Sustainable Energy Fund Of Central Eastern Pennsylvania
(As established by the PUC-PP&L Utilities Settlement Agreement)

Annual Report
To the
Pennsylvania Public Utility Commission
And to the
Joint Petitioners

For the Period
July 1, 2000 - June 30, 2001

October 16, 2001

Sustainable Energy Fund
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Thomas J. Tuffey, Ph.D.
Executive Director

Our mission is 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 PPL ratepayers.

1.0 OVERVIEW

This is the Sustainable Energy Fund of Central Eastern Pennsylvania's (SEF) first annual report to the Pennsylvania Public Utility Commission and to the joint petitioners in the PPL Utilities restructuring proceeding. It discusses the progress that the SEF has made in the period from July 1, 2000 through June 30, 2001

The SEF Board of Directors chose to develop a new organization through which to manage its funds and accomplish its mission. By doing so, they also chose to be actively involved in the conduct of the SEF.

Consequently the first six-month period was characterized by the start-up activities that took the Fund to a fully functioning operation. The SEF constructed governance, administrative, marketing, and financial management systems while still reserving time to do some real business. The second half of the year was characterized by more networking activities and our increased focus on program related investments (PRI's). By the end of the fiscal year, June 30, 2001, the SEF made commitments to $2,365,000.00 in grants and PRI's, almost twice the first year goal.

The current and future SEF focus, is to move beyond the capacity to merely meet obligations. We intend to improve the systems, alliances, and behaviors so that we, and our partners, may together excel.

2.0 ACCOMPLISHMENTS

Some of this period's accomplishments follow:

2.1 Governance

The PUC approved the SEF by-laws at the end of June 2000 and the SEF began official operations July 1, 2000. The period prior to operation was an active one, during which the Board met eleven times to plan the organization and prepare its affairs to be ready for start-up operations. The Directors also contracted with a consultant [1] to provide staff to carry out its activities and to assist them in forming

[1] Winsor Associates, Philadelphia, PA

a common vision. It further retained Dechert, Price & Rhoads for legal counsel and to prepare its by-laws. Start-up costs prior to by-laws approval were either directly paid by PPL or were paid through funds advanced to SEF by PPL.
During this early period, the Board was able to accomplish several critical tasks as follow:

- The decision to develop its own organization rather than contract the funds to be administered by an existing entity. Accompanying this decision was the design for structure and governance of the new organization.
- The By-Laws were prepared and submitted to the PUC for approval.
- The Investment Policy was developed and approved. Asset management firms and accountants were solicited and selected.
- An open search process for an Executive Director was conducted. The finalist, Mr. Thomas J. Tuffey was selected from 126 candidates and retained in May 2000 as a consultant to further plan for start-up upon approval of the by-laws.

The Executive Director officially started on July 1, 2000, immediately upon PUC approval of the by-laws. There have been six formal meetings of the Board since retaining the Executive Director, including a one and one half day planning retreat to develop the scope of the Annual Plan. Additionally, all of our Directors attended the two-day "Partners Retreat" of the regional funds at Lake Wallenpaupack. A majority of the Board also attended the Directors Training Program at the Rittenhouse Hotel, Philadelphia, PA. The Board approved the Plan and budget, made $2,365,000.00 in grants and investment commitments, and directed the operations. The Board Committees: Administration/Finance (A/F), and Program Related Investments (PRI), are regularly engaged in issues or considering PRI opportunities, often by e-mail or telephone, and in face to face meetings. SEF staff consults and meets with individual Directors several times a week. Director referrals of PRI opportunities occur regularly. This is a very involved Board.

To avoid market confusion, the Board approved the use of a fictitious name in business dealings. The SEF does business as the Sustainable Energy Fund of Central Eastern Pennsylvania.

During the second half of the year, the U.S. Internal Revenue Service (IRS) approved our status as a 501c3 non-profit foundation, supporting organization. The SEF is neither subject to federal taxation, nor does the SEF have a tax motivation obligation to make grants. The Board still chose to assign 5-10% of the disbursement budget to grants.

The SEF has actively participated in the design and start-up of the Pennsylvania Sustainable Energy Board (PASEB). This organization is intended to provide both support and oversight to the regional funds. SEF considers it to be a critical success factor and it is committed to its early and effective implementation.

2.2 Asset Management

Funds were held since January 1, 1999 by PPL in an interest bearing account until the SEF was prepared to accept them. On July 10, 2000 the SEF received a transfer of $4,863,251.99.[2]

Additional funds are transferred monthly from PPL to the SEF account with First Union National Bank. SEF management retains funds for operations and PRI disbursements, and transfers investment assets to custodian accounts at Charles Schwab Inc. All transactions are in accordance with SEF operating practices and are carefully monitored.

The Finance Committee prepared the Statement of Investment Policy that was adopted by the Board. Our investment policy is environmentally responsible and attempts to support our energy mission. Based on this policy, RFP's were issued for two asset managers and one custodial account manager. In July 2000, Berkshire Asset Management, Inc., and Dearden, Maguire, Weaver and Barrett, Inc. were both retained as asset managers, each to manage one half of the allocated investment funds. Both were instructed to employ 70% equity and 30% fixed income securities portfolio allocation. Charles Schwab, Inc. was appointed as the Custodian and First Union National Bank was approved for the working capital accounts. The asset managers will report performance quarterly and may be replaced at any time.

We disbursed $4,700,000.00 to the Asset Managers in July 2000. An additional $1,750,000.00 was disbursed throughout the year.

The period reported on was a very difficult one for the equity markets, however, through a combination of cautious entry of the equities market, exceptional equity selections, a strong preference for large capitalization companies with strong earnings growth available for reasonable price, and solid performance of the cash and fixed assets portfolios, the asset accounts net of fees grew by $76,852, just over 1% (one percent). Certainly less than the planned 8% (eight percent) of our Plan, but considering the market conditions, when the S&P was down 14.32% (7/31/00 – 7/31/01 during the same period, our Asset Managers did a fine job.

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[2] Funds are collected by PPL from the ratepayer in accordance with the Joint Petitioners for the settlement of PP&L restructuring plan, as approved by the PUC, which established the Sustainable Energy Fund.

Although our investment performance fell short of the plan, it was offset by higher ratepayer income due to an exceptionally cold winter, a lag in cash disbursements after PRI commitments by the Board (due to legal document preparations and negotiations), and a budget surplus from SEF operations.

The SEF completed the year with the asset accounts at $6,526,852.00, and an operating cash position of $1,084,581.00. (The latter is consciously high to meet an October disbursement requirement of $1,150,000.00).

All taken into account, The SEF completed the year with a Fund balance of $7,589,000 versus a plan of $6,972,000, a $617,000 positive variance.

Hence, we judge our Balance Sheet position to be essentially on plan and strong. We remain cautious relative to the equity markets, but believe we are well positioned.

2.3 Operations

The operational strategy during this period was to establish a foundation organization and to solicit and make our first Program Related Investments. This approach recognized the importance of initiating marketing for deal flow and that operating experience is the best determinant of ultimate organizational design.

Considerable staff time and attention was devoted to start up; as of the end of the first fiscal year, the SEF was fully functional.

Accomplishments include:

- Selected office location, furniture, equipment and supplies
- Recruited staff (full time Executive Director, Associate and part time Financial Comptroller)
- Established asset transaction systems and procedures
- Retained accountant and auditor, Campbell, Rappold & Yurasits, and attorneys, Hourigan, Kluger & Quinn
- Established payroll, insurance, and vendor contracts through a critical selection process
- Established financial accounting & reporting systems and procedures
- Developed PRI Tracking & Reporting System
- Developed standard business forms and contracts
- Completed and Submitted approval of tax status to IRS
- Completed of Annual Plan and Budget
- Completed and submitted Semi-Annual Report to PUC
- Established Personnel & Benefits Policy
- Completed marketing brochure
- Initiated an extensive market/alliance networking program

2.4 Program Related Investments

A broad range of marketing, network and alliance building activities were conducted. As a result, the SEF received and considered over 110 inquires and requests. Each was considered by staff to determine mission fit in accordance with the criteria established in the Annual Plan. Most were also discussed with the Chairman of the Investment Committee to keep him informed and to seek guidance.

The Board of Directors made the following commitments, totaling $2,365,000:

- ***Grant $165,000***
  - $20,000 Allentown technology demonstration micro turbines generating power for sewage treatment plant digester gas
  - $50,000 to Pennsylvania Sustainable Energy Board
  - $10,000 to MAREC (Mid Atlantic Renewable Energy Coalition) to support consumer education/awareness advertising
  - $10,000 to Clean Energy Fund Network (CEFN) to support common initiatives across the seven northeast states' clean energy funds
  - $75,000 to the SEF Program to place windmills for demonstration and curriculum purposes at Environmental Education Centers

- ***Program Related Investments $2,225,000***
  - $100,000 *Loan* to Energy Unlimited to support wind energy development projects in PPL territory
  - $500,000 *Subordinated Debt with Warrants* to PowerWeb, an energy load management software company, co-invested with SDF
  - $150,000 *Loan/Royalty payments* to Community Energy, Inc. to market renewable/wind energy in the PPL territory
  - $25,000 *Loan* AFC First Financial to aid in the development of the business plan for the FANNIE MAE Energy Loan Program for owner occupied residential properties
  - $300,000 *Loan* to Masonic Homes for new energy efficient heating system incorporating micro turbines. (Subsequently declined for more advantageous bond financing by MH)
  - $1,150,000 *Loan* to Somerset Wind for 9 MW wind project, co-invested with other regional PA Funds

There is a lag time between Board Commitments and cash disbursements as the legal documents are drafted and further negotiations are conducted. Additionally, a recipient may choose to cancel/delay a project or finance it through other channels.

Funds disbursed by June 30, 2001 totaled $360,000.

3.0 FINANCIAL REPORT

As discussed, the SEF received $4,863,252 (includes interest $199,929) from PPL on July 10, 2000. Monthly fund transfers from PPL through the period were:

July	$266,721
August	$261,021
September	$268,303
October	$243,883
November	$250,670
December	$292,013
January	$340,942
February	$343,146
March	$294,772
April	$270,017
May	$251,792
June	$250,230

As of year-end, a total of $8,196,792 has been received.

During the first fiscal year, the SEF received Grants totaling $47,300 from the following:[3]

$10,000 PA DEP – Allentown technology demonstration, micro turbines
$10,000 PA DEP – Windmills/wind education for environmental education centers
$10,000 PPL, Inc. – Windmills/wind education for environmental education centers
$ 7,300 PA Environmental Council – Partner's Retreat
$ 5,000 GPU Berks – Venture Capital for PA Funds
$ 5,000 GPU West Penn – Venture Capital for PA Funds

$6,450,000 has been transferred to the Schwab custodian accountants for investment by the two asset managers. As of year-end, the assets invested after fees and market fluctuations totaled $6,526,852

Operating expenses for the fiscal year, July 2000 to June 2001 totaled $258,122 9.2% under the approved budget, additionally, start-up expenses were $103,332.

At end of year, cash totaled $812,041.

The SEF completed the year with Net Assets of $7,589,000.

[3] NOTE: Cash is not received until all grant milestones are fulfilled.

The year-end audited financial statements may be found in Appendix A.

4.0 NEXT STEPS

The SEF focus going forward is to concentrate of building the marketing infrastructure and alliances that will produce solid deal flow into the future. The flexibility to stay sensitive to the market opportunities and to adjust operations to capitalize on those opportunities will be key. The second year plan will be available on October 16, 2001 upon approval by the Board and presented at the Annual Meeting on that date.

Further attention will be devoted to fine tuning the systems and practices established during the first six-month period.

5.0 CONCLUSION

The Sustainable Energy Fund has made satisfactory progress during this initial formative period. The SEF looks forward to further progress in fulfilling its mission to develop a sustainable energy environment via market leadership and sustainable program related investments.

6.0 BOARD MEMBERSHIP

Craig Onori, President
Agere Systems
Room 22E-130HC
555 Union Blvd.
Allentown, PA 18103-3286

Brian Nagle, Vice President & Chairman Program Related Investment Committee
PPL, Corporate Services
Two North Ninth Street, GENTW8
Allentown, PA 18101-1170

Eric J. Epstein, Chairman Administrative/Finance Committee
EFMR Monitoring Group
4100 Hillsdale Road
Harrisburg, PA 17712-1419

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Energy Opportunities
1200 East Camping Road
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OPEN SEAT

PP&L SUSTAINABLE ENERGY FUND
d/b/a SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

Financial Statements and Auditors' Report

June 30, 2001

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

PP&L SUSTAINABLE ENERGY FUND
d/b/a SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

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Certified Public Accountants
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INDEPENDENT AUDITORS' REPORT

Board of Directors
PP&L Sustainable Energy Fund
d/b/a Sustainable Energy Fund of
Central Eastern PA
Allentown, PA

We have audited the accompanying statement of financial position of PP&L Sustainable Energy Fund (A Not-for-Profit Corporation) as of June 30, 2001 and the related statement of activities and cash flows for the year then ended. These financial statements are the responsibility of the Organization'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 PP&L Sustainable Energy Fund as of June 30, 2001, and the results of its operations and changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Campbell, Rappold & Yurasits LLP
Certified Public Accountants

August 17, 2001

PP&L SUSTAINABLE ENERGY FUND
d/b/a SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

STATEMENT OF FINANCIAL POSITION
June 30, 2001

ASSETS:	
Cash	$ 812,041
Ratepayer's Contribution Receivable	266,104
Royalty Receivable	2,160
Investments (Note 3)	6,526,852
Program Related Investments, Net (Note 4)	334,167
Office Equipment, Net (Note 5)	9,410
Deposits	875
Total Assets	$7,951,609
LIABILITIES:	
Accounts Payable	$ 25,089
Accrued Employee Benefits	18,251
Total Liabilities	43,340
NET ASSETS:	
Unrestricted Net Assets	7,908,269
Total Liabilities and Net Assets	$7,951,609

See accompanying notes to financial statements.

PP&L SUSTAINABLE ENERGY FUND
d/b/a SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

STATEMENT OF ACTIVITIES
Year Ended June 30, 2001

Revenues and Gains:	
PPL Ratepayers' Contribution (Note 8)	$8,196,762
Interest Income	26,050
Investment Return (Note 3)	76,852
Royalties	2,160
Other	18,300
Total Revenue and Gains	8,320,124
Expenses:	
Grants Made	35,401
Loss Reserve	15,000
Total Program Expenses	50,401
Salaries and Wages	107,595
Fringe Benefits	29,178
Payroll Taxes	10,613
Training	1,425
Rent	9,980
Insurance	3,842
Depreciation	2,029
Furniture Rental	300
Dues and Publications	463
Marketing	6,771
Printing and Postage	6,742
Telephone	4,864
MIS Support/Web Hosting	1,466
Start-up Costs (Note 8)	103,332
Board Expense/Stipends	12,523
Professional Fees	42,095
Travel	10,799
Office Supplies	5,610
Miscellaneous	1,827
Total Management and General Expense	361,454
Total Expenses	411,855
Increase in Unrestricted Net Assets	7,908,269
Unrestricted Net Assets, Beginning	–
Unrestricted Net Assets, Ending	$7,908,269

See accompanying notes to financial statements.

PP&L SUSTAINABLE ENERGY FUND
d/b/a SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

STATEMENT CASH FLOWS
Year Ended June 30, 2001

Cash Flows from Operating Activities:	
Increase in Net Assets	$7,908,269
Adjustments to Reconcile Change in Net Assets to Net Cash Used by Operating Activities:	
Depreciation	2,029
Loan Loss Reserve	15,000
Increase in Accounts Receivable	(268,264)
Increase in Deposit	(875)
Increase in Account Payable	25,089
Increase in Accrued Employee Benefit	18,251
Loss on Investments	90,931
Net Cash Provided by Operating Activities	7,790,430
Cash Flows from Investing Activities:	
Purchase of Office Equipment and Furniture	(11,439)
Purchase of Investments	(6,989,723)
Proceeds from Sale of Investments	371,940
Increase in Program Related Investments	(350,000)
Return of Program Related Investments	833
Net Cash Used in Investing Activities	(6,978,389)
Increase in Cash and Cash Equivalents	812,041
Cash and Cash Equivalents, Beginning of Year	–
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 812,041

See accompanying notes to financial statements.

PP&L SUSTAINABLE ENERGY FUND
d/b/a SUSTAINABLE ENERGY FUND OF CENTRAL EASTERN PA
(A Not-for Profit Corporation)

NOTES TO FINANCIAL STATEMENTS
June 30, 2001

1. Nature of Organization

PP&L Sustainable Energy Fund, d/b/a Sustainable Energy Fund of Central Eastern PA (the Organization) 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 PPL ratepayers.

The Organization was incorporated in November, 1999 and began operations July, 2000. The Organization 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. The surcharge is collected from the ratepayers by the power distribution entity, PPL Electric Utilities Corporation for this local service area, and remitted to the Organization for investment.

The Organization is managed by an executive director who reports to a Board of Directors. The Board members were nominated by the various petitioners to the joint settlement agreement. The PUC also maintains oversight of the Fund.

2. Summary of Significant Accounting Policies

Basis of Accounting

The financial statements of PP&L Sustainable Energy 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 Organization 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, 2001, all net assets are unrestricted.

Cash and Cash Equivalents

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

Concentration of Revenue

The Organization receives a substantial amount of its support from the PPL ratepayer's contributions, as more fully described in Note 1, which expires after 2004.

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, principally the members of the Board of Directors, 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

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.

Concentration of Credit and Market Risk

Financial instruments that potentially expose the Organization to concentrations of credit and market risk consist primarily of cash equivalents and investments. The Organization places its cash at a high credit quality financial institution. From time to time, deposits at the institution exceed federal depository insurance limits. The Organization 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 Organization. In addition, investments do not represent significant concentrations of market risk in as much as the Organization'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 who are predominately located in central eastern Pennsylvania and associated with the power industry. Consequently, the ability to realize the amounts may be affected by economic fluctuations in the power industry in this geographic region. The Organization 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 and computed on straight-line and accelerated methods.

Advertising Costs

Advertising costs are expensed as incurred.

3. **Investments**

Investments are managed by professional investment managers. The investment managers are subject to the Organization's investment policies which contain objectives, guidelines and restrictions designed to complement the Organization's activities and mission. Investments at June 30, 2001 were comprised of the following:

	Cost	Fair Value	Unrealized Appreciation (Depreciation)
U.S. Government Obligations	$ 940,792	$ 969,321	$ 28,529
Corporate Bonds	807,047	802,414	(4,633)
Equity Securities	4,379,127	4,244,038	(135,089)
Temporary Cash and Money Market	511,079	511,079	–
	$6,638,045	$6,526,852	$(111,193)

Investment return is summarized as follows:

Interest and Dividend Income	$195,368
Net Realized and Unrealized Losses On Investments	(90,931)
	104,437
Less Investment Advisory Fees	(27,585)
Total Investment Return	$ 76,852

4. Program Related Investments

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

$500,000 Loan Receivable, Monthly Principal Repayments of $1,042 Through April 2002, $3,125 Through April 2003 and $7,500 Thereafter, Due April 2008. $250,000 Advanced as of June 30, 2001 with Required Principal Payments Reduced Pro-rata. Borrower Pays Monthly Royalties at 3% of their Gross Revenue up to a Maximum of $1,300,000 Over the Term of the Loan. Secured by Assets of the Borrowers.	$249,167
$100,000 Loan Receivable, Interest Only at 10%, Due February, 2006. Secured by Assets of the Borrower	100,000
	349,167
Less Loss Reserve	(15,000)
	$334,167

5. Office Equipment

Furniture	$ 6,904
Computer Equipment	4,535
	11,439
Less Accumulated Depreciation	(2,029)
	$ 9,410

6. Lease

The Organization leases its office facilities under a non-cancellable operating lease commencing January 1, 2001 through June 30, 2003 with automatic one year renewal terms thereafter. Future minimum lease payments under the lease are:

Years ended June 30:	Amount
2002	$16,800
2003	19,200

7. **Retirement Plan**

The Organization 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 Organization makes contribution to the Plan each year equal to 10% of all participants compensation plus 4.3% of compensation in excess of 40% of the Social Security Taxable Wage base in effect on the first day of each Plan year. Total expense for the year ended June 30, 2001 was $11,980.

8. **Startup and Pre-Operating Activities**

Included in Ratepayer Contributions in the accompanying Statements of Activities is $4,663,323 of surcharges collected for the period January 1999 (inception) through June 30, 2000 plus $199,929 of related earnings. Also, included in Start-up Costs in the statement is $71,161 of organizational and development costs incurred during the same period. In July 2000, upon commencement of the Organization's operations, the former custodian of the funds distributed the net amount to the Organization. Accordingly, the amounts are reported in current period operations.