

APPENDIX B

**THE SUSTAINABLE ENERGY FUND OF
CENTRAL EASTERN PA
(A Not-for Profit Corporation)**

Financial Statements and Auditors' Report

June 30, 2005

CAMPBELL, RAPPOLD & YURASITS LLP
Certified Public Accountants
1033 SOUTH CEDAR CREST BOULEVARD
ALLENTOWN, PA 18103

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)**

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INDEPENDENT AUDITORS' REPORT

Board of Directors
The Sustainable Energy Fund Central Eastern PA
Allentown, PA

We have audited the accompanying statement of financial position of The Sustainable Energy Fund of Central Eastern PA (A Not-for-Profit Corporation) as of June 30, 2005 and 2004 and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 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 Sustainable Energy Fund of Central Eastern PA as of June 30, 2005 and 2004, and the results of its operations and changes in net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Campbell, Rappold & Yurasits LLP

Certified Public Accountants

August 11, 2005

MEMBERS: AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
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THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

STATEMENTS OF FINANCIAL POSITION

	June 30	
	2005	2004
<u>ASSETS:</u>		
Cash and Cash Equivalents	\$ 3,088,827	\$ 1,867,712
Ratepayer's Contribution Receivable	279,792	268,266
Grant Receivable	22,737	25,193
Investments (Note 3 and 4)	13,520,779	12,514,535
Program Related Investments, Net (Note 5)	2,471,077	1,699,734
Office Equipment, Net (Note 6)	16,180	13,785
Prepaid Expense and Deposits	4,961	5,017
Investments - Deferred Compensation Plan (Note 9)	-	55,534
	Total Assets	Total Assets
	\$ 19,404,353	\$ 16,449,776
 <u>LIABILITIES:</u>		
Accounts Payable	\$ 23,408	\$ 75,988
Accrued Employee Benefits	5,400	14,818
Deferred Compensation Liability (Note 9)	-	55,534
	Total Liabilities	Total Liabilities
	28,808	146,340
 <u>NET ASSETS:</u>		
Unrestricted Net Assets	19,375,545	16,303,436
	Total Liabilities and Net Assets	Total Liabilities and Net Assets
	\$ 19,404,353	\$ 16,449,776

See notes to financial statements.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)**

STATEMENT OF ACTIVITIES

	June 30	
	2005	2004
<i>Revenues and Gains</i>		
PP&L Ratepayers' Contribution	\$ 3,429,799	\$ 3,405,695
Grant Revenue	11,204	22,882
Interest Income - Operating and Money Market	38,063	28,818
Investment Return (Note 3):		
Interest and Dividend Income	400,573	251,749
Net Realized and Unrealized Gains (Losses)	(16,000)	1,220,599
Less Investment Advisory and Custodian Fees	(78,329)	(62,867)
Interest-Program Loans	71,841	57,884
Royalties and Dividends-Program Related	15,000	22,500
Other	198	2,300
	<u>3,872,349</u>	<u>4,949,560</u>
<i>Expenses</i>		
Program Services		
Grants Awarded	135,355	117,239
Loss Reserve	60,830	62,500
Operating Expenses	290,441	355,779
	<u>486,626</u>	<u>535,518</u>
Management and General	313,614	314,060
	<u>800,240</u>	<u>849,578</u>
Increase in Unrestricted Net Assets	3,072,109	4,099,982
Unrestricted Net Assets, Beginning	<u>16,303,436</u>	<u>12,203,454</u>
Unrestricted Net Assets, Ending	<u>\$ 19,375,545</u>	<u>\$ 16,303,436</u>

THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

STATEMENT OF FUNCTIONAL EXPENSES

For the Year Ended June 30, 2005

With Comparative Totals for 2004

	Program Services	Management & General	Total	
			2005	2004
Grants Awarded	\$ 135,355	\$ -	\$ 135,355	\$ 117,239
Program Related Investments				
Loss Reserve	60,830	-	60,830	62,500
Operating Expenses:				
Salaries and Wages	126,230	116,532	242,762	226,803
Fringe Benefits	19,245	17,767	37,012	44,804
Payroll Taxes	10,090	9,315	19,405	18,021
Contract Managers	33,495	-	33,495	44,460
Training	205	189	394	298
Recruiting	29,632	15,956	45,588	20,071
Subtotal Staff	218,897	159,759	378,656	354,457
Rent	18,445	13,457	31,902	31,925
Insurance	951	693	1,644	3,512
Depreciation	4,898	3,574	8,472	6,224
Subtotal Occupancy	24,294	17,724	42,018	41,661
Board Stipends	9,090	21,210	30,300	35,700
Board Expense	4,021	9,383	13,404	7,137
Dues and Publications	-	756	756	2,284
Marketing	2,576	-	2,576	4,071
Office Supplies	3,003	2,191	5,194	5,356
Education Consulting	-	-	-	481
Audit	-	9,750	9,750	9,500
Legal	5,830	58,461	64,291	80,404
Due Diligence	8,185	-	8,185	48,337
Organization Design	-	18,299	18,299	11,415
Financial System Support	490	2,776	3,266	6,042
DEP grant Reimbursable Expenses	843	-	843	14,937
Printing and Postage	1,933	1,410	3,343	5,423
Telephone	4,874	3,556	8,430	7,703
Travel	2,161	1,576	3,737	9,599
MIS Support/Web Hosting	3,431	3,431	6,862	5,226
Director and Officer Insurance	-	2,738	2,738	2,738
Workout Expenses	-	-	-	16,362
Miscellaneous	813	594	1,407	1,006
Subtotal Other	47,250	136,131	183,381	273,721
Total Operating Expenses	290,441	313,614	604,055	669,839
Totals	\$ 486,626	\$ 313,614	\$ 800,240	\$ 849,578

See notes to financial statements.

THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

STATEMENT OF CASH FLOWS

	Years Ended June 30,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in Net Assets	\$ 3,072,109	\$ 4,099,982
Adjustments to Reconcile Increase in Net Assets to Net Cash Provided by Operating Activities:		
Depreciation	8,472	6,224
Loss Reserve	60,830	62,500
Net Realized and Unrealized (Gains) Losses on Investments	16,000	(1,220,599)
Changes in Assets and Liabilities		
Decrease (Increase) in Accounts and Grants Receivables	(9,070)	4,554
Decrease (Increase) in Prepaid Expense and Deposits	56	(59)
Increase (Decrease) in Accounts Payable	(52,580)	17,668
Increase (Decrease) in Employee Benefit Liabilities	(64,952)	25,276
<u>Net Cash Provided by Operating Activities</u>	<u>3,030,865</u>	<u>2,995,546</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Equipment and Furniture	(10,867)	(2,249)
Net Purchase of Investments	(1,022,245)	(2,938,883)
(Additions to) Distributions from to Deferred Compensation Plan Investments	55,534	(17,667)
Increase in Program Related Investments	(1,566,051)	(900,000)
Return of Program Related Investments	733,879	124,618
<u>Net Cash Used in Investing Activities</u>	<u>(1,809,750)</u>	<u>(3,734,181)</u>
Increase (Decrease) in Cash and Cash Equivalents	1,221,115	(738,635)
Cash and Cash Equivalents, Beginning of Year	<u>1,867,712</u>	<u>2,606,347</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 3,088,827</u></u>	<u><u>\$ 1,867,712</u></u>

See notes to financial statements.

THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

1. Nature of Organization

PP&L Sustainable Energy Fund, d/b/a Sustainable Energy Fund of Central Eastern PA (the Fund) is a Pennsylvania non-profit corporation formed to promote, research and invest in clean and renewable energy technologies, energy conservation, energy efficiency and sustainable energy enterprises that provide opportunities and benefits for PP&L ratepayers.

The Fund was formed pursuant to a joint settlement agreement arising from the Pennsylvania Utility Commission (PUC) electric utility deregulation proceedings in 1998. The agreement provides, in part, a rate surcharge on electric power consumers (ratepayers) through 2004. In 2005, the rate surcharge was renewed for an additional two years through December 31, 2006. The 2005 surcharge will continue at the existing .01 cents per kwh and decline to .005 cents per kwh in 2006. The surcharge is collected from the ratepayers by the power distribution entity, PPL Electric Utilities for this local service area, and remitted to the Fund for investment.

The Fund is managed by an executive director who reports to a Board of Directors. The PUC also maintains oversight of the Fund.

2. Summary of Significant Accounting Policies

Basis of Accounting

The financial statements of the Fund have been prepared on the accrual basis of accounting and accordingly reflect all significant receivables, payables, and other liabilities.

Basis of Presentation

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Fund is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. At June 30, 2005 and 2004, all net assets are unrestricted.

Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Fund considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Concentration of Revenue

The Fund receives a substantial amount of its support from the PPL ratepayers contributions, as more fully described in Note 1, which will expire December 31, 2006.

Donated Services

No amounts have been reflected in the financial statements for donated services. The Organization generally pays for services requiring specific expertise. However, individuals volunteer their time and perform a variety of tasks that assist the Organization with specific investment programs, and various committee assignments.

Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Investments in Marketable Securities

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Investment income or loss (including gains and losses on investments, interest and dividends) is included in the statement of activities as increases or decreases in unrestricted net assets unless the income or loss is restricted by donor or law.

Program Related Investments

(a) **Linked Deposits**

A deposit held in an account with a financial institution to induce that institution's support for one or more projects.

(b) **Loans**

Loans are stated at their outstanding unpaid principal balance. Interest income is recognized as revenue when received.

(c) **Allowance for Loan Losses**

The allowance for loan losses has been established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance and subsequent recoveries, if any, are credited to the allowance. The allowance is maintained at a level considered adequate to provide for potential loan losses. In making this determination, management takes into consideration the results of internal review procedures, prior loan loss experience, an assessment of the effect of current and anticipated future economic conditions, the financial condition of the borrower and such other factors that, in management's judgment, deserve consideration. The determination of the adequacy of the allowance is inherently subjective, as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
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NOTES TO FINANCIAL STATEMENTS

June 30, 2005

(c) Nonmarketable Equity Securities

Nonmarketable equity investments are holdings of less than 20% of the stock of investees and are carried at cost. The shares carry various conditions or restrictions on transfers and redemptions. Cost is reduced for permanent declines in value, as estimated by management, and dividends, if any, are treated as income when received. Investees are typically start-up developmental activities and as such are highly speculative. The determination of write-downs, if any, or ultimate realization of the investment is inherently subjective and as such, it requires material estimates regarding their valuation that are susceptible to significant change. Royalty and dividend income is recognized as revenue when received.

Concentration of Credit and Market Risk

Financial instruments that potentially expose the Fund to concentrations of credit and market risk consist primarily of cash equivalents and investments. The Fund places its cash at a high credit quality financial institution. From time to time, deposits at the institution exceed federal depository insurance limits. The Fund has significant investments in stocks and bonds. Though the market value of investments is subject to fluctuations, management believes the investment policy is prudent for the long-term welfare of the Fund. In addition, investments do not represent significant concentrations of market risk in as much as the Fund's investment portfolio is adequately diversified among issuers.

Concentrations of credit risk with respect to program related investments are subject to the individual credit worthiness of the borrowers and investees who are predominately located in Central Eastern Pennsylvania and associated with early stage sustainable or alternate energy endeavors. Consequently, the ability to realize the amounts may be affected by economic and political fluctuations in the power industry in this geographic region. The Fund performs ongoing credit evaluations and reserves for estimated and known uncollectibles.

Office Equipment

Office equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful lives of the assets of three to five years and computed on straight-line and accelerated methods.

Additions and betterments of \$500 or more are capitalized, while maintenance and repairs that do not improve or extend the original useful lives of the assets are expensed as incurred.

Advertising Costs

Advertising costs are expensed as incurred.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
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NOTES TO FINANCIAL STATEMENTS

June 30, 2005

3. Investments

Investments are managed by professional investment managers. The investment managers are subject to the Fund's investment policies which contain objectives, guidelines and restrictions designed to complement the Fund's activities and mission. Investments at fair value at June 30, are comprised of the following:

	2005	2004
U.S. Government Obligations	\$ 3,071,502	\$ 2,985,942
Corporate Bonds	594,302	404,133
Equity Securities	9,435,224	8,915,787
Temporary Cash and Money Market	419,751	208,673
	\$ 13,520,779	\$ 12,514,535

Investment return is summarized as follows:

Interest and Dividend Income	\$ 400,573	\$ 251,749
Net Realized and Unrealized Gains (Losses) on Investments	(16,000)	1,220,599
	384,573	1,472,348
Less Investment Advisory and Custodian Fees	(78,329)	(62,867)
Total Investment Return	\$ 306,244	\$ 1,409,481

4. Commitments-Program Related Investments

The Organization has designated \$4,760,000 of investments to be used for program related investments (i.e.-loans, equity, grants) which have been committed or are pending approval as of June 30, 2005 but have not yet been disbursed.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

5. Program Related Investments

Program related investments consist of loans to and equity investments in entities to assist them in pursuing sustainable energy opportunities.

	2005	2004
<u>Linked Deposit</u>		
Perry Green Building Housing Corporation - certificate of deposit with bank, 1% interest.	\$ 1,004,986	\$ -
<u>Loans</u>		
Powerweb Technologies, Inc. - interest only accrues at 5% per annum, early payment incentive of \$114,000 by January, 2006 satisfies entire obligation, otherwise due in full January, 2008.	228,000	431,250
Energy Unlimited, Inc. - interest only due monthly at 10%, due February, 2006.	100,000	100,000
Energy Unlimited, Inc. - interest accruing at 7.5%, principal and accrued interest due earlier of December 31, 2005 or upon related project's completion.	200,000	200,000
Community Energy, Inc. - due in monthly installments of \$3,042, including interest at 8%, due December, 2006. Paid July, 2004.	-	82,451
Community Energy, Inc. - \$250,000 line of credit, interest only due monthly at prime plus 1%, due June, 2004. Paid July, 2004.	-	250,000
Allentown Technology Center - interest only due monthly at 6% through May, 2004, thereafter, monthly installments of \$3,207, including interest at 6%, due November, 2009. Paid November, 2004.	-	177,691

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
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NOTES TO FINANCIAL STATEMENTS

June 30, 2005

5. Program Related Investments (continued)

	2005	2004
Nova Cruz, Products, Inc. - due March 3007, royalties payable at 3% of net factoring sales, up to a maximum of \$487,500, secured by assets of the borrower. Foreclosed in August 2003, reduced to expected net realized value.	\$ 50,000	\$ 50,000
Londonderry School - due in monthly installments of \$2,773 including interest at 3% plus \$115,522 principal due on each of May, 2006 and November, 2008, due in Full May, 2011.	470,489	489,342
Pine Hurst Acres - interest only due monthly at 2% until project start-up date, thereafter, \$1,000 a month plus interest at 2%, due December, 2012.	140,000	-
Diocese of Scranton - due in monthly installments of \$1,622, including interest of 2%, due June, 2008.	152,566	-
<u>Refundable Grants</u>		
Kauffman-Gamber - due in monthly installments of \$142, non interest bearing, due October, 2009.	7,366	-
Children's Wonderland Child Care Center - due in quarterly installments of \$500, non interest bearing, due April, 2010.	9,500	-
	1,357,921	1,780,734
Less Loss Reserve	(391,830)	(331,000)
Total Loans and Refundable Grants, Net	966,091	1,449,734

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2005**

5. Program Related Investments (continued)

Nonmarketable Equity Securities

250,000 Shares Community Energy, Inc., Series A Preferred	\$ 250,000	\$ 250,000	
132,591 Shares Community Energy, Inc., Common	250,000	-	
Total Equity Investments	500,000	250,000	
Total Program Related Investments	\$ 2,471,077	\$ 1,699,734	

In July, 2004, the two Community Energy loans totaling \$332,451 were repaid. Subsequently, the Organization acquired 132,591 shares of Community Energy new common stock for \$250,000 subject to terms of the original November, 2001 investors agreement.

In January 2005, the Powerweb agreement was modified to the terms described above, pursuant to a \$200,000 accelerated repayment received in 2005. Formerly, repayment was in accelerating monthly principal repayments plus royalties of 3% of borrowers gross revenue through April, 2008.

6. Office Equipment

	2005	2004	
Furniture	\$ 12,482	\$ 12,482	
Computer and Phone Equipment	28,529	17,662	
	41,011	30,144	
Less: Accumulated Depreciation	(24,831)	(16,359)	
	\$ 16,180	\$ 13,785	

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

7. Lease

The Fund leases its office facilities under a non-cancellable operating lease expiring September 30, 2005. The lease provides for monthly base rent of \$2,494 through September 30, 2005. The Fund entered into a non-cancellable operating lease for new office space commencing September 15, 2005 and expiring September 14, 2008. The Organization also leases office equipment under a non-cancellable operating lease. Future minimum lease payments are:

Years ended <u>June 30:</u>	<u>Office</u>	<u>Equipment</u>
2006	35,484	2,388
2007	34,100	2,388
2008	34,700	1,194
2009	5,800	-

Total rents charged to expense under the leases were \$31,164 and \$31,433 for the years ended June 30, 2005 and 2004, respectively.

8. Retirement Plan

The Fund has a defined contribution retirement plan (the Plan) covering all full time employees having attained 21 years of age with three months of service. The Fund makes contribution to the Plan each year equal to 10% of all participants' compensation plus 4.3% of compensation in excess of \$35,160 and \$34,800 for 2005 and 2004, respectively, being 40% of the social security taxable wage base in effect on July 1, the first day of each Plan year. Total expense was \$28,320 and \$23,302 for the years ended June 30, 2005 and 2004, respectively.

9. Deferred Compensation Plan

The Fund provided a key employee a non-qualified deferred compensation retirement plan. The liability is financed with contributions to Fund owned, participant directed, mutual funds. The assets are payable to the participant upon termination. In 2005, upon the employee's termination, the accumulated fund balance of \$63,878 was distributed.

10. Line of Credit

The Fund has a \$750,000 Line of Credit with a bank, expiring February 2006. Interest on borrowings is payable at the bank's prime rate minus .75%. There were no borrowings on the line as of or during the periods ended June 30, 2005 and 2004.

**THE SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

11. Litigation

On December 22, 2004, the Public Utility Commission entered an Opinion and Order in which it concluded that SEF funding within PPL's distribution rates should continue for 2005 and 2006 at rates of .01 cents per kWh and .005 cents per kWh, respectively. On April 29, 2005 the PP & L Industrial Customer Alliance filed an appeal with the Commonwealth Court Challenging, inter alia, the Public Utility Commission's decision to allow continued funding of SEF. SEF intervened in the Commonwealth Court proceeding and filed a brief in support of the Public Utility Commission's decision. In the meantime, funding has continued despite the filing of the appeal. Although it is not possible at this time to know the outcome of the Commonwealth Court proceedings, management has been advised by legal counsel that the continued funding of SEF is consistent with the law and supported by substantial evidence and that a favorable outcome affirming the Commission's decision is reasonably likely.