NORTH CAROLINA ADVANCED ENERGY CORPORATION

Financial Statements

December 31, 1998 and 1997

(With Independent Auditors' Report)

BATCHELOR, TILLERY & ROBERTS, LLP
CERTIFIED PUBLIC ACCOUNTANTS
POST OFFICE BOX 18068
RALEIGH, NORTH CAROLINA 27619

RONALD A. BATCHELOR
ANN H. TILLERY
FRANKLIN T. ROBERTS
GREGORY H. BRILEY
WM. JAMES BLACK, JR.

4700 HOMEWOOD COURT, SUITE 300
RALEIGH, NORTH CAROLINA 27609
TELEPHONE (919) 787-8212
FACSIMILE (919) 783-6724

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, 1998 and 1997 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 generally accepted auditing standards. 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 Corporation as of December 31, 1998 and 1997, and the changes in net assets and cash flows for the years then ended in conformity with generally accepted accounting principles.

Batchelor, Tillery & Roberts, LLP

March 31, 1999

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Financial Position

December 31, 1998 and 1997

	1998	1997
Assets		
Current assets:		
Cash and cash equivalents	$ 2,648,380	2,360,224
Receivables:		
Accounts receivable	567,767	520,852
Other	11,378	6,361
	579,145	527,213
Prepaid expenses and other assets	43,596	21,483
Total current assets	3,271,121	2,908,920
Property and equipment:		
Equipment, furniture and fixtures	1,562,598	1,361,934
Less accumulated depreciation and amortization	(893,576)	(660,027)
	669,022	701,907
	$ 3,940,143	3,610,827
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	315,779	300,968
Deferred revenue	16,394	118,365
Total current liabilities	332,173	419,333
Commitments		
Net assets:		
Unrestricted	3,407,970	3,191,494
Unrestricted-board designated	200,000	-
	3,607,970	3,191,494
	$ 3,940,143	3,610,827

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Activities

Years ended December 31, 1998 and 1997

	1998	1997
Revenues:		
Utility funding	$ 3,536,978	3,535,713
Interest	131,311	106,287
Other revenue	834,107	904,436
Total revenues	4,502,396	4,546,436
Expenses:		
Products and services	2,843,490	3,133,307
Business development	656,922	-
Corporate support services	585,508	834,414
Total expenses	4,085,920	3,967,721
Increase in net assets	416,476	578,715
Net assets, beginning of year	3,191,494	2,612,779
Net assets, end of year	$ 3,607,970	3,191,494

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Cash Flows

Years ended December 31, 1998 and 1997

	1998	1997
Operating activities:		
Increase in net assets	$ 416,476	578,715
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	233,549	249,066
Loss on sales of equipment	-	21,891
Changes in operating assets and liabilities:		
Receivables	(51,932)	17,044
Prepaid expenses and other assets	(22,113)	(14,554)
Accounts payable and accrued expenses	14,811	145,750
Unearned revenue	(101,971)	83,630
Net cash provided by operating activities	488,820	1,081,542
Investing activities:		
Purchases of equipment, furniture and fixtures	(200,664)	(260,561)
Proceeds from sales of equipment	-	522
Net cash used in investing activities	(200,664)	(260,039)
Net increase in cash and cash equivalents	288,156	821,503
Cash and cash equivalents, beginning of year	2,360,224	1,538,721
Cash and cash equivalents, end of year	$ 2,648,380	2,360,224

See accompanying notes to financial statements.

(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 generally accepted accounting principles 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.

(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, 1998 and 1997 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 Advanced Energy 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 the years ended December 31, 1998 and 1997 was $233,549 and $249,066, 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.

(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) Lease Commitments

The Corporation is obligated under an operating lease for the rental of office space which expires in September, 2006. Rent expense was $345,522 and $337,010 for the years ended December 31, 1998 and 1997, respectively.

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

Year ending December 31:	
1999	$ 345,522
2000	345,522
2001	345,522
2002	345,522
2003	345,522
Thereafter	921,390
	$ 2,649,000

(3) Retirement Plan

Effective January 1, 1982, the Corporation 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 1998 and 1997 was $174,198 and $165,854, respectively.

(4) 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, 1998, cash and cash equivalents consist of $2,000,000 in commercial paper and $874,642 in a repurchase agreement with a bank. As of December 31, 1997, cash and cash equivalents consist of $1,600,000 in commercial paper and $738,864 in a repurchase agreement with a bank.

Five North Carolina investor-owned utilities comprise 75% and 70% of the Corporation's receivables as of December 31, 1998 and 1997, respectively.

(5) Functional Expenses

Functional expenses consist of the following:

	Year ended December 31, 1998			
	Products/ services	Business development	Corporate support	Total
Salaries	$ 1,273,625	307,014	245,125	1,825,764
Professional services	382,098	83,246	58,855	524,199
Facilities	375,921	60,953	51,858	488,732
Fringe benefits	273,982	74,442	56,658	405,082
Travel	220,132	102,363	32,673	355,168
Team expenses	178,451	17,840	24,059	220,350
Equipment	92,349	-	74,630	166,979
Other costs	46,932	11,064	41,650	99,646
	$ 2,843,490	656,922	585,508	4,085,920

(5) Functional Expenses, continued

	Year ended December 31, 1997		
	Products/ services	Corporate support services	Total
Salaries	$ 1,455,156	370,454	1,825,610
Fringe benefits	327,025	83,255	410,280
Travel	149,401	20,430	169,831
Materials and supplies	125,326	3,573	128,899
Equipment	108,784	80,188	188,972
Professional services	268,104	106,722	374,826
Facilities	444,509	88,271	532,780
Other indirect expenses	255,002	81,521	336,523
	$ 3,133,307	834,414	3,967,721

(6) Year 2000

The Corporation recognizes that a plan to modify its information technology to be ready for year 2000 is critical. The Corporation has completed an assessment and has modified or replaced portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. The Corporation's current estimate is that the costs associated with the year 2000 issue, and the consequences of incomplete or untimely resolution of the year 2000 issue, will not have a materiel adverse effect on the result of operations or financial position of the Corporation in any given year. In addition, even if the internal systems of the Corporation are not materially affected by the year 2000 issue, the Corporation could be affected through disruption in the operation of the enterprises with which the Corporation interacts.