

April 29, 2009

I am pleased to present the 2008 audited Financial Statements of the Electric Power Research Institute. The audit was performed by PricewaterhouseCoopers (PWC) in accordance with generally accepted auditing standards. At the conclusion of the audit, PWC:

- Issued an unqualified audit opinion
- Identified "no deficiencies . . . which would constitute a material weakness in internal controls"
- Found no "going concern" issues

In 2007, EPRI's financials reflected a significant, unrealized impairment in the value of certain Auction Rate Securities held by the Institute. In 2008, conditions in both the credit and financial markets deteriorated significantly. As a result, the estimate of the impairment increased substantially for the year ended December 31, 2008. EPRI has conducted and will continue to conduct all financial planning and budgeting work as if the value of those investments was \$0. Even with that assumption, management has concluded that the impairment will not have a material impact on EPRI's liquidity, cash flow or ability to fund its operations.

Should you have any questions regarding the assumptions or conclusions made in this year's statement, please don't hesitate to contact me.

Sincerely,



Steve Yamamoto  
syamamoto@epri.com  
650-855-2254

# EPRI Financial Report

Consolidated Statements of Financial Position, December 31 (thousands of dollars)

	2008	2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$75,609	\$55,659
Investments <i>(Note 2)</i>	4,805	2,090
Receivables—members, net of reserves	3,006	15,020
Receivables—supplemental funding, net of reserves	19,453	15,407
Other current assets	4,891	10,295
Total current assets	107,764	98,471
Long term investments <i>(Note 2)</i>	5,349	50,198
Property, facilities, building improvements and equipment <i>(Note 3)</i>	38,682	36,775
Total assets	\$151,795	\$185,444
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities:		
Accounts payable (primarily research and development)	\$44,176	\$54,071
Deferred revenue	114,997	92,953
Accrued liabilities <i>(Note 4)</i>	24,386	20,754
Obligation under capital leases—current portion	—	190
Total current liabilities	183,559	167,968
Long-term research and development expenses payable and other deposits	225	171
Accumulated postretirement benefit obligation <i>(Note 6)</i>	8,947	9,148
Unearned prepaid rent	—	863
Long-term deferred supplemental revenue	875	—
Total liabilities	193,606	178,150
Total unrestricted net assets <i>(Note 5)</i>	(41,811)	7,294
Total liabilities and net assets	\$151,795	\$185,444

The accompanying notes are an integral part of these consolidated financial statements.

1

Consolidated Statements of Activities, Years Ended December 31 (thousands of dollars)

	<b>2008</b>	<b>2007</b>
<b><i>CHANGES IN NET ASSETS</i></b>		
Revenues:		
Membership	\$162,137	\$179,786
Supplemental funding	145,709	107,148
Other income	5,298	4,958
<b>Total revenues</b>	<b>313,144</b>	<b>291,892</b>
Expenses:		
Environment	37,350	32,535
Power Delivery and Markets	65,765	56,539
Generation	71,847	67,400
Nuclear	117,815	105,318
Technology Innovation Activities	29,384	32,168
<b>Total expenses</b>	<b>322,161</b>	<b>293,960</b>
<b><i>EXCESS OF EXPENSES OVER REVENUES</i></b>	<b>(9,017)</b>	<b>(2,068)</b>
Other:		
Interest income	4,685	7,584
Loss on Investments and Asset Disposals	(44,773)	(33,160)
<b>Total other</b>	<b>(40,088)</b>	<b>(25,576)</b>
<b><i>CHANGE IN NET ASSETS, UNRESTRICTED</i></b>	<b>(49,105)</b>	<b>(27,644)</b>
<b><i>NET ASSETS, UNRESTRICTED, AT BEGINNING OF YEAR</i></b>	<b>7,294</b>	<b>34,938</b>
<b><i>NET ASSETS, UNRESTRICTED, AT END OF YEAR</i></b>	<b>(\$41,811)</b>	<b>\$7,294</b>

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows, Years Ended December 31 (thousands of dollars)

	<b>2008</b>	<b>2007</b>
Cash flows from operating activities:		
Change in net assets	(\$49,105)	(\$27,644)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	6,053	5,157
Amortization of prepaid rent received on leased buildings	(863)	(1,090)
Loss on retirement of equipment and other changes in properties	44	289
Loss on investments	44,729	33,257
Realized (gain) loss on investments (AMSC)	—	(386)
Allowance for doubtful accounts	(13)	(22)
Changes in assets and liabilities:		
Receivables—members	12,014	1,399
Receivables—supplemental funding	(4,033)	3,431
Other current assets	5,404	(6,019)
Accounts payable	(4,737)	16,568
Deferred revenue	22,044	17,750
Accrued liabilities	2,678	(446)
Accumulated postretirement benefit obligation	(201)	260
Long-term research and development expenses payable and other deposits	928	(22)
Net cash provided by operating activities	34,942	42,482
Cash flows from investing activities:		
Cash received from sale of assets	—	4
Capital expenditures	(8,337)	(9,902)
Purchases of investments	(52,813)	(57,507)
Proceeds from sale and maturity of investments	50,218	41,341
Net cash used in investing activities	(10,932)	(26,064)
Cash flows from financing activities:		
Change in bank overdraft	(3,870)	485
Obligation under capital leases	(190)	(307)
Net cash provided by financing activities	(4,060)	178
Net increase in cash and cash equivalents	19,950	16,596
Cash and cash equivalents at beginning of year	55,659	39,063
Cash and cash equivalents at end of year	\$75,609	\$55,659
<i>Supplemental disclosure of cash flow information:</i>		
Cash paid by subsidiary (ESI) in current year for income taxes	\$11	\$254
Cash paid for PP&E in subsequent year for current year acquisitions	\$1,131	\$1,465

See accompanying notes to financial statements.

## Notes to Financial Statements

### Note 1—Description of Organization and Summary of Significant Accounting Policies

#### *Organization*

The Electric Power Research Institute, Inc. (EPRI) was organized in 1972 under the District of Columbia Nonprofit Corporation Act. The purpose of EPRI is to conduct a research and development program relating to the production, transmission, distribution, and utilization of electric energy. EPRI's activities include technological assessment of both near-term and long-term research needs, their arrangement into an orderly strategic plan, the assignment of priorities and allocation of funds, the implementation and management of the resulting projects, and the integration and dissemination of the information gained. These activities are carried out primarily under the sponsorship of the public, private, and cooperative sectors of the U.S. and international electric utility industries.

EPRI has been determined to be exempt from federal taxes as a scientific organization under Section 501(c)(3) of the Internal Revenue Code (the Code). Hence, only unrelated business income, as defined in the Code, is subject to federal income taxes. In 2008, as in prior years, EPRI had no significant taxable income.

The financial statements are consolidated to include the accounts of EPRI and its wholly owned subsidiaries. All intercompany accounts have been eliminated. The EPRI subsidiaries are EPRI Solutions, Inc. (ESI) and EPRI International, Inc. (EI). EI is a wholly owned for-profit subsidiary (incorporated in Delaware) and includes the accounts of its for-profit subsidiaries (i) EPRI International S.A. (Brussels, Belgium, 99% owned by EI and 1% by EPRI), and (ii) Beijing Electric Power Technology Company, Ltd. (Beijing, China, 100% owned by EI). In January, 2008 the China subsidiary achieved final liquidation. In December, 2008 the Belgium subsidiary achieved final liquidation.

On December 31, 2006, certain assets and obligations of ESI were transferred to EPRI, and EPRI presently maintains many of the operations and functions formerly fulfilled by ESI. The final contractual obligations of ESI were transferred to EPRI at the end of January 2008.

#### *Summary of Significant Accounting Policies*

*Cash and Cash Equivalents:* EPRI considers all highly liquid investment instruments with an initial or remaining maturity of three months or less at the time of purchase to be cash equivalents.

*Investments* are carried at fair value. Cash is concentrated with Bank of America; Union Bank of California is the custodian for EPRI's investments. Realized and unrealized gains or losses on investments are reflected in the statements of activities.

*Fair Value of Financial Instruments:* Unless otherwise noted, the fair value of EPRI's financial instruments at December 31, 2008 and 2007 was approximately equal to their recorded value.

*Property, Facilities, Building Improvements and Equipment:* The cost of buildings under capitalized lease and land leaseholds used in the management of research projects is amortized over the respective lease terms. Buildings and improvements are depreciated over various lives, ranging from 10 to 30 years, principally by the straight-line method. Equipment is depreciated using the straight-line method over various lives, ranging from 4 to 5 years. Leasehold improvements are amortized using the straight-line method over the shorter of the terms of the respective leases or their economic life. Internal use software is capitalized, if appropriate, based on the project stage. Equipment that is highly specialized and offers no alternative future use to EPRI or its contractors is expensed as incurred. Costs associated with individual research and development projects conducted at the facilities are charged to expense as incurred. Any gain or loss from the sale or other disposition of property, facilities, and equipment is recorded in Other Income.

*Other Assets:* Other assets consist primarily of prepaid expenses, miscellaneous receivables and cash and cash equivalents restricted for workers' compensation.

*Revenue Recognition:* Revenue from memberships is generally recognized over the annual membership period. Supplemental funding and other contract services are considered exchange transactions. Revenue for those projects is recorded on the percentage of completion basis, upon execution of a funding agreement and determination that collection of the resulting receivables is reasonably assured. Advances on projects are reflected as deferred revenue. Supplemental funding for EPRI included \$757,000 in 2008 and \$71,000 in 2007 of contractual revenue where funding had not yet been received by EPRI but related costs had been incurred on cofunding projects. Revenue is concentrated among members of the U.S. electric utility industry. EPRI maintains reserves for doubtful accounts and other collection issues for membership and supplemental funding on the basis of historical experience and an analysis of specific accounts. Such reserves amounted to \$268,000 and \$280,000 at December 31, 2008 and 2007, respectively.

*Accounts Payable:* Certain research contracts provide for the retainage of contract payments by EPRI until completion of the contract. Retainage amounts where the scheduled contract completion date is beyond one year are recorded as Long-Term Research and Development Expenses Payable.

*Basis of Presentation:* EPRI's financial statements are prepared on the accrual basis of accounting and in conformity with accounting principles applicable to not-for-profit organizations. Generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could vary from those estimates.

*SFAS No. 157 – Fair Value Measurements:* In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities. The adoption by EPRI of SFAS No. 157, effective January 1, 2008, did not have any impact on its change in net assets or financial position and was substantially limited to the one area, investments, where EPRI applies fair value. The disclosures required under SFAS No. 157 are set forth in Note 2.

In October 2008, the FASB released FASB Staff Position (“FSP”) FAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, which clarifies the application of SFAS No. 157 in situations in which the market for a financial asset is inactive. FSP FAS No. 157-3 was effective on September 30, 2008, but did not have a material impact on EPRI's financial position or change in net assets.

*SFAS No. 159 – Fair Value Option for Financial Assets and Financial Liabilities:* In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure selected financial assets and liabilities and other eligible items at fair value, which are not otherwise currently required to be measured at fair value. EPRI did not elect the fair value option for any financial assets or liabilities during its fiscal year 2008.

## **Note 2— Investments**

The aggregate carrying amounts of investments, including cash and cash equivalents, at December 31, 2008 and 2007, were as follows:

	2008	2007
	<i>(thousands of dollars)</i>	
Money market accounts and cash	\$35,489	\$3,349
Commercial paper / treasury bills	40,120	52,310
Cash and cash equivalents	\$75,609	\$55,659
Short term investments	\$4,805	\$2,090
Investments in other companies	60	105

Long term investments	CDOs	3,589	14,406
	CLNs	1,700	21,296
	ARPs	-	14,391
<b>Total long term investments</b>		<b>\$5,349</b>	<b>\$50,198</b>
<b>Total</b>		<b>\$85,763</b>	<b>\$107,947</b>

Short term investments include fixed time deposits of \$340,000 and \$428,000 in 2008 and 2007, respectively. Net realized and unrealized losses on investments of \$44,729,474 and \$32,871,000, were recognized and included in Other Income in 2008 and 2007, respectively.

Long term investments at December 31, 2008 and 2007 consist of Auction Rate Securities (ARS). ARS are structured with short-term interest rate reset dates of generally less than ninety days, but with contractual maturities that can be well in excess of ten years. At the end of each reset period, which occurs every seven to thirty-five days, investors can sell at an auction or continue to hold the securities at par. At December 31, 2008 and 2007, EPRI held three types of Auction Rate Securities: Collateralized Debt Obligations (CDOs), Credit Linked Notes (CLNs), and Auction Rate Preferred (ARPs). EPRI had actively traded ARS for the past 15 years without incident until August 2007 when EPRI experienced “failed auctions” or the inability to settle as scheduled. EPRI has performed a review of its ARS investments to determine any impairment in its value. In 2008, EPRI has followed the guidance offered by SFAS 157 to estimate the fair value of its ARS investments. SFAS 157 defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” As such, fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing assets or liabilities.

#### Fair Value Hierarchy

SFAS 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy, which prioritizes the inputs used to measure fair value from market based assumptions to entity specific assumptions, is as follows:

Level 1: “Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.”

Level 2: “Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include the following:

- Quoted prices for similar assets or liabilities in active markets
- Quoted prices for identical or similar assets or liabilities in markets that are not active.
- Inputs other than quoted prices that are observable for the assets or liability (for example, interest rates and yield curves)
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means”

Level 3: “Inputs are unobservable inputs for the assets or liability. Unobservable inputs shall be used to measure fair value to the extent that the observable inputs are not available. Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity’s own data.”

#### Methodology

No Level 1 or 2 inputs exist for the ARS held by EPRI as a result of negative credit conditions in the global credit markets and the specific failure of the ARS auction process. Without such information, Management must rely on a qualitative approach, Level 3, to estimate the fair value of the ARS investments for purposes of stating a value on EPRI’s financial statements as of December 31, 2008.

At December 31, 2008 and 2007, EPRI holds ARS with a face value of \$83,350,000. Auctions for the ARS in which EPRI had invested began to fail in August 2007. EPRI has not been able and will not be able to access these funds unless and until a future auction is successful or a buyer is found outside of the auction process. The fair value of those investments was estimated as \$50,100,000 as of December 31, 2007. That methodology involved projections of interest payments and termination events based, in part, on reasonable estimations that the auction markets for these securities could return in the intermediate future and that certain favorable termination events for the securities could occur, albeit with some impairment as set forth in the prior statements. EPRI has closely monitored developments in the financial markets since the 2007 year end and, based on the continuing negative conditions, concluded that the likelihood of either the return of active auction markets or investor-favorable termination events is significantly reduced.

To develop Level 3 inputs for the 2008 valuation estimate, EPRI engaged an independent advisor to review the securities and the markets in which they would potentially trade in an effort to help EPRI identify a reasonable valuation methodology based upon information currently available. Management concluded that based on current market conditions the most appropriate indicative valuation methodology would consider a range of qualitative inputs including: broker quotes, collateral risk evaluations, and review of various rights and obligations of the underlying investments.

Using a qualitative assessment approach in 2008, the fair value of EPRI's ARS investments has been estimated at \$5,300,000 at December 31, 2008.

#### **Collateralized Debt Obligations (CDOs):**

CDOs are notes issued by trusts holding pools of mortgage-backed or asset-backed securities, synthetic securities, medium and long-term notes, and in a few cases, interests in other CDOs.

The 2008 information used for valuing the CDOs was as follows:

- CDO bid indications from brokers (including the lead underwriter).
- CDO trends in key elements that may influence the future cash flows including, but not limited to: repayments of collateral, repayments of the various classes of the notes, changes in credit ratings of the collateral, over-collateralization, interest coverage ratios, covenants and the average life of collateral securities.
- Public documents indicating price deterioration.

The 2007 information used for valuing the CDOs was as follows:

- The trustees charged with maintaining the books and records of the trusts, as well as with collecting and disbursing cash, publish periodic reports that provide EPRI with the details of the collateral. Critically, these reports also detail tests of various covenants included in the indentures that govern the terms of the notes.
- The major contractual and economic aspects of the securities that have a bearing on the future cash flow that EPRI can expect for the CDOs.

#### **Credit Linked Notes (CLNs):**

CLN's are supported by floating rate notes and corporate debt. The CLN's are structured with an imbedded credit swap allowing the issuer to transfer a specific credit risk to credit investors. It is issued by a special purpose company or trust, designed to offer investors par value at maturity unless the referenced entity defaults.

Proceeds from the sale of the CLNs to investors flow to a Master Trust that acquires collateral, typically medium term, high credit quality floating rate notes. The interest earned on the collateral is then paid to Deutsche Bank who in turn pays the interest payments due to the CLN holders based on rates set in auctions. Deutsche Bank also buys credit default insurance from the trust. This credit default insurance identifies 125 corporate bonds as reference entities and an associated notional dollar value of purchased insurance for each entity. Upon the occurrence of an event of default by one or more of the reference entities, the trust will remit to Deutsche Bank a portion of the collateral equal to the loss in notional value associated with the defaults.

The 2008 information used for valuing the CLNs was as follows:

- CLN bid indications from brokers supported by collateral analysis.
- CLN indicative bids from broker-dealers.
- Discounted cash flow based on estimated interest payment streams.

The 2007 information used for valuing the CLNs was as follows:

- The intrinsic value of a given CLN, that is, a discounted cash flow model give uncertain future cash flows.
- The expected terminal value and the interest income accruing in the event of a positive terminal collateral value.
- The credit rating agencies' expert opinion of the probability of default on any reference obligation.

**Auction Rate Preferred (ARPs):**

ARPs represent a partnership interest in a trust. The trusts are special purpose entities formed solely for the purpose of issuing the ARP, acquiring a diversified portfolio of short-term, high credit quality commercial paper, entering into a put agreement with Ambac Assurance Corporation, and purchasing, at the option of Ambac Assurance, the perpetual preferred stock of Ambac Assurance, pursuant to the put agreement. In December 2008, Ambac Assurance exercised its put option to convert the ARP into Ambac Assurance preferred stock. As of December 31, 2008, Ambac Assurance preferred stock had no existing public market, declared a suspension of dividend distributions and no assets in the new entity; they are consequently valued at zero. The 2007 information used to value the ARP investments was credit ratings, the protection provision of the preferred stock and the structure of the ARP.

As of December 31, 2008, EPRI's auction rate securities with a cost value of \$83,350,000 continued to fail auction. These investments continue to pay interest based upon monthly / quarterly interest reset rates. Based on the aforementioned analysis of their current fair value, EPRI recorded an unrealized loss of \$44,804,000 and \$33,257,000 related to auction rate securities in 2008 and 2007, respectively. This impairment is reflected in EPRI's Statement of Activities. The funds associated with failed auctions will not be accessible until a successful auction occurs, a buyer is found outside of the auction process or the underlying securities have matured. As a result, EPRI has classified the residual ARS investment balance of \$5,289,000 as long-term assets in its consolidated Statement of Financial Position.

Management does not anticipate having to sell these securities in order to operate EPRI's business. Management believes that, based on EPRI's current cash and cash equivalents and short term investments of \$80,414,000 at December 31, 2008, the impairment will not have a material impact on EPRI's liquidity, cash flow or ability to fund its operations.

**Note 3— Properties, Facilities, Building Improvements and Equipment**

	2008	2007
	<i>(thousands of dollars)</i>	
Buildings and land leases	\$56,949	\$51,383
Equipment and leasehold improvements	17,165	19,234
Software and computer equipment	20,842	17,358
	\$94,956	\$87,975
Accumulated depreciation and amortization	(56,274)	(51,200)
	\$38,682	\$36,775

The depreciation expense for the years ended December 31, 2008 and 2007, was \$6,052,000 and \$5,157,000 respectively. As of December 31, 2008 and 2007, EPRI held \$35,737,000 and \$34,105,000 of fully depreciated assets, respectively.

**Note 4—Accrued Liabilities**

	2008	2007
	<i>(thousands of dollars)</i>	
Accrued compensation	\$18,221	\$14,858
Accrued vacation	3,946	3,450
Other	2,219	2,446
	\$24,386	\$20,754

**Note 5—Net Assets, Unrestricted**

EPRI's net assets at December 31, 2008 and 2007, and all activities for each year then ended are unrestricted. \$5,985,698 and \$4,906,208 of net assets were appropriated as Tailored Collaboration matching, as of December 31, 2008 and 2007 respectively. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors. As of December 31, 2007 the Board of Directors had designated \$7,294,000 for member directed Research and Development. During 2008, this amount was spent. As of December 31, 2008, \$0 is designated by the Board of Directors. Based on its current year ARS investment re-valuation and resulting \$44,804,000 impairment, EPRI has a deficit in net assets at December 31, 2008 of \$41,811,000.

**Note 6—Benefit Plans**

EPRI has a defined contribution pension plan for its employees. It is EPRI's policy to fund pension costs accrued. The pension expense was \$9,981,000 for 2008 and \$8,376,000 for 2007.

EPRI provides an unfunded postretirement health care benefit plan to employees meeting certain requirements. Prior to January 1, 2007, all employees who retired on or after age 55 with a minimum of 5 years of service and whose aggregate years of service plus age totaled 70 years or more were covered by the plan. Effective January 1, 2007, employees are eligible only if the sum of their age plus years of service equaled or exceeded 50 as of December 31, 2006 and, if upon their retirement from EPRI, they have completed a minimum of 5 years of service, have attained a minimum of age 55 and their aggregate age plus years of service total 70 or more. No employee hired or rehired on or after January 1, 2007 is eligible for the benefit. Spouses of eligible participants are also covered. Each non officer participant and spouse receives up to \$75 monthly for medical insurance premium reimbursement. Officers who attained officer status before January 1, 2007 are required to pay 20% of the actual premium cost of the medical plan of their choice. EPRI pays the remaining 80% of the premium cost. For officers, health care costs are assumed to remain at a rate of 9.0% for 2009, then grade down by 1% per year to an ultimate trend rate of 5% for 2013 and later.

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 6.25% in 2008 and 6.0% in 2007. The health care trend is assumed to be between 5.00% - 9.00% per year for all future years.

In September 2006, FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans- an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS 158 requires organizations to recognize a net liability or asset to report the funded status of their defined benefit pension and other post retirement benefit plans in their statement of financial position. It also requires that plan assets and benefit obligations be measured as of the date of an employer's statement of financial position. An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, EPRI elected for early adoption of this statement as of December 31, 2006. In addition, SFAS 158 requires EPRI to adjust its measurement date to its year end date beginning in 2008. The measurement date used for 2007 was September 30, 2007.

	2008 *	2007 **
	<i>(thousands of dollars)</i>	
<b><i>Change in Benefit Obligation</i></b>		
Benefit obligation at end of prior year	\$9,976	\$9,518
Service cost	196	181
Interest cost	722	521
Actuarial (gain) loss	(661)	215
Benefits paid	<u>(555)</u>	<u>(459)</u>
Benefits obligation at end of year	\$9,678	\$9,976
<b><i>Change in Plan Assets</i></b>		
Employer contributions	\$555	\$459
Benefits paid	<u>(555)</u>	<u>(459)</u>
<b><i>Funded status at 9/30</i></b>	N/A	9,976
Estimated contributions 9/30 -12/31	-	(115)
<b><i>Funded status at end of year</i></b>	<u>\$9,678</u>	<u>\$9,862</u>
<b><i>Amounts recognized in statement of financial position:</i></b>		
Current liabilities	\$731	\$714
Noncurrent liabilities	<u>8,947</u>	<u>9,148</u>
	<u>\$9,678</u>	<u>\$9,862</u>
<b><i>Net periodic benefit costs:</i></b>		
Service cost	\$196	\$181
Interest cost	722	521
Amortization of net loss	<u>64</u>	<u>65</u>
Net periodic benefit cost	<u>\$982</u>	<u>\$767</u>

Due to change of measurement date, period is:

\* from 10/1/07 to 12/31/08.

\*\* from 10/01/06 to 9/30/07.

#### **Note 7— Commitments and Contingencies**

As a matter of business practice, EPRI extends indemnification to its members, funders and collaborators for certain contractual risks; furthermore, EPRI is required to provide certain indemnifications arising through EPRI's government contracts. In addition, through its bylaws and/or by operation of law, EPRI may owe indemnification in certain matters to members of its Board of Directors, officers and employees.

EPRI has three standby letters of credit with Bank of America which provide for security for total obligations of \$365,000. There was no balance outstanding under the letters of credit at either December 31, 2008 or 2007. Two letters totaling \$250,000 expire on June 30, 2009 and one letter in the amount of \$115,000 expires on February 15, 2009.

EPRI has entered into lease arrangements under operating leases for research, office, and storage facilities and for equipment. Rental expense under these leases was \$1,597,000 in 2008 and \$1,508,000 in 2007. The terms included in certain of these leases provide that EPRI is responsible for property taxes, insurance, and maintenance expenses, and in certain cases renewal options are included.

EPRI leases certain buildings under a long-term non-cancelable operating lease. The current lease for the Palo Alto location was extended last year to January 31, 2019. The ten year extension is being accounted for as an operating lease. The capitalized cost of these buildings as of December 31, 2008 was \$3,807,000 with a current net book value of zero.

Future minimum non-cancelable operating lease commitments (*by year*) with initial terms of one year or more at December 31, 2008 are as follows:

Year	(thousands of dollars)
2009	\$1,423
2010	1,392
2011	1,391
2012	1,156
Thereafter	<u>3,212</u>
	\$8,574

In 2005, a long-term lease to a third party was entered into for three buildings until 2018, which resulted in a prepayment of the first three years of rent of \$3,278,000. The sum of future lessee payments is \$23,245,000 as of December 31, 2008.

Annually, EPRI authorizes the maximum amounts that may be expended on research projects. EPRI negotiates research contracts on those projects with companies and organizations that result in a contractual commitment for a given year. Such commitments cannot exceed the cumulative authorization. At December 31, 2008, EPRI had commitments with contractors to reimburse their future research costs in the amount of approximately \$62,197,000. Generally, EPRI has the right to cancel research and development contract commitments on 30 days' notice, subject to the payment of certain termination costs.

Certain research contracts are funded from federal government sources. Amounts received from these contracts are subject to audit by the awarding agencies. To date, no significant cost disallowances have resulted from such audits.

**Note 8—Income Taxes**

EPRI's for-profit subsidiaries account for income taxes under the asset and liability method. Income tax expense was \$157,000 in 2008 and \$123,000 in 2007. Deferred tax assets and liabilities are recognized for future tax consequences of carrying differences between financial statement and tax bases of assets and liabilities. Income tax expense and deferred taxes are not significant; however, for tax purposes as of December 31, 2008, EPRI subsidiaries have net operating loss ('NOL') carryovers available to offset future federal taxable income as follows:

Year Generated	Year of Expiration	Total
		(thousands of dollars)
2000	2020	\$2,411
2001	2021	703
2002	2022	1,270
		\$4,384

These NOL carryovers provide a potential future income tax benefit of \$1,491,000. For financial reporting purposes, a valuation allowance of \$1,339,000 has been recognized to offset a portion of the deferred tax assets relating to these NOL carryovers, since their use is limited and a portion is expected to expire before being fully utilized. There was no change in the valuation allowance in 2008 or 2007.

**Note 9—Related Party Transactions**

During 2008, 27 of the 33 seats on EPRI's Board of Directors were filled by individuals that were affiliated with companies that are members of EPRI. In addition to membership funding, these member companies may also have provided supplemental funding to EPRI for certain research projects. Those member companies with representation on the Board during 2008 provided approximately 51% of membership revenue compared to 52% in 2007.

**Note 10—Subsequent Events**

Since January 1, 2009, EPRI has eliminated 47 positions or approximately 6% of its staff. The impact of this reduction in force has not been included in the financial statements as of December 31, 2008.

## Report of Independent Auditors

### *To the Board of Directors of EPRI*

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows present fairly, in all material respects, the financial position of the Electric Power Research Institute (EPRI) at December 31, 2008 and 2007, 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. These financial statements are the responsibility of EPRI's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*Princeton House Corp. LLP*

San Francisco, California

April 24, 2009