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N.C. Utilities Commission

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Audit Reports

Years ended December 31, 2001 and 2000

(Clerk/PM)
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NORTH CAROLINA ADVANCED ENERGY CORPORATION

2001 Audit

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**CHIEF CLERK
N.C. UTILITIES COMMISSION**

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

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**CHIEF CLERK
N.C. UTILITIES COMMISSION**

BATCHELOR, TILLERY & ROBERTS, LLP

CERTIFIED PUBLIC ACCOUNTANTS

POST OFFICE BOX 18068

RALEIGH, NORTH CAROLINA 27619

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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, 2001 and 2000, 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 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 North Carolina Advanced Energy Corporation as of December 31, 2001 and 2000, 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 a report dated April 3, 2002, on our consideration of the Association's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of the Corporation taken as a whole. The accompanying Schedule of Expenditures of Federal and State Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular (OMB) 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, Tillery & Roberts, LLP

April 3, 2002

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Financial Position

December 31, 2001 and 2000

| <u>Assets</u> | <u>2001</u> | <u>2000</u> |
|--|---------------------|--------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 2,641,753 | 2,623,661 |
| Receivables- | | |
| Accounts receivable | 837,721 | 877,404 |
| Other | - | 8,890 |
| Prepaid expenses and other assets | 27,801 | 49,235 |
| Total current assets | <u>3,507,275</u> | <u>3,559,190</u> |
| Property and equipment: | | |
| Equipment, furniture and fixtures | 1,716,909 | 1,670,168 |
| Less accumulated depreciation and amortization | <u>(1,316,828)</u> | <u>(1,214,783)</u> |
| | 400,081 | 455,385 |
| Investment | <u>150,000</u> | <u>150,000</u> |
| | <u>\$ 4,057,356</u> | <u>4,164,575</u> |
| <u>Liabilities and Net Assets</u> | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | 460,491 | 350,411 |
| Deferred revenue | 33,338 | 11,444 |
| Total current liabilities | <u>493,829</u> | <u>361,855</u> |
| Commitments | | |
| Net assets: | | |
| Unrestricted | 2,428,135 | 2,866,430 |
| Unrestricted-board designated | <u>1,135,392</u> | <u>936,290</u> |
| | <u>3,563,527</u> | <u>3,802,720</u> |
| | <u>\$ 4,057,356</u> | <u>4,164,575</u> |

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Activities

Years ended December 31, 2001 and 2000

| | <u>2001</u> | <u>2000</u> |
|-----------------------------------|---------------------|------------------|
| Revenues: | | |
| Utility funding | \$ 3,587,423 | 3,525,508 |
| Government grants | 322,661 | 161,678 |
| Interest | 108,187 | 165,220 |
| Other revenue | <u>1,394,387</u> | <u>858,771</u> |
| Total revenues | <u>5,412,658</u> | <u>4,711,177</u> |
| Expenses: | | |
| Products and services | 4,079,689 | 2,825,514 |
| Business development | 607,557 | 926,968 |
| Corporate support services | <u>964,605</u> | <u>926,398</u> |
| Total expenses | <u>5,651,851</u> | <u>4,678,880</u> |
| (Decrease) increase in net assets | (239,193) | 32,297 |
| Net assets, beginning of year | <u>3,802,720</u> | <u>3,770,423</u> |
| Net assets, end of year | \$ <u>3,563,527</u> | <u>3,802,720</u> |

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Statements of Cash Flows

Years ended December 31, 2001 and 2000

| | <u>2001</u> | <u>2000</u> |
|--|---------------------|------------------|
| Operating activities: | | |
| (Decrease) increase in net assets | \$ (239,193) | 32,297 |
| Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 183,917 | 177,485 |
| Changes in operating assets and liabilities: | | |
| Receivables | 48,573 | (107,919) |
| Prepaid expenses and other assets | 21,434 | 83,168 |
| Accounts payable and accrued expenses | 110,080 | 135,934 |
| Unearned revenue | 21,894 | 1,999 |
| Net cash provided by operating activities | <u>146,705</u> | <u>322,964</u> |
| Investing activities: | | |
| Purchases of equipment, furniture and fixtures | (128,613) | (139,979) |
| Investments | - | (150,000) |
| Net cash used in investing activities | <u>(128,613)</u> | <u>(289,979)</u> |
| Net increase in cash and cash equivalents | 18,092 | 32,985 |
| Cash and cash equivalents, beginning of year | <u>2,623,661</u> | <u>2,590,676</u> |
| Cash and cash equivalents, end of year | \$ <u>2,641,753</u> | <u>2,623,661</u> |

See accompanying notes to financial statements.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements

December 31, 2001 and 2000

(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. During 1997, the Corporation changed its legal name from North Carolina Alternative 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 economical 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 (the "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, 2001 and 2000

(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, 2001 and 2000 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 Corporation 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 2001 and 2000 was \$183,917 and \$177,485, 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, 2001 and 2000

(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.

(k) Reclassifications

Certain reclassifications have been made to the 2000 statement of activities to conform with the 2001 presentation. These reclassification had no effect on the change in net assets.

(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 \$25,044 and \$11,699 in 2001 and 2000, respectively.

(3) Lease Commitments

The Corporation is obligated under an operating lease for the rental of office space which expires in September, 2006. Rent expense was \$351,009 and \$347,669 for 2001 and 2000, respectively. The Corporation also entered into an operating lease for equipment beginning in March, 2002 and ending in February, 2006.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2001 and 2000

(3) Lease Commitments, Continued

Future minimum lease payments under the above operating leases are as follows:

| <u>Year ending December 31:</u> | |
|---------------------------------|---------------------|
| 2002 | \$ 362,644 |
| 2003 | 364,481 |
| 2004 | 364,481 |
| 2005 | 364,481 |
| 2006 | <u>334,024</u> |
| | <u>\$ 1,790,111</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 2001 and 2000 was \$195,462 and \$175,813, 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, 2001, cash and cash equivalents include \$1,896,954 in commercial paper and \$893,120 in a repurchase agreement with a bank.

As of December 31, 2000, cash and cash equivalents include \$1,939,322 in commercial paper and \$663,173 in a repurchase agreement with a bank.

Five North Carolina utilities comprise 59% and 40% of the Corporation's receivables as of December 31, 2001 and 2000, respectively.

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 2001 and 2000

(6) Functional Expenses

Functional expenses consist of the following:

| | 2001 | | | |
|-----------------------|-------------------------------|---------------------------------|------------------------------|------------------|
| | <u>Products/ services</u> | <u>Business development</u> | <u>Corporate support</u> | <u>Total</u> |
| Salaries | \$ 1,512,959 | 232,689 | 450,253 | 2,195,901 |
| Professional services | 1,038,262 | 174,823 | 100,633 | 1,313,718 |
| Travel and meetings | 279,959 | 93,684 | 71,101 | 444,744 |
| Facilities | 532,511 | - | 96,578 | 629,089 |
| Fringe benefits | 485,162 | 79,807 | 136,269 | 701,238 |
| Team expenses | 121,922 | 19,169 | 47,198 | 188,289 |
| Equipment | 82,060 | - | 65,151 | 147,211 |
| Other | <u>26,854</u> | <u>7,385</u> | <u>(2,578)</u> | <u>31,661</u> |
| | <u>\$ 4,079,689</u> | <u>607,557</u> | <u>964,605</u> | <u>5,651,851</u> |

| | 2000 | | | |
|-----------------------|-------------------------------|---------------------------------|------------------------------|------------------|
| | <u>Products/ services</u> | <u>Business development</u> | <u>Corporate support</u> | <u>Total</u> |
| Salaries | \$ 1,063,430 | 344,866 | 458,036 | 1,866,332 |
| Professional services | 461,423 | 157,546 | 133,266 | 752,235 |
| Travel and meetings | 304,811 | 149,634 | 47,157 | 501,602 |
| Facilities | 328,810 | 70,713 | 90,609 | 490,132 |
| Fringe benefits | 297,541 | 89,483 | 89,938 | 476,962 |
| Team expenses | 154,419 | 27,914 | 13,682 | 196,015 |
| Equipment | 81,879 | - | 58,052 | 139,931 |
| Other | <u>133,201</u> | <u>86,812</u> | <u>35,658</u> | <u>255,671</u> |
| | <u>\$ 2,825,514</u> | <u>926,968</u> | <u>926,398</u> | <u>4,678,880</u> |

NORTH CAROLINA ADVANCED ENERGY CORPORATION.

Schedule of Expenditures of Federal and State Awards

Year ended December 31, 2001

| Federal or State Grantor/ Pass-through Grantor/ Program Title | Federal CFDA Number | State Contract Number | Total Expenditures |
|---|------------------------|--------------------------|-----------------------|
| U.S. Department of Energy: | | | |
| Field Study Comparison of the Energy and Moisture Performance Characteristics of Ventilated vs. Sealed Crawlspace in the South | 81.117 | - | \$ 245,225 |
| Pass-through from North Carolina Department of Administration: | | | |
| Flood Recovery Technical Assistance | 81.041 | 01-8002-DAP1 | 67,188 |
| | | | <u>312,413</u> |
| U.S. Department of Health and Human Services: | | | |
| Pass-through from North Carolina Department of Health and Human Services, Office of Economic Opportunity: | | | |
| Residential Energy Assistance Challenge Option (REACH) | 93.568 | OEO00350 | 10,248 |
| | | | <u>\$ 322,661</u> |

Note to the Schedule of Expenditures of Federal and State Awards

Note 1. Basis of Presentation

The accompanying schedule of expenditures of Federal and State awards includes the Federal and State 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.

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**CHIEF CLERK
N.C. UTILITIES COMMISSION**

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

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**REPORT ON COMPLIANCE AND ON
INTERNAL CONTROL OVER FINANCIAL REPORTING 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") (a nonprofit organization) as of and for the year ended December 31, 2001, and have issued our report thereon dated April 3, 2002. 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 of America.

Compliance

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 grants, 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 that are required to be reported under *Government Auditing Standards*.

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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a 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 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. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the Corporation in a separate letter dated April 3, 2002.

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

Batchelor, Fillery & Roberts, LLP

April 3, 2002

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APR 09 2003

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N.C. UTILITIES COMMISSION**

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N.C. UTILITIES COMMISSION

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

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**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND 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") (a nonprofit organization) 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 its major federal programs for the year ended December 31, 2001. The Corporation's major federal programs are 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 programs 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 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, 2001.

Internal Control Over Compliance

The management of the Corporation is responsible for establishing and maintaining effective internal control over compliance with 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 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 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, federal awarding agency and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Batchelor, Gillery & Roberts, LLP

April 3, 2002

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**CHIEF CLERK
N.C. UTILITIES COMMISSION**

Summary Schedule of Findings and Questioned Costs

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**CHIEF CLERK
N.C. UTILITIES COMMISSION**

NORTH CAROLINA ADVANCED ENERGY CORPORATION

Schedule of Findings and Questioned Costs

Year ended December 31, 2001

SUMMARY OF AUDITORS' RESULTS

- I. Type of report issued on the financial statements: Unqualified
- II. No reportable conditions in internal control were disclosed by the audit.
- III. The audit did not disclose any noncompliance which is material to the financial statements.
- IV. No reportable conditions in internal control over major programs were disclosed by the audit.
- V. Type of report issued on compliance for major programs: Unqualified
- VI. The audit did not disclose an audit finding which is required to be reported.
- VII. The major program:
 - U.S. Department of Energy - Field Study Comparison of the Energy and Moisture Performance Characteristics of Ventilated vs. Sealed Crawlspace in the South, Federal CFDA Number: 81.117
- VIII. The dollar threshold used to distinguish between Type A and Type B programs: \$300,000
- IX. The Corporation does not qualify as a low-risk auditee.

FINDINGS RELATING TO THE FINANCIAL STATEMENTS

(Which are required to be reported in accordance with generally accepted *Government Auditing Standards*)

There are no such findings required to be reported.

FINDINGS AND QUESTIONED COSTS FOR FEDERAL AND STATE AWARDS

There are no such findings required to be reported.

PRIOR YEAR AUDIT FINDINGS

There were no such findings required to be reported.