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Independent Auditors' Report

The Board of Directors
North Carolina Alternative Energy Corporation:

We have audited the accompanying statement of financial position of North Carolina Alternative Energy Corporation (the "Corporation") as of December 31, 1996 and the related statements of activities and cash flows for the year 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 audit. The financial statements of North Carolina Alternative Energy Corporation as of December 31, 1995 were audited by other auditors whose report dated February 7, 1996 expressed an unqualified opinion on those financial statements.

We conducted our audit 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 audit provides 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, 1996, and the changes in net assets and cash flows for the year then ended in conformity with generally accepted accounting principles.

Batchelor, Tillery & Roberts, LLP

February 11, 1997

NORTH CAROLINA ALTERNATIVE ENERGY CORPORATION

Statements of Financial Position

December 31, 1996 and 1995

	1996	1995
Assets		
Current assets:		
Cash and cash equivalents	$ 1,538,721	2,413,783
Receivables:		
Funding receivable	527,398	362,780
Other	16,859	16,085
	544,257	378,865
Prepaid expenses and other assets	6,929	11,898
Total current assets	2,089,907	2,804,546
Equipment, furniture and fixtures	1,232,138	908,853
Less accumulated depreciation and amortization	(519,313)	(424,989)
	712,825	483,864
	$ 2,802,732	3,288,410
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	$ 155,218	258,175
Deferred revenue	34,735	228,157
Total current liabilities	189,953	486,332
Commitments		
Net assets:		
Unrestricted	2,612,779	1,861,246
Unrestricted-Board-designated	-	940,832
Total net assets	2,612,779	2,802,078
	$ 2,802,732	3,288,410

See accompanying notes to financial statements.

NORTH CAROLINA ALTERNATIVE ENERGY CORPORATION

Statements of Activities

Years ended December 31, 1996 and 1995

	1996	1995
Revenues:		
Utility funding	$ 3,572,983	3,594,114
Interest	121,817	144,461
Other revenue	406,590	477,211
Total revenues	4,101,390	4,215,786
Expenses:		
Products and services	2,937,423	2,969,990
Corporate support services	1,353,266	1,271,824
Total expenses	4,290,689	4,241,814
Decrease in net assets	(189,299)	(26,028)
Net assets, beginning of year	2,802,078	2,828,106
Net assets, end of year	$ 2,612,779	2,802,078

See accompanying notes to financial statements.

NORTH CAROLINA ALTERNATIVE ENERGY CORPORATION

Statements of Cash Flows

Years ended December 31, 1996 and 1995

	1996	1995
Operating activities:		
Decrease in net assets	$ (189,299)	(26,028)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation and amortization	152,056	151,509
Loss on sale of equipment	3,063	-
Changes in operating assets and liabilities:		
Receivables	(165,392)	(32,217)
Prepaid expenses and other assets	4,969	1,173
Accounts payable and accrued expenses	(102,957)	(78,465)
Deferred revenue	(193,422)	(295,503)
Net cash used in operating activities	(490,982)	(279,531)
Investing activities:		
Purchases of equipment, furniture and fixtures	(386,020)	(176,260)
Proceeds from sale of equipment, furniture and fixtures	1,940	-
Net cash used in investing activities	(384,080)	(176,260)
Net decrease in cash and cash equivalents	(875,062)	(455,791)
Cash and cash equivalents, beginning of year	2,413,783	2,869,574
Cash and cash equivalents, end of year	$ 1,538,721	2,413,783

See accompanying notes to financial statements.

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

The North Carolina Alternative Energy Corporation (the "Corporation") was formed on April 18, 1980 as a nonprofit entity. The two major corporate goals are to work to moderate the rise in demand for electricity and to help shift demands for electricity to off-peak periods. The Articles of Incorporation also charge the Corporation with fulfilling the complementary purposes of educating consumers about energy, providing alternatives to current electric generation technologies, developing more economic sources of electric power, increasing system efficiency and load factors through conservation and load management, helping to moderate the future cost of electric service, and demonstrating and promoting more efficient uses of electric power. The Corporation has received a ruling from the Internal Revenue Service that it is exempt from federal income tax 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 Utilities Commission decide that collecting these funds (or all of 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.

(d) Revenue Sources and Recognition

The funding from investor-owned utilities regulated by the North Carolina Utilities Commission ("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.

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

(e) Deferred Revenues

The Corporation records deferred revenues for payments received from South Carolina utility customers for Industrial Electrotechnology Laboratory "IEL" services that have not been requested by those customers as of year end.

(f) 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 5 to 10 years. Depreciation and amortization expense for the years ended December 31, 1996 and 1995 was $152,056 and $151,509, respectively.

(g) Product/Service Teams

Product/Service teams develop products and services and deliver them to customers. These teams work in the following areas: motors, electrotechnologies, 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.

(h) Funding Receivable

Funding receivable consists of unconditional promises receivable due in less than one year. Management has not recorded any provision for uncollectible promises in the accompanying financial statements due to historical collection trends.

(i) Corporate Support Services

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

(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 $322,114 and $255,561 for the years ended December 31, 1996 and 1995, respectively.

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

Year ending December 31:	
1997	$ 276,300
1998	276,300
1999	276,300
2000	276,300
2001	276,300
Thereafter	1,312,425
	$ 2,693,925

In January, 1997, the Corporation entered into a lease agreement for additional space. Annual minimum rent under terms of the lease is $30,300 per year, and the lease term is ten years.

(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 the years ended December 1996 and 1995 was $183,482 and $170,349, 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, 1996 cash and cash equivalents consist of $1,579,720 in commercial paper and $253,213 in a repurchase agreement with a bank as of December 31, 1996. As of December 31, 1995, cash and cash equivalents consist of $2,055,581 in commercial paper and $374,287 in a repurchase agreement with a bank.

Five North Carolina investor-owned utilities comprise 83% and 85% of the Corporation's receivables as of December 31, 1996 and 1995, respectively.

NORTH CAROLINA ALTERNATIVE ENERGY CORPORATION

Notes to Financial Statements, Continued

December 31, 1996 and 1995

(5) Functional Expenses

Functional expenses consist of the following:

	Year ended December 31, 1996		
	Products/ Services	Corporate support services	Total
Salaries	$ 1,194,095	437,510	1,631,605
Fringe benefits	514,025	188,336	702,361
Travel	130,792	27,476	158,268
Materials and supplies	136,719	5,084	141,803
Equipment	116,463	30,557	147,020
Professional services	320,093	140,903	460,996
Other indirect expenses	148,551	326,161	474,712
Indirect marketing expenses	81,259	56,532	137,791
Facilities	295,426	140,707	436,133
	$ 2,937,423	1,353,266	4,290,689

	Year ended December 31, 1995		
	Products/ Services	Corporate support services	Total
Salaries	$ 901,759	596,081	1,497,840
Fringe benefits	389,301	258,082	647,383
Travel	128,088	42,770	170,858
Materials and supplies	121,423	14,707	136,130
Equipment	164,778	1,483	166,261
Professional services	830,250	117,787	948,037
Other indirect expenses	114,289	102,661	216,950
Indirect marketing expenses	46,879	20,936	67,815
Facilities	273,223	117,317	390,540
	$ 2,969,990	1,271,824	4,241,814