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NORTH CAROLINA ADVANCED
ENERGY CORPORATION

Financial Statements

December 31, 2002 and 2001

(With Independent Auditors' Report Thereon)

FILED

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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") as of December 31, 2002 and 2001 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. 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, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina Advanced Energy Corporation as of December 31, 2002 and 2001, and the changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Batchelor, Tillery & Roberts, LLP

March 7, 2003

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Financial Position

December 31, 2002 and 2001

<u>Assets</u>	<u>2002</u>	<u>2001</u>
Current assets:		
Cash and cash equivalents	\$ 2,125,630	2,641,753
Accounts receivable	790,703	837,721
Prepaid expenses and other assets	<u>3,152</u>	<u>27,801</u>
Total current assets	<u>2,919,485</u>	<u>3,507,275</u>
Property and equipment:		
Equipment, furniture and fixtures	1,825,291	1,716,909
Less accumulated depreciation and amortization	<u>(1,371,861)</u>	<u>(1,316,828)</u>
	<u>453,430</u>	<u>400,081</u>
Investment	<u>150,000</u>	<u>150,000</u>
	<u>\$ 3,522,915</u>	<u>4,057,356</u>
 <u>Liabilities and Net Assets</u>		
Current liabilities:		
Accounts payable and accrued expenses	398,911	460,491
Deferred revenue	<u>33,338</u>	<u>33,338</u>
Total current liabilities	<u>432,249</u>	<u>493,829</u>
Commitments		
Net assets:		
Unrestricted	1,894,607	2,428,135
Unrestricted-board designated	<u>1,196,059</u>	<u>1,135,392</u>
	<u>3,090,666</u>	<u>3,563,527</u>
	<u>\$ 3,522,915</u>	<u>4,057,356</u>

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Activities

Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Revenues:		
Utility funding	\$ 3,520,386	3,587,423
Government grants	193,038	322,661
Interest	31,348	108,187
Other revenue	<u>1,137,353</u>	<u>1,394,387</u>
Total revenues	<u>4,882,125</u>	<u>5,412,658</u>
Expenses:		
Products and services	4,405,740	4,687,246
Corporate support services	<u>949,246</u>	<u>964,605</u>
Total expenses	<u>5,354,986</u>	<u>5,651,851</u>
Decrease in net assets	(472,861)	(239,193)
Net assets, beginning of year	<u>3,563,527</u>	<u>3,802,720</u>
Net assets, end of year	\$ <u>3,090,666</u>	<u>3,563,527</u>

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Cash Flows

Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Operating activities:		
Decrease in net assets	\$ (472,861)	(239,193)
Adjustments to reconcile decrease in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	163,179	183,917
Gain on sale of assets	(1,133)	-
Changes in operating assets and liabilities:		
Receivables	47,018	48,573
Prepaid expenses and other assets	24,649	21,434
Accounts payable and accrued expenses	(61,580)	110,080
Unearned revenue	-	21,894
Net cash (used in) provided by operating activities	<u>(300,728)</u>	<u>146,705</u>
Investing activities:		
Purchases of equipment, furniture and fixtures	(217,004)	(128,613)
Proceeds from sale of assets	1,609	-
Net cash used in investing activities	<u>(215,395)</u>	<u>(128,613)</u>
Net (decrease) increase in cash and cash equivalents	(516,123)	18,092
Cash and cash equivalents, beginning of year	<u>2,641,753</u>	<u>2,623,661</u>
Cash and cash equivalents, end of year	\$ <u>2,125,630</u>	<u>2,641,753</u>

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements

December 31, 2002 and 2001

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

North Carolina Alternative Energy Corporation (the "Corporation") was formed on April 18, 1980, as a nonprofit entity. During 1997, the Corporation changed its legal name to North Carolina Advanced Energy Corporation. Corporate goals are directed towards helping residential, commercial, and industrial customers improve the "return" on their energy investment. The Corporation has in the past and is now pursuing various broad-based programs that should help 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 income taxes under Section 501(c)(3) of the Internal Revenue Code.

Approximately 80% 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 was 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 the 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, 2002 and 2001

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

(d) Accounts Receivable

Accounts receivable consists of unconditional promises to give due in less than one year and receivables related to services provided to clients. Management uses the direct write-off method of accounting for uncollectible accounts. In the opinion of management, all accounts considered to be uncollectible as of December 31, 2002 and 2001 had been written off. *Bad debt expense using the direct write-off method would not differ materially from bad debt expense calculated using the reserve method.*

(e) 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.

(f) 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.

(g) 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. Depreciation and amortization expense for 2002 and 2001 was \$163,179 and \$183,917, respectively.

(h) 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.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2002 and 2001

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

(i) Corporate Support Services

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

(j) Unrestricted Net Assets-Board Designated

The board of directors has designated a fund balance to segregate funds that have accumulated as a result of a multi-year plan to prepare for the possibility of electric utility restructuring legislature in North Carolina. Planned segregation of funds will be adjusted yearly as necessary as it becomes more clear whether and when deregulation will take place in North Carolina. It is anticipated that in the final year of the plan, the annual division of Commission authorized funding between this fund and monies dedicated to member utility service accounts will be determined by the amount of value-added services our member utilities will order after deregulation.

(2) Investment

The Corporation has invested \$150,000 in Microcell Corporation ("Microcell"), a for-profit development stage company, whose president is a former employee of the Corporation. This investment is carried at lower of cost or estimated fair market 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. In addition, Microcell leases office space from the Corporation, and total payments by Microcell to the Corporation were \$4,087 and \$25,044 in 2002 and 2001, respectively.

(3) Lease Commitments

The Corporation is obligated under operating leases for the rental of office space and equipment. Rent expense was \$373,372 and \$351,009 for 2002 and 2001, respectively.

Future minimum lease payments under the above operating lease is as follows:

<u>Year ending December 31,</u>	
2003	\$ 402,311
2004	402,311
2005	389,701
2006	<u>334,024</u>
	\$ <u>1,528,347</u>

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2002 and 2001

(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 2002 and 2001 was \$221,003 and \$195,462, 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, 2002, cash and cash equivalents include \$800,000 in commercial paper, 797,727 in a money market fund, and \$595,253 in a repurchase agreement with a bank.

As of December 31, 2001, cash and cash equivalents include 1,896,954 in commercial paper and \$893,120 in a repurchase agreement with a bank.

Five North Carolina investor-owned utilities comprise 49% and 59% of the Corporation's receivables as of December 31, 2002 and 2001, respectively.

(6) Functional Expenses

Functional expenses consist of the following:

	2002		
	<u>Products/ services</u>	<u>Corporate support</u>	<u>Total</u>
Salaries	\$ 2,019,877	501,244	2,521,121
Professional services	740,408	100,680	841,088
Travel and meetings	335,462	58,980	394,442
Facilities	480,014	69,594	549,608
Fringe benefits	510,861	107,681	618,542
Team expenses	217,276	56,781	274,057
Equipment	68,246	52,407	120,653
Other costs	<u>33,596</u>	<u>1,879</u>	<u>35,475</u>
	\$ <u>4,405,740</u>	<u>949,246</u>	<u>5,354,986</u>

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2002 and 2001

(6) Functional Expenses, Continued

		2001	
	<u>Products/ services</u>	<u>Corporate support</u>	<u>Total</u>
Salaries	\$ 1,745,648	450,253	2,195,901
Professional services	1,213,085	100,633	1,313,718
Travel and meetings	382,659	71,701	454,360
Facilities	441,613	96,171	537,784
Fringe benefits	564,969	136,268	701,237
Team expenses	222,973	47,006	269,979
Equipment	82,060	65,151	147,211
Other costs	<u>34,239</u>	<u>(2,578)</u>	<u>31,661</u>
	<u>\$ 4,687,246</u>	<u>964,605</u>	<u>5,651,851</u>

(7) Subsequent Events

The Corporation received a grant effective February 15, 2003 in the amount of \$700,000 from the United States Department of Housing and Urban Development (HUD) to be funded on a reimbursement basis. The grant amount is contingent upon the Corporation matching expenses in the amount of \$1,993,303 related to the grant project. The period of performance ends February 14, 2006.

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