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N-VIRO INTERNATIONAL CORP

Form 10-K

April 16, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001
OR
[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 0-21802

N-VIRO INTERNATIONAL CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

34-1741211
(I.R.S. EMPLOYER IDENTIFICATION N

3450 W. CENTRAL AVENUE, SUITE 328
TOLEDO, OHIO 43606
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (419) 535-6374

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
Common Stock, par value \$.01 per share

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for at least the past 90 days. Yes X No
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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

The aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the last sale price of registrant's Common Stock in the National Association of Securities Dealers, Inc. Automated Quotation System ("Nasdaq") as of March 22, 2002, was approximately \$1,313,000.

The number of shares of Common Stock of the registrant

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outstanding as of March 22, 2002, was 2,577,433.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement for the annual shareholders' meeting to be held May 9, 2002 are incorporated by reference into Part III.

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PART I

ITEM 1. BUSINESS

GENERAL

N-Viro International Corporation (the "Company" or "N-Viro"), incorporated in April, 1993, owns and licenses the N-Viro Process, a patented technology to treat and recycle wastewater sludges and other bio-organic wastes, utilizing certain alkaline and mineral by-products produced by the cement, lime, electric utilities and other industries. See "The N-Viro Process."

In 1979, Mr. J. Patrick Nicholson and several investors formed N-Viro Energy Systems, Limited (the "Partnership"). The Partnership's initial strategy was to license the N-Viro Process to third parties through independent agents. Each independent agent acted in its respective territory as a marketing and distribution agent of the Partnership, and the Partnership retained the marketing and distribution rights to certain other territories. In early 1993, as a result of the then pending implementation of the 40 CFR part 503 Sludge Regulations (as defined below) and the market environment, the Partnership concluded that a strategy that also included the development and operation, on a contract management basis, of N-Viro facilities for third parties, and of Company-owned and/or co-owned N-Viro facilities, would potentially expand the opportunities to capitalize on the N-Viro Process.

In order to implement this strategy, the Partnership agreed to combine with American N-Viro Resources, Inc., National N-Viro Tech, Inc., N-Viro Midwest, Inc., N-Viro Soil South, Inc. and Tennessee-Carolina N-Viro (collectively, the "Combined Agents") to form the Company. The Company was incorporated in April 1993 primarily to expand the opportunities for capitalizing on the N-Viro Process. The Company assumed the Partnership's agreements with the remaining agents who were continuing to market the N-Viro Process in their respective territories.

The Company became a public company on October 12, 1993 with an initial public offering (the "IPO") of 2,000,000 shares of Common Stock at \$9.50 per share. On October 19, 1993, the Partnership contributed to the Company all of its assets (except certain marketable securities and accounts receivable from certain related parties), subject to all liabilities (except certain retained liabilities), and the stockholders of the Combined Agents contributed to the Company all of the outstanding capital stock of such entities in exchange for a total of 6,000,000 shares of Common Stock of the Company and organization notes totaling \$5,221,709 (including notes of \$276,909 which resulted from a partial exercise of an over-allotment option). The organization notes were repaid out of the proceeds from the IPO. On November 10, 1993, an additional 112,000 shares were sold pursuant to the exercise by the Underwriters of their over-allotment option.

On October 30, 1995, at a Special Meeting of the Shareholders, the shareholders approved a one for four reverse stock split which reduced the number of issued and outstanding shares of the Common Stock. This reverse split did not affect the Company's retained deficit and the stockholders' equity remained substantially unchanged. This action was deemed necessary by management of the Company to remain in compliance with the minimum bid price requirement of the National Association of Securities Dealers Automatic Quotation System ("Nasdaq") or the alternative net tangible assets requirement and for continued listing of the Common Stock on Nasdaq. The reverse split reduced the number of

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issued and outstanding shares of the Common Stock to approximately 2,037,000 (net of 57,250 treasury shares).

In late 1995, the Company's business strategy changed from being a low cost provider of a process to marketing the N-Viro Process, which produces an "exceptional quality" sludge product, as defined in the 40 CFR part 503 Sludge Regulations under the Clean Water Act of 1987 (the "part 503 Regs"), with multiple commercial uses. In this strategy, the primary focus is to identify allies, public and private, who will build and operate the N-Viro facility. To date, the Company's revenues primarily have been derived from the licensing of the N-Viro Process to treat and recycle wastewater sludges generated by municipal wastewater treatment plants and from the sale to licensees of the alkaline admixture used in the N-Viro Process. The Company has also operated N-Viro facilities for third parties on a start-up basis and currently operates one N-Viro facility on a contract management basis. There are currently over 80 wastewater treatment facilities throughout the world treating sludge using the N-Viro Process. The Company estimates that these facilities are treating and recycling sludge at an annualized rate of over 140,000 dry tons per year.

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There are several licensees not currently operating, including both international and domestic contractors or public generators, who are developing or designing site-specific N-Viro facilities.

Since 1995, the Company has marketed licenses for the use of the N-Viro Process through its own sales and marketing force in the United States in all 50 states and the District of Columbia and internationally throughout the world. In certain other parts of the world, the Company licenses the N-Viro Process through agents (the "Agents"). Typically, the agreements with the Agents provide for the Company to receive a portion of the up-front license fees and ongoing royalty fees paid by the licensees and a portion of the proceeds from the distribution and resale of alkaline admixture and the sale of N-Viro Soil™. Agents have total responsibility and control over the marketing and contracts for N-Viro technology subject only to license models or minimum agreements with the Company. The sales representative network is the key component of the Company's domestic sales strategy. The manufacturers representatives network was started by the Company after acquiring eight of eleven domestic agents. These representatives receive a commission on certain revenue.

The Toledo, Ohio facility is managed by the Company through a Contract Management Agreement with the City of Toledo. Revenue generated from and related to the Toledo operation accounts for about 39% of the Company's total revenue. The Company processes a portion of Toledo's wastewater sludge and sells the N-Viro Soil product. This contract with the City of Toledo was renewed in October 1999, to extend through the year 2004; in 2001, the City exercised its option to renew the contract for an additional five years through 2009. Currently, the contract is in its fourteenth year of operation. The relationship between the City of Toledo and the Company has been satisfactory.

On November 29, 2001, the Company received notification from Nasdaq that as of September 30, 2001, the Company did not meet its minimum net tangible assets and/or minimum stockholders' equity requirements (the "Requirements") for continued listing on the Nasdaq SmallCap Market, as set forth in Marketplace Rule 4310(c)(2)(B). Presently, the Company does not satisfy any of the Requirements. The Company subsequently submitted a plan to Nasdaq for the Company to meet the Requirements. Nasdaq rejected the Company's plan and ordered that the Company's common stock be delisted from the Nasdaq SmallCap Market. The Company has appealed this determination. Pending resolution of the Company's appeal, the Company's common stock will remain listed on the Nasdaq SmallCap Market. The Company has been notified that an oral hearing before a Nasdaq

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Listing Qualifications Panel will be held on April 18, 2002. The Company is hopeful that it will be able to demonstrate to Nasdaq that current developments will enable the Company to meet one or more of the Requirements, however, there can be no assurances that the Company will be able to do this and that the Company's shares won't be delisted from the Nasdaq SmallCap Market. If the Company's common stock is delisted from Nasdaq, the Company's shares of common stock will be traded on the Over-The-Counter Market and may not be subsequently relisted on Nasdaq until the Company can meet the Requirements. The Company does not anticipate that the delisting of its common stock on the Nasdaq SmallCap Market will have a material adverse effect on the financial condition or results of operations of the Company. The delisting of the Company's common stock from Nasdaq, however, will have a material adverse effect on the marketability of the Company's shares.

THE N-VIRO PROCESS

The N-Viro Process is a patented process for the treatment and recycling of bio-organic wastes, utilizing certain alkaline by-products produced by the cement, lime, electric utilities and other industries. To date, the N-Viro Process has been commercially utilized for the recycling of wastewater sludges from municipal wastewater treatment facilities. N-Viro Soil produced according to N-Viro Process specifications is an "exceptional quality" sludge product under the part 503 Regs.

The N-Viro Process involves mixing the wastewater sludge with an alkaline admixture and then subjecting the mixture to a controlled period of storage, mechanical turning and accelerated drying in which a blending of the sludge and the alkaline admixture occurs. The N-Viro Process stabilizes and pasteurizes the wastewater sludge, reduces odors to acceptable levels, neutralizes or immobilizes various toxic components and generates N-Viro Soil™, a product which has a granular appearance similar to soil and has multiple commercial uses. These uses include agricultural lime, soil enrichment, top soil blend, landfill cover and filter, and land reclamation.

The alkaline admixture used in the N-Viro Process consists of by-product dusts from cement or lime kilns, certain fly ashes and other products of coal, coke or petroleum combustion and by-product dusts from sulfuric acid

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"scrubbers" used in acid rain remediation systems and from fluidized bed coal-fired systems used in electric power generation. The particular admixture that is used usually depends upon cost and availability in local markets. In certain cases, commercial lime may also be added to the admixture.

The Company is a distributor of alkaline admixture and is responsible for quality control of the admixture. The Company also works with established by-product marketers. The Company generally charges a mark-up over its cost for alkaline admixture sold directly by the Company.

N-Viro Soil is sold for agricultural use as a bio-organic and mineral fertilizer with agricultural liming and nutrient values, as landfill cover material, as a topsoil blending ingredient and for land reclamation projects. The Company estimates that approximately five percent of the N-Viro Soil produced is sold to landfills for cover material, small amounts are sold for land reclamation and similar projects, and a substantial portion of the remainder is sold for agricultural use or as a topsoil blend. Although the use of N-Viro Soil is not subject to any federal regulations or restrictions, each N-Viro facility is typically required to obtain a state and/or local permit for the sale of N-Viro Soil. In addition, many states and/or local governments require site-specific permits for the use of sludge products in bulk amounts.

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RESEARCH AND DEVELOPMENT

Research and development on the N-Viro Process is performed primarily by BioCheck Laboratories, Inc. ("BioCheck"). In 2001, the Company expended approximately \$23,000 on continuous research on process improvements through BioCheck, and considers its relationship with BioCheck to be satisfactory.

In 2001 the Company expended approximately \$65,000 on research and patent development, including the amount expended to BioCheck. Research and development on N-Viro Soil has been, to date, performed primarily by BioCheck and Dr. Terry J. Logan. Research was conducted by Dr. Logan and his staff at The Ohio State University pursuant to a research arrangement with the Company. Through June 30, 1999, Dr. Logan acted as an independent consultant to the Company on a part-time basis and was, and continues to be, a director of the Company. Since July 1, 1999, Dr. Logan has been employed with the Company as President and Chief Operating Officer.

All participants on the Company's technology council, including Dr. Logan and the officers of BioCheck, have contracts with the Company, protecting the Company's rights.

In addition, grants totaling approximately \$221,000 were secured from several sources for process and product research. The United States Department of Agriculture (USDA) funded research on the use of bio-mineral and compost technology to disinfect and immobilize nutrients and metals in animal manure. This research was conducted at USDA's Agricultural Research Service (ARS) laboratory at Beltsville, MD and at BioCheck Labs. A field-scale test of the Company's animal manure treatment technology was tested at a large poultry operation in the State of Delaware in 2001 in collaboration with Environmental Technologies of Delaware LLC ("ETD"). ETD holds an exclusive license for the Company's animal manure treatment technology ("Nuresoil") for the States of Delaware, Maryland and Virginia. The State of Maryland funded a study, conducted with the University of Maryland, to utilize bio-mineral treated poultry manure to reclaim acidic landfill cover. In 1999, two patents were submitted to the U.S. Patent and Trademark Office and to the European Patent Office for disinfection and for phosphorus and trace metal immobilization in animal manure. In late 2000, the U.S. Patent and Trademark Office ("USPTO") declared the manure disinfection technology to be patentable and this patent was issued in 2001. The second manure patent, for phosphorus and trace metal immobilization, was declared by the USPTO to be patentable in 2001 and that patent is expected to be awarded in 2002. International patents have also been applied for. The Company continues to investigate methods to shorten drying time, substitute various other materials for use as alkaline admixture and improve the quality and attractiveness of N-Viro Soil to a variety of end-users. Several new developments are the subject of issued patents, including the use of carbon dioxide in the N-Viro Process as a means to (i) reduce by-product carbon dioxide emissions from industrial processes by immobilizing carbon dioxide in N-Viro Soil and (ii) improve the quality and value of N-Viro Soil. In addition, the Company has developed a dryer system which will reduce processing time while continuing to permit the survival of beneficial microflora. Licensees of the Company began operating dryer facilities in Phillipsburg, New Jersey and Leamington, Ontario Canada in 1995. A new facility in Sarnia, Ontario, Canada came on line in March, 2001. The Company's "BioBlend", which uses N-Viro Soil as a reagent to accelerate and deodorize yard waste composting, is being utilized to produce a topsoil at the new Englewood, Ohio N-Viro facility.

In 2000, the Department of Agri-Food Canada, filed Canadian and U.S. patents on the use of N-Viro Soil to suppress soybean cyst nematode (SCN), a

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soil pathogen which can severely reduce soybean yields and for which there is no effective control. SCN damage is a widespread problem throughout soybean growing areas. Research in Canada, and confirmed in Ohio, show that there is potential for N-Viro Soil to increase soybean yields in areas with heavy infestations of SCN. N-Viro is the exclusive licensee for the use patent in the U.S. and internationally. In Canada, the license is held by N-Viro Systems Canada, Inc. The USDA funded research in 2001-2002 on the effects of N-Viro Soil and Nuresoil on the control of certain soil nematodes in soybeans and other crops.

In 2001, the Company filed two patents with the USPTO that deal with controlled heating, drying and combustion of organic wastes, including sewage sludges, animal manures, and pulp and paper wastes. One of the patents teaches the ability of mineral by-products, such as coal combustion by-products, to control the burning of organic wastes in a coal-fired power plant as a coal substitute. The patent also teaches the generation of ammonia from the organic waste for NOx control at the power plant, and the utilization of waste heat from the power plant to dry the organic wastes. The original submission was declared to be patentable by the USPTO in late 2001, and amended claims filed in 2001 were also declared to be patentable in early 2002. International patents have also been applied for. The Company is currently in discussions with a major U.S. utility to form a joint venture company to exploit the technology.

ORGANIZATION

Day-to-day operations, including management of the Toledo, Ohio facility, and support functions, is directed by the Company's President and Chief Operating Officer. Support functions include alkaline admixture procurement and sales, product market development and sales, regulatory affairs, and licensee support. Domestic sales and marketing and project development is directed by the Company's Executive Vice-President who coordinates internal staff, a network of manufacturers representatives, and consultants. International sales and marketing, legal affairs and stockholder relations is directed by the Company's Chief Executive Officer. The company's Chief Financial Officer has responsibility for all finance and accounting functions and reporting, filings with the Securities and Exchange Commission, and serves as Secretary of the Board.

The following table sets forth the Agents of the Company and the territorial rights of each Agent:

The Agents

Agent	Territory
Bio-Recycle Pty. Ltd.....	Australia, New Zealand and Singapore
CRM Technologies.....	Eastern Europe
EIEC.....	Spain
Esson Technology, Inc.....	China
Itico.....	Egypt, North Africa, The Middle East
Nesher Israel Cement, Ltd.....	Israel
N-Viro Filipino.....	Phillipines
N-Viro Systems Canada, Inc.....	Canada
South Africa N-Viro	All Africa except North Africa

In 1995, the Company sold the territorial rights of Europe, Africa and the Middle East and granted an exclusive license for these territories to an

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investor group headed by Mr. Robin Millard. This group acquired one of the Company's wholly owned subsidiaries, N-Viro Worldwide Limited. In late 2000, an agreement was reached for the Company to reacquire this territory and corresponding Internet marketing capabilities from Mr. Millard in exchange with the Company to dismiss its legal proceedings against Mr. Millard. This agreement was completed in 2001. See Item 3, "Legal Proceedings" for further discussion.

In January, 2000, the Company acquired the territorial rights from ISG Resources, Inc. for the states of Colorado, Iowa, Kansas, Minnesota, Montana, Nebraska, North Dakota, South Dakota and Wyoming. This territory was acquired by a termination of the existing agency agreement and concurrently executing a Memorandum of Understanding to provide an exclusive supply of alkaline materials to the Company, with a competitive market cap on the cost.

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In 2001, the Company settled a dispute with Hydropress Environmental Services ("Hydropress") that resulted in the reacquisition of Hydropress' licensing and territory rights in New England and the Mid-Atlantic States. Hydropress retained a non-exclusive license for the N-Viro technology for its Phillipsburg, NJ merchant facility. See Item 3, "Legal Proceedings" for further discussion.

In their respective territories, the Agents market licenses for the N-Viro Process, serve as distributors of alkaline admixture, oversee quality control of the N-Viro Process and N-Viro Soil, enforce the terms of the license agreements with licensees and market N-Viro Soil (or assist licensees in marketing N-Viro Soil). In general, the Agents have paid one-time, up-front fees to the Company for the rights to market or use the N-Viro Process in their respective territories. Typically, the agreements with the Agents provide for the Company to receive a portion of the up-front license fees and ongoing royalty fees paid by the licensees and a portion of the proceeds from the distribution and resale of alkaline admixture and the sale of N-Viro Soil.

INDUSTRY OVERVIEW

Sludge Management Practices and the 40 CFR part 503 Sludge Regulations. Historically, sludge management has involved either disposal, principally by landfilling, incineration, ocean dumping and surface disposal, or land application for beneficial use. On February 19, 1993, the EPA published the 40 CFR part 503 Sludge Regulations ("part 503 Regs") under the Clean Water Act of 1987 implementing the EPA's "exceptional quality" sludge program. The part 503 Regs establish sludge use and disposal standards applicable to approximately 35,000 publicly and privately-owned wastewater treatment plants in the United States, including primary publicly-owned treatment works ("POTWs"), secondary and advanced treatment POTWs, privately-owned treatment works, federally-owned treatment works and domestic septage haulers. The EPA currently estimates that the 13,000 to 15,000 POTWs generate 110 to 150 million wet metric tons of sewage sludge per year. Under the part 503 Regs, sludge may be disposed of in municipal solid waste landfills approved under Subtitle D of the Resource Conservation and Recovery Act ("RCRA"), or may be surface disposed, incinerated or land applied for beneficial use in accordance with the requirements established by the part 503 Regs.

Disposal. Landfilling, incineration and ocean dumping have traditionally provided inexpensive, reliable methods of sludge disposal. Ocean dumping was banned in the United States in December 1992. Under the part 503 Regs, landfilling and incineration remain permissible sludge management alternatives but have become subject to more stringent regulatory standards. The vast majority of states have some site restrictions or other management practices governing the disposal of sludge in landfills. Amendments to the Clean Air Act

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governing incineration and disposal of residual ash also impose stricter air emission standards for incineration in general, and the part 503 Regs impose additional specific pollutant limits for sludges to be incinerated and for the resulting air emissions.

Surface disposal of sludge involves the placement of sludge on the land at a dedicated site for disposal purposes. The part 503 Regs subject surface disposal to increased regulation by requiring, among other things, run-off and leachate collection systems, methane monitoring systems and monitoring of, and limits on, pollutant levels. In addition, sludge placed in a surface disposal site is required to meet certain standards with respect to pathogen levels relating to coliform or salmonella bacteria counts ("Class B" pathogen levels), levels of various pollutants, including metals, and elimination of attractiveness to pests, such as insects and rodents.

Land Application for Beneficial Use. Land application for beneficial use involves the application of sludge or sludge-based products, for non-disposal purposes, including agricultural, silvicultural and horticultural uses and for land reclamation. Under the part 503 Regs, sludge products that meet certain stringent standards with respect to pathogen levels relating to coliform, salmonella, enteric viruses and viable helminth ova counts ("Class A" pathogen levels), levels of various pollutants, including metals, and elimination of attractiveness to pests, such as insects and rodents, are considered by the EPA to be "exceptional quality" sludge products. The Class A pathogen levels are significantly more stringent than the Class B pathogen levels; for example, permitted Class B fecal coliform levels are 2,000 times higher than their Class A counterparts.

"Exceptional quality" sludge products are treated by the EPA as fertilizer material, thereby exempting these products from federal restrictions on their agricultural use or land application. N-Viro Soil that is produced according to N-Viro Process specifications meets the pollutant concentration limits and other standards set forth in the part 503 Regs and, therefore, is an "exceptional quality" sludge product that exceeds the EPA's standards for unrestricted agricultural use and land application. Lower quality sludges, including sludge-based products that meet Class B

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pathogen levels and certain pollutant control and pest attraction requirements, may also be applied to the land for beneficial use but are subject to greater record keeping and reporting requirements and restrictions governing, among other items, the type and location of application, the volume of application and limits on cumulative levels of metals. Sludges applied to the land for agricultural use must meet Class B pathogen levels and, if applied in bulk, require an EPA permit.

COMPETITION

The Company is in direct and indirect competition with other businesses, including disposal and other wastewater sludge treatment businesses, some of which are larger and more firmly established and may have greater marketing and development budgets and capital resources than the Company. There can be no assurance that the Company will be able to maintain a competitive position in the sludge treatment industry.

A 1988 EPA survey estimated that sludge generators in the United States utilized landfilling, incineration, surface disposal and ocean dumping as sludge management alternatives for approximately two-thirds of wastewater sludges generated. Although ocean dumping was banned in December 1992, other methods of sludge disposal remain permissible sludge management alternatives under the part

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503 Regs, and in many instances will be less expensive than treatment methods, including the N-Viro Process.

Sludge treatment alternatives other than disposal include processes, such as aerobic and anaerobic digestion and lime stabilization, that typically produce lower quality sludge products, and other processes, such as pelletization, composting, high heat lime sterilization and high heat en-vessel lime pasteurization, that produce "exceptional quality" sludge products. Some of these processes have established a significant market presence, and the Company cannot predict whether any of such competing treatment processes will be more or less successful than the N-Viro Process. In 2000 the primary competition to N-Viro technology was the dumping of raw sewage sludge in landfills. While such practices are prohibited in some states (e.g., North Carolina and New Jersey), the practice is accepted by the USEPA.

ENVIRONMENTAL REGULATION

Various environmental protection laws have been enacted and amended during recent decades in response to public concern over the environment. The Company's operations and those of its licensees are subject to these evolving laws and the implementing regulations. The United States environmental laws which the Company believes are, or may be, applicable to the N-Viro Process and the land application of N-Viro Soil include Resource Conservation and Recovery Act ("RCRA"), as amended by the Hazardous and Solid Waste Amendments of 1984 ("HSWA"), the Federal Water Pollution Control Act of 1972 (the "Clean Water Act"), the Clean Air Act of 1970, as amended (the "Clean Air Act"), the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), the Pollution Prevention Act of 1990 and the Federal Insecticide, Fungicide and Rodenticide Act ("FIFRA"). These laws regulate the management and disposal of wastes, control the discharge of pollutants into the air and water, provide for the investigation and remediation of contaminated land and groundwater resources and establish a pollution prevention program. Many of these laws have international counterparts, particularly in Europe and elsewhere in North America. In addition, various states have implemented environmental protection laws that are similar to the applicable federal laws and, in addition, states may require, among other things, permits to construct N-Viro facilities and to sell and/or use N-Viro Soil. There can be no assurance that any such permits will be issued.

The part 503 Regulations. Sewage sludge and the use and disposal thereof is regulated under the Clean Water Act. On February 19, 1993, the EPA published the part 503 Regs under the Clean Water Act implementing the EPA's "exceptional quality" sludge program. These regulations establish sludge use and disposal standards applicable to approximately 35,000 wastewater treatment plants in the United States, including approximately 12,750 publicly owned treatment works ("POTWs"). Under the part 503 Regs, sludge products that meet certain stringent standards are considered to be "exceptional quality" sludge products and are not subject to any federal restrictions on agricultural use or land application. N-Viro Soil produced according to N-Viro Process specifications is an "exceptional quality" sludge product. Lower quality sludges and sludge products are subject to federal restrictions governing, among other items, the type and location of application, the volume of application and the cumulative application levels for certain pollutants. Agricultural application of these lower quality sludges in bulk amounts also requires an EPA permit. Agricultural and land applications of all sludges and sludge products, including N-Viro Soil

and other "exceptional quality" sludge products, are typically subject to state and local regulation and, in most cases, require a permit.

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In order to ensure compliance with the part 503 Regs, the Company reviews the results of regular testing of sludges required by the EPA to be conducted by wastewater treatment plants, and itself tests N-Viro Soil produced at N-Viro facilities on a regular basis. In general, the Company does not license or permit the ongoing use of the N-Viro Process to treat any sludge that may not be processed into an "exceptional quality" sludge product. In one N-Viro facility, however, the Company has permitted the use of the N-Viro Process to produce a product that is not an "exceptional quality" sludge product due to the high pollutant levels of the resulting product. This product is not considered to be N-Viro Soil and is used solely for landfill cover at an adjacent landfill. In addition, the Company has previously licensed for use at five treatment facilities an earlier sludge treatment process that is designed to produce a sludge product that meets only Class B pathogen levels, and therefore does not produce an "exceptional quality" sludge product.

Although N-Viro Soil exceeds the current federal standards imposed by the EPA for unrestricted agricultural use and land application, state and local authorities are authorized under the Clean Water Act to impose more stringent requirements than those promulgated by the EPA. Most states require permits for land application of sludge and sludge based products and several states, such as Rhode Island, Massachusetts and New Jersey, currently have regulations that impose more stringent numerical concentration limits for certain pollutants than the federal rules.

The Resource Conservation and Recovery Act. RCRA regulates all phases of hazardous waste generation, management and disposal. A waste is subject to regulation as a hazardous waste under RCRA if it is a solid waste specifically listed as a hazardous waste by the EPA or exhibits a defined hazardous characteristic. Although domestic sewage and mixtures of domestic sewage and other wastes that pass through a sewer system to a POTW are specifically exempted from the definition of solid waste, once treated by the POTW, the sewage sludge is considered a solid waste. However, such sewage sludge is not considered a hazardous waste unless it exhibits a hazardous characteristic. While it is possible that sewage sludge could exhibit the toxicity characteristic, the Company believes that regular tests for hazardous constituent levels provide assurance that the sewage sludge used in the N-Viro Process does not exhibit the toxicity characteristic. The alkaline admixtures used in the N-Viro Process are specifically exempted from RCRA regulation by the so-called Bevill Amendments to RCRA. Although the benefit of the exemption provided by the "Bevill Amendments" can be lost if the alkaline admixture is derived from or mixed with a hazardous waste, the Company has adopted and implemented policies and operational controls, including review of operating permits held by alkaline admixture suppliers and periodic testing of such admixtures, to ensure that the alkaline admixtures used in the N-Viro Process by itself and its licensees are not derived from or mixed with hazardous wastes.

Although neither the alkaline admixture nor wastewater sludges used in the N-Viro Process are regulated as hazardous waste under RCRA, states may impose restrictions that are more stringent than federal regulations. Accordingly, the raw materials used in the N-Viro Process may be regulated under some state hazardous waste laws as "special wastes," in which case specific storage and record keeping requirements may apply.

The Clean Air Act. The Clean Air Act empowers the EPA to establish and enforce ambient air quality standards and limits of emissions of pollutants from specific facilities. The Clean Air Act Amendments of 1990 (the "Clean Air Act Amendments") impose stringent requirements upon owners and operators of facilities that discharge emissions into the air.

Existing N-Viro facilities generally have installed "baghouse" technology for alkaline admixture storage and handling operations in order to collect airborne dust. At present, the Company does not believe that any N-Viro

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facilities will be required to undertake any further measures in order to comply with the Clean Air Act or the existing Clean Air Act Amendments. Ammonia odors of varying strength typically result from sludge treatment processes, including the N-Viro Process. A number of N-Viro facilities have installed ammonia "scrubbers" to reduce ammonia odors produced to varying degrees by the N-Viro Process. The installation of ammonia "scrubbers" is not required by the Clean Air Act or the existing Clean Air Amendments. However, the Company or its licensees may be required under the Occupational Safety and Health Act and state laws regulating nuisances, odors and air toxic emissions to install odor control technology to limit ammonia emissions and odors produced during the N-Viro Process, particularly at N-Viro facilities located near populated residential areas. The amount of ammonia gas produced is dependent upon the type of sludge being treated and the amount and type of alkaline admixture being used.

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The Comprehensive Environmental Response, Compensation and Liability Act of 1980. CERCLA imposes strict, joint and several liability upon owners and operators of facilities where a release of hazardous substances has occurred, upon parties who generated hazardous substances into the environment that were released at such facilities and upon parties who arranged for the transportation of hazardous substances to such facilities.

The Company believes that the N-Viro Process poses little risk of releasing hazardous substances into the environment that presently could result in liability under CERCLA. Although the sewage sludge and alkaline waste products could contain hazardous substances (as defined under CERCLA), the Company has developed plans to manage the risk of CERCLA liability, including training of operators, regular testing of the sludge and the alkaline admixture to be used in the N-Viro Process and reviewing incineration and other permits held by the entities from whom alkaline admixtures are obtained.

Other Environmental Laws. The Pollution Prevention Act of 1990 establishes pollution prevention as a national objective, naming it a primary goal wherever feasible. The act states that where pollution cannot be prevented, materials should be recycled in an environmentally safe manner. The Company believes that the N-Viro Process contributes to pollution prevention by providing an alternative to disposal.

The alkaline admixtures used in the N-Viro Process may be required to be registered as pesticides under FIFRA because of their effect on pathogens in sludge. The EPA does not currently regulate commercial lime or any alkaline by-products under FIFRA and has not attempted to assert such jurisdiction to date. In the event the alkaline by-products are required to be registered under FIFRA, the Company would likely be required to submit certain data as part of the registration process and might be subject to further federal regulation.

State Regulations. State regulations typically require an N-Viro facility to obtain a permit for the sale of N-Viro Soil for agricultural use, and may require a site-specific permit by the user of N-Viro Soil. In addition, in some jurisdictions, state and/or local authorities have imposed permit requirements for, or have prohibited, the land application or agricultural use of sludge products, including "exceptional quality" sludge products. There can be no assurance that any such permits will be issued or that any further attempts to require permits for, or to prohibit, the land application or agricultural use of sludge products will not be successful.

In addition, many states enforce landfilling restrictions for non-hazardous sludge. These regulations typically require a permit to sell or use sludge products as landfill cover material. There can be no assurance that N-Viro facilities or landfill operators will be able to obtain required permits.

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Environmental impact studies may be required in connection with the development of future N-Viro facilities. Such studies are generally time consuming and may create delays in the construction process. In addition, unfavorable conclusions reached in connection with such a study could result in termination of, or expensive alterations to, the N-Viro facility being developed.

EMPLOYEES

As of December 31, 2001, the Company had 20 employees in the following capacities: 8 engaged in sales and marketing; 5 in finance and administration; and 7 in operations. The Company considers its relationships with its employees to be satisfactory.

The Company is a party to a collective bargaining agreement (the "Labor Agreement") covering certain employees of National N-Viro Tech, Inc., a wholly-owned subsidiary of the Company. The employees that are covered by the Labor Agreement work at the Toledo, Ohio N-Viro facility which is operated by the Company on a contract management basis for the City of Toledo. These employees are members of the International Brotherhood of Teamsters, Chauffeurs, Warehouseman and Helpers Local Union No. 20, and the Company considers its relationships with the organization to be satisfactory. At present, the Labor Agreement expires October 31, 2004.

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N-VIRO FACILITIES

To date, the Company principally has licensed the N-Viro Process to municipalities for use in municipally-owned wastewater treatment plants. The Company has also operated, generally on a start-up basis, N-Viro facilities for municipalities and currently operates one municipally-owned N-Viro facility on a contract management basis. In most cases, however, municipal licensees have elected to design, construct and operate N-Viro facilities independently.

As of December 31, 2001, there were more than 40 N-Viro facilities operating throughout the world. The sludge processing capacity of these facilities ranges from one to 160 dry tons per day. Based upon reports received from N-Viro facilities, the Company estimates they are processing wastewater sludge at an annualized rate of over 140,000 dry tons per year. The chart below summarizes the current annualized sludge processing volume for each of the five largest N-Viro facilities through December 31, 2001.

Facility Location	Approximate Sludge Processing Volume (dry tons/year)
Middlesex County, New Jersey	57,300
Wilmington, Delaware	12,000
Syracuse, New York	10,700
Toledo, Ohio	8,100
Phillipsburg, New Jersey	7,100

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All of the existing N-Viro facilities are owned and operated by third parties, with the exception of the Toledo, Ohio facility which has been operated by the Company on a contract management basis since January 1990.

Design and construction of a facility using the N-Viro Process is typically undertaken by local independent engineering and construction firms. Such a facility can be completed in approximately six months, but could take substantially longer, depending on the size and complexity of the facility. The N-Viro Process produces ammonia in various concentrations, depending on the characteristics of the sludge. A number of N-Viro facilities, typically those located near residential areas, have installed odor control systems in order to minimize the release of ammonia odors resulting from the N-Viro Process. An odor control system can significantly increase construction time and cost. Construction of N-Viro facilities generally requires state and local permits and approvals and, in certain instances, may require an environmental impact study.

The Company had previously licensed for use at five treatment facilities an earlier sludge treatment process that is designed to produce a sludge product that meets only Class B pathogen levels, and therefore does not produce an "exceptional quality" sludge product under the part 503 Regs. Royalty payments from sludge processed at the five facilities using such earlier technology currently account for less than two percent of total royalty payments to the Company and the Company does not actively market the use of this process.

SEGMENT INFORMATION

EARNINGS VARIATION DUE TO BUSINESS CYCLES AND SEASONAL FACTORS. The Company's operating results can experience quarterly or annual variations due to business cycles, seasonality and other factors. The market price for its common stock may decrease if its operating results do not meet the expectations of the market.

Currently, approximately 37% of the Company's revenue is from management operations, 53% from other domestic operations, 5% from research and development grants and the remaining 5% from foreign operations. Sales of the N-Viro technology are affected by general fluctuations in the business cycles in the United States and worldwide, instability of economic conditions (such as the current conditions in the Asia Pacific region and Latin America) and interest rates, as well as other factors. In addition, operating results of some of the Company's business segments are influenced, along with other factors such as interest rates, by particular business cycles and seasonality. See Notes to the Financial Statements contained in Item 8 hereof.

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COMPETITION. The Company competes against companies in a highly competitive market and has fewer resources than most of those companies. Its business competes within and outside the United States principally on the basis of the following factors:

SEGMENT	Management Operations	Other Domestic Operations	Foreign Operations
	Price	Price	Price

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COMPETITIVE FACTORS	Reliability	Reputation	Product quality and specifications	
	Product quality and specifications	Product quality and specifications	Custom design	
	Responsiveness to customer	Technical support	Equipment financing assistance	P
	Technical support	Custom design	Technical support	
	Reputation	Equipment financing assistance	Reputation	E

Competitive pressures, including those described above, and other factors could cause the Company to lose market share or could result in decreases in prices, either of which could have a material adverse effect on its financial position and results of operations.

RISKS OF DOING BUSINESS IN OTHER COUNTRIES. The Company conducts business in markets outside the United States, and expects to continue to do so. In addition to the risk of currency fluctuations, the risks associated with conducting business outside the United States include: social, political and economic instability; slower payment of invoices; underdeveloped infrastructure; underdeveloped legal systems; and nationalization. The Company has not entered into any currency swap agreements which may reduce these risks. The Company may enter into such agreements in the future if it is deemed necessary to do so.

Current economic and political conditions in the Asia Pacific and Middle East regions have affected the Company outlook for potential revenue there. The Company cannot predict the full impact of this economic instability, but it could have a material adverse effect on revenues and profits.

ITEM 2. PROPERTIES

The Company's executive and administrative offices are located in Toledo, Ohio, under a lease that expires on December 31, 2002. The Company believes its relationship with its lessor is satisfactory.

In early 1994 the Company purchased a site in Fort Meade, Florida to develop a Company-owned N-Viro processing facility. Construction was started at the site in late 1994 and the facility became operational in early 1995. In December 1995, the Company entered into a Memorandum of Understanding with VFL Technologies, Inc. to jointly own, through a limited partnership named Florida N-Viro, LP ("Florida N-Viro"), the Fort Meade, Florida facility, beginning January 1, 1996. On December 31, 1997, the members of Florida N-Viro Management, LLC, the management company of the Florida entity, approved a Settlement Agreement that amended certain provisions and increased the Company's ownership percentage in Florida N-Viro to 50%.

In August 2000, a Memorandum of Understanding was entered into between the Company and VFL, clarifying decisions, information and additional operating requirements of Florida N-Viro. Later that month, the Company loaned Florida N-Viro \$120,000 cash to help meet operating expenses, and was issued a Promissory Note. An additional \$50,000 cash was loaned in November, 2000 under similar circumstances, and a second Promissory Note was issued to the Company. Both Notes are unsecured and are payable on demand, and both bear interest at 9.75%.

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In January 2001, a Special Meeting of the Board of Directors of Florida N-Viro Management LLC was held. Among the decisions made were amendments to both the Partnership Agreement and the Memorandum of Understanding entered into in August, 2000. The aggregate ownership percentages in the Florida investment of the

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Company and VFL were amended to 47.5% and 52.5%, respectively, effective January 1, 2001. Also, a decision was made to relieve the requirement of the Company from funding any additional losses of Florida N-Viro, provided the Company loan an additional total of \$180,000 between January and February, 2001, to be evidenced by a third Promissory Note. The Note is unsecured, due on demand and bears interest at prime (tied to a local Bank) plus 1/4%, or the Applicable Federal Rate, whichever is higher. All loans made by the Company to Florida N-Viro in 2000 and 2001, were made to equalize each partner's advances to the partnership, required after additional monies were advanced by VFL during 2000.

The Company is currently in negotiations to sell its investment in Florida N-Viro to an unrelated third party purchaser.

Because of the joint development of early N-Viro patents with the Medical College of Ohio ("MCO"), in 1995, the Company and MCO agreed that the rights of MCO to any intellectual property of value to the Company in development, patentable or patented would generate royalties to MCO. The Company and MCO have also agreed that future claims to the N-Viro Soil process is 1/4% of technical revenues. MCO rights to BioBlend and other N-Viro technologies range from 2% to 4% of technical revenues derived from these newer technologies. Cumulative royalties due to MCO through December 31, 2001 is \$51,975.

ITEM 3. LEGAL PROCEEDINGS.

During 1994, the Company entered into an agreement to reacquire territory rights from a former agent, Hydropress Environmental Services, Inc. ("Hydropress"), in exchange for 66,250 shares of unregistered common stock. This agreement stated that if Hydropress elected to sell these shares, the Company would guarantee a value of \$6 per common share.

In October 1998, Hydropress filed suit against the Company seeking a declaratory judgment as to Hydropress' rights and duties related to certain obligations pursuant to a license agreement and a prior settlement agreement related to the license agreement. Hydropress filed the Complaint, but failed to obtain service of process upon the Company.

During 1999, Hydropress and the Company entered into a Settlement Agreement that provided, among other things, for the dismissal of the suit, mutual limited releases, agreements as to past due amounts that Hydropress owed the Company, as well as a basis for determining future amounts, and an agreement that, for a period of eighteen (18) months from the date of the settlement agreement, Hydropress would not sell any of the 66,250 shares of Company stock that it had been issued in 1994 and that Hydropress could thereafter sell no more than 10,000 shares of the Company's stock per month.

In February 2000, Hydropress and the Company modified the 1999 agreement by agreeing to allow Hydropress to sell shares of the Company's stock before the eighteen-month period, in addition to increasing the maximum amount of shares it could sell without approval from the Company in any one month to 15,000 shares. In exchange, Hydropress released the Company from its minimum price guarantee obligations under the 1999 Settlement Agreement. The Company understood the letter agreement to excuse it entirely from its obligation to guarantee Hydropress' receipt of proceeds of at least \$6.00 per share from the sale of the

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Company stock. This was consistent with the position taken in the Company's public filings under and pursuant to the terms of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, as well as the Company's audited financial statements. In late September 2000, representatives of Hydropress informed the Company that Hydropress maintained that the letter suspended for a fixed period of time the \$6.00 per share guarantee of proceeds, but that following that period of time, the guarantee remained in effect. In November 2000, the Company brought suit against Hydropress. The Complaint sought a declaratory judgment that the minimum price guarantee was no longer in effect.

In November, 2001, the Company and Hydropress signed a Settlement Agreement, as filed under Form 8-K dated December 14, 2001. Each party dismissed its claims against the other with prejudice and entered into general releases of the other party. N-Viro purchased back the 66,250 N-Viro shares held by Hydropress at the market price as of November 15, 2001, which was \$1.01 per share for a total of \$66,913. The Company also purchased back three patent license agreements (including territory rights) from Hydropress valued at approximately \$287,000. The first license concerned the exclusive right to sell and use the N-Viro technology in Massachusetts, Vermont and New Hampshire. The second concerned the non-exclusive right to sell and use the N-Viro technology in New Jersey, Delaware, Maryland and Eastern Pennsylvania. The third concerned amendments to the two prior-mentioned agreements and the exclusive right to use the N-Viro technology at Hydropress' facility in Phillipsburg, New Jersey.

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N-Viro and Hydropress entered into a new patent license agreement granting Hydropress the non-exclusive right to use the N-Viro technology at its facility in Phillipsburg, New Jersey. The Company is paying certain amounts due to Hydropress under the Settlement Agreement pursuant to the terms of a promissory note (the "Note"). The principal amount of the Note is \$204,587, is non-interest bearing and matures on October 15, 2002 with a balloon payment of \$144,587. At December 31, 2001 the outstanding principal balance on the Note was \$198,587.

On February 25, 2000, the Company filed a Complaint for Patent Infringement in the United States District Court for the Northern District of Ohio against the City of Warren, Ohio. The Company believed that the City of Warren had willfully and intentionally infringed patents the Company owns and was seeking both equitable remedies in the form of an injunction and legal remedies in the form of damages. On April 17, 2000, the City of Warren responded by filing an Answer and Counterclaims against the Company. On September 14, 2000, the Company and the City of Warren settled the dispute, with the City of Warren paying the Company the sum of \$100,000. The successful conclusion of the litigation with the City of Warren reinforces the Company's commitment to defend its intellectual property.

In July 2000, the Company terminated the license of N-Viro Worldwide Limited and filed suit against Robin Millard and R3 Management Limited ("R3M" in the United States district Court for the Northern District of Ohio (#3:00CV7443). The suit sought damages for breach of contract, breach of fiduciary duty and related torts based on intellectual property developed by Mr. Millard that the Company contends is owned by the Company.

N-Viro settled this lawsuit with Mr. Millard and R3M. The terms are as follows: N-Viro dismissed its claims with prejudice and renounced any prior interest in R3M's technology. R3M licensed its proprietary technology to N-Viro on a worldwide non-exclusive basis subject to certain exceptions. N-Viro paid a \$5,000 fee for the license, which also provides for royalty payments if N-Viro uses or licenses the technology. R3M assigned to N-Viro R3M's interest in sublicense agreements with Yorkshire Water, Ltd. and Silt (now DEC), N.V. N-Viro terminated its exclusive license with R3M related to N-Viro's proprietary

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technology in specified countries in Europe, the Middle East and the former Soviet Union. R3M and an affiliate, N-Viro Worldwide, Ltd. ("NVWL") agreed to cease using the name "N-Viro" and to transfer to N-Viro the internet URL "n-viro.com." NVWL agreed to pay N-Viro \$195,532 for past fees owed and for equipment. N-Viro agreed to pay NVWL \$195,532 for ceasing to use the N-Viro name and for transferring the internet URL "n-viro.com."

In 2001, officials of the North Carolina Department of Revenue (the "Department") contacted the Company and indicated that the Company was under investigation for failing to file sales tax returns in the state of North Carolina during the period from December 1994 to June 2001. The Company acknowledged to Department officials that during that period of time, it had collected approximately \$80,000 in sales taxes from certain customers but had not collected sales tax from other customers in North Carolina. The Company submitted a memorandum to the Department arguing that no sales tax was due by the Company because the sales at issue were exempt from sales tax. The Department disagreed with this memorandum and levied a fine and civil penalty totaling approximately \$70,000 plus interest due on the previous unremitted taxes, which the Company agreed to in lieu of litigation. To date the Company has remitted all sales tax due the State, as well as paid the fine and approximately one-third of the civil penalty and interest due, and has arranged a short-term payment schedule agreed to by the Department on the balance. The Company has voluntarily approached state tax authorities in South Carolina and acknowledged failing to file sales tax returns within that state. The Company has collected and accrued approximately \$167,000 in sales tax from customers in South Carolina that has not been remitted to South Carolina tax authorities. The Company believes that the sales at issue are exempt from sales tax. The Company has retained counsel in South Carolina to assist it in negotiating a settlement of this matter.

On October 30, 2001, the Company settled its lawsuit with RDP Technologies, Inc. ("RDP"). RDP filed the lawsuit in Delaware federal court in August 2000, asserting claims for tortious interference with prospective business relations and unfair competition, and later adding a claim for a declaratory judgment regarding infringement, validity and enforceability of two of the Company's patents. The Company denied all of RDP's claims. As a result of the settlement, RDP's claims were dismissed with prejudice, and each party agreed to bear its own costs and attorneys fees.

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

None.

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PART II

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

MARKET INFORMATION

The Company's Common Stock is listed in the Nasdaq Small Cap Market under the symbol "NVIC". The price range of the Common Stock in the Market since January 1, 2000, was as follows:

QUARTER	HIGH	LOW
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First 2000	5.75	1.66
Second 2000	5.25	2.94
Third 2000	3.94	2.56
Fourth 2000	3.00	1.38
First 2001	2.75	1.75
Second 2001	2.18	1.54
Third 2001	1.80	1.04
Fourth 2001	1.15	0.80

The Company's stock price closed at \$0.87 per share on March 22, 2002.

HOLDERS

As of March 22, 2002, the number of holders of record of the Company's Common Stock was approximately 1,285.

DIVIDENDS

The Company has never paid dividends with respect to its Common Stock.

UNREGISTERED SALES OF SECURITIES

None.

ITEM 6. SELECTED FINANCIAL DATA

The Company was incorporated in April 1993. In September 1993, an agreement was entered into pursuant to which N-Viro Energy Systems, Ltd., an Ohio limited partnership contributed to the Company all of its assets (except certain marketable securities and accounts receivable from certain related parties) subject to all liabilities (except certain retained liabilities), and the stockholders of the Combined Agents contributed to the Company all of the outstanding capital stock of each of such entities, in each case in exchange for Common Stock and promissory notes (the "Organization"). The Organization was accounted for as if the Partnership and the Combined Agents (collectively, the "Company Entities") had always been members of the same operating group. Accordingly, historical financial statements of each of such entities have been combined throughout all relevant periods herein. Certain adjustments have been made to eliminate intercompany transactions between the Company Entities.

The following selected consolidated statement of operations data for the years ended December 31, 1997, 1998, 1999, 2000 and 2001; and the consolidated balance sheet data set forth below as of December 31, 1997, 1998, 1999, 2000 and 2001 respectively, have been derived from the financial statements of the Company which have been audited by McGladrey & Pullen, LLP, independent auditors for the years ending December 31, 1997 and 1998, and Hausser + Taylor, LLP, independent auditors for the years ended December 31, 1999, 2000 and 2001. In the opinion of management, the financial data presented below reflect all adjustments (which are of a normal recurring nature)

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necessary to present fairly the Company's financial position and results of operations. The data presented below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Financial Statements and Supplementary Data appearing elsewhere in this Form 10-K.

STATEMENT OF OPERATIONS DATA (IN THOUSANDS, EXCEPT PER SHARE DATA) :

	12/31/01	12/31/00	12/31/99	12/31/98	12/31/97
Revenues	\$4,383	\$4,166	\$4,749	\$3,929	\$3,929
Net income (loss)	(1,267)	(845)	471	(373)	(373)
Net income (loss) per share	\$ (0.48)	\$ (0.32)	\$0.18	\$ (0.15)	\$ (0.15)

BALANCE SHEET DATA (IN THOUSANDS) :

	12/31/01	12/31/00	12/31/99	12/31/98	12/31/97
Total assets	\$4,133	\$4,752	\$4,772	\$3,783	\$4,133
Notes and line of credit payable	\$1,402	\$ 649	\$ 352	\$ 161	\$ 161
Shareholder Advance	\$ 24	\$ 22	\$ 49	\$ 47	\$ 47

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

OVERVIEW

The following is a discussion of our results of operations and financial position for the periods described below, and should be read in conjunction with "Selected Financial Data" and the Financial Statements and Supplementary Data appearing elsewhere in this Form 10-K. The discussion includes various forward-looking statements about our markets, products, services and our results. These statements are based on certain assumptions that we consider reasonable. Our actual results may differ materially from these indicated forward-looking statements.

The following table sets forth, as a percentage of total revenues for the periods presented, revenues related to each of (i) technology fees, (ii) facility management, (iii) products and services:

FOR THE YEAR ENDED DECEMBER 31,

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	2001	2000
Technology fees	19.4%	24.0%
Facility management	37.3%	36.5%
Products and services	43.3%	39.5%
Totals	100.0%	100.0%

Technology fee revenues consist of: royalty revenue, which represent ongoing amounts received from licensees for continued use of the N-Viro Process and are typically based on volumes of sludge processed; license and territory fees, which represent non-recurring payments for the right to use the N-Viro Process in a specified geographic area or at a particular N-Viro facility; research & development revenue, which represent payments from federal and state agencies awarded to the Company to fund ongoing site-specific research utilizing the N-Viro technology.

Facility management revenues are recognized under contracts where the Company itself manages the N-Viro Process to treat sludge, pursuant to a fixed price contract.

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Product and service revenues consist of: alkaline admixture revenue, which represent ongoing payments from licensees arising from the sale and distribution of alkaline admixture by the Company and the Agents to N-Viro facilities; N-Viro Soil sales, which represent either revenue received from sales of N-Viro Soil sold by N-Viro facilities, or through sales of N-Viro Soil sold directly by the Company; commissions earned on sales of equipment to an N-Viro facility; rental of equipment to a licensee or agent; testing income, which represent fees charged for the periodic quality control of the N-Viro Soil produced; equipment sales, which represent the price charged for equipment held for subsequent sale.

The Company's policy is to record fully revenues payable pursuant to agency and license agreements when the Company has fulfilled its obligations under the relevant contract, except when the license agreement pertains to a foreign contract. In this case revenue is recorded when cash is received and when the Company has fulfilled its obligations under the relevant contract.

RECENT DEVELOPMENTS

The Company received notice on November 29, 2001 from Nasdaq regarding the Company's continued listing on the Nasdaq SmallCap Market. The Nasdaq maintains that the Company is in violation of a listing rule requiring all listed companies to maintain either (1) a net tangible asset value of \$2,000,000 or more, or (2) \$2,500,000 or more in stockholders' equity, or (3) a market capitalization of \$35,000,000, or (4) net income of at least \$500,000 for the most recently completed fiscal year, or two of the three most recently completed fiscal years (the "Requirements"). Presently, the Company does not satisfy any of these Requirements. The Company subsequently provided Nasdaq with a plan to achieve and sustain compliance with all of the Requirements. On February 28, 2002, the Company received a Nasdaq staff determination indicating that it had rejected the Company's plan and the Company fails to comply with the minimum net tangible assets or minimum stockholders' equity requirements for continued listing on the Nasdaq SmallCap Market, as set forth in Nasdaq Marketplace Rule

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4310(c)(2)(B). The Company filed an appeal to the staff's determination. Pending resolution of the Company's appeal, the Company's common stock will remain listed on the Nasdaq SmallCap Market. The Company's oral hearing before a Nasdaq Listing Qualifications Panel will be held on April 18, 2002. While the Company anticipates that it can bring itself into compliance with Nasdaq Requirements on or before June 30, 2002, there can be no assurances that this will occur, or even if it does occur, that the timing of compliance will be soon enough to satisfy Nasdaq authorities and avoid the delisting of the Company's common stock. If the Company's common stock is delisted from Nasdaq, the Company's shares of common stock will be traded on the Over-The-Counter market and there can be no assurance that such shares will be relisted on the Nasdaq. The Company does not anticipate that the delisting of its common stock on the Nasdaq SmallCap Market may have a material adverse effect on the financial condition or results of operations of the Company. The delisting of the Company's common stock from Nasdaq, however, may have a material adverse effect on the marketability of the Company's shares, as shares traded on the Over-the-Counter market generally experience lower trading value than those traded on the organized exchanges.

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RESULTS OF OPERATIONS

The following tables set forth, for the periods presented, (i) certain items in the Combined Statement of Operations, (ii) the percentage change of each such item from period to period and (iii) each such item as a percentage of total revenues in each period presented.

(Dollars in thousands) -----	Year Ended December 31, 2001	Period to Period Percentage Change	Year Ended December 31, 2000	Period to Period Percentage Change

COMBINED STATEMENT OF OPERATIONS DATA:				
Revenues	\$ 4,383	5.2%	\$ 4,166	(12.3%)
Cost of revenues	2,795	14.7%	2,437	8.6%
	-----		-----	
Gross profit	1,588	(8.2%)	1,729	(31.0%)
Operating expenses	2,717	12.8%	2,408	21.8%
	-----		-----	
Operating income (loss)	(1,129)	*	(679)	*
Non-operating income (expense)	(138)	*	146	*
	-----		-----	
Income (loss) before income tax expense	(1,267)	*	(533)	*
Federal and state income tax expense	0	*	312	*
	-----		-----	
Net income (loss)	\$ (1,267)	*	\$ (845)	*
	=====		=====	

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PERCENTAGE OF REVENUES:

Revenues	100.0%	100.0%
Cost of revenues	63.8	58.5
	-----	-----
Gross profit	36.2	41.5
Operating expenses	62.0	57.8
	-----	-----
Operating income (loss)	(25.8)	(16.3)
Non-operating income (expense)	(3.1)	3.5
	-----	-----
Income (loss) before income tax expense	(28.9)	(12.8)
Federal and state income tax expense	0.0	7.5
	-----	-----
Net income (loss)	(28.9%)	(20.3%)
	=====	=====

* Period to period percentage change comparisons have only been calculated for positive numbers.

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COMPARISON OF YEAR ENDED DECEMBER 31, 2001 WITH YEAR ENDED DECEMBER 31, 2000

Revenues increased \$216,000, or 5%, to \$4,383,000 for the year ended December 31, 2001 from \$4,166,000 for the year ended December 31, 2000. The increase in revenue was due to the following: revenues from one-time domestic license or international territory fees decreased \$202,000, to \$34,000 for 2001 from \$236,000 for 2000; revenues from existing on-line facilities increased \$419,000 to \$4,349,000 from \$3,930,000 for 2000, primarily from an increase in royalties of \$81,000, an increase in management fee operations of \$116,000, an increase in alkaline admixture revenue of \$86,000, an increase in product and consulting revenue totaling \$43,000, offset by decreases in research and development project revenue of \$28,000 and testing revenue (now billed directly from an outside laboratory) of \$25,000. In 2001 the Company realized a new type of revenue when it recorded \$144,000 in cash received from a foreign licensee from the sale of equipment for the start-up of operations. Also, in 2001 the Company recorded no gross royalty revenue from its former European licensee, N-Viro Worldwide, Ltd., a decrease of \$25,000 from 2000.

Gross Profit decreased \$141,000, or 8%, to \$1,588,000 for the year ended December 31, 2001 from \$1,729,000 for the year ended December 31, 2000. The decrease in gross profit was primarily due to the increased revenue from sales of equipment, facility management and alkaline admixture revenue which has a higher associated cost of revenue than other types, and to the decreased revenue from licensing which has a lower associated cost of revenue. The Company's largest increase in revenue in 2001 was from the sale of equipment, which has a lower gross profit margin than the Company's overall profit margin. The overall gross profit margin decreased to 36% in 2001 from 42% for 2000. This decrease in gross profit margin was primarily due to the decrease in one-time fee revenue, and furthered by the increase in revenue from sales of equipment,

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facility management operations and alkaline admixture revenue, which are at higher and lower gross profit margins, respectively. One of the factors contributing to the higher cost of revenue and lower margins was that management operations saw increases in product distribution costs for the N-Viro Soil(TM) product, which costs were primarily affected by the weather. Another factor was the cost increase to the Company in 2001 for the alkaline additive used in the process. This increase was primarily due to higher transportation costs, which themselves were driven partially by increases in fuel prices. However, in early 2002, the Company secured a major source of lower cost alkaline additive in early 2002, which will generate revenue from the management of the alkaline additive. This source should increase the gross profit margin for these locations. The gross profit margin from existing on-line facilities remained the same from the previous year at 39%.

Operating expenses increased \$309,000, or 13% to \$2,717,000 for the year ended December 31, 2001 from \$2,408,000 for the year ended December 31, 2000. The main reason for this increase was that the Company incurred fees and expenses of approximately \$650,000 in 2001 for the defense of its patents and licensing rights, which was approximately \$520,000 more than in 2000. This increase was partially offset by a total of approximately \$210,000 primarily for: a decrease of \$200,000 in salaries and employee benefits, a decrease in shareholder relations expense of \$80,000, a \$58,000 writedown of the Company's allowance for bad debts, and an increase of \$130,000 in legal fees, interest and penalties in connection with the resolution of issues related to sales tax audits in North Carolina and South Carolina. Because certain significant litigation involving the Company was concluded in 2001, the Company anticipates lower operating expenses for current ongoing operations for 2002.

Nonoperating income (expense) decreased by \$284,000 to expense of \$138,000 for the year ended December 31, 2001 from income of \$146,000 for the year ended December 31, 2000. The increase was primarily due to the recovery in 2000 of \$275,000 of a bad debt previously written off. The bad debt previously written off was a note receivable from a Canadian licensee, which was fully reserved for in allowance for bad debts.

In 1997, the Company recorded a deferred tax asset and a corresponding income tax benefit of \$312,000 to recognize the benefit of \$800,000 in loss carryforwards expected to be realized. The Company believed that sufficient taxable income would be generated in the near term, as the Company had changed its strategic focus to its profitable core business. Based on the results of the Company's 2000 operating performance, the Company believed that the recording of a deferred tax asset for the tax benefit of its net operating loss carryforward was no longer appropriate. As a result, in 2000, the Company provided an additional valuation allowance against the tax benefit associated with the net operating loss and recognized expense of \$312,000 to reduce the recorded tax benefit of the net operating loss carryforwards to zero.

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The Company recorded a net loss of \$1,267,000 for the year ended December 31, 2001 compared to a net loss of \$845,000 for the year ended December 31, 2000.

The Company incurred a loss of approximately \$137,000 on its share of Florida N-Viro, LLP in 2001, an increased loss of \$8,000 from 2000. The Company anticipates this operation to continue to be unprofitable in 2002, and has taken steps to minimize the impact of this investment on its net profit and cash flow. The Company is currently in negotiations to sell its interest in this investment to an unrelated third party purchaser. See the discussion in Liquidity and Capital Resources section later in this Item 6. The audited financial statements of Florida N-Viro are included in this document after the Company's financial

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statements as Item 14(d), Financial Statements of Subsidiaries not Consolidated.

COMPARISON OF YEAR ENDED DECEMBER 31, 2000 WITH YEAR ENDED DECEMBER 31, 1999

Revenues decreased \$583,000, or 12%, to \$4,166,000 for the year ended December 31, 2000 from \$4,749,000 for the year ended December 31, 1999. The decrease in revenue was due to the following: revenues from one-time domestic license or international territory fees decreased \$523,000, to \$236,000 for 2000 from \$759,000 for 1999; revenues from existing on-line facilities decreased \$60,000 to \$3,930,000 from \$3,990,000 for 1999, primarily from a decrease in royalties of \$149,000, a decrease in management fee operations of \$85,000 and a decrease in revenue from research and development projects of \$75,000, offset by an increase in alkaline admixture revenue of \$299,000. In 2000 the Company recorded approximately \$25,000 in gross royalty revenue from its former European licensee, N-Viro Worldwide, Ltd., a decrease of \$75,000 from 1999.

Gross Profit decreased \$776,000, or 31%, to \$1,729,000 for the year ended December 31, 2000 from \$2,505,000 for the year ended December 31, 1999. The decrease in gross profit was primarily due to the decrease in revenues from one-time domestic license or international territory fees, and royalty fee revenue. This revenue has a higher gross profit associated with them than other types of revenue. The Company's largest percentage increase in revenue in 2000 was from the sale of alkaline admixture, which traditionally has a lower gross profit margin than the Company's overall margin. The overall gross profit margin decreased to 42% in 2000 from 53% for 1999. This decrease in gross profit margin was primarily due to the decrease in one-time fees and royalty fee revenue, and furthered by the increase in alkaline admixture revenue, which are at higher and lower gross profit margins, respectively. The gross profit margin from existing on-line facilities decreased to 39% from 46% for 1999, primarily from the aforementioned increase in alkaline admixture revenue.

Operating expenses increased \$432,000, or 22% to \$2,408,000 for the year ended December 31, 2000 from \$1,976,000 for the year ended December 31, 1999. The Company increased expenditures for salaries and employee benefits by \$141,000, the net cost (after a \$100,000 settlement recovery) of patent litigation initiated in 1999 by \$123,000, legal and other professional fees by approximately \$120,000, research & development by approximately \$41,000 and sales, promotion, administrative overhead and outside consultants by a combined total of \$7,000. The Company anticipates its increase in operating expense in 2000 will translate into increased sales of the N-Viro technology in the near future.

Nonoperating income (expense) increased by \$215,000 to income of \$146,000 for the year ended December 31, 2000 from an expense of \$69,000 for the year ended December 31, 1999. The increase was primarily due to the recovery of \$275,000 of a bad debt previously written off, and an increase in the loss in the equity of a joint venture from a loss of \$69,000 in 1999 to a loss of \$129,000 in 2000. The bad debt previously written off was a note receivable from a Canadian licensee, which was fully reserved for in allowance for bad debts. See the discussion below of the investment in the Ft. Meade, Florida operation.

In 1997, the Company recorded a deferred tax asset and a corresponding income tax benefit of \$312,000 to recognize the benefit of \$800,000 in loss carryforwards expected to be realized. The Company believed that sufficient taxable income would be generated in the near term, as the Company had changed its strategic focus to its profitable core business. Based on the results of the Company's 2000 operating performance, the Company believed that the recording of a deferred tax asset for the tax benefit of its net operating loss carryforward was no longer appropriate. As a result, in 2000, the Company has provided an additional valuation allowance against the tax benefit associated with the net operating loss and recognized expense of \$312,000 to reduce the recorded tax benefit of the net operating loss carryforwards to zero.

The Company recorded a net loss of \$845,000 for the year ended December 31, 2000 compared to net income of \$471,000 for the year ended December 31, 1999.

In early 1996 the Company completed the transfer of its interest in the Fort Meade, Florida facility. The Company incurred a loss of approximately \$129,000 on its share of Florida N-Viro, LLP in 2000, an increased loss of \$60,000 from 1999. The Company anticipates this operation to continue to be unprofitable in 2001, but has taken steps to minimize the impact of Florida N-Viro on its net profit and cash flow. The audited financial statements of Florida N-Viro are included in this document after the Company's financial statements as Item 14(d), Financial Statements of Subsidiaries not Consolidated.

LIQUIDITY AND CAPITAL RESOURCES

The Company had a working capital deficit of approximately \$955,000 at December 31, 2001 compared to positive working capital of \$311,000 at December 31, 2000, a decrease of approximately \$1,266,000. Current assets at December 31, 2001 included cash and investments of \$445,000 (including restricted cash of \$400,000), which is a decrease of about \$101,000 from December 31, 2000. The decrease in working capital was principally due to the operating loss for the year.

In 2001 the Company's operating cash flow remained negative, and the Company had difficulty paying its unsecured trade vendors. No unusual cash transactions were recorded in 2001.

In 1997 the Company obtained a working capital line of credit of \$200,000 and in the third quarter of 1998 the line was increased to \$500,000. This debt was collateralized by a certificate of deposit with the lender, accounts receivable, inventories and equipment, assignment of the Contract between the City of Toledo and the Company, was due on demand, and, required the Company to maintain certain financial covenants.

In April 2000, the Company renewed its agreement for a line of credit of \$1 million, and in May 2001 this renewal was agreed to for \$750,000 that expires April 30, 2002. This agreement is secured by a certificate of deposit with the lender of \$400,000, with all other terms similar as agreed to in 1998 except there are no financial covenants. Borrowings up to \$400,000 bear interest at prime minus .5%, and borrowings above \$400,000 bear interest at prime plus 1%. The balance owed on the line at December 31, 2001 was approximately \$504,000.

The normal collection terms for accounts receivable are approximately 60 days for a majority of the customers. This is a result of the nature of the license contracts, type of customer and the amount of time required to obtain the information to prepare the billing. The Company lowered its reserve for bad debts during 2001 as a result of the collection of certain accounts that were previously reserved for.

The Company is currently negotiating with several third parties in an attempt to obtain additional sources of funds which, in management's opinion, would provide adequate cash flows to finance the Company's cash requirements. The satisfactory completion of these negotiations is essential as these avenues are the Company's principal means of providing sufficient cash flows to meet 2002 requirements. Because these negotiations are still in progress, there can be no assurance the Company will have sufficient funds to finance its

operations.

Current market trends and Company business development provide significant basis for the Company's optimistic outlook for 2002 and beyond. The national public attack on Class B levels of sludge treatment is rapidly moving the market to Class A technologies, of which the Company's patented N-Viro processes are very cost competitive, and well established in the market place. The development and patenting of new technologies for animal manure treatment, bio-fuel and nematode control have the potential to expand the Company's revenue base over the next five years and beyond.

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CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The following are the significant estimates and assumptions made in preparation of the financial statements:

Non-domestic license and territory fees - We do not recognize revenue on any non-domestic license or territory fee contracts until the cash is received by the Company, assuming all other tests of revenue recognition are met. Canada is excluded from this definition of non-domestic.

Allowance for Doubtful Accounts - We estimate losses for uncollectible accounts based on the aging of the accounts receivable and the evaluation and the likelihood of success in collecting the receivable.

Income Taxes - We assume the deductibility of certain costs in our income tax filings and estimate the recovery of deferred income tax assets.

New Accounting Standards - In June 1998, SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," was issued. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations." SFAS No. 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interest method and further clarifies the criteria to recognize intangible assets separately from goodwill. The adoption of SFAS Nos. 133 and 141 had no material effect on the Company's financial statements.

In June 2001, FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to periodic impairment tests. Other intangible assets will continue to be amortized over their useful lives. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. In June 2001, FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which is effective the first quarter of fiscal year 2003. SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of long-lived assets and the associated asset retirement cost. In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," which is effective the first

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quarter of fiscal year 2002. SFAS No. 144 modifies and expands the financial accounting and reporting for the impairment or disposal of long-lived assets other than goodwill. The Company is still evaluating the impact of these new standards, but at this time does not believe their adoption will have a significant impact on its financial position and results of operations.

Actual results could differ materially from the estimates and assumptions that we use in the preparation of our financial statements.

OUR ABILITY TO GROW MAY BE LIMITED BY COMPETITION

We provide a variety of technology and services relating to the transportation and treatment of wastewater residuals. We are in direct and indirect competition with other businesses that provide some or all of the same services including regional residuals management companies and national and international water and wastewater operations/privatization companies, technology suppliers, municipal solid waste companies and farming operations. Some of these competitors are larger and have greater capital resources than we do.

We derive a substantial portion of our revenue from services provided under municipal contracts, and many of these are subject to competitive bidding. We also intend to bid on additional municipal contracts, however, we may not be the successful bidder. In addition, some of our contracts will expire in the future and those contracts may be renewed on less attractive terms. If we are not able to replace revenues from contracts lost through competitive bidding or from the renegotiation of existing contracts with other revenues within a reasonable time period, the lost revenue could have a material and adverse effect on our business and financial condition.

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WE ARE AFFECTED BY UNUSUALLY ADVERSE WEATHER CONDITIONS

Our business is adversely affected by unusual weather conditions and unseasonably heavy rainfall which can temporarily reduce the availability of land application sites in close proximity to our business. In addition, our revenues and operational results are adversely affected during the winter months which limits the level of land application that can be performed. Long periods of adverse weather could have a material negative effect on our business and financial condition.

FUEL COST VARIATION COULD AFFECT OPERATING RESULTS AND EXPENSES

The price and supply of fuel is unpredictable and fluctuates based on events outside our control, including demand for oil and gas, actions by OPEC and other oil and gas producers, and war in oil producing countries. Because fuel is needed to run the trucks that purchase the processing materials and supplies for our customers, price escalations or reductions in the supply of fuel could increase our operating expenses and have a negative impact on the results of operations. We are not always able to pass through all or part of the increased fuel costs due to the terms of certain customers' contracts and the inability to negotiate such pass through costs in a timely manner.

WE ARE DEPENDENT ON THE MEMBERS OF OUR MANAGEMENT TEAM

We are highly dependent on the services of our management team, the loss

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of any of whom may have a material adverse effect on our business and financial condition.

We have entered into employment agreements with certain members of our management team, which contain non-compete and other provisions. The laws of each state differ concerning the enforceability of non-competition agreements. We cannot predict with certainty whether or not a court will enforce a non-compete covenant in any given situation based on the facts and circumstances at that time. If one of our key executive officers were to leave us and the courts refused to enforce the non-compete covenant, we might be subject to increased competition, which could have a material and adverse effect on our business and financial condition.

OUR INTELLECTUAL PROPERTY MAY BE MISAPPROPRIATED OR SUBJECT TO CLAIMS OF INFRINGEMENT

We attempt to protect our intellectual property rights through a combination of patent, trademark, and trade secret laws, as well as licensing agreements. Our failure to obtain or maintain adequate protection of our intellectual property rights for any reason could have a material adverse effect on our business and financial condition.

Our competitors, many of whom have substantially greater resources and have made substantial investments in competing technologies, may have applied for or obtained, or may in the future apply for and obtain, patents that will prevent, limit or otherwise interfere with our ability to offer our services. We have not conducted an independent review of patents issued to third parties.

We also rely on unpatented proprietary technology. It is possible that others will independently develop the same or similar technology or otherwise obtain access to our unpatented technology. If we are unable to maintain the proprietary nature of our technologies, we could be materially adversely affected.

The Company cautions that words used in this document such as "expects," "anticipates," "believes," "may," and "optimistic," as well as similar words and expressions used herein, identify and refer to statements describing events that may or may not occur in the future. These forward-looking statements and the matters to which they refer are subject to considerable uncertainty that may cause actual results to be materially different from those described herein. Some, but not all, of the factors that could cause actual results to be different than those anticipated or predicted by the Company include: (i) a deterioration in economic conditions in general; (ii) a decrease in demand for the Company's products or services in particular; (iii) the Company's loss of a key employee or employees; (iv) regulatory changes, including changes in environmental regulations, that may have an adverse affect on the demand for the Company's products or services; (v) increases in the Company's operating expenses resulting from increased costs of labor and/or consulting services; and (vi) a failure to collect upon or otherwise secure the benefits of existing contractual commitments with third parties, including customers of the Company. For example, while the Company anticipates obtaining the permits and approvals necessary for the Bio-Fuel pilot program to commence operations in

2002, such program may not begin until 2003 or ever. Delay or cancellation with respect to this project could result from (1) a failure to achieve acceptable air quality levels in preliminary testing, (2) costs associated with the use of

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Bio-Fuel significantly exceeding current estimates, or (3) competing technologies rendering the Bio-Fuel process less attractive.

INFLATION

The Company believes that inflation has not had a material impact to date on the Company's operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of December 31, 2001, the Company held \$400,000 in a certificate of deposit with its bank. Market risk is considered to be low, with the potential for loss of earnings, value or other changes in interest rates to be immaterial to the Company.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Public Accountants

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To the Board of Directors
N-Viro International Corporation
Toledo, Ohio

We have audited the accompanying consolidated balance sheets of N-Viro International Corporation and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended 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 on our audits.

We did not audit the financial statements of Florida N-Viro, L.P., a limited partnership, the investment in which is reflected in the accompanying financial statements using the equity method of accounting. The investment in this partnership represents 13% and 14% of total assets as of December 31, 2001 and 2000. The Company's share of the net loss of this partnership represents 11% and 15% of the net loss of the Company for the years ended December 31, 2001 and 2000, respectively, and a 13% reduction of the net income (before such net loss) of the Company for the year ended December 31, 1999. The financial statements of this partnership were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to amounts and information relating to this partnership, is based solely on the reports of the other auditors.

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 misstatement. 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 that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of N-Viro International Corporation and subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

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The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1D to the financial statements, the Company has in the past and continues to sustain substantial net and operating losses. In addition, the Company has used substantial amounts of working capital in its operations which has reduced the Company's liquidity to a low level. At December 31, 2001, current liabilities exceed current assets by \$955,360. Additionally, the Company has been notified by the Nasdaq Stock Market that it is in violation of the Market's listing standards for continued listing on the Nasdaq SmallCap Market, which might further limit the Company's ability to raise equity capital. These matters raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the

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recoverability and classification of recorded assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

HAUSSER + TAYLOR LLP

Cleveland, Ohio
March 12, 2002

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N-VIRO INTERNATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

December 31, 2001 and 2000

	2001	2000
	----	----
ASSETS		

CURRENT ASSETS		
Cash and cash equivalents:		
Unrestricted	\$ 45,427	\$ 128,485
Restricted	400,000	417,666
Securities available-for-sale	1,401	1,401
Receivables:		
Trade, net of allowance of \$87,501 in 2001 and \$144,564 in 2000	854,011	1,500,514
Notes and other	22,000	22,540
Related parties	24,461	21,912
Prepaid expenses and other assets	49,757	83,569
	-----	-----
Total current assets	1,397,057	2,176,087
PROPERTY AND EQUIPMENT	479,541	581,196
INVESTMENT IN FLORIDA N-VIRO, L.P.	525,086	661,966
INTANGIBLE AND OTHER ASSETS	1,731,647	1,332,728
	-----	-----
	\$4,133,331	\$4,751,977
	=====	=====

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

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N-VIRO INTERNATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

December 31, 2001 and 2000

	2001	2000
	----	----
LIABILITIES AND STOCKHOLDERS' EQUITY		

CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 438,534	\$ 119,344
Line-of-credit	503,613	300,000
Accounts payable	991,344	1,085,000
Accrued liabilities	418,926	359,000
	-----	-----
Total current liabilities	2,352,417	1,863,344
LONG-TERM DEBT, LESS CURRENT MATURITIES	460,342	228,000
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, \$.01 par value		
Authorized - 7,000,000 shares		
Issued - 2,700,933 shares	27,010	27,010
Additional paid-in capital	13,495,602	13,498,000
Retained earnings (deficit)	(11,517,150)	(10,249,000)
	-----	-----
	2,005,462	3,275,010
Less treasury stock, at cost, 123,500 shares in 2001		
and 57,250 shares in 2000	684,890	617,000
	-----	-----
Total stockholders' equity	1,320,572	2,657,010
	-----	-----
	\$ 4,133,331	\$ 4,751,354
	=====	=====

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

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N-VIRO INTERNATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2001, 2000 and 1999

	2001 ----	2000 ----
REVENUES	\$ 4,382,664	\$ 4,166,435
COST OF REVENUES	2,794,950 -----	2,436,942 -----
GROSS PROFIT	1,587,714	1,729,493
OPERATING EXPENSES		
Selling, general and administrative	2,167,308	2,272,978
Patent litigation expense	549,852 -----	135,272 -----
	2,717,160 -----	2,408,250 -----
OPERATING INCOME (LOSS)	(1,129,446)	(678,757)
NONOPERATING INCOME (EXPENSE)		
Interest income (expense), net	4,113	(50)
Recovery of bad debt allowance	-	275,000
Loss on sale of assets	(5,005)	-
Loss from equity investment in joint venture	(136,880) -----	(128,701) -----
	(137,772) -----	146,249 -----
INCOME (LOSS) BEFORE INCOME TAXES	(1,267,218)	(532,508)
Federal and state income taxes	- -----	312,000 -----
NET INCOME (LOSS)	\$ (1,267,218) =====	\$ (844,508) =====
Basic and diluted earnings (loss) per share	\$ (0.48) =====	\$ (0.32) =====
Weighted average common shares outstanding	2,635,334 =====	2,635,475 =====

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

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N-VIRO INTERNATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2001, 2000 and 1999

	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Trea St
	-----	-----	-----	-----
BALANCE - JANUARY 1, 1999	\$ 28,298	\$ 13,632,425	\$ (9,876,798)	\$ (1,
Net income	-	-	471,374	
Issuance of common stock for fees and services	84	11,766	-	
Sale of common stock, net of expenses of \$1,288	1,000	197,712	-	
Retirement of treasury stock	(2,500)	(497,500)	-	
Other	-	37,690	-	
	-----	-----	-----	-----
BALANCE - DECEMBER 31, 1999	26,882	13,382,093	(9,405,424)	(
Net loss	-	-	(844,508)	
Exercise of qualified stock options	24	3,726	-	
Issuance of common stock for fees and services	104	28,014	-	
Other	-	84,769	-	
	-----	-----	-----	-----
BALANCE - DECEMBER 31, 2000	27,010	13,498,602	(10,249,932)	(
Net loss	-	-	(1,267,218)	
Purchase of treasury stock	-	-	-	
Other	-	(3,000)	-	
	-----	-----	-----	-----
BALANCE - DECEMBER 31, 2001	\$ 27,010	\$ 13,495,602	\$ (11,517,150)	\$ (
	=====	=====	=====	=====

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

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N-VIRO INTERNATIONAL CORPORATION

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2001, 2000 and 1999

	2001 ----	2000 ----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (1,267,218)	\$ (844,5
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	263,861	188,3
Provision (credit) for bad debts	(57,063)	(315,0
Deferred income taxes	-	312,0
Loss on the sale of fixed assets	5,005	7
Issuance of common stock and options for fees and services	-	112,8
Other	136,880	155,0
Decrease (increase) in trade receivables	554,153	(214,4
Decrease (increase) in prepaid expenses	33,812	(11,3
(Decrease) increase in accounts payable and accrued liabilities	(35,274)	411,4
	-----	-----
Net cash (used in) provided by operating activities	(365,844)	(204,7
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in restricted cash and cash equivalents	-	(417,6
Reductions to restricted cash and cash equivalents	17,666	
Purchases of property and equipment	(43,681)	(49,1
Proceeds from sale of equipment	-	6,0
Collections from (advances to) related parties	(2,549)	26,6
Increase in notes receivable	(212,873)	(174,6
Collections on notes receivable	20,777	371,4
Expenditures for intangible and other assets	(42,726)	(233,5
Additional investment in Florida N-Viro, L.P.	-	
	-----	-----
Net cash used in investing activities	(263,386)	(470,9
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings on line-of-credit	203,613	300,0
Borrowings under long-term obligations	523,472	77,1
Principal payments on long-term obligations	(177,913)	(129,6
Proceeds from sale of common stock	-	
Other	(3,000)	3,7
	-----	-----
Net cash provided by financing activities	546,172	251,2
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(83,058)	(424,3
CASH AND CASH EQUIVALENTS - BEGINNING	128,485	552,8
	-----	-----
CASH AND CASH EQUIVALENTS - ENDING	\$ 45,427	\$ 128,4
	=====	=====

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

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. Nature of Business - The Company owns and licenses the N-Viro Process, a patented technology to treat and recycle wastewater sludges and other bio-organic wastes, utilizing certain alkaline by-products produced by the cement, lime, electric utilities and other industries. Revenue and the related accounts receivable are due from companies acting as independent agents or licensees, principally municipalities. Credit is generally granted on an unsecured basis. Periodic credit evaluations of customers are conducted and appropriate allowances are established.
- B. Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
- C. Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company accounts for its investments in joint ventures under the equity method.

- D. Going Concern - The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has in the past and continues to sustain substantial net and operating losses. In addition, the Company has used substantial amounts of working capital in its operations which has reduced the Company's liquidity to a low level. At December 31, 2001, current liabilities exceed current assets by \$955,360. Additionally, the Company has been notified by the Nasdaq Stock Market that it is in violation of the Market's listing standards for continued listing on the Nasdaq SmallCap Market, which might further limit the Company's ability to raise equity capital. These matters raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

Management of the Company is currently negotiating with several

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third parties in an attempt to obtain additional sources of funds which, in management's opinion, would provide adequate cash flows to finance the Company's cash requirements. The satisfactory completion of these negotiations is essential as these avenues are the Company's principal means of providing sufficient cash flows to meet 2002 requirements. Because these negotiations are still in progress, there can be no assurance that the Company will have sufficient funds to finance its operations. However, management of the Company expects significant improvements in operating results for 2002 and believes that many of the costs (including significant litigation costs associated with patent defense and license recovery) incurred in 2001 are nonrecurring. Additionally, market developments and opportunities with a major utilities company and a large wastewater contractor, which are currently in the negotiation phase, if finalized, should provide enhanced liquidity and positively impact 2002 operations.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Fair Value of Financial Instruments - The fair values of cash, accounts receivable, accounts payable and other short-term obligations approximate their carrying values because of the short maturity of these financial instruments. The carrying values of the Company's long-term obligations approximate their fair value. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosure About Fair Value of Financial Instruments," rates available at balance sheet dates to the Company are used to estimate the fair value of existing debt.

F. Cash and Cash Equivalents - The Company has cash on deposit in one financial institution which, at times, may be in excess of FDIC insurance limits.

For purposes of the statements of cash flows, the Company considers all certificates of deposit with initial maturities of 90 days or less to be cash equivalents.

Restricted cash consists of a certificate of deposit which is held as collateral against the Company's line-of-credit.

G. Property and Equipment - Depreciation has been computed primarily by the straight-line method over the estimated useful lives of the assets. Generally, useful lives are thirty-one years for leasehold improvements and five to fifteen years for equipment and furniture and fixtures. Depreciation expense amounted to \$140,331, \$106,231 and \$107,850 in 2001, 2000 and 1999, respectively. Management has reviewed property and equipment for impairment when events and circumstances indicate that the assets might be impaired and the carrying values of

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those assets may not be recoverable. Management believes the carrying amount is not impaired based upon estimated future cash flows.

- H. Intangible Assets - Patent costs and territory rights are recorded at cost and then amortized by the straight-line method over periods ranging from twelve to seventeen years. Amortization expense amounted to \$123,530, \$82,167 and \$67,724 in 2001, 2000 and 1999, respectively. Management has reviewed intangible assets for impairment when events and circumstances indicate that the assets might be impaired and the carrying values of those assets may not be recoverable. Management believes the carrying amount is not impaired based upon estimated future cash flows.

- I. Revenue Recognition - Facility management revenue, sludge processing revenue and royalty fees are recognized under contracts where the Company or licensees utilize the N-Viro Process to treat sludge, either pursuant to a fixed-price contract or based on volumes of sludge processed. Revenue is recognized as services are performed.

Alkaline admixture sales, equipment sales and N-Viro Soil revenue are recognized upon shipment.

License and territory fees are generated by selling the right to market or use the N-Viro Process in a specified territory. The Company's policy is to record revenue for the license agreements when all material services relating to the revenue have been substantially performed, conditions related to the contract have been met and no material contingencies exist.

Research and development revenue is recognized as work is performed and billed to the contracting entity.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- I. Revenue Recognition (Continued)

Any type of revenue generated from international customers is recognized when the cash is received.

- J. Earnings (Loss) Per Common Share - Earnings (loss) per common share has been computed on the basis of the weighted-average number of common shares outstanding during each period presented. For the years ended December 31, 2001 and 2000, the effects of the stock options granted are excluded from the diluted per share calculation because they would be antidilutive. For the year ended December 31, 1999, the effect of stock options increased the weighted average number of shares by 9,804.

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- K. New Accounting Standards - In June 1998, SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," was issued. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations." SFAS No. 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interest method and further clarifies the criteria to recognize intangible assets separately from goodwill. The adoption of SFAS Nos. 133 and 141 had no material effect on the Company's financial statements.

In June 2001, FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to periodic impairment tests. Other intangible assets will continue to be amortized over their useful lives. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. In June 2001, FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which is effective the first quarter of fiscal year 2003. SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of long-lived assets and the associated asset retirement cost. In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," which is effective the first quarter of fiscal year 2002. SFAS No. 144 modifies and expands the financial accounting and reporting for the impairment or disposal of long-lived assets other than goodwill. The Company is still evaluating the impact of these new standards, but at this time does not believe their adoption will have a significant impact on its financial position and results of operations.

- L. Reclassifications - Certain amounts from the prior year financial statements have been reclassified to conform with the current year presentation.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 2. BALANCE SHEET DATA

TRADE RECEIVABLES:

Trade receivables in the accompanying balance sheets at December 31, 2001 and 2000 are stated net of an allowance for doubtful accounts of \$87,501 and \$144,564, respectively.

NOTES AND OTHER RECEIVABLES:

The Company has notes receivable with customers and various

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other parties, totaling \$426,130 in 2001 and \$234,034 in 2000. At December 31, 2001, unsecured, 9.75% demand notes receivable totaling \$191,141 (including accrued interest of \$21,141) and unsecured, prime (stated by a local bank) plus 1/4% demand note receivable totaling \$196,343 (including accrued interest of \$16,343) are due from Florida N-Viro, the Company's joint venture investee. The notes due from Florida N-Viro have been deemed to be noncurrent by management in the accompanying balance sheets. At December 31, 2001, a note receivable of \$38,646, \$22,000 of which is current, is due from a non-related licensee.

The Company has various unsecured notes receivable from related parties totaling \$24,461 in 2001 and \$21,912 in 2000, which bear interest at 6% and are due on demand.

PROPERTY AND EQUIPMENT (AT COST):

	2001 ----	2000 ----
Land and leasehold improvements	\$ 44,911	\$ 44,911
Equipment	1,141,408	1,252,342
Furniture and fixtures	195,318	195,719
	-----	-----
	1,381,637	1,492,972
Less accumulated depreciation and amortization	902,096	911,776
	-----	-----
	\$ 479,541	\$ 581,196
	=====	=====

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 2. BALANCE SHEET DATA (CONTINUED)

INVESTMENT IN FLORIDA N-VIRO, L.P.:

Florida N-Viro, L.P. was formed in January 1996 pursuant to a joint venture agreement between the Company and VFL Technology Corporation (VFL). The Company owns a 47.5% interest in the joint venture.

Condensed financial information of the partnership as of December 31, 2001 and 2000 is as follows:

2001	2000
----	----

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Current assets	\$ 633,019	\$ 387,650
Long-term assets	2,113,032	2,270,824
	-----	-----
	\$2,746,051	\$2,658,474
	=====	=====
Current liabilities	\$1,610,090	\$1,170,915
Long-term liabilities	110,198	173,629
Partners' equity	1,025,763	1,313,930
	-----	-----
	\$2,746,051	\$2,658,474
	=====	=====

	Year Ended December 31,		
	2001	2000	1999
	----	----	----
Net sales	\$ 2,930,294	\$ 2,777,606	\$ 1,498,821
Net loss	(288,168)	(257,402)	(138,686)

During 2001, 2000 and 1999, the Partnership's largest customer accounted for 19%, 17% and 27%, respectively, of its revenue. Additionally, during 2001, 2000 and 1999, the Partnership's largest customers accounted for 59% (four customers), 77% (four customers) and 78% (six customers) of total revenue, respectively.

INTANGIBLE AND OTHER ASSETS:

	2001	2000
	----	----
Patents and other intangibles, less accumulated amortization		
2001 - \$325,000; 2000 - \$266,000	\$ 772,124	\$ 815,587
Territory rights, less accumulated amortization		
2001 - \$145,000; 2000 - \$108,000	555,393	305,647
Notes receivable - Florida N-Viro, L.P.	387,484	174,611
Other notes receivable	16,646	36,883
	-----	-----
	\$1,731,647	\$1,332,728
	=====	=====

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 2. BALANCE SHEET DATA (CONTINUED)

INTANGIBLE AND OTHER ASSETS (CONTINUED):

During the year ended December 31, 2001, the Company repurchased, as part of the settlement of a lawsuit (see Note 6), the exclusive license and territory rights, valued at approximately \$287,000, for portions of the Northeast and Mid-Atlantic United States from an unrelated party.

During the year ended December 31, 2000, the Company purchased from the Canadian government the right to market and sell licenses promoting a patent-pending technology that inhibits the growth of soybean cyst nematodes, in exchange for the forgiveness of a portion of a note receivable for \$250,000 due the Company from an unrelated licensee. This portion of the note had previously been fully reserved for in the allowance for bad debts and the Company recognized income in 2000 on the recovery of this note. In 2000, the Company purchased a non-exclusive license to use a patent-pending technology and Internet site address from an unrelated party in exchange for a total of approximately \$205,500. Additionally, in 2000, the Company repurchased the territory covering nine midwestern and western states of the United States from an unrelated party in exchange for \$10,000 cash.

During the year ended December 31, 1999, the Company repurchased portions of the Kentucky, Virginia and West Virginia territory from an unrelated party in exchange for \$15,000 cash and a \$135,000 note payable.

ACCRUED LIABILITIES:

	2001	

Employee benefits	\$ 56,116	\$
Sales tax payable	168,274	
Other	194,536	

	\$418,926	\$
	=====	=

NOTE 3. PLEDGED ASSETS, LINE-OF-CREDIT AND LONG-TERM DEBT

The Company has available a \$750,000 line-of-credit with a bank which expires April 30, 2002. Borrowings against the line-of-credit bear interest at prime minus .5% on borrowings up

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to \$400,000 and prime plus 1% for borrowings above \$400,000. Borrowings, which are collateralized by accounts receivable, inventories, equipment, assignment of a \$400,000 certificate of deposit and assignment of certain contracts, are due on demand. At December 31, 2001, the Company had borrowed \$503,613 against the line.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 3. PLEDGED ASSETS, LINE-OF-CREDIT AND LONG-TERM DEBT (CONTINUED)

Long-term debt at December 31, 2001 and 2000 is as follows:

	2001

Notes payable	\$898,876
Less current maturities	438,534

	\$460,342
	=====

The notes payable are notes signed for amounts owed to vendors and other parties. The notes bear interest ranging from 6% to 19% and are due at varying dates through March 2007. Aggregate maturities of long-term debt for the years ending December 31 are as follows: 2002 - \$438,534; 2003 - \$133,173; 2004 - \$117,855; 2005- \$99,782; 2006 - \$85,603 and 2007 - \$23,929. Interest expensed and paid was approximately \$58,000, \$36,500 and \$25,200 for the years ended December 31, 2001, 2000 and 1999, respectively.

NOTE 4. EQUITY TRANSACTIONS

The Company has authorized 2,000,000 shares of preferred stock, par value of \$.01 per share, of which no shares were outstanding at December 31, 2001 and 2000.

The Company has a stock option plan for directors and key officers under which 600,000 shares of common stock may be issued. The options are 20% vested on the date of grant, with the balance vesting 20% per year over the next four years except for directors whose options vest immediately. Options have been granted at the approximate market value of the stock at date of grant.

The following summarizes the number of grants and their respective exercise prices and grant date fair values per option for the years ended December 31, 2001, 2000 and 1999 and the number outstanding and exercisable at those dates:

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	2001		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	516,325	\$2.69	454,325	\$2.62
Granted	93,200	1.50	95,500	3.37
Expired during the year	(42,000)	2.72	(33,500)	3.72
Outstanding, end of year	567,525	2.49	516,325	2.69
Eligible for exercise at end of year	403,425		316,125	
Weighted average fair value per option for options granted during the year		\$1.50		\$3.29

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 4. EQUITY TRANSACTIONS (CONTINUED)

A further summary of stock options follows:

	Options Outstanding			Options
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercised
		2001		
Range of exercise prices:				
\$1.50 to \$2.43	458,600	7.37	\$2.01	324
\$4.00 to \$5.00	108,925	4.77	4.52	79
		2000		
Range of exercise prices:				
\$1.56 to \$2.43	398,400	7.74	\$2.14	240
\$4.00 to \$5.00	117,925	5.94	4.55	75
		1999		

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Range of exercise prices:

\$1.56 to \$2.38	359,200	8.27	\$2.21	171
\$4.00 to \$4.75	95,125	4.14	4.17	90

As permitted under accounting principles generally accepted in the United States of America, the Company's present accounting with respect to the recognition and measurement of stock-based employee compensation costs is in accordance with APB Opinion No. 25, which generally requires that compensation costs be recognized for the difference, if any, between the quoted market price of the stock at grant date and the amount an employee must pay to acquire the stock. The Company follows the disclosure provisions of SFAS Statement No. 123 which prescribes a fair-value based method of measurement that results in the disclosure of computed compensation costs for essentially all awards of stock-based compensation to employees.

Had compensation cost been determined based upon the fair value method prescribed in SFAS Statement No. 123, reported net income (loss) would have been \$(1,513,440), (\$1,064,278) and \$313,173 and basic earnings (loss) per share would have been \$(.57), (\$.40) and \$.12 for the years ended December 31, 2001, 2000 and 1999, respectively.

In determining the pro forma amounts above, the value of each grant is estimated at the grant date using the fair value method prescribed in Statement No. 123, with the following weighted-average assumptions for grants in 2001, 2000 and 1999, respectively: no assumed dividend rates for all years; risk-free interest rates of 5.0%, 6.0% and 5.5% on expected lives of 10 years for all years; and expected price volatility of 113%, 135% and 114%, respectively.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 5. REVENUE AND MAJOR CUSTOMERS

Revenues for the years ended December 31, 2001, 2000 and 1999 consist of the following:

	2001 ----	2000 ----
Facility management	\$1,637,243	\$1,520,830
Technology fees	849,086	999,345
Products and services	1,896,335	1,646,260
	-----	-----
	\$4,382,664	\$4,166,435
	=====	=====

Cost of revenues for the years ended December 31, 2001, 2000 and

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1999 consist of the following:

	2001 ----	2000 ----
Facility management	\$1,272,566	\$1,138,071
Technology fees	183,294	219,852
Products and services	1,339,090	1,079,019
	-----	-----
	\$2,794,950	\$2,436,942
	=====	=====

Revenues for the years ended December 31, 2001, 2000 and 1999 include revenues from one major customer, the City of Toledo, Ohio (included in the facility management and products and services classifications), which represented approximately 39%, 38% and 35%, respectively, of total revenues. In addition, the Company had another major customer, the City of Greenville, South Carolina, totaling approximately 7%, 12% and 10% of total revenues (which is included mainly in the products and services classification) for the years ended December 31, 2001, 2000 and 1999, respectively. The accounts receivable balances due from these customers at December 31, 2001 and 2000 were approximately \$118,000 and \$217,000, respectively.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 6. COMMITMENTS AND CONTINGENCIES

In November 2001, the Company and Hydropress Environmental Services, Inc. ("Hydropress") signed a Settlement Agreement, as filed under Form 8-K dated December 14, 2001. Each party dismissed its claims against each other with prejudice and entered into general releases of the other party. N-Viro purchased back the 66,250 N-Viro shares held by Hydropress at the market price as of November 15, 2001, which was \$1.01 per share for a total of \$66,913. This has been recorded as treasury stock in the financial statements. N-Viro also purchased back three patent license agreements (including territory rights) from Hydropress valued at approximately \$287,000. The first license concerned the exclusive right to sell and use the N-Viro technology in Massachusetts, Vermont and New Hampshire. The second concerned the non-exclusive right to sell and use the N-Viro technology in New Jersey, Delaware, Maryland and Eastern Pennsylvania. The third concerned amendments to the two prior-mentioned agreements and the exclusive right to use the N-Viro technology at Hydropress' facility in Phillipsburg, New Jersey. N-Viro and Hydropress entered into a new patent license agreement granting Hydropress the non-exclusive right to use the N-Viro technology at its facility in Phillipsburg, New Jersey. As to payment, Hydropress credited N-Viro with \$149,413 for past royalties that Hydropress owed N-Viro. Thus, at settlement, N-Viro owed Hydropress \$204,587. N-Viro issued Hydropress a

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Promissory Note providing for ten equal monthly installments of \$6,000 each to be paid by the 15 of each month beginning in December 2001 and ending in September 2002. On or before October 15, 2002, N-Viro will pay Hydropress the balance of \$144,587. The 66,250 N-Viro shares purchased from Hydropress are being held in escrow until the note payable is fully paid. All scheduled payments to date have been made timely.

In July 2000, the Company terminated the license of N-Viro Worldwide Limited and filed suit against Robin Millard and R3 Management Limited ("R3M"). The suit sought damages for breach of contract, breach of fiduciary duty and related torts based on intellectual property developed by Mr. Millard that the Company contends is owned by the Company. N-Viro settled this lawsuit with Mr. Millard and R3M in the United States district Court for the Northern District of Ohio (#3:00CV7443). The terms are as follows: N-Viro dismissed its claims with prejudice and renounced any prior interest in R3M's technology. R3M licensed its proprietary technology to N-Viro on a worldwide non-exclusive basis subject to certain exceptions. N-Viro paid a \$5,000 fee for the license, which also provides for royalty payments if N-Viro uses or licenses the technology. R3M assigned to N-Viro R3M's interest in sublicense agreements with Yorkshire Water, Ltd. and Silt (now DEC), N.V. N-Viro terminated its exclusive license with R3M related to N-Viro's proprietary technology in specified countries in Europe, the Middle East and the former Soviet Union. R3M and an affiliate, N-Viro Worldwide, Ltd. ("NVWL"), agreed to cease using the name "N-Viro" and to transfer to N-Viro the Internet URL "n-viro.com." NVWL agreed to pay N-Viro \$195,532 for past fees owed and for equipment. N-Viro agreed to pay NVWL \$195,532 for ceasing to use the N-Viro name and for transferring the Internet URL "n-viro.com."

On October 30, 2001, the Company settled its lawsuit with RDP Technologies, Inc. ("RDP"). RDP filed the lawsuit in Delaware federal court in August 2000, asserting claims for tortious interference with prospective business relations and unfair competition, and later adding a claim for a declaratory judgment regarding infringement, validity and enforceability of two of the Company's patents. The Company denied all of RDP's claims. As a result of the settlement, RDP's claims were dismissed with prejudice, and each party agreed to bear its own costs and attorneys fees.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 6. COMMITMENTS AND CONTINGENCIES (CONTINUED)

In 2001, officials of the North Carolina Department of Revenue (the "Department") contacted the Company and indicated that the Company was under investigation for failing to file sales tax returns in the state of North Carolina during the period from December 1994 to June 2001. The Company acknowledged to Department officials that during that period of time, it had collected approximately \$80,000 in sales taxes from certain customers but had not collected sales tax from other customers in North Carolina. The Company submitted a memorandum to the

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Department arguing that no sales tax was due by the Company because the sales at issue were exempt from sales tax. The Department disagreed with this memorandum and levied a fine and civil penalty plus interest due on the previous unremitted taxes, which the Company agreed to in lieu of litigation. To date the Company has remitted all sales tax due the State, as well as paid the fine and approximately one-third of the civil penalty and interest due, and has arranged a short-term payment schedule agreed to by the Department on the balance.

The Company has voluntarily approached state tax authorities in South Carolina and acknowledged failing to file sales tax returns within that state. The Company has collected and accrued approximately \$167,000 in sales tax from customers in South Carolina that has not been remitted to South Carolina tax authorities. The Company believes that the sales at issue are exempt from sales tax. The Company has retained counsel in South Carolina to assist it in negotiating a settlement of this matter.

The Company leases office space under an agreement which requires monthly payments of approximately \$5,200. The lease expires in December 2002. The Company also leases various equipment on a month-to-month basis. The total rental expense included in the statements of operations for the years ended December 31, 2001, 2000 and 1999 is approximately \$63,300, \$59,000 and \$56,000, respectively.

The Company has a minimum commitment for 2002 under an agreement with a consultant payable in cash or stock of \$60,000.

During 1999, the Company entered into employment and consulting agreements with two officers of the Company. The employment agreements expire in July 2002 and June 2004. Future compensation amounts are to be determined annually by the Board. In addition, one of the agreements provides for payment of life insurance premiums and the provision of health insurance coverage to the officer and his spouse for their lives. The present value of estimated costs related to the insurance provisions of this agreement total \$129,000 at July 2002. The cost is being recognized over the term of the employment agreement. The consulting agreements begin upon termination of the respective employment agreements and extend through July 2015 and June 2014, respectively. The agreements require minimum future services to be provided to be eligible for compensation.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 6. COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Company operates in an environment with many financial risks, including, but not limited to, major customer concentrations, competing technologies, infringement and/or misappropriation of intellectual property rights, and the highly competitive and, at times, seasonal nature of the industry and worldwide economic conditions. The Company's ability to expand and diversify its operations is also dependent upon the

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Company's ability to obtain the necessary capital through operating cash flow, additional borrowings or additional equity funds (also see Note 1.D. - Going Concern). Various federal, state and governmental agencies are considering, and some have adopted, laws and regulations regarding environmental protection which could adversely affect the business activities of the Company. The Company cannot predict what effect, if any, current and future regulations may have on the operations of the Company.

The Company is involved in legal proceedings and subject to claims which have arisen in the ordinary course of business. These actions, when concluded and determined, will not, in the opinion of management, have a material adverse effect upon the financial position, results of operations or cash flows of the Company.

NOTE 7.

INCOME TAX MATTERS

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the current period plus or minus the change during the period in deferred tax assets and liabilities.

The composition of the deferred tax assets and liabilities at December 31, 2001 and 2000 is as follows:

	2001 ----
Gross deferred tax liability, accelerated depreciation	\$ (25,00)
Gross deferred tax assets:	
Loss carryforwards	4,481,00
Patent costs	361,00
Allowance for doubtful accounts	35,00
Property and equipment basis difference	9,00
Other	9,00

	4,895,00
Less valuation allowance	(4,870,00)

	\$ -
	=====

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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NOTE 7.

INCOME TAX MATTERS (CONTINUED)

The income tax provisions differ from the amount of income tax determined by applying the U.S. Federal income tax rate to pre-tax income from continuing operations for the years ended December 31, 2001, 2000 and 1999 and are as follows:

	2001	2000
	----	----
Computed "expected" tax (credits)	\$ (431,000)	\$ (181,000)
State taxes, net of federal tax benefit	(38,000)	(16,000)
(Decrease) increase in income taxes resulting from:		
Change in valuation allowance	455,000	480,000
Other	14,000	29,000
	-----	-----
	\$ -	\$ 312,000
	=====	=====

The net operating losses available at December 31, 2001 to offset future taxable income total approximately \$11,000,000 and expire principally in years 2009 - 2021. The tax effect of net operating loss carryforwards reduced the 1999 current provision for income taxes by \$115,000.

In 1997, the Company recorded a deferred tax asset and a corresponding income tax benefit of \$312,000 to recognize the benefit of \$800,000 in loss carryforwards expected to be realized. The Company believed that sufficient taxable income would be generated in the near term, as the Company had changed its strategic focus to its profitable core business. Based on the results of the Company's 2000 operating performance, the Company believes that the recording of a deferred tax asset for the tax benefit of its net operating loss carryforward is no longer appropriate. As a result, in 2000, the Company has provided an additional valuation allowance against the tax benefit associated with the net operating loss and recognized expense of \$312,000 to reduce the recorded tax benefit of the net operating loss carryforwards to \$-0-.

NOTE 8.

CASH FLOWS INFORMATION

Information relative to the statements of cash flows not disclosed elsewhere for the year ended December 31, 1999 follows:

Supplemental schedule of noncash investing and financing activities:

Common stock subscribed	\$150,000
	=====
Retirement of treasury stock	\$500,000

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 9. SEGMENT INFORMATION

The Company has determined that its reportable segments are those that are based on the Company's method of internal reporting, which segregates its business by product category and service lines. The Company's reportable segments are as follows:

Management Operations - The Company provides employee and management services to operate the Toledo Wastewater Treatment Facility.

Other Domestic Operations - Sales of territory or site licenses and royalty fees to use N-Viro technology in the United States.

Foreign Operations - Sale of territory or site licenses and royalty fees to use N-Viro technology in foreign operations.

Research and Development - The Company contracts with Federal and State agencies to perform or assist in research and development on the Company's technology.

The accounting policies of the segments are the same as those described in Note 1 which contains the Company's significant accounting policies. Fixed assets generating specific revenue are identified with their respective segments as they are accounted for as such in the internal accounting records. All other assets, including cash and other current assets, and all long-term assets, other than fixed assets, are identified with the Corporate segment. The Company does not allocate any selling, general and administrative expenses to any specific segments. All of the other income (expense) costs or income are non-apportionable and not allocated to a specific segment. The Company accounts for and analyzes the operating data for its segments generally by geographic location, with the exception of the Management Operations and Research and Development segments. These segments represent both a significant amount of business generated as well as a specific location and unique type of revenue.

The next two segments are divided between domestic and foreign sources, as these segments differ in terms of environmental and municipal legal issues, nature of the waste disposal infrastructure, political climate and availability of funds for investing in the Company's technology. These factors have not changed significantly over the past three years and are not expected to change in the near term.

A new segment first presented at December 31, 2000 is the Research and Development segment. Prior year amounts have been reclassified to conform with the current year presentation. This

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segment is unlike any other segment in that revenue is generated as a result of a specific project to conduct initial or additional ongoing research into the Company's emerging technologies.

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 9. SEGMENT INFORMATION (CONTINUED)

The table below presents information about the segment profits and segment identifiable assets used by the chief operating decision makers of the Company as of and for the years ended December 31, 2001, 2000 and 1999 (dollars in thousands).

	Management Operations -----	Other Domestic Operations -----	Foreign Operations -----	Rese Deve -----
			2001	
Revenues	\$1,727	\$2,213	\$ 222	\$
Cost of revenues	1,273	1,206	132	
Segment profits	454	1,007	90	
Identifiable assets	184	87	-	
Depreciation	31	71	-	
			2000	
Revenues	\$1,582	\$2,265	\$ 70	\$
Cost of revenues	1,138	1,115	-	
Segment profits	444	1,150	70	
Identifiable assets	205	74	-	
Depreciation	25	45	-	
			1999	
Revenues	\$1,677	\$2,640	\$ 163	\$
Cost of revenues	1,084	985	-	
Segment profits	593	1,655	163	
Identifiable assets	189	82	-	
Depreciation	15	43	-	

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 9. SEGMENT INFORMATION (CONTINUED)

A reconciliation of total segment profits, identifiable assets and depreciation and amortization to the consolidated financial statements as of and for the years ended December 31, 2001, 2000 and 1999 follows (dollars in thousands):

	2001

Segment profits:	
Segment profits for reportable segments	\$ 1,588
Corporate selling, general and administrative expenses and research and development costs	(2,717)
Other income (expense)	(138)

Consolidated earnings before taxes	\$ (1,267)
	=====
Identifiable assets:	
Identifiable assets for reportable segments	\$ 322
Corporate property and equipment	158
Current assets not allocated to segments	1,397
Intangible and other assets not allocated to segments	2,491
Consolidated eliminations	(234)

Consolidated assets	\$ 4,134
	=====
Depreciation and amortization:	
Depreciation for reportable segments	\$ 109
Corporate depreciation and amortization	155

Consolidated depreciation and amortization	\$ 264
	=====

NOTE 10. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of selected quarterly financial data for the years ended December 31, 2001 and 2000:

	Quarters Ended		
	March 31	June 30	September
	-----	-----	-----
2001			

Revenues	\$1,162,764	\$1,115,478	\$1,175,050
Operating loss	(208,626)	(157,866)	(280,930)
Net loss	(219,735)	(203,158)	(356,850)
Basic and diluted loss per share	\$ (0.08)	\$ (0.08)	\$ (0.10)

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N-VIRO INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 10. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED) (CONTINUED)

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	Quarters Ended		
	March 31	June 30	September
2000			
Revenues	\$1,107,033	\$1,112,463	\$1,083,13
Operating income (loss)	(58,505)	43,027	(82,79
Net income (loss)	163,034	14,875	(161,43
Basic and diluted income			
(loss) per share	\$ 0.06	\$ 0.01	\$ (0.0

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Report of Independent Public Accountants

To the Board of Directors
N-Viro International Corporation
Toledo, Ohio

Our audits of the consolidated financial statements of N-Viro International Corporation and subsidiaries included Schedule II, contained herein, for each of the three years in the period ended December 31, 2001. Such schedule is presented for purposes of complying with the Securities and Exchange Commission's rule and is not a required part of the basic consolidated financial statements. In our opinion, such schedule presents fairly the information set forth therein, in conformity with accounting principles generally accepted in the United States of America.

HAUSSER + TAYLOR LLP

Cleveland, Ohio
March 12, 2002

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N-VIRO INTERNATIONAL CORPORATION

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

December 31, 2001, 2000 and 1999

	Balance at Beginning of Period	Charged to Operations
Allowance for doubtful accounts - deducted		

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from trade receivables and notes receivable
in the balance sheets:

2001	\$145,000 =====	\$ - =====
2000	\$460,000 =====	\$16,000 =====
1999	\$460,000 =====	\$ - =====

- (1) The 2000 deduction from reserves was the result of a transaction which included the Company acquiring technology from the Canadian government in exchange for the forgiveness of a portion of a note receivable (see Note 2).
- (2) The 2001 deduction from reserves was the result of the Company collecting amounts due from certain customers that were previously reserved for.

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item is incorporated by reference to the information under the heading "Election of Directors" and "Executive Officers of the Company" in the definitive proxy statement of the Company filed with the Commission on April 12, 2002.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the information under the heading "Remuneration" in the definitive proxy statement of the Company filed with the Commission on April 12, 2002.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item is incorporated by reference to the information under the heading "Security Ownership of Directors and Management" in the definitive proxy statement of the Company filed with the Commission on April 12, 2002.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item is incorporated by reference to the information under the heading "Certain Relationship and Related Transactions" in the definitive proxy statement of the Company filed with the Commission on April 12, 2002.

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PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)1. AND (a)2. FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

See "Index to Financial Statements and Schedule" set forth in Item 8 at page 20 of this Form 10-K.

(a)3. EXHIBITS

Exhibit

Number Description

3.1 Certificate of Incorporation of the Company
(incorporated by reference to Exhibit 3.1 to the
Registration Statement of the Registrant on Form S-1
(Reg. No. 33-62766) (the "Registration Statement").)

3.2 By-Laws of the Company (incorporated by reference to
Exhibit 3.2 to the Registration Statement).

10.1 The Amended and Restated N-Viro International
Corporation Stock Option Plan (incorporated by
reference to Form S-8 filed May 9, 2000).

10.2 Employment Agreement, dated December 2, 1999, between
N-Viro International Corporation and J. Patrick
Nicholson (incorporated by reference to Exhibit 1 to
the Form 8-K dated December 2, 1999).

10.3 Transitional Consulting and Sales Representative
Agreement, dated September 2, 1993, and amended
January 1, 1994, between N-Viro International
Corporation and Bobby B. Carroll (incorporated by
reference to Exhibit 10.102 to Amendment No. 1 to the
Registration Statement).

10.4 Employment Agreement, dated June 14, 1999, between
N-Viro International Corporation and Terry J. Logan
(incorporated by reference to Exhibit 1 to the Form
8-K dated June 30, 1999)

13 2001 Executive Review (as exhibit in Form 10-K filed
electronically)

21.1 List of subsidiaries of the Company.#

24.1 Powers of Attorney.#

#Only included in Form 10-K filed electronically with
the Securities and Exchange Commission

(b) REPORTS ON FORM 8-K

The Company filed a report on Form 8-K dated November
29, 2001, to disclose both the receipt of a letter from Nasdaq
regarding the Company's continued listing on the Nasdaq SmallCap
Market, and the settlement of a criminal matter in the State of
North Carolina.

The Company filed a report on Form 8-K dated December

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14, 2001, to disclose its settlement of lawsuits with Hydropress Environmental Services, Inc. and Robin Millard and R3M Management Limited.

The Company filed a report on Form 8-K dated March 6, 2002, to disclose the receipt of a Nasdaq Staff determination letter indicating the Company fails to comply with the continued listing requirements of the Market.

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The Company filed a report on Form 8-K dated March 18, 2002, to disclose both the receipt of a notice that the Company's oral hearing before a Nasdaq Listing Qualifications Panel will be held, and the announcement of the retirement of Mr. James O'Neil from the Board of Directors.

- (c) The exhibits listed in Item 14(a)(3) are filed with this Form 10-K.

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- (d) FINANCIAL STATEMENTS OF SUBSIDIARIES NOT CONSOLIDATED

FLORIDA N-VIRO, L.P.

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[letterhead - "Joseph M. Cahill, Ltd. - Certified Public Accountant"]

February 6, 2002

INDEPENDENT AUDITOR'S REPORT

To the Partners

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Florida N-Viro, L.P.
West Chester, Pennsylvania

I have audited the accompanying balance sheets of Florida N-Viro, L.P., (a Limited Partnership), as of December 31, 2001 and 2000, and the related statements of income (loss) and partners' capital, and cash flows for the years then ended. These financial statements are the responsibility of the Partnership's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Florida N-Viro, L.P. as of December 31, 2001 and 2000, and the results of operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

JMC/rb

/s/ Joseph M. Cahill, Ltd.

[letterhead - "189 W. Lancaster Avenue Paoli, Pennsylvania 19301
610 889 3300 Fax 610 889 3303"]

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FLORIDA N-VIRO, L.P.

Balance Sheets

December 31, 2001 and 2000

ASSETS

	2001	
	-----	-----
Current Assets:		
Cash	\$	5,056
Accounts Receivable		468,058
Prepaid Expenses		159,905
	-----	-----
Total Current Assets		633,019
Property and Equipment		
Land		147,163

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Site improvements	312,517	
Building	1,183,169	
Operating equipment	1,242,795	
Furniture and fixtures	13,215	

	2,898,859	
Less Accumulated Depreciation	785,827	

Total Property and Equipment	2,113,032	

Total Assets	\$ 2,746,051	\$
	=====	=====

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

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FLORIDA N-VIRO, L.P.

Balance Sheets

December 31, 2001 and 2000

LIABILITIES AND PARTNERS' CAPITAL

	2001	2000
	-----	-----
Current Liabilities:		
Payables:		
Trade	\$ 337,800	\$ 354,655
Related party	308,672	200,073
Notes payable -- current	64,199	111,942
Notes payable -- related party	700,000	340,000
Accrued expenses	199,419	164,245
	-----	-----
Total Current Liabilities	1,610,090	1,170,915
Long-term Liabilities:		
Notes Payable	110,198	173,629
	-----	-----
Total Liabilities	1,720,288	1,344,544
Partners' Capital	1,025,763	1,313,931
	-----	-----
Total Liabilities and Partners' Capital	\$2,746,051	\$2,658,475
	=====	=====

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

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FLORIDA N-VIRO, L.P.

Statements of Income(Loss) and Partners' Capital

For the years ended December 31, 2001 and 2000

	2001	2000
Revenues	\$ 2,930,294	\$ 2,777,606
Cost of sales	2,839,116	2,802,843
Gross profit (loss)	91,178	(25,237)
Selling, general and administrative	300,118	200,750
Income (loss) from operations	(208,940)	(225,987)
Other income (expense):		
Interest income	5	428
Gain (loss) on sale of assets	(2,860)	
Interest expense	(76,343)	(31,843)
Total other income (expense)	(79,228)	(31,415)
Net Income (loss)	(288,168)	(257,402)
Beginning partners' capital	1,313,931	1,571,333
Ending partners' capital	\$ 1,025,763	\$ 1,313,931

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

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FLORIDA N-VIRO, L.P.

Statements of Cash Flows

For the years ended December 31, 2001 and 2000

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	2001	2000
Cash flows from operating activities		
Net income (loss)	\$ (288,168)	\$ (257,402)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	183,891	201,971
(Gain) loss on sale of assets	2,890	
(Increase) decrease in:		
Accounts receivable-trade	(112,963)	(128,193)
Accounts receivable-related party	-	14,387
Prepaid expenses	(134,118)	4,524
Increase (decrease) in:		
Accounts payable-trade	(16,855)	(150,947)
Accounts payable-related party	108,599	195,073
Accrued expenses	35,174	(16,443)
Net cash provided (used) by operating activities	(221,550)	(137,030)
Cash flows from investing activities:		
Proceeds from the sale of assets	8,367	-
Acquisition of property and equipment	(37,356)	(467,365)
Net cash provided (used) by investing activities	(28,989)	(467,365)
Cash flows from financing activities:		
Proceeds from new borrowings	360,000	571,260
Proceeds from contributed capital	-	-
Payments on long-term debt	(111,174)	(81,634)
Net cash provided (used) by financing activities	248,826	489,626
Net increase (decrease) in cash and cash equivalents	(1,713)	(114,769)
Cash and cash equivalents at beginning of year	6,769	121,538
Cash and cash equivalents at end of year	\$ 5,056	\$ 6,769
Supplemental disclosure for cash flows		
Interest Paid	\$ 20,220	\$ 31,843

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

FLORIDA N-VIRO, L.P.

Notes to Financial Statements

December 31, 2001 and 2000

Note A - Background

Business Activities - Florida N-Viro, L.P. was formed January 1, 1996 as a Delaware Limited Partnership under the Delaware Revised Limited Partnership Act. The Partnership has entered into a patent and technology agreement with N-Viro International Corporation for the exclusive, royalty free, use in Florida of certain systems/processes for the treatment and remediation of wastewater sludge. The Partnership operates from its Ft. Meade and Volusia, Florida facilities.

The Partnership consists of one general partner, Florida N-Viro Limited Liability Corporation, a Delaware limited liability corporation, and two limited partners: VFL Technology Corporation and N-Viro International Corporation. The general partner is a limited liability corporation that has limited resources and is responsible for the liabilities of the partnership beyond the capital contributed by the limited partners.

The Partnership agreement terminates on December 31, 2026.

Note B - Summary of Accounting Principles

1. Method of Accounting and Use of Estimates - The financial statements are prepared using the accrual basis of accounting. Generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.
2. Cash and Cash Equivalents - The Partnership considers all short-term investments with an original maturity of three months or less to be cash equivalents.
3. Property and Equipment - Property and equipment, carried at cost, are depreciated over the estimated useful life of the related assets. Depreciation is computed principally by the straight-line method. The estimated useful lives used in computing depreciation are summarized as follows:

FLORIDA N-VIRO, L.P.

Notes to Financial Statements (continued)

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	Years of Useful Life
Operating equipment	5-10
Furniture and fixtures	5-7
Site improvements	15
Buildings	39

Depreciation amounted to \$183,891 and \$201,971 for 2001 and 2000, respectively.

Maintenance, repairs and expenditures for renewals and betterments not determined to extend the useful life or to increase materially the productivity of the properties to which they are applied are charged to income as incurred. Other renewals and betterments are capitalized.

It is the policy of the Partnership generally to eliminate from the accounts the cost and related allowances for depreciation applicable to assets retired or otherwise disposed of, charging or crediting to income the differences between depreciation cost and the proceeds of sale or salvage.

4. Income Taxes - No provision for income taxes is required since the partners report their proportionate share of partnership taxable income or loss on their respective income tax returns. Such income or losses are proportionately allocated to the partners based upon their ownership interests.

5. Advertising - The Partnership follows the policy of charging the costs of advertising to expense as incurred.

Advertising expense is \$9,837 and \$6,359 for 2001 and 2000, respectively.

6. Reclassifications - Certain reclassifications were made to the 1999 financial statements presentation in order to conform to the 2000 financial statements presentation.

Note C - Related Parties

VFL Technology Corporation charged the Partnership \$40,570 in 2001 and \$23,556 in 2000 for certain operating and engineering services.

The Partnership has a fee sharing arrangement with N-Viro International Corporation for services provided to certain customers. The agreement terminated during 2000. The Partnership's share of these fees was approximately \$34,269 for 2000.

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FLORIDA N-VIRO, L.P.

Notes to Financial Statements (continued)

The Partnership had payable balances due the general partner and limited

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partners as of December 31, 2001 and 2000 of \$308,672 and \$200,073 respectively.

As of December 31, 2001 and 2000, the Partnership had notes due to the limited partners, payable on demand and bearing interest of 9.75% accrued monthly.

Note D - Concentration of Credit Risk

In the normal course of business, the Partnership extends credit to customers principally in the State of Florida. The Partnership does not provide an allowance for doubtful accounts since it expects to collect all of its accounts receivable.

The Partnership conducts a major portion of its business with several customers. For the year ended December 31, 2001, four customers accounted for 59% of total revenue. For 2000, six customers accounted for 77% of revenue.

The Partnership maintains its operating checking account at a bank located in Southeastern Pennsylvania. The balance in this account may at times exceed the federally insured limit of \$100,000.

NOTE E - LONG-TERM NOTES PAYABLE

Long-term notes payable consist of the following:

	2001	2000
	-----	-----
9.25% Note payable to bank, monthly payments of \$2,245, including interest, secured by equipment, due August 2002	17,355	41,468
10.007% Note payable to bank, monthly payments of \$2,445, including interest, secured by equipment, due June 2005	88,341	105,965
8.97% Note payable to bank, monthly payments of \$745, including interest, secured by automobile, due May 2002	-	11,193
10.037% Note payable to bank, monthly payments of \$2,353, including interest, secured by equipment, due July 2001	-	13,711
9.54% Note payable to bank, monthly payments of \$2,550, including interest, secured by equipment, due October 2001	-	26,837

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FLORIDA N-VIRO, L.P.

Notes to Financial Statements (continued)

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	2001	2000
10.257% Note payable to bank, monthly payments of \$2,279, including interest, secured by equipment, due October 2004	68,701	86,397
Total Long Term Debt	\$174,397	\$285,571
Less current maturities	64,199	111,942
	\$110,198	\$173,629

Maturities of Long Term Debt are as follows:

2002	\$ 64,199
2003	47,731
2004	48,216
2005	14,251

	\$174,397
	=====

Note F - Lease Commitments

The Partnership leases various equipment under operating leases that expire at various times through the year 2006.

The following is a schedule detailing future minimum lease payments:

Year Ended December 31	
2002	\$ 25,295
2003	21,663
2004	19,847
2005	19,847
2006	3,308

	\$ 89,960
	=====

Note G - Working Capital Deficiency

The Partnership's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Partnership has incurred losses over the past several years and has working capital

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deficiencies as of December 31, 2001 and 2000.

Management believes that actions presently being taken to expand the customer base and revenues and for the partners to provide additional working capital when needed, will provide the opportunity for the Partnership to continue as a going concern.

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FLORIDA N-VIRO, L.P.

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[letterhead - "Joseph M. Cahill, Ltd. - Certified Public Accountant"]

February 14, 2001

INDEPENDENT AUDITOR'S REPORT

To the Partners
Florida N-Viro, L.P.
West Chester, Pennsylvania

I have audited the accompanying balance sheets of Florida N-Viro, L.P., (a Limited Partnership), as of December 31, 2000 and 1999, and the related

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statements of income (loss) and partners' capital, and cash flows for the years then ended. These financial statements are the responsibility of the Partnership's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Florida N-Viro, L.P. as of December 31, 2000 and 1999, and the results of operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

JMC/rb

/s/ Joseph M. Cahill, Ltd.

[letterhead - "189 W. Lancaster Avenue Paoli, Pennsylvania 19301 610 889 3300
Fax 610 889 3303"]

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FLORIDA N-VIRO, L.P.

Balance Sheets

December 31, 2000 and 1999

ASSETS

	2000	1999
Current Assets:		
Cash	\$ 6,769	\$ 121,538
Receivables:		
Trade	355,095	226,902
Related party	-	14,387

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Prepaid Expenses	25,786	30,310

Total Current Assets	387,650	393,137
Property and Equipment		
Land	147,163	147,163
Site improvements	285,519	123,159
Building	1,183,169	1,183,169
Operating equipment	1,262,387	960,878
Furniture and fixtures	13,215	9,718

	2,891,453	2,424,087
Less Accumulated Depreciation	620,629	418,658

Total Property and Equipment	2,270,824	2,005,429

Total Assets	\$ 2,658,474	\$ 2,398,566
	=====	

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

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FLORIDA N-VIRO, L.P.

Balance Sheets

December 31, 2000 and 1999

LIABILITIES AND PARTNERS' CAPITAL

	2000	1999

Current Liabilities:		
Payables:		
Trade	\$ 354,655	\$ 505,602
Related party	200,073	5,000
Notes payable - current	111,942	56,445
Notes payable - related party	340,000	-
Accrued expenses	164,245	180,688

Total Current Liabilities	1,170,915	747,735
Long-term Liabilities:		
Notes Payable	173,629	79,498

Total Liabilities	1,344,544	827,233

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Partners' Capital	1,313,930	1,571,333

Total Liabilities and Partners' Capital	\$2,658,474	\$2,398,566
	=====	

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

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FLORIDA N-VIRO, L.P.

Statements of Income (Loss) and Partners' Capital

For the years ended December 31, 2000 and 1999

	2000	1999
	-----	-----
Revenues	\$ 2,777,606	\$ 1,498,821
Cost of sales	2,802,843	1,498,425
	-----	-----
Gross profit (loss)	(25,237)	396
Selling General and Administrative	200,750	139,264
	-----	-----
Income (loss) from operations	(225,987)	(138,868)
Other income (expense)		
Interest income	428	2,204
Interest expense	(31,843)	(2,022)
	-----	-----
Total other income (expense)	(31,415)	182
	-----	-----
Net Income (loss)	(257,402)	(138,686)
Beginning partners' capital	1,571,333	1,695,019
Capital contribution	-	15,000
	-----	-----
Ending partners' capital	\$ 1,313,931	\$ 1,571,333
	=====	=====

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

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FLORIDA N-VIRO, L.P.

Statements of Cash Flows

For the years ended December 31, 2000 and 1999

	2000	1999
	-----	-----
Cash flows from operating activities		
Net income (loss)	\$ (257,402)	\$ (138,686)
Adjustments to reconcile net income		
to net cash provided by operating		
activities:		
Depreciation	201,971	132,765
(Increase) decrease in:		
Accounts receivable-trade	(128,193)	(97,405)
Accounts receivable-related party	14,387	93,029
Prepaid expenses	4,524	(24,436)
Increase (decrease) in:		
Accounts payable-trade	(150,947)	221,310
Accounts payable-related party	195,073	5,000
Accrued expenses	(16,443)	59,363
	-----	-----
Net cash provided (used) by		
operating activities	(137,030)	250,940
Cash flows from investing activities		
Acquisition of property and equipment	(467,365)	(344,023)
	-----	-----
Net cash provided (used) by		
investing activities	(467,365)	(344,023)
Cash flows from financing activities		
Proceeds from new borrowings	571,260	198,452
Proceeds from contributed capital	-	15,000
Payments on long-term debt	(81,634)	(38,719)
	-----	-----
Net cash provided (used) by		
financing activities	489,626	174,733
	-----	-----
Net increase (decrease) in cash and cash equivalents	(114,769)	81,650
Cash and cash equivalents at beginning of year	121,538	39,888
	-----	-----
Cash and cash equivalents at end of year	\$ 6,769	\$ 121,538
	=====	=====

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Supplemental disclosure for cash flows

Interest paid

\$	31,843	\$	2,022
=====			

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

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FLORIDA N-VIRO, L.P.

Notes to Financial Statements

December 31, 2000 and 1999

Note A - Background

Business Activities - Florida N-Viro, L.P. was formed January 1, 1996 as a Delaware Limited Partnership under the Delaware Revised Limited Partnership Act. The Partnership has entered into a patent and technology agreement with N-Viro International Corporation for the exclusive, royalty free, use in Florida of certain systems/processes for the treatment and remediation of wastewater sludge. The Partnership operates from its Ft. Meade and Volusia, Florida facilities.

The Partnership consists of one general partner, Florida N-Viro Limited Liability Corporation, a Delaware limited liability corporation, and two limited partners: VFL Technology Corporation and N-Viro International Corporation. The general partner is a limited liability corporation that has limited resources and is responsible for the liabilities of the partnership beyond the capital contributed by the limited partners.

The Partnership agreement terminates on December 31, 2026.

Note B - Summary of Accounting Principles

1. Method of Accounting and Use of Estimates - The financial statements are prepared using the accrual basis of accounting. Generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.
2. Cash and Cash Equivalents - The Partnership considers all short-term investments with an original maturity of three months or less to be cash equivalents.
4. Property and Equipment - Property and equipment, carried at cost, are depreciated over the estimated useful life of the related assets. Depreciation is computed principally by the straight-line method. The estimated useful lives used in computing depreciation are summarized as follows:

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	Years of Useful Life

Operating equipment	5-10
Furniture and fixtures	5-7

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FLORIDA N-VIRO, L.P.

Notes to Financial Statements (continued)

Site improvements	15
Buildings	39

Depreciation amounted to \$201,973 and \$132,765 for 2000 and 1999, respectively.

Maintenance, repairs and expenditures for renewals and betterments not determined to extend the useful life or to increase materially the productivity of the properties to which they are applied are charged to income as incurred. Other renewals and betterments are capitalized.

It is the policy of the Partnership generally to eliminate from the accounts the cost and related allowances for depreciation applicable to assets retired or otherwise disposed of, charging or crediting to income the differences between depreciation cost and the proceeds of sale or salvage.

4. Income Taxes - No provision for income taxes is required since the partners report their proportionate share of partnership taxable income or loss on their respective income tax returns. Such income or losses are proportionately allocated to the partners based upon their ownership interests.
5. Advertising - The Partnership follows the policy of charging the costs of advertising to expense as incurred.

Advertising expense for 2000 is \$6,359. There was no advertising expense for 1999.
6. Reclassifications - Certain reclassifications were made to the 1999 financial statements presentation in order to conform to the 2000 financial statements presentation.

Note C - Related Parties

VFL Technology Corporation charged the Partnership \$23,556 in 2000 for certain operating and engineering services.

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The Partnership has a fee sharing arrangement with N-Viro International Corporation for services provided to certain customers. The Partnership's share of these fees was approximately \$34,269 for 2000 and \$37,800 for 1999.

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FLORIDA N-VIRO, L.P.

Notes to Financial Statements (continued)

The Partnership had the following receivable balances due as of December 31, from its partners:

	2000	1999
	-----	-----
General Partner	\$ -	\$ -
Limited Partners	-	14,387
	-----	-----
	\$ -	\$ 14,387
	=====	=====

The Partnership had payable balances due the general partner and limited partners as of December 31, 2000 and 1999 of \$200,073 and \$5,000, respectively.

As of December 31, 2000, the Partnership had notes due to the limited partners, payable on demand and bearing interest of 9.75% accrued monthly.

Note D - Concentration of Credit Risk

In the normal course of business, the Partnership extends credit to customers principally in the State of Florida. The Partnership does not provide an allowance for doubtful accounts since it expects to collect all of its accounts receivable.

The Partnership conducts a major portion of its business with several customers. For the year ended December 31, 2000, six customers accounted for 77% of total revenue. For 1999, four customers accounted for 78% of revenue.

The Partnership maintains its operating checking account at a bank located in Southeastern Pennsylvania. The balance in this account may at times exceed the federally insured limit of \$100,000.

NOTE E - LONG-TERM NOTES PAYABLE

Long-term notes payable consist of the following:

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	2000	1999
8.97% Note payable to bank, monthly payments of \$745, including interest, secured by automobile, due May 2002	\$ 11,193	\$ 18,755

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FLORIDA N-VIRO, L.P.

Notes to Financial Statements (continued)

	2000	1999
9.54% Note payable to bank, monthly payments of \$2,550, including interest, secured by equipment, due October 2001	26,837	53,729
9.25% Note payable to bank, monthly payments of \$2,245, including interest, secured by equipment, due August 2003	41,468	63,459
10.037% Note payable to bank, monthly payments of \$2,353, including interest, secured by equipment, due July 2001	13,711	-
10.007% Note payable to bank, monthly payments of \$2,445, including interest, secured by equipment, due June 2005	105,965	-
10.257% Note payable to bank, monthly payments of \$2,279, including interest, secured by equipment, due October 2004	86,397	-
Total Long Term Debt	\$285,571	\$135,943
Less current maturities	111,942	56,445
	\$173,629	\$ 79,498

Maturities of Long Term Debt are as follows:

2001	\$111,942
2002	63,431
2003	47,731
2004	48,216
2005	14,251

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\$285,571
=====

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment No. 2 to be signed on its behalf by the undersigned, thereunto duly authorized.

N-VIRO INTERNATIONAL CORPORATION

Dated: April 15, 2002

By: /s/ J. Patrick Nicholson*

J. Patrick Nicholson, Chairman of the Board of Directors
and Chief Executive Officer
(Principal Executive Officer)

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

Dated: April 15, 2002

/s/ J. Patrick Nicholson*

J. Patrick Nicholson, Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

/s/ Terry J. Logan, Ph.D.*

Terry J. Logan, Ph.D., Chief Operating
President and Director

/s/ James K. McHugh

Chief Financial Officer, Secretary and Treasurer
(Principal Financial and Accounting Officer)

/s/ Michael G. Nicholson*

Michael G. Nicholson, Senior Vice-President
and Director

/s/ Wallace G. Irmscher*

Wallace G. Irmscher, Director

/s/ R. Francis DiPrete*

R. Francis DiPrete, Director

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/s/ B.K. Wesley Copeland*

B.K. Wesley Copeland, Director

/s/ Bobby B. Carroll*

Bobby B. Carroll, Director

/s/ Daniel J. Haslinger*

Daniel J. Haslinger, Director

/s/ Charles B. Kaiser, Jr.*

Charles B. Kaiser, Jr., Director

*By: /s/ James K. McHugh

James K. McHugh, Attorney-in-Fact