

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-K

☒ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2022

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission file number: 001-31972

TELKONET, INC.

(Exact name of registrant as specified in its charter)

Utah
(State or Other Jurisdiction of Incorporation or Organization)

87-0627421
(I.R.S. Employer Identification No.)

20800 Swenson Drive Suite 175, Waukesha, WI
(Address of Principal Executive Offices)

53186
(Zip Code)

(414) 302-2299
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
None	None	None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$0.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(b) of the Act. ☐ Yes ☒ No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262 (b)) by the registered public accounting firm that prepared or issued its audit report. ☐

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) ☐ Yes ☒ No

Aggregate market value of the voting and non-voting common equity stock held by non-affiliates (based upon the closing sale price of \$0.05 per share on the OTCBB) of the registrant as of June 30, 2022: \$11,968,491

Number of outstanding shares of the registrant's par value \$0.001 common stock as of March 24, 2023: 299,212,282.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's definitive proxy statement, in connection with its 2023 annual meeting of stockholders, to be filed within 120 days of December 31, 2022, are incorporated by reference into Part III of this Annual Report on Form 10-K.

TELKONET, INC.
FORM 10-K
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PART I

ITEM 1. DESCRIPTION OF BUSINESS.

Some of the statements contained in this Annual Report on Form 10-K discuss future expectations, contain projections of results of operations or financial condition or state other “forward-looking” information. Those statements include statements regarding the intent, belief or current expectations of Telkonet, Inc. (“we,” “us,” “our” or the “Company”) and our management team. Words such as “expects,” “anticipates,” “targets,” “goals,” “projects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “continues,” “may,” and variations of these words, as well as similar expressions, are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth, trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those projected in the forward-looking statements. These risks and uncertainties include but are not limited to those risks and uncertainties set forth in Item 1A of this report. In light of the significant risks and uncertainties inherent in the forward-looking statements included in this report, the inclusion of such statements should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

General Development of Business

Telkonet, Inc. (“we,” “us,” “our,” the “Company,” or “Telkonet”), formed in 1999 and incorporated under the laws of the state of Utah, is the creator of the EcoSmart and the Rhapsody Platforms of intelligent automation solutions designed to optimize energy efficiency, comfort and analytics in support of the emerging Internet of Things (“IoT”). The platforms are deployed primarily in the hospitality, educational, governmental and other commercial markets, and is specified by engineers, HVAC professionals, building owners, and building operators. We currently operate in a single reportable business segment.

In 2007, the Company acquired substantially all of the assets of Smart Systems International (“SSI”), which was a provider of energy management products and solutions to customers in the United States and Canada and the precursor to the Company’s EcoSmart Platform. In 2020, the Company launched the Rhapsody Platform, which simplifies the installation and setup of the Company’s newest products and integrations. Both platforms provide comprehensive savings, management reporting, analytics and virtual engineering of a customer’s portfolio and/or property’s room-by-room energy consumption. Telkonet has deployed more than a half million intelligent devices worldwide in properties within the hospitality, educational, governmental and other commercial markets. The platforms are recognized as solutions for reducing energy consumption, operational costs and carbon footprints, and eliminating the need for new energy generation in these marketplaces – all whilst improving occupant comfort and convenience.

On August 6, 2021, the Company entered into a stock purchase agreement (the “Purchase Agreement”) with VDA Group S.p.A., an Italian joint stock company (“VDA”), pursuant to which VDA would, at the Closing (as defined in the Purchase Agreement), contribute \$5 million to Telkonet (the “Financing”) and, in exchange, Telkonet would issue to VDA (the “Issuance”): (i) 162,900,947 shares of the Company’s common stock; and (ii) a warrant to purchase 105,380,666 additional shares of the Company’s common stock (the “Warrant”) (the Issuance and the Financing referred to collectively herein as the “VDA Transaction”). The Closing occurred on January 7, 2022.

Following the issuance of 162,900,947 shares of the Company’s common stock to VDA upon the Closing, VDA owns 53% of the issued and outstanding common stock on a fully diluted as exercised/converted basis, resulting in a change of control of the Company. VDA could eventually own as much as 65% of the issued and outstanding common stock on a fully diluted as exercised/converted basis if it fully exercises the Warrant.

The Company has elected not to apply pushdown accounting adjustments to the Company’s financial statements related to the change in control as allowed by Accounting Standards Update No. 2017-17.

Form 8-K was filed on March 29, 2023, announcing the Company’s intention to voluntarily deregister its common stock from the requirements of Sections 12(g) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and suspend its reporting obligations under Section 15(d) of the Exchange Act. Telkonet intends to file a Form 15 to effect the deregistration and suspension with the U.S. Securities and Exchange Commission (the “SEC”) shortly after Telkonet’s filing of its Form 10-K for the fiscal year ending December 31, 2022, to be filed on or before March 31, 2023 (the “2022 10-K”). The filing of the 2022 10-K will be Telkonet’s final periodic SEC filing. For more details, please see Note P SUBSEQUENT EVENTS.

Recent Developments

Impact of COVID-19 Pandemic

We believe that the COVID-19 pandemic has had, and any lingering effects of the pandemic may continue to have, an adverse effect on many of our customers and suppliers, which has had an adverse effect on our results of operations and may affect our future results of operations.

We cannot predict the extent to which any lingering effects of the COVID-19 pandemic may affect our future business or operating results, which is highly dependent on inherently uncertain future developments, including the severity of outbreaks of COVID-19, the effects of new variants, the actions taken by governments and private businesses in relation to COVID-19 containment, the availability, deployment and efficacy of vaccines, and the transition from COVID-19 being a pandemic to an endemic illness.

In geographies where we, our customers and our suppliers operate, health concerns and political or governmental developments in response to COVID-19 have resulted in, and could in the future result in, economic, social or labor instability or prolonged contractions in the industries in which our customers operate, slowdowns in our sales process, customers not purchasing at all or at reduced volumes, customers failing to make payments, slowdowns in our product development efforts, or other effects that may have a material adverse effect on our business or our results of operations and financial condition.

Recently, the effects of the pandemic have been most severe in China, where we employ several members of our product development team. Because our platform is offered as a subscription-based service, the effect of the pandemic may not be fully reflected in our operating results until future periods, if at all.

The hospitality industry, our largest market that generally accounts for a majority of our revenue, has suffered as much as any since the onset of the pandemic. While the industry is trending toward recovery, the situation remains fragile. The effects of supply-chain issues, inflation, rising interest rates labor shortages, and subsequent rising wages, all present some level of pandemic uncertainty for the foreseeable future. STR and Tourism Economics reports that the U.S. hotel industry achieved revenue per available room (RevPAR) in 2022 that was above 2019 levels on a nominal basis, but would not be fully recovered (when adjusted for inflation) until 2025¹.

Preservation of Liquidity and Expense Management

The Company is focused on preserving liquidity, managing expenses, and targeted sales and new product growth. The Company has taken, and is continuing to take, a number of actions to preserve cash. These actions include decreasing the use of engineering consultants, exploring cheaper alternatives for our facility leases, cancelling all non-essential travel and limiting the Company's attendance at trade shows (implemented prior to applicable government stay-at-home orders being put in place). In early April of 2020, management made the decision to furlough certain employees, instituted pay cuts for certain other employees and suspended the Company's 401(k) match through the end of 2020. With the receipt of a loan under the Paycheck Protection Program ("PPP") (discussed below), the Company was able to bring back the furloughed employees, restore payroll to prior levels and delay suspension of the 401(k) match. However, the pandemic continued to impact the Company's operations and financial results, and consequently, in late June of 2020 management once again made the decision to furlough certain employees, instituted pay cuts for certain other employees and suspended the Company's 401(k) match. The furloughs and pay cuts continued through September 2020, at which time management determined it was necessary to discontinue the furloughs and pay cuts in order to retain necessary personnel for the Company's ongoing operations. The Company's 401(k) match was reinstated in January 2023.

In addition to the actions noted above, on April 21, 2020, the Company entered into an unsecured promissory note, dated April 17, 2020, with Heritage Bank for a \$913,063 loan under the PPP ("the First PPP Loan"). In January 2021, the Company applied for forgiveness of the amount due on the First PPP Loan. On February 16, 2021, the outstanding principal and interest accrued of \$7,610 on the First PPP Loan was fully forgiven.

¹ "STR, TE make modest upgrade to first U.S. hotel forecast of 2023", STR and Tourism Economics 23 January 2023

On April 27, 2021, the Company entered into a second unsecured promissory note, dated as of April 26, 2021, for a second PPP loan (“the Second PPP Loan” and, together with the PPP Loan, the “PPP Loans”), with Heritage Bank under a second draw of the PPP administered by the SBA and authorized by the Keeping American Workers Employed and Paid Act. In September 2021, the Company applied for forgiveness of the amount due on the Second PPP Loan. On September 15, 2021, Heritage Bank confirmed that the Second PPP Loan granted to the Company, in the original principal amount of \$913,063 plus accrued interest of \$3,044 thereon, was forgiven in full.

See Note G – Debt in the Notes to the Consolidated Financial Statements under Item 15 of Part IV of this Annual Report on Form 10-K for a summary of the terms of the PPP Loans.

The more recent actions described above are in addition to the cost elimination and liquidity management actions that the Company began implementing in the second half of 2019, including reviewing opportunities to decrease spend with third party consultants and providers, strategically reviewing whether or not to fill employee positions in the event of vacancies, and implementing sales campaigns to sell slow-moving inventory and reduce existing inventory volumes. There is no guarantee, however, that these actions, nor any other actions identified, will yield profitable operations in the foreseeable future.

Markets & Products

Rhapsody Platform and Expanded Sales through Value-Added Resellers

The Company remains focused on selling its EcoSmart Platform (discussed below) into its target markets, while also developing a new platform – Rhapsody. The Rhapsody Platform was launched in 2020. The Rhapsody Platform simplifies the installation and setup of Telkonet’s newest products and integrations. The key goals of the Rhapsody Platform are to open up Telkonet’s core products to distribution and additional resellers through expanded capabilities while also reducing the reliance on internal Telkonet resources for support.

The Rhapsody Platform focuses on utilizing WIFI and Bluetooth Low Energy (“BLE”) for mobile app based setup and configuration. By utilizing an installer’s smart phone, the barrier for technical training is reduced as well as the potential commissioning and support needs of Telkonet for its value-added resellers. With continued enhancements to the Rhapsody Platform, Telkonet hopes to further grow both domestic and international value added resellers.

Narrative Description of the Business

Telkonet is the creator of the EcoSmart and Rhapsody Platforms of intelligent automation solutions designed to optimize energy efficiency, comfort and analytics in support of the emerging IoT. The platforms are deployed primarily in the hospitality, educational, governmental and other commercial markets, and is specified by engineers, HVAC professionals, building owners, and building operators.

EcoSmart Platform

Telkonet’s EcoSmart Platform is comprised of four primary pillars:

- **EcoSmart Product Suite:** The suite of intelligent hardware products designed and developed to provide monitoring, management and reporting over individual and grouped energy consumption throughout building environments. Products include thermostats, sensors, switches, and outlets.
- **EcoCentral:** The cloud-based dashboard that provides visualization and remote management of Telkonet’s monitoring, reporting and analytics through deployed EcoSmart and integrated products. EcoCentral is the intelligence behind the EcoSmart Platform.
- **EcoCare:** Telkonet’s professional support and maintenance services including engineering, analytics, reporting, software and hardware updates, extended warranty, project and relationship management and onsite support.

The EcoSmart Platform provides comprehensive energy and operational savings, management monitoring, reporting, analytics of a property or individual room by adding intelligence to HVAC runtimes and through integrations with door locks, lighting, window coverings, and more end-user attributes. The EcoSmart Platform is a solution for reducing energy consumption, operational costs and carbon footprints, and eliminating the need for new energy generation in these markets – all while engaging and delighting guests.

Controlling energy consumption can make a significant impact on a building's bottom line, as HVAC costs represent a substantial portion of a facility's overall utility bill. Hospitality is a key market for Telkonet. U.S. hotels spend an average of \$2,196 per room on energy costs each year. HVAC and lighting account for approximately 45% of hotel energy usage². Telkonet approaches the opportunity to reduce consumed energy by adding intelligence to a property's HVAC and lighting systems.

Energy is often wasted through the lighting, powering, heating and cooling of unoccupied spaces. These spaces with intermittent occupancy constitute Telkonet's target markets, and our experience, supported by independent research and customer data, suggests these rooms are unoccupied as much as 70% of the time.

EcoSmart Product Suite:

- **EcoInput:** A lighting controller installed directly in line with existing light switches, making them intelligent and manageable. IoT solutions are no longer hindered by interior design requirements, often mandating specific light switches be featured in guest rooms, which can result in increased project costs. It is compatible with LED, CFL, and incandescent lighting for enhanced dimming controls.
- **EcoTouch Thermostat:** An all touch capacitive thermostat interface available in wired and wireless models offering a premium aesthetic. The EcoTouch allows building owners to match the thermostat with the design of their room by changing the color of the outer edge and by selecting between black or white options.
- **EcoInsight Thermostat:** A programmable and controllable wired thermostat with over 125 configurable settings used to control the efficiency of HVAC through the use of environment variables and triggers.
- **EcoAir Thermostat:** A wireless thermostat mirroring the EcoInsight footprint while enabling the relocation of in room controls without the usual construction expense and downtime.
- **EcoSource Controller:** The remote HVAC control device associated with Telkonet's thermostat interfaces allowing control while removing the need for expensive rewiring and construction. The EcoSource may also be used for third-party integrations, monitoring and control scenarios.
- **EcoSmart VRF Controller:** Works with most of the new variable refrigerant systems coming to market. The devices replace the EcoSource where discrete relays are not available.
- **EcoConnect Bridge:** An Ethernet to Zigbee bridge that serves as the coordinator for all EcoSmart devices connected to the intelligent automation network, managing approximately 30 - 70 device connections each.
- **EcoCommander Gateway:** EcoSmart's network-edge gateway server that provides real-time proactive data aggregation, analytics, reporting and management of the EcoSmart product suite.
- **EcoSense Occupancy Sensor:** A remote occupancy sensor that monitors environments with ultra, high-sensitive sensors designed to detect motion or body heat. All sensors are programmed to ensure accurate occupancy detection. The EcoSense Occupancy Sensor may be hardwired or programmed to communicate wirelessly and may be battery operated or utilize external power.

² Lodging Staff, 'Here's Where Hotels Spend the Most on Energy', Lodging Magazine.com, 2018, <https://lodgingmagazine.com/where-hotels-spend-most-energy/>

- **EcoSwitch Light Switch:** An EcoSmart energy management product with the appearance of a traditional ‘rocker’ light switch. Turning lights off, even for a short time, saves energy and extends lamp life. The EcoSwitch can be used to compose and automate dramatic lighting scenes in a room.
- **EcoGuard Outlet:** An EcoSmart control that acts as the replacement for an in-wall outlet and has the ability to monitor and control the flow of power to one or both outlets. Based on occupancy, it can turn off lamps, televisions, appliances, and any other energy-consuming loads that are plugged in, preventing a property from consuming power in an empty room. The EcoGuard completely disconnects devices from the power supply, preventing lights and other in-room electronics from needlessly consuming energy as well as providing monitoring of energy flow and efficiency when a plug is enabled.
- **EcoContact Door & Window Sensor:** A remote, wireless door/window contact with the ability to provide additional occupancy data and control HVAC operability and other consumption measures when doors or windows are open.

Several of these devices have been recently released in “Plus” models which provide greater functionality and increased capabilities.

EcoCentral

Telkonet’s EcoSmart Platform is a comprehensive solution for intelligent automation and energy management. The platform has a well-developed upgrade path with the final and complete version of the platform offering real-time control and analytics provided through a cloud computing platform called EcoCentral. EcoCentral derives its name through its ability to direct user resources to where they add the most value. From monitoring equipment operation and determining where engineering efforts are needed and notifying staff when performance is degrading, EcoCentral creates a comprehensive tool for providing insights and access for EcoSmart Platform deployments either individually or across an entire building portfolio.

EcoCare

EcoCare is Telkonet’s professional support services including call, email and chat support, repair and replacement services, periodic reporting, communication with customers’ utility and Internet Service Provider (“ISP”) partners and more. Telkonet provides three packages of EcoCare services as well as allows customers to create their own package of services ala carte. EcoCare allows EcoSmart customers to ensure that they continue to recognize the savings estimated and benefit from the intended return on investment (ROI). Typical EcoCare contracts range from one to five years and have automatic renewal terms built into each individual contract. All support staff are located at Telkonet’s Waukesha, Wisconsin headquarters.

Rhapsody Platform

Telkonet launched a new platform in 2020 named Rhapsody. Although the Rhapsody Platform shares many similarities with the EcoSmart Platform, it extends beyond some EcoSmart capabilities with native support for our new devices that use WIFI and BLE for configuration and setup. It also provides a more modern architecture to allow for enhanced scalability of real time IoT data. For example, data reporting is instantaneous with the Rhapsody Platform because it is based on data change instead of 15-minute interval reporting like the EcoSmart Platform. The main components that make up the Rhapsody Platform are:

- **Rhapsody Dashboard:** The cloud-based portal that provides remote management, monitoring and reporting capabilities of supported hardware.
- **Rhapsody Mobile:** The app that assists with the installation and configuration of all supported hardware. It also provides remote control capabilities for residential customers
- **API:** The collection of interfaces available for third party data and command access to products running on the Rhapsody Platform. These interfaces include BACnet and Rest API options.

Intelligent Energy Management

Telkonet's energy management platforms apply and improve building intelligence to deliver energy and cost savings through controlling lighting, plugload and HVAC runtimes. Captured data may be presented on a grouped, property or room-by-room basis, allowing very granular management of in-room energy use and environmental conditions. Telkonet achieves this by leveraging our device platforms, including occupancy sensors and intelligent programmable thermostats connected with packaged terminal air conditioner ("PTAC") controllers or any other terminal equipment HVAC products and managed wireless light switches and in wall electrical plugs to adjust and maintain energy consumption including a room's temperature according to occupancy, eliminating wasteful heating and cooling of unoccupied rooms. All of these can be accomplished from the in-room devices or via any web-connected device, such as smart phones, tablets and laptop computers.

EcoSmart and Rhapsody are energy management platforms that deliver optimal, individual room energy savings without compromising occupant comfort, due to a proprietary technology named "Recovery Time."

Recovery Time Technology

Telkonet's HVAC controls feature Recovery Time, technology designed to maximize energy efficiency without sacrificing occupant comfort. When a room is occupied, the temperature selected by the occupant will be maintained by the Telkonet system. Once a Telkonet occupancy sensor determines that the room is unoccupied, the system adjusts the room temperature using Recovery Time. Unlike other systems, Recovery Time technology constantly performs calculations that evaluate how far each individual room's temperature can drift from the occupant's preferred setting ("set-point"), to harvest energy savings while still being able to return to the occupant's set-point within a customer's pre-defined period of time.

When determining the temperature setting, Recovery Time technology considers how long it will take to return the temperature to the occupant's set-point once they return to their room. The temperature will only drift far enough to ensure the system will return to the occupant's preferred temperature setting within minutes upon their return to the room. The specific length of recovery time is selected by property management at the time of the installation; however, it can be altered at any time by management.

How Do Other Systems Work?

In competing systems the occupant chooses their preferred temperature. When the occupant leaves, the thermostat reverts to a set-point of a fixed number of degrees different than the preferred set temperature (lower in winter and higher in summer). In some products temperature gap is a fixed temperature selected by the property owner. Because each occupant room will require different lengths of time to return to the occupant's desired temperature, based on room size and orientation, whether blinds are open, outdoor temperature, sun, and wind, the length of time required for the HVAC to return to temperature can vary dramatically and can often be prohibitive. Additionally, a dirty HVAC filter or coil will reduce heat transfer, increasing that recovery time.

EcoSmart and Rhapsody Deliver Room-by-Room Savings

Because each room's environment is unique, Telkonet's approach is likewise unique. Rooms are evaluated independently in real-time to determine its energy efficient temperature, or setback. Recovery Time technology constantly calculates in real-time how far the room temperature can drift, by taking into consideration the environmental characteristics that impact the temperature in the room, including:

- The occupant's preferred temperature setting
- The location of the room within the building
- The window placement – facing the sun or shade
- If the drapes are open or closed

- If the climate is dry or humid
- The varying weather conditions throughout the day
- The condition of the HVAC unit, such as age and efficiency

Through the constant monitoring of the HVAC unit's ability to drive the temperature and the real-time adjustment of the setback temperature, rooms are never excessively hot or cold when an occupant returns to the room. The room will always be just minutes away from an occupant's desired comfort setting. As a result, Recovery Time technology delivers room-by-room, occupant-by-occupant savings. The technology also significantly improves the guest experience, driving loyalty to the property and brand, and decreases service calls.

The EcoSmart and Rhapsody Platforms maximize energy reductions while at the same time ensuring occupant comfort, maximizing energy savings and extending equipment life expectancy. The technology is particularly attractive to customers in the hospitality industry, as well as the education, healthcare, public housing and government/military markets, who are constantly seeking ways to reduce costs and meet federal and state mandates without impacting building occupant comfort.

Using standard communication protocols, ensuring widespread adoption and a simple interface, Telkonet's technology may also be integrated with utility controls, property management systems and building automation systems to be used in load shedding initiatives. This feature provides management companies and utilities enhanced opportunities for cost savings, environmental protections and energy management. Additionally, Telkonet's energy management systems qualify for most state and federal energy efficiency and rebate programs.

Competitive Advantages

We believe our intelligent automation platforms, with our proprietary Recovery Time technology, deliver extensive differentiation against competing products, including:

- Technology that evaluates each room's environmental conditions results in maximum energy savings;
- The ability to reduce HVAC runtimes increases overall equipment life;
- Increased occupant control and comfort, driving brand and property loyalty;
- Multiple thermostat options, including wired and wireless, to fit a brand's image and application;
- Backlight of thermostat improves the experience for the visually impaired;
- Web-based access with extremely powerful and simple dashboard web interface;
- Breadth of HVAC system compatibility;
- Adaptive learning and system programming;
- Utility-integrated events capabilities;
- Remote HVAC control network;
- Expert EcoCare support, staffed in the USA;

- Plug load, lighting and HVAC controls;
- Extensive 3rd-party integrations, including lighting, door locks, window treatments and building management systems;
- Industry standard software and communication protocols, Linux and ZigBee;
- ROI in as little as two years; and
- Mobile applications provide installation, remote management and end-user accessibility.

Our open, scalable and standards-based architecture approach allows for truly custom deployments. The platforms integrate seamlessly with back-office management systems, property management systems, building automation systems, and utility demand/response programs, as well as additional third-party network architecture to recognize increased efficiency and savings.

Based on these platform features and capabilities, we've been awarded, and continue to receive, contracts in the hospitality, educational, governmental and other commercial markets. In addition, our relationships with utility-sponsored direct-install and rebate-funded programs provide us with a significant advantage over our competitors in the commercial space.

Given the population growth in the United States and the increasing demand for energy, we forecast additional energy-related infrastructure will be needed. We believe the use of Smart Grid technologies and energy efficiency management platforms are affordable alternatives to building additional power generation through leveraging existing resources and providing enhanced energy savings costs.

Target Markets

Rooms with intermittent occupancy are most commonly found in the following market sectors:

- **Hospitality:** hotels, motels, resorts, timeshares and casinos.
- **Educational:** residence halls, dormitories and other campus living options. Also K-12 environments with distributed and portable classrooms.
- **Government:** residence halls, barracks, military apartments and other campus living options.
- **Healthcare:** medical office buildings, assisted and independent living facilities.
- **Multiple Dwelling Units ("MDUs"):** apartments and other public living options.

Industry and Market Overview

A significant amount of the energy consumed by commercial buildings in the United States is used to cool, heat, or light the buildings.³ In an effort to remain competitive and manage expenses, governments, building owners, building tenants, and companies in general are looking for ways to become more efficient both fiscally and environmentally. The American Council for an Energy Efficient Economy reported that the cost of saving one unit of energy through energy efficiency is one-fifth (1/5) the cost required to generate that same unit of energy. As a result, we feel that the growth opportunities in the energy management market are in their infancy.

³ <https://www.eia.gov/energyexplained/use-of-energy/commercial-buildings.php>

Telkonet's key industries are all prime candidates for energy management, in part due to their utilizing energy "on-demand" or intermittently. Providing energy, and engaging the equipment to supply it, to those rooms and spaces only when occupied results in significant energy savings in addition to affording longer life and reduced maintenance to the HVAC systems.

Hospitality Industry

There is a constant balancing act for hotel operators between managing guest comfort and operating margins. Telkonet's Recovery Time allows operators to manage operation costs yet still provide for a comfortable and engaging guest experience. Through Telkonet's platforms, individual hospitality brands and properties can create a desired guest environment and still allow for energy savings via the Recovery Time algorithm.

Educational Industry

Telkonet approaches the education industry with strategic relationships with enterprise energy service companies ("ESCOs") throughout the USA. Telkonet partners with ESCOs to include our energy management platforms for deployment within residence halls on university campuses. The ESCOs bundle our technology with other facility improvement measures designed to reduce operating costs across the entire campus, bundling solutions with acceptable ROI and which meet state mandated guidelines. ESCOs also structure self-funding financial transactions called "Performance Contracts" in which the savings are greater than the repayment costs, typically guaranteeing the financial and operational performance in this type of engagement. This type of approach can remove any capital expense barriers and improve adoption.

During our history, deployments have occurred at the University of California-Davis, University of Miami, Kansas State University, North Carolina State University, University of Notre Dame, US Military Academy at West Point, New York University, and Texas A&M University-Commerce.

The opportunities in this market are not limited to higher education institutions. According to an NRG Business Energy Advisor report, schools in the United States spend \$8 billion on energy costs annually, with 73% of natural gas use going towards heating and 35% of electricity consumption going towards cooling. While heating and cooling account for only 2 – 4% of district costs, it is an opportunity for significant impact and gain.

We believe that our platforms are important tools for participants in the education industry seeking to control student-related energy costs. We have focused our sales efforts on members of the education industry who are seeking to expand their energy efficiency initiatives as well as the ESCOs who target the educational marketplace and have thus far had success with at least one school district installing EcoSmart in each classroom throughout the district.

Governmental Industry

The Department of Defense ("DOD") is the single largest energy consumer in the United States federal government – accounting for more than 76% of the entire federal government's energy expenditures during FY2017.⁴ Thus, we view this market as strategically significant to Telkonet's interests.

Our energy management platforms are already successfully incorporated into the energy initiatives in several military housing sites, military academies and barracks. Telkonet benefited from and continues to make use of government funding and other government contracts to provide our platforms for use on military bases and other facilities, helping both the DOD and the government as a whole achieve their long-term energy efficiency goals.

⁴ <https://fas.org/sgp/crs/natsec/R45832.pdf>

Healthcare Industry

Healthcare organizations currently spend over \$6.5 billion on energy each year, a cost which continues to rise in an effort to meet patient needs⁵. This is viewed as an emerging market for energy management systems. Although hospitals have many specific regulatory mandates, Telkonet has been working closely with operators and developers of healthcare support facilities, like medical office buildings, assisted living and other similar facilities, to integrate our energy management initiatives into efficiency opportunities supported by state and federal energy programs. For example, hospital energy managers can use energy efficiency strategies to offset high costs caused by growing plug loads and rising energy prices. A typical 200,000-square-foot, 50-bed hospital in the U.S. annually spends \$680,000, or roughly \$13,611 per bed on electricity and natural gas. By increasing energy efficiency, hospitals can improve the bottom line and free up funds to invest in new technologies and improve patient care.

These facilities offer a commercial environment similar to the hospitality or educational housing markets, and the increasing aging population and assisted living markets present attractive potential for energy efficiency. This market is expected to grow rapidly over the next several years due to its energy savings capabilities and an aging population.

MDU Industry

Public housing, which are properties owned and managed by the government, is an additional emerging market for energy management solutions. The tenants occupying these properties must meet specific eligibility requirements, and their utility bills are typically paid for by government programs. Many of the ESCO clients that Telkonet supports today have dedicated teams pursuing opportunities with the owners and operators of government-subsidized housing. Telkonet's platforms are an ideal solution for conserving energy, allowing remote monitoring, and improving tenant comfort.

Competition for Markets

We currently compete primarily within commercial and industrial markets, including the hospitality, education, healthcare, governmental and MDU sectors. Within each target market, we offer savings through our intelligent automation platforms. Our products offer significant competitive and complementary benefits when compared with alternative offerings including Building Automation Systems ("BAS") or Building Management Systems ("BMS"), static temperature occupancy-based systems, scheduling/programmable thermostats and high-efficiency HVAC systems.

We participate in a relatively small competitive field within the hospitality industry, with the majority of the energy management sales handled by fewer than seven manufacturers. The key competitors in the market segment are Inncom by Honeywell and Schneider Electric, with each offering some level of comparable products to our standalone and/or networked products. Telkonet leverages the above-mentioned competitive advantages to successfully compete in these spaces and win business.

The educational space is new to adopt occupancy-based controls. Our platforms have been introduced for use within student dormitories, which traditionally had few, if any, controls. More recently we've also been requested to install our products into classrooms, which traditionally have been an environment for BAS/BMS. Since the dormitory environment is very similar to the hospitality market, we believe we offer similarly-scaled energy savings. Since the market is still in its infancy, very few comparable offerings have entered the market but competitors within the hospitality segment are beginning to respond. Again, our key differentiators allow us to compete and win business in this space.

⁵ <https://www.energystar.gov/ia/partners/publications/pubdocs/Healthcare.pdf>

The healthcare and governmental markets are very similar in scope, relative to energy management systems. A key differentiator in these environments is the specific implementation being considered. Each market utilizes BAS/BMS for wide scale energy management initiatives. When addressing housing environments, including elderly care and assisted living facilities and military dormitories or barracks, Telkonet's platforms are able to provide increased energy savings and efficiency. Competitors operating in the BAS/BMS space include Honeywell, Schneider Electric, Johnson Controls, Siemens, Trane and others, many of whom Telkonet partners with to provide a comprehensive and integrated energy management solution to effectively address energy efficiency opportunities in all types of facilities. The MDU market is split into two distinct categories, public and upscale residential housing. Public housing benefits similarly to hospitality and educational housing where intelligent, occupancy-based automation reduces operating costs. Upscale residential facilities benefit from exclusive automation solutions and centralized data reporting resulting in maintenance efficiencies.

Inventory

We are dependent on a limited number of vendors to provide certain inventory and components. We've not experienced significant problems or issues purchasing any essential materials, parts or components, but have experienced gross profit pressure as a result of price increases and the impact of tariffs (discussed below). We contract the majority of our inventory with ATR Manufacturing, based in China, which provides substantially all the manufacturing requirements for Telkonet's energy management platforms. For the year ended December 31, 2022, 81% of our total purchases were from ATR Manufacturing.

Customers

We are neither limited to, nor reliant upon, a single or narrowly segmented customer base to derive our revenues. Our current focus includes the hospitality, educational, governmental, healthcare, and MDU markets, as well as expanding into the consumer market specifically through our resale channel as part of our long term strategic growth.

For the year ended December 31, 2022, two customers represented approximately 20% and 17% of total net revenues, respectively. For the year ended December 31, 2021, one customer represented approximately 18% of total net revenues.

Intellectual Property

Telkonet has acquired certain intellectual properties, including but not limited to patent US-10564660-B2 granted 2/18/20 on the water heater energy management controller and a provisional patent US-20200022243-A1 granted 20/1/16 on the lighting dimmer module and method of calibration. While we view these patents as valuable, we do not view any single patent as material to the Company as a whole.

There can be no assurance that any of our current or future patent applications will be granted, or, if granted, that such patents will provide necessary protection for our technology or our product offerings, or be of commercial benefit to us.

On November 30, 2020, Telkonet entered into a Wireless Network Patent License Agreement (the "License Agreement") with Sipco, LLC ("Sipco") and IPCO, LLC dba Intus^{IQ} (collectively, the "Licensors") in order to settle a patent infringement lawsuit without the expense of costly litigation. Without admission as to infringement, validity, or enforceability of the Licensed Patents (as defined in the License Agreement) or liability with respect to any claims of the complaint filed in the patent infringement lawsuit, Telkonet has agreed to pay certain royalty fees to the Licensors in exchange for the right under the Essential Claims (as defined in the License Agreement) of the Licensed Patents (as defined in the License Agreement), including multiple essential wireless mesh ("EWM") patents to manufacture, have manufactured, sell, offer to sell, import, export, and use the Licensed Products (as defined in the License Agreement). The EWM patent portfolio covers technologies used in multi-hop wireless networks utilizing wireless protocols such as, but not limited to, Zigbee. The portfolio also covers applications including, but not limited to, home and building automation and industrial controls.

As of December 31, 2022, the Company had a current liability of approximately \$200,000, of which \$60,000 is included in accounts payable and \$140,000 in other accrued liabilities (See Note F – Current Accrued Liabilities for further breakdown of accrued liabilities), along with a non-current liability of \$220,000 included in accrued royalties – long-term recorded on its Consolidated Balance Sheet. The corresponding expense was recorded in 2020 in the selling, general and administrative line of the Consolidated Statements of Operations. The payment of the royalty fees is expected to have a material and adverse impact on the Company's results of operations and liquidity. See Note M – Commitments and Contingencies in the Notes to the Consolidated Financial Statements under Item 15 of Part IV of this Annual Report on Form 10-K for a discussion of the patent infringement lawsuit and the License Agreement.

Government Regulation

As discussed in Item IA – Risks Relating to Our Financial Results, given the fact that we purchase the majority of our inventory from a supplier based in China, we are subject to and have been adversely affected by the tariffs imposed by the United States Federal Government on imports of industrial sector products from China.

In addition, we are subject to regulation in the United States by the Federal Communications Commission (“FCC”). FCC rules permit the operation of unlicensed digital devices that radiate radio frequency emissions if the manufacturer complies with certain equipment authorization procedures, technical requirements, marketing restrictions and product labeling requirements.

Future products designed by us will require testing for compliance with FCC and European Commission (“EC”) standards. Moreover, if in the future, the FCC or EC changes its technical requirements, further testing and/or modifications may be necessary in order to achieve compliance.

Research & Development

During the years ended December 31, 2022 and 2021, the Company spent \$1,070,473 and \$1,129,957, respectively, on research and development activities. Telkonet continues to invest in research & development to maintain and grow our competitive differentiation and customer value.

Key initiatives for 2023 include:

- developing a new Rhapsody thermostat based on the popular EcoSmart EcoInsight thermostat to help contain costs caused by the global chip shortages, work with VDA on product design changes to allow for easier global manufacturing and reduction in tariff expenses, add more global product certifications for opening additional markets,
- growing our Rhapsody platform with new software and providing interfaces to property management systems and door lock systems,
- enhancing our current EcoSmart products with new wireless capabilities to communicate with additional hospitality vendors, and
- building on the core pieces of the Rhapsody platform to continue the expanding deployments further into our core markets.

Additional Information

Employees

As of December 31, 2022, we had 29 full-time employees and 1 part-time employee.

Environmental Matters

We do not anticipate any material effect on our capital expenditures, earnings or competitive position due to compliance with government regulations involving environmental matters.

Available information

Our internet address is: <https://telkonet.com/>.

ITEM 1A. RISK FACTORS.

Our results of operations, financial condition and cash flows can be adversely affected by various risks. These risks include, but are not limited to, the principal factors listed below and the other matters set forth in this Annual Report on Form 10-K. You should carefully consider all of these risks.

Risks Relating to Our Financial Results

We expect to continue to incur operating losses and have negative operating cash flows for the foreseeable future.

Since inception through December 31, 2022, we have incurred cumulative losses of \$129,953,413 and have never generated enough funds through operations to support our business. For the year ended December 31, 2022, the Company had a cash flow deficit from operations of \$3,598,322. The Company has made significant investments in the engineering, development and marketing of its intelligent automation platforms, including but not limited to, hardware and software enhancements, support services and applications. The funding for these development efforts has contributed to, and continues to contribute to, the ongoing operating losses and use of cash. Operating losses have been financed by debt and equity transactions, capacity under the Company's \$1 million revolving credit facility with Heritage Bank of Commerce ("Heritage Bank"), the sale of a wholly-owned subsidiary, and management of working capital levels.

We have a limited number of shares of common stock available for future issuance which could adversely affect our ability to raise capital or consummate strategic transactions.

We are currently authorized to issue 475,000,000 shares of common stock under our Amended Restated and Articles of Incorporation. As of March 24, 2023, we have issued 299,212,282 shares of common stock and have approximately 107,907,513 shares of common stock committed for issuance giving effect to the assumed exercise of all outstanding warrants and options and assumed conversion of preferred stock.

If we fail to remain current on our reporting requirements, we could be removed from the OTCQB, which would limit the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

Companies trading on the OTCQB that are also reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, (the "Exchange Act"), and must be current in their reports under Section 13 of the Exchange Act in order to maintain price quotation privileges on the OTCQB. If we fail to remain current on our reporting requirements, we could be removed from the OTCQB. As a result, the market liquidity for our securities could be adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

Risks Related to Our Business and Operations

The Company's operations, financial results, and liquidity have been materially and adversely impacted by the COVID-19 pandemic.

We believe that the COVID-19 pandemic has had, and any lingering effects of the pandemic may continue to have, an adverse effect on many of our customers and suppliers, which has had an adverse effect on our results of operations and may affect our future results of operations.

We cannot predict the extent to which any lingering effects of the COVID-19 pandemic may affect our future business or operating results, which is highly dependent on inherently uncertain future developments, including the severity of outbreaks of COVID-19, the effects of new variants, the actions taken by governments and private businesses in relation to COVID-19 containment, the availability, deployment and efficacy of vaccines, and the transition from COVID-19 being a pandemic to an endemic illness.

In geographies where we, our customers and our suppliers operate, health concerns and political or governmental developments in response to COVID-19 have resulted in, and could in the future result in, economic, social or labor instability or prolonged contractions in the industries in which our customers operate, slowdowns in our sales process, customers not purchasing at all or at reduced volumes, customers failing to make payments, slowdowns in our product development efforts, or other effects that may have a material adverse effect on our business or our results of operations and financial condition.

Recently, the effects of the pandemic have been most severe in China, where we employ several members of our product development team. Because our platform is offered as a subscription-based service, the effect of the pandemic may not be fully reflected in our operating results until future periods, if at all.

Due to travel restrictions and social distancing edicts, the hospitality industry, our largest market that generally accounts for a majority of our revenue, has suffered as much as any. For a more detailed discussion of the impact of COVID-19 on the hospitality industry, see Item 1 – Recent Developments – Impact of COVID-19 Pandemic.

Tariffs have had, and continued tariffs and evolving trade policy between the United States and China may have, a material adverse effect on our business.

During 2018, the United States Federal Government imposed significant tariffs on imports from numerous countries, including China. Subsequent to this, the Office of the United States Trade Representative (“USTR”) announced an initial proposed list of imports from China that could be subject to additional tariffs. The list of imports for which Customs and Border Protection began collecting additional duties during July 2018 focuses on the industrial sector. The Company’s main supplier, accounting for approximately 81% of total purchases in 2022, is located in China. The products that the Company purchases from the supplier are subject to up to 25% tariffs. As a result of the tariffs, our cost of sales has increased.

The Biden administration has not stated whether it will ultimately remove or alter any of the tariffs. There continues to be significant uncertainty about the future relationship between the United States and other countries with respect to the trade policies, treaties, taxes, government regulations and tariffs that would be applicable. It is unclear what changes might be considered or implemented and what response to any such changes may be by the governments of other countries. These changes have created significant uncertainty about the future relationship between the United States and China, as well as other countries, including with respect to the trade policies, treaties, government regulations and tariffs that could apply to trade between the United States and other nations. If additional tariffs or other restrictions are placed on Chinese imports or any related counter-measures are taken by China, our revenue and results of operations may be materially harmed. Even in the absence of further tariffs, the related uncertainty and the market’s fear of an escalating trade war might create forecasting difficulties for us and cause our customers and business partners to place fewer orders for our products and services, which could have a material adverse effect on our business, liquidity, financial condition, and/or results of operations.

These developments, or the perception that any of them could occur, may have a material adverse effect on global economic conditions and the stability of global financial markets, and may significantly reduce global trade and, in particular, trade between these nations and the United States. Any of these factors could depress economic activity and restrict our access to suppliers or customers and have a material adverse effect on our business, financial condition and results of operations and affect our strategy in China and elsewhere around the world. Given the relatively fluid regulatory environment in China and the United States and uncertainty how the U.S. Administration or foreign governments will act with respect to tariffs, international trade agreements and policies, a trade war, further governmental action related to tariffs or international trade policies, or additional tax or other regulatory changes in the future could directly and adversely impact our financial results and results of operations.

We rely on a limited number of third party suppliers. If these companies fail to perform or experience delays, shortages, or increased demand for their products or services, we may face shortages, increased costs, and may be required to suspend deployment of our products and services.

We depend on a limited number of third party suppliers to provide the components and the equipment required to deliver our solutions, with purchases from one supplier comprising approximately 81% of total purchases for the year ended December 31, 2022. If these providers fail to perform their obligations under our agreements with them or we are unable to renew these agreements, we may be forced to suspend the sale and deployment of our products and services and enrollment of new customers, which would have an adverse effect on our business, prospects, financial condition and operating results.

We are subject to risks related to Inflation.

The general rate of inflation has increased in conjunction with overall imbalances in supply and demand recoveries from the COVID-19 pandemic. Some of the underlying factors impacting inflation may include, but are not limited to, global supply chain disruptions, shipping bottlenecks, labor market constraints, and side effects from monetary and fiscal expansions. Inflationary pressures are expected to continue in 2023. If these inflationary pressures persist or worsen, and commodity prices continue to remain at attractive levels that stimulate increased industry activity, we may face shortages of service providers, equipment, and materials. Such shortages could result in increased competition which may lead to further increases in costs.

High inflation could continue to adversely impact us. Although inflation appears to be declining, during 2021 and 2022, our operations were impacted by the highest domestic inflation rates in decades. If inflation rates remain elevated, our operations will likely continue to be impacted. Potential impacts of high inflation include (i) lower revenue if inflationary pressures cause customers to defer, decrease or cancel their expenditures on our products and services, (ii) lower margins if we cannot offset the higher cost of our labor and supplies by raising our prices or reducing our other expenses, (iii) higher interest costs to the extent inflation places upwards pressure on prevailing interest rates and (iv) as noted above, potential difficulties retaining personnel if we do not match the salary increase expectations of our workforce.

We are in a period of increasing inflation and economic uncertainty. The economy is facing inflationary pressures which has resulted in a few challenges for our business, most notably in the form of a tight labor market where job candidates have considerable bargaining power which has driven wages up. Additionally, we are experiencing higher labor and benefit related costs to retain our existing personnel. We believe we will continue to see significant pressure in our labor and benefit related costs which impacts both our gross margins and net income. We also continue to monitor for weakened demand in our software and related consulting business segment due to significant customer concentration. Increased inflation could place pressure on our customers' timing of approval for consulting projects to move forward. Currently, it is difficult to estimate the financial impact to our software and related consulting revenue, if any. We actively market our sustainability solutions and services to new types of customers. We believe the growing awareness of environmental, social and governance ("ESG") matters creates a key opportunity for us because we have the expertise and technology needed to help companies achieve ESG objectives within the food supply chain.

The industry within which we operate is intensely competitive and rapidly evolving.

We operate in a highly competitive, quickly changing environment, and our future success will depend on our ability to develop and introduce new products and product enhancements that achieve broad market acceptance in the markets within which we compete. We will also need to respond effectively to new product announcements by our competitors by quickly developing and introducing competitive products.

Delays in product development and introduction could result in:

- loss of or delay in revenue and loss of market share;
- negative publicity and damage to our reputation and the reputation of our product offerings; and
- a decline in the average selling price of our products.

We may incur substantial damages due to Patent Infringement litigation.

We cannot be certain that our products do not and will not infringe issued patents or other intellectual property rights of others. If it were determined that our products infringe the intellectual property rights of another, we could be required to pay substantial damages or be enjoined from licensing or using the infringing products or technology. Additionally, if it were determined that our products infringe the intellectual property rights of others, we would need to obtain licenses from these parties or substantially re-engineer our products in order to avoid infringement. We might not be able to obtain the necessary licenses on acceptable terms or at all, or to re-engineer our products successfully. Similar to the Sipco Lawsuit and License Agreement discussed earlier, any of the foregoing could cause us to incur significant costs and prevent us from selling our products.

We have identified material weaknesses in our internal controls as of December 31, 2022 that, if not properly remediated, could result in material misstatements in our financial statements.

Based on an evaluation of our disclosure of internal controls and procedures as of December 31, 2022, our management has concluded that, as of such date, there were material weaknesses in our internal control over financial reporting related to a lack of segregation of duties due to the limited size of the Company's accounting department, a failure to implement adequate internal control over financial reporting including in our IT general control environment and the need for a stronger internal control environment particularly around accounting for inventory. A material weakness is a control deficiency, or a combination of control deficiencies, in internal control over financial reporting, such that there is a more than a remote likelihood that a material misstatement of annual or interim financial statements would not be prevented or detected in a timely manner. As disclosed in Item 9A of Part II of this report, because of the material weaknesses identified by the Company, our consolidated financial statements may contain material misstatements that would require restatement of the Company's financial results in this report. Management of the Company believes that these material weaknesses are due to the small size of the Company's accounting staff. The small size of the Company's accounting staff may prevent adequate controls in the future, such as segregation of duties, due to the cost/benefit of such remediation. At present, the Company does not expect to hire additional personnel to remediate these control deficiencies in the near future.

Until and if these material weaknesses in our internal control over financial reporting are remediated, there is a reasonable possibility that material misstatements of our annual or interim consolidated financial statements could occur and not be prevented or detected by our internal controls in a timely manner. Material misstatements in our financial statements could result in litigation or regulatory enforcement actions, which would require additional financial and management resources; loss of investor confidence; and delays in filing required financial disclosures, one or more of which could have a material adverse effect on our business and financial condition. The Company believes the consolidated financial statements as of December 31, 2022 and 2021 are free of material misstatements.

Government regulation of our products could impair our ability to sell such products in certain markets.

The rules of the FCC permit the operation of unlicensed digital devices that radiate radio frequency emissions if the manufacturer complies with certain equipment authorization procedures, technical requirements, marketing restrictions and product labeling requirements. Differing technical requirements apply to "Class A" devices intended for use in commercial settings, and "Class B" devices intended for residential use to which more stringent standards apply. An independent, FCC-certified testing lab has verified that our product suite complies with the FCC technical requirements for Class A and Class B digital devices. No further testing of these devices is required, and the devices may be manufactured and marketed for commercial and residential use. Additional devices designed by us for commercial and residential use will be subject to the FCC rules for unlicensed digital devices. Moreover, if in the future, the FCC changes its technical requirements for unlicensed digital devices, further testing and/or modifications of devices may be necessary. Failure to comply with any FCC technical requirements could impair our ability to sell our products in certain markets and could have a negative impact on our business and results of operations.

Products sold by our competitors could become more popular than our products or render our products obsolete.

The market for our products and services is highly competitive. Some of our competitors have longer operating histories, greater name recognition and substantially greater financial, technical, sales, marketing and other resources. These competitors may, among other things, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, obtain more favorable pricing from suppliers and manufacturers and exert more influence on the sales channel than we can. As a result, we may not be able to compete successfully with these competitors, and these competitors may develop or market technologies and products that are more widely accepted than those being developed by us or that would render our products obsolete or noncompetitive. We anticipate that competitors will also intensify their efforts to penetrate our target markets. These competitors may have more advanced technology, more extensive distribution channels, stronger brand names, bigger promotional budgets and larger customer bases than we do. These companies could devote more capital resources to develop, manufacture and market competing products than we could. If any of these companies are successful in competing against us, our sales could decline, our margins could be negatively impacted, and we could lose market share, any of which could seriously harm our business, results of operations, and prospects.

We depend on a small team of senior management and may have difficulty attracting and retaining additional personnel.

Our future success will depend in large part upon the continued services and performance of senior management and other key personnel. If we lose the services of any member of our senior management team, our overall operations could be materially and adversely affected. In addition, our future success will depend on our ability to identify, attract, hire, train, retain and motivate other highly skilled technical, managerial, marketing, purchasing and customer service personnel when they are needed. Competition for these individuals is intense. We cannot ensure that we will be able to successfully attract, integrate or retain sufficiently qualified personnel when the need arises. Any failure to attract and retain the necessary technical, managerial, marketing, purchasing and customer service personnel could have a negative effect on our financial condition and results of operations.

We may be affected if the United States participates in wars or other military action or by international terrorism.

Involvement in a war or other military action or acts of terrorism may cause significant disruption to commerce throughout the world and may cause people to limit travel. To the extent that such disruptions result in (i) delays or cancellations of customer orders, (ii) declines in spending in the hospitality industry, our largest market that generally accounts for a majority of our revenue, (iii) a general decrease in consumer spending on information technology, (iv) our inability to effectively market and distribute our services or products or (v) our inability to access capital markets, our business and results of operations could be materially and adversely affected. We are unable to predict whether the involvement in a war or other military action will result in any long-term commercial disruptions or if such involvement or responses will have any long-term material adverse effect on our business, results of operations, or financial condition.

Cyber security risks and cyber incidents could adversely affect our business and disrupt operations.

Cyber incidents can result from deliberate attacks or unintentional events. These incidents can include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. The result of these incidents could include, but are not limited to, disrupted operations, misstated financial data, liability for stolen assets or information, increased cyber-security protection costs, litigation and reputational damage adversely affecting customer or investor confidence. We have implemented systems and processes to focus on identification, prevention, mitigation and resolution. However, these measures cannot provide absolute security, and our systems may be vulnerable to cyber-security breaches such as viruses, hacking, and similar disruptions from unauthorized intrusions. In addition, we rely on third party service providers to perform certain services, such as payroll and tax services. Any failure of our systems or third party systems may compromise our sensitive information and/or personally identifiable information of our employees. While we have secured cyber insurance to potentially cover certain risks associated with cyber incidents, there can be no assurance the insurance will be sufficient to cover any such liability.

Our exposure to the credit risk of our customers and suppliers may adversely affect our financial results.

We sell our products to customers that have in the past, and may, in the future, experience financial difficulties. If our customers experience financial difficulties, we could have difficulty recovering amounts owed to us from these customers. While we perform credit evaluations and adjust credit limits based upon each customer's payment history and credit worthiness, such programs may not be effective in reducing our exposure to credit risk. We evaluate the collectability of accounts receivable, and based on this evaluation make adjustments to the allowance for doubtful accounts for expected losses. Actual bad debt write-offs may differ from our estimates, which may have a material adverse effect on our financial condition, operating results and cash flows.

Our suppliers may also experience financial difficulties, which could result in our having difficulty sourcing the materials and components we use in producing our products and providing our services. This risk is increased given we depend on a limited number of third party suppliers to provide the components and the equipment required to deliver our solutions, with purchases from one supplier comprising approximately 81% of total purchases for the year ended December 31, 2022. If we encounter such difficulties, we may not be able to produce our products for our customers in a timely fashion which could have an adverse effect on our results of operations, financial condition and cash flows.

Changes in the economy and credit markets may adversely affect our future results of operations.

Our operations and performance depend to some degree on general economic conditions and their impact on our customers' finances and purchase decisions, particularly given the hospitality industry generally accounts for a majority of our revenue. As a result of economic events, potential customers may elect to defer purchases of capital equipment items, such as the products we manufacture and supply. Additionally, the credit markets and the financial services industry are subject to change. While the ultimate outcome of these events cannot be predicted, it may have a material adverse effect on our customers' ability to fund their operations thus adversely impacting their ability to purchase our products or to pay for our products on a timely basis, if at all. These and other economic factors could have a material adverse effect on demand for our products, the collection of payments for our products and on our financial condition and operating results.

We may not be able to obtain payment and performance bonds, which could have a material adverse effect on our business.

Our ability to deploy our suite of products into the energy management initiatives in federally funded or assisted projects may rely on our ability to obtain payment and performance bonds which may be an essential element to work orders for the installation of our products and services. If we are unable to obtain payment and performance bonds in a timely fashion as required by an applicable work order, we may not be entitled to payment under the work order until such bonds have been provided or until such a requirement is expressly waived. In addition, any delays due to a failure to furnish bonds may not entitle us to a price increase for the work or an extension of time to complete the work and may entitle the other party to terminate our work order without liability and to indemnify such party from damages suffered as a result of our failure to deliver the bonds and the termination of the work order. As a result, the failure to obtain bonds where required could negatively impact our business, results of operations, and prospects.

Risks Relating to the Ownership of Our Common Stock

Our common stock is thinly traded and there may not be an active trading market for our common stock.

Our common stock is currently quoted on the OTCQB, operated by the OTC Markets Group. However, there is no guarantee that our common stock will be actively traded on the OTCQB, or that the volume of trading will be sufficient to allow for timely trades. Investors may not be able to sell their shares quickly or at the latest market price if trading in our stock is not active or if trading volume is limited. In addition, if trading volume in our common stock is limited, trades of relatively small numbers of shares may have a disproportionate effect on the market price of our common stock.

The market price of our common stock has been and may continue to be volatile.

The trading price of our common stock has been and may continue to be highly volatile and could be subject to wide fluctuations in response to various factors. Some of the factors that may cause the market price of our common stock to fluctuate include:

- fluctuations in our quarterly financial and operating results or the quarterly financial results of companies perceived to be similar to us;
- changes in estimates of our financial results or recommendations by securities analysts;
- potential deterioration of investor confidence resulting from material weaknesses in our internal control over financial reporting;
- our ability to raise and generate working capital to meet our obligations in the ordinary course of business;
- changes in general economic, industry and market conditions;
- failure of any of our products to achieve or maintain market acceptance;

- changes in market valuations of similar companies;
- failure of our products to operate as advertised;
- success of competitive products;
- changes in our capital structure, such as future issuances of securities or the incurrence of additional debt;
- announcements by us or our competitors of significant products, contracts, acquisitions or strategic alliances;
- regulatory developments in the United States, foreign countries or both;
- litigation involving our Company, our general industry or both;
- additions or departures of key personnel; and
- investors' general perception of us.

In addition, if the market for technology stocks or the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

Anti-takeover provisions in our charter documents and Utah law could discourage, delay or prevent a change of control of our Company and may affect the trading price of our common stock.

We are a Utah corporation and the anti-takeover provisions of the Utah Control Shares Acquisition Act may discourage, delay or prevent a change of control by limiting the voting rights of control shares acquired in a control share acquisition. In addition, our Amended and Restated Articles of Incorporation and Bylaws may discourage, delay or prevent a change in our management or control over us that shareholders may consider favorable. Among other things, our Amended and Restated Articles of Incorporation and Bylaws:

- authorize the issuance of “blank check” preferred stock that could be issued by our board of directors in response to a takeover attempt;
- provide that vacancies on our board of directors, including newly created directorships, may be filled only by a majority vote of directors then in office, except a vacancy occurring by reason of the removal of a director without cause shall be filled by vote of the shareholders; and
- limit who may call special meetings of shareholders.

These provisions could have the effect of delaying or preventing a change of control, whether or not it is desired by, or beneficial to, our shareholders.

We do not currently intend to pay dividends on our common stock

We do not expect to pay cash dividends on our common stock. Any future dividend payments are within the absolute discretion of our board of directors and will depend on, among other things, our results of operations, working capital requirements, capital expenditure requirements, financial condition, contractual restrictions, business opportunities, anticipated cash needs, provisions of applicable law and other factors that our board of directors may deem relevant. We may not generate sufficient cash from operations in the future to pay dividends on our common stock.

Our common stock is subject to “Penny Stock” restrictions.

As long as the price of our common stock remains at less than \$5 per share, we will be subject to so-called “penny stock rules” which could decrease our stock’s market liquidity. The Securities and Exchange Commission (“SEC”) has adopted regulations which define a “penny stock” to include any equity security that has a market price of less than \$5 per share or an exercise price of less than \$5 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require the delivery to and execution by the retail customer of a written declaration of suitability relating to the penny stock, which must include disclosure of the commissions payable to both the broker/dealer and the registered representative and current quotations for the securities. Finally, the broker/dealer must send monthly statements disclosing recent price information for the penny stocks held in the account and information on the limited market in penny stocks. Those requirements could adversely affect the market liquidity of our common stock. There can be no assurance that the price of our common stock will rise above \$5 per share so as to avoid these regulations.

Further issuances of equity securities may be dilutive to current stockholders.

It is possible that we will be required to seek additional capital in the near term. This capital funding could involve one or more types of equity securities, including convertible debt, common or convertible preferred stock and warrants to acquire common or preferred stock. Such equity securities could be issued at or below the then-prevailing market price for our common stock. Any issuance of additional shares of our common stock will be dilutive to existing stockholders and could adversely affect the market price of our common stock.

The exercise of conversion rights, options and warrants outstanding and available for issuance may adversely affect the market price of our common stock.

As of December 31, 2022, we had outstanding employee options to purchase a total of 2,526,847 shares of common stock at exercise prices ranging from \$0.14 to \$0.19 per share, with a weighted average exercise price of \$0.15. As of December 31, 2022, there was a warrant outstanding for 105,380,666 shares in favor of VDA, which was part of their purchase consideration in January 2022. The exercise of outstanding options and warrants and the sale in the public market of the shares purchased upon such exercise could be dilutive to existing stockholders and could adversely affect the market price of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

In October 2013, the Company entered into a lease agreement for 6,362 square feet of commercial office space in Waukesha, Wisconsin for its corporate headquarters. On April 7, 2017, the Company executed an amendment to the existing lease to expand another 3,982 square feet, bringing the total leased space to 10,344 square feet, and extending the lease term for the total leased space from May 1, 2021 to April 30, 2026. The commencement date for this amendment was July 15, 2017.

In May 2017, the Company entered into a lease agreement for 5,838 square feet of floor space in Waukesha, Wisconsin for its inventory warehousing operations. The Waukesha lease expires in May 2024.

In November 2021, the Company entered into a lease agreement for 425 square feet of commercial office space in Gaithersburg, Maryland. Originally expiring on November 30, 2022, the lease expiry date was extended to November 30, 2023 on September 12, 2022.

ITEM 3. LEGAL PROCEEDINGS.

The Company continues to fulfill its obligations under the Wireless Network Patent License Agreement (the “License Agreement”) between SIPCO, LLC (“Sipco”) and IPCO, LLC dba IntusIQ (collectively, the “Licensors”) and the Company, dated November 30, 2020. The parties entered into the License Agreement in connection with the settlement of a lawsuit filed by Sipco as disclosed in more detail in the Company’s previously filed reports.

The minimum payments required under the License Agreement have been accrued for on the Company's Condensed Consolidated Balance Sheets in accordance with GAAP, which specifies that when a liability is probable and the amount can be reasonably estimated, said liability should be recorded in the current reporting period. Per the License Agreement, the contractual minimum payments began on January 1, 2022 and continue until December 31, 2024, thus satisfying both criteria of probable and reasonably estimable. Accordingly, a long-term liability was recorded representing the sum of those contractual minimums. As of December 2022, the Company had a current liability of approximately \$200,000, which \$60,000 is included in accounts payable and \$140,000 in other accrued liabilities (See Note F – Current Accrued Liabilities for further breakdown of accrued liabilities), along with a non-current liability of \$220,000 included in accrued royalties – long-term recorded on its Condensed Consolidated Balance Sheets.

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, other than the Sipco Lawsuit discussed above and which has been terminated, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity.

ITEM 4. MINE SAFETY DISCLOSURES.

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is currently quoted on the OTCQB under the symbol "TKOI." The OTCQB is not a stock exchange and any over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

Record Holders

As of March 1, 2023, we had 274 holders of record of our common stock and 299,212,282 shares of our common stock issued and outstanding.

Dividend Policy

The Company has never paid dividends on its common stock and does not anticipate paying dividends in the foreseeable future. It is also subject to certain contractual restrictions on paying dividends on its common stock under the terms of its Series A and B preferred stock.

Securities Authorized for Issuance under Equity Compensation Plans

See Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters for information about securities authorized for issuance under the Company's equity compensation plans.

Unregistered Sales of Equity Securities and Use of Proceeds

None.

Issuer Purchases of Equity Securities

None.

ITEM 6. [RESERVED]

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying financial statements and related notes thereto.

Recent Developments

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. On an ongoing basis, the Company evaluates significant estimates used in preparing its consolidated financial statements including those related to revenue recognition and allowances for uncollectible accounts receivable, inventory obsolescence, recovery of long-lived assets, income tax provisions and related valuation allowance, stock-based compensation, and contingencies. The Company bases its estimates on historical experience, underlying run rates and various other assumptions that the Company believes to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ from these estimates. The following are critical judgments, assumptions, and estimates used in the preparation of the consolidated financial statements.

Revenue from Contracts with Customers

Accounting Standards Codification Topic 606, Revenue from Contracts with Customers (“ASC 606, the Standard”) supersedes nearly all legacy revenue recognition guidance. ASC 606, the Standard outlines a comprehensive five-step revenue recognition model based on the principle that an entity should recognize revenue based on when it satisfies its performance obligations by transferring control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for said goods or services.

Identify the customer contracts

The Company accounts for a customer contract under ASC 606 when the contract is legally enforceable. A contract is legally enforceable when all of the following criteria are met: (1) the contract has been approved by the Company and the customer and both parties are committed to perform their respective obligations, (2) the Company can identify each party’s rights regarding goods or services transferred, (3) the Company can identify payment terms for goods or services transferred, (4) the contract has commercial substance, and (5) collectability of all the consideration to which the Company is entitled in exchange for the goods or services transferred is probable.

A contract does not exist if each party to the contract has the unilateral right to terminate a wholly unperformed contract without compensating the other party (or parties). Nearly all of the Company’s contracts do not contain such mutual termination rights for convenience. All contracts are in written form.

Identify the performance obligations

The Company will enter into product only contracts that contain a single performance obligation related to the transfer of products to a customer.

The Company will also enter into certain customer contracts that encompass product and installation services, referred to as “turnkey” solutions. These contracts ultimately provide the customer with a solution that enhances the functionality of the customer’s existing equipment. For this reason, the Company has determined that the product and installation services are not separately identifiable performance obligations, but in essence represent one, combined performance obligation (“turnkey”).

The Company also offers post-installation support services to customers. Support services are considered a separate performance obligation.

Determine the transaction price

The Company generally enters into contracts containing fixed prices. It is not customary for the Company to include contract terms that would result in variable consideration. In the rare situation that a contract does include this type of provision, it is not expected to result in a material adjustment to the transaction price. The Company regularly extends pricing discounts; however, they are negotiated up front and adjust the fixed transaction price set out in the contract.

Customer contracts will typically contain upfront deposits that will be applied against future invoices, as well as customer retainage. The intent of any required deposit or retainage is to ensure that the obligations of either party are honored and follow customary industry practices. In addition, the Company will typically be paid in advance at the beginning of any support contracts, consistent with industry practices. None of these payment provisions are intended to represent significant implicit financing. The Company’s standard payment terms are thirty days from invoice date. Products are fully refundable when returned in their original packaging without damage or defacing less a restocking fee. Historical returns have shown to be immaterial. The Company offers a standard one-year assurance warranty. However customers can purchase an extended warranty. Under the revenue standard, extended warranties are accounted for as a service warranty, requiring the revenue to be recognized over the extended service periods. Contracts involving an extended warranty are immaterial and will continue to be combined with support revenue and recognized on a straight-line basis over the support revenue term.

Allocate the transaction price to the performance obligations

Revenues from customer contracts are allocated to the separate performance obligations based on their relative stand-alone selling price (“SSP”) at contract inception. The SSP is the price at which the Company would sell a promised good or service separately. The best evidence of an SSP is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. However, turnkey solutions are sold for a broad range of amounts resulting from, but not limited to, tiered discounting for value added resellers (“VAR”) based upon committed volumes and other economic factors. Due to the high variability of our pricing, the Company cannot establish a reliable SSP using observable data. Accordingly, the Company uses the residual approach to allocate the transaction price to performance obligations related to its turnkey solutions. When support services are not included within the turnkey solution, the residual method is not utilized and no allocation of the transaction price to the performance obligation is necessary.

All support service agreements, whether single or multi-year terms, automatically renew for one-year terms at a suggested retail price (“SRP”), unless terminated by either party. Support service renewals are consistently priced and therefore would support the use of SRP as the best estimate of an SSP for such performance obligations.

Revenue Recognition

The Company recognizes revenues from product only sales at a point in time when control over the product has transferred to the customer. As the Company’s principal terms of sale are FOB shipping point, the Company primarily transfers control and records revenue for product only sales upon shipment.

A typical turnkey project involves the installation and integration of 200-300 rooms in a customer-controlled facility and takes approximately sixty days to complete. Since control over goods and services transfers to a customer once a room is installed, the Company recognizes revenue for turnkey solutions over time. The Company uses an outputs measure based on the number of rooms installed to recognize revenues from turnkey solutions.

Revenues from support services are recognized over time, in even daily increments over the term of the contract, and are presented as “Recurring Revenue” in the Statements of Operations.

Contracts are billed in accordance with the terms and conditions, either at periodic intervals or upon substantial completion. This can result in billing occurring subsequent to revenue recognition, resulting in contract assets. Contract assets are presented as current assets in the Consolidated Balance Sheet.

Contract liabilities include monthly support service fees, customer deposits, and billings in advance of revenue recognition. The long term portion of these liability balances represent the amount of revenues that will be recognized after December 31, 2023.

Contract Fulfillment Cost

The Company recognizes related costs of the contract over time in relation to the revenue recognition. Costs included within the projects relate to the cost of material, direct labor and costs of outside services utilized to complete projects. These are presented as “Contract assets” in the Consolidated Balance Sheet.

Accounts Receivable

Accounts receivable are uncollateralized customer obligations due under normal trade terms. The Company records allowances for doubtful accounts based on customer-specific analysis and general matters such as current assessment of past due balances and economic conditions. The Company writes off accounts receivable when they become uncollectible. Management identifies a delinquent customer based upon the delinquent payment status of an outstanding invoice, generally greater than 30 days past due date. The delinquent account designation does not trigger an accounting transaction until such time the account is deemed uncollectible. The allowance for doubtful accounts is determined by examining the reserve history and any outstanding invoices that are over 30 days past due as of the end of the reporting period. Accounts are deemed uncollectible on a case-by-case basis, at management’s discretion based upon an examination of the communication with the delinquent customer and payment history. Typically, accounts are only escalated to “uncollectible” status after multiple attempts at collection have proven unsuccessful.

Inventory Obsolescence

Inventories consist of thermostats, sensors and controllers for Telkonet's product platforms. These inventories are purchased for resale and do not include manufacturing labor and overhead. Inventories are stated at the lower of cost or net realizable value determined by the first in, first out (FIFO) method. The Company's inventories are subject to technological obsolescence. Management evaluates the net realizable value of its inventories on a quarterly basis and when it is determined that the Company's carrying cost of such excess and obsolete inventories cannot be recovered in full, a charge is taken against income for the difference between the carrying cost and the estimated realizable amount.

Guarantees and Product Warranties

The Company records a liability for potential warranty claims. The amount of the liability is based on the trend in the historical ratio of claims to sales. The products sold are generally covered by a warranty for a period of one year. In the event the Company determines that its current or future product repair and replacement costs exceed its estimates, an adjustment to these reserves would be charged to earnings in the period such determination is made. During each of the years ended December 31, 2022 and 2021, the Company experienced approximately between 1% and 3% of returns related to product warranties. As of December 31, 2022 and 2021, the Company recorded warranty liabilities in the amount of \$13,663 and \$46,650, respectively, using this experience factor range.

Income Taxes

The Company accounts for income taxes in accordance with ASC 740-10. Under this method, deferred income taxes (when required) are provided based on the difference between the financial reporting and income tax bases of assets and liabilities, and net operating losses at the statutory rates enacted for future periods, expected when the differences reverse. The Company has a policy of establishing a valuation allowance when it is more likely than not that the Company will not realize the benefits of its deferred income tax assets in the future.

Stock Based Compensation

We account for our stock based awards in accordance with ASC 718, which requires a fair value measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors, including employee stock options and restricted stock awards.

We estimate the fair value of stock options granted using the Black-Scholes valuation model. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them and the estimated volatility of our common stock price. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in our consolidated statements of operations.

Recovery of Long -Lived Assets

We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with ASC 360-10. Recoverability is measured by comparison of the carrying amount to the future net undiscounted cash flows which the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed their fair value.

Sales Tax

Unless provided with a resale or tax exemption certificate, the Company assesses and collects sales tax on sales transactions and records the amount as a liability. It is recognized as a liability until remitted to the applicable state. Total revenues do not include sales tax as the Company is considered a pass through conduit for collecting and remitting sales taxes.

Results of Operations

Year Ended December 31, 2022 Compared to Year Ended December 31, 2021

The Company's operations and financial results have been impacted by the COVID-19 pandemic. Further, significant uncertainty remains regarding the full impact of the COVID-19 pandemic – both in terms of the health and economic aspects – and the timing of any recovery in markets such as hospitality, our largest market that generally accounts for a majority of our revenue.

Revenues

The table below outlines our product versus recurring revenues from operations for comparable periods:

	December 31, 2022		Twelve Months Ended December 31, 2021		Variance	
Product	\$ 7,793,740	92%	\$ 5,542,404	88%	\$ 2,251,336	41%
Recurring	654,279	8%	731,995	12%	(77,716)	-11%
Total	<u>\$ 8,448,019</u>	100%	<u>\$ 6,274,399</u>	100%	<u>\$ 2,173,620</u>	35%

Product Revenue

Product revenue principally arises from the sale and installation of energy management platforms. The suite of products consists of thermostats, sensors, controllers, wireless networking products, switches, outlets and a control platform.

For the year ended December 31, 2022, product revenues increased by 41% or \$2.25 million when compared to the prior year. Hospitality revenues increased 12% to \$5.29 million, government revenues increased 412% to \$0.99 million, education revenues increased 411% to \$1.43 million while MDU revenues decreased 73% to \$0.08 million and healthcare revenues decreased 100% to \$0.00 million. Product revenues derived from value-added resellers and distribution partners were \$6.41 million for the year ended December 31, 2022, an increase of 41% compared to the prior year period. For the year ended December 31, 2022, international revenues increased 18% to \$0.77 million when compared to the prior year period. The increase in international revenues was primarily driven by volumes from one existing customer.

Backlogs were approximately \$3.00 million and \$2.39 million at December 31, 2022 and 2021, respectively.

Recurring Revenue

Recurring revenue is attributed to our call center support services. The Company recognizes revenue ratably over the service period for monthly support revenues and defers revenue for annual support services over the term of the service period. Recurring revenue consists of Telkonet's EcoCare service and support program.

For the year ended December 31, 2022, recurring revenue decreased by 11% or \$0.08 million when compared to the prior year period. The decrease was related to decreased unit sales of call center support services.

Cost of Sales

The tables below outline product versus recurring cost of sales, along with respective amounts of those costs as a percentage of revenue for the comparable periods:

	Twelve Months Ended								
	December 31, 2022			December 31, 2021		Variance			
Product	\$	4,112,166	53%	\$	2,978,886	54%	\$	1,133,279	38%
Recurring		132,983	20%		52,774	7%		80,209	152%
Total	\$	4,245,149	50%	\$	3,031,660	48%	\$	1,213,488	40%

Costs of Product Revenue

Costs of product revenue include materials and installation labor related to Telkonet's platform technology. For the year ended December 31, 2022, product costs increased 38% compared to the prior year period based upon greater revenues. The variance was primarily attributable to increases in material costs of \$1.08 million, logistical expenses of \$0.16 million, inclusive of import tariffs and the use of installation subcontractors of \$0.16 million, offset by decreases in inventory adjustments of \$0.36 million. Material costs as a percentage of product revenues were 40%, an increase of 4%, compared to the prior year period.

Costs of Recurring Revenue

Recurring revenue costs are comprised primarily of call center support labor. For the year ended December 31, 2022, recurring revenue costs increased by 152% when compared to the prior year period. The variance was primarily due to increases in call center staffing.

Gross Profit

The tables below outline product versus recurring gross profit, along with respective actual gross profit percentages for the comparable periods:

	Twelve Months Ended								
	December 31, 2022		December 31, 2021		Variance				
Product	\$	3,681,574	47%	\$	2,563,518	46%	\$	1,118,057	44%
Recurring		521,296	80%		679,221	93%		(157,926)	-23%
Total	\$	4,202,870	50%	\$	3,242,739	52%	\$	960,131	30%

Gross Profit on Product Revenue

Gross profit on product revenue is influenced by pricing, revenue volume and the composition of those revenues.

Gross profit for the year ended December 31, 2022 increased 44% or \$1.12 million when compared to the prior year period. The increase in gross profit was primarily attributable to an increase in revenues of \$2.25 million and a decrease in inventory adjustments of \$0.22 million, partially offset by increases in material costs of \$1.08 million resulting from increased product revenues, logistical expenses of \$0.16 million and the use of installation subcontractors of \$0.16 million. Material costs as a percentage of product revenues were 40%, an increase of 4%, compared to the prior year period. For the year ended December 31, 2022, the actual gross profit percentage increased by 3% to 47% compared to the prior year period. Tariffs imposed on Chinese imports resulted in an adverse impact of approximately 4% on the actual gross profit percentage for the year ended December 31, 2022, which was unchanged compared to the year ended December 31, 2021.

Gross Profit on Recurring Revenue

Gross profit for the year ended December 31, 2022 decreased 23% when compared to the prior year period. The decrease was primarily due to increases in call center staffing as well as a decline in revenues.

Operating Expenses

The tables below outline operating expenses for the comparable periods, along with percentage change:

The Company's operating expenses are comprised of research and development, selling, general and administrative expenses and depreciation and amortization expense. During the year ended December 31, 2022, operating expenses decreased by less than 1% when compared to the prior year as outlined below.

	Twelve Months Ended			
	December 31, 2022	December 31, 2021	Variance	
R&D	\$ 5,449,003	\$ 5,463,348	\$ (14,345)	0%

Research and Development

	Twelve Months Ended			
	December 31, 2022	December 31, 2021	Variance	
R&D	\$ 1,070,473	\$ 1,129,957	\$ (59,484)	-5%

Research and development costs are related to both present and future products and are expensed in the period incurred. Current research and development costs are associated with product development and integration. For the year ended December 31, 2022, research and development costs decreased by 5% when compared to the prior year period. The variance is primarily attributable to decreases in payroll expenses of \$0.08 million, partially offset by increases incurred with third-party consultants of \$0.03 million.

Selling, General and Administrative Expenses

	Twelve Months Ended			
	December 31, 2022	December 31, 2021	Variance	
R&D	\$ 4,334,698	\$ 4,289,920	\$ 44,778	1%

For the year ended December 31, 2022, selling, general and administrative expenses increased by 1% compared to the prior year period. The variance is primarily attributable to increases in staffing payroll of \$0.20 million and payroll taxes of \$0.42 million, partially offset by decreases in legal fees of \$0.46 million and third-party consulting fees of \$0.12 million. The payroll tax increase was primarily the result of a non-recurring Employee Retention Credit ("ERC") that reduced payroll taxes by \$0.48 million in 2021, allowed under the CARES Act, which is a refundable payroll tax credit that encouraged businesses to keep employees on the payroll during the COVID-19 pandemic.

Operating Loss

Operating loss for the year ended December 31, 2022 improved 44% to \$1.25 million compared to the prior year of \$2.22 million. This improvement is primarily due to an increase in gross profit resulting from an increase in revenues and relatively unchanged operating expenses as discussed above.

Net Loss

For the year ended December 31, 2022, the Company had a net loss of \$1.29 million compared to a net loss of \$0.41 million during the prior year. This net loss variance is primarily due to \$1.84 million of non-cash gains on debt extinguishment in connection with full forgiveness of the PPP Loans in 2021.

Non-GAAP Financial Measures

Management believes that certain non-GAAP financial measures may be useful to investors in certain instances to provide additional meaningful comparisons between current results and results in prior operating periods. Adjusted earnings before interest, taxes, depreciation, amortization and stock-based compensation ("Adjusted EBITDA") is a metric used by management and frequently used by the financial community. Adjusted EBITDA provides insight into an organization's operating trends and facilitates comparisons between peer companies, since interest, taxes, depreciation, amortization and stock-based compensation can differ greatly between organizations as a result of differing capital structures and tax strategies. Adjusted EBITDA is one of the measures used for determining our debt covenant compliance. Adjusted EBITDA excludes certain items that are unusual in nature or not comparable from period to period. While management believes that non-GAAP measurements are useful supplemental information, such adjusted results are not intended to replace our GAAP financial results. Adjusted EBITDA is not, and should not be considered, an alternative to net income (loss), operating income (loss), or any other measure for determining operating performance or liquidity, as determined under accounting principles generally accepted in the United States (GAAP). In assessing the overall health of its business for the years ended December 31, 2022 and 2021, the Company excluded items in the following general categories described below:

- Stock-based compensation: The Company believes that because of the variety of equity awards used by companies, varying methodologies for determining stock-based compensation and the assumptions and estimates involved in those determinations, the exclusion of non-cash stock-based compensation enhances the ability of management and investors to understand the impact of non-cash stock-based compensation on our operating results. Further, the Company believes that excluding stock-based compensation expense allows for a more transparent comparison of its financial results to the previous year.

RECONCILIATION OF NET LOSS TO ADJUSTED EBITDA FOR THE YEARS ENDED DECEMBER 31,

	Year Ended December 31,	
	2022	2021
Net Income (loss)	\$ (1,285,237)	\$ (412,785)
Gain on debt extinguishment	—	(1,836,780)
Gain / (Loss on sale of asset	526	—
Interest expense, net	23,542	21,067
Income tax provision	15,036	7,889
Depreciation and amortization	43,832	43,471
EBITDA	(1,202,301)	(2,177,138)
Adjustments:		
Stock-based compensation	—	7,262
Adjusted EBITDA	<u>\$ (1,202,301)</u>	<u>\$ (2,169,876)</u>

Liquidity and Capital Resources

For the year ended December 31, 2022, the Company reported a net loss of \$1,285,237 and had cash used in operating activities of \$3,598,322, and ended the year with an accumulated deficit of \$129,953,413 and total current assets in excess of current liabilities of \$4,643,011. At December 31, 2022, the Company had \$3,243,594 of cash and \$1,000,000 of availability on its Credit Facility. The Credit Facility is a \$1,000,000 line of credit, which is subject to a borrowing base calculation based on the Company's eligible accounts receivable and eligible inventory, each multiplied by an applicable advance rate, with an overall limitation tied to the Company's eligible accounts receivable as well as financial covenants including a requirement to maintain a minimum unrestricted cash balance of \$1,000,000. As of December 31, 2022, we had a total borrowing base of approximately \$1,000,000, an outstanding balance of \$0, and a cash management services reserve of \$0, resulting in the availability of \$1,000,000 on the Credit Facility.

Since inception through December 31, 2022, we have incurred cumulative losses of \$129,953,413 and have never generated enough cash through operations to support our business. For the year ended December 31, 2022, we had a cash flow deficit from operations of \$3,598,322. The Company has made significant investments in the engineering, development and marketing of its intelligent automation platforms, including but not limited to, hardware and software enhancements, support services and applications. The funding for these development efforts has contributed to, and continues to contribute to, the ongoing operating losses and use of cash. Operating losses have been financed by debt and equity transactions, Credit Facility capacity, the sale of a wholly-owned subsidiary, and the management of working capital levels.

As discussed above, the Company's operations and financial results have also been impacted by the COVID-19 pandemic. Both the health and economic aspects of the COVID-19 pandemic are highly fluid and the future course of each is uncertain. We cannot predict whether the outbreak of COVID-19 will be effectively contained on a sustained basis. Depending on the length and severity of the COVID-19 pandemic, the demand for our products, our customers' ability to meet payment obligations to the Company, our supply chain and production capabilities, and our workforces' ability to deliver our products and services could be impacted. Management is actively monitoring the impact of the global situation on the Company's financial condition, liquidity, operations, suppliers, industry, and workforce. While we expect this disruption to continue to have a material adverse impact on our results of operations, financial condition cash flows, and liquidity, the Company is unable to reasonably determine the full extent of the impact at this time.

The more recent actions described above are in addition to the cost elimination and liquidity management actions that the Company began implementing in the second half of 2019, including reviewing opportunities to decrease spend with third party consultants and providers, strategically reviewing whether or not to fill employee positions in the event of vacancies, and implementing sales campaigns to sell slow-moving inventory and reduce existing inventory volumes. There is no guarantee, however, that these actions, nor any other actions identified, will yield profitable operations in the foreseeable future.

Revolving Credit Facility

On September 30, 2014, the Company entered into a loan and security agreement (the "Heritage Bank Loan Agreement") with Heritage Bank governing a revolving credit facility in a principal amount not to exceed \$2,000,000 (the "Credit Facility"). Availability of borrowings under the Credit Facility is subject to a borrowing base calculation based on the Company's eligible accounts receivable and eligible inventory each multiplied by an applicable advance rate, with an overall limitation tied to the Company's eligible accounts receivable. The Credit Facility is secured by all of the Company's assets. The Credit Facility is available for working capital and other general business purposes.

The outstanding principal balance of the Credit Facility bears interest at the Prime Rate plus 3.00%, which was 10.50% at December 31, 2022 and 6.25% at December 31, 2021. On November 6, 2019, the eleventh amendment to the Credit Facility was executed to extend the maturity date to September 30, 2021, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement, and eliminate the maximum EBITDA loss covenant. The eleventh amendment was effective as of September 30, 2019.

On September 30, 2021, the Company entered into a twelfth amendment to the Heritage Bank Loan Agreement to extend the revolving maturity date to December 31, 2021, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement. In addition, subject to certain conditions as specified in the twelfth amendment, Heritage Bank consented to the VDA Transaction (as described above under the "Business and Basis of Presentation" section in Note A – Basis of Presentation and Significant Accounting Policies) between the Company and VDA, and acknowledged and agreed that certain events occurring in connection with the Transaction, including the change of control of the Company resulting from the Transaction, do not constitute Events of Default as defined in the Loan Agreement.

On December 13, 2021, the Company entered into a thirteenth amendment to the Heritage Bank Loan Amendment to extend the revolving maturity date to March 31, 2022, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement. In addition, the Heritage Bank Loan Amendment reduced the credit extension amount to \$1,000,000 and reduced unrestricted cash maintained in the Company's accounts at Bank to be at least \$1,000,000.

On March 10, 2022, the Company entered into a fourteenth amendment to the Heritage Bank Loan Amendment to extend the revolving maturity date to June 30, 2023, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement.

The Heritage Bank Loan Agreement contains covenants that place restrictions on, among other things, the incurrence of debt, granting of liens and sale of assets. The Heritage Bank Loan Agreement also contains financial covenants. As discussed above, the EBITDA loss covenant was eliminated in the eleventh amendment to the Credit Facility. The sole remaining financial covenants are a minimum asset coverage ratio and a minimum unrestricted cash balance of \$1 million, both of which are measured at the end of each month. A violation of either of these covenants could result in an event of default under the Heritage Bank Loan Agreement. Upon the occurrence of such an event of default or certain other customary events of defaults, payment of any outstanding amounts under the Credit Facility may be accelerated and Heritage Bank's commitment to extend credit under the Heritage Bank Loan Agreement may be terminated. The Heritage Bank Loan Agreement contains other representations and warranties, covenants, and other provisions customary to transactions of this nature.

The outstanding balance on the Credit Facility was \$0 and \$403,089 at December 31, 2022 and 2021 respectively, and the remaining available borrowing capacity was approximately \$1,000,000 and \$460,000, respectively. As of December 31, 2022, the Company was in compliance with all financial covenants.

Paycheck Protection Program

The Company has received two loans under the Paycheck Protection Program (the "PPP") administered by the United States Small Business Administration (the "SBA") and authorized by the Keeping American Workers Employed and Paid Act, which is part of the Coronavirus Aid, Relief, and Economic Security Act, enacted on March 27, 2020.

On April 17, 2020, the Company entered into an unsecured promissory note for \$913,063 ("the First PPP Loan"). In January 2021, the Company applied for forgiveness of the amount due on the First PPP Loan. On February 16, 2021, Heritage Bank confirmed that the First PPP Loan granted to the Company, in the original principal amount of \$913,063 plus accrued interest of \$7,610 thereon, was forgiven in full.

On April 27, 2021, the Company entered into an unsecured promissory note, dated as of April 26, 2021, for a second PPP loan ("the Second PPP Loan" and together with the First PPP Loan, the "PPP Loans"), with Heritage Bank under a second draw of the PPP administered by the SBA and authorized by the Keeping American Workers Employed and Paid Act. In September 2021, the Company applied for forgiveness of the amount due on the Second PPP Loan. On September 15, 2021, Heritage Bank confirmed that the Second PPP Loan granted to the Company, in the original principal amount of \$913,063 plus accrued interest of \$3,044 thereon, was forgiven in full.

See Note G – Debt in the Notes to the Consolidated Financial Statements under Item 15 of Part IV of this Annual Report on Form 10-K for a summary of the terms of the PPP Loans.

Cash Flow from Operations Analysis

Cash used in operating activities of operations was \$3,598,322 and \$1,699,615 during the years ended December 31, 2022 and 2021, respectively. As of December 31, 2022, our primary capital needs included costs incurred to increase energy management sales, inventory procurement, and managing current liabilities. The working capital increase of approximately \$3,434,000 during the year ended December 31, 2022 was primarily related to a \$947,000 increase in accounts receivables, an approximate \$720,000 decrease in accounts payables, a \$481,000 increase in inventories, an \$883,000 increase in cash and cash equivalents and a \$403,000 reduction in the line of credit. The working capital changes during the year ended December 31, 2021 were primarily related to an approximate \$823,000 increase in accounts payable, a \$563,000 decrease in net inventories, a \$155,000 net increase in accrued liabilities, which includes an \$11,000 decrease for interest forgiven on the PPP Loans, partially offset by an approximate \$592,000 increase in prepaid expenses, a \$161,000 increase in contract assets, and a \$145,000 increase in accounts receivable. Accounts receivable fluctuates based on the negotiated billing terms with customers and collections. We purchase inventory based on forecasts and orders, and when those forecasts and orders change, the amount of inventory may also fluctuate. Accounts payable fluctuates with changes in inventory levels, volume of inventory purchases, and negotiated supplier and vendor terms.

Cash used in investing activities was \$88,000 in purchasing capital equipment in 2022, with no such expenditure in 2021.

Cash provided by financing activities was \$4,567,110 and \$1,048,863 during the years ended December 31, 2022 and 2021, respectively. Proceeds from the \$5,000,000 stock and warrants issued to VDA in connection with the VDA Transaction combined with the proceeds borrowed under the Heritage Bank Loan Agreement totaling \$4,434,152, were partially offset by cash used for payments on the line of credit of \$4,837,241 and repayment of Series B shares of \$29,801 during the year ended December 31, 2022. Proceeds from the Second PPP loan were \$913,063, proceeds borrowed from the line of credit were \$6,764,968 and cash used for payments on the line of credit were \$6,629,168 during the year ended December 31, 2021.

Off-Balance Sheet Arrangements

The Company has no material off-balance sheet arrangements.

New Accounting Pronouncements

See Note B – New Accounting Pronouncements in the Notes to the Consolidated Financial Statements under Item 15 of Part IV of this Annual Report on Form 10-K for a description of new accounting pronouncements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

This item is not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

See the Consolidated Financial Statements and Notes thereto commencing on Page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

This item is not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that material information required to be disclosed in our periodic reports filed under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms and to ensure that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure. The Company’s Chief Executive Officer and Chief Financial Officer each evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2022. Based on these evaluations, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures required by paragraph (b) of Rule 13a-15 and 15d-15 were not effective as of December 31, 2022 as a result of the material weaknesses discussed below.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurances regarding the reliability of financial reporting and the preparation of the financial statements of the Company in accordance with U.S. generally accepted accounting principles, or GAAP. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the policies or procedures may deteriorate.

With the participation of our Chief Executive Officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2022 based on the framework in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on our evaluation and the material weaknesses described below, management concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2022 based on the COSO framework criteria.

Management did not properly design or maintain effective controls over certain aspects of the control environment and monitoring components of COSO. We did not have a sufficient complement of accounting and financial personnel with an appropriate level of knowledge to address technical accounting and financial reporting matters in accordance with GAAP and the Company's overall financial reporting requirements. We also lack sufficient information technology resources to address our IT general control environment requirements. The failures within the control environment and monitoring components contributed to the following control activity level material weaknesses:

- Inventories – We did not properly design or maintain effective controls relating to the accuracy and valuation of inventory
- Information Technology – We did not properly design or maintain effective controls to prevent unauthorized access to certain systems, programs and data, and provide for periodic review and monitoring of access and changes in programs, including review of security logs and analysis of segregation of duties conflicts.
- Segregation of Duties – We did not maintain adequate segregation of duties within the Company's business processes, financial applications, and IT systems. Specifically, we did not have appropriate controls in place to adequately assess the segregation of job responsibilities and system user access for initiating, authorizing, and recording transactions.

These control deficiencies could result in a misstatement of account balances resulting in a more than remote likelihood that a material misstatement to our financial statements may not be prevented or detected on a timely basis. Accordingly, we have determined that these control deficiencies as described above constitute material weaknesses.

As we continue to evaluate and work to improve our internal controls over financial reporting, our senior management may determine to take additional measures to address deficiencies or modify the remediation efforts. Until the remediation efforts that our senior management may identify as necessary are completed, tested and determined effective, the material weaknesses described above will continue to exist. At present, the Company does not expect to hire additional personnel to remediate these control deficiencies in the near future.

In light of these material weaknesses, we performed additional analyses and procedures in order to conclude that our consolidated financial statements as of and for the year ended December 31, 2022 included in this Annual Report on Form 10-K were fairly stated in accordance with U.S. GAAP. Notwithstanding the identified material weaknesses, our management has concluded that the audited financial statements included in this Annual Report on Form 10-K for the year ended December 31, 2022 fairly state, in all material respects, our financial position, results of operations, cash flows, and changes in stockholders' equity as of and for the periods presented in accordance with U.S. GAAP.

Under applicable Securities Law, the Company is not required to obtain an attestation report from the Company's independent registered public accounting firm regarding internal control over financial reporting, and accordingly, such an attestation has not been obtained or included in this Annual Report.

Attestation Report of the Registered Public Accounting Firm

Not applicable.

Changes in Internal Controls

Other than the material weaknesses discussed above, during the year ended December 31, 2022, there have been no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

ITEM 9B. OTHER INFORMATION.

None.

ITEM 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS.

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Pursuant to General Instruction G(3), information on directors and executive officers of the Registrant and corporate governance matters is incorporated by reference from our definitive proxy statement on Schedule 14A in connection with our 2023 Annual Meeting of Stockholders, to be filed within 120 days after December 31, 2022 (the “2022 Proxy Statement”).

Code of Ethics

The Board has approved, and Telkonet has adopted, a Code of Ethics that applies to all directors, officers and employees of the Company. A copy of the Company’s Code of Ethics was filed as Exhibit 14 to the Company’s Annual Report on Form 10-KSB for the year ended December 31, 2003 (filed with the Securities and Exchange Commission on March 30, 2004). In addition, the Company will provide a copy of its Code of Ethics free of charge upon request to any person submitting a written request to the Company’s Chief Executive Officer.

Insider Trading Policy

The Board adopted a written insider trading compliance policy to promote compliance with federal securities laws by directors, officers, employees, contractors and consultants of the Company and its affiliates, as well as any immediate family members sharing the household of any of the foregoing, and any entities controlled by any of the foregoing persons, including corporations, partnerships or trusts. The Company’s insider trading policy is included herein as Exhibit 19.1.

ITEM 11. EXECUTIVE COMPENSATION.

Pursuant to General Instruction G(3), information on executive compensation is incorporated by reference from the Company’s 2023 Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

The Board, or any committee appointed by the Board to grant awards, grants awards without regard to the share price or the timing of the release of material nonpublic information and does not time grants for the purpose of affecting the value of executive compensation. Accordingly, it is our policy that our management team makes a good faith effort to advise the Board, or any committee appointed by the Board to grant awards, whenever it is aware that material nonpublic information is planned to be released to the public in close proximity to the grant of equity awards.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Pursuant to General Instructions G(3), information on security ownership of certain beneficial owners and management and related stockholder matters are incorporated by reference from the Company's 2023 Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information concerning securities authorized for issuance pursuant to equity compensation plans approved by the Company's stockholders and equity compensation plans not approved by the Company's stockholders as of December 31, 2022.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights		Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))	
	(a)		(b)	(c)	
Equity compensation plans approved by security holders	2,526,847	(1)	\$ 0.15	10,000,000	(2)
Equity compensation plans not approved by security holders	—		—	—	
Total	2,526,847	(1)	\$ 0.15	10,000,000	(2)

(1) 2,526,847 shares of common stock to be issued upon exercise of options and warrants issued under the 2010 Amended and Restated Stock Option and Incentive Plan, as amended.

(2) 10,000,000 shares of common stock available for future issuance under the 2021 Stock Option and Incentive Plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

Pursuant to General Instruction G(3), information on certain relationships and related transactions and director independence is incorporated by reference from the Company's 2023 Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

Pursuant to General Instruction G(3), information on principal accounting fees and services is incorporated by reference from the Company's 2023 Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) Documents filed as part of this report.

(1) Financial Statements. The following financial statements are included in Part II, Item 8 of this Annual Report on Form 10-K:

Report of Independent Registered Public Accounting Firm, Wipfli LLP

Consolidated Balance Sheets as of December 31, 2022 and 2021

Consolidated Statements of Operations for the Years ended December 31, 2022 and 2021

Consolidated Statements of Stockholders' Equity for the Years ended December 31, 2022 and 2021

Consolidated Statements of Cash Flows for Years ended December 31, 2022 and 2021

Notes to Consolidated Financial Statements

(2) Financial Statement Schedules

Additional Schedules are omitted as the required information is inapplicable or the information is presented in the financial statements or related notes.

(3) Exhibits required to be filed by Item 601 of Regulation S-K

EXHIBIT INDEX

The following exhibits are included herein or incorporated by reference:

- 2.1 [Asset Purchase Agreement by and among EthoStream, LLC, Telkonet, Inc., and DCI-Design Communications, dated as of March 28, 2017](#) (incorporated by reference from Exhibit 2.1 to our Form 8-K (File No. 001-31972) filed on March 31, 2017)
- 2.2 [Stock Purchase Agreement, dated August 6, 2021, between Telkonet, Inc. and VDA Group S.p.A.](#) (incorporated by reference to our Form 8-K (File No. 000-31972) filed August 10, 2021)
- 3.1 [Amended and Restated Articles of Incorporation of the Company](#) (incorporated by reference from Exhibit 3.1 to our Form S-8 (File No. 333-47986), filed on October 16, 2000)
- 3.2 [Bylaws of the Company](#) (incorporated by reference from Exhibit 3.2 to our Registration Statement on Form S-1 (File No. 333-108307), filed on August 28, 2003)
- 3.3 [Amendment to Amended and Restated Articles of Incorporation of Telkonet, Inc.](#) (incorporated by reference from Exhibit 3.5 to Telkonet, Inc.'s Annual Report on Form 10-K (File No. 001-31972), filed on March 30, 2011)
- 3.4 [Amendment to Amended and Restated Articles of Incorporation of the Company](#) (incorporated by reference from Exhibit 3.1 to our Form 8-K (File No. 001-31972) filed on April 13, 2011)
- 4.1 [Form of Warrant to Purchase Common Stock](#) (incorporated by reference from Exhibit 10.3 to our Form 8-K (File No. 001-31972) filed on November 18, 2009)
- 4.2 [Form of Warrant to Purchase Common Stock](#) (incorporated by reference from Exhibit 10.3 to our Form 8-K (File No. 001-31972) filed on August 9, 2010)
- 4.3 [Form of Warrant to Purchase Common Stock](#) (incorporated by reference from Exhibit 4.1 to our Form 8-K (File No. 001-31972) filed on April 13, 2011)
- 4.4 [Description of the Registrant's Securities Registered Pursuant to Section 12 of the Securities and Exchange Act of 1934](#) (incorporated by reference from Exhibit 4.4 to our Form 10-K (File No. 001-31972) filed on March 30, 2020)
- 10.1 [Series A Convertible Redeemable Preferred Stock Securities Purchase Agreement, dated November 16, 2009](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed on November 18, 2009)
- 10.2 [Series A Convertible Redeemable Preferred Stock Registration Rights Agreement, dated November 16, 2009](#) (incorporated by reference from Exhibit 10.2 to our Form 8-K (File No. 001-31972) filed on November 18, 2009)
- 10.3 [Form of Director and Officer Indemnification Agreement](#) (incorporated by reference from Exhibit 10.12 to our Form 10-K (File No. 001-31972) filed on March 31, 2010)
- 10.4 [Series B Convertible Redeemable Preferred Stock Securities Purchase Agreement, dated August 4, 2010](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed on August 9, 2010)
- 10.5 [Series B Convertible Redeemable Preferred Stock Registration Rights Agreement, dated August 4, 2010](#) (incorporated by reference from Exhibit 10.2 to our Form 8-K (File No. 001-31972) filed on August 9, 2010)
- *10.6 [2010 Stock Option and Incentive Plan](#) (incorporated by reference from Exhibit 10.1 to our Registration Statement filed on Form S-8 (File No. 333-175737) filed July 22, 2011)
- 10.7 [Securities Purchase Agreement, dated April 8, 2011, by and among Telkonet, Inc. and the parties listed therein](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed on April 13, 2011)
- 10.8 [Registration Rights Agreement, dated April 8, 2011, by and among Telkonet, Inc. and the parties listed therein](#) (incorporated by reference from Exhibit 10.2 to our Form 8-K (File No. 001-31972) filed on April 13, 2011)
- *10.9 [Employment Agreement by and between Telkonet, Inc. and John M. Srouji, dated as of February 1, 2023](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 000-31972) filed on February 8, 2023).
- *10.10 [Employment Agreement by and between Telkonet, Inc. and Jeffrey J. Sobieski, dated as of February 1, 2023](#) (incorporated by reference from Exhibit 10.2 to our Form 8-K (File No. 000-31972) filed on February 8, 2023).
- *10.11 [Employment Agreement by and between Telkonet, Inc. and Richard E. Mushrush, dated as of February 1, 2023](#) (incorporated by reference from Exhibit 10.3 to our Form 8-K (File No. 000-31972) filed on February 8, 2023).
- *10.12(a) [2010 Amended and Restated Stock Option and Incentive Plan](#) (amended and restated effective as of November 17, 2016, incorporated by reference from Exhibit 10.27 to our Form 10-K (File No. 001-31972) filed April 3, 2017)

- *10.12(b) [Amendment to Telkonet, Inc. 2010 Stock Option and Incentive Plan](#) (incorporated by reference from Exhibit 10.2 to our Form 10-Q (File No. 001-31972) filed on May 15, 2020)
- *10.12(c) [2023 Long Term Cash Incentive Plan & Retention Bonus Agreement](#) (incorporated by reference from Exhibits 10.1 to 10.3 to our Form 8-K (File No. 000-31972) filed February 3, 2023)
- 10.13 [Loan and Security Agreement, dated September 30, 2014, by and between Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed October 2, 2014)
- 10.14 [First Amendment to Loan and Security Agreement, dated February 17, 2016, by and between Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed February 23, 2016)
- 10.15 [Second Amendment to Loan and Security Agreement, dated October 27, 2016, by and between Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed October 28, 2016)
- 10.16 [Third Amended to Loan and Security Agreement, dated January 25, 2017, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.16 to our Form 10-K (File No. 001-31972) filed March 30, 2020)
- 10.17 [Fourth Amended to Loan and Security Agreement, dated March 29, 2017, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.17 to our Form 10-K (File No. 001-31972) filed March 30, 2020)
- 10.18 [Fifth Amended to Loan and Security Agreement, dated August 29, 2017, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.18 to our Form 10-K (File No. 001-31972) filed March 30, 2020)
- 10.19 [Sixth Amendment to Loan and Security Agreement, dated October 23, 2017, by and between Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed October 26, 2017)
- 10.20 [Seventh Amendment to Loan and Security Agreement entered into as of February 2, 2018, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 10-Q (File No. 001-31972) filed November 14, 2018)
- 10.21 [Eighth Amendment to Loan and Security Agreement entered into as of April 5, 2018, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.2 to our Form 10-Q (File No. 001-31972) filed November 14, 2018)
- 10.22 [Ninth Amendment to Loan and Security Agreement entered into as of November 7, 2018, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference to our Form 10-Q (File No. 001-31972) filed November 14, 2018)
- 10.23 [Tenth Amendment to Loan and Security Agreement entered into as of February 12, 2019, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed February 14, 2019)
- 10.24 [Eleventh Amendment to Loan and Security Agreement entered into as of November 6, 2019, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed November 7, 2019)
- 10.25 [Paycheck Protection Program Promissory Note, dated April 17, 2020, between Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed April 27, 2020)
- 10.26 [Telkonet, Inc. 2020 Stock Option and Incentive Plan](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed on June 2, 2020)
- **10.27 [Wireless Network Patent License Agreement, dated effective November 30, 2020, by and between Telkonet, Inc., SIPCO, LLC, and IPCO, LLC dba IntusTM](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K/A (File No. 001-31972) filed February 19, 2021)
- 10.28 [Form of Common Stock Purchase Warrant](#) (incorporated by reference to our Form 8-K (File No. 001-31972) filed August 10, 2021)
- 10.29 [Form of Voting Agreement](#) (incorporated by reference to our Form 8-K (File No. 001-31972) filed August 10, 2021)
- 10.30 [Registration Rights Agreement, dated August 6, 2021, between Telkonet, Inc. and VDA Group S.p.A.](#) (incorporated by reference to our Form 8-K (File No. 001-31972) filed August 10, 2021)
- 10.31 [Twelfth Amendment to Loan and Security Agreement entered into as of September 30, 2021, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed on October 6, 2021)
- 10.32 [Thirteenth Amendment to Loan and Security Agreement entered into as of December 13, 2021, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed on December 15, 2021)
- 10.33 [Consulting Agreement by and between Telkonet and Piercarlo Gramaglia dated as of November 16, 2021](#)
- 10.34 [Fourteenth Amendment to Loan and Security Agreement entered into as of March 10, 2022, by and among Telkonet, Inc. and Heritage Bank of Commerce](#) (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 001-31972) filed on March 16, 2022)
- 10.35 [Severance and Release Agreement entered into as of March 10, 2022, by and between Telkonet, Inc. and Mr. Tienor](#) (incorporated by reference from Exhibit 10.2 to our Form 8-K (File No. 001-31972) filed on March 16, 2022)

10.36	Telkonet, Inc. 2023 Long Term Cash Incentive Plan (incorporated by reference from Exhibit 10.1 to our Form 8-K (File No. 000-31972) filed February 3, 2023)
10.37	Form of Telkonet, Inc. 2023 Long-Term Cash Incentive Plan Award Agreement (incorporated by reference from Exhibit 10.2 to our Form 8-K (File No. 000-31972) filed February 3, 2023)
10.38	Form of Retention Bonus Agreement (incorporated by reference from Exhibit 10.3 to our Form 8-K (File No. 000-31972) filed February 3, 2023)
10.39	Appointment of Edward L. Helvey to the Board of Directors effective August 1, 2022 (incorporated by reference from our Form 8-K (File No. 000-31972) filed on July 21, 2022).
***19.1	Insider Trading Policy of Telkonet, Inc.
14.1	Code of Ethics (incorporated by reference from Exhibit 14 to our Form 10-KSB (File No. 001-31972), filed on March 30, 2004)
21.1	Telkonet, Inc. Subsidiaries
***23.1	Consent of Wipfli LLP, Independent Registered Public Accounting Firm
***31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Piercarlo Gramaglia
***31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Richard E. Mushrush
***32.1	Certification of Piercarlo Gramaglia pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
***32.2	Certification of Richard E. Mushrush pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
****101.INS	Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
****101.SCH	Inline XBRL Taxonomy Extension Schema Document
****101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
****101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
****101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
****101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
****104	Cover Page Interactive Data File (formatted in inline XBRL, and included in exhibit 101).
*	Indicates management contract or compensatory plan or arrangement.
**	Certain portions of this exhibit have been redacted pursuant to Item 601(b)(10)(iv) of Regulation S-K. The Company agrees to provide an un-redacted copy of the exhibit on a supplemental basis to the SEC upon its request.
***	Filed herewith.
****	Submitted electronically with this report.

ITEM 16. FORM 10-K SUMMARY.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TELKONET, INC.

Dated: March 31, 2023

/s/ Piercarlo Gramaglia
Piercarlo Gramaglia
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Position</u>	<u>Date</u>
<u>/s/ Piercarlo Gramaglia</u> Piercarlo Gramaglia	Chief Executive Officer and Director (principal executive officer)	March 31, 2023
<u>/s/ Richard E. Mushrush</u> Richard E. Mushrush	Chief Financial Officer (principal financial officer and principal accounting officer)	March 31, 2023
<u>/s/ Steven E. Quick</u> Steven E. Quick	Chairman of the Board	March 31, 2023
<u>/s/ Tim S. Ledwick</u> Tim S. Ledwick	Director	March 31, 2023
<u>/s/ Flavio de Paulis</u> Flavio de Paulis	Director	March 31, 2023
<u>/s/ Edward L. Helvey</u> Edward L. Helvey	Director	March 31, 2023

TELKONET, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
Telkonet, Inc.
Waukesha, Wisconsin

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Telkonet, Inc. and subsidiaries (the “Company and subsidiaries”) as of December 31, 2022 and 2021, and the related consolidated statements of operations, stockholders’ equity, and cash flows for the years then ended and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material aspects, the financial position of the Company at December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, 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.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and the significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of this critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Critical Audit Matter Description

Revenue recognition on turnkey solution customer contracts ongoing at year-end

As described in Note A to the financial statements, revenue from customer contracts which encompass both product and installation services are referred to as “turnkey solutions” and contain a single performance obligation. Revenue from turnkey solution customer contracts is recognized over time using an output measure based on the number of rooms installed. We identified revenue recognition on turnkey solution customer contracts ongoing at year-end as a critical audit matter because of the estimates used by management to measure progress and the impact these estimates have on revenue recognition.

How the Critical Audit Matter Was Addressed in the Audit

Our audit procedures related to evaluating the estimates used by management in the determination of the accounting for turnkey solution customer contracts ongoing at year-end included the following, among others:

We selected a sample of turnkey solution customer contracts ongoing at year-end and evaluated management’s calculation of revenue recognized over time by performing the following procedures:

- Analyzed the contract to determine if all arrangement terms that may have an impact on revenue recognition were identified and evaluated management's accounting for the contract.
- Obtained and reviewed the contract to evaluate whether the transaction price was appropriately identified.
- Tested the data used in the revenue recognition schedule for completeness and accuracy by agreeing key inputs to supporting documentation.
- Tested management’s revenue recognition calculation schedule for mathematical accuracy

/s/ Wipfli LLP
Minneapolis, Minnesota

March 31, 2022

We have served as the Company’s auditor since 2020.

TELKONET, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2022 AND 2021

	<u>December 31, 2022</u>	<u>December 31, 2021</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,243,594	\$ 2,361,059
Accounts receivable, net	1,958,103	1,010,554
Inventories, net	1,306,186	825,559
Contract assets	94,840	266,014
Prepaid expenses	702,500	735,092
Total current assets	<u>7,305,223</u>	<u>5,198,278</u>
Property and equipment, net	<u>126,096</u>	<u>84,201</u>
Other assets:		
Deposits	4,595	7,595
Operating lease right of use assets	442,903	570,512
Total other assets	<u>447,498</u>	<u>578,107</u>
Total Assets	<u><u>\$ 7,878,817</u></u>	<u><u>\$ 5,860,586</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	1,145,658	1,865,535
Accrued liabilities	702,583	718,721
Line of credit	—	403,089
Contract liabilities - current	650,340	800,965
Lease Liabilities - current	157,334	195,176
Income taxes payable	6,297	5,431
Total current liabilities	<u>2,662,212</u>	<u>3,988,917</u>
Long-term liabilities:		
Lease liabilities	350,694	459,668
Contract liabilities - long term	49,213	140,265
Accrued royalties - long-term	220,000	360,000
Total long-term liabilities	<u>619,907</u>	<u>959,933</u>
Total liabilities	<u>3,282,119</u>	<u>4,948,850</u>
Stockholders' Equity		
Preferred Stock Series A, par value \$.001 per share; 215 shares designated, 181 shares outstanding at December 31, 2022 and 185 outstanding at December 31, 2021, preference in liquidation of \$1,855,454 and \$1,822,450 as of December 31, 2022 and December 31, 2021, respectively.	1,310,765	1,340,566
Preferred Stock Series B, par value \$.001 per share; 567 shares designated, 52 shares outstanding at December 31, 2022 and December 31, 2021, preference in liquidation of \$518,428 and \$497,605 as of December 31, 2022 and December 31, 2021 respectively.	362,059	362,059
Common Stock, par value \$.001 per share; 475,000,000 shares authorized; 299,212,282 and 136,311,335 shares issued and outstanding at December 31, 2022 and December 31, 2021, respectively.	299,212	136,311
Additional paid-in-capital	132,578,075	127,740,976
Accumulated deficit	(129,953,413)	(128,668,176)
Total stockholders' equity	<u>4,596,698</u>	<u>911,736</u>
Total Liabilities and Stockholders' Equity	<u><u>\$ 7,878,817</u></u>	<u><u>\$ 5,860,586</u></u>

See accompanying notes to consolidated financial statements

TELKONET, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

	Year Ended December 31	
	2022	2021
Revenues, net:		
Product Revenue	\$ 7,793,740	\$ 5,542,404
Recurring Revenue	654,279	731,995
Total Net Revenues	<u>8,448,019</u>	<u>6,274,399</u>
Cost of Sales:		
Product COGS	4,112,166	2,978,886
Recurring COGS	132,983	52,774
Total Cost of Sales	<u>4,245,149</u>	<u>3,031,660</u>
Gross Profit	<u>4,202,870</u>	<u>3,242,739</u>
Operating Expenses:		
Research and development	1,070,473	1,129,957
Selling, general and administrative	4,334,698	4,289,920
Depreciation and amortization	43,832	43,471
Total Operating Expenses	<u>5,449,003</u>	<u>5,463,348</u>
Operating (Loss)	<u>(1,246,133)</u>	<u>(2,220,609)</u>
Other Income / (Expenses):		
Gain on Debt Extinguishment	—	1,836,780
(Loss) on Fixed Assets Disposal	(526)	—
Interest expense, net	(23,542)	(21,067)
Total Other Income / (Expenses):	<u>(24,068)</u>	<u>1,815,713</u>
(Loss) before Provision for Income Taxes	<u>(1,270,201)</u>	<u>(404,896)</u>
Income Tax Provision	15,036	7,889
Net (Loss)	<u>\$ (1,285,237)</u>	<u>\$ (412,785)</u>
Net (Loss) per Common Share:		
Basic – net income (loss) attributable to common stockholders	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Diluted – net income (loss) attributable to common stockholders	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Weighted Average Common Shares Outstanding – basic	296,497,266	136,311,335
Weighted Average Common Shares Outstanding – diluted	296,497,266	136,311,335

See accompanying notes to consolidated financial statements

TELKONET, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
JANUARY 1, 2021 THROUGH DECEMBER 31, 2021

	Series A Preferred Stock Shares	Series A Preferred Stock Amount	Series B Preferred Stock Shares	Series B Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid In Capital	Accumulated Deficit	Total Stockholders' Equity
Balance at January 1, 2021	185	\$ 1,340,566	52	\$ 362,059	136,311,335	\$ 136,311	\$ 127,733,714	\$ (128,255,391)	\$ 1,317,259
Stock-based compensation expense related to employee stock options	—	—	—	—	—	—	7,262	—	7,262
Net loss attributable to common stockholders	—	—	—	—	—	—	—	(412,785)	(412,785)
Balance at December 31, 2021	<u>185</u>	<u>\$ 1,340,566</u>	<u>52</u>	<u>\$ 362,059</u>	<u>136,311,335</u>	<u>\$ 136,311</u>	<u>\$ 127,740,976</u>	<u>\$ (128,668,176)</u>	<u>\$ 911,736</u>

See accompanying notes to consolidated financial statements

TELKONET, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
JANUARY 1, 2022 THROUGH DECEMBER 31, 2022

	Series A Preferred Stock Shares	Series A Preferred Stock Amount	Series B Preferred Stock Shares	Series B Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid In Capital	Accumulated Deficit	Total Stockholders' Equity
Balance at January 1, 2022	185	\$ 1,340,566	52	\$ 362,059	136,311,335	\$ 136,311	\$ 127,740,976	\$ (128,668,176)	\$ 911,736
Stock and warrants issued in VDA Transaction	—	—	—	—	162,900,947	162,901	4,837,099	—	5,000,000
Shares repurchased per severance agreement	(4)	(29,801)	—	—	—	—	—	—	(29,801)
Stock-based compensation expense related to employee stock options	—	—	—	—	—	—	—	—	—
Net loss attributable to common stockholders	—	—	—	—	—	—	—	(1,285,237)	(1,285,237)
Balance at December 31, 2022	<u>181</u>	<u>\$ 1,310,765</u>	<u>52</u>	<u>\$ 362,059</u>	<u>299,212,282</u>	<u>\$ 299,212</u>	<u>\$ 132,578,075</u>	<u>\$ (129,953,413)</u>	<u>\$ 4,596,698</u>

See accompanying notes to the consolidated financial statements

See accompanying notes to consolidated financial statements

TELKONET, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

	Year Ended December 31	
	2022	2021
Cash Flows from Operating Activities:		
Net loss	\$ (1,285,237)	\$ (412,785)
Adjustments to reconcile net loss to cash used in operating activities:		
Stock-based compensation expense related to employee stock options	–	7,262
Depreciation and amortization	43,832	43,471
Loss on fixed asset disposal	526	–
Noncash operating lease expense (ROU)	127,609	229,548
Gain on debt extinguishment	–	(1,836,780)
Changes in operating assets and liabilities:		
Accounts receivable, net	(947,549)	(145,380)
Inventories, net	(480,627)	562,703
Prepaid expenses	32,592	(592,359)
Deposits	3,000	(595)
Accounts payable	(719,877)	822,528
Accrued royalties - long-term	(140,000)	(140,000)
Accrued liabilities	(16,138)	166,063
Contract liabilities	(241,677)	(111,137)
Contract assets	171,174	(161,025)
Operating lease liabilities	(146,816)	(242,305)
Accrued income tax payable	866	5,431
Income taxes receivable	–	105,745
Net Cash Used In Operating Activities	(3,598,322)	(1,699,615)
Cash Flows From Investing Activities:		
Payments for Property & Equipment	(87,553)	–
Proceeds from sale of fixed assets	1,300	–
Net Cash Used in Investing Activities	(86,253)	–
Cash Flows From Financing Activities:		
Proceeds from Note Payable	–	913,063
Proceeds from stock and warrants issued in VDA Transaction	5,000,000	–
Repurchase of employee-owned Series A shares	(29,801)	–
Proceeds from line of credit	4,434,152	6,764,968
Payments on line of credit	(4,837,241)	(6,629,168)
Net Cash Provided By Financing Activities	4,567,110	1,048,863
Net increase/(decrease) in cash and cash equivalents	882,535	(650,752)
Cash and cash equivalents at the beginning of the period	2,361,059	3,011,811
Cash and cash equivalents at the end of the period	\$ 3,243,594	\$ 2,361,059

See accompanying notes to consolidated financial statements

TELKONET, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

	Year Ended December 31,	
	2022	2021
Supplemental Disclosures of Cash Flow Information:		
Cash transactions:		
Cash paid during the period for interest	\$ 23,542	\$ 22,885
Cash paid (received) during the year from income taxes, net of refunds	—	(104,456)

See accompanying notes to consolidated financial statements

TELKONET, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2022 AND 2021

NOTE A – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

Business and Basis of Presentation

Telkonet, Inc. (the “Company”, “Telkonet”), formed in 1999 and incorporated under the laws of the state of Utah, is the creator of the EcoSmart and the Rhapsody Platforms of intelligent automation solutions designed to optimize energy efficiency, comfort and analytics in support of the emerging Internet of Things (“IoT”).

In 2007, the Company acquired substantially all of the assets of Smart Systems International (“SSI”), which was a provider of energy management products and solutions to customers in the United States and Canada and the precursor to the Company’s EcoSmart platform. In 2020, the Company launched the Rhapsody Platform, which simplifies the installation and setup of the Company’s newest products and integrations. Both platforms provide comprehensive savings, management reporting, analytics and virtual engineering of a customer’s portfolio and/or property’s room-by-room energy consumption. Telkonet has deployed more than a half million intelligent devices worldwide in properties within the hospitality, educational, governmental and other commercial markets. The platforms are recognized as a solution for reducing energy consumption, operational costs and carbon footprints, and eliminating the need for new energy generation in these marketplaces – all whilst improving occupant comfort and convenience.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Telkonet Communications, Inc., operating as a single reportable business segment.

VDA Transaction and Change in Control

On August 6, 2021, the Company entered into a stock purchase agreement (the “Purchase Agreement”) with VDA Group S.p.A., an Italian joint stock company (“VDA”), pursuant to which VDA would, at the Closing (as defined in the Purchase Agreement), contribute \$5 million to Telkonet (the “Financing”) and, in exchange, Telkonet would issue to VDA: (i) 162,900,947 shares of Company Common Stock (the “Issuance”); and (ii) a warrant to purchase 105,380,666 additional shares of Common Stock (the “Warrant”) (the Issuance and the Warrant referred to collectively herein as the “VDA Transaction”). The Closing occurred on January 7, 2022.

Following the issuance of 162,900,947 shares of Common Stock to VDA upon the Closing, VDA owns 53% of the issued and outstanding Common Stock on a fully diluted as exercised/converted basis, resulting in a change of control of the Company. VDA could eventually own as much as 65% of the issued and outstanding Common Stock on a fully diluted as exercised/converted basis if it fully exercises the Warrant.

The Company has elected not to apply pushdown accounting adjustments to the Company’s financial statements related to the change in control as allowed by Accounting Standards Update No. 2017-17.

Concentrations of Credit Risk

Financial instruments and related items, which potentially subject the Company to concentrations of credit risk, consist primarily of cash, cash equivalents and trade receivables. The Company places its cash and temporary cash investments with credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit. The Company has never experienced any losses related to these balances. With respect to trade receivables, the Company performs ongoing credit evaluations of its customers’ financial conditions and limits the amount of credit extended when deemed necessary. The Company provides credit to its customers primarily in the United States in the normal course of business. The Company routinely assesses the financial strength of its customers and, as a consequence, believes its trade receivables credit risk exposure is limited.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with an original maturity date of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable are uncollateralized customer obligations due under normal trade terms. The Company records allowances for doubtful accounts based on customer-specific analysis and general matters such as current assessment of past due balances and economic conditions. The Company writes off accounts receivable when they become uncollectible. The allowance for doubtful accounts was \$32,058 and \$5,563 at December 31, 2022 and 2021, respectively. Management identifies a delinquent customer based upon the delinquent payment status of an outstanding invoice, generally greater than 30 days past due date. The delinquent account designation does not trigger an accounting transaction until such time the account is deemed uncollectible. The allowance for doubtful accounts is determined by examining the reserve history and any outstanding invoices that are over 30 days past due as of the end of the reporting period. Accounts are deemed uncollectible on a case-by-case basis, at management's discretion based upon an examination of the communication with the delinquent customer and payment history. Typically, accounts are only escalated to "uncollectible" status after multiple attempts at collection have proven unsuccessful.

Inventories

Inventories consist of thermostats, sensors and controllers for Telkonet's product platforms. These inventories are purchased for resale and do not include manufacturing labor and overhead. Inventories are stated at the lower of cost or net realizable value determined by the first in, first out (FIFO) method. The Company's inventories are subject to technological obsolescence. Management evaluates the net realizable value of its inventories on a quarterly basis and when it is determined that the Company's carrying cost of such excess and obsolete inventories cannot be recovered in full, a charge is taken against income for the difference between the carrying cost and the estimated realizable amount. The reserve for inventory obsolescence was approximately \$388,000 and \$443,000 at December 31, 2022, and 2021, respectively.

Property and Equipment

In accordance with Accounting Standards Codification ASC 360 "Property Plant and Equipment", property and equipment is stated at cost and is depreciated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives range from 2 to 10 years.

Fair Value of Financial Instruments

The Company accounts for the fair value of financial instruments in accordance with ASC 820, which defines fair value for accounting purposes, establishes a framework for measuring fair value and expanded disclosure requirements. Fair value is defined as an exit price, which is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date. The degree of judgment utilized in measuring the fair value of assets and liabilities generally correlates to the level of pricing observability. Financial assets and liabilities with readily available, actively quoted prices or for which fair value can be measured from actively quoted prices in active markets generally have more pricing observability and require less judgment in measuring fair value. Conversely, financial assets and liabilities that are rarely traded or not quoted have less price observability and are generally measured at fair value using valuation models that require more judgment. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency of the asset, liability or market and the nature of the asset or liability. The Company categorizes financial assets and liabilities that are recurring, at fair value into a three-level hierarchy in accordance with these provisions.

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; or
- Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and are unobservable.

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, line of credit and certain accrued liabilities. The carrying amounts of these assets and liabilities approximate fair value due to the short maturity of these instruments (Level 1 instruments), except for the line of credit. The carrying amount of the line of credit approximates fair value due to the interest rate and terms approximating those available to the Company for similar obligations (Level 2 instruments).

Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with ASC 360-10. Recoverability is measured by comparison of the carrying amount to the future net cash flows which the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Based on the assessment for impairment performed during 2022 and 2021, no impairment was recorded.

Income (Loss) per Common Share

The Company computes earnings per share under ASC 260-10, "Earnings per Share". Basic net income (loss) per common share is computed using the weighted average shares outstanding. Diluted net income (loss) per common share is computed using the treasury stock method, which assumes that the proceeds to be received on exercise of outstanding stock options and warrants are used to repurchase shares of the Company at the average market price of the common shares for the year. Dilutive common stock equivalents consist of shares issuable upon the exercise of the Company's outstanding stock options and warrants. For the years ended December 31, 2022 and 2021, there were 108,704,218 and 3,349,793 shares respectively of common stock underlying options and warrants excluded due to these instruments being anti-dilutive.

Numerator for basic and diluted loss per share:

	Year Ended December 31	
	2022	2021
Net Income / (Loss)	\$ (1,285,237)	\$ (412,785)
Less cumulative dividends earned on Preferred stock	(94,850)	(94,850)
Net loss attributable to common shareholders	<u>\$ (1,380,087)</u>	<u>\$ (507,635)</u>

Shares used in the calculation of diluted EPS for the years ended December 31, 2022 and 2021 are summarized below:

	Year Ended December 31	
	2022	2021
Weighted average common shares outstanding - basic	296,497,266	136,311,335
Dilutive effect of stock options and warrants	—	—
Weighted average common shares outstanding - diluted	<u>296,497,266</u>	<u>136,311,335</u>

Use of Estimates

The preparation of financial statements in conformity with United States of America (U.S.) generally accepted accounting principles ("GAAP") requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates are used when accounting for items and matters such as revenue recognition and allowances for uncollectible accounts receivable, inventory obsolescence, depreciation and amortization, long-lived assets, taxes and related valuation allowance, income tax provisions, stock-based compensation, and contingencies. The Company believes that the estimates, judgments and assumptions are reasonable, based on information available at the time they are made. Actual results may differ from those estimates.

Income Taxes

The Company accounts for income taxes in accordance with ASC 740-10 "Income Taxes." Under this method, deferred income taxes (when required) are provided based on the difference between the financial reporting and income tax bases of assets and liabilities and net operating losses at the statutory rates enacted for future periods, expected when the differences reverse. The Company has a policy of establishing a valuation allowance when it is more likely than not that the Company will not realize the benefits of its deferred income tax assets in the future.

The Company follows ASC 740-10-25, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740-10-25 also provides guidance on de-recognition, classification, treatment of interest and penalties, and disclosure of such positions.

Revenue from Contracts with Customers

Accounting Standards Codification Topic 606, Revenue from Contracts with Customers (“ASC 606, the Standard”) supersedes nearly all legacy revenue recognition guidance. ASC 606, the Standard outlines a comprehensive five-step revenue recognition model based on the principle that an entity should recognize revenue based on when it satisfies its performance obligations by transferring control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for said goods or services.

Identify the customer contracts

The Company accounts for a customer contract under ASC 606 when the contract is legally enforceable. A contract is legally enforceable when all of the following criteria are met: (1) the contract has been approved by the Company and the customer and both parties are committed to perform their respective obligations, (2) the Company can identify each party’s rights regarding goods or services transferred, (3) the Company can identify payment terms for goods or services transferred, (4) the contract has commercial substance, and (5) collectability of all the consideration to which the Company is entitled in exchange for the goods or services transferred is probable.

A contract does not exist if either party to the contract has the unilateral right to terminate a wholly unperformed contract without compensating the other party (or parties). Nearly all of the Company’s contracts do not contain such mutual termination rights for convenience. All contracts are in written form.

Identify the performance obligations

The Company will enter into product only contracts that contain a single performance obligation related to the transfer of products to a customer.

The Company will also enter into certain customer contracts that encompass product and installation services, referred to as “turnkey” solutions. These contracts ultimately provide the customer with a solution that enhances the functionality of the customer’s existing equipment. For this reason, the Company has determined that the product and installation services are not separately identifiable performance obligations, but in essence represent one, combined performance obligation (“turnkey”).

The Company also offers technical phone support services to customers. This service is considered a separate performance obligation.

Determine the transaction price

The Company generally enters into contracts containing fixed prices. It is not customary for the Company to include contract terms that would result in variable consideration. In the rare situation that a contract does include this type of provision, it is not expected to result in a material adjustment to the transaction price. The Company regularly extends pricing discounts; however, they are negotiated up front and adjust the fixed transaction price set out in the contract.

Customer contracts will typically contain upfront deposits that will be applied against future invoices, as well as customer retainage. The intent of any required deposit or retainage is to ensure that the obligations of either party are honored and follow customary industry practices. In addition, the Company will typically be paid in advance at the beginning of any support contracts, consistent with industry practices. None of these payment provisions are intended to represent significant implicit financing. The Company’s standard payment terms are thirty days from invoice date. Products are fully refundable when returned in their original packaging without damage or defacing less a restocking fee. Historical returns have shown to be immaterial. The Company offers a standard one-year assurance warranty. However, customers can purchase an extended warranty. Under the revenue recognition standard, extended warranties are accounted for as a service warranty, requiring the revenue to be recognized over the extended service periods. Contracts involving an extended warranty are immaterial and will continue to be combined with technical phone support services revenue and recognized on a straight-line basis over the term of the contract.

Allocate the transaction price to the performance obligations

Revenues from customer contracts are allocated to the separate performance obligations based on their relative stand-alone selling price (“SSP”) at contract inception. The SSP is the price at which the Company would sell a promised good or service separately. The best evidence of an SSP is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. However, turnkey solutions are sold for a broad range of amounts resulting from, but not limited to, tiered discounting for value-added resellers (“VAR”) based upon committed volumes and other economic factors. Due to the high variability of our pricing, the Company cannot establish a reliable SSP using observable data. Accordingly, the Company uses the residual approach to allocate the transaction price to performance obligations related to its turnkey solutions. When support services are not included within the turnkey solution, the residual method is not utilized and no allocation of the transaction price to the performance obligation is necessary.

All support service agreements, whether single or multi-year terms, automatically renew for one-year terms at a suggested retail price (“SRP”). Support service renewals are consistently priced and therefore would support the use of SRP as the best estimate of an SSP for such performance obligations.

Revenue Recognition

The Company recognizes revenues from product only sales at a point in time when control over the product has transferred to the customer. As the Company’s principal terms of sale are FOB shipping point, the Company primarily transfers control and records revenue for product only sales upon shipment.

A typical turnkey project involves the installation and integration of 200-300 rooms in a customer-controlled facility and takes approximately sixty days to complete. Since control over goods and services transfers to a customer once a room is installed, the Company recognizes revenue for turnkey solutions over time. The Company uses an outputs measure based on the number of rooms installed to recognize revenues from turnkey solutions.

Revenues from support services are recognized over time, in even daily increments over the term of the contract, and are presented as “Recurring Revenue” in the Statement of Operations.

Contracts are billed in accordance with the terms and conditions, either at periodic intervals or upon substantial completion. This can result in billing occurring subsequent to revenue recognition, resulting in contract assets. Contract assets are presented as current assets in the Consolidated Balance Sheet.

Contract liabilities include deferrals for the monthly support service fees. Long-term contract liabilities represent support service fees that will be recognized as revenue after December 31, 2023.

Contract Fulfillment Cost

The Company recognizes related costs of the contract over time in relation to the revenue recognition. Costs included within the projects relate to the cost of material, direct labor and costs of outside services utilized to complete projects. These are presented as “Contract assets” in the Consolidated Balance Sheet.

Sales Taxes

Unless provided with a resale or tax exemption certificate, the Company assesses and collects sales tax on sales transactions and records the amount as a liability. It is recognized as a liability until remitted to the applicable state. Total revenues do not include sales tax as the Company is considered a pass through conduit for collecting and remitting sales taxes.

Guarantees and Product Warranties

The Company records a liability for potential warranty claims in cost of sales at the time of sale. The amount of the liability is based on the trend in the historical ratio of claims to sales, the historical length of time between the sale and resulting warranty claim, new product introductions and other factors. The products sold are generally covered by a warranty for a period of one year. In the event the Company determines that its current or future product repair and replacement costs exceed its estimates, an adjustment to these reserves would be charged to earnings in the period such determination is made. For the years ended December 31, 2022 and 2021, the Company experienced returns of approximately 1% to 3% of materials included in cost of sales, respectively. As of December 31, 2022 and 2021, the Company recorded warranty liabilities in the amount of \$13,663 and \$46,650, respectively, using this experience factor range.

Product warranties for the years ended December 31 are as follows:

	December 31, 2022	December 31, 2021
Beginning balance	\$ 46,650	\$ 45,328
Warranty claims incurred	(14,659)	(16,075)
Provision charged (credited) to expense	(18,328)	17,397
Ending balance	<u>\$ 13,663</u>	<u>\$ 46,650</u>

Advertising

The Company follows the policy of charging the costs of advertising to expenses as incurred. The Company incurred \$3,502 and \$10,104 in advertising costs during the years ended December 31, 2022 and 2021, respectively.

Research and Development

The Company accounts for research and development costs in accordance with ASC 730-10, "Research and Development". Under ASC 730-10, all research and development costs must be charged to expense as incurred. Accordingly, internal research and development costs are expensed as incurred. Third-party research and development costs are expensed when the contracted work has been performed or as milestone results have been achieved. Company-sponsored research and development costs related to both present and future products are expensed in the period incurred. Total expenditures on research and product development for 2022 and 2021 were \$1,070,473 and \$1,129,957, respectively.

Stock-Based Compensation

The Company accounts for stock-based awards in accordance with ASC 718-10, "Share-Based Compensation", which requires a fair value measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors, including employee stock options and restricted stock awards. The Company estimates the fair value of stock options granted using the Black-Scholes valuation model. This model requires the Company to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will hold vested stock options before exercising them, the estimated volatility of the Company's common stock price and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in the Company's consolidated statements of operations.

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. The expected stock price volatility is based on the historical volatility of the Company's stock for the related expected term.

Stock-based compensation expense in connection with options granted to employees was \$0 and \$7,262 for the years ended December 31, 2022 and 2021 respectively.

NOTE B – NEW ACCOUNTING PRONOUNCEMENTS

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 provides guidance for estimating credit losses on certain types of financial instruments, including trade receivables, by introducing an approach based on expected losses. The expected loss approach will require entities to incorporate considerations of historical information, current information and reasonable and supportable forecasts. ASU 2016-13 also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The guidance requires a modified retrospective transition method and early adoption is permitted. In November 2019, FASB issued ASU No. 2019-10, Financial Instruments – Credit Losses, Derivatives and Hedging, and Leases (“ASU 2019-10”), which defers the adoption of ASU 2016-13 for smaller reporting companies until January 1, 2023. The Company will continue to evaluate the impact of ASU 2016-13 on its consolidated financial statements.

Management has evaluated other recently issued accounting pronouncements and does not believe any will have a significant impact on our consolidated financial statements and related disclosures.

NOTE C– REVENUE

The following table presents the Company’s product and recurring revenues disaggregated by industry for the year ended December 31, 2022.

	Hospitality	Education	Multiple Dwelling Units	Government	Healthcare	Total
Product Revenue	\$ 5,289,933	\$ 1,429,292	\$ 80,700	\$ 993,452	\$ 363	\$ 7,793,740
Recurring Revenue	539,891	112,448	1,940	0	0	654,279
	\$ 5,829,824	\$ 1,541,740	\$ 82,640	\$ 993,452	\$ 363	\$ 8,448,019
% of Total	69%	18%	1%	12%	0%	100%

The following table presents the Company’s product and recurring revenues disaggregated by industry for the year ended December 31, 2021.

	Hospitality	Education	Multiple Dwelling Units	Government	Healthcare	Total
Product Revenue	\$ 4,724,880	\$ 279,486	\$ 295,873	\$ 193,970	\$ 48,195	\$ 5,542,404
Recurring Revenue	592,655	112,879	26,461	0	0	731,995
	\$ 5,317,535	\$ 392,365	\$ 322,334	\$ 193,970	\$ 48,195	\$ 6,274,399
% of Total	85%	6%	5%	3%	1%	100%

Sales taxes and other usage-based taxes are excluded from revenues.

Remaining performance obligations

As of December 31, 2022, the aggregate amount of the transaction price allocated to remaining performance obligations was approximately \$0.4 million. Except for support services, the Company expects to recognize 100% of the remaining performance obligations over the next six months. As of December 31, 2021, the aggregate amount of the transaction price allocated to remaining performance obligations was approximately \$1.2 million.

Contract assets and liabilities

	December 31, 2022	December 31, 2021	January 1, 2021
Contract assets	\$ 94,840	\$ 266,014	\$ 104,989
Contract liabilities - current	650,340	941,230	1,052,367

Contracts are billed in accordance with the terms and conditions, either at periodic intervals or upon substantial completion. This can result in billing occurring subsequent to revenue recognition, resulting in contract assets. Contract assets are presented as current assets in the Consolidated Balance Sheet.

Often, the Company will require customers to pay a deposit upon contract signing that will be applied against work performed or products shipped. In addition, the Company will often invoice the full term of support at the start of the support period. Billings that occur prior to revenue recognition result in contract liabilities. The change in the contract liability balance during the 12 month period ended December 31, 2022 is the result of cash payments received and billing in advance of satisfying performance obligations.

Contract costs

Costs to complete a turnkey contract primarily relate to the materials cost and direct labor and are recognized proportionately as the performance obligation is satisfied. The Company will defer cost to complete a contract when materials have shipped (and control over the materials has transferred to the customer), but an insignificant amount of rooms have been installed. The Company will recognize any deferred costs in proportion to revenues recognized from the related turnkey contract. The Company does not expect deferred contract costs to be long-lived since a typical turnkey project takes approximately sixty days to complete. Deferred contract costs are generally presented as current assets in the Consolidated Balance Sheet.

The Company incurs incremental costs to obtain a contract in the form of sales commissions. These costs, whether related to performance obligations that extend beyond twelve months or not, are immaterial and will continue to be recognized in the period incurred within selling, general and administrative expenses.

NOTE D – ACCOUNTS RECEIVABLE

Components of accounts receivable as of December 31, 2022 and 2021 are as follows:

	December 31, 2022	December 31, 2021
Accounts receivable	\$ 1,990,161	\$ 1,016,117
Allowance for doubtful account	(32,058)	(5,563)
Accounts receivable, net	<u>\$ 1,958,103</u>	<u>\$ 1,010,554</u>

NOTE E – PROPERTY AND EQUIPMENT

The Company's property and equipment as of December 31, 2022 and 2021 consists of the following:

	December 31, 2022	December 31, 2021
Computer Hardware	\$ 63,953	\$ 66,685
Computer Software	76,134	76,134
Furniture & Fixtures	412,889	330,568
Leasehold Improvements	18,016	18,016
Machinery & Equipment	16,461	16,461
Total	<u>587,453</u>	<u>507,864</u>
Accumulated Depreciation	<u>(461,357)</u>	<u>(423,663)</u>
Total Property and Equipment	<u>\$ 126,096</u>	<u>\$ 84,201</u>

Depreciation and amortization expense included as a charge to income was \$43,832 and \$43,471 for the years ended December 31, 2022 and 2021, respectively.

NOTE F – CURRENT ACCRUED LIABILITIES

Current accrued liabilities as of December 31, 2022 and 2021 are as follows:

	December 31, 2022	December 31, 2021
Accrued payroll and payroll taxes	\$ 252,193	\$ 242,131
Accrued professional fees	143,706	136,584
Accrued sales taxes, penalties and interest	778	16,634
Product warranties	13,663	46,650
Other accrued liabilities	292,243	276,722
Total current accrued liabilities	<u>\$ 702,583</u>	<u>\$ 718,721</u>

NOTE G – DEBT**Revolving Credit Facility**

On September 30, 2014, the Company entered into a loan and security agreement (the “Heritage Bank Loan Agreement”), with Heritage Bank of Commerce, a California state chartered bank (“Heritage Bank”), governing a revolving credit facility in a principal amount not to exceed \$2,000,000 (subsequently reduced to \$1,000,000 on December 13, 2021), (the “Credit Facility”). Availability of borrowings under the Credit Facility is subject to a borrowing base calculation based on the Company’s eligible accounts receivable and eligible inventory each multiplied by an applicable advance rate, with an overall limitation tied to the Company’s eligible accounts receivable. The Credit Facility is secured by all of the Company’s assets. The Credit Facility is available for working capital and other general business purposes.

The outstanding principal balance of the Credit Facility bears interest at the Prime Rate plus 3.00%, which was 10.5% on December 31, 2022 and 6.25% on December 31, 2021. On October 9, 2014, as part of the Heritage Bank Loan Agreement, Heritage Bank was granted a warrant to purchase 250,000 shares of Telkonet common stock. The warrant had an exercise price of \$0.20 and expired October 9, 2021. On November 6, 2019, the Company entered into an eleventh amendment to the Heritage Bank Loan Agreement to extend the revolving maturity date to September 30, 2021, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement, and eliminate the maximum EBITDA loss covenant. The Eleventh Amendment was effective as of September 30, 2019.

On September 30, 2021, the Company entered into a twelfth amendment to the Heritage Bank Loan Agreement (the “Twelfth Amendment”) to extend the revolving maturity date to December 31, 2021, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement. In addition, subject to certain conditions as specified in the Twelfth Amendment, Heritage Bank consented to the VDA Transaction (as described above in Note A – Basis of Presentation and Significant Accounting Policies - Business) between the Company and VDA, and acknowledged and agreed that certain events occurring in connection with the VDA Transaction, including the change of control of the Company resulting from the VDA Transaction, do not constitute Events of Default as defined in the Heritage Bank Loan Agreement.

On December 13, 2021, the Company entered into a thirteenth amendment to the Heritage Bank Loan Agreement (the “Thirteenth Amendment”) to extend the revolving maturity date to March 31, 2022, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement. In addition, the Thirteenth Amendment reduced the credit extension amount to \$1,000,000 and reduced unrestricted cash maintained in the Company’s accounts at Heritage Bank to be at least \$1,000,000, rather than \$2,000,000.

On March 10, 2022, the Company entered into a fourteenth amendment to the Heritage Bank Loan Agreement to extend the revolving maturity date to June 30, 2023, unless earlier accelerated under the terms of the Heritage Bank Loan Agreement.

The Heritage Bank Loan Agreement contains covenants that place restrictions on, among other things, the incurrence of debt, granting of liens and sale of assets. The Heritage Bank Loan Agreement also contains financial covenants. As discussed above, the EBITDA loss covenant was eliminated in the Eleventh Amendment. The sole financial covenants are a minimum asset coverage ratio and a minimum unrestricted cash balance of \$1 million, both of which are measured at the end of each month. A violation of either of these covenants could result in an event of default under the Heritage Bank Loan Agreement. Upon the occurrence of such an event of default or certain other customary events of defaults, payment of any outstanding amounts under the Credit Facility may be accelerated and Heritage Bank's commitment to extend credit under the Heritage Bank Loan Agreement may be terminated. The Heritage Bank Loan Agreement contains other representations and warranties, covenants, and other provisions customary to transactions of this nature.

The outstanding balance on the Credit Facility was \$0 and \$403,089 at December 31, 2022 and December 31, 2021 respectively, and the remaining available borrowing capacity was approximately \$1,000,000 and \$460,000, respectively. As of December 31, 2022, the Company was in compliance with all financial covenants.

Paycheck Protection Program

The Company has received two loans under the Paycheck Protection Program (the "PPP") administered by the United States Small Business Administration (the "SBA") and authorized by the Keeping American Workers Employed and Paid Act, which is part of the Coronavirus Aid, Relief, and Economic Security Act, enacted on March 27, 2020.

On April 17, 2020, the Company entered into an unsecured promissory note for \$913,063 ("the First PPP Loan"). In January 2021, the Company applied for forgiveness of the amount due on the First PPP Loan. On February 16, 2021, Heritage Bank confirmed that the First PPP Loan granted to the Company, in the original principal amount of \$913,063 plus accrued interest of \$7,610 thereon, was forgiven in full.

On April 27, 2021, the Company entered into an unsecured promissory note, dated as of April 26, 2021, for a second PPP loan ("the Second PPP Loan" and together with the First PPP Loan, the "PPP Loans"), with Heritage Bank under a second draw of the PPP administered by the SBA and authorized by the Keeping American Workers Employed and Paid Act. In September 2021, the Company applied for forgiveness of the amount due on the Second PPP Loan. On September 15, 2021, Heritage Bank confirmed that the Second PPP Loan granted to the Company, in the original principal amount of \$913,063 plus accrued interest of \$3,044 thereon, was forgiven in full.

The total amount forgiven in 2021 for principal and accrued interest under the PPP Loans was \$1,836,780 and is shown as a gain on debt extinguishment.

NOTE H – PREFERRED STOCK

Series A

The Company has designated 215 shares of preferred stock as Series A Preferred Stock ("Series A"). Each share of Series A is convertible, at the option of the holder thereof, at any time, into shares of the Company's common stock at a conversion price of \$0.363 per share. On November 16, 2009, the Company sold 215 shares of Series A with attached warrants (since expired) to purchase an aggregate of 1,628,800 shares of the Company's common stock at \$0.33 per share. The Series A shares were sold at a price per share of \$5,000 and each Series A share is convertible into approximately 13,774 shares of common stock at a conversion price of \$0.363 per share. The Company received \$1,075,000 from the sale of the Series A shares. In prior years, 30 of the preferred shares issued on November 16, 2009 were converted to shares of the Company's common stock. In a prior year, the redemption feature available to the Series A holders expired.

Series B

The Company has designated 567 shares of preferred stock as Series B Preferred Stock ("Series B"). Each share of Series B is convertible, at the option of the holder thereof, at any time, into shares of the Company's common stock at a conversion price of \$0.13 per share. On August 4, 2010, the Company sold 267 shares of Series B with attached warrants (since expired) to purchase an aggregate of 5,134,626 shares of the Company's common stock at \$0.13 per share. The Series B shares were sold at a price per share of \$5,000 and each Series B share was convertible into approximately 38,461 shares of common stock at a conversion price of \$0.13 per share. The Company received \$1,335,000 from the sale of the Series B shares on August 4, 2010. On April 8, 2011, the Company sold 271 additional shares of Series B with attached warrants (since expired) to purchase an aggregate of 5,211,542 shares of the Company's common stock at \$0.13 per share. The Series B shares were sold at a price per share of \$5,000 and each Series B share was convertible into approximately 38,461 shares of common stock at a conversion price of \$0.13 per share. The Company received \$1,355,000 from the sale of the Series B shares on April 8, 2011. In prior years, 486 of the preferred shares issued on August 4, 2010 and April 8, 2011 were converted to shares of the Company's common stock. In a prior year, the redemption feature available to the Series B holders expired.

Preferred stock carries certain preference rights as detailed in the Company's Amended Articles of Incorporation related to both the payment of dividends and as to payments upon liquidation in preference to any other class or series of capital stock of the Company. As of December 31, 2022, the liquidation preference of the preferred stock is based on the following order: first, Series B with a preference value of \$518,428, which includes cumulative accrued unpaid dividends of \$258,428, and second, Series A with a preference value of \$1,855,454, which includes cumulative accrued unpaid dividends of \$950,454. As of December 31, 2021, the liquidation preference of the preferred stock is based on the following order: first, Series B with a preference value of \$497,605, which includes cumulative accrued unpaid dividends of \$237,605, and second, Series A with a preference value of \$1,822,450, which includes cumulative accrued unpaid dividends of \$897,450.

NOTE I – CAPITAL STOCK

The Company has authorized 15,000,000 shares of preferred stock, with a par value of \$.001 per share. Of those shares, the Company has designated 215 shares as Series A preferred stock and 567 shares as Series B preferred stock. At December 31, 2022, there were 181 shares of Series A and 52 shares of Series B outstanding. At December 31, 2021, there were 185 shares of Series A and 52 shares of Series B outstanding.

As of December 31, 2022 and December 31, 2021, the Company has authorized 475,000,000 shares of common stock with a par value of \$.001 per share. As of December 31, 2022 and 2021, the Company had 299,212,282 and 136,311,335 shares of common stock issued and outstanding, respectively.

During the year ended December 31, 2022, the Company issued to VDA 162,900,947 of Company Common Stock and a warrant to purchase 105,380,666 additional shares of Common Stock. During the year ended December 31, 2021, the Company issued 320,844 shares of common stock to directors for services performed during 2020. These shares were valued at \$18,000, which approximated the fair value of the shares when they were issued.

During the years ended December 31, 2022 and 2021, no warrants were exercised.

During the years ended December 31, 2022 and 2021, no shares of Series A or B preferred stock were converted to shares of common stock.

NOTE J – STOCK OPTIONS AND WARRANTS

Employee Stock Options

The Company maintains an equity incentive plan (the "2020 Plan"). The 2020 Plan was established in 2020 as an incentive plan for officers, employees, non-employee directors, prospective employees and other key persons. The 2020 Plan replaced the 2010 Amended and Restated Stock Option and Incentive Plan, as amended (the "2010 Plan"), which expired on November 17, 2020. The 2020 Plan is administered by the Board of Directors or the compensation committee, which is comprised of not less than two non-employee directors who are independent. A total of 10,000,000 shares of stock were reserved and available for issuance under the 2020 Plan. The exercise price per share for the stock covered by a stock option granted shall be determined by the administrator at the time of grant but shall not be less than 100 percent of the fair market value on the date of grant. The term of each stock option shall be fixed by the administrator, but no stock option shall be exercisable more than ten years after the date the stock option is granted. As of December 31, 2022, there were approximately 10,000,000 shares remaining for issuance under the 2020 Plan.

It is anticipated that providing such persons with a direct stake in the Company's welfare will assure a better alignment of their interests with those of the Company and its stockholders.

The following table summarizes the changes in options outstanding and the related prices for the shares of the Company's common stock issued to employees of the Company under the 2010 Plan as of December 31, 2022. No options have been issued under the 2020 Plan.

Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.01-\$0.15	2,000,000	2.13	0.14	2,000,000	\$ 0.14
\$0.16-\$0.20	526,847	2.55	0.19	526,847	\$ 0.19
	<u>2,526,847</u>	<u>2.22</u>	<u>0.15</u>	<u>2,526,847</u>	<u>\$ 0.15</u>

Transactions involving stock options issued to employees are summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Balance January 1, 2021	3,349,793	\$ 0.16
Granted	—	—
Cancelled, Expired	—	—
Exercised	—	—
Balance December 31, 2021	3,349,793	\$ 0.16
Granted	—	—
Cancelled, Expired	(822,946)	\$ 0.17
Exercised	—	—
Balance December 31, 2022	2,526,847	\$ 0.16

The expected life of awards granted represents the period of time that they are expected to be outstanding. The Company determines the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules, exercise patterns and pre-vesting and post-vesting forfeitures. The Company estimates the volatility of the Company's common stock based on the calculated historical volatility of the Company's common stock using the share price data for the trailing period equal to the expected term prior to the date of the award. The Company bases the risk-free interest rate used in the Black-Scholes option valuation model on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term equal to the expected life of the award. The Company has not paid any cash dividends on the Company's common stock and does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model. The Company uses historical data to estimate pre-vesting option forfeitures and records share-based compensation for those awards that are expected to vest. In accordance with ASC 718-10, the Company calculates share-based compensation for changes to the estimate of expected equity award forfeitures based on actual forfeiture experience.

There were no options granted in the years ended December 31, 2022 and 2021.

The total fair value of underlying shares related to options that vested during the years ended December 31, 2022 and 2021 was \$0 and \$5,053, respectively. The aggregate intrinsic value of the vested options was zero as of December 31, 2022 and 2021. During the year ended December 31, 2022 no options were granted, exercised or cancelled, but 822,946 expired. During the year ended December 31, 2021 no options were granted, exercised, cancelled or expired. Total stock-based compensation expense in connection with options granted to employees recognized in the consolidated statements of operations for the years ended December 31, 2022 and 2021 was \$0 and \$7,262 respectively.

Warrants

The following table summarizes the changes in warrants outstanding and the related exercise price for the warrants issued.

Transactions involving warrants are summarized as follows:

	Number of Shares	Weighted Average Price / Share
Outstanding at January 1, 2021	250,000	\$ 0.20
Granted	—	—
Exercised	—	—
Cancelled or Expired	(250,000)	0.20
Outstanding at December 31, 2021	—	\$ —
Granted	105,380,666	0.06
Exercised	—	—
Cancelled or Expired	—	—
Outstanding at December 31, 2022	105,380,666	\$ 0.06

The active warrants relate to those owned by VDA as a result of the VDA Transaction, which closed on January 7, 2022.

NOTE K – RELATED PARTY TRANSACTIONS

During the years ended December 31, 2022 and 2021, the Company paid cash consideration of \$311,960 and \$0, respectively to the Company's non-employee directors as compensation for their attendance and participation in the Company's Board of Director and committee meetings. The amount payable to directors at December 31, 2022 and 2021 was \$8,333 and \$223,000, respectively.

During the year ended December 31, 2022, the Company recognized revenue of \$98,289 from VDA. Accounts receivable from VDA totaled \$93,083 at December 31, 2022.

During the year ended December 31, 2022, the Company had purchases from VDA of \$56,963. Accounts Payable and accrued expenses to VDA at December 31, 2022 totaled \$44,175.

NOTE L – INCOME TAXES

The Company follows ASC 740-10 "Income Taxes" which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statement or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between financial statements and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

A reconciliation of tax expense computed at the statutory federal tax rate on loss from operations before income taxes to the actual income tax (benefit) / expense is as follows:

	2022	2021
Tax benefit computed at the statutory rate	\$ (266,742)	\$ (85,028)
State Taxes	39,875	(7,398)
Book expenses not deductible for tax purposes	944	(385,135)
Rate change	(29,705)	26,739
Deferred Tax Write Off	–	42,782
Other	3,370	(393)
	(252,258)	(408,433)
Change in valuation allowance for deferred tax assets	267,293	416,322
Income tax (benefit) expense	\$ 15,036	\$ 7,889

Deferred income taxes include the net tax effects of net operating loss (NOL) carry forwards and the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

	2022	2021
Deferred Tax Assets:		
Net operating loss carried forward	\$ 22,499,045	\$ 22,078,280
Intangibles	–	17,728
Credits	–	–
Other	502,733	638,477
Total Deferred Tax Assets	23,001,778	22,734,485
Deferred Tax Liability		
Intangibles	–	–
Total Deferred Tax Liabilities	–	–
Valuation Allowance	(23,001,778)	(22,734,485)
Net Deferred Tax Assets	\$ –	\$ –

A valuation allowance is recorded when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets depends on the ability of the Company to generate sufficient taxable income of the appropriate character in the future and in the appropriate taxing jurisdictions. As of December 31, 2022 and December 31, 2021, the Company's valuation allowance, established for the tax benefit that may not be realized, totaled approximately \$23,000,000 and \$22,730,000, respectively. The overall increase in the valuation allowance is related to insignificant fluctuations in the temporary differences and federal and state net operating losses.

At December 31, 2022 the Company had net operating loss carryforwards of approximately \$100,300,000 and \$26,700,000 for federal and state income tax purposes respectively, which will expire at various dates from 2023 – 2042. There are approximately \$13,300,000 of net operating losses that do not expire.

The Company's NOL and tax credit carryovers may be significantly limited under Section 382 of the Internal Revenue Code (IRC). NOL and tax credit carryovers are limited under Section 382 when there is a significant "ownership change" as defined in the IRC. During 2022, and in 2005 and prior years, the Company may have experienced such ownership changes that could have imposed such limitations.

The limitation imposed by Section 382 would place an annual limitation on the amount of NOL and tax credit carryovers that can be utilized. When the Company completes the necessary studies, the amount of NOL carryovers available may be reduced significantly. However, since the valuation allowance fully reserves for all available carryovers, the effect of the reduction would be offset by a reduction in the valuation allowance.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The Company is generally no longer subject to U.S. federal income tax examinations by tax authorities for years before 2018 and various states before 2018. Although these years are no longer subject to examination by the Internal Revenue Service (IRS) and various state taxing authorities, net operating loss carryforwards generated in those years may still be adjusted upon examination by the IRS or state taxing authorities if they have been or will be used in a future period.

The Company follows the provisions of uncertain tax positions as addressed in FASB Accounting Standards Codification 740-10-65-1. The Company recognized no change in the liability for unrecognized tax benefits. The Company has no tax positions at December 31, 2022 or 2021 for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expense. No such interest or penalties were recognized during the periods presented. The Company had no accruals for interest and penalties at December 31, 2022 or 2021. The Company's utilization of any net operating loss carryforwards may be unlikely due to its continuing losses.

NOTE M – COMMITMENTS AND CONTINGENCIES

Office Leases Obligations

In October 2013, the Company entered into a lease agreement for 6,362 square feet of commercial office space in Waukesha, Wisconsin for its corporate headquarters. The Waukesha lease would have expired in April 2021, but was subsequently amended and extended through April 30, 2026. On April 7, 2017 the Company executed an amendment to its existing lease in Waukesha, Wisconsin to expand another 3,982 square feet, bringing the total leased space to 10,344 square feet. In addition, the lease term was extended from May 1, 2021 to April 30, 2026. The commencement date for this amendment was July 15, 2017.

In May 2017, the Company entered into a lease agreement for 5,838 square feet of floor space in Waukesha, Wisconsin for its inventory warehousing operations. This lease expires on May 31, 2024.

In November 2021, the Company entered into a lease agreement for 425 square feet of commercial office space in Gaithersburg, Maryland. This lease would have expired in April 2021, but was subsequently amended and extended through November 30, 2023.

The Company determines if an arrangement is a lease at inception. This determination generally depends on whether the arrangement conveys to the Company the right to control the use of an explicitly or implicitly identified fixed asset for a period of time in exchange for consideration. Control of an underlying asset is conveyed to the Company if the Company obtains the rights to direct the use of and to obtain substantially all of the economic benefits from using the underlying asset. The Company does not separate non-lease components from lease components to which they relate and accounts for the combined lease and non-lease components as a single lease component.

Operating leases are included in our Consolidated Balance Sheet as right-of-use assets, operating lease liabilities – current and operating lease liabilities – long-term. We do not recognize a right-of-use asset and lease liability for leases with a term of 12 months or less. Our current operating leases are for facilities. Our leases may contain renewal options; however, we do not recognize right-of-use assets or lease liabilities for renewal periods unless it is determined that we are reasonably certain of renewing the lease at inception or when a triggering event occurs. Some of our lease agreements may contain rent escalation clauses, rent holidays, capital improvement funding, or other lease concessions.

In determining our right-of-use assets and lease liabilities, we apply a discount rate to the minimum lease payments within each lease agreement. ASC 842 requires us to use the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term, an amount equal to the lease payments in a similar economic environment. When we cannot readily determine the discount rate implicit in the lease agreement, we utilize our current borrowing rate on our outstanding line of credit. The Company's line of credit utilizes market rates to assess an interest rate. Refer to Note G for further discussion.

We recognize our minimum rental expense on a straight-line basis based on the fixed components of a lease arrangement. Payments are set on a pre-determined schedule within each lease agreement. We amortize this expense over the term of the lease beginning with the date of the standard adoption for current leases and beginning with the date of initial possession, which is the date we enter the leased space and begin to make improvements in the preparation for its intended use, for future leases. Variable lease components represent amounts that are not fixed in nature and are not tied to an index or rate and are recognized as incurred. Variable lease components consist primarily of the Company's proportionate share of common area maintenance, utilities, taxes and insurance and are presented as operating expenses in the Company's statements of operations in the same line item as expense arising from fixed lease payments.

The components of lease expense for the years ended December 31 are as follows:

	Year Ended December 31	
	2022	2021
Operating lease cost - fixed	\$ 175,959	\$ 229,548
Variable lease cost	135,109	122,356
Total operating lease cost	<u>\$ 311,068</u>	<u>\$ 351,904</u>

Other information related to leases as of December 31 is as follows:

	December 31, 2022	December 31, 2021
Operating lease liability - current	\$ 157,334	\$ 195,176
Operating lease liability - long term	350,694	459,668
Operating cash flows from operating leases	311,068	242,305
Weighted-average remaining lease term of operating leases	3.2 years	4.1 years
Weighted-average discount rate of operating leases	8.5%	8.5%

Future annual minimum operating lease payments as of December 31, 2022 were as follows:

2023	\$ 193,170
2024	172,424
2025	158,510
2026	53,184
2027	—
2028 and thereafter	—
Total minimum lease payments	<u>577,288</u>
Less imputed interest	<u>(69,260)</u>
Total	<u>\$ 508,028</u>

Rental expenses charged to operations for the years ended December 31, 2022 and 2021 was \$311,068 and \$351,904, respectively.

Employment and Consulting Agreements

The Company has employment agreements with certain of its key employees which include non-disclosure and confidentiality provisions for protection of the Company's proprietary information.

Under the terms of a Consulting Agreement dated January 7, 2022, Piercarlo Gramaglia will serve as Chief Executive Officer of the Company for a term of eighteen (18) months, unless earlier terminated pursuant to the terms of the Consulting Agreement. In exchange for his service as Chief Executive Officer, the Company will pay Mr. Gramaglia an annual fee of \$30,000 and will pay his reasonable expenses associated with the performance of his duties as Chief Executive Officer.

John M. Srouji, Chief Sales & Operations Officer, is employed pursuant to an employment agreement with us effective February 1, 2023 and expiring on May 31, 2026. The term of the employment agreement will automatically renew for an additional twelve months. Mr. Srouji will receive a base salary of \$300,000 per year and bonuses and benefits based on the Company's internal policies and on participation in the Company's incentive and benefit plans.

Jeffrey J. Sobieski, Chief Technology Officer, is employed pursuant to an employment agreement with us effective February 1, 2023 and expiring May 31, 2026. The term of the employment agreement will automatically renew for a period of an additional twelve (12) months, and provides for a base salary of \$250,000 per year and bonuses and benefits based upon the Company's internal policies and participation in the Company's incentive and benefit plans. Per the agreement, Mr. Sobieski is eligible to receive a bonus, not to exceed 15% of his base salary, should predetermined objectives be met.

Richard E. Mushrush, Chief Financial Officer, is employed pursuant to an employment agreement with us effective February 1, 2023 and expiring May 31, 2026. The term of the employment agreement will automatically renew for a period of an additional twelve (12) months, and provides for a base salary of \$122,000 per year and bonuses and benefits based upon the Company's internal policies and participation in the Company's incentive and benefit plans. Per the agreement, Mr. Mushrush is eligible to receive a bonus, not to exceed 20% of his base salary, should predetermined objectives be met.

In addition to the foregoing, stock options may be periodically granted to employees under the Company's 2020 equity incentive plan at the discretion of the Compensation Committee of the Board of Directors. Executives of the Company are eligible to receive stock option grants, based upon individual performance and the performance of the Company as a whole.

Litigation

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, other than the Sipco litigation discussed below, which has been dismissed, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity.

Sipco Litigation and License Agreement

The Company continues to fulfill its obligations under the Wireless Network Patent License Agreement (the "License Agreement") between SIPCO, LLC ("Sipco") and IPCO, LLC dba IntusIQ (collectively, the "Licensors") and the Company, dated November 30, 2020. The parties entered into the License Agreement in connection with the settlement of a lawsuit filed by Sipco as disclosed in more detail in the Company's previously filed reports.

The minimum payments required under the License Agreement have been accrued for on the Company's Condensed Consolidated Balance Sheets in accordance with GAAP, which specifies that when a liability is probable and the amount can be reasonably estimated, said liability should be recorded in the current reporting period. Per the License Agreement, the contractual minimum payments began on January 1, 2022 and continue until December 31, 2024, thus satisfying both criteria of probable and reasonably estimable. Accordingly, a long-term liability was recorded representing the sum of those contractual minimums. As of December 2022, the Company had a current liability of approximately \$196,724, which \$56,724 is included in accounts payable and \$140,000 in other accrued liabilities (See Note F – Current Accrued Liabilities for further breakdown of accrued liabilities), along with a non-current liability of \$220,000 included in accrued royalties – long-term recorded on its Condensed Consolidated Balance Sheets.

Indemnification Agreements

On March 31, 2010, the Company entered into Indemnification Agreements with executives Jason L. Tienor, then President and Chief Executive Officer, and Jeffrey J. Sobieski, then Chief Operating Officer. On April 24, 2012, the Company entered into an Indemnification Agreement with director Tim S. Ledwick. On January 1, 2017, the Company entered into an Indemnification Agreement with Chief Financial Officer Richard E. Mushrush.

The Indemnification Agreements provide that the Company will indemnify the Company's officers and directors, to the fullest extent permitted by law, relating to, resulting from or arising out of any threatened, pending or completed action, suit or proceeding, or any inquiry or investigation by reason of the fact that such officer or director (i) is or was a director, officer, employee or agent of the Company or (ii) is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Company, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. In addition, the Indemnification Agreements provide that the Company will make an advance payment of expenses to any officer or director who has entered into an Indemnification Agreement, in order to cover a claim relating to any fact or occurrence arising from or relating to events or occurrences specified in this paragraph, subject to receipt of an undertaking by or on behalf of such officer or director to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Company as authorized under the Indemnification Agreement.

Sales Tax

Unless provided with a resale or tax exemption certificate, the Company assesses and collects sales tax on sales transactions and records the amount as a liability. It is recognized as a liability until remitted to the applicable state. Total revenues do not include sales tax as the Company is considered a pass through conduit for collecting and remitting sales taxes.

The following table sets forth the change in the sales tax accrual during the years ended December 31:

	December 31, 2022	December 31, 2021
Beginning balance	\$ 16,634	\$ 31,396
Sales tax collected	162,710	85,589
Provisions (reversals)	(10,610)	(7,685)
Payments	(167,956)	(92,666)
Ending balance	<u>\$ 778</u>	<u>\$ 16,634</u>

NOTE N – BUSINESS CONCENTRATION

For the year December 31, 2022, two customers, each representing over 15% of total net revenues, accounted for approximately 37% of total net revenues. For the year ended December 31, 2021, one customer represented approximately 18% of total net revenues.

As of December 31, 2022, one customer accounted for approximately 35% of the Company's net accounts receivable. As of December 31, 2021, there were five customers, each representing over 10% of the Company's net accounts receivable, accounting for 64% of the Company's net accounts receivable.

Purchases from two suppliers accounted for \$3,919,435, or 95%, of total purchases for the year ended December 31, 2022 and one vendor accounted for \$1,878,803, or 82%, of total purchases for the year ended December 31, 2021.

The amount due to one supplier, net of deposits paid, was approximately \$487,000 and \$134,000 as of December 31, 2022 and 2021, respectively.

NOTE O – EMPLOYEE BENEFIT PLAN

The Company has an employee savings plan covering substantially all employees who are at least 21 years of age and have completed at least 3 months of service. The plan provides for matching contributions equal to 100% of each dollar contributed by the employee up to 4% of the employee's salary. The Company's matching contributions vest immediately. The Company may also elect to make discretionary contributions. In response to the impact COVID-19 has had on the Company's operations and financial results, in June 2020 management suspended the Company's 401(k) match and reinstated it on January 1, 2023. The Company did not make any contributions to the plan for the years ended December 31, 2022 or 2021, respectively.

NOTE P – SUBSEQUENT EVENT

A Form 8-K was filed on March 29, 2023, announcing the Company's intention to voluntarily deregister its common stock from the requirements of Sections 12(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and suspend its reporting obligations under Section 15(d) of the Exchange Act. Telkonet intends to file a Form 15 to effect the deregistration and suspension with the U.S. Securities and Exchange Commission (the "SEC") shortly after Telkonet's filing of its Form 10-K for the fiscal year ending December 31, 2022, to be filed on or before March 31, 2023 (the "2022 10-K"). The filing of the 2022 10-K will be Telkonet's final periodic SEC filing.

Telkonet's board of directors (the "Board") has determined that the elimination of reporting requirements under the Exchange Act will be in the best interests of Telkonet and its stockholders. The Board's decision was based on eliminating the expense of its public reporting requirements under the Exchange Act, as well as management's time in complying with the public reporting requirements.

Exhibit 19.1

803 Insider Trading

Effective Date 1/1/2023

The purpose of this Insider Trading Policy (the “Policy”) is to promote compliance with applicable securities laws by Telkonet Inc. and its affiliated entities (“Telkonet Inc.” or the “Company”) and all directors, officers and employees thereof, in order to preserve the reputation and integrity of Telkonet Inc. as well as that of all persons affiliated with it. Applicability

The Policy is applicable to all directors, officers, and employees of Telkonet Inc. Questions regarding this policy should be directed to the Company’s Chief Financial Officer.

Policy

If a director, officer or any employee of the Company or any agent or advisor of the Company has material, nonpublic information relating to the Company, it is the Company’s policy that neither that person nor any Related Person (as defined below) may buy or sell securities of the Company (the “Company Securities”) or engage in any other action to take advantage of, or pass on to others, that information. This Policy also applies to material, nonpublic information relating to any other company with publicly traded securities, including our customers or suppliers, obtained in the course of employment by or association with Telkonet Inc.

To avoid even the appearance of impropriety, additional restrictions on trading Company Securities apply to directors and members of executive management. See Additional Restrictions and Requirements for Directors and “Officers” below.

DEFINITIONS/EXPLANATIONS

Who is an “Insider”?

Any person who possesses material, nonpublic information is considered an insider as to that information. Insiders include Company directors, officers, employees, independent contractors, and those persons in a special relationship with the Company, e.g., its auditors, consultants or attorneys. The definition of insider is transaction specific; that is, an individual is an insider with respect to each material, nonpublic item of which he or she is aware.

What is “Material” Information?

The materiality of a fact depends upon the circumstances. A fact is considered “material” if there is a substantial likelihood that a reasonable investor would consider it important in deciding to buy, sell or hold a security or where the fact is likely to have a significant effect on the market price of the security. Material information can be positive or negative and can relate to virtually any aspect of a company’s business or to any type of security – debt or equity.

Some examples of material information include:

- Unpublished financial results
- News of a pending or proposed company transaction
- Significant changes in corporate objectives
- News of a significant sale of assets
- Changes in dividend policies
- Financial liquidity problems

The above list is only illustrative; many other types of information may be considered “material,” depending on the circumstances. The materiality of information is subject to reassessment on a regular basis.

What is “Nonpublic” Information?

Information is “nonpublic” if it is not available to the public. For information to be considered public, it must be widely disseminated in a manner making it generally available to investors through such media as Dow Jones, Reuters Economic Services, The Wall Street Journal, Associated Press, or United Press International. The circulation of rumors, even if accurate and reported in the media, does not constitute effective public dissemination.

In addition, even after a public announcement of material information, a reasonable period must elapse in order for the market to react to the information. Generally, one should allow approximately four full trading days following publication as a reasonable waiting period before such information is deemed to be public. Therefore, if an announcement is made before the commencement of trading on a Monday, an employee may trade in Company Securities starting on Friday of that week, because four full trading days would have elapsed by then (all of Monday through Thursday). If the announcement is made on Monday after trading begins, employees may not trade in Company Securities until the following Monday. If the announcement is made on Friday after trading begins, employees may not trade in Company Securities until Friday of the following week.

Who is a “Related Person”?

For purposes of this Policy, a Related Person includes your spouse, minor children, and anyone else living in your household; partnerships in which you are a general partner; trusts of which you are a trustee; estates of which you are an executor; and other equivalent legal entities that you control. Although a person’s parent or sibling may not be considered a Related Person (unless living in the same household), a parent or sibling may be a “tippee” for securities laws purposes. See [Guidelines – Tipping Information to Others](#) below for a discussion on the prohibition on “tipping.”

GUIDELINES

Non-disclosure of Material Nonpublic Information

Material, nonpublic information must not be disclosed to anyone, except the persons within the Company or third-party agents of the Company (such as investment banking advisors or outside legal counsel) whose positions require them to know it, until such information has been publicly released by the Company.

Prohibited Trading in Company Securities

No person may place a purchase or sell order or recommend that another person place a purchase or sell order in Company Securities (including initial elections, changes in elections or reallocation of funds relating to 401(k) plan accounts) when he or she has knowledge of material information concerning the Company that has not been disclosed to the public. Loans, pledges, gifts, charitable donations, and other contributions of Company Securities are also subject to this Policy.

Twenty-Two Hindsight

If securities transactions ever become the subject of scrutiny, they are likely to be viewed after-the-fact with the benefit of hindsight. As a result, before engaging in any transaction an insider should carefully consider how his or her transaction may be construed in the bright light of hindsight. Again, in the event of any questions or uncertainties about the Policy, please consult the Company’s Chief Financial Officer or someone that he or she has delegated responsibility for advising of the Policy.

“Tipping” Information to Others

Insiders may be liable for communicating or tipping material nonpublic information to any third party (“tippee”), not limited to just Related Persons. Further, insider trading violations are not limited to trading or tipping by insiders. Persons other than insiders also can be liable for insider trading, including tippees who trade on material, nonpublic information tipped to them and individuals who trade on material, nonpublic information which has been misappropriated.

Tippees inherit an insider’s duties and are liable for trading on material, nonpublic information illegally tipped to them by an insider. Similarly, just as insiders are liable for the insider trading of their tippees, so are tippees who pass the information along to others who trade. In other words, a tippee’s liability for insider trading is no different from that of an insider. Tippees can obtain material, nonpublic information by receiving overt tips from others or through, among other things, conversations at social, business, or other gatherings.

Avoid Speculation

Directors, officers and employees, and their Related Persons may not trade in options, warrants, puts and calls or similar instruments on Company Securities or sell Company Securities “short.” In addition, directors, officers and employees, and their Related Persons may not hold Company Securities in margin accounts. Investing in Company Securities provides an opportunity to share in the future growth of the Company. Investment in the Company and sharing in the growth of the Company, however, does not mean short-range speculation based on fluctuations in the market. Such activities may put the personal gain of the director, officer, or employee in conflict with the best interests of the Company and its security holders. Anyone may, of course, in accordance with this Policy and other Company policies, exercise options granted to them by the Company.

Trading in Other Securities

No director, officer or employee may place purchase or sell orders or recommend that another person place a purchase or sell order in the securities of another company if the person learns of material, nonpublic information about the other company in the course of his/her employment with Telkonet Inc.

Blackout Periods

Telkonet Inc. prohibits directors, officers, employees, and consultants who have access to material nonpublic information about the Company from buying and selling the Company’s securities during certain periods. These persons will be prohibited from buying and selling Telkonet Inc. securities during the period beginning on the last day of each fiscal quarter and ending the day Telkonet Inc.’s quarterly report for such quarter (or annual report in the case of Telkonet Inc.’s fourth fiscal quarter) is released to the public. If a material event occurs outside this blackout period, the Company will consider imposing an event-specific blackout period while the event remains material and nonpublic.

Additional Restrictions and Requirements for Directors and “Officers” Trading Window.

In addition to being subject to all the other limitations in this Policy, directors and members of the Company’s Executive Leadership Team may only buy or sell Company Securities in the public market during the period beginning four full trading days after the release of the Company’s quarterly earnings and ending one calendar month prior to the end of the next fiscal quarter.¹

Pre-Clearance

Directors and Officers of the Company (as such term is defined pursuant to Section 16 of the Securities Exchange Act, as amended) must obtain prior clearance from the Company’s Chief Financial Officer, or his or her designee, before he, she or a Related Person makes any purchases or sales of Company Securities, including any exercise of stock options. Prior clearance is required for all purchases or sales. Each proposed transaction will be evaluated to determine if it raises insider trading concerns or other concerns under the federal or state securities laws and regulations. Any advice will relate solely to the restraints imposed by law and will not constitute advice regarding the investment aspects of any transaction. Clearance of a transaction is valid only for a 48-hour period. If the transaction order is not placed within that 48-hour period, clearance of the transaction must be re-requested. If clearance is denied, the fact of such denial must be kept confidential by the person requesting such clearance.

Prohibition on Selling Stock Acquired by Option Exercise

Officers are prohibited from selling Company stock acquired by exercising stock options until such Officer is in compliance with the Company’s stock ownership requirement. Notwithstanding the preceding sentence, Officers may immediately sell Company stock acquired by exercising stock options for the limited purposes of paying the exercise price of the stock option and any applicable tax liability.

¹ The securities laws allow for specific safe harbors from insider trading liability, such as a written trading plan pursuant to Rule 10b5-1(c) of the Exchange Act, the potential availability of which may also be discussed when obtaining prior clearance from the Chief Financial Officer.

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements of Telkonet, Inc. on Forms S-8 (Nos. 333-161909 and 333-175737) of our report dated March 31, 2023, relating to the financial statements of Telkonet, Inc. for the year ended December 31, 2022, appearing in this Annual Report on Form 10-K.

Wipfli LLP

Wipfli LLP
Minneapolis, Minnesota March 31, 2023

CERTIFICATIONS

I, Piercarlo Gramaglia, certify that:

1. I have reviewed this annual report on Form 10-K of Telkonet, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2023

By: /s/ Piercarlo Gramaglia
Piercarlo Gramaglia
Chief Executive Officer

CERTIFICATIONS

I, Richard E. Mushrush, certify that:

1. I have reviewed this annual report on Form 10-K of Telkonet, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2023

By: /s/ Richard E. Mushrush
Richard E. Mushrush
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Telkonet, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2022 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Piercarlo Gramaglia, Chief Executive Officer of Telkonet, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Piercarlo Gramaglia
Piercarlo Gramaglia
Chief Executive Officer
March 31, 2023

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Telkonet, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2022 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Richard E. Mushrush, Chief Financial Officer of Telkonet, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard E. Mushrush
Richard E. Mushrush
Chief Financial Officer
March 31, 2023