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Clerk's Office  
N.C. Utilities Commission

**NORTH CAROLINA ADVANCED  
ENERGY CORPORATION**

Financial Statements

December 31, 2003 and 2002

(With Independent Auditors' Report Thereon)

Clark <sup>only</sup>

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**CERTIFIED PUBLIC ACCOUNTANTS**

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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, 2003 and 2002 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, 2003 and 2002, 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.

*Batchelor, Tillery & Roberts, LLP*

March 12, 2004

# NORTH CAROLINA ADVANCED ENERGY CORPORATION

## Statements of Financial Position

December 31, 2003 and 2002

<u>Assets</u>	<u>2003</u>	<u>2002</u>
Current assets:		
Cash and cash equivalents	\$ 1,575,868	2,125,630
Accounts receivable	1,345,965	790,703
Prepaid expenses and other assets	33,496	3,152
Total current assets	<u>2,955,329</u>	<u>2,919,485</u>
Property and equipment:		
Equipment, furniture and fixtures	1,986,757	1,825,291
Less accumulated depreciation and amortization	<u>(1,552,757)</u>	<u>(1,371,861)</u>
	434,000	453,430
Investment	<u>150,000</u>	<u>150,000</u>
	<u>\$ 3,539,329</u>	<u>3,522,915</u>
 <u>Liabilities and Net Assets</u>		
Current liabilities:		
Accounts payable and accrued expenses	412,039	398,911
Deferred revenue	<u>33,338</u>	<u>33,338</u>
Total current liabilities	<u>445,377</u>	<u>432,249</u>
Commitments		
Net assets:		
Unrestricted	3,093,952	1,894,607
Unrestricted-board designated	<u>-</u>	<u>1,196,059</u>
	<u>3,093,952</u>	<u>3,090,666</u>
	<u>\$ 3,539,329</u>	<u>3,522,915</u>

See accompanying notes to financial statements.

# NORTH CAROLINA ADVANCED ENERGY CORPORATION

## Statements of Activities

Years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Revenues:		
Utility funding	\$ 3,589,798	3,520,386
Government grants	290,228	193,038
Interest	18,748	31,348
Other revenue	<u>1,312,255</u>	<u>1,137,353</u>
Total revenues	<u>5,211,029</u>	<u>4,882,125</u>
Expenses:		
Products and services	4,049,817	4,405,740
Corporate support services	<u>1,157,926</u>	<u>949,246</u>
Total expenses	<u>5,207,743</u>	<u>5,354,986</u>
Increase (decrease) in net assets	3,286	(472,861)
Net assets, beginning of year	<u>3,090,666</u>	<u>3,563,527</u>
Net assets, end of year	\$ <u>3,093,952</u>	<u>3,090,666</u>

See accompanying notes to financial statements.

# NORTH CAROLINA ADVANCED ENERGY CORPORATION

## Statements of Cash Flows

Years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Operating activities:		
Increase (decrease) in net assets	\$ 3,286	(472,861)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities:		
Depreciation and amortization	180,896	163,179
Gain on sale of assets	-	(1,133)
Changes in operating assets and liabilities:		
Receivables	(555,262)	47,018
Prepaid expenses and other assets	(30,344)	24,649
Accounts payable and accrued expenses	<u>13,128</u>	<u>(61,580)</u>
Net cash used in operating activities	<u>(388,296)</u>	<u>(300,728)</u>
Investing activities:		
Purchases of equipment, furniture and fixtures	(161,466)	(217,004)
Proceeds from sale of assets	<u>-</u>	<u>1,609</u>
Net cash used in investing activities	<u>(161,466)</u>	<u>(215,395)</u>
Net decrease in cash and cash equivalents	(549,762)	(516,123)
Cash and cash equivalents, beginning of year	<u>2,125,630</u>	<u>2,641,753</u>
Cash and cash equivalents, end of year	\$ <u>1,575,868</u>	<u>2,125,630</u>

See accompanying notes to financial statements.

# NORTH CAROLINA ADVANCED ENERGY CORPORATION

## Notes to Financial Statements

December 31, 2003 and 2002

### (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 income taxes under Section 501(c)(3) of the Internal Revenue Code.

Approximately 70% 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 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, 2003 and 2002

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

#### (d) Accounts Receivable

Accounts receivable consists of amounts due from state and federal grants and receivables related to services provided to customers. 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, 2003 and 2002 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.

Revenue from government grants is recognized when expenses are incurred under the grants.

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

#### (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 2003 and 2002 was \$180,896 and \$163,179, 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, 2003 and 2002

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

#### (i) 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.

#### (j) Unrestricted Net Assets-Board Designated

The board of directors had designated net assets to segregate funds that had accumulated as a result of a multi-year plan to prepare for the possibility of electric utility restructuring legislation in North Carolina. As a result of a change in the regulatory environment of the electric utilities industry, the Board now considers deregulation to be a remote possibility and therefore, has decided in 2003 to undesignate the remaining 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 leased office space through March 2002 from the Corporation, and made total payments to the Corporation of \$4,087 in 2002.

### (3) Lease Commitments

The Corporation is obligated under operating leases for the rental of office space and equipment. Rent expense totaled \$409,862 and \$373,372 for 2003 and 2002, respectively.

Future minimum lease payments under operating leases are as follows:

<u>Year ending December 31,</u>	
2004	\$ 402,000
2005	413,000
2006	<u>359,000</u>
	\$ <u>1,174,000</u>

# NORTH CAROLINA ADVANCED ENERGY CORPORATION

## Notes to Financial Statements, Continued

December 31, 2003 and 2002

### (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 2003 and 2002 was \$221,208 and \$221,003, 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, 2003, cash and cash equivalents include \$1,000,000 in commercial paper and \$631,619 in a repurchase agreement with a bank.

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.

North Carolina investor-owned utilities and electric cooperatives comprise 28% and 49% of the Corporation's receivables as of December 31, 2003 and 2002, respectively. NC GreenPower Corporation ("NC GreenPower"), an affiliated non-profit organization, comprised 35% of receivables as of December 31, 2003 (See note 6).

### (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 will be 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 2003, the Corporation made payments on behalf of NC GreenPower totaling \$341,479 and provided services for which it charged \$136,240. As of December 31, 2003, NC GreenPower owed the Corporation \$477,719. In addition, during 2003, the Corporation contributed \$78,902 to NC GreenPower.

# NORTH CAROLINA ADVANCED ENERGY CORPORATION

## Notes to Financial Statements, Continued

December 31, 2003 and 2002

### (7) Functional Expenses

Functional expenses consist of the following:

	<u>2003</u>		
	<u>Products/ services</u>	<u>Corporate support</u>	<u>Total</u>
Salaries	\$ 1,957,794	592,940	2,550,734
Professional services	352,816	93,978	446,794
Travel and meetings	327,233	71,555	398,788
Facilities	524,898	77,171	602,069
Fringe benefits	538,379	143,808	682,187
Team expenses	154,384	74,057	228,441
Equipment	59,709	82,642	142,351
Other costs	<u>134,604</u>	<u>21,775</u>	<u>156,379</u>
	<u>\$ 4,049,817</u>	<u>1,157,926</u>	<u>5,207,743</u>

  

	<u>2002</u>		
	<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>

### (8) Grants

The Corporation has received numerous state and federal grants, the most significant of which is a grant for \$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 totaling \$1,993,303 related to the grant project. The period of performance ends February 14, 2006. During 2003, the Corporation recognized \$49,523 in revenue from this grant and had a receivable of \$4,039 outstanding as of December 31, 2003.