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Clerk's Office
N.C. Utilities Commission

NORTH CAROLINA ADVANCED
ENERGY CORPORATION

Financial Statements

December 31, 2005 and 2004

(With Independent Auditors' Report Thereon)

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NORTH CAROLINA ADVANCED ENERGY CORPORATION

2005 Audit

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*Unqualified Opinion on Financial Statements and
Supplementary Schedule of Expenditures of Federal
Awards*

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Independent Auditors' Report

The Board of Directors
North Carolina Advanced Energy Corporation:

We have audited the accompanying statements of financial position of North Carolina Advanced Energy Corporation (the "Corporation") (a nonprofit organization) as of December 31, 2005 and 2004, and the related statements of activities, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 the 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, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 17, 2006, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Batchelor, Jellery & Roberts, LLP

April 17, 2006

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Financial Position

December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<u>Assets</u>		
Current assets:		
Cash and cash equivalents	\$ 594,778	597,528
Marketable securities	1,300,000	1,300,000
Accounts receivable	928,414	749,634
Grants receivable	412,496	403,010
Prepaid expenses and other assets	36,274	67,405
Total current assets	<u>3,271,962</u>	<u>3,117,577</u>
Property and equipment:		
Equipment, furniture and fixtures	1,867,699	1,880,144
Less accumulated depreciation and amortization	<u>(1,484,359)</u>	<u>(1,503,929)</u>
	<u>383,340</u>	<u>376,215</u>
Investment	<u>150,000</u>	<u>150,000</u>
	<u>\$ 3,805,302</u>	<u>3,643,792</u>
 Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	696,077	411,015
Deferred revenue	<u>38,338</u>	<u>33,338</u>
Total current liabilities	<u>734,415</u>	<u>444,353</u>
Commitments		
Net assets - unrestricted	<u>3,070,887</u>	<u>3,199,439</u>
	<u>\$ 3,805,302</u>	<u>3,643,792</u>

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Activities

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Revenues:		
Utility funding	\$ 3,775,031	3,707,816
Government grants	1,181,094	794,476
Interest	39,701	18,040
Other revenue	<u>2,022,090</u>	<u>1,767,681</u>
Total revenue	<u>7,017,916</u>	<u>6,288,013</u>
Expenses:		
Products and services	5,457,576	4,780,730
Corporate support services	<u>1,688,892</u>	<u>1,401,796</u>
Total expenses	<u>7,146,468</u>	<u>6,182,526</u>
(Decrease) increase in net assets	(128,552)	105,487
Net assets, beginning of year	<u>3,199,439</u>	<u>3,093,952</u>
Net assets, end of year	\$ <u>3,070,887</u>	<u>3,199,439</u>

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating activities:		
Change in net assets	\$ (128,552)	105,487
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	175,956	175,824
Loss from theft	-	12,562
Changes in operating assets and liabilities:		
Receivables	(188,266)	193,321
Prepaid expenses and other assets	31,131	(33,909)
Accounts payable and accrued expenses	285,062	(1,024)
Deferred revenue	5,000	-
Net cash provided by operating activities	<u>180,331</u>	<u>452,261</u>
Investing activities - purchases of equipment, furniture and fixtures	<u>(183,081)</u>	<u>(130,601)</u>
Net (decrease) increase in cash and cash equivalents	(2,750)	321,660
Cash and cash equivalents, beginning of year	<u>597,528</u>	<u>275,868</u>
Cash and cash equivalents, end of year	\$ <u>594,778</u>	<u>597,528</u>

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements

December 31, 2005 and 2004

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

North Carolina Advanced Energy Corporation (the "Corporation") was formed on April 18, 1980, as a nonprofit entity. Corporate goals are directed towards helping residential, commercial, and industrial customers improve the "return" on their energy investment. The Corporation pursues various broad-based programs to achieve these goals. With expertise in applied building science, industrial process technologies, and electric motors and drives, the Corporation provides extensive testing, training, and consulting to utilities and energy consumers.

Other related programs that have been undertaken by the Corporation include helping to shift demands for electricity to off-peak periods, educating consumers about energy, researching alternatives to current electric generation technologies, developing more economic sources of electric power, increasing system efficiency and load factors through conservation and load management, and demonstrating and promoting efficient uses of electric power.

The Corporation has received a ruling from the Internal Revenue Service that it is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state statutes.

Approximately 54% of the Corporation's funding is derived from the ratepayers of four North Carolina investor-owned utilities and the state's twenty-eight electric cooperatives. Should the electric utilities and the North Carolina Utilities Commission ("Commission") decide that collecting these funds is no longer either in the utilities' interest or in the interest of their customers, then this action could have a material adverse effect on the Corporation's operating results.

(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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(c) Cash Equivalents

The Corporation considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2005 and 2004

(1) Organization and Summary of Significant Accounting Policies, Continued

(d) Marketable Securities

Marketable securities consist of auction rate securities which are long-term, variable rate bonds tied to short-term interest rates. They are recorded at cost (par) which approximates fair market value and are backed by student loans. Despite the long-term nature of the stated contractual maturities, there is a readily liquid market for them.

(e) Receivables

Receivables consist of amounts due from state and federal grants and receivables related to services provided to customers. In the opinion of management, all accounts considered to be uncollectible as of December 31, 2005 and 2004 had been written off, and no allowance for doubtful accounts was required.

(f) Revenue Sources and Recognition

The funding from investor-owned utilities regulated by the Commission is derived from a special charge authorized by the Commission that may be assessed to retail customers in North Carolina on the basis of kilowatt hour usage. Other in-state member organizations are charged for services rendered based on a charge to their customers of no less than 60% of the amount authorized by the Commission for regulated utilities.

Revenue from government grants is recognized when expenses are incurred under the grants and are billed on a reimbursement basis.

Other revenue, consisting primarily of training and seminar fees and consulting services, is recognized when earned.

(g) Deferred Revenues

The Corporation records deferred revenues for payments received from certain utility customers for services that have not been requested by those customers as of year-end.

(h) Equipment, Furniture and Fixtures

Equipment, furniture and fixtures are recorded at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the assets ranging from three to ten years.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2005 and 2004

(1) Organization and Summary of Significant Accounting Policies, Continued

(i) Donated Services

Donated services are recognized as contributions if the services (a) create or enhance nonfinancial assets or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased by the Corporation. Donated services totaled \$149,218 in 2005 and are included in the statements of activities as other revenue and professional services. These donated services consisted of motor testing and engineering services.

(j) Product/Service Teams

Product/Service teams develop products and services and deliver them to customers. These teams work in the following areas: motors, industrial process technologies, HVAC, ground-source heat pumps, residential new construction (site-built), manufactured housing, and building diagnostics (residential and commercial). The Board of Directors approves the Corporation's annual Business Plan, which includes the plans of each of the Product/Service Teams.

(k) Corporate Support Services

Corporate Support consists of corporate planning and services which are made up of accounting, contracts, personnel, office functions, and information services. These personnel provide corporate-level management and specialized support for the Corporation.

(l) Reclassification

Certain reclassifications have been made in the 2004 financial statements to conform with the 2005 presentation. Such reclassification have no impact on change in net assets or net assets.

(2) Investment

The Corporation has invested \$150,000 in Microcell Corporation ("Microcell"), a for-profit company, whose president is a former employee of the Corporation. This investment is carried at cost because the fair value is not readily determinable and there has been no event or circumstances that might have a significant adverse effect on the fair value.

Microcell has developed an innovative fuel cell that could greatly increase energy efficiency in North Carolina. The investment is in preferred stock of Microcell. Any benefits from appreciation in the Corporation's investment will be used by the Corporation to assist North Carolina electric rate payers in ways consistent with the Corporation's charter.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2005 and 2004

(3) Lease Commitments

The Corporation is obligated under operating leases for the rental of office space and equipment. Rent expense totaled \$412,207 and \$412,210 for 2005 and 2004, respectively.

Future minimum lease payments under operating leases are as follows:

Year ending December 31.

2006	\$ 403,000
2007	410,000
2008	418,000
2009	428,000
2010	437,000
Thereafter	<u>409,000</u>
	\$ <u>2,505,000</u>

(4) Retirement Plan

The Corporation has established a defined contribution retirement plan under Section 403(b) of the Internal Revenue Code. The plan benefits all employees meeting certain eligibility requirements. Employees are allowed to make contributions to the plan in addition to the Corporation's contribution which is based on an employee's level of annual compensation. Employees become 100% vested in the Corporation's contribution concurrent with meeting the eligibility requirements. Retirement expense for 2005 and 2004 was \$256,150 and \$227,731, respectively.

(5) Credit Risk

Financial instruments which potentially subject the Corporation to concentration of credit risk consist primarily of cash and cash equivalents and receivables.

As of December 31, 2005, cash and cash equivalents include \$594,778 in a checking account with a high credit quality bank.

North Carolina investor-owned utilities and electric cooperatives comprise 41% and 32% of the Corporation's receivables as of December 31, 2005 and 2004, respectively. NC GreenPower an affiliated nonprofit entity comprised 20% and 7% of the Corporation's receivables as of December 31, 2005 and 2004, respectively.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2005 and 2004

(6) Related Party

In February 2003, NC GreenPower was incorporated as a nonprofit entity. The mission of NC GreenPower is to provide financial incentives to encourage the development of renewable energy resources. It is funded primarily by voluntary contributions from electric utilities ratepayers in North Carolina. The Corporation's Board of Directors constitute the members of NC GreenPower. Certain resolutions of the Board of Directors of NC GreenPower require two-thirds of the votes of the members to adopt.

During 2005, the Corporation contributed \$115,000 to NC GreenPower, all of which was paid as of December 31, 2005. In addition, during 2005, the Corporation billed NC GreenPower \$255,718 for facilities, personnel and overhead costs, \$120,315 of which was receivable as of December 31, 2005. NC GreenPower also held deposits totaling \$67,629 which are owed to the Corporation as of December 31, 2005 and were remitted to the Corporation in March 2006.

During 2004, the Corporation contributed \$165,549 to NC GreenPower, \$42,549 of which was payable as of December 31, 2004. In addition, during 2004, the Corporation billed NC GreenPower \$268,676 for facilities, personnel and overhead costs, \$56,146 of which was receivable as of December 31, 2004.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2005 and 2004

(7) Functional Expenses

Functional expenses consist of the following:

		2005	
	<u>Products/ services</u>	<u>Corporate support</u>	<u>Total</u>
Salaries	\$ 2,263,859	835,555	3,099,414
Professional services	809,899	171,960	981,859
Travel and meetings	356,114	104,847	460,961
Facilities	501,321	107,000	608,321
Fringe benefits	668,171	241,893	910,064
Team expenses	600,748	94,860	695,608
Equipment	41,915	92,858	134,773
Other costs	<u>215,549</u>	<u>39,919</u>	<u>255,468</u>
	<u>\$ 5,457,576</u>	<u>1,688,892</u>	<u>7,146,468</u>

		2004	
	<u>Products/ services</u>	<u>Corporate support</u>	<u>Total</u>
Salaries	\$ 2,010,848	711,096	2,721,944
Professional services	509,502	142,828	652,330
Travel and meetings	313,322	86,954	400,276
Facilities	508,734	98,364	607,098
Fringe benefits	594,353	173,466	767,819
Team expenses	595,144	78,307	673,451
Equipment	43,251	94,296	137,547
Other costs	<u>205,576</u>	<u>16,485</u>	<u>222,061</u>
	<u>\$ 4,780,730</u>	<u>1,401,796</u>	<u>6,182,526</u>

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Schedule of Expenditures of Federal Awards

Year ended December 31, 2005

Federal Grantor/ Pass-through Grantor/ <u>Program Title</u>	Federal CFDA <u>Number</u>	State Contract Number	Total <u>Expenditures</u>
Federal Awards:			
United States Department of Energy:			
Pass-through from North Carolina State			
Energy Office:			
State Energy Program Special Projects	81.119	N/A	\$ 53,269
Conservation Research and Development	81.086	N/A	283,304
Pass-through from National Association of State			
Energy Officials:			
Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training and Technical Analysis/Assistance	81.117	N/A	546,516
United States Department of Housing and			
Urban Development:			
Healthy Homes Technical Studies	14.906	N/A	210,996
Community Development Block Grants/Brownfields Economics Development Initiative	14.246	N/A	4,261
Pass-through from Duke University Office of			
Sponsored Programs:			
Healthy Homes Demonstrations Grant	14.901	04-SC-HUD-1004	43,377
United States Environmental Protection Agency:			
Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	66.034	N/A	<u>39,371</u>
Research and development cluster			\$ <u>1,181,094</u>

(Continued)

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Schedule of Expenditures of Federal Awards, Continued

Year ended December 31, 2005

Note to the Schedule of Expenditures of Federal Awards

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Corporation and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

*Report on Internal Control over Financial Reporting
and on Compliance Based on an Audit of Financial
Statements Performed in Accordance with Government
Auditing Standards*

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

The Board of Directors
North Carolina Advanced Energy Corporation:

We have audited the financial statements of North Carolina Advanced Energy Corporation (the "Corporation") as of and for the year ended December 31, 2005, and have issued our report thereon dated April 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Board of Directors
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This report is intended solely for the information and use of the Board of Directors, management, and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Batchelor, Jellery & Roberts, LLP

April 17, 2006

*Report on Compliance with Requirements Applicable to
Each Major Program and on Internal Control over
Compliance in Accordance with OMB Circular A-133*

BATCHELOR, TILLERY & ROBERTS, LLP

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**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

The Board of Directors
North Carolina Advanced Energy Corporation:

Compliance

We have audited the compliance of North Carolina Advanced Energy Corporation (the "Corporation") with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended December 31, 2005. The Corporation's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of Corporation's management. Our responsibility is to express an opinion on the Corporation's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Corporation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Corporation's compliance with those requirements.

In our opinion, the Corporation complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2005.

Internal Control Over Compliance

The management of the Corporation is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Corporation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Batchelor, Jillery & Roberts, LLP

April 17, 2006

Summary Schedule of Findings and Questioned Costs

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Summary Schedule of Findings and Questioned Costs

Year ended December 31, 2005

SECTION I-Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial report:

- Material weaknesses identified? ☐ Yes ☒ No
- Reportable conditions identified that are not considered to be material weaknesses ☐ Yes ☒ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over financial report:

- Material weaknesses identified? ☐ Yes ☒ No
- Reportable conditions identified that are not considered to be material weaknesses ☐ Yes ☒ None reported

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? ☐ Yes ☒ None reported

Identification of major programs:

CFDA Number

Name of Federal Program or Cluster

Not applicable

Research and development cluster

Dollar threshold used to distinguish between type A and type B programs: \$ 300,000

Auditee qualified as low-risk auditee? ☐ Yes ☒ No

SECTION II-Financial Statement Findings

Not applicable

SECTION III-Federal Award Findings and Questioned Costs

Not applicable