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PART I

ITEM 1. BUSINESS

When used in this Form 10-KSB, the words "expects," "anticipates," "estimates" and similar expressions are intended to identify forward-looking statements. Such statements are subject to risks and uncertainties, including those set forth below under "Risks and Uncertainties," that could cause actual results to differ materially from those projected. These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any statement is based. This discussion should be read together with the financial statements and other financial information included in this Form 10-KSB.

General

Telkonet is a high technology systems application developer with a primary focus on high speed Internet distribution over the electrical power lines for the commercial and the multi-dwelling residential markets. Telkonet, Inc. (hereinafter "The Company", "Telkonet" and "TCI"), a development stage company, was incorporated on November 1999 under the laws of the State of Utah. Its Articles of Incorporation provided for authorized capital of One hundred million (100,000,000) shares of Common Stock, par value \$0.001.

In 1999, Telkonet Communications, Inc. was formed to develop applications for the emerging power line carrier technologies. On August 30th, 2000, a Utah Corporation formerly known as Comstock Coal Company, Inc. was merged into Telkonet, Inc., NASDAQ - (OTCBB:"TLKO"), which as of December 31, 2001 has 22 million shares of common stock outstanding. Telkonet Communications, Inc. is a wholly owned subsidiary of Telkonet, Inc. As of March 5, 2002 there were 13,179,127 outstanding shares as referenced in Item# 12.

There have been no bankruptcy, receiverships, or similar proceedings by or

against the Company. There has been no material reclassification, merger, consolidation, or purchase or sale of any significant asset(s).

The Company's principal executive offices are located at: 902 A Commerce Road Annapolis, Maryland 21401.

Business History

The Company was formed to design and develop high technology applications with a primary focus on high speed Internet distribution over the electrical power lines. Telkonet believes that utilizing the power line to deliver Internet and telephony connectivity for the commercial and the multi-dwelling residential markets creates a significant and definitive niche market opportunity for the Company.

Telkonet's solutions overcome many of the difficulties associated with power-line communications that historically have prevented the achievement of high data transmission rates.

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Because the existing power line is the most ubiquitous wired network in the home, or business, service providers and consumers can now avoid the expense, time and inconvenience of installing new wiring. Consumers can achieve reliable, secure communications simply by plugging our devices into their existing standard electrical outlets.

In July 2001, the Company announced that it has completed the initial product development phase of their proprietary communications system, which utilizes the existing electrical wiring infrastructure in residential and commercial buildings for Internet connectivity. The Telkonet System receives the Internet signal in the traditional manner from either a standard telephone line, DSL line or from a satellite connection at your home or office. The telephone line or satellite cable connection is then plugged into the Telkonet Gateway, a small appliance not much larger than a box of cereal that is attached to the electrical system. Once the installation of the Gateway is complete the Internet signal is transmitted over the existing electrical wiring to every standard electrical outlet in the building. To access the Internet the user simply plugs the Telkonet PlugFast Terminal (the size of a standard modem) into any electrical outlet and then plugs the computer into the Terminal for clear connectivity at whatever speeds are offered by the users Internet Service Provider.

In August 2001, the Company announced that successful system tests were recently performed in the Washington D.C. metropolitan area, where Telkonet's PlugFast connectivity solution was demonstrated in a 28-unit residential apartment building and a 5-story commercial office building. Clear and unrestricted high-speed data connectivity was successfully achieved from the basements to the farthest receptacles on the top floors.

In concert with previous testing, early in the second quarter of 2002, Telkonet is readying for the deployment and field testing of the initial final components of the entire systems architecture with early adopters and potential customers who have indicated interest in utilizing the Telkonet PlugFast solution for a variety of installations, both commercial and multi-dwelling residential. The company sees this interest as validation of its offerings, and looks forward to the potential of acquiring these candidates as customers.

Telkonet Communications, Inc. is now at a point in the Company's business development cycle where the system requirements and hardware have been developed, and the Company is ready to bring to market their suite of PlugFast products for high-speed Internet access. Telkonet has successfully demonstrated the viability of the PlugFast solution, and the Company is now aggressively moving toward finalizing testing, manufacturing arrangements, and executing a marketing and sales initiative.

The Company has applied for patents that cover its unique technology, and intends to utilize recently announced advancements in transmission speeds to build next generation devices for field tests and marketing demonstrations.

The Company continues to identify, design and develop enhancements to its core technologies that will provide additional functionality, diversification of application and desirability for current and future users. It is the intent of the Company to protect this Intellectual Property by filing additional Patent applications.

TCI's technology will be licensed or sold to strategic customers and partners with vertical markets where TCI's products and services satisfy the demand for communication services.

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TCI has developed working prototypes for products designed to provide telephony services and Internet connectivity through transmission over existing electrical power line networks.

As Internet access becomes a more critical tool, the demand for higher access speeds has triggered the growth of broadband solutions, and as these roll out, the desire for access to these emerging broadband networks provides opportunities for Telkonet. The built-in dial-up modems that have become a part of most new PCs are not suitable for higher speed connections. Hardwired network connections with high construction costs and disruption of the workplace, or complex wireless networks which have coverage and security issues are the only solutions available today.

The Telkonet PlugFast family of Internet access products provides a viable and cost effective alternative to the challenges of hardwired and wireless LANs.

This solution set is comprised of two products, the PlugFast Gateway and the PlugFast Terminal. The Telkonet PlugFast Gateway and Terminal are aimed at multi-user applications such as residential apartment complexes, hotels and motels, and a variety of small and medium businesses types. High-speed Internet connections are becoming widely available and providers of these pipelines are anxious to fill them up with customers. Several companies now specialize in providing T1 access in addition to the offerings from most telephone companies in the form of DSL products. Microwave networks, 2-way Satellite, Fiber and Cable connections are also being offered but share in the same problem: getting the access to where the customers want it.

The Telkonet solution interfaces to the backbone of the Internet by taking the signal from any of these broadband sources and, through the Telkonet PlugFast Gateway, distributes access to the Internet to the ultimate user over the existing electrical wiring in the building. With the Gateway in place, access is provided by simply plugging the user's Telkonet PlugFast Terminal into the nearest standard electrical outlet. Any existing electrical outlet in the structure can provide immediate access to the Internet via a Telkonet PlugFast Terminal. Moving the location of a PC, server, or printer is accomplished by simply moving the PlugFast Terminal to another electrical outlet. No additional wiring is required and changes can be made quickly and easily.

The current generation of the Telkonet PlugFast system delivers data at speeds in excess of 7 Mega bits per second (Mbps), with burst speeds of 12.6 Mbps. The Telkonet PlugFast Gateway provides the connection to the incoming broadband signal (DSL, TL, Satellite, Cable Modem) and the Telkonet PlugFast Terminal connects to a user device. Many PCs, each equipped with one Telkonet PlugFast Terminal, can communicate amongst themselves and can share a single broadband resource via the Telkonet PlugFast Gateway.

Business Development

Telkonet is a high technology systems application developer with a primary focus on high speed Internet distribution over the electrical power lines for the commercial and the multi-dwelling residential markets. We have designed and constructed our third generation of powerline communication products to provide high speed Internet access to office buildings, hotels, schools, shopping malls, commercial buildings, and multi-dwelling units. These products provide connectivity over the existing electrical wiring and do not require the addition of costly wiring, or major disruption to business activity. In many situations the Telkonet system can be implemented more quickly and less expensively than adding dedicated wiring or installing wireless systems.

The Company believes that through extensive research and development, it has refined a business model that will provide marketable Internet services across a wide spectrum of commercial and business end users. Initial prototype versions of the Telkonet product have undergone successful field-testing in both commercial and multi-dwelling residential markets. Beta units are currently in production and select commercial and multi-dwelling residential locations will receive operational products for beta testing early in the second quarter of 2002.

Marketing Strategy

Telkonet intends to become a key global supplier of power line communications products into the commercial marketplace. Target markets for Telkonet include malls, shopping centers, office buildings and parks, high-rise offices, light-industrial multi-use commercial space, hotels and motels, schools, government facilities, and any other commercial facilities that have a need for Internet access and network connectivity.

Key Telkonet Communications Advantages:

- o Convenience of using every ordinary electrical outlet in the building or dwelling to provide Internet access.
- o No special cabling or expensive wiring required for hotels, office buildings or multi-dwelling residential complexes to provide Internet connection.
- o Avoids interruption of business, tenant, or guest activities due to new wiring installation activities.
- o Easy, instant installation enables "try-before-you-buy" model for our channel partners.

The Company will market its products principally through service providers and network system integrators who already use a variety of network technologies and have an established customer base. Virtually every large systems integrator and property management company that we have met with as part of our marketing efforts has immediately identified properties and situations that are ideal for the Telkonet approach. Our products will allow them to reach whole new classes of users, enhance their property offerings, and ultimately provide a vehicle for incremental revenue. We will continue to examine, select and approach entities with existing distribution channels that will be enhanced by the Telkonet offerings. Several DSL, fiber and satellite access providers have indicated significant interest with demonstrations and technical discussions underway.

Underserved and Rural Areas, ("The Digital Divide") are market segments that represent additional opportunities for creating sales and product recognition. The Telkonet solution includes strategic relationships with Internet Service Providers who can access underserved and rural locations. Telkonet has begun discussions with major providers of VSAT/ISP products and services regarding the domestic introduction of the Internet product designed for multi-users that would be compatible with and complimentary to this solution. Telkonet will continue to target and develop relationships with Internet Service Providers (ISP's) who can provide service to these and other clients.

According to the 1999 American Housing Survey conducted by HUD and the Bureau of the Census, the multi-family dwelling sector consists of 28,439,000 housing units, of which 18,543,000 are grouped into properties of 5 or more units. Research groups such as Dataquest and Forrester Research predict a rapid expansion of broadband Internet, most expecting 10% of residences to install high-speed access by 2002. They estimate that currently less than 50% of the population is currently within the service area of a high-speed access provider. The Telkonet model is particularly appealing to apartment owners or condominium service companies. In these under-serviced areas, bringing in a Satellite, Fiber link or fixed wireless access and distributing it can provide a very lucrative opportunity. The use of powerline technologies eliminates the major cost, time

delay and risk of wiring existing buildings for data. The potential market for a Telkonet type solution in this area alone could exceed 2 million units in the next 2 years.

Additional Marketing Opportunities exist in Europe, South America, Asia and Pac Rim where the Internet is available. Access to the Internet is restricted in some developing countries by the limitation of the infrastructure of the basic Public Service Telephone Network and the pricing methodology of charging the user for every minute that the user is on line. The Telkonet solution would allow economical access to the Internet by simply bypassing the per-minute charge to the user when implemented in conjunction with a 2-way satellite link, dedicated landline or fixed wireless access.

Competition

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Several established networking vendors, including Linksys and Netgear, have planned and/or announced Powerline Communications products that are compliant with the Homeplug alliance. Both Linksys and Netgear are focused on products for the home and residential marketplace. While these companies may choose to move into the commercial market at a future date, at this time they do not represent a direct threat to Telkonet. Telkonet is specifically focused on the needs of the business customer where issues like security, support for greater distances, a larger number of users, and enhanced network management preclude the use of a product developed to suit the home market. Telkonet therefore finds these potential competitors to actually be complementary in nature and a validation of the viability of the powerline communications market overall.

Employees

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Currently, the Company has 8 full time employees. Additional key staff is planned in the areas of business development, marketing, and engineering.

Government Regulations

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The FCC regulates RF emission levels for all electrical equipment. The silicon providers to the powerline industry are currently completing FCC certification testing of the devices that they will provide Telkonet and will make any changes necessary to their devices that the testing will mandate. No related problems are anticipated.

Raw Materials

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The Company does not rely on any one or more raw materials or raw material suppliers for the normal course of business. The Company has developed relationships with a cross-section of qualified and quality providers of

components and parts necessary for the Company's product line, and uses multiple vendors for certain items dependent on internal purchasing criteria, inclusive of price, delivery schedule and specification evaluation.

Intellectual Property

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From the Company's inception, Telkonet has continued to pursue the perfection of its technology and enhance its core technological values. The company believes they have developed certain Intellectual Property and have filed both provisional and standard patent applications with the United States Patent and Trademark Office.

There can be no assurance that any of the Company's current or future patent applications will be granted, or will provide necessary protection for the Company's technology or their product offerings, or be of commercial benefit to the Company, or that these patent applications will not be challenged.

Customers

The Company currently does not rely on one or a few customers to continue business nor does the Company believe such a dependency shall evolve in the future for the Company. Potential customers include: 1) General Use applications such as multi-occupant residences, businesses, office buildings, schools and universities, to provide basic service or as a revenue generator for the building owner. 2) Hotels- for fast economically favorable rollout of Internet access offerings to guests as a revenue generator, at low capital cost. 3) Any Location world-wide with limited telecom infrastructure, through Satellite link 4) Europe, South America, Asia and Pac Rim - to avoid per minute tariff structures

ITEM 2. PROPERTIES

The Company currently leases office space at 902A Commerce Drive, Annapolis, MD 21401, which occupies approximately 3,000 square feet of designated office space, designed to provide short term/temporary accommodation solution to emerging and growing businesses. The facility allows businesses to lease spaces on a short-term or project basis. These office quarters are adequate for the immediate short term. The Company anticipates the need for additional office space in conjunction with the projected personnel requirements in the business plan.

- (a) Real Estate- None
- (b) Computer and Office Equipment- \$75,000

ITEM 3. LEGAL PROCEEDINGS

The Company is not a party to any legal proceedings.

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Matters submitted during the fiscal year covered by this report to a vote of security holders of the Company, through the solicitation of proxies consisted of the annual election of Directors and the appointment of independent accountants at the annual shareholders meeting held on Friday June 8th, 2001.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

- (a) The Company's Common Shares are currently quoted on NASDAQ -Over The Counter Bulletin Board market under the ticker symbol (OTCBB:"TLKO").
- (b) As of December 31, 2001, the Company had approximately 126 shareholders of record of the common stock.
- (c) No dividends on outstanding common stock have been paid within the last two fiscal years, and interim periods. The Company does not anticipate or intend upon paying dividends for the foreseeable future.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion contains forward-looking statements that are subject to significant risks and uncertainties. There are several important factors that could cause actual results to differ materially from historical results and percentages and results anticipated by the forward-looking statements. The Company has sought to identify the most significant risks to its business, but cannot predict whether or to what extent any of such risks may be realized nor can there be any assurance that the Company has identified all possible risks that might arise. Investors should carefully consider all of such risks before

making an investment decision with respect to the Company's stock. In particular, investors should refer to the section entitled, "Factors that May Affect Future Results and Market Price of Stock".

Plan of Operation

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The Company is still in the development stage and is yet to earn revenues from operations. The Company may experience fluctuations in operating results in future periods due to a variety of factors including, but not limited to, market acceptance of the Internet and power line communication technologies as a medium for customers to purchase the Company's products, the Company's ability to acquire and deliver high quality products at a price lower than currently available to consumers, the Company's ability to obtain additional financing in a timely manner and on terms favorable to the Company, the Company's ability to successfully attract customers at a steady rate and maintain customer satisfaction, Company promotions, branding and sales programs, the amount and timing of operating costs and capital expenditures relating to the expansion of

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the Company's business, operations and infrastructure and the implementation of marketing programs, key agreements and strategic alliances, the number of products offered by the Company, the number of returns experienced by the Company, and general economic conditions specific to the Internet, power-line communications, and the communications industry.

Revenues

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The Company has generated no revenues from operations from its inception. The Company believes it will begin earning revenues from operations within the next twelve months as it transitions from a development stage company to that of an active growth and acquisition stage company.

On October 3, 2000 the Company entered into a Sales/Marketing Agreement with Medical Advisory Systems, Inc. (MAS) (AMEX:DOC) that provides for MAS to perform international business development, marketing (including demographic analysis), and sales/support services for the Company's products and services through an international network of call centers owned by CORIS Group International of Paris, France. Through its agreement with CORIS, MAS may market the Company's power-line technology in up to 38 countries located on six continents. This geographic focus would include all the former Soviet Republics in Eastern Europe where the need for basic telephony exists for most rural citizens. Also, MAS through CORIS would provide legal, business, regulatory and technical consulting for countries targeted by the Company where CORIS is positioned. CORIS would make introductions with other potential partners for the Company for the purpose of increasing the scope and deployment of its power-line technology. The Company would reimburse CORIS for all costs associated with pursuing the agreed upon services plus an administrative fee for sales contracts that are successfully completed on behalf of the Company.

Private Placements 2001

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In June 2001, the Company initiated a Private Placement raising \$150,000 in funds from private investors. The offering consisted of Investment Units translating to one (1) share of Common Stock at \$.50, and one (1) Warrant to purchase 1/2 a share of the Common Stock of the Company at any time on or before the date which occurs three (3) years from the date of issuance of the Warrant at an exercise price of \$1.00 per share, by the payment of the exercise price in cash. The offering was terminated per the offering documents on June 30, 2001.

In August of 2001, the Company initiated a Private Placement through Attkisson Carter & Co., raising \$818,000, net of costs. The offering of investment Units consisted of a convertible debenture accruing interest at 8% per annum, payable quarterly, and warrants a to purchase one share of the Common Stock. The Debentures may be converted to shares of Common Stock at any time after the date which occurs six (6) month following the date of issuance up to the maturity by the holder at a price of Fifty Cents (\$.50) per share. The warrants are warrants to purchase the Common Stock of the Company at any time on or before the date

which occurs (3) years from the date of issuance of the Warrant at an exercise price of \$1.00 per share, either by payment of the exercise price in cash or a cashless exercise. The Company paid Attkisson Carter & Co., acting as the Company's placement agents a fee consisting of: a) a retainer of \$25,000 payable from the first funds received, b) a commission equal to 8% of the selling price for each Unit, c) an investment banking fee of 2% of the selling price of each Unit, and d) warrants for the purchase of Common Stock in a number equal to twenty (20%)

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multiplied by the aggregate selling price for each unit sold, with an exercise price of \$.525 per share, with allowance for a cashless exercise of the Warrant. As of December 31, 2001, Company was still accepting subscription agreements for additional financing, from the debenture prospectus, which was scheduled to terminate as of March 30, 2002 unless extended by the Company.

Costs and expenses

From its inception on November 3, 1999 through December 31, 2001, the Company has not generated any revenues. The Company has incurred expenses of \$2,969,833 during this period. These expenses were associated principally with compensation to employees, product development costs and professional services.

Liquidity and Capital Resources

As of December 31, 2001, the Registrant had a deficiency in working capital \$502,356. As a result of the Company's operating losses from its inception through December 31, 2001, the Registrant generated a cash flow deficit of \$2,047,440 from operating activities. Cash flows used in investing activities was \$54,950 during the period November 3, 1999 through December 31, 2001. The Company met its cash requirements during this period through the private placement of \$818,000, net of costs of convertible debentures, the sale of the Company's common stock of \$898,986, net of costs and bank loan proceeds of \$400,000.

While the Company has raised capital to meet its working capital and financing needs in the past, additional financing is required in order to meet the Company's current and projected cash flow deficits from operations and development. The Company is seeking financing in the form of equity in order to provide the necessary working capital. The Company currently has no commitments for financing. There are no assurances the Company will be successful in raising the funds required.

The Company's independent certified public accountants have stated in their report included in this Form 10-KSB, that the Company has incurred operating loss losses from its inception, and that the Company is dependent upon management's ability to develop profitable operations. These factors among others, may raise substantial doubt about the Company's ability to continue as a going concern.

Product Research and Development

Company-sponsored research and development costs related to both present and future products are expended in the period incurred. Total expenditures on research and product development for the period November 3, 1999 (date of inception) through December 31, 2001 were approximately \$279,115.

The current generation of the Telkonet PlugFast system delivers data at speeds in excess of 7 Mega bits per second (Mbps), with burst speeds of 12.6 Mbps. The Telkonet PlugFast Gateway provides the connection to the broadband connection (DSL, TL, Satellite, Cable Modem) and the Telkonet PlugFast Terminal connects to a user device. Many PCs, each equipped with one Telkonet PlugFast Terminal, can communicate amongst themselves and can share a single expensive broadband resource via the single Telkonet PlugFast Gateway.

Acquisition or Disposition of Plant and Equipment

The Company does not anticipate the sale of any significant property, plant or equipment during the next twelve months. The Company does not anticipate the acquisition of any significant property, plant or equipment during the next 12 months, other than computer equipment and peripherals used in the Company's day-to-day operations. The Company believes it has sufficient resources available to meet these acquisition needs.

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Number of Employees

As of March 5, 2002, the Company had five (8) full time employees. In order for the Company to attract and retain quality personnel, the Company anticipates it will continue to offer competitive salaries to current and future employees. The Company anticipates increasing its employment base to meet the needs outlined in the business plan.

As the Company continues to expand, the Company will incur additional costs for personnel. This projected increase in personnel is dependent upon the Company generating revenues and obtaining sources of financing. There are no assurances the Company will be successful in raising the funds required or generating revenues sufficient to fund the projected increase in the number of employees.

Trends, Risks and Uncertainties

The Company has sought to identify what it believes to be the most significant risks to its business, but cannot predict whether or to what extent any of such risks may be realized nor can there be any assurances that the Company has identified all possible risks that might arise. Investors should carefully consider all of such risk factors before making an investment decision with respect to the Company's stock.

Limited operating history; Anticipated Losses; Uncertainty of Future Results.

Telkonet has only a limited operating history upon which an evaluation of the Company and its prospects can be based. The Company's prospects must be evaluated with a view to the risks encountered by a company in an early stage of development, particularly in light of the uncertainties relating to the new and evolving distribution methods with which the Company intends to operate and the acceptance of the Company's business model. The Company will be incurring costs to develop, introduce and enhance its interactive website, to establish marketing relationships, to acquire and develop products that will compliment each other and to build an administrative organization. To the extent that such expenses are not subsequently followed by commensurate revenues, the Company's business, results of operations and financial condition will be materially adversely affected. There can be no assurance that the Company will be able to generate sufficient revenues from the sale of their first product suite, and other product candidates. The Company expects negative cash flow from operations to continue for the next 12 months as it continues to develop and market its business. If cash generated by operations is insufficient to satisfy the Company's liquidity requirements, the Company may be required to sell additional equity or debt securities. The sale of additional equity or convertible debt securities would result in additional dilution to the Company's stockholders.

Potential fluctuations in quarterly operating results

The Company's quarterly operating results may fluctuate significantly in the future as a result of a variety of factors, most of which are outside the Company's control, including: the level of use of the Internet; the demand for high-tech goods; seasonal trends in both Internet use, the amount and timing of

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capital expenditures and other costs relating to the expansion of the Company's

Internet operations; price competition or pricing changes in the industry; technical difficulties or system downtime; general economic conditions, and economic conditions specific to the Internet and Communications Industry. The Company's quarterly results may also be significantly impacted by the impact of the accounting treatment of acquisitions, financing transactions or other matters. Particularly at the Company's early stage of development, such accounting treatment can have a material impact on the results for any quarter. Due to the foregoing factors, among others, it is likely that the Company's operating results will fall below the expectations of the Company or investors in some future quarter.

Limited public market, possible volatility of share price

The Company's Common Stock is currently quoted on the NASDAQ - (OTCBB:"TLKO") As of December 31, 2001, there were approximately 22,115,371- shares of Common Stock outstanding. As of March 5, 2002 there were 13,179,127 outstanding shares as referenced in Item# 12. Telkonet Communications, Inc. is a wholly owned subsidiary of Telkonet. There can be no assurance that a trading market will be sustained in the future. Factors such as, but not limited to, technological innovations, new products, acquisitions or strategic alliances entered into by the Company or its competitors, failure to meet security analysts' expectations, government regulatory action, patent or proprietary rights developments, and market conditions for technology stocks in general could have a material effect on the volatility of the Company's stock price.

Recent Accounting Pronouncements

In March 2000, the FASB issued interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25". FIN 44 clarifies the application of APB No. 25 for (a) the definition of employee for purposes of applying APB No. 25, (b) the criteria for determining whether a plan qualifies as a noncompensatory plan, (c) the accounting consequences of various modifications to previously fixed stock option or award, and (d) the accounting for an exchange of stock compensation awards in a business combination. FIN 44 is effective July 2, 2000 but certain conclusions cover specific events that occur after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have an effect on the Company's financial statements but may impact the accounting for grants or awards in future periods.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, Business Combinations (FAS 141), and FAS 142, Goodwill and Other Intangible Assets (FAS 142). FAS 141 addresses the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. FAS 142 addresses the initial recognition and measurement of intangible assets acquired outside of a business combination, whether acquired individually or with a group of other assets, and the accounting and reporting for goodwill and other intangibles subsequent to their acquisition. These standards require all future business combinations to be accounted for using the purchase method of accounting. Goodwill will no longer be amortized but instead will be subject to impairment tests at least annually. The Company is required to adopt FAS 141 and FAS 142 on a prospective basis as of January 1, 2002; however, certain provisions of these new standards may also apply to any acquisitions concluded subsequent to June 30, 2001. As a result of implementing these new standards, the Company will discontinue the amortization

of goodwill as of December 31, 2001. The Company does not believe that the adoption of FAS 141 or 142 will have a material impact on its consolidated financial statements.

In October 2001, the Financial Accounting Standards Board issued FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144). FAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes FAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" (FAS 121) and related literature and establishes a single accounting model, based on the framework established in FAS 121, for long-lived assets to be

disposed of by sale. The Company is required to adopt FAS 144 no later than January 1, 2002. The Company does not believe that the adoption of FAS 144 will have a material impact on its consolidated financial statements.

Risk Factors that may affect future results and market price of stock

The business of the Company involves a number of risks and uncertainties that could cause actual results to differ materially from results projected in any forward-looking statement, or statements, made in this report. These risks and uncertainties include, but are not necessarily limited to the risks set forth below. The Company's securities are speculative and investment in the Company's securities involves a high degree of risk and the possibility that the investor will suffer the loss of the entire amount invested.

LIMITED OPERATING HISTORY; ANTICIPATED LOSSES; UNCERTAINTY OF FUTURE RESULTS

The Company was organized in 1997, and has no operating history upon which an evaluation of its business and prospects can be based. The Company's prospects must be evaluated with a view to the risks encountered by a company in an early stage of development, particularly in light of the uncertainties relating to the acceptance of the Company's business model. The Company will be incurring costs to develop and market its IT solutions, to establish marketing relationships, and to build an administrative organization. There can be no assurance that the Company will be profitable on a quarterly or annual basis. In addition, as the Company expands its business network and marketing operations it will likely need to increase its operating expenses, broaden its customer support capabilities, and increase its administrative resources. To the extent that such expenses are not subsequently followed by commensurate revenues, the Company's business, results of operations and financial condition will be materially adversely affected.

POSSIBLE NEED FOR ADDITIONAL FINANCING

It is possible that revenues from the Company's operations may not be sufficient to finance its initial operating cost to reach breakeven. If this were to occur, the Company would need to raise or find additional capital. While the Company expects to be able to meet its financial obligations for approximately the next twelve months, there is no assurance that, after such period, the Company will be operating profitably. If they are not, there can be no assurance that any required capital would be obtained on terms favorable to the Company. Failure to obtain adequate additional capital on favorable terms could result in significant delays in the expansion of new services and market share and could even result in the substantial curtailment of existing operations and services to clients.

UNPREDICTABILITY OF FUTURE REVENUES; POTENTIAL FLUCTUATIONS IN QUARTERLY RESULTS.

As a result of the Company's lack of operating history and the emerging nature of the market in which it competes, the Company is unable to forecast its revenues accurately. The Company's current and future expense levels are based largely on its investment/operating plans and estimates of future revenue and are to a large extent based on the Company's own estimates. Sales and operating results generally depend on the volume of, timing of, and ability to obtain customers, orders for services received, and revenues therefrom generated. These are, by their nature, difficult at best to forecast.

The Company may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall or delay. Accordingly, any significant shortfall or delay in revenue in relation to the Company's planned expenditures would have an immediate adverse effect on the Company's business, financial condition, and results of operations. Further, in response to changes in the competitive environment, the Company may from time to time make certain pricing, service, or marketing decisions that could have a material adverse effect on the Company's business, financial condition, operating results, and cash flows.

DEVELOPING MARKET; ACCEPTANCE OF THE INTERNET AS A MEDIUM FOR COMMERCE JUST NOW BEING PROVEN.

The Company's long-term viability is substantially dependent upon the continued widespread acceptance and use of the Internet as a medium for business commerce, in terms of the sales of both products and services to businesses and individuals. The use of the Internet as a means of business sales and commerce is has only recently reached a point where many companies are making reasonable profits from their endeavors therein, and there can be no assurance that this trend will continue.

The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and amount of traffic. There can be no assurance that the Internet infrastructure will continue to be able to support the demands placed on it by this continued growth. In addition, delays in the development or adoption of new standards and protocols to handle increased levels of Internet activity or increased governmental regulation could slow or stop the growth of the Internet as a viable medium for business commerce. Moreover, critical issues concerning the commercial use of the Internet (including security, reliability, accessibility and quality of service) remain unresolved and may adversely affect the growth of Internet use or the attractiveness of its use for business commerce.

The failure of the necessary infrastructure to further develop in a timely manner, or the failure of the Internet to continue to develop rapidly as a valid medium for business would have a material adverse effect on the Company's business, financial condition, operating results, and cash flows.

UNPROVEN ACCEPTANCE OF THE COMPANY'S SERVICES AND/OR PRODUCTS

The Company is still in its development stage. As a result, it does not know with any certainty whether its services and/or products will be accepted within the business marketplace. If the Company's services and/or products prove to be unsuccessful within the marketplace, or if the Company fails to attain market acceptance, it could materially adversely affect the Company's financial condition, operating results, and cash flows.

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DEPENDENCE ON KEY PERSONNEL

The Company's performance and operating results are substantially dependent on the continued service and performance of its officer and directors. The Company intends to hire additional technical, sales, and other personnel as they move forward with their business model. Competition for such personnel is intense, and there can be no assurance that the Company can retain its key technical employees, or that it will be able to attract or retain highly qualified technical and managerial personnel in the future. The loss of the services of any of the Company's key employees or the inability to attract and retain the necessary technical, sales, and other personnel could have a material adverse effect upon the Company's business, financial condition, operating results, and cash flows. The Company does not currently maintain "key man" insurance for any of its key employees.

DEPENDENCE ON THE INTERNET

Online companies have experienced interruptions in their services as a result of outages and other delays occurring due to problems with the Internet network infrastructure, disruptions in Internet access provided by third-party providers or failure of third party providers to handle higher volumes of user traffic. If Internet usage grows, the Internet infrastructure or third-party service providers may be unable to support the increased demands which may result in a decline of performance, reliability or ability to access the Internet. If outages or delays frequently occur in the future, Internet usage, as well as usage of the Company's Internet Web-sites, could grow more slowly or decline.

COMPETITION

The IT solutions market in which the Company will operate is very competitive. Many competitors have substantially greater, financial, technical, marketing, and distribution resources than the Company.

In all its markets, the Company competes against a large number of companies of

varying sizes and resources. There are an increasing number of competitive services and products offered by a growing number of companies. Increased competition in any service or product area may result in a loss of a client, reduction in sales revenue, or additional price competition, any of which could have a material adverse effect on the Company's operating results. In addition, existing competitors may continue to broaden their service and/or product lines and other potential competitors may enter or increase their presence in the IT solutions market, resulting in greater competition for the Company.

Most of the Company's current and potential competitors have substantially longer operating histories, larger customer bases, greater name and service recognition, and significantly greater financial, marketing, and other resources than the Company. In addition, competitors may be acquired by, receive investments from or enter into other commercial relationships with larger, well-established and well-financed companies as the use of the Internet and other online services increases. Many of the Company's competitors may be able to respond more quickly to changes in customer preferences/needs, devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing policies and devote substantially more resources to Internet site and systems development than the Company.

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It is possible that new competitors or alliances among competitors may emerge and rapidly acquire market share. Increased competition may result in reduced operating margins and/or loss of market share, either of which could materially adversely affect the Company's business, results of operations and financial condition. There can be no assurance that the Company will be able to compete successfully against current or future competitors or alliances of such competitors, or that competitive pressures faced by the Company will not materially adversely affect its business, financial condition, operating results and cash flows.

INTELLECTUAL PROPERTY RIGHTS

As part of its confidentiality procedures, the Company has entered into nondisclosure and confidentiality agreements with its key employees, and consultants and/or business partners and will limit access to and distribution of its technology, documentation, and other proprietary information.

Despite the Company's efforts to protect any intellectual property rights it may have, unauthorized third parties, including competitors, may from time to time copy or reverse-engineer certain portions of the Company's technology and use such information to create competitive services and/or products.

It is possible that the scope, validity, and/or enforceability of the Company's intellectual property rights could be challenged by other parties, including competitors. The results of such challenges before administrative bodies or courts depend on many factors, which cannot be accurately assessed at this time. Unfavorable decisions by such administrative bodies or courts could have a negative impact on the Company's intellectual property rights. Any such challenges, whether with or without merit, could be time consuming, result in costly litigation and diversion of resources, and cause service or product delays. If such events should occur, the Company's business, operating results and financial condition could be materially adversely affected.

RISKS OF TECHNOLOGY TRENDS AND EVOLVING INDUSTRY STANDARDS

The Company's success will depend on its ability to develop Information Technology solutions that will meet customers' changing requirements. The IT solutions industry is characterized by rapidly changing technology, evolving industry standards, and changes in customer need and frequent new service and product introductions. The Company's future success will depend, in part, on its ability to effectively use leading edge technologies, to continue to develop its technological expertise, to enhance its current service, to develop new products that meet changing customer preferences and to influence and respond to merging industry standards and other technological changes on a timely and cost-effective basis.

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DEPENDENCE OF LICENSED TECHNOLOGY

The Company may rely on certain technology licensed from third parties, and there can be no assurance that these third party technology licenses will be available to the Company on acceptable commercial terms or at all.

ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements attached to this Report on Form 10-KSB as pages F-1 to F-21 are incorporated herein by reference.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

(a) Directors and Officers

The following table furnishes the information concerning the Company's directors and officers as of March 5, 2002. The directors of the Company are elected every year and serve until their successors are elected and qualify.

Name	Age	Title	Term
Joseph Gregory Fowler	40	President and CEO	3 years
David Grimes	63	Outside Director	1 year
Stephen Sadle	55	Chief Operating Officer/ Director	3 years
Robert P. Crabb	54	Director/Secretary	1 year
Hugo DeCesaris	43	Director	1 year
David S. Yaney, Ph.D.	50	Chief Technical Officer	3 Years

The following table sets forth the portion of their time the Officers and Directors devote to the Company:

Joseph Gregory Fowler	100%
Stephen Sadle	100%
David S. Yaney, Ph.D.	100%
Robert P. Crabb	40%
Hugo DeCesaris	Director
David Grimes	Director

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The term of office for each director is one (1) year, or until his/her successor is elected at the Company's annual meeting and is qualified. The term of office for each officer of the Company is at the pleasure of the board of directors.

The board of directors does not have a nominating committee. Therefore, the selection of persons or election to the board of directors was neither independently made nor negotiated at arm's length.

- (b) Identification of Certain Significant Employees - The directors and executive officers of the Company handle strategic matters and critical decisions.
- (c) Family Relationships - None
- (d) Business Experience -

J. GREGORY FOWLER, PRESIDENT AND CHIEF EXECUTIVE OFFICER
Mr. Fowler has over twenty years of experience in the communications industry with proven results in engineering, business development, sales, marketing, and

management. His primary focus has been the Internet and related technologies and has distinguished himself at several industry leading network equipment manufacturers. Prior to Telkonet, Mr. Fowler was at Nortel Networks where he managed a team that successfully designed, implemented, and fielded communications solutions for service providers, growing the revenue from \$500K to over \$50M in two years. He has held similar positions at Bay Networks, Wellfleet Communications, and 3Com Corporation where he has led the design, development and deployment of IP and Ethernet based LAN and WAN solutions. Mr. Fowler holds a BS in Computer Engineering and brings significant market awareness, industry knowledge, executive leadership, and entrepreneurial skills to the Company.

DR. DAVID S. YANEY, CHIEF TECHNOLOGY OFFICER

Dr. Yaney has over twenty-four years of industry experience with proven results in engineering and product development, business development, program execution, fiscal management and decision-making. He has held senior level engineering management positions with major industry leaders including AT&T, Motorola, Allied Signal, Ultratech Stepper, and most recently 3Com, where he lead the Residential Connectivity Group's Digital Home enterprise, and was General Manager of the Consumer DSL Business Unit. While at 3Com Dr. Yaney was responsible for leading the DSL effort to generate over \$80M in annual revenue, while streamlining the product portfolio and the units cost structure by over 30%. Dr. Yaney has authored numerous publications in semiconductor fabrication technology and has been awarded three patents, and he holds a BS, MS, and PHD in electrical engineering from Rensselaer Polytechnic Institute. His insight, engineering leadership and experience in bringing new product to market are well recognized throughout the industry.

STEPHEN L. SADLE, CHIEF OPERATING OFFICER, is a co-founder of the company. From 1970-1986 Sadle co-founder and was president of a successful infrastructure construction and development company in the Washington D.C. metro area and was awarded Small Businessman of the Year in 1980. From 1986-1999 He was Vice President of Business Development and Sales for The Driggs Corporation, a major heavy and infrastructure firm interfacing with both government and the private sectors. From 1999-2000 Sadle was Vice President and General Sales Manager of Internos, a provider of web based vertical intranet applications and developed operating extranets in the transportation and construction industries. He brings significant management, contracting and entrepreneurial skills to the company.

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ROBERT P. CRABB, CORPORATE SECRETARY AND DIRECTOR. Mr. Crabb is the President and Managing Director of Susquehanna Development L.L.C. a marketing and management-consulting firm. He has over 30 years of sales, marketing and public and private corporate management experience. His entrepreneurial expertise includes public company administration, marketing consulting, and commercial and residential real estate development. Mr. Crabb's experience includes a career of sales management with MetLife.

DAVID W. GRIMES, CHAIRMAN, is a co-founder of the company. From 1963-1982 Grimes was the Senior Executive with NASA for the Delta Program, heading the \$200 Million per annum program. From 1982-1989 he was Founder and CEO of Transpace Carriers Inc., a venture to commercialize the delta launch vehicle. From 1989-1992 he was the Engineering Division Director at EER Inc., of Seabrook Maryland with responsibility for over 100 engineers and technicians on electrical mechanical and thermal tasks for Goddard Space Flight Center. From 1992-1999, Chief Engineer for Final Analysis, Inc. and led the design and development of the Low Earth Orbit constellation of 38 satellites for use in global store and forward communications. Grimes is a recognized expert in space and ground communications systems and brings this expertise to bear on the implementation of the hybrid telephony and high speed Internet technology. David Grimes is retired from daily business of the Company, however he maintains an active interest in the Company through a consulting relationship.

A. HUGO DECESARIS, DIRECTOR, Regional Vice President and Director for the Maryland Division of Washington Homes, Inc. In January of 2001, Washington Homes, Inc. became a wholly owned subsidiary of K. Hovnanian Enterprises, Inc. and is now one of the top ten homebuilders in the nation. President and Owner of Southern Maryland's largest Marina in California, Maryland and is a member of the Board of directors of MNCBIA Volume Builders Council. Mr. DeCesaris brings his expertise and insight as a successful and experienced upper level management

executive in the homebuilding industry, to the Telkonet Board of directors.

- (e) Directors Compensation- Directors who are also officers of the Registrant receive no cash compensation for services as a director.

ITEM 10. EXECUTIVE COMPENSATION

Section 16(a) of the Securities Exchange Act of 1934, as amended (The "Exchange Act"), requires the Registrant's officers and directors, and persons who own more than 10% of a registered class of the Registrant's equity securities, to file reports of ownership and changes in ownership of equity securities of the Registrant with the Securities and Exchange Commission and NASDAQ. Officers, directors and greater-than 10% shareholders are required by the Securities and Exchange Commission regulation to furnish to Registrant with copies of all Section 16(a) that they file.

Some of the officers and directors of the Company will not devote more than a portion of their time to the affairs of the Company. There will be occasions when the time requirements of the Company's business conflict with the demands of their other business and investment activities.

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Such conflict may require that the company attempt to employ additional personnel. There is no assurance that the services of such persons will be available or that they can be obtained upon terms favorable to the Company.

- (a) Cash Compensation.

Compensation paid by the Company for all services provided up to December 31, 2001 to each of its executive officers.(Long Term compensation (f&g) positions as of March 5, 2002)

<TABLE>

SUMMARY COMPENSATION TABLE OF EXECUTIVES

<CAPTION>

(a) Name and Principal Position	(b) Year	Annual Compensation			Long Term Compensation			(h) Underlying/OptiLTIP
		(c) Year (\$)	(d) Salary Compensation (\$)	(e) Bonus Awards	(f) Annual Stock	(g) Other Stock other	(h) Restricted Securities or	
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
L. Peter Larson, CEO	2000		\$130,000	\$ -	\$ -	750,000	200,000	-
David Grimes, Chairman	2000		57,000	-	-	1,250,000	160,000	-
Stephen Sadle, COO	2000		130,000	-	-	3,500,000	200,000	-
Robert P Crabb, Secretary	2000		-0-			-0-	100,000	

</TABLE>

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ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

a) Beneficial owners of five percent (5%) or greater, of the Company's common stock: No preferred stock is outstanding at the date of this offering. The following sets forth information with respect to ownership by holders of more than five percent (5%) of the Registrant's common stock known by the Registrant based upon 22,115,371 shares outstanding at December 31, 2001. As of March 5, 2002 there were 13,179,127 outstanding shares as referenced in Item# 12.

<TABLE>

<CAPTION>

Title of Class	Name and Address of Beneficial Owner	Amount of Beneficial Interest	Percent of Class
<S>	<C>	<C>	<C>
Common	David Grimes, 1621 John Ross Lane, Crownsville MD	5,071,918	23.0 %
Common	Stephen Sadle, 1200 John Ross Court, Crownsville, MD	5,842,695	26.0 %
Common	Donald Erat, 13700 Canal Vista Court, Potomac, MD	2,861,347	13.0 %
Common	L. Peter Larson, 125 Spa View Ave, Annapolis, MD	1,625,285	6.8 %
Common	Ron Pickett, 2321 Ocean Point Drive, Wilmington, NC	2,058,964	9.0%
	FERST for St. Mary's Inc. 2321 Ocean Point Drive, Wilmington, NC	1,958,549	8.0%

b) The following sets forth information with respect to the Company's common stock beneficially owned by each Officer and Director, and by all Directors and Officers as a group, at December 31, 2001.

<TABLE>
<CAPTION>

Title of Class	Name and Address of Beneficial Owner	Amount of Beneficial Interest	Percent of Class
<S>	<C>	<C>	<C>
Common	David Grimes, 1621 John Ross Lane, Crownsville MD	5,071,918	23.0 %
Common	Stephen Sadle, 1200 John Ross Court, Crownsville, MD	5,842,695	26.0 %
Common	Robert P Crabb, 583 Lombard Rd. Rising Sun, MD	379,793	1.0 %
Common	L. Peter Larson, 125 Spa View Ave, Annapolis, MD	1,625,285	8.0 %

</TABLE>

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ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

SUBSEQUENT EVENT

In a Board of Directors meeting, held January 11th, the Founders and Executive Management focused on the importance of finding competent leadership to successfully shepherd the Company towards its future objectives. Management wholly agreed upon the importance of diversifying the Board in order to broaden both its expertise and influence as it prepares the Company for its upcoming sales and marketing initiatives.

Management reassessed Telkonet's initial capital structure. Agreements were reached on a realignment of the initial Founders' share distribution in order to attract additional management and marketing expertise, and to raise the necessary capital for manufacturing, sales, and marketing. The Founders agreed to surrender their current stock and option positions in return for adjusted stock and option positions as set forth in the following schedule:

FOUNDERS	PRIOR SHARES	RETURNED SHARES	ADJUSTED SHARES	RETURNED OPTIONS	VESTED OPTIONS
Dave Grimes	4,971,918	3,721,918	1,250,000	160,000	1,000,000
Pete Larson	1,455,285	705,285	750,000	200,000	1,000,000
Don Erat	2,861,348	2,361,348	500,000	-0-	500,000
Steve Sadle	5,647,695	2,147,695	3,500,000	200,000	1,000,000

This re-allocation of Founders stock and option positions will benefit the Company, its shareholders, and the Founders in several ways. The changes retain the Founders core competence in the Company, provides each with both fair and equitable stock positions, and an orderly method of liquidity, and reduces the dilution factor for shareholders thus helping to attract perspective management talent and potential investors. The net effect of the recapitalization reduces the number of shares outstanding from approximately 22.1 to 13.1 million shares.

David Grimes, Founder has retired. He will continue on the Board and has agreed to remain active within the Company under a multi-year Consulting Agreement.

Donald F. Erat, Founder has agreed to remain active within the Company under a multi-year Consulting Agreement.

L. Peter Larson, Founder/ Director and Former President & CEO, has resigned as Director and will remain active within the Company under a multi-year Consulting Agreement.

Stephen L. Sadle, Founder and Chief Operating Officer has extended his Employment Agreement with the Company for three years.

Robert P. Crabb, Secretary, will join the Board of Directors

Supplemental Beneficial Ownership Table as of March 5, 2002

Beneficial owners of five percent (5%) or greater, of the Company's common stock: No preferred stock is outstanding at the date of this offering. The following sets forth information with respect to ownership by holders of more than five percent (5%) of the Registrant's common stock known by the Registrant based upon 13,179,127 shares outstanding as of March 5, 2002.

<TABLE>

<CAPTION>

Title of Class	Name and Address of Beneficial Owner	Amount of Beneficial Interest	Percent of Class
<S> Common	<C> David Grimes, 1621 John Ross Lane, Crownsville MD	<C> 1,250,000	<C> 9.0 %
Common	Stephen Sadle, 1200 John Ross Court, Crownsville, MD	3,500,000	27.0 %
Common	L. Peter Larson, 125 Spa View Ave, Annapolis, MD	750,000	.06 %
Common	Ron Pickett, 2321 Ocean Point Drive, Wilmington, NC	2,058,964	15.6 %
Common	FERST for St. Mary's Inc. 2321 Ocean Point Drive, Wilmington, NC	1,958,549	14.8 %

</TABLE>

b) The following sets forth information with respect to the Company's common stock beneficially owned by each Officer and Director, and by all Directors and Officers as a group, at March 5, 2002.

<TABLE>

<CAPTION>

Title of Class	Name and Address of Beneficial Owner	Amount of Beneficial Interest	Percent of Class
<S> Common	<C> David Grimes, Chairman 1621 John Ross Lane, Crownsville MD	<C> 2,250,000	<C> 17.1 %
Common	Stephen Sadle, COO 1200 John Ross Court, Crownsville, MD	4,500,000	34.1 %
Common	Susquehanna Development, LLC- 583 Lombard Rd. Rising Sun, MD	679,793	5.1 %
Common	J. Gregory Fowler- President & CEO 9948 Providence Forest Lane, Charlotte NC	650,000	4.9 %

Common	Hugo DeCesaris- Director	1,125,000	8.5 %
	Annapolis Maryland	-----	-----
All directors and executive officers as a group (7 persons in group)		<u>9,204,793</u>	<u>69.70 %</u>

</TABLE>

PART IV

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(A) Exhibits

The exhibits listed below are required by Item 601 of Regulation S-K. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K has been identified.

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Exhibit Number	Description of Document
-----	-----
3.1 (a)	Articles of Incorporation of the Registrant
3.2 (a)	By-laws of the Registrant

-
- (a) Included as an Exhibit to the Company's Form 8-K dated August 30, 2000 Include the 8-K that from January 16, 2002 and all others that are relevant.
 - (b) Reports On Form 8-K.

The Company did not file any current reports on Form 8-K during the reporting period.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 11, 2002 Telkonet, Inc.

/s/Joseph Gregory Fowler

Joseph Gregory Fowler, President and CEO

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.

Name	Position	Date
----	-----	----
/s/ Stephen Sadle		

Stephen Sadle	Chief Operating Officer	March 11, 2002
/s/ Hugo DeCesaris		

Hugo DeCesaris	Director	March 11, 2002

/s/ David Grimes

David Grimes Director March 11, 2002

/s/Robert P. Crabb

Robert P. Crabb Director and Secretary March 11, 2002

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FINANCIAL STATEMENTS AND SCHEDULES

DECEMBER 31, 2001 AND 2000

FORMING A PART OF ANNUAL REPORT
PURSUANT TO THE SECURITIES EXCHANGE ACT OF 1934

TELKONET, INC.

<TABLE>

TELKONET, INC.

INDEX TO FINANCIAL STATEMENTS

<CAPTION>

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Report of Independent Certified Public Accountants		F-2
Consolidated Balance Sheet at December 31, 2001 and 2000		F-3
Consolidated Statement of Losses for the Years ended December 31, 2001 and 2000 and for the Period November 3, 1999 (Date of Inception) Through December 31, 2001	F-4	
Consolidated Statement of Deficiency in Stockholder's Equity for the Period November 3, 1999 (Date of Inception) Through December 31, 2001		F-5-6
Consolidated Statement of Cash Flows for the Years ended December 31, 2001 and 2000 and for the Period November 3, 1999 (Date of Inception) through December 31, 2001	F-7	
Notes to Consolidated Financial Statements		F-8 - F-21

</TABLE>

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STEFANO & COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS

1360 Beverly Road
Suite 305
McLean, VA 22101-3621
703-448-9200
703-448-3515 (fax)

Philadelphia, PA

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Telkonet, Inc.
Annapolis, MD

We have audited the accompanying consolidated balance sheets of Telkonet, Inc. (a development stage company) as of December 31, 2001 and 2000 and the related consolidated statements of losses, deficiency in stockholders' equity, and cash flows for the years ended December 31, 2001 and 2000 and for the period November 3, 1999 (date of inception) to December 31, 2001. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based upon our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Telkonet, Inc. as of December 31, 2001 and 2000, and the results of its operations and its cash flows for the two years then ended, and from November 3, 1999 (date of inception), to December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As shown in the financial statements, the Company has incurred net losses since its inception. This raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to this matter are described in Note K. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ STEFANOU & COMPANY, LLP

Stefanou & Company, LLP
Certified Public Accountants

McLean, Virginia
February 14, 2002

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<TABLE>

TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2001 AND 2000

<CAPTION>

	2001	2000	
	-----	-----	
<S>	<C>	<C>	
ASSET			
CURRENT ASSETS:			
Cash and equivalents	\$ 21,885	\$ 10,450	
Total Current Assets	21,885	10,450	
PROPERTY AND EQUIPMENT AT COST:			
Furniture, equipment and leasehold improvements		54,950	89,029
Less accumulated depreciation		28,108	22,080
	26,842	66,949	

Financing Costs, less amortization costs of \$415,742 and \$0 in 2001 and 2000, respectively	684,325	--
Deposits	4,625	4,625
	688,950	4,625
	<u>\$ 737,677</u>	<u>\$ 82,024</u>

LIABILITIES AND DEFICIENCY IN STOCKHOLDER'S EQUITY

CURRENT LIABILITIES:

Accounts payable and accrued expenses	\$ 116,741	\$ 253,586
Notes payable (Note D)	400,000	--
Due to shareholder (Note C)	7,500	10,000
Total current liabilities	524,241	263,586

Convertible Debentures (Notes D and E)	940,000
--	---------

COMMITMENTS AND CONTINGENCIES (Note H)	--	--
--	----	----

DEFICIENCY IN STOCKHOLDER'S EQUITY (Note E)

Common stock, par value \$ 0.001 per share; 100,000,000 shares authorized; 22,115,371 and 21,815,371 issued at December 31, 2001 and 2000	22,115	21,815
Additional Paid in Capital	2,221,154	760,316
Deficit accumulated during development stage	(2,969,833)	(963,693)
Deficiency in stockholder's equity	(726,564)	(181,562)
	<u>\$ 737,677</u>	<u>\$ 82,024</u>

See accompanying notes to consolidated financial statements

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</TABLE>

<TABLE>

TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENT OF LOSSES

<CAPTION>

	For the Year Ended December 31, 2001	For the Year Ended December 31, 2000	For the Period November 3, 1999 (Date of Inception) to December 31, 2001
<S>	<C>	<C>	<C>
Cost and expenses:			
Research and development	\$ 160,115	\$ 119,000	\$ 279,115
General and administrative	1,386,222	773,336	2,193,259
Interest	417,503	15,576	433,079
Depreciation and amortization	43,557	21,808	65,637
	-----	-----	-----
Loss from Operations	(2,007,397)	(929,720)	(2,971,090)
Other Income	1,257	-	1,257
	-----	-----	-----
Net Loss	<u>\$ (2,006,140)</u>	<u>\$ (929,720)</u>	<u>\$ (2,969,833)</u>
Loss per common share (basic and assuming dilution)	<u>\$ (0.09)</u>	<u>\$ (0.04)</u>	<u>\$ (0.14)</u>
Weighted average Common shares outstanding (Note I)	21,974,439	20,891,349	21,435,998

</TABLE>

<TABLE>

TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENT OF DEFICIENCY IN STOCKHOLDERS' EQUITY
FOR THE PERIOD NOVEMBER 3, 1999 (DATE OF INCEPTION) TO DECEMBER 31, 2001

<CAPTION>

	Common Shares	Stock Amount	Additional Paid in Capital	Deficit Accumulated During Development Stage	Total	
	<C>	<C>	<C>	<C>	<C>	
<S> Net Loss	--	\$ --	\$ --	\$ (33,973)	\$ (33,973)	
BALANCE AT DECEMBER 31, 1999			--	--	--	(33,973) (33,973)
Shares issued to founders January 2000, in exchange for services and costs valued at \$ 0.60 per share	19,300		193	11,387	--	11,580
Shares issued in June 2000, for cash in connection with private placement at \$375 per share, net of costs	1,735		17	644,219	--	644,236
Shares issued in July 2000, for warrants exercised at a price of \$375 per share		190	--	71,250	--	71,250
Shares issued in August 2000, in connection with the merger of Comstock Coal and Telkonet Communications, Inc.		21,775,345	21,775	--	--	21,775
August 2000, retirement of Telkonet Communications, Inc. shares		(21,225)	(210)	--	--	(210)
Shares issued in October 2000, in exchange for warrants exercised at a price of \$1 per share	29,145		29	29,115	--	29,144
Shares issued in October 2000, in exchange for warrants exercised at a price of \$0.40 per share	10,881		11	4,345	--	4,356
Net loss	--	--	--	(929,720)	(929,720)	
BALANCE AT DECEMBER 31, 2000		21,815,371	21,815	760,316	(963,693)	(181,562)
Shares issued in June 2001, for cash in connection with a private placement, shares issued at \$.50 a share, net of costs	260,000		260	129,740	--	130,000
1,839,378 warrants issued in June 2001, valued at \$.13 per warrant in exchange for services	--	--	--	237,036	--	237,036
72,668 stock options issued in June 2001, valued at \$.09 per option, in exchange for services	--	--	--	6,375	--	6,375
245,287 warrants issued in July 2001, valued at \$.08 per warrant, in exchange for services	--	--	--	18,568	--	18,568
36,917 stock options issued in July 2001, valued at \$.08 per option, in exchange for services	--	--	--	2,795	--	2,795

Shares issued in August 2001, for cash in connection with a private placement, shares issued at \$.50 a share, net of costs

	40,000	40	19,960	--	20,000
--	--------	----	--------	----	--------

See accompanying notes to consolidated financial statements

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</TABLE>

<TABLE>

TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENT OF DEFICIENCY IN STOCKHOLDERS' EQUITY
FOR THE PERIOD NOVEMBER 3, 1999 (DATE OF INCEPTION) TO DECEMBER 31, 2001

<CAPTION>

	Common Shares	Stock	Additional Paid in Amount Capital	Deficit Accumulated During Development Stage	Total
	<C>	<C>	<C>	<C>	<C>
241,000 warrants issued in August 2001, valued at \$.39 per warrant, in exchange for financing costs	--	--	94,687	--	94,687
114,000 warrants issued in August 2001, valued at \$.43 per warrant in exchange for interest	--	--	49,020	--	49,020
150,000 warrants issued in August 2001, valued at \$.16 per warrant in exchange for services	--	--	23,340	--	23,340
36,917 stock options issued in August 2001, valued at \$.06 per option in exchange for services	--	--	2,422	--	2,422
818,000 warrants issued in September 2001, valued at \$.14 per warrant in exchange for financing costs	--	--	112,230	--	112,230
1,636,000 warrants issued in September 2001, valued at \$.40 per warrant in exchange for interest	--	--	654,400	--	654,400
25,000 warrants issued in September 2001, valued at \$.30 per warrant in exchange for services	--	--	7,380	--	7,380
60,000 warrants issued in October 2001, valued at \$.16 per warrant in exchange for financing costs	--	--	9,720	--	9,720
120,000 warrants issued in October 2001, valued at \$.44 per warrant in exchange for interest	--	--	52,800	--	52,800
95,000 warrants issued in October 2001, valued at \$.21 per warrant in exchange for services	--	--	19,558	--	19,558
5,000 warrants issued in November 2001, valued at \$.16 per warrant in exchange for financing costs	--	--	810	--	810
10,000 warrants issued in November 2001, valued at \$.44 per warrant in exchange for interest	--	--	4,400	--	4,400

25,000 warrants issued in November 2001, valued at \$.33 per warrant in exchange for services	--	--	8,218	--	8,218		
25,000 warrants issued in December 2001, valued at \$.30 per warrant in exchange for services	--	--	7,380	--	7,380		
Net loss	--	--	--	(2,006,140)	(2,006,140)		
BALANCE AT DECEMBER 31, 2001			22,115,371	\$ 22,115	\$ 2,221,155	\$(2,969,833)	\$ (726,563)

See accompanying notes to consolidated financial statements

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</TABLE>

<TABLE>

TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE PERIOD ENDING DECEMBER 31, 2001 AND 2000 AND
FOR THE PERIOD NOVEMBER 3, 1999 (DATE OF INCEPTION) TO DECEMBER 31, 2001

<CAPTION>

	For the Year Ended December 31, 2001	For the Year Ended December 31, 2000	For the Period November 3, 1999 (Date of Inception) to December 31, 2001		
<S>	<C>	<C>	<C>		
INCREASE (DECREASE) IN CASH AND EQUIVALENTS					
CASH FLOWS FROM OPERATING ACTIVITIES:					
Net loss from development stage operations		\$(2,006,140)	\$ (929,720)	\$(2,969,833)	
Adjustments to reconcile net loss from development stage operations to cash used for operating activities					
Warrants issued in exchange for financing and interest		378,213		378,213	
Warrants issued in exchange for services		333,072		333,072	
Common stock issued in exchange for services rendered		11,580		11,580	
Depreciation and amortization		43,557	22,080	65,637	
Increase (decrease) in:					
Deposits	--	(4,625)	(4,625)		
Accounts payable and accrued expenses, net		(136,845)	241,388	138,516	
NET CASH USED BY OPERATING ACTIVITIES			(1,388,143)	(659,297)	(2,047,440)
CASH FLOWS USED IN INVESTING ACTIVITIES :					
Capital expenditures, net of disposals		34,079	(89,029)	(54,950)	
NET CASH USED IN INVESTING ACTIVITIES			34,079	(89,029)	(54,950)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Proceeds from sale of common stock, net of costs		150,000	748,776	898,776	
Proceeds from (repayments to) stockholder advances		(2,500)	10,000	7,500	
Proceeds from issuance of convertible debentures, net of costs	818,000	--	818,000		
Proceeds from bank loans	400,000	--	400,000		
Proceeds from shareholder loans	--	235,000	235,000		
Repayment of shareholder loans	--	(235,000)	(235,000)		
NET CASH PROVIDED (USED) IN FINANCING ACTIVITIES			1,365,500	758,776	2,124,276
NET (DECREASE) INCREASE IN CASH AND EQUIVALENTS			11,435	10,450	21,885
Cash and equivalents at beginning of period		10,450	--	--	
CASH AND EQUIVALENTS AT END OF PERIOD			\$ 21,885	\$ 10,450	\$ 21,885
Supplemental Disclosure of Cash Flow Information					
Cash paid during the period for interest		\$ 24,965	\$ --	\$ 24,965	

Income taxes paid	--	--	--
Issuance of warrants for financing and interest		1,278,983	--
Issuance of warrants and options for services		333,072	--
Common stock issued for services	--	11,580	11,580
Acquisition:			
Assets Acquired	--	1	1
Accumulated deficit	--	2,643	2,643
Liabilities Assumed	--	(2,642)	(2,642)
	-----	-----	-----
	\$ --	\$ 1	\$ 1

See accompanying notes to consolidated financial statements

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</TABLE>

TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE A - SUMMARY OF 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. ("Company"), formerly Comstock Coal Company, Inc, was formed on November 3, 1999 under the laws of the state of Utah. The Company is a development stage enterprise, as defined by Statement of Financial Accounting Standards No. 7 ("SFAS 7") and is seeking to develop, produce and market proprietary equipment enabling the transmission of voice and data over electric utility lines. From its inception through the date of these financial statements the Company has recognized no revenues and has incurred significant operating expenses.

The consolidated financial statements include the accounts of the Company, and its wholly-owned subsidiary, Telkonet Communications, Inc. Significant intercompany transactions have been eliminated in consolidation.

Advertising

The Company follows the policy of charging the costs of advertising to expenses incurred. The Company incurred no advertising costs during the year ended December 31, 2001 and for the period November 3, 1999 (date of inception) through December 31, 2001.

Property and Equipment

For financial statement purposes, property and equipment are depreciated using the straight-line method over their estimated useful lives (three to five years for furniture, fixtures and equipment). The straight-line method of depreciation is also used for tax purposes.

Marketable Securities

Marketable securities consist primarily of corporate equity securities. The Company's marketable securities are considered to be "available for sale" and accordingly, are carried on the balance sheet at fair market value, which approximates cost. Gains and losses from securities have not been material.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

Income Taxes

Income taxes are provided based on the liability method for financial reporting purposes in accordance with the provisions of Statements of Financial Standards No. 109, "Accounting for Income Taxes". Under this method deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be removed or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statements of operations in the period that includes the enactment date.

Cash Equivalents

For purposes of the Statements of Cash Flows, the Company considers all highly liquid debt instruments purchased with a maturity date of three months or less to be cash equivalents.

Impairment of Long-Lived Assets

The Company has adopted Statement of Financial Accounting Standards No. 121 (SFAS 121). The Statement requires that long-lived assets and certain identifiable intangibles held and used by the Company be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. SFAS 121 also requires assets to be disposed of be reported at the lower of the carrying amount or the fair value less costs to sell.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly actual results could differ from those estimates.

Research and Development

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 2001 and 2000 were \$160,115 and \$119,000, respectively.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

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 currently has no customers.

Stock Based Compensation

The Company accounts for stock transactions in accordance with APB Opinion 25, "Accounting for Stock Issued to Employees." In accordance with statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," the Company has adopted the proforma disclosure requirements. From time to time, the Company grants options or warrant to non employees in return for services rendered. The Company recognizes a charge or the fair value ascribed to such options and warrants over the service or vesting period.

Liquidity

As shown in the accompanying financial statements, the Company has incurred losses of \$2,969,833 from its inception through December 31, 2001. The Company's current liabilities exceed its current assets by \$502,356 at December 31, 2001.

Reclassifications

Certain reclassifications have been made in prior year's financial statements to conform to classifications used in the current year.

Comprehensive Income

The Company does not have any items of comprehensive income in any of the periods presented.

Segment Information

The Company adopted Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information ("SFAS 131") in the year ended December 31, 1998. SFAS establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions how to allocate resources and assess performance. The information disclosed herein, materially represents all of the financial information related to the Company's principal operating segment.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

New Accounting Pronouncements

In March 2000, the FASB issued interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25". FIN 44 clarifies the application of APB No. 25 for (a) the definition of employee for purposes of applying APB No. 25, (b) the criteria for determining whether a plan qualifies as a noncompensatory plan, (c) the

accounting consequences of various modifications to previously fixed stock option or award, and (d) the accounting for an exchange of stock compensation awards in a business combination. FIN 44 is effective July 2, 2000 but certain conclusions cover specific events that occur after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have an effect on the Company's financial statements but may impact the accounting for grants or awards in future periods.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, Business Combinations (FAS 141), and FAS 142, Goodwill and Other Intangible Assets (FAS 142). FAS 141 addresses the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. FAS 142 addresses the initial recognition and measurement of intangible assets acquired outside of a business combination, whether acquired individually or with a group of other assets, and the accounting and reporting for goodwill and other intangibles subsequent to their acquisition. These standards require all future business combinations to be accounted for using the purchase method of accounting. Goodwill will no longer be amortized but instead will be subject to impairment tests at least annually. The Company is required to adopt FAS 141 and FAS 142 on a prospective basis as of January 1, 2002; however, certain provisions of these new standards may also apply to any acquisitions concluded subsequent to June 30, 2001. As a result of implementing these new standards, the Company will discontinue the amortization of goodwill as of December 31, 2001. The Company does not believe that the adoption of FAS 141 or 142 will have a material impact on its consolidated financial statements.

In October 2001, the Financial Accounting Standards Board issued FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144). FAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes FAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" (FAS 121) and related literature and establishes a single accounting model, based on the framework established in FAS 121, for long-lived assets to be disposed of by sale. The Company is required to adopt FAS 144 no later than January 1, 2002. The Company does not believe that the adoption of FAS 144 will have a material impact on its consolidated financial statements.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE B - MERGER

On August 25, 2000, Telkonet Communications, Inc ("TCI") completed an Agreement and Plan of Reorganization ("Agreement") with Comstock Coal Company, Inc. ("Comstock") in a transaction accounted for using the purchase method of accounting. The total purchase price and carrying value of net assets acquired of Comstock was \$1. From Comstock's inception, until the date of the merger, Comstock was an inactive corporation with no assets and liabilities. As a result of the acquisition, there was a change in control of the public entity. Subsequent to the date of the merger, Comstock Coal Company, Inc. changed its name to Telkonet, Inc. ("Company"), with Telkonet Communications, Inc becoming a wholly owned subsidiary of the Company.

Effective with the Agreement, all previously outstanding common stock, preferred stock, options and warrants owned by former Comstock stockholders were exchanged for an aggregate of 1,980,000 shares of Telkonet Communications, Inc.'s common stock. The value of the stock that was issued was the historical cost of Comstock's net tangible assets, which did not differ materially from their fair value. The results of operations subsequent to the date of acquisition are included in the Company's consolidated statement of losses. In accordance with Accounting Principles Opinion No. 16, Telkonet Communications, Inc. is the acquiring entity.

The total purchase price and carrying value of net assets acquired of Comstock was \$1. The net assets acquired were as follows:

Net Assets	\$ 1
Accumulated Deficit	2,643
Net Liabilities	(2,642)

	\$ 1
	=====

NOTE C - DUE TO SHAREHOLDER

Significant shareholders of the Company have advanced funds to the Company for working capital purposes. The amount of the advances at December 31, 2001 and 2000 are \$7,500 and \$10,000, respectively. No formal repayment terms exist.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE D - NOTES PAYABLE

Notes payable at December 31, 2001 and 2000 consists of the following:

<TABLE>
<CAPTION>

	2001	2000
	----	----
	<C>	<C>
Note payable in monthly installments of interest only at 7.5% per annum, unsecured and guaranteed by a Company shareholder.	\$ 150,000	\$ -
Note payable in monthly installments of interest only at the prime lending rate plus 1% unsecured and guaranteed by a Company shareholder	250,000	-
Convertible notes payable, in quarterly installments of interest only at 8% per annum, unsecured and due three years from the date of the note with the latest maturity November, 2004; Noteholder has the option to convert unpaid note principal together with accrued and unpaid interest to the Company's common stock at a rate of \$.50 per share six months after issuance.	940,000	-
	-----	-----
	1,340,000	-
Less: current portion	(400,000)	-
	-----	-----
	\$ 940,000	\$ -
	=====	=====

</TABLE>

Aggregate maturities of long-term debt as of December 31, 2001 are as follows:

Year	Amount
----	-----
2002	\$ 400,000
2003	-
2004	940,000
2005	-
2006 and after	-

	\$1,340,000

The Company incurred an aggregate of \$339,447 of financing costs associated with the placement of the convertible debentures. The costs have been capitalized and are being amortized over a term of the convertible debentures. Financing costs amortized in 2001 were \$37,529 and have been charged to operations.

In addition, the Company recognized the imbedded beneficial conversion feature in the convertible debenture by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid in capital. The Company recognized an aggregate of \$760,620 of imbedded beneficial conversion feature and has amortized that cost over six months after the issuance of the

debentures. Costs associated with this beneficial conversion features amortized in 2001 were \$278,213 and have been charged to interest expense in the current year.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE E - CAPITAL STOCK

The Company was incorporated under the laws of the State of Utah on November 3, 1999 under the name of Telkonet Communications, Inc. The Company is a successor to Telkonet Communications, Inc., a company formed under the laws of the State of Maryland ("Predecessor"). The Predecessor was an inactive corporation entity with no significant assets or operations.

The Company has authorized 100,000,000 shares of common stock , with a par value of \$.001 per share.

In January 2000, the Company issued 19,300 shares to its founders, in exchange for costs and services, valued at \$11,580.

In June 2000, the Company issued a total of 1,735 shares of common stock in a private placement to sophisticated investors, primarily in the United States in exchange for \$644,236 net of costs and fees. In July, 2000 addition, the Predecessor issued 190 shares of common stock in exchange for exercised warrants at \$375 per share, totaling \$71,250

In August 2000, the Company issued 21,775,345 shares of common stock in conjunction with the merger of Comstock Coal Company, Inc (Note B). In connection with the transaction, the Company retired 21,225 shares of previously issued Telkonet Communications, Inc common stock.

In October 2000, the Company issued 29,145 and 10,881 shares of common stock in exchange for exercised warrants, with and exercise price of \$1.00 and \$0.40 per share, respectively.

In June 2001 and August 2001, the Company issued 260,000 and 40,000 shares of its common stock, respectively, in a private placement to sophisticated investors in exchange for \$150,000 , net of costs and fees

In 2001, the Company issued \$940,000 of 8% Convertible Debentures (see Note D). The debentures are due three years from date of issuance, and can be converted to the Company's common stock at the rate of \$.50 per share six months after issuance.

Share amounts presented in the consolidated balance sheets and consolidated statements of stockholders' equity reflect the actual share amounts outstanding for each period presented.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE F - STOCK OPTIONS AND WARRANTS

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 a non-qualified employee stock option plan.

<TABLE>

<CAPTION>

Options Outstanding			Options Exercisable		
Number Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	
<S>	<C>	<C>	<C>	<C>	<C>
1.00	1,055,000	10	1.00	23,334	1.00

Transactions involving options issued to employees are summarized as follows:

	Number of Shares	Weighted Average Price Per Share
Outstanding at January 1, 2000	-	-
Granted	840,000	\$ 1.00
Exercised	-	1.00
Canceled or expired	-	1.00
Outstanding at December 31, 2000	840,000	1.00
Granted	215,000	1.00
Exercised	-	1.00
Canceled or expired	-	1.00
Outstanding at December 31, 2001	1,055,000	\$ 1.00

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE F - STOCK OPTIONS AND WARRANTS (CONTINUED)

The weighted-average fair value of stock options granted to employees during the years ended December 31, 2001 and 2000 and the weighted-average significant assumptions used to determine those fair values, using a Black-Scholes option pricing model are as follows:

	2001	2000
Weighted average grant date fair value per share:	\$ 1.15	\$ 1.00
Significant assumptions (weighted-average):		
Risk-free interest rate at grant date	4.25%	5.85%
Expected stock price volatility	21%	0%
Expected dividend payout	-	-
Expected option life-years (a)	10	10

(a) The expected option life is based on contractual expiration dates.

If the Company recognized compensation cost for the non-qualified employee stock option plan in accordance with SFAS No. 123, the Company's pro forma net loss and net loss per share would have been \$(2,015,040) and \$(0.09) in 2001 and \$(929,720) and \$(0.04) in 2000, respectively.

The Company incurred costs and expenses in connection with granting certain stock warrants and options to non-employees. These warrants and options were granted in lieu of cash compensation for services performed and in connection with placement of convertible debentures (see Note D).

The following table summarizes the changes in warrants outstanding and the related prices for the shares of the Company's common stock issued to non-employees of the Company.

<TABLE>
<CAPTION>

Warrants Outstanding			Warrants Exercisable			
	Number Outstanding	Weighted Average	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	
		Contractual Life (Years)			Exercise Price	
Exercise Prices:						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
	\$.50	1,100,000	8	\$.50	1,100,000	\$.50
	.53	184,000	3	.53	184,000	.53
	1.00	4,124,665	2	1.00	4,124,665	1.00
		<u>5,408,665</u>			<u>5,408,665</u>	

</TABLE>

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE F - STOCK OPTIONS AND WARRANTS (CONTINUED)

Transactions involving warrants issued to non-employees are summarized as follows:

	Weighted Average Number of Shares	Price Per Share
Outstanding at January 1, 2000		
Granted	1,210,572	\$ 1.00
Exercised	-	1.00
Canceled or expired	-	1.00
Outstanding at December 31, 2000	1,210,572	\$ 1.00
Granted	5,408,665	.67
Exercised	-	.67
Canceled or expired	(1,210,572)	1.00
Outstanding at December 31, 2001	<u>5,408,665</u>	<u>\$ 0.78</u>

The following table summarizes the changes in options outstanding and the related prices for the shares of the Company's common stock issued to non-employees of the Company.

<TABLE>
<CAPTION>

Options Outstanding			Options Exercisable			
	Number Outstanding	Weighted Average	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	
		Contractual Life (Years)			Exercise Price	
Exercise Prices:						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
	1.00	210,751	3	1.00	210,751	1.00
	.40	35,751	1	.40	35,751	.40

246,502
=====

246,502
=====

</TABLE>

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE F - STOCK OPTIONS AND WARRANTS (CONTINUED)

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

	Weighted Average Number of Shares	Price Per Share
Outstanding at January 1, 2000	-	-
Granted	286,528	\$ 0.70
Exercised	(40,026)	.70
Canceled or expired	-	.70
Outstanding at December 31, 2000	246,502	.70
Granted	-	-
Exercised	-	-
Canceled or expired	-	-
Outstanding at December 31, 2001	246,502	\$ 0.70

The amount of the expense charged to operations in connection with granting the warrants and options to non-employees was \$550,518 and \$0 during 2001 and 2000, respectively. The amount incurred in connection with placement of the convertible debentures was \$217,447 in 2001 and is included in the costs of financing and amortized over the term of the debentures.

NOTE G - INCOME TAXES

The Company has adopted Financial Accounting Standard number 109 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. Temporary differences between taxable income reported for financial reporting purposes and income tax purposes are insignificant.

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE G - INCOME TAXES (CONTINUED)

For income tax reporting purposes, the Company's aggregate unused net operating losses approximate \$2,900,000 which expire through 2021, subject to limitations of Section 382 of the Internal Revenue Code, as amended. The deferred tax asset related to the carryforward is approximately \$986,000. The Company has provided a valuation reserve against the full amount of the net operating loss benefit,

since in the opinion of management based upon the earning history of the Company, it is more likely than not that the benefits will be realized.

Components of deferred tax assets as of December 31, 2001 are as follows:

Non Current:	
Net operating loss carryforward	\$ 986,000
Valuation allowance	(986,000)

Net deferred tax asset	\$ -
	=====

NOTE H - COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Company leases office space on a year to year basis in Annapolis, Maryland for its corporate offices. Rental expense charged to operations in 2001 ad 2000 was \$56,911 and \$37,000, respectively. Commitments for minimum rentals under non cancelable leases at the end of 2001 are as follows:

2002	\$ 58,000
2003	44,746

	\$102,746
	=====

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TELKONET, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE H - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Employment and Consulting Agreements

The Company has an employment agreement with the Company's Chief Executive Officer and Chief Operating Officer. In addition to salary and benefit provisions, the agreement includes defined commitments should the employee terminate the employment with or without cause.

The Company has consulting agreements with outside contractors to provide marketing and financial advisory services. The Agreements are generally for a term of 12 months from inception and renewable automatically from year to year unless either the Company or Consultant terminates such engagement by written notice.

NOTE I - LOSSES PER COMMON SHARE

The following table presents the computations of basic and dilutive loss per share:

	2001	2000	
	----	----	
Net loss available to common shareholders	\$ (2,006,140)	\$ (929,720)	
	=====	=====	
Basic and fully diluted loss per share	\$ (0.09)	\$ (0.04)	
	=====	=====	
Weighted average common shares outstanding	21,974,439	20,891,349	
	=====	=====	

NOTE J - SUBSEQUENT EVENTS

Subsequent to the date of the financial statements, the Company re-organized its capital structure, whereby the Company agreed to purchase 8,936,244 shares of the Company's common stock held by the Founders and cancel certain vested options held by the Founders to purchase the Company's common stock, in exchange for the issuance of newly issued options to purchase 3,500,000 of the Company's common stock. The new stock options expire in January 2012, and have an exercise price of \$1.00 per share.

Subsequent to the date of the financial statements, the Company has received an additional \$92,000 in convertible debentures (see Note D).

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TELKONET, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE K - GOING CONCERN MATTERS

The accompanying statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the financial statements from November 3, 1999 (date of inception of Company), the Company incurred losses from operations of \$2,969,833. This factor among others may indicate that the Company will be unable to continue as a going concern for a reasonable period of time.

The Company's existence is dependent upon management's ability to develop profitable operations and resolve its liquidity problems. Management anticipates the Company will attain profitable status and improve its liquidity through the continued developing of its products, establishing a profitable market for the Company's products and additional equity investment in the Company. The accompanying financial statements do not include any adjustments that might result should the Company be unable to continue as a going concern.

In order to improve the Company's liquidity, the Company is actively pursuing additional equity financing through discussions with investment bankers and private investors. There can be no assurance the Company will be successful in its effort to secure additional equity financing.

If operations and cash flows continue to improve through these efforts, management believes that the Company can continue to operate. However, no assurance can be given that management's actions will result in profitable operations or the resolution of its liquidity problems.

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