Consolidated Financial Statements and Report of Independent Certified Public Accountants

Green States Energy, Inc. and Subsidiaries

December 31, 2012 and 2011

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Report of Independent Certified Public Accountants

Board of Directors
Green States Energy, Inc. and Subsidiaries;

We have audited the accompanying consolidated financial statements of **Green States Energy, Inc.** (a Delaware corporation) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Green States Energy, Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended December 31, 2012 and 2011 in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Charlotte, North Carolina
April 19, 2013

Consolidated balance sheets

December 31	2012	2011
	$	$
Assets		
Current assets:		
Cash	358,749	113,632
Accounts receivable	335,163	25,962
Grants receivable	-	7,852,668
Prepaid expenses and other current assets	43,408	93,290
Total current assets	737,320	8,085,552
Investment in energy property, net	27,232,268	28,345,635
Other assets:		
Intangible assets, net	2,337,233	2,598,129
Restricted cash	724,990	512,500
Deferred tax asset	42,916	38,752
Deferred costs, net	12,751	96,122
Total other assets	3,117,890	3,245,503
Total assets	31,087,478	39,676,690
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	1,828,067	791,068
Stock warrant liability	1,081,703	575,965
Deferred tax liability	42,916	38,752
Development service fees payable, current portion	144,000	132,000
Notes payable, short term	-	50,000
Total current liabilities	3,096,686	1,587,785
Long term liabilities:		
Notes payable, long term	8,428,136	16,629,676
Development service fees payable, net of current portion	1,957,062	2,060,764
Asset retirement obligation	179,505	169,345
Deferred grants, net of current portion	7,443,675	7,836,308
Total long-term liabilities	18,008,378	26,696,093
Stockholders' equity		
Preferred stock, par value $0.001, 40,000,000 shares authorized, 80,000 shares issued and outstanding	80	80
Common stock, par value $0.001, 100,000,000 shares authorized; 18,845,224 and 15,132,332 shares issued and outstanding in 2012 and 2011, respectively	18,844	15,132
Additional paid-in capital	4,033,919	1,892,278
Retained deficit	(3,600,683)	(1,043,165)
Noncontrolling interest	9,530,254	10,528,487
Total equity	9,982,414	11,392,812
Total liabilities and stockholders' equity	31,087,478	39,676,690

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

Consolidated statements of operations

Year ended December 31	2012	2011
	$	$
Revenues		
Energy generation revenue	1,776,268	25,962
Deferred grant revenues	392,633	16,360
Total revenues	2,168,901	42,322
Operating expenses		
Selling, general and administrative expenses	4,213,311	1,571,814
Total operating expenses	4,213,311	1,571,814
Net operating loss	(2,044,410)	(1,529,492)
Other income (expense)		
Bargain purchase gain	-	5,645,982
Registration penalty	(628,532)	-
Gain on change in fair value of stock warrants	38,975	129,416
Interest expense, net	(1,394,355)	(32,401)
Unrecoverable project costs	15,646	(435,963)
Organization and legal costs	-	(413,743)
Total other (expense) income	(1,968,266)	4,893,291
Net (loss) income	(4,012,676)	3,363,799
Loss (income) attributable to noncontrolling interest	1,455,158	(4,383,546)
Net (loss) income attributable to Green States Energy, Inc.	(2,557,518)	(1,019,747)

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

Statements of stockholders' equity

Description	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Earnings/(Deficit)	Noncontrolling Interest	Total Stockholders' Equity
Balance as of December 31, 2010	**80,000**	**80**	**12,220,000**	**12,220**	**368,871**	**(23,418)**	**-**	**357,753**
Common stock warrant issuances	-	-	-	-	25,246			25,246
Common stock issuances, net of offering costs of $481,742	-	-	2,912,332	2,912	1,498,161	-	-	1,501,073
Phase I GSE NC 1, LLC contribution, net of offering costs of $309,241	-	-	-	-	-	-	6,144,941	6,144,941
Net income	-	-	-	-	-	(1,019,747)	4,383,546	3,363,799
Balance as of December 31, 2011	**80,000**	**80**	**15,132,332**	**15,132**	**1,892,278**	**(1,043,165)**	**10,528,487**	**11,392,812**
Common stock issuances, net of offering costs of $308,321	-	-	2,576,334	2,576	1,514,245	-	-	1,516,821
Issuance of common stock for registration penalty	-	-	1,136,558	1,136	627,396	-	-	628,532
Phase II GSE NC 1, LLC contribution	-	-	-	-	-	-	629,676	629,676
Dividends declared	-	-	-	-	-	-	(172,751)	(172,751)
Net loss	-	-	-	-	-	(2,557,518)	(1,455,158)	(4,012,676)
Balance at December 31, 2012	**80,000**	**80**	**18,845,224**	**18,844**	**4,033,919**	**(3,600,683)**	**9,530,254**	**9,982,414**

Statements of cash flows

Year ended December 31	2012	2011
	$	$
Cash flows from operating activities:		
Net (loss) income	(4,012,676)	3,363,799
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,776,662	114,441
Accretion expense	10,160	222
Amortization of deferred grants	(392,633)	(16,360)
Change in fair value of warrants	(38,975)	(129,416)
Registration penalty	628,532	-
Bargain purchase gain	-	(5,645,982)
Changes in operating assets and liabilities:		
Accounts receivable	(309,201)	(25,962)
Grant receivable	7,852,668	-
Prepaid expenses	49,882	(93,290)
Accounts payable and accrued expenses	979,861	791,068
Net cash provided by (used in) operating activities	6,544,280	(1,641,480)
Cash flows from investing activities:		
Investment in energy assets	(278,730)	(22,179,842)
Net cash used in investing activities	(278,730)	(22,179,842)
Cash flows from financing activities:		
Financing fees paid	-	(115,741)
Restricted cash	(212,490)	(500,000)
Payments on deferred developer fee	(132,000)	(500,000)
Proceeds from notes payable	-	16,679,676
Payments on notes payable	(8,251,540)	-
Issuances of common stock, net of offering costs	1,516,821	1,501,073
Issuances of warrants, net of offering costs	544,713	705,381
Distributions to noncontrolling interest	(128,113)	-
Capital contributions by noncontrolling interest holders, net of offering costs	629,676	6,144,941
Net cash (used in) provided by financing activities	(6,032,933)	23,915,330
Net increase in cash and cash equivalents	232,617	94,008
Cash and cash equivalents, beginning of year	113,632	19,624
Cash and cash equivalents, end of year	346,249	113,632
Cash paid during the year for interest	841,360	32,986
Issuance of common stock for registration penalty	628,532	-
Common stock warrants issued in lieu of deferred financing fees	-	25,246
Distributions to noncontrolling interest declared, but unpaid	44,638	-
Non-cash investment activities - asset retirement obligation	-	169,123

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

Notes to consolidated financial statements

1 Organization and Nature of Operations

Organization and Principles of Consolidation

Green States Energy, Inc. (GSE) was formed as a Florida corporation on June 3, 2010. GSE was incorporated in Delaware on December 9th, 2011. GSE includes two consolidated Subsidiaries (collectively, the Subsidiaries), GSE Operations Company, LLC (GSE OPS) and GSE NC 1, LLC (GSE NC), and its variable interest entity (VIE), GSE Development Company, LLC (GSE DEV) (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation.

GSE OPS was formed as a Delaware limited liability company on December 21, 2011. GSE OPS provides the operations and maintenance as well as the administrative functions for GSE operating assets. GSE OPS is wholly-owned by GSE.

GSE NC was formed as a Delaware limited liability company on December 23, 2011. GSE NC conducts its business through its wholly-owned subsidiaries. GSE is the managing member and holds all control rights from GSE NC and, accordingly, consolidates GSE NC. GSE NC's wholly owned subsidiaries (collectively, the Subsidiaries) at December 31, 2012 and 2011 are as follows:

Sunrise NC Alexander Lessee, LLC (Alexander Project)
Sunrise NC Daughter Lessee, LLC (Daughter Project)
Sunrise NC Hindsman Lessee, LLC (Hindsman Project)
Sunrise NC Martin Lessee, LLC (Martin Project)
Sunrise NC RKAN Lessee, LLC (RKAN Project)
Sunrise NC Shields Lessee, LLC (Shields Project)

The Managing Member of GSE NC is GSE. The Investor Member of GSE NC is Red Stone Renewable Energy Fund, LLC. For the period from date of formation until the Flip Date, defined as the later of 61 months from the date the assets were placed in service or the last day of the quarter in which the Investor Member meets a targeted internal rate of return, the resulting ownership of GSE NC will be 99% to the Investor Member and 1% to the Managing Member. After the Flip Date, the resulting ownership will be 95% to the Managing Member and 5% to the Investor Member.

GSE DEV was formed in 2011 for the purpose of providing development services to GSE and its affiliates. It is owned by three executives of GSE.

Nature of Operations

Through its Subsidiaries, the Company engages in the development, construction, financing, ownership, operation, and acquisition of distributed generation and utility-scale solar photovoltaic facilities (the solar energy facilities) in the United States. Financing of the solar energy facilities is done through equity and third party debt. The Company sells the solar energy generated by the solar energy facilities under pilot participation agreements (PPAs) to a single third party customer.

The cost of the facilities built in the United States of America qualify for energy investment tax credits as provided under Section 48 of the Internal Revenue Code (IRC) (Section 48 Tax Credit) or alternatively, upon election, may be eligible for the United States Department of the Treasury (Treasury) grant payment for specified energy property in lieu of tax credits pursuant to Section 1603 of the American Recovery and Reinvestment Act of 2009 (Section 1603 Grant). The cost of the facilities built in the United States of America qualify for state energy investment tax credits as provided under North Carolina General Statute §105-129.16A.

2 Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses for the period presented. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Company considers cash, demand deposits and highly liquid investments with original maturities of less than three months to be cash and cash equivalents. The Company maintains cash deposits with major banks, which may at times exceed federally insured limits. The Company periodically assesses the financial condition of the institutions and believes the risk of loss to be remote.

Restricted Cash

Restricted cash consists of funds held in escrow related to common stock offerings of $224,990 and $12,500 at December 31, 2012 and 2011, respectively, as well as cash held in escrow at GSE DEV of $500,000 at both December 31, 2012 and 2011. Funds held in escrow related to common stock offerings will be released upon completion of all necessary compliance procedures. The release of cash held in escrow at GSE DEV is contingent upon future cash flows and distributions to the Investor Member.

Energy Property

Energy property is recognized at fair value at the date of acquisition. The Company provides for depreciation utilizing the straight-line method by charges to operations over estimated useful lives of 20 years for solar energy facilities. Expenditures during the construction of new solar energy facilities are capitalized to development in progress as incurred until achievement of the commercial operation date (COD). Expenditures for maintenance and repairs are charged to expense as incurred. Upon retirement, sale or other disposition of equipment, the cost and accumulated depreciation are removed from the accounts and the related gain or loss, if any, is reflected in the year of disposal.

When the Company abandons the anticipated construction of a new solar energy facility during the development phase, costs previously capitalized to development in progress are written off. The Company wrote off project costs totaling $435,963 for the year ended December 31, 2011. During the year ended December 31, 2012, the Company successfully recovered from vendors previously expensed project costs of $15,646. These amounts are reflected in unrecoverable project costs in the accompanying consolidated statements of operations.

Impairment of Long-Lived Assets

The Company reviews its investment in energy property and pilot participation agreements (PPAs) for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. When evaluating impairment, if the undiscounted cash flows estimated to be generated by the energy property are less than its carrying amount, management compares the carrying amount of the energy property to its fair value in order to determine whether an impairment loss has occurred. The amount of the impairment loss is equal to the excess of the asset's carrying value over its estimated fair value. No impairment loss was recognized during the year ended December 31, 2012 and 2011.

Deferred Costs

Costs in connection with leasing expenses are amortized over the term of the lease agreement using the straight-line method. Legal costs associated with the creation of the PPAs are amortized over the term of the PPAs using the straight-line method. Financing costs associated with the promissory note are amortized over the term of the loan. Accounting principles generally accepted in the United States of America require that the effective yield method be used to amortize financing costs; however, the effect of using the straight-line method is not materially different from the results that would have been obtained under the effective yield method. Total deferred costs before accumulated amortization were $13,481 and $140,987 at December 31, 2012 and 2011, respectively. Amortization of deferred costs totaled $83,371 and $44,865 for the year ended December 31, 2012 and 2011, respectively.

Intangible Assets

The intangible asset associated with the acquisition of the PPAs was initially recognized at its fair value of $2,609,000 at the time of acquisition and is being amortized over the term of the related PPAs using the straight-line method. Amortization of these intangibles totaled $260,896 and $10,871 in the years ended December 31, 2012 and 2011, respectively. The following table summarizes intangible assets at December 31, 2012 and 2011:

December 31	2012	2011
Intangible assets	$	$
Pilot participation agreements	2,609,000	2,609,000
Accumulated amortization	(271,767)	(10,871)
Total intangible assets, net	2,337,233	2,598,129

Estimated amortization expense for each of the next five years and thereafter is as follows:

	Amount
	$
2013	260,900
2014	260,900
2015	260,900
2016	260,900
2017	260,900
Thereafter	1,032,733
	2,337,233

Asset Retirement Obligation

The Company is required to assess its arrangements for the requirement to record asset retirement obligations (AROs) when it has the legal obligation to retire long-lived assets. Upon the expiration of the Company's PPAs for owned solar energy facilities, customers generally have the option to purchase the solar energy facilities at fair market value, extend the PPA or require the Company to remove the solar energy facilities at the Company's expense. If the Company determines that an asset retirement obligation is required for a specific solar energy facility, the Company records the present value of the estimated liability when the solar energy facility is placed in service. AROs recorded for owned facilities are recorded by increasing the carrying value of investment in energy property and depreciated over the solar energy facility's useful life, while an ARO recorded for a leasing arrangement is accounted for as deferred rent in the initial period recognized and amortized over the term of the lease. After initial recognition of the liability, the Company accretes the ARO to its future value over the solar energy facility's useful life or lease period.

Revenue Recognition

The Company derives revenues from the following services: sales of electricity and receipt of grants from government entities.

Energy generation revenue is recognized as electricity is generated by the solar energy facility and delivered to the customers. Revenues are based on actual output and contractual sale prices set forth in long-term PPAs. The Company extends credit based on an evaluation of customers' financial conditions, generally without requiring collateral. Exposure to losses on receivables is principally dependent on each customer's financial condition. The Company considers invoices past due when they are outstanding longer than the stated term. The Company monitors its exposure for credit losses and maintains allowances for anticipated losses. No allowance for doubtful accounts was necessary at December 31, 2012 or 2011.

The Company receives Section 1603 Grants. The Company records a receivable and corresponding deferred revenue for the grants when the solar energy facilities achieve COD. Upon receipt of the grants, the Company amortizes the deferred revenue using the straight-line method over the useful life of the related solar energy facility.

Subsequent to its acquisition of the Subsidiaries and achievement of COD in December 2011, the Company became eligible and filed for the receipt of a Section 1603 Grant in the initial amount of $7,852,668, which was received in 2012. Revenue recognized from the amortization of this deferred grant during the year ended December 31, 2012 and 2011 was $392,633 and $16,360, respectively.

Variable Interest Entity

The Company consolidates entities in which it has a controlling financial interest.

The Company follows the authoritative guidance included in generally accepted accounting principles on accounting for consolidation of VIEs. Such guidance applies to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties.

In the normal course of business, the Company enters into a variety of transactions with VIEs. The Company determines the primary beneficiary based on an evaluation of which party has both: (i) the power to direct the activities that most significantly impact the economic performance of the VIE; and (ii) has the obligation to absorb losses, or the right to receive benefits that potentially are significant to the VIE. The Company evaluates its relationships with other entities to identify whether those entities are VIEs and to assess whether it is the primary beneficiary of such entities. If the determination is made that the Company is the primary beneficiary, then that entity is included in the consolidated financial statements. The Company is the primary beneficiary for such a VIE, GSE DEV (Note 9).

Stock Warrants

The Company accounts for warrants issued with a fixed exercise price as equity instruments and warrants issued with exercise prices based on the greater of a multiple of a future financing event or a fixed amount as liability instruments in the consolidated balance sheets.

Income Taxes

Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts for financial reporting purposes.

The Company evaluates its uncertain tax positions in accordance with the applicable guidance. Accordingly, a loss contingency is recognized when it is probable that a liability has been incurred as of the date of the financial statements and the amount of the loss can be reasonably estimated. The amount recognized is subject to estimate and management judgment with respect to the likely outcome of each uncertain tax position. The amount that is ultimately sustained for an individual uncertain tax position or for all uncertain tax positions in the aggregate could differ from the amount recognized. As of December 31, 2012 and 2011, the Company had no uncertain tax positions and no unrecognized tax benefits. Penalties and interest assessed by income tax authorities are included in general and administrative expenses. For the years ended December 31, 2012 and 2011, the Company did not incur any penalties and interest.

Stock Split

In December 2012, the Company executed a 2:1 stock split for all then outstanding shares of its common stock. The amounts shown in the accompanying consolidated financial statements for shares authorized, issued and outstanding have been retrospectively adjusted to reflect the stock split as if it had occurred at December 31, 2010.

Registration Penalty

The Company's common stock offering in 2011 contained a requirement that the Company list its shares on a publicly traded exchange by May 2012. The Company did not meet this requirement, and, as required by the offering agreement, issued 1,136,558 additional shares of common stock with an estimated fair value of $628,532 as compensation to affected shareholders. No further compensation to affected shareholders is required.

3 Acquisition

On December 23, 2011, the Company, through GSE NC, acquired 100% of the membership interests in six limited liability companies (the Subsidiaries). The interests were acquired for the purpose of owning and operating a solar energy project consisting of six installations in and around Murphy, North Carolina. The consideration for the acquisition consisted of cash of $21,959,750. The Company, through its consolidated variable interest entity, GSE DEV, also incurred certain development fees to be paid to a third party with an estimated present value of $2,692,764 (Note 8). The fair value of the assets acquired was determined using a discounted cash flow methodology.

A summary of the purchase price allocation follows:

		Estimated useful life
Assets acquired	**$**	
Energy property	27,689,496	20 years
Pilot participation agreements	2,609,000	10 years
	30,298,496	
Cash purchase price	(21,959,750)	
Bargain purchase gain before development fees	8,338,746	
Development fees expensed	(2,692,764)	
Bargain purchase gain, net	5,645,982	

A bargain purchase gain, net of development fees, in the amount of $5,645,982 was recognized at acquisition in 2011. The gain is the excess of the fair value of identifiable assets over total consideration. The Company also incurred organizational and advisory costs related to the acquisition of the Subsidiaries and organization of GSE NC in the amount of $513,743, of which $100,000 is reflected in selling, general and administrative expenses and $413,743 is reflected in organization and legal costs in the accompanying consolidated statements of operations for the year ended December 31, 2011.

4 Investment in Energy Property

Investment in energy property consists of the following as of December 31, 2012 and 2011:

December 31	2012	2011
	$	$
Solar energy facilities - Operating	27,689,496	27,689,496
Asset retirement obligation	169,123	169,123
Development in progress	824,451	545,721
	28,683,070	28,404,340
Accumulated depreciation	(1,450,802)	(58,705)
	27,232,268	28,345,635

Depreciation expense was $1,392,097 and $58,705 for the years ended December 31, 2012 and 2011, respectively.

5 Notes Payable

On December 23, 2011, each of the Subsidiaries entered into a promissory note with Hunt Electric Corporation which is collateralized by the assets of the Subsidiaries. The notes bear interest at the greater of the Prime rate plus two percent or 6 percent per annum. Beginning on January 30, 2012, interest only payments began and will continue until the maturity date on March 30, 2012 at which time all outstanding principal and interest shall be due unless extended. During 2012, the Company paid the necessary extension fees and the maturity date of the loan was extended to January 4, 2013. These fees totaled $253,113 and are included in interest expense in the accompanying statement of operations. Subsequent to December 31, 2012, the Company amended the agreement again, extending the maturity date to March 15, 2014. In July 2012, in connection with the receipt of section 1603 grant funds and the closing of the second equity contribution from the Investor Member, the Company made a payment on the loan of $8,201,540. The notes do not have any financial covenants..

As of December 31, 2012 and 2011, $8,428,136 and $16,629,676, respectively, remained outstanding.

The amount outstanding at December 31, 2012 is comprised of notes specific to projects as follows:

	$
Daughter Project	1,626,598
Alexander Project	1,599,620
Hindsman Project	1,589,707
Martin Project	1,595,660
RKAN Project	1,013,573
Shields Project	1,002,978
	8,428,136

The Company had a short-term bridge financing loan outstanding at December 31, 2011 in the amount of $50,000, which bore interest at 12%. This amount was paid in full in 2012.

6 Stock Warrants

During 2010 the Company issued 2,291,685 warrants. The warrants vested immediately and have a term of five years from the grant date. Of the warrants issued in 2010, 2,222,240 warrants can be exercised at a fixed price of $0.18 per share. The remaining 69,445 can be exercised at a fixed price of $0.21 per share. These warrants were accounted for as equity instruments through a charge to expense, with a corresponding increase to additional paid-in capital in the accompanying consolidated financial statements.

The Company issued 1,287,167 and 1,456,166 stock warrants accounted for as liability instruments during the year ended December 31, 2012 and 2011, respectively. The fair value of these warrants was estimated at the date of grant using the calculated-value method incorporating a Black-Scholes Option Pricing Model. Expected volatility is based on average volatilities of similar public entities. The risk-free interest rate for periods within the contractual life of the warrant is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life represents an estimate of the length of time the warrants are expected to remain outstanding. The warrants have a term of no greater than five years from the grant date and vested immediately. These warrants can be exercised at the lower of $3.70 per share of 70% of the common stock offering price on an initial public offering. Because these warrants include a down-round provision, the fair value of the warrants is recognized as a liability at the balance sheet date. At December 31, 2012 and 2011, the fair value of warrants recognized as liabilities was $1,081,703 and $575,965, respectively. Changes in the year-over-year fair value of warrants are recognized in other income (expense) in the consolidated statements of operations. The Company also issued 365,939 warrants in 2011 as compensation for financing costs with a fair value of $25,246. The expense related to these warrants was charged to interest expense.

The following table presents the range of weighted-average assumptions used in the valuation and the resulting weighted-average fair value per option granted.

	2012	2011
Risk-free interest rate	1.90%	0.60%
Dividend yield	-	-
Expected volatility	77.3% to 77.3%	77.3% to 85.6%
Expected life (years)	5.0	5.0

The options have a term of no greater than five years from the grant date and vested immediately. These warrants can be exercised at the lower of $3.70 per share of 70% of the common stock offering price on an initial public offering. Because these warrants include a round-down provision, the fair value of the warrants is recognized at the balance sheet date. At December 31, 2012 and 2011, the fair value of warrants recognized as liabilities was $1,081,703 and $575,965, respectively. Changes in the year-over-year fair value of warrants are recognized in other income (expense) in the consolidated income statements. The Company also issued 365,939 warrants as compensation for financing costs with a fair value of $25,246.

The table below summarizes activity in 2012 and 2011:

	2012		2011	
	Warrants	Average Exercise Price	Warrants	Average Exercise Price
		$		$
Balance, beginning of the year	4,113,790	1.61	2,291,685	0.18
Granted during the year	2,095,000	3.70	1,822,105	3.21
Forefeited during the year	-	-	-	-
Cancelled during the year	-	-	-	-
Balance, end of year	6,208,790	2.04	4,113,790	1.61
Exercisable, end of year	6,208,790	2.04	4,113,790	1.61

7 Fair Value Measurements

The accounting standard for fair value measurement and disclosures defines fair value, establishes a framework for measuring fair value, and provides for expanded disclosure about fair value measurements. Fair value is defined by the accounting standard for fair value measurement and disclosures as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It also establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three levels. The following summarizes the three levels of inputs and hierarchy of fair value the partnership uses when measuring fair value:

Level 1 Inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the partnership has the ability to access;

Level 2 Inputs may include quoted prices for similar assets and liabilities in active markets, as well as interest rates and yield curves that are observable at commonly quoted intervals; and

Level 3 Inputs are unobservable inputs for the asset or liability that are typically based on an entity's own assumptions as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the fair value measurement will fall within the lowest level input that is significant to the fair value measurement in its entirety. The following table presents the Company's financial instruments measured at fair value on a recurring basis at December 31, 2012 and 2011:

	Fair value measurements			
December 31, 2012	Level 1	Level 2	Level 3	Total
	$	$	$	$
Warrants	-	-	1,081,703	1,081,703
	-	-	1,081,703	1,081,703

	Fair value measurements			
December 31, 2011	Level 1	Level 2	Level 3	Total
	$	$	$	$
Warrants	-	-	575,965	575,965
	-	-	575,965	575,965

The following table presents the assets and liabilities that were measured at fair value on December 23, 2011 (the date of acquisition) on a non-recurring basis:

	Fair value measurements			
December 23, 2011	Level 1	Level 2	Level 3	Total
	$	$	$	$
Energy Property	-	-	27,689,496	27,689,496
Pilot participation agreements	-	-	2,609,000	2,609,000
	-	-	30,298,496	30,298,496

8 Operating Leases

Site Lease

The Company, through GSE NC and the Subsidiaries, has entered into various lease agreements for the sites where solar energy facilities have been constructed. Rent expense is payable monthly in the amount of $0.02 per kilowatt-hour for each kilowatt-hour of electricity generated by the facilities. Rent expense totaled $142,192 and $2,155 for the years ended December 31, 2012 and 2011, respectively.

9 Related-Party Transactions

Development Service Fees

The Company entered into an agreement with North Carolina Solar Trust, LLC, an unrelated party, through its consolidated subsidiary GSE DEV. For the year ended December 31, 2011, development service fees under this agreement with a face value of $3,025,000 were incurred in connection with the acquisition of the Subsidiaries.

The fees are non-interest bearing, payable from capital contributions and cash flow, as defined, with all amounts outstanding due and payable by December 31, 2024. The development services fee payable was initially recorded at its estimated present value and includes a discount in the original amount of $332,236. The discount will be amortized over the life of the agreement using the straight-line method, which approximates the effective interest method. The following table summarizes the development service fee payable at December 31, 2012 and 2011:

	Face Amount	Discount	Discounted Amount
	$	$	$
2012	2,393,000	(291,938)	2,101,062
2011	2,525,000	(332,236)	2,192,764

Amortization expense was $40,298 for the year ended December 31, 2012, and is included in interest expense in the accompanying consolidated statements of operations. No amortization expense was recognized for year ended December 31, 2011. Estimated amortization expense for each of the next five years and thereafter is as follows:

	Amount
	$
2013	40,298
2014	40,298
2015	40,298
2016	40,298
2017	40,298
Thereafter	90,448
	291,938

The Company is the primary beneficiary of GSE DEV. As of December 31, 2012 and 2011, and for the years then ended, GSE DEV has been consolidated with the Company.

The Consolidated financial statements for December 31, 2012 and 2011 include the following amounts as a result of the VIE's consolidation:

	2012	2011
	$	$
Cash and cash equivalents	500,000	500,000
Development services fee payable	2,101,062	2,192,764
Net income	11,485	227,358

As the VIE has elected to be taxed as a partnership for federal and state income tax purposes, there was no effect on income tax expense as a result of the consolidation.

10 Asset Retirement Obligation

The Company's asset retirement obligation relates to its owned solar energy facility in Murphy, North Carolina. The lease and associated PPA requires that, upon the end of the period, the solar energy facility be removed from the host customer's site. The Company recognized an increase to investment in energy property and an asset retirement liability upon COD. Each period, the liability will be accreted to its future value while the capitalized cost of $169,123 is depreciated over a period of 20 years. As of December 31, 2012 and 2011, the asset retirement obligation was $179,505 and $169,345, respectively. Accretion expense was $10,160 and $222 for the years ended December 31, 2012 and 2011, respectively, and is included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

11 Income Taxes

Under the liability method, a deferred tax asset or liability is measured based on the difference between the financial statement and tax bases of assets and liabilities, as measured by the enacted tax rates.

The Company's deferred income tax assets (liabilities) are as follows:

	December 31, 2012	December 31, 2011
Current	**$**	**$**
Accruals	29,243	12,144
Stock warrant liability	(64,922)	(49,895)
Valuation allowance	(7,237)	(1,001)
Total	(42,916)	(38,752)
Non-current		
Net operating losses	4,361,853	4,800,559
Property and equipment	385,818	482,269
Investment in GSE NC	(3,557,474)	(4,825,419)
Other	36,798	18,399
Valuation allowance	(1,184,079)	(437,056)
Total	42,916	38,752

The Company continues to evaluate unrecognized tax benefits as additional legislation and tax rulings are issued by the various tax authorities to which the Company is subject and as additional facts and circumstances develop.

The Company has federal and state net operating losses of approximately $12,314,341 and $3,842,648, respectively, as of December 31, 2012. These net operating losses (NOLs) begin to expire in 2031.

Applicable authoritative accounting guidance requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences are deductible. In making this determination, management considers all available positive and negative evidence affecting specific deferred tax assets, including the Company's past and anticipated future performance, the reversal of deferred tax liabilities, the length of carryback and carryforward periods and the implementation of tax planning strategies.

Objective positive evidence is necessary to support a conclusion that a valuation allowance is not needed for all or a portion of deferred tax assets when significant negative evidences exist. Allocations of income from GSE NC are expected to be sufficient to allow the Company to realize the benefit of a portion of its deferred tax assets, including NOLs. The Company has recognized a valuation allowance against the remaining deferred tax assets. The change in the valuation allowance from 2011 to 2012 was a result of a reduction in the deferred tax liability associated with the Company's investment in GSE NC.

The actual income tax expense for the years ended December 31, 2012 and 2011 differed from the expected amounts of income taxes computed by applying the statutory federal income tax rate to income before taxes due to permanent differences and the change in the valuation allowance.

Management's judgment is required in determining tax provisions and evaluating tax positions. Although management believes its tax positions and related provisions reflected in the consolidated financial statements are fully supportable, it recognizes that these tax positions and related provisions may be challenged by various tax authorities. These tax positions and related provisions are reviewed on an ongoing basis and are adjusted as additional facts and information become available, including progress on tax audits, changes in interpretation of tax laws, developments in case law and closing of statute of limitations. The Company's tax provision includes the impact of recording reserves and any changes thereto. As of December 31, 2012, the Company has a number of open tax years with various taxing jurisdictions that range from 2010 to 2012.

12 Commitments and Contingencies

Section 1603 Grant Compliance

As a condition to claiming Section 1603 Grants, the Company is required to maintain compliance with Section 48 of the IRC for a period of five years following COD. Failure to maintain compliance with the requirements of Section 48 could result in recapture of the amounts received, plus interest. The Company was in compliance with all relevant requirements of Section 48 at December 31, 2012.

13 Pilot Participation Agreements

The Company has entered into a 10-year PPA with the Tennessee Valley authority, which provides for the receipt of payments in exchange for the sale of all solar-powered electric energy. The electricity payments are calculated based on the amount of electricity delivered at a designated delivery point at a fixed price equal to $0.12 per kilowatt hour sold plus a variable rate equal to the GSA1 rate. The GSA1 rate has both a residential and commercial component. At December 31, 2012 and 2011, the GSA1 residential rate was $.1083 and $.1037, respectively, and the commercial rate was $.1272 and $.1224, respectively, per kilowatt hour. The Company is dependent on this arrangement. Should the arrangement with the Tennessee Valley Authority be terminated or expire, the Company would be financially dependent on the stockholders.

14 Subsequent Events

Management evaluated the activity of GSE and Subsidiaries through April 19, 2013, the date the financial statements were available to be issued, and concluded that the following subsequent events would require disclosure in the Financial Statements or disclosure in the notes to the financial statements:

On February 12, 2013, the Company modified its note with Hunt Electric by extending the maturity date from January 4, 2013 to March 15, 2014. There were no modifications made to the outstanding principal or effective interest rate.

On February 12, 2013, the Company purchased an interest in 5.4MW of solar photovoltaic projects located in and around Roswell, New Mexico, for a cash purchase price of $8,000,000, plus the assumption of existing indebtedness. Acquisition financing comprised a combination of equity capital, debt and federal section 1603 cash grant proceeds. The first 2.9MW phase of the portfolio (Phase 1) is completed and operational and will be accounted for as a business combination. The remaining 2.5MW (Phase 2) is under construction. The Company entered into a loan services agreement with Bridge Bank in 2013 for approximately $6,100,000 for Phase 1 and approximately $6,200,000 for Phase 2. The Company also entered into an Engineering Procurement and Construction Contract for $7,900,000 for the construction of Phase 2.