

Financial Statements and Auditor's Report

To: Board of Directors Azeri Star Microfinance LLC

From: SMART AUDIT LLC

Introduction

"SMART AUDIT" have audited the accompanying balance sheet of "Azeri Star Microfinance", non-banking credit organization (hereinafter referred to as "the Company") as of December 31, 2007 and the related statements of income, changes in equity and cash flows for the period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this financial information. Our responsibility is to express a conclusion on this financial information based on our audit.

Scope of audit

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles and significant estimates made by the management, as well as evaluating overall financial presentation. We believe that our audit provides a reasonable basis for our opinion.

Conclusion

Based on our audit, nothing has come to our attention that causes us to believe that the accompanying financial information does not give a true and fair view of the financial position of the entity as of December 31, 2007, and of its financial performance and its cash flows for the period then ended in accordance with International Accounting Standards.

19.01.2008

_____ Emil Mamedov

Azeri Star Microfinance Non-Banking Credit organization
Balance sheet for the year ending on December 31, 2007
(The figures are reflected in AZN)

	Comments	December31, 2006	December31, 2007
ASSETS			
Cash and cash equivalent	4	3,617.5	4,055.3
Total loan portfolio	5	754,809.4	1,107,299.4
(Loan Loss Reserve)	6	(17,348.9)	(22,348.9)
Advance payment	7		
Total short term assets		741,078.0	1,088,530.0
Total current assets	8	42,627.6	46,727.0
Depreciation		(15,611.5)	(23,758.9)
Total long term assets		27,016.1	22,968.0
TOTAL ASSETS		768,094.1	1,111,498.1
LIABILITIES			
Long term assets	9	69,712.0	245,327.8
Taxes		25,399.5	18,981.9
Total Liabilities		95,111.5	264,309.7
EQUITY			
Share holder equity	10	32,228.6	32,228.6
Retained earnings	11	75,399.3	211,641.4
Accumulated Grants	12	551,000.3	588,963.9
Capital reserves		14,354.5	14,354.5
Total equity		672,982.6	847,188.4
TOTAL LIABILITIES AND EQUITY		768,094.1	1,111,498.1

NOTE: Comments on pages 5-10 are the consisting part of this financial statement

Azeri Star Microfinance Non-Banking Credit Organization
Financial Statement for the year ending on December 31, 2007
(The figures are reflected in AZN)

	Comments	December 31, 2007
Interest income		
Interest income on loans		517,970.25
Less: Interest expense on long-term borrowings		(9,091.82)
Less: Interest expense on overdraft		
Total interest income		508,878.43
Other operating income		8,548.77
Penalties from loans		224.24
Total other operating income		8,773.01
Total interest and other operating income		571,651.44
Less :Increase in allowance for loan losses provisions	6	(6,845.85)
Interest and other operating income after allowance for loan losses		510,805.59
Operating expenses		
Salaries and benefits		221,825.36
Transport expenses		61,558.81
Rent charges		19,824.00
Depreciation	8	24,366.25
Other expenses	13	8,147.41
Total operating and other expenses		335,721.83
Net operating income		175,083.76
Exchange losses		(414.32)
Net operating income after exchange losses		174,669.44
Tax		38,427.28
Net operating income after tax		136,242.16

NOTE: Comments on pages 5-10 are the consisting part of this financial statement

Azeri Star Microfinance Non-Banking Credit Organization
Cash Flow Statements for the year ending on December 31, 2007
(The figures are reflected in AZN)

ASSETS					
Short term assets	December 31, 2006	December 31, 2007	Operational activity	Investment activity	Financial activity
Cash and cash equivalent	3,617.5	4,055.3			
Gross portfolio outstanding	754,809.4	1,107,299.57	(352,490.17)		
(Loan Loss Reserve)	(17,348.9)	(22,824.85)			
Advance prepayment					
Total short term assets	741,078.0	1,088,530.02			
Current assets					
Gross fixed assets	42,627.6	46,727.01		(4,099.41)	
Depreciation charges	15,611.5	23,758.94			
Total current assets	27,016.1	22,968.07			
TOTAL ASSETS	702,517.9	1,111,498.09			
LIABILITIES					
Taxes	25,399.5	18,981.93	6,417.57		
Long-term loans	69,712.0	245,327.80			175,615.80
TOTAL LIABILITIES	95,111.5	264,309.73			
EQUITY					
Share holder equity	32,228.6	32,228.59			
Retained earnings	75,399.3	211,641.42	136,242.14		
Accumulated Grants	551,000.3	551,000.25			
Capital reserves	14,354.5	14,354.48			
Grant		37,963.62			37,963.62
TOTAL EQUITY	672,982.6	847,188.36			
TOTAL LIABILITIES AND EQUITY	768,094.1	1,111,498.09	(209,830.46)	(4,099.41)	213,579.42

Total decrease is equal to 350.47

NOTE: Comments on pages 5-10 are the consisting part of this financial statement

Azeri Star Microfinance Non-Banking Credit Organization
Financial Statement for the year ending on December 31, 2007
(The figures are reflected in AZN)

Comment 1: Principals of Activities

“Azeri Star Microfinance” is Non-Banking Credit Organization (hereinafter referred to as “the Company”) was established by “Save the children Federation, Inc” in 18.07.2002 and entered the state registration in 30.05.2003 but began operating in 01.03.2006. The Company’s operations are based on the general banking license provided by the National Bank of Azerbaijan Republic. The Company has 2 representative offices with Head Office in the city of Barda. The Company is involved in one main type of activity (i.e. lending) and operates in one geographical area (i.e. Azerbaijan).

The main objective of the company is:

- Support the development of micro, small and medium sized enterprises, including those engaged in production and agricultural activities
- The creation of new employment opportunities in family, and other types of enterprises
- Provide equal access to financial resources for both men and women

The legal address of the Head office is:
Azerbaijan, Barda city, Garabag str 22.

Comment 2: Basis of preparation

Basis of accounting and preparation of accounting statements

The Company has to maintain its primary accounting records in accordance with internal regulations. These financial statements have been prepared based on the Company's primary records, and adjusted as necessary in order to conform in all material respects with International Financial Reporting Standards (IFRS)

These financial statements cover the period from January 01st, 2007 to December 31, 2007. The figures are expressed in national currency of Azerbaijan Republic, i.e. Azeri manats (AZN).

We have to point out that, in order to start operating, the Organization was provided with active credit portfolio, current and other assets and liabilities by the establisher. All these facts have been reflected in balance sheet confirmed between the organization and the establisher as to 28.02.2006. But all these figures have not been confirmed by the auditor.

Comment 3: Significant Accounting Policies

Use of estimates

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect reported assets and liabilities as well as reported income and expenses for each year. Actual results could differ from those estimates. Estimates that are particularly susceptible to change relate to the allowances for losses on loans and impairment and the fair value of financial instruments. According to IFRS requires during the preparation of financial report company make estimates and assumptions that affect reported assets and liabilities as well as reported income and expenses for each year.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and unrestricted balances on accounts with the commercial banks. The Company realizes the credit operations only in national currency of Azerbaijan Republic, i.e. Azeri manats (AZN).

Loans, loan loss allowance and write-offs

The “Company” realized credit operations on two models—group and individual. Group credits are divided into “Business”, “Livestock” and “Graduated” groups. Loans are given at different periods and different fixed rates.

Group name	Periodic and monthly rate	
Business	4-12 monthly	3,5%
Livestock	4-12 monthly	3,5%
Graduated	4-12 monthly	4%
Individual	4-18 monthly	4%

As seen above, the Company determines the rates of loans not yearly, but monthly. The reason is minimal loan sum and taking the loan for short period.

During the audit period the loan portfolio of the Company increased for 26,71% and made, 1,107,299.57 AZN. The loan portfolio was 754,810.9 AZN on December 31, 2007. Rate accounting on given loans is carried out in accordance with “PMS” program and accounting is with “MIP Accounting” program.

Loans were presented as a balance for the year-end excluding Loan Loss Reserve. Reserves potentially were included in loan portfolio, but had not been shown as part of loan portfolio by 01st January 2007. The Company creates reserves based on the internal policy, which was partially adopted from National Bank’s regulation for the credit unions. The adequacy of the loan loss provisioning is determined based on provisioning allowance percentages multiplied by the outstanding overdue loan balances in various aging categories, as shown below:

Loan status	Allowance {percent}
1-30 days overdue loan balance	

31-60 days overdue loan balance	2
61-90 days overdue loan balance	6
91-180 days overdue loan balance	25
More than 181 days overdue loan balance	50
	100

Management evaluates the adequacy of the allowance for loan losses regularly. Factors considered in evaluating the adequacy of the allowance include the size of the portfolio, previous loss experience, current economic conditions and their effect on clients.

Loans, loan loss allowance and write-offs

The figures presented as a result of the loan portfolio analyses show that the amount of loan per borrower for the period has increased. This is a normal practice by way of improvement of quality of a portfolio and reduction of operational costs on carrying out of credit work the Company

Loans, which cannot be repaid, are written-off from the loan portfolio and loan loss reserve is reduced for the same amount. Write-off is done after all necessary legal procedures and final definition of the amount of loss.

We have to point out that, after being assure of having loan loss “The Company” starts writing them off.

Risk application and other fee income (penalty)

Clients are charged a risk fee of 0.5 percent calculated on loan amount in arrears. These amounts are referred to other income.

The credit risk means possibility of financial losses in the result of non-fulfillment of liabilities by borrowers that is expressed in a non-returned (in full or in part) of the basic debt sum and interests on it in the established deadline by the contract.

Property, equipment and depreciation

Property and equipment is shown in the balance sheet historical costs with the deduction of depreciation. Depreciation is calculated based on Tax Code of Azerbaijan Republic.

In 2005, the Company received some fixed assets as Grants. The accrued amount of depreciation was accounted as income and expenses.

Share capital

According to confirmed Instructions, the share capital of the company was determined as 33,000 USA dollars (32,228.6 AZN) in two contribution forms. 8,414 dollars contribution was made in the form of cash but 24,586 dollars as fixed assets.

Share capital

Share capital contribution made in the form of cash is registered at fair value at the date of contribution.

Grants

The company received Grants for the loan portfolio, and operating and administrative expenses. The purchase of property and equipment are recorded in income statement after the net income from operations. Grants for periods beyond the current operating period are recorded under liabilities as grant revenue. During the useful work period these fixed assets will be decreased as depreciation amount and will be accounted as “non-operating income” in profit/loss statement. During the year of 2007 Save the children organization gave the grant at the amount of 37,963.62 AZN (44,000.00 USD).

Comment 4: Cash and cash equivalents

Content	31.12.2007	31.12.2006
Cash	864.38	812.7
Assets in correspondent bank accounts	3,190.92	2,804.8
TOTAL	4,055.30	3,617.5

Comment 5: Loan portfolio

Content	31.12.2007	31.12.2006
Outstanding loans	1,107,299.57	754,810.9
Past-due loans	(22,824.85)	(17,348.8)
TOTAL	1,084,474.72	737,462.1

Comment 6: Calculation of Loan Loss Reserve

Classification	31.12.2007		31.12.2006	
	Credit portfolio	Credit portfolio	Credit portfolio	Loan reserves
Reserve for Satisfactory loans (2%)	1,105,274.67	22,105.49	752,323.85	15,046.5
Reserve for Watch loans (6%)	959.60	57.58	-	
Reserve for Unsatisfactory loans (25%)	-	-	-	
Reserve for Doubtful loans (50%)	807.02	403.51	369.4	184.7
Reserve for Lost loans (100%)	258.28	258.28	2,117.7	2,117.7
Total	1,107,299.57	22,824.86	754,810.9	17,348.9
Loan Loss Reserve ratio		2.10%		2.30%

Comment 7: Accrued interest receivable

Content	31.12.2007	31.12.2006
Interest receivable	51.25	5.36

Total	51.25	5.36
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Comment 8: Fixed assets

Cost	Machinery and equipments	Furniture and other assets	Transport	Total
Cost	21,415.66	8,749.08	12,462.86	42,627.60
Reclassification	854.32	166.00	3,079.08	4,099.40
Disposed assets				
As at 31.12. 2007	22,269.98	8,915.08	15,541.94	46,727.00
Depreciation	11,836.39	5,700.27	6,222.28	23,758.94
Cost				
Accumulated depreciation for the year	7,599.2	4,896.6	3,115.7	15,611.53
Depreciation of disposed assets				
As at 31.07.2007	10,433.59	3,214.81	9,319.66	22,968.06
Net Book Value as at 01.03.2007	21,415.66	8,749.08	12,462.86	42,627.60
Net Book Value as at 31.12.2007	10,433.59	3,214.81	9,319.66	22,968.06

Comment 9: Involved capital

Content	31.12.2007	31.12.2006
“Qafqaz credit” LLC	70,308.0	69,712.0
Triple Jump	175,019.8	
Total	245,327.8	69,712.0

The reason is exchange rate.

Comment 10: Shareholder equity

Content	Amount	Share %
Save the children	32,228.6	100
Total shareholder equity	32,228.6	100

Comment 11: Retained earnings

Content	31.12.2007
Net operating income after tax	136,242.16
Travel expenses (over norm)	(764.98)

Business lunch	(78.60)
Other expenses	(2,019.90)
Penalty by Tax Orgarns	
Total	133,378.68

Comment 12: Accumulated grants:

Content	31.12.2007	31.12.2006
As credit portfolio	588,963.85	551,000.3
As current assets	14,354.50	14,354.5
Total	603,318.35	565,354.8

Comment 13: General, administrative and other operational expenses

Content	Total
Clerk chargers	4,668.33
Printed product	224.30
Other expenses	51.32
Audit chargers	6,800.00
Vehicle maintenance and insurance	175.00
Rating expenses	9,514.39
Repair expenses	512.91
Training expenses	1,420.00
Membership expenses	1,000.00
Total	24,366.25

Comment 14: Other expenses using net profit

Content	TOTAL
Travel expences (over norm)	764.98
Bizness lunch	78.60
Other expenses	2,019.90
Total	2,863.48