		

NOTE 5 - STOCK WARRANT AGREEMENTS

On January 27, 2015, the Company entered into two stock warrant agreements with a company controlled by a Board Member. The agreements allow for 7,000,000 shares and 6,000,000 shares of Company stock to be purchased at $0.15 and $0.20 per share, respectively. The agreements include a provision whereby the shareholder could exercise a "cashless" provision in which shares of stock could be exchanged in a cashless transaction for a lesser number of shares based upon a stated formula. In exchange for the rights under the warrant agreements, the related company agreed to exchange certain fixed and intangible assets. The warrant agreements originally expired on September 30, 2015 and 2016, respectively and extensions on the agreements were granted.

The Company has determined the estimated fair value of assets exchanged for the warrant agreements using the Black-Scholes option-pricing model based on market data as of January 27, 2015. The expected dividend yield of 0.0% and expected volatility was 126.62% and 106.96% for the two warrant agreements were used to model the values.

NOTE 5 - STOCK WARRANT AGREEMENTS (CONTINUED)

The risk-free rate of return ranges was 0.17% and 0.54%which was based on the yield of a U.S. Treasury note with a term of ten years. There was no expected term on the warrant agreements as the valuation was for the exchanged assets as of January 27, 2015.The estimated fair value was $580,000 on January 27, 2015, of which $265,335 was allocated to fixed assets and $314,665 to intangible assets as discussed further in Note 8.

At the expiration dates, the two warrant agreements were extended and were revalued for the extensions using the Black-Scholes option-pricing model based on market data as of September 30, 2015 and September 30, 2016, the respective expiration dates., The expected dividend yield of 0.0% and expected volatility was 92,91% and 80.34% for the two warrant agreements were used to model the values. The risk-free rate of return ranges were 0.33% and 0.23%which was based on the yield of a U.S. Treasury note with a term of ten years. There terms of the extensions were for seven months and 2 months. In accordance with professional accounting standards related to extensions of stock warrant agreements, the Company recorded $300,000 and $420,000 in warrant extension expense and additional paid in capital for the years ended December 31, 2016 and 2015, respectively. As of December 31, 2016, all shares available for purchase under the two warrant agreements had been acquired.

NOTE 6 - INVENTORY

Inventory consists of the following at December 31:

	2016	2015
Parts and components	$ 8,401	$ -
WIP-electrolyzers	221,074	401
WIP - other	47,708	5,916
Gensets	52,000	-
	$ 329,183	$ 6,317

NOTE 7 – PROPERTY AND EQUIPMENT, NET

Property and equipment are summarized as follows:

	December 31, 2016	December 31, 2015
Land and land improvements	$ 25,000	$ -
Building	600,250	-
Building rennovations	31,233	-
Leasehold improvements	56,843	53,128
Vehicles	8,870	1,650
Furniture and equipment	485,179	476,575
	1,207,375	531,353
Less: accumulated depreciation	(183,053)	(104,087)
	$ 1,024,322	$ 427,266

Depreciation expense for the years ended December 31, 2016 and 2015 was $75,966 and $62,113, respectively.

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NOTE 8 - 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 December 31, net intangible assets include the following:

	2016	2015
Patents	$ 120,000	$ 120,000
Technical knowledge	194,665	194,665
	314,665	314,665
less: Accumulated amortization	(38,403)	(18,367)
Intangibles, net of amortization	$ 276,262	$ 296,298

Amortization expense associated with intangible assets was $20,036 and $18,367 for the years ended December 31, 2016 and 2015, respectively.

Future amortization of intangibles is as follows:

Year Ending December 31,	
2017	$ 20,036
2018	20,036
2019	20,036
2020	20,036
2021	20,036
Thereafter	176,082
	$ 276,262

NOTE 9 – 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 December 31, 2016 and 2015 is $221,392 and $222,967, respectively. 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 December 31, 2016 is $515,625 and is included in current portion of notes payable.

NOTE 9 – NOTES PAYABLE (CONTINUED)

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 and, 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 December 31, 2016 and 2015 is $53,113 and $53,113, respectively.

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 and was secured by real estate. Since the Company did not meet the jobs created requirements and, 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 December 31, 2016 and 2015 is $146,124 and $146,124 respectively.

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 at December 31, 2016 and 2015 is $87,500 and $87,500 respectively.

The Company has a note payable with an individual dating back to April 2010. The note originally required monthly principal payments, including interest at 9% per annum, of $4,516 with a maturity date of June 2012. The Company is in default on this note payable and interest has been accruing at the rate stated. Accrued interest on this loan is included in accrued interest payable. The outstanding balance on this loan at December 31, 2016 and 2015 is $107,379 and $107,379 respectively. As discussed in Note 18, the Company had a judgment entered against it in 2017 related to this note payable.

NOTE 10 – JUDGMENT 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.

NOTE 11 – ADDITIONAL PAID IN CAPITAL

Additional paid in capital is composed of the following:

	2016	2015
Common stock transactions	$ 19,818,919	$ 18,234,455
Issuance of stock warrants	580,000	580,000
Stock warrant extensions	720,000	420,000
Vested stock options	228,733	144,438
Total	$ 21,347,652	$ 19,378,893

NOTE 12 – OPERATING LEASES

The Company's corporate facilities are located in Greeneville, Tennessee and are leased for a twelve-month term. The lease agreement is renewable in February of each year. The monthly lease payment is $4,500 and the current lease has been renewed through February 2018. Lease expense incurred for the years ended December 31, 2016 and 2015 is $54,000 and $51,500, respectively.

Future minimum lease payments are as follows:

Year Ending December 31,	Amount
2017	$ 54,000
2018	9,000
	$ 63,000

The Company has entered into a month to month agreement with an unrelated company to sublease a portion of the corporate facilities. This agreement calls for lease payments of $750 per month. Rental income related to this sublease for the years ending December 31, 2016 and 2015 is $7,500 and $6,000, respectively.

NOTE 13 – RELATED PARTY TRANSACTIONS

During the years ended December 31, 2016 and 2015, 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 14 – 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 are summarized as follows:

	December 31,	
	2016	**2015**
Deferred tax liabilities:		
Depreciation	$ (82,499)	$ (81,030)
	$ (82,499)	$ (81,030)
Deferred tax assets:		
Inventory	$ 164,557	$ 164,557
NOL carryforward	6,506,544	5,978,057
Stock option compensation	88,062	55,609
Accrued officers compensation	280,945	255,106
Accrued interest	122,594	110,123
Tax credit carryforward	178,154	178,154
Gross deferred tax assets	7,340,856	6,741,605
Net deferred tax assets	7,258,357	6,660,575
less: valuation allowance	(7,258,357)	(6,660,575)
Net deferred tax asset	$ -	$ -

The Company has cumulative Federal net operating loss carryforwards of approximately $15,300,000 as of December 31, 2016 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 December 31, 2016 expire beginning in 2023 through 2036. 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 15 – 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 16 – 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 17 – 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 18 – SUBSEQUENT EVENT

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.

NOTE 19 – 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 December 31, 2016, we had an accumulated deficit of approximately $22.6 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.