PALESTINE FOR CREDIT AND DEVELOPMENT - FATEN
FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2004
TOGETHER WITH INDEPENDENT AUDITORS' REPORT

ERNST & YOUNG

P.O.Box 1373
Sixth Floor
Trust Building
Jerusalem Street
Ramallah, Palestine

Telephone : 02 2401011
Fax : 02 2402324

Independent Auditors' Report

To the Shareholders of
Palestine for Credit and Development (FATEN)
Ramallah, Palestine

We have audited the accompanying balance sheet of Palestine for Credit and Development (FATEN) as of December 31, 2004, and the related statements of income, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of FATEN's management. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Palestine for Credit and Development as of December 31, 2004 and the results of its operations and its cash flows for the year then ended in conformity with the basis of accounting described in note 2.

Ernst + Young

Ramallah - Palestine
May 5, 2005

PALESTINE FOR CREDIT AND DEVELOPMENT - FATEN

Balance Sheet
As of December 31, 2004

	Notes	2004 USD	2003 USD
Assets			
Current Assets:			
Cash and cash at banks	3	3,491,348	3,900,685
Loans receivable, net	4	2,300,459	1,187,623
Other current assets	5	240,961	28,078
Total current assets		6,032,768	5,116,386
Property, plant and equipment, net	6	381,889	435,466
Total Assets		6,414,657	5,551,852
Liabilities and Equity			
Current Liabilities:			
Payables and accruals	7	99,101	94,999
Non-current Liabilities:			
Provisions for employees' indemnity	8	528,081	473,084
Total Liabilities		627,182	568,083
Equity			
Paid in capital		4,080	4,080
Accumulated donations		7,809,701	6,751,008
Accumulated losses		(2,026,306)	(1,771,319)
Total Equity		5,787,475	4,983,769
Total Liabilities and Equity		6,414,657	5,551,852

The attached notes from 1 to 14 form part of these financial statements.

PALESTINE FOR CREDIT AND DEVELOPMENT - FATEN

Statement of Income

For the year ended December 31, 2004

	Notes	2004 USD	2003 USD
Operating revenues			
Interest and fees on loans		430,021	196,835
Provision (recoveries) for loan losses	4	(9,398)	47,786
Net interest income		420,623	244,621
Other operating revenues			
Collection of loans previously written-off		46,873	151,938
Application fees		61,148	23,754
Penalty fees and others		34,306	21,989
Bank interests		27,805	41,753
Other revenues		12,846	2,938
Total other operating revenues		182,978	242,372
Total operating revenues		603,601	486,993
Operating expenses	9	(858,588)	(881,048)
Net operating loss		(254,987)	(394,055)
Grants to subsidise operations	10	254,987	394,055
Net loss after grants		-	-

The attached notes from 1 to 14 form part of these financial statements.

Statement of Changes in Equity
For the year ended December 31, 2004

	USD			
	Paid in Capital	Accumulated Donations	Accumulated Losses	Total
2004				
Balance as of January 1, 2004	4,080	6,751,008	(1,771,319)	4,983,769
Donations recorded directly to balance sheet	-	803,706	-	803,706
Grants to subsidise operations	-	254,987	-	254,987
Net operating loss for the year	-	-	(254,987)	(254,987)
Balance as of December 31, 2004	4,080	7,809,701	(2,026,306)	5,787,475
2003				
Balance as of January 1, 2003	4,080	6,313,582	(1,377,264)	4,940,398
Donations recorded directly to balance sheet	-	43,371	-	43,371
Grants to subsidise operations	-	394,055	-	394,055
Net operating loss for the year	-	-	(394,055)	(394,055)
Balance as of December 31, 2003	4,080	6,751,008	(1,771,319)	4,983,769

The attached notes from 1 to 14 form part of these financial statements.

PALESTINE FOR CREDIT AND DEVELOPMENT - FATEN

Statement of Cash Flows

For the year ended December 31, 2004

	2004	2003
	USD	USD
Cash flows from operating activities		
Net operating loss	(254,987)	(394,055)
Adjustments:		
Depreciation	50,340	58,110
Gain on sale of fixed assets	(3,924)	-
Provision for loan losses	9,398	(47,786)
Provision for employees' indemnity	136,551	137,842
Change in working capital:		
Increase in other current assets	(212,883)	(4,505)
Increase in payables and accruals	4,102	10,798
Employees' indemnity paid	(81,554)	(100,499)
Net cash flows used in operating activities	(352,957)	(340,095)
Cash flows from investing activities:		
Net increase in loans receivable	(1,122,234)	(712,270)
Proceed from sales of fixed assets	7,161	(15,307)
Net cash flows used in investing activities	(1,115,073)	(727,577)
Cash flows from financing activities:		
Donations and grants	1,058,693	437,426
Net cash flows from financing activities	1,058,693	437,426
Decrease in cash and cash at banks	(409,337)	(630,246)
Cash and cash at banks, beginning of year	3,900,685	4,530,931
Cash and cash at banks, ending of year	3,491,348	3,900,685

The attached notes from 1 to 14 form part of these financial statements.

1. General

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 limited liability private not-for-profit corporation in Gaza under registration number 563124478 in accordance with the Company's 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 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.

FATEN employed 57 and 77 employees' as at December 31, 2004 and 2003, respectively.

FATEN financial statements as of December 31, 2004 were approved by the Board of Directors on May 5, 2005.

2. Significant Accounting Policies

– 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 and individual loans, which are accounted for when received, rather than when earned.

The accounting policies are consistent with those used in the previous year.

– 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.

- Loans Receivable

  Loans are reduced by the provision for loan losses. Management evaluates 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.

  Management provides for loan losses every month in order to maintain the provision for loan losses at adequate levels. The adequacy of the provision for loan losses is determined by applying defined percentages to the outstanding balances in various aging categories as shown below:

Loan status	Provision percentage
1 – 30 days overdue	10%
31 – 60 days overdue	50%
61 – 90 days overdue	75%
91 – 180 days overdue	100%

  FATEN is 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. Loans written off are charged against the provision for loan losses when management believes that the principal is unlikely to be collected.

- Property, Plant and equipment

  Property, plant equipment are stated at cost on the date of acquisition or, in the case of gifts, at fair market value at the 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 amount.

- 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.

- Expenses Recognition

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

– 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 labour 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.

– Foreign Currency Transactions

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

Exchange differences arising from the conversion of foreign currency balances are reflected in the statement of income.

Exchange rates against JOD as of the balance sheet date were as follow:

	2004	2003
	← JOD	→
United States Dollars (USD)	0.71	0.71
New Israeli Shekel (NIS)	0.163	0.163

– Translation to the reporting currency

For the purpose of reporting to donors and other foreign interested parties, FATEN uses the United States Dollar (USD) as its reporting currency. Balances of assets and liabilities are translated to USD using the exchange rates prevailing at the balance sheet date. All income and expense balances are translated to USD using the average rate of exchange prevailing during the year.

3. Cash and Cash at Banks

	2004	2003
	USD	USD
Cash on hand	1,380	1,483
Cash at banks in NIS	6,244	9,480
Cash at banks in JOD	234,957	489,524
Deposit at banks in USD	2,837,669	3,042,605
	3,080,250	3,543,092
Deposits restricted for employees' indemnity	411,098	357,593
	3,491,348	3,900,685

Bank deposits with commercial banks in Palestine are short term in nature, with an average interest rate of 1% for deposits in USD.

4. Loans Receivable

– By type of loans:

	2004	2003
	USD	USD
Group loans	701,541	518,975
Fast loans	26,300	12,563
Individual loans	1,180,672	220,554
	1,908,513	752,092
FATEN employees' loans	127,445	128,216
NGOs' employees' loans	347,943	381,359
	2,383,901	1,261,667
Provision for loan losses	(83,442)	(74,044)
Loans receivable, net	2,300,459	1,187,623

– By geographic area:

	2004		
	Outstanding Balance	Provision for Loan Losses	Net Realizable Value
	USD	USD	USD
North Area / West Bank	415,844	17,548	398,296
South Area / West Bank	832,074	32,177	799,897
Central Area / West Bank	475,389	-	475,389
Gaza	660,594	33,717	626,877
	2,383,901	83,442	2,300,459

– The movements on the loans receivable were as follows:

	Beginning	Issued	Repaid	Loans written- off	Ending
	USD	USD	USD	USD	USD
Group loans	518,975	2,145,548	1,962,982	-	701,541
Fast loans	12,563	251,256	237,519	-	26,300
Individual loans	220,553	1,712,162	752,043	-	1,180,672
Employees' Loans	128,215	89,777	90,547	-	127,445
NGOs' employees' loans	381,361	223,281	256,699	-	347,943
	1,261,667	4,422,024	3,299,790	-	2,383,901

– The movement on the provision for loan losses during the year was as follows:

	2004	2003
	USD	USD
Balance, beginning of year	74,044	121,830
Additions (deductions) during the year	9,398	(47,786)
Balance, end of year	83,442	74,044

5. Other Current Assets

	2004	2003
	USD	USD
Receivables from donors	224,270	9,722
Prepayments	13,125	18,356
Others	3,566	-
	240,961	28,078

6. Property, Plant and Equipment

	USD			
	Balance, beginning of year	Additions / Depreciation	Disposals	Balance, end of year
Cost:				
Building	319,846	-	-	319,846
Vehicles	89,714	-	17,723	71,991
Furniture and equipment	274,754	-	1,740	273014
	684,314	-	19,463	664,851
Accumulated depreciation:				
Building	24,166	6,397	-	30,563
Vehicles	64,272	11,670	13,732	62,210
Furniture and equipment	160,410	32,273	2,494	190,189
	248,848	50,340	16,226	282,962
Net book value	435,466			381,889

Property, plant and equipment include USD 67,166 of fully depreciated fixed assets that are still operational as of December 31, 2004.

7. Payables and Accruals

	2004	2003
	USD	USD
Unearned interest revenue	35,641	45,883
Customers' savings liability	39,403	28,644
Due to suppliers	10,530	10,530
Others	13,527	9,942
	99,101	94,999

8. Provision for Employees' Indemnity

The movement on the provision for employees' indemnity during the year 2004 was as follows:

	Balance, beginning of year	Additions	Payments	Balance, end of year
	USD	USD	USD	USD
Provident fund	313,179	91,452	42,919	361,712
End of service benefit	159,905	45,099	38,635	166,369
	473,084	136,551	81,554	528,081

9. Operating Expenses

	2004	2003
	USD	USD
Salaries and related benefits	624,201	639,280
Professional fees	17,280	19,768
Stationery and office supplies	11,110	12,442
Communication	40,242	41,762
Transportation	36,893	43,049
Occupancy costs	47,962	53,341
Equipment rental and maintenance	20,799	7,869
Depreciation expense	50,340	58,110
Other expenses	9,761	5,427
	858,588	881,048

10. Donations, Grants, and In-kind Contributions

Following are the details of the donations recorded directly to the balance sheet, and grants to subsidise operation per donor:

	2004				2003
	Ministry of Social Affairs	Sub-Grant # SC/FA 003 Save the Children RLF	Sub-Grant #SC/FA 007 USAID	Total	Total
	USD	USD	USD	USD	USD
Donations recorded directly to balance sheet	3,500	365,515	434,691	803,706	43,371
Grants to subsidise operations	-	200,237	54,750	254,987	394,055
	3,500	565,752	489,441	1,058,693	437,426

11. 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 consist payables and accruals.

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

12. Risk Management

– Interest rate risk

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

– Liquidity risk

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

– 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.

– Credit risk

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

13. Concentration of Risk in Geographic 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.