

Palestine for Credit & Development - FATEN
Ramallah – Palestine

Auditors' Report &
Financial Statements
for the year ended December 31, 2007

Talal Abu-Ghazaleh & Co.
Certified Public Accountants



Palestine for Credit & Development - FATEN
Ramallah – Palestine

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Auditors' Report

**To M/s the Shareholders
Palestine for Credit and Development (FATEN)
Ramallah – Palestine**

We have audited the accompanying financial statements of **Palestine for Credit & Development (FATEN)**, which comprise the statement of financial position as at December 31, 2007 and the statement of activities, cash flows statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management responsibility for financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

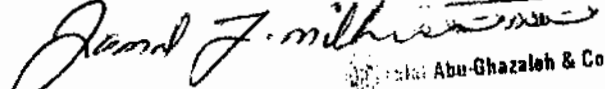
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Auditor's opinion

In our opinion, the financial statements give a true and fair view of financial position of the **Palestine for Credit & Development (FATEN)** as at December 31, 2007 and of its financial performance and its cash flows for the year then ended, in conformity with International Financial Reporting Standards.

Talal Abu-Ghazaleh & Co.


Jamal Milhem
Talal Abu-Ghazaleh & Co.

Certified Accountant License # (100/98)

Ramallah, March 9, 2008

Palestine for Credit & Development (FATEN)
Ramallah – Palestine
Balance sheet as at December 31, 2007

Exhibit "A"

<u>Assets</u>	<u>Note</u>	<u>2007</u>	<u>2006</u>
		USD	USD
Cash in hand and at banks	(3)	7,446,309	5,680,023
Net loan portfolio	(2b-c, 4a)	5,786,164	7,654,367
Other current assets	(5)	32,369	85,085
Fixed assets – net	(2d, 6)	397,646	396,520
Total assets		13,662,488	13,815,995
<u>Liabilities and equity</u>			
Payables and accruals	(7)	511,481	667,233
Long term loans	(8)	200,000	200,000
Provision for employees' indemnity	(9)	742,974	720,645
Total liabilities		1,454,455	1,587,878
<u>Equity</u>			
Paid-in capital		4,080	4,080
Accumulated donations	(11)	14,430,713	14,381,038
Accumulated losses		(2,226,760)	(2,157,001)
Total equity		12,208,033	12,228,117
Total liabilities and equity		13,662,488	13,815,995

"The accompanying notes constitute an integral part of this statement"

Palestine for Credit & Development (FATEN)
Ramallah – Palestine
Statement of income for the year ended
December 31, 2007

Exhibit "B"

	<u>Note</u>	<u>2007</u>	<u>2006</u>
<u>Revenues</u>		USD	USD
Interest on loans		644,553	939,324
Profit on Morabaha		58,046	46,910
Commission revenues		4,827	7,542
Fees on loans		47,511	59,672
Provision for loan losses		(229,567)	(364,000)
Net interest income		525,370	689,448
<u>Other operating revenues</u>			
Collection of loans previously written-off		9,052	8,663
Application fees		11,518	8,425
Penalty fees and others		1,909	2,680
Bank interests		234,082	86,659
Consulting and MIS sales		1,350	8,375
Other revenues		21,299	7,422
Total other operating revenues		279,210	122,224
Total operating revenues		804,580	811,672
Operating and administrative expenses	(10)	(874,339)	(934,828)
Prior years adjustments		--	9,654
Net operating loss		(69,759)	(113,502)
Grants to subsidies operations	(11)	22,074	174,268
Net (loss) profit after grants		(47,685)	60,766
		=====	=====

“The accompanying notes constitute an integral part of this statement”

Palestine for Credit & Development (FATEN)
Ramallah – Palestine
Statement of changes in equity for the year ended
December 31, 2007

Exhibit "C"

<u>Description</u>	<u>Paid in capital USD</u>	<u>Accumulated donations USD</u>	<u>Accumulated losses USD</u>	<u>Total USD</u>
Balance as at 01/01/2007	4,080	14,381,038	(2,157,001)	12,228,117
Donations recorded directly to balance sheet & in-kind contribution	--	27,600	--	27,600
Grants to subsidies operations	--	22,074	--	22,074
Net operating loss for the year	--	--	(69,759)	(69,759)
Balance as at 31/12/ 2007	4,080	14,430,713	(2,226,760)	12,208,033
Balance as at 01/01/2006	4,080	12,233,519	(2,043,499)	10,194,100
Donations recorded directly to balance sheet	--	1,973,251	--	1,973,251
Grants to subsidies operations	--	174,268	--	174,268
Net operating loss for the year	--	--	(113,502)	(113,502)
Balance as at 31/12/2006	4,080	14,381,038	(2,157,001)	12,228,117

“The accompanying notes constitute an integral part of this statement”

Palestine for Credit & Development (FATEN)
Ramallah – Palestine
Cash flows statement for the year ended
December 31, 2007

Exhibit "D"

<u>Operating activities</u>	<u>Note</u>	<u>2007</u>	<u>2006</u>
		USD	USD
Net operating loss		(69,759)	(113,502)
Adjustments to reconcile changes in net assets during the year to net cash used for (provided from) activities			
<u>Non cash items</u>			
Depreciation expenses	(6)	38,705	37,308
Provision for loan losses	(4a)	229,567	364,000
Written-off loans	(4f)	(50,495)	--
Gain on sales of assets		(15,754)	--
Provision for employees' indemnity	(9)	184,274	164,435
<u>Changes in current assets and current liabilities:</u>			
Net increase in loan portfolio		1,689,130	649,989
Decrease in other current assets		52,716	446,946
(Decrease) in payable and accruals	(7)	(155,752)	(2,706)
Employees' indemnity paid	(9)	(161,944)	(63,553)
Net cash flows provided from (used by) operating activities		1,740,688	1,482,917
<u>Cash flows from investing activities:</u>			
Purchase of fixed assets	(6)	(41,681)	(70,420)
Collection of sold of fixed assets		17,604	1,484
Net cash used by investing activities		(24,077)	(68,936)
<u>Cash flows from financing activities</u>			
Donations and grants	(11)	49,675	2,147,519
Net cash provided from financing activities		49,675	2,147,519
Increase (decrease) in cash and cash equivalent		1,766,286	3,561,500
Cash and cash equivalent beginning of year	(3)	5,680,023	2,118,523
Cash and cash equivalent ending of year	(3)	7,446,309	5,680,023

"The accompanying notes constitute an integral part of these financial statements"

Palestine for Credit & Development (FATEN)

Ramallah – Palestine

Notes to the financial statements

1. Background:

- a. Palestine for Credit and Development (FATEN) was part of Save the Children Federation – West Bank and Gaza. On July 14, 1998, FATEN was registered as a Private limited liability not for Profit Corporation in Gaza under registration number 563124478 in accordance with the Companies' Law of 1929. FATEN has commenced its operations on March 1, 1999. FATEN's authorized share capital is 10,000 common shares at par value USD 1 each. As of the financial statements date, the issued and fully paid capital amounted to USD 4,080. The governmental controlling party is the Ministry of Economic. The main objectives of FATEN are the following:
- Providing Palestinian micro-entrepreneurs with sustainable access to financial services.
 - Offering diverse credit products and other financial services.
 - Achieving qualitative and effective capacity and clients' services.
 - Becoming financially sustainable institution.
- b. FATEN employed 55 and 63 employees as at December 31, 2007 and 2006 respectively.
- c. These financial statements were approved by the board of directors on 02/04/2008.

2. Significant accounting policies:

a. Basis of preparation:

The financial statements have been prepared under the historical cost convention, in accordance with International Financial Reporting Standards, as published by the International Accounting Standards Boards (IASB), except for interest on group loans, which are accounted for when received, rather than when earned.

b. Use of Estimates:

The preparation of the financial statements in conformity with International Financial Reporting Standards requires management to make estimates and assumptions that affect reported assets and liabilities as well as reported income and expenses for each year. A material estimate that is particularly susceptible to significant changes relates to the determination of provisions for loan losses.

c. Loans receivable:

1. Loans are reduced by the provision for loan losses. Management evaluation the adequacy of the provision for loan losses regularly. Factors considered in evaluating the adequacy of the provision include the size of the portfolio, previous loss experience, current economic conditions and their effect on clients, and the performance of individual loans in relation to contract terms. The provision for loan losses charged to expenses is based on management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb losses.

- a. The timetable of the loans will be taken in consideration:

<u>Loan status</u>	<u>Provision percentage</u>
1 to 30 days overdue	10%
31 to 60 days overdue	50%
61 to 90 days overdue	75%
91 to 180 days overdue	100%

b. The provides for loan losses an monthly basis using the percentages of 12% in 2007 (8% in 2006) of the total portfolio.

The management will use one of two choices (A or B) based on the qualified conclusions, which is higher value.

2. FATEN was not a licensed financial intermediary, therefore; its provision policy is based on management's analysis of the historical performance of the overdue portfolio, age by the same categories rather than on Palestine Monetary Authority Regulation.

Written of loans are charged against the provision for loan losses when management believe that the principal is unlikely to be collected.

d. Types of Loans and guarantee:

These items consists the types of loans:

- Performance loans: the group guarantees
- Individual, Individual 11, Morabaha, Housing and Family guarantee: is salary transfer and sponsor person.
- NGOs and its staff loan the guarantee as provision for employees' indemnity and Provident fund.

e. Fixed assets:

Fixed assets are stated at cost on the date of acquisition or, in the case of gifts, at fair market value at date of donation. Depreciation is computed on a straight-line basis over the useful lives of the property and equipment using the following annual depreciation rates:

- | | |
|---------------------------|-----|
| - Building | 2% |
| - Vehicles | 15% |
| - Furniture and equipment | 15% |

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable mount.

f. Interest Revenues:

- FATEN used accrual basis to calculate the credit interest for all loans, and then calculated the interest rate as time average basis after take the amount of balance and interest. Except performing loans, because it is less than six months, so the interest will be smaller. After three months of accrued installment payment, no interests will be calculating for individual loans.
- There are no specific policies for rescheduling outstanding loan.

g. Donations:

- Donations to subsidize operating and administrative expenses are recorded in the statement of income as grant income.
- Donations to finance lending operations or the purchase of fixed assets are shown as direct additions to equity and the corresponding asset account.
- There are in-kind donations during the year of 2007 (A car from SC, two PC's from TIPH).

h. Expenses recognition:

Expenses are recognized when incurred based on the accrual basis of accounting.

i. Employees indemnity:

FATEN provides for employees' end of service benefits by accruing for one-month compensation for each year of service based on the last salary paid during the year, in accordance with labor law prevailing in Palestine. FATEN also provides employees a provident fund. Total contributions by the employees and FATEN are set at 10%, each based on the employees' basic monthly salaries.

j. Foreign currency transactions:

The books of accounts are maintained in Jordanian Dinars (JD). Transactions which are denominated in other currencies are converted into JD using the prevailing exchange rates at the date of the transactions.

Assets and liabilities, which are denominated in foreign currencies at the balance sheet date, are translated into JD using the prevailing exchange rates at the balance date. Exchange differences arising from these translations are recorded in the statement of income.

Exchange rates against JD as of the balance sheet date were as follows:

	<u>2007</u>	<u>2006</u>
	JD	JD
- USD	0.71	0.71
- NIS	0.167	0.168

k. Transaction to the reporting currency:

These financial statements were prepared in USD to meet stakeholders' requirements. Balances of assets and liabilities are translated into USD using the exchange rates prevailing at the balance sheet date. All income and expenses balances are translated to USD using the average rate of exchange prevailing during the year 1 USD = 0.71 JD.

3. Cash in hand and at banks:

a. This item consists of:	<u>2007</u>	<u>2006</u>
	USD	USD
- Cash in hand	1,509	1,539
- Cash at banks- NIS	13,570	9,031
- Cash at banks – JD	85,133	32,313
- Cash at banks - USD	337,253	407,812
- Deposit at bank - JD	5,668,465	3,870,137
- Deposit at banks – USD	694,172	800,110
Total	<u>6,800,102</u>	<u>5,120,942</u>
Deposits restricted for employees'		
Indemnity - b	646,207	559,081
Total	<u>7,446,309</u>	<u>5,680,023</u>
	=====	=====

b. Bank deposits at local banks in Palestine are short term in nature, with an average interest rate of 3.5% - 4.65% for deposits in USD and rate 3% for deposits in JD.

c. By region

	<u>Cash at bank</u>		
	<u>West Bank</u>	<u>Gaza</u>	<u>Total</u>
	USD	USD	USD
- Current Accounts	356,717	79,239	435,956
- Deposit maturity /month or less	5,082,123	1,280,513	6,362,636
- Deposit maturity 1 month to 3 months	646,207	--	646,207
Total	<u>6,085,047</u>	<u>1,359,752</u>	<u>7,444,799</u>
	=====	=====	=====

4. **Net loan portfolio:**

a. By type of loans:

	<u>2007</u> <u>USD</u>	<u>2006</u> <u>USD</u>
- Housing loans	2,231,634	3,082,511
- Family loans	2,536,502	3,109,013
- Consumption loans	209,204	97,410
- Morabaha	765,867	846,052
- Group loans	610,493	732,562
- Fast loans	6,251	6,537
- Individual loans	46,402	81,962
	<u>6,406,353</u>	<u>7,956,047</u>
- FATEN employees' loans	107,710	173,029
- NGOs' employees' loans	90,984	165,101
	<u>6,605,047</u>	<u>8,294,178</u>
Provision for loan losses	(818,883)	(639,811)
Loans portfolio – net	<u>5,786,164</u>	<u>7,654,367</u>

- d. The amount of USD 6,605,047 includes the amount of USD 368,152 as loans with accrued installments over 90 days recording without the accrued interest for the period after the 90 days.

c. By geographical area:

	<u>Outstanding</u> <u>Balance</u> <u>USD</u>	<u>Provision for</u> <u>loan losses</u> <u>USD</u>	<u>Net realizable</u> <u>value</u> <u>USD</u>
- North Area – West Bank	2,327,610	(198,743)	2,128,867
- South area – West Bank	2,187,601	(305,052)	1,882,549
- Central area – West Bank	193,961	--	193,961
- Gaza	1,895,875	(315,087)	1,580,788
Total	<u>6,605,047</u>	<u>(818,883)</u>	<u>5,786,164</u>

d. The movement in the loans receivable were as follows:

<u>Description</u>	<u>Beginning</u> <u>balance</u> <u>USD</u>	<u>Issued</u> <u>USD</u>	<u>Repaid</u> <u>USD</u>	<u>Loans</u> <u>written-off</u> <u>USD</u>	<u>Ending</u> <u>balance</u> <u>USD</u>
“Al-Qard Al-Hasan “	--	29,600	24,867		4,733
“Morabaha “	846,052	210,478	290,663		765,867
Consumption	97,410	248,916	136,330	792	209,204
Family loans	3,109,013	1,414,810	1,987,321		2,536,502
Housing loans	3,082,511	343,495	1,194,220	152	2,231,634
Group loans	732,562	747,292	838,561	30,801	610,492
Fast loans	6,537	1,549	1,413	422	6,251
Individual loans	81,962	228	19,505	16,283	46,402
Employees' loans	173,029	68,903	136,910	2,045	102,977
NGO's employees' loans	165,101	54,832	128,949	--	90,984
Total	<u>8,294,178</u>	<u>3,120,103</u>	<u>4,758,654</u>	<u>50,495</u>	<u>6,605,047</u>

- e. FATEN has an insider loans and loans for related party, and employee loans are Guarantee with end of services, indemnity and provident fund.

f. The movement in the provision for loans losses during the year was as follows:

	<u>2007</u> USD	<u>2006</u> USD
- Balance, beginning of year	639,811	275,811
- Additions during the year	229,567	364,000
- Written-off loans	(50,495)	--
Balance – ending of year	818,883	639,811
	=====	=====

g. The loan portfolio as at Dec 31, 2007 distributed by maturity as follows:

	<u>2007</u> USD	<u>2006</u> USD
- Up to one year	1,471,389	2,483,050
- From one year to 2 years	2,758,803	2,010,138
- Over two years	2,374,855	3,800,990

h. Collection of written-off:

The management of FATEN wrote-off loans totaling USD 506,249 during the years 2000, up to 2007 amount of USD 320,502 were collected during the period from 2002 till 2007. The balance as at December 31, 2007 was USD 185,747.

5. Other current assets:

This item consists of:	<u>2007</u> USD	<u>2006</u> USD
- Receivable from donors	--	16,044
- Prepayments	10,041	9,564
- Accrued bank interests	8,719	8,587
- Interest receivables	13,609	50,890
Balance – ending of year	32,369	85,085
	=====	=====

6. Fixed assets:

a. This item consists of:

<u>Description</u>	<u>Buildings</u> USD	<u>Vehicles</u> USD	<u>Furniture & equipment</u> USD	<u>Total</u> USD
Balance as at 01/01/2007	319,846	93,309	330,000	743,155
Additions	--	37,870	3,810	41,680
Deductions	--	(36,413)	(28,733)	(65,146)
Balance as at 31/12/2007	319,846	94,766	305,077	719,689
<u>Accumulated depreciation</u>				
Balance at 01/01/2007	43,357	58,818	244,460	346,635
Depreciation	6,397	9,479	22,829	38,705
Deductions	--	(36,414)	(26,883)	(63,297)
Balance at 31/12/2007	49,754	31,883	240,406	322,043
<u>Net book value as at:</u>				
31/12/2007	270,092	62,883	64,671	397,646
	=====	=====	=====	=====
31/12/2006	276,489	34,491	85,540	396,520
	=====	=====	=====	=====

b. Fixed assets include USD 158,594 of fully depreciated fixed assets that are still operational as at December 31, 2007.

7. Payables and accruals:

This item consists of:

	<u>2007</u> <u>USD</u>	<u>2006</u> <u>USD</u>
- Unearned interest & commission revenue	467,023	627,319
- Customers' savings liability	16,368	12,642
- Accrued audit fees	4,184	7,898
- Others	23,906	19,374
Total	511,481	667,233
	=====	=====

8. Long term loans:

An agreement was signed on October 14, 2004 between *Small Projects Support Program in Palestine* represented by the Islamic Bank for Development and *FATEN* to support the small projects according to the Islamic terms, such as (Morabaha loans and others), which benefits the poor people were affected by bad conditions. The amounts of USD 200,000 from the program and USD 100,000 from FATEN were deposited in special bank account, Arab Bank, A/C# 9550-360500. The amount of USD 200,000 will be settled during the end of the fourth year with zero interest rate beginning from the date of signing the agreement (there were no guarantee for this loan).

9. Provisions for employees' indemnity:

This movement on the provision for employees' indemnity during the year 2007 was as follows:

<u>Description</u>	<u>Beginning</u> <u>balance</u> <u>USD</u>	<u>Payments</u> <u>USD</u>	<u>Additions</u> <u>USD</u>	<u>Total</u> <u>USD</u>
Provident fund	495,163	111,234	115,345	499,274
End of service benefit	225,482	50,710	68,928	243,700
Total	720,645	161,944	184,273	742,974
	=====	=====	=====	=====

10. Operating and administrative expenses:

This item consists of:

	<u>2007</u> <u>USD</u>	<u>2006</u> <u>USD</u>
- Salaries and related benefits	614,860	641,185
- Professional fees	4,969	18,397
- Stationery and office supplies	13,029	12,796
- Communication	24,465	23,793
- Transportation and auto operations	42,369	58,639
- Occupancy costs	66,526	73,325
- Equipment rental and maintenance	6,291	6,086
- Depreciation	38,705	37,311
- Other expenses	23,303	16,706
- Bank charges	39,813	45,748
- Loss on foreign currency	9	842
Total	874,339	934,828
	=====	=====

11. Accumulated donations, grants and in-kind contribution:

This item consists of:

<u>Description</u>	<u>2007</u>			<u>2006</u>	
	<u>Sub-grant #</u> <u>SC/FA 003</u> <u>Save the</u> <u>Children</u> <u>USD</u>	<u>Save the</u> <u>Children</u> <u>USD</u>	<u>TIPH</u> <u>USD</u>	<u>Total</u> <u>USD</u>	<u>Total</u> <u>USD</u>
	- Donations recorded directly to balance sheet	--	--	9,930	9,930
- Grants to subsidize Operations	22,075	--	--	22,075	174,268
- In-kind contribution	--	16,870	800	17,670	--
Total	22,075	16,870	10,730	49,675	2,147,519
Accumulated donations as at December 31, 2007				14,381,038	12,233,519
Accumulated donations as at Dec. 31, 2007				14,430,713	14,381,038

12. Fair values of financial instruments:

Financial instruments comprise of financial assets and financial liabilities. Financial assets consist of cash and cash at banks and loans receivable. Financial liabilities consists payables and accruals.

The fair value of financial instruments is not materially different from their carrying values.

13. Construction of main assets and liabilities :

This item consists of:

<u>Description</u>	<u>2007</u>			<u>2006</u> <u>USD</u>
	<u>West Bank</u> <u>USD</u>	<u>Gaza Strip</u> <u>USD</u>	<u>Total</u> <u>USD</u>	
- Cash in hand and at bank	6,086,054	1,360,255	7,446,309	5,680,023
- Net loan portfolio	4,205,376	1,580,788	5,786,164	7,654,367
- Other current assets	28,290	4,079	32,369	85,085
- Fixed assets (net)	277,853	119,793	397,646	396,520
- Payables & Accruals	(402,741)	(108,740)	(511,481)	667,233
- Long term loan	(200,000)	--	(200,000)	(200,000)

14. Net assets for foreign currencies :

This item consists of:

	<u>2007</u> <u>USD</u>	<u>2006</u> <u>USD</u>
- Total Assets	12,973,004	13,102,051
- Total Liabilities	(982,797)	(975,190)
Net Assets	11,990,207	12,126,861
	=====	=====
- Cash in hand and at bank	6,830,898	5,198,408
- Loan receivables	6,132,500	7,879,857
- Other current assets	9,606	23,786
- Payable & Accruals	(39,823)	(54,545)
- Long term loan	(200,000)	(200,000)
- Provision for employees' indemnity	(742,974)	(720,645)

Foreign currencies: currencies other than the basic currency (Jordanian Dinar).

15. Risk management:**a. Interest rate risk:**

FATEN is exposed to interest rate risk on the time deposits that are considered interest-bearing assets (Note 3).

b. Liquidity risk:

FATEN limits its liquidity risk by maintaining adequate cash balances to meet its current obligations and to finance its operating activities.

c. Foreign currency risk:

FATEN maintains its major liabilities and assets in one currency, which is the USD. In addition, its major donation revenues are collected in USD and most of its expenses are paid in USD.

d. Credit risk:

FATEN limits its credit risk by maintaining adequate collateral such as; post-dated checks, promissory notes, notary deeds and transferred salaries.

16. Concentration of risk in geographical area:

FATEN is carrying out all of its activities in Palestine. The political and economical destabilization in the area increases the risk of carrying out these activities and adversely affects the performance.

17. General

Certain comparative figures have been reclassified to comply with this year financial statements presentation.