

Palestine Electric Company
Public Shareholding Company Limited

Consolidated Financial Statements
December 31, 2010



Emphasis of Matters

Without qualifying our opinion, as explained in note (9) to the accompanying consolidated financial statements, the Palestinian Energy and Natural Resources Authority (PENRA) is the sole customer of the Company. To the date of the issuance of this report, PENRA did not provide the Company with the letter of credit as required by the power purchase agreement. In addition, as explained in note (10) to the accompanying consolidated financial statements, to the date of issuance of this report, the two remaining step-up transformers PENRA is committed to supply and install have not been supplied nor installed. PENRA did however make a commitment to supply and install these two transformers as soon as the situation in Gaza permits.

Furthermore, as explained in note (27) to the accompanying consolidated financial statements, the Company's assets which mainly comprise property, plant and equipment are located in Gaza. Recoverability of these assets from the Company's operations depends on the stabilization of the political and economic situation in Gaza.

A handwritten signature in blue ink that reads "Ernst + Young".

Gaza, Palestine
March 15, 2011



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Independent Auditors' Report to the Shareholders of Palestine Electric Company - Public Shareholding Company Limited

We have audited the accompanying consolidated financial statements of Palestine Electric Company - Public Shareholding Company Limited (the Company), which comprise the consolidated statement of financial position as of December 31, 2010 and the consolidated statement of income and comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 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 financial statements. The procedures selected depend on the auditors' 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.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Palestine Electric Company - Public Shareholding Company Limited as at December 31, 2010 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Palestine Electric Company
Public Shareholding Company Limited

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at December 31, 2010

	Notes	2010 U. \$. \$	2009 U.S. \$
ASSETS			
Non-current assets			
Property, plant and equipment	4	83,796,560	90,732,759
Intangible asset	5	1,717,184	1,846,784
Prepayments	6	306,575	778,066
Investment in an associate	7	112,577	-
		<u>85,932,896</u>	<u>93,357,609</u>
Current assets			
Materials and inventories	8	6,266,548	5,269,389
Accounts receivable	9	22,638,192	9,642,336
Other current assets	10	3,819,063	6,729,608
Cash and bank accounts	11	5,893,895	19,011,167
		<u>38,617,698</u>	<u>40,652,500</u>
TOTAL ASSETS		<u>124,550,594</u>	<u>134,010,109</u>
EQUITY AND LIABILITIES			
Equity			
Paid-in share capital	12	60,000,000	60,000,000
Statutory reserve	13	6,054,356	5,376,118
Retained earnings		<u>9,714,421</u>	<u>9,610,276</u>
Total equity		<u>75,768,777</u>	<u>74,986,394</u>
Non-current liabilities			
Long term loan	14	21,942,000	34,542,000
Provision for employees' indemnity	15	<u>1,795,186</u>	<u>1,407,972</u>
		<u>23,737,186</u>	<u>35,949,972</u>
Current liabilities			
Current portion of long term loan	14	18,603,000	12,006,000
Other current liabilities	16	<u>6,441,631</u>	<u>11,067,743</u>
		<u>25,044,631</u>	<u>23,073,743</u>
Total liabilities		<u>48,781,817</u>	<u>59,023,715</u>
TOTAL EQUITY AND LIABILITIES		<u>124,550,594</u>	<u>134,010,109</u>

The attached notes 1 to 27 form part of these consolidated financial statements

Palestine Electric Company
Public Shareholding Company Limited

CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME
Year Ended December 31, 2010

	Notes	2010 U.S. \$	2009 U.S. \$
Revenues			
Capacity charges	17	29,622,024	29,361,312
Interest on PENRA's receivables		490,128	449,641
		<u>30,112,152</u>	<u>29,810,953</u>
Operating expenses	18	<u>(21,957,729)</u>	<u>(27,154,577)</u>
		8,154,423	2,656,376
Force majeure government assistance	19	6,676,569	6,760,332
Finance costs		(1,558,298)	(2,360,574)
Impairment of accounts receivable	9	(6,756,132)	-
Share of losses of an associate	7	(92,423)	-
Loss from damaged materials		-	(209,833)
Other income		358,244	137,124
Profit for the year		<u>6,782,383</u>	<u>6,983,425</u>
Other comprehensive income		-	-
Total comprehensive income for the year		<u>6,782,383</u>	<u>6,983,425</u>
Basic and diluted earnings per share	20	<u>0.11</u>	<u>0.12</u>

The attached notes 1 to 27 form part of these consolidated financial statements

Palestine Electric Company
Public Shareholding Company Limited

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2010

	Paid-in Share Capital <u>U.S. \$</u>	Statutory Reserve <u>U.S. \$</u>	Retained Earnings <u>U.S. \$</u>	Total Equity <u>U.S. \$</u>
2010				
Balance at January 1, 2010	60,000,000	5,376,118	9,610,276	74,986,394
Total comprehensive income for the year	-	-	6,782,383	6,782,383
Transfer to statutory reserve	-	678,238	(678,238)	-
Dividends (note 21)	-	-	(6,000,000)	(6,000,000)
Balance at December 31, 2010	<u>60,000,000</u>	<u>6,054,356</u>	<u>9,714,421</u>	<u>75,768,777</u>
2009				
Balance at January 1, 2009	60,000,000	4,677,775	9,325,194	74,002,969
Total comprehensive income for the year	-	-	6,983,425	6,983,425
Transfer to statutory reserve	-	698,343	(698,343)	-
Dividends (note 21)	-	-	(6,000,000)	(6,000,000)
Balance at December 31, 2009	<u>60,000,000</u>	<u>5,376,118</u>	<u>9,610,276</u>	<u>74,986,394</u>

The attached notes 1 to 27 form part of these consolidated financial statements

Palestine Electric Company
Public Shareholding Company Limited

CONSOLIDATED STATEMENT OF CASH FLOWS
Year Ended December 31, 2010

	2010	2009
	U.S. \$	U.S. \$
<u>Operating activities</u>		
Profit for the year	6,782,383	6,983,425
Adjustments:		
Provision for employees' indemnity	413,058	328,705
Depreciation	6,958,822	6,965,241
Amortization	271,267	271,267
Finance costs	1,558,298	2,360,574
Impairment of accounts receivable	6,756,132	-
Share of losses of an associate	92,423	-
Loss from damaged materials	-	209,833
	<u>22,832,383</u>	<u>17,119,045</u>
<u>Working capital adjustments:</u>		
Accounts receivable	(19,751,988)	5,587,500
Other current assets	2,910,545	(3,249,007)
Materials and inventories	(997,159)	(1,410,175)
Other current liabilities	(5,382,472)	6,862,019
Employees' indemnity paid	(25,844)	(159,553)
	<u>(414,535)</u>	<u>24,749,829</u>
<u>Net cash flows (used in) from operating activities</u>		
<u>Investing activities</u>		
Force majeure payments received from PENRA	-	2,173,185
Purchase of property, plant and equipment	(22,623)	(168,483)
Investment in an associate	(205,000)	-
	<u>(227,623)</u>	<u>2,004,702</u>
<u>Net cash flows (used in) from investing activities</u>		
<u>Financing activities</u>		
Loan repayment	(6,003,000)	(11,592,000)
Finance cost payments	(656,080)	(2,030,750)
Dividends paid	(5,816,034)	(5,847,230)
	<u>(12,475,114)</u>	<u>(19,469,980)</u>
<u>Net cash flows used in financing activities</u>		
(Decrease) increase in cash and cash equivalents	<u>(13,117,272)</u>	<u>7,284,551</u>
Cash and cash equivalents at January 1	<u>19,011,167</u>	<u>11,726,616</u>
Cash and cash equivalents at December 31	<u><u>5,893,895</u></u>	<u><u>19,011,167</u></u>

The attached notes 1 to 27 form part of these consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010

1. General

Palestine Electric Company - Public Shareholding Company Limited (PEC/the Company) located in Gaza - Palestine was established and registered in Gaza on December 14, 1999, under registration number (563200971) in accordance with the Companies' Law of 1929.

The main objectives of PEC are to establish electricity generating plants in the territories of the Palestinian National Authority (PNA) and to carry out all the operations necessary for the production and generation of electricity.

Gaza Power Generating Private Limited Company (GPGC/the subsidiary) has an exclusive right from PNA to provide capacity and generate electricity in Gaza for the benefit of entities owned or controlled by the PNA for 20 years following commercial operation of its power plant with the opportunity to continue for up to two additional consecutive five-year periods. Commercial operation started on March 15, 2004.

The Company is considered a subsidiary of Palestine Power Private Limited Company (PPP). PPP owns % 64.99 of the Company's share capital. The financial statements of the Company are consolidated with the financial statements of PPP.

The consolidated financial statements were authorized for issuance by the Company's board of directors on March 15, 2011.

2. Consolidated Financial Statements

The consolidated financial statements comprise the financial statements of the Company and its wholly owned subsidiary, GPGC, as at December 31, 2010. GPGC was established in Gaza as a private shareholding limited company, with an authorized share capital of 6,000,000 shares of U.S. \$ 10 par value each.

A subsidiary is a company over which PEC exercises control over the financial and operational policies.

3.1 Basis of Preparation

The consolidated financial statements of the Company and its subsidiary have been prepared in accordance with International Financial Reporting Standards as issued by International Accounting Standard Board (IASB).

The consolidated financial statements have been presented in U.S. Dollar, which is the functional currency of the Company

The consolidated financial statements have been prepared under the historical cost convention.

3.2 Basis of Consolidation

The financial statements of the subsidiary, GPGC, are prepared for the same reporting year as the Company, using consistent accounting policies.

A subsidiary is fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continues to be consolidated until the date that such control ceases.

All intra-company balances, transactions, income and expenses and profits and losses resulting from intra-company transactions that are recognized in assets, are eliminated in full.

3.3 Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except that the Company has adopted the following new and amended IFRSs during the year. Adoption of these revised standards did not have any effect on the financial performance or position of the Company.

IFRS 3 - Business Combinations (Revised)

IAS 27 - Consolidated and Separate Financial Statements (Amendment)

The following IFRSs have been issued but are not yet mandatory, and have not been adopted by the Company:

IFRS 9 - Financial Instruments

IAS 24 - Related Party Disclosures (Revised)

3.4 Estimates and Assumptions

The preparation of the financial statements in conformity with IFRS requires the use of accounting estimates and assumptions. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The Company's management continually evaluates its estimates, assumptions and judgments based on available information and experience. As the use of estimates is inherent in financial reporting, actual results could differ from these estimates.

Useful lives of tangible and intangible assets

The Company's management reassesses the useful lives of tangible and intangible assets, and make adjustments if applicable, at each financial year end.

Impairment of accounts receivable

When the Company has objective evidence that it will not be able to collect certain debts, estimates, are used in determining the level of debts that the Company believes will not be collected.

The Company's management believes that the estimates and assumptions used are reasonable.

3.5 Summary of Significant Accounting Policies

Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

Capacity charges

Capacity charge revenues from the use of the power plant are recognized during the period in which electricity is available according to the power purchase agreement signed with PENRA. This results in revenue recognition approximating the straight-line requirements of IAS (17) on leases.

The Company applies IFRIC (4) which relates to arrangements that do not take the legal form of a lease but convey the right to use an asset in return for a payment or a series of payments. An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

- The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
- The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
- Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

As the Palestinian Energy and Natural Resources Authority (PENRA) is the sole purchaser of the electricity generated from power plant at a price other than at market price and the price varies other than in response to market price changes, this variability is regarded by IFRIC (4) as capacity payments are being made for the right to use the power plant. Hence, such arrangement is accounted for in accordance with IAS (17) on leases. The power purchase agreement does not transfer substantially all the risks and rewards incidental to the Company's ownership of the power plant to PENRA. Therefore, the Company considered the arrangement of the power plant agreement as an operating lease and electrical capacity charges from the use of power plant to generate electricity as rental payment.

Interest revenues

Interest revenue is recognized as interest accrues using the effective interest method using the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

Government grants and assistance

A government's grant and assistance that becomes receivable as compensation for expenses or losses incurred for the purpose of giving immediate financial support to the entity with no future related costs shall be recognized as income for the period in which it becomes available.

Government grants and assistance are recognized where there is a reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognized as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

A government's grant and assistance in the form of a transfer of a non-monetary asset, which is intended for use of the entity, is recognized at fair value of that asset. Fair value is the amount for which an asset could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transactions.

Expense recognition

Expenses are recognized when incurred in accordance with the accrual basis of accounting.

Finance costs

Finance costs are recognized as an expense when incurred. Finance costs consists of interest using the effective interest method and other costs incurred in connection with borrowing of funds.

Property, plant and equipment

Property, plant and equipment is stated at cost, net of accumulated depreciation and/or accumulated impairment losses, if any. Such cost includes the cost of replacing part of the property, plant and equipment and borrowing costs for long-term construction projects if the recognition criteria are met. All other repair and maintenance costs are recognized in the consolidated income statement as incurred. Depreciation is calculated on a straight line basis over the estimated useful lives of the assets as follows:

	Useful lives (Years)
Power plant	20
Building	20
Motor vehicles	5
Computers and printers	4
Office equipment	4
Furniture and fixture	5

Any item of property, plant, and equipment and any significant part initially recognized is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated income statement when the asset is derecognized.

The assets' residual values, useful lives and methods of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

Intangible assets

Intangible assets acquired through government grant and assistance are initially measured at fair value. Following initial recognition, intangible assets are carried net of any accumulated amortization and any accumulated impairment losses.

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated income statement in the expense category consistent with the function of the intangible asset.

Right to use PENRA's transformers

Right to use PENRA's transformers is amortized using the straight-line method over a period equals the remaining useful life of the Power Plant at the time of acquiring the right to use these transformers being 17.5 years. Amortization expense is recognized in the consolidated income statement.

Fair values

For investments traded in an active market, fair value is determined by reference to quoted market bid prices at the close of business on the financial statements date.

The fair value of interest-bearing items is estimated based on discounted cash flows using interest rates for items with similar terms and risk characteristics.

For unquoted equity investments, fair value is determined by reference to the market value of a similar investment or is based on the expected discounted cash flows.

Impairment and uncollectibility of financial assets

An assessment is made at each statement of financial position date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognized in the consolidated income statement. Impairment is determined as follows:

- For assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognized in the consolidated income statement;
- For assets carried at cost, impairment is the difference between carrying value and the present value of future cash flows discounted at the current market rate of return for a similar financial asset;
- For assets carried at amortized cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective interest rate.

Materials and inventories

Materials and inventories are stated at the lower of cost using the weighted average method or net realizable value. Costs are those amounts incurred in bringing each item of materials and inventories to its present location and condition.

Accounts receivable

Accounts receivable are stated at original invoice amount less a provision for any impaired amounts. An estimate for impaired accounts receivable is made when collection of the full amount is no longer probable. Bad debts are written off when there is no possibility of recovery.

Investment in an associate

The Company's investment in its associates is accounted for using the equity method. An associate is an entity in which the Company has significant influence.

Under the equity method, the investment in the associates is carried in the statement of financial position at cost plus post acquisition changes in the Company's share of net assets of the associates.

The consolidated income statement reflects the share of the results of operations of the associates. Unrealized gains and losses resulting from transactions between the Company and the associates are eliminated to the extent of the interest in the associates.

The financial statements of the associates are prepared for the same reporting period as the Company. Where necessary, adjustments are made to bring the accounting policies in line with those of the Company.

Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash on hand, bank balances, and short-term deposits with an original maturity of three months or less net of restricted bank deposits.

Loans

After initial recognition, interest bearing loans are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the consolidated income statement when the liabilities are derecognized as well as through the effective interest rate method (EIR) amortization process.

Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR. The EIR amortization is included in finance cost in the consolidated income statement.

Accounts payable and accruals

Liabilities are recognized for amounts to be paid in the future for goods or services received, whether billed by the supplier or not.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

Provision for employees' indemnity

Provision for employees' indemnity is calculated in accordance with the labor law prevailing in Palestine, and the Company's internal policies, based on one-month salary for each year of employment.

Foreign currency

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the financial statements date. All differences are recognized to the consolidated income statement.

4. Property, Plant and Equipment

	Power plant	Building	Motor vehicles	Computers and printers	Office equipment	Furniture and fixture	Total
	U.S. \$	U.S. \$	U.S. \$	U.S. \$	U.S. \$	U.S. \$	U.S. \$
2010							
Cost							
At January 1, 2010	135,440,605	1,464,904	440,392	271,470	138,197	188,194	137,943,762
Additions	-	-	-	15,647	-	6,976	22,623
At December 31, 2010	<u>135,440,605</u>	<u>1,464,904</u>	<u>440,392</u>	<u>287,117</u>	<u>138,197</u>	<u>195,170</u>	<u>137,966,385</u>
Accumulated Depreciation							
At January 1, 2010	46,164,020	338,154	184,120	228,844	122,539	173,326	47,211,003
Depreciation charges for the year	6,772,015	73,248	73,153	23,623	5,236	11,547	6,958,822
At December 31, 2010	<u>52,936,035</u>	<u>411,402</u>	<u>257,273</u>	<u>252,467</u>	<u>127,775</u>	<u>184,873</u>	<u>54,169,825</u>
Net carrying amount							
At December 31, 2010	<u>82,504,570</u>	<u>1,053,502</u>	<u>183,119</u>	<u>34,650</u>	<u>10,422</u>	<u>10,297</u>	<u>83,796,560</u>
2009							
Cost							
At January 1, 2009	135,440,605	1,464,904	290,392	265,097	126,087	188,194	137,775,279
Additions	-	-	150,000	6,373	12,110	-	168,483
At December 31, 2009	<u>135,440,605</u>	<u>1,464,904</u>	<u>440,392</u>	<u>271,470</u>	<u>138,197</u>	<u>188,194</u>	<u>137,943,762</u>
Accumulated Depreciation							
At January 1, 2009	39,392,000	265,001	123,498	190,181	118,972	156,110	40,245,762
Depreciation charges for the year	6,772,020	73,153	60,622	38,663	3,567	17,216	6,965,241
At December 31, 2009	<u>46,164,020</u>	<u>338,154</u>	<u>184,120</u>	<u>228,844</u>	<u>122,539</u>	<u>173,326</u>	<u>47,211,003</u>
Net carrying amount							
At December 31, 2009	<u>89,276,585</u>	<u>1,126,750</u>	<u>256,272</u>	<u>42,626</u>	<u>15,658</u>	<u>14,868</u>	<u>90,732,759</u>

Property, plant and equipment include U.S. \$ 550,574 and U.S. \$ 392,708 of fully depreciated assets as at December 31, 2010 and 2009, respectively, which are still used in the Company's operations.

5. Intangible Asset

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Balance, beginning of the year	1,846,784	1,976,384
Amortization	<u>(129,600)</u>	<u>(129,600)</u>
Balance, end of year	<u>1,717,184</u>	<u>1,846,784</u>

Intangible asset represents the Company's right to use PENRA's four step-up transformers installed on October 1, 2006 for use by GPGC as part of the agreement made on September 2, 2006 between GPGC and PENRA. According to the agreement, PENRA would rectify all damages within the power plant resulted from the Israeli air strike during June 2006 to restore the power supply from the power plant by agreeing to purchase and install six step-up transformers to replace GPGC's destroyed transformers. These transformers will be owned by PENRA; and GPGC will have the right to use such transformers and will be responsible for their operation and maintenance. The right to use the transformers was initially recognized at the fair value of the four step-up transformers already installed, amounted to U.S. \$ 2,267,984.

6. Prepayments

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Land lease *	141,663	283,330
Legal fees **	164,912	494,736
	<u>306,575</u>	<u>778,066</u>

* The amount represents prepaid lease of the land on which the power plant is constructed. The land lease agreement was signed on November 25, 1999. The duration of the agreement is 30 years and may be further extended for an additional 10 years period. GPGC paid U.S. \$ 1,700,000 for the first 12 years of the lease period after which the lease payments are fixed at U.S. \$ 147,000 annually for the remaining 18 years totaling U.S.\$ 2,646,000. Movement on prepaid land lease is as follows:

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Balance, beginning of the year	283,330	424,997
Amortization of land lease for the year	<u>(141,667)</u>	<u>(141,667)</u>
Balance, end of year	<u>141,663</u>	<u>283,330</u>

** This item represents the legal fees paid in relation with the long term loan. The fees are amortized over the loan original term of 11 years starting July 1, 2000. Amortization of legal fees is accounted for as finance costs.

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Balance, beginning of the year	494,736	824,560
Amortization for the year	<u>(329,824)</u>	<u>(329,824)</u>
Balance, end of year	<u>164,912</u>	<u>494,736</u>

7. Investment in an Associate

The Company together with other investors worked on establishing Palestine Power Generating Company, public shareholding company (the associate) in the West Bank with an initial share capital of U.S. \$ 2,000,000 with an intention to increase the capital to U.S. \$ 120,000,000 during the development of the power plant project intended to establish. The board of directors of the Company agreed to invest in 41% of the share capital of the associate.

Company's share of the associate's assets and liabilities is as follows:

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Non-current assets	<u>180,595</u>	-
Current assets	<u>159,622</u>	-
Non-current liabilities	<u>5,093</u>	-
Current liabilities	<u>273,797</u>	-

Company's share of the associate's revenues and results of operations for the year is as follows:

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Revenue	-	-
Results of operations	<u>92,423</u>	-

8. Materials and Inventories

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Spare parts	5,217,648	4,808,423
Consumables	212,000	136,530
Goods in transit	819,432	313,082
Others	<u>17,468</u>	<u>11,354</u>
	<u>6,266,548</u>	<u>5,269,389</u>

9. Accounts Receivable

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Accounts receivable from capacity charges	25,845,791	5,964,857
Force majeure government assistance receivable (note 19)	<u>3,548,533</u>	<u>3,677,479</u>
	29,394,324	9,642,336
Impairment of accounts receivable	<u>(6,756,132)</u>	-
	<u>22,638,192</u>	<u>9,642,336</u>

Impaired account receivable amounted to U.S \$ 12,605,449 as of December 31, 2010.

The aging analysis of the unimpaired accounts receivable as at December 31, 2010 and 2009 is as follows:

	Total	Neither past due nor impaired	Past due but not impaired			
			Less than 30 days	30-60 days	60-120 days	More than 120 days
			U.S.\$	U.S.\$	U.S.\$	U.S.\$
2010	<u>16,788,875</u>	<u>2,555,510</u>	<u>4,165,562</u>	<u>5,066,403</u>	<u>5,001,400</u>	<u>-</u>
2009	<u>9,642,336</u>	<u>2,465,211</u>	<u>3,677,479</u>	<u>-</u>	<u>-</u>	<u>3,499,646</u>

Unimpaired receivables are expected, on the basis of past experience, to be fully recoverable. All GPGC capacity charges revenue from the use of power plant is generated from one customer, PENRA. According to the power purchase agreement, PENRA is required to provide GPGC with a letter of credit of U.S. \$ 20,000,000 from a qualified bank as defined in the agreement. To the date of these financial statements, PENRA has not provided GPGC with the letter of credit, therefore, accounts receivable are unsecured.

10. Other Current Assets

	2010	2009
	U.S. \$	U.S. \$
Due from PENRA *	1,133,992	1,133,992
Value Added Tax receivable	162,015	6,169
Due from shareholders	572,478	4,385,411
Due from an associate	61,737	70,000
Prepaid insurance	386,372	420,669
Advances to suppliers	1,453,147	680,248
Others	49,322	33,119
	<u>3,819,063</u>	<u>6,729,608</u>

* The amount represents the fair value of the two remaining transformers that PENRA is committed to supply and install in accordance with the agreement signed between GPGC and PENRA on September 2, 2006 (note 5). PENRA has made a commitment to supply and install the two transformers as soon as the situation in Gaza permits.

11. Cash and Bank Accounts

	2010	2009
	U.S. \$	U.S. \$
Cash on hand	9,000	19,365
Current accounts at banks in U.S. \$	5,884,895	18,991,802
	<u>5,893,895</u>	<u>19,011,167</u>

12. Paid-in Share Capital

	<u>2010</u>	<u>2009</u>
	<u>U.S. \$</u>	<u>U.S. \$</u>
Authorized share capital	<u>60,000,000</u>	<u>60,000,000</u>
Subscribed share capital	<u>60,000,000</u>	<u>60,000,000</u>
Paid-in share capital	<u>60,000,000</u>	<u>60,000,000</u>

The share capital of the Company comprises 60,000,000 ordinary shares at par value equal U.S. \$ 1 for each share.

13. Statutory Reserve

The amount represents cumulative transfers of 10% of profits to statutory reserve in accordance with the Companies' Law.

14. Long Term Loan

On June 26, 2000, GPGC signed an agreement with Arab Bank P.L.C. for a long term loan of U.S. \$ 90,000,000. On November 16, 2003, GPGC signed a restatement and amendment agreement with the Arab Bank related to the long term loan and to obtain a working capital facility of U.S. \$ 3,000,000. According to this agreement, Arab Bank and GPGC agreed that the long term loan will be repaid over 19 semi-annual installments the first of which started on December 31, 2004 and the last installment due on December 31, 2013. These installments are based on predetermined percentage of the loan amount. Further, the interest rate on the long term loan was reduced to six month LIBOR plus 2.25%.

Interest rate was further reduced during 2008 to six month LIBOR plus 2% effective from December 31, 2007.

Payment schedule of the loan is as follows:

	<u>U.S. \$</u>
Due	<u>6,003,000</u>
2011	<u>12,600,000</u>
2012	<u>12,510,000</u>
2013	<u>9,432,000</u>
	<u>40,545,000</u>

As a collateral for the loan, Arab Bank has a security pledge over all GPGC's assets and all of GPGC's shares owned by PEC. PEC's shares traded in Palestine Exchange are not part of this security pledge.

The main financial covenants of the loan agreement include keeping certain financial ratios before any distribution of dividends is approved, maintaining current corporate existence of the Company, investing only in assets allowed by the loan agreement and not incurring indebtedness unless previously approved by Arab Bank.

15. Provision for Employees' Indemnity

Movement on the provision for employees' end of service indemnity during the year was as follows:

	<u>2010</u>	<u>2009</u>
	<u>U.S. \$</u>	<u>U.S. \$</u>
Balance, beginning of the year	1,407,972	1,238,820
Additions	413,058	328,705
Payments	(25,844)	(159,553)
Balance, end of year	<u>1,795,186</u>	<u>1,407,972</u>

16. Other Current Liabilities

	<u>2010</u>	<u>2009</u>
	<u>U.S. \$</u>	<u>U.S. \$</u>
Due to maintenance contractor	-	4,277,144
Accrued loan interest	572,394	-
Provision for maintenance	1,798,623	2,735,487
Dividends payable	2,020,247	1,836,281
Due to Consolidated Contractors Company	55,568	34,023
Due to United Engineering Services S.A.	-	160,000
Payroll income tax *	503,225	503,225
Accrued expenses	95,192	143,036
Provision for employees' vacations	219,126	186,985
Other provisions	1,177,256	1,191,562
	<u>6,441,631</u>	<u>11,067,743</u>

* The Company did not withhold income tax on employees salaries based on the presidential decree issued on June 26, 2007 exempting all tax payers of southern governorates (Gaza Strip) from taxes.

17. Capacity Charges

The amount represents revenues from capacity charges invoices issued by GPGC for the use of power plant to generate electric capacity for the benefit of PENRA according to the power purchase agreement, which is considered an operating lease under IFRIC (4) as further explained in accounting policies note (3.5).

Capacity charges are materially straight-line over the life of the plant which results in revenue recognition approximating the straight-line requirements of IAS (17) on leases. According to the agreement, PENRA shall pay for all the electric capacity available from the use of GPGC's power plant, regardless of the extent to which PENRA can absorb that capacity, for a predetermined price set out in the power purchase agreement for each operating year. In addition, PENRA shall, at all times, supply and deliver all the fuel required to generate the power needed.

18. Operating Expenses

	<u>2010</u>	<u>2009</u>
	<u>U.S. \$</u>	<u>U.S. \$</u>
Salaries and wages	4,149,777	3,852,740
Employees' indemnity	413,058	328,705
Board of directors remuneration	164,500	169,500
Employees' insurance	125,186	108,315
Development and technical advisory services	2,284,845	2,553,000
Travel and transportation	488,991	526,267
Power plant insurance	799,009	798,622
Power plant operation and maintenance	4,296,896	9,034,821
Depreciation	6,958,822	6,965,241
Amortization of intangible asset	129,600	129,600
Amortization of land lease	141,667	141,667
Professional and consultancy expenses	390,499	395,233
Telephone and fax	101,918	118,872
Legal fees	20,520	21,142
Palestine Exchange listing fee	24,874	25,222
Office supplies	84,747	87,068
Advertisements	281,185	26,834
Security service costs	622,229	1,586,344
Miscellaneous	479,406	285,384
	<u>21,957,729</u>	<u>27,154,577</u>

19. Force Majeure Government Assistance

The item represents financial assistance provided from PENRA to GPGC to cover force majeure events that caused GPGC to incur maintenance costs as results of the political and security situation in Gaza. GPGC received U.S. \$ 3,128,036 during the year and an amount of U.S. \$ 3,548,533 is receivable as of December 31, 2010 (note 9).

20. Basic and Diluted Earnings Per Share

	<u>2010</u>	<u>2009</u>
	<u>U.S. \$</u>	<u>U.S. \$</u>
Profit for the year	<u>6,782,383</u>	<u>6,983,425</u>
	<u>Shares</u>	<u>Shares</u>
Weighted average of subscribed share capital during the year	<u>60,000,000</u>	<u>60,000,000</u>
	<u>U.S. \$</u>	<u>U.S. \$</u>
Basic and diluted earnings per share	<u>0.11</u>	<u>0.12</u>

Basic earnings per share is calculated by dividing profit for the year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the profit attributable to ordinary equity holders of the Company (after adjusted for income or expenses associated with the dilutive potential shares) by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares

21. Dividends

PEC's general assembly, in its meeting held on April 25, 2010, approved the proposed dividends distribution by the Company's board of directors of U.S. \$ 6,000,000 for the year 2009, the equivalent of 10% of paid-in share capital.

PEC's general assembly, in its meeting held on April 25, 2009, approved the proposed dividends distribution by the Company's board of directors of U.S. \$ 6,000,000 for the year 2008, the equivalent of 10% of paid-in share capital.

22. Related Party Transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of PEC and GPGC, and companies of which they are principal owners. Pricing policies and terms of these transactions are approved by PEC's board of directors.

Balances with related parties included in the consolidated statement of financial position are as follows:

	<u>Nature of relation</u>	<u>2010</u>	<u>2009</u>
		<u>U.S. \$</u>	<u>U.S. \$</u>
Cash at Arab Bank	Major shareholder	<u>5,884,895</u>	<u>18,991,802</u>
Receivable from shareholder	Major shareholder	<u>572,478</u>	<u>4,385,411</u>
Due from an associate	Associate	<u>61,737</u>	<u>70,000</u>
Arab Bank long term loan	Major shareholder	<u>40,545,000</u>	<u>46,548,000</u>
Accrued interest loan	Major shareholder	<u>572,394</u>	<u>-</u>
Payable to Consolidated Contractors Company	Major shareholder	<u>55,568</u>	<u>34,023</u>
Payable to United Engineering Services S.A.	Sister company	<u>-</u>	<u>160,000</u>

The consolidated income statement includes the following transactions with related parties:

	<u>Nature of relation</u>	<u>2010</u>	<u>2009</u>
		<u>U.S. \$</u>	<u>U.S. \$</u>
Arab Bank finance cost	Major shareholder	<u>1,492,541</u>	<u>2,030,750</u>
Development and technical advisory services charged by United Engineering Services S.A	Sister company	<u>2,284,845</u>	<u>2,553,000</u>
Consulting and service fee charged by Consolidated Contractors Company	Major shareholder	<u>564,000</u>	<u>564,000</u>

Compensation of key management personnel:

Salaries and wages	<u>613,835</u>	<u>602,075</u>
Employees' end of service benefits	<u>41,046</u>	<u>39,318</u>
Board of directors remuneration	<u>164,500</u>	<u>169,500</u>

23. Income Tax

The PNA has agreed to exempt GPGC and its shareholders (with respect to dividends and earnings from GPGC), for the term of the agreement of 20 years including any extensions thereof, from all Palestinian taxes.

24. Commitments and Contingencies

Commitments and contingencies represent the following:

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Long term maintenance service agreement *	12,200,969	11,848,417
Land lease agreement (note 6)	2,646,000	2,646,000
Unpaid and unsubscribed shares in an associate capital	615,000	820,000
	<u>15,461,969</u>	<u>15,314,417</u>

* The Company has a commitment resulted from the long term maintenance service agreement which represents the difference between the contract gross amount of Swedish Krona (SEK) 179,000,000 and the executed portion of the contract at the financial statements date. The unexecuted portion of the contract amounted to SEK 86,266,813 and SEK 89,500,000 as of December 31, 2010 and 2009, respectively.

Future minimum capacity charge expected to be receivable under the power purchase agreement for the use of power plant in effect as of December 31, 2010 and 2009 were as follows:

	<u>2010</u>	<u>2009</u>
	U.S. \$	U.S. \$
Within one year	29,890,896	29,622,024
After one year and up to five years	122,416,726	121,258,416
More than five years	268,907,906	299,957,112
	<u>421,215,528</u>	<u>450,837,552</u>

25. Fair Values of Financial Instruments

Financial instruments comprise of financial assets and financial liabilities. Financial assets consist of cash and bank accounts, accounts receivable and some other current assets. Financial liabilities consist of long term loan and some other current liabilities.

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

26. Risk Management

The Company's principal financial liabilities comprise long term loan and some other current liabilities. The main purpose of these financial liabilities is to raise finance for the Company's operations. The Company has various financial assets such as accounts receivable, cash and bank accounts, and some other current assets which arise directly from the Company's operations.

The main risks arising from the Company's financial instruments are interest rate risk, credit risk, liquidity risk, and foreign currency risk. The Company's Board of Directors reviews and approves policies for managing these risks which are summarized below.

Interest rate risk

The following table demonstrates the sensitivity of the consolidated income statement to reasonably possible changes in interest rates as of December 31, 2010, with all other variables held constant.

The sensitivity of the consolidated income statement is the effect of the assumed changes in interest rates on the Company's profit for one year, based on the floating rate of financial assets and financial liabilities at December 31, 2010 and 2009. There is no direct impact on the Company's equity. The effect of decrease in interest rate is expected to be equal and opposite to the effect of increases shown below:

	<u>Increase in interest rate Basis points</u>	<u>Effect on profit for the year U.S. \$</u>
2010		
U.S. Dollar	+10	(40,545)
2009		
U.S. Dollar	+10	(46,548)

Credit risk

The Company is currently exposed to credit risk as all the revenues of its subsidiary from the use of the power plant to generate electric capacity is generated from one customer, PENRA. PENRA has not provided the Company's subsidiary with required letter of credit of U.S. \$ 20,000,000 as required by the power purchase agreement.

With respect to credit risk arising from the other financial assets, the Company's exposure to credit risk arises from the possibility of default of the counterparty, with a maximum exposure equal to the carrying amount of these other financial assets.

Liquidity risk

PEC and of its subsidiary limit their liquidity risk by ensuring bank facilities are available and by maintaining adequate cash balances to meet their current obligations and to finance its operating activities and by following up on the collection of accounts receivable from PENRA. The table below summarizes the maturity profile of the Company's financial liabilities at December 31, 2010 and 2009 based on contractual undiscounted payments.

	<u>Less than 3 Months U.S.\$</u>	<u>3 to 12 months U.S.\$</u>	<u>More than 1 year up to 5 years U.S.\$</u>	<u>Total U.S.\$</u>
December 31, 2010				
Long term loan	6,003,000	13,649,632	22,938,373	42,591,005
Other current liabilities	640,108	2,280,549	-	2,920,657
	<u>6,643,108</u>	<u>15,930,181</u>	<u>22,938,373</u>	<u>45,511,662</u>
December 31, 2009				
Long term loan	-	13,353,764	36,314,831	49,668,595
Other current liabilities	4,688,826	1,927,791	-	6,616,617
	<u>6,616,617</u>	<u>15,281,555</u>	<u>36,314,831</u>	<u>56,285,212</u>

Foreign currency risk

The table below indicates the Company's foreign currency exposure, as a result of its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the U.S. \$ currency rate against foreign currencies, with all other variables held constant, on the consolidated income statement. The effect of decrease in foreign currency exchange rate is expected to be equal and opposite to the effect of increases shown below:

	Increase in EURO rate to U.S.\$ <u> %</u>	Effect on profit for the year <u> U.S.\$</u>	Increase in ILS rate to U.S.\$ <u> %</u>	Effect on profit for the year <u> U.S.\$</u>	Increase in SEK rate to U.S.\$ <u> %</u>	Effect on profit for the year <u> U.S.\$</u>
<u>2010</u> U.S.\$	+10	(20,331)	+10	(71,976)	+10	579,035
<u>2009</u> U.S.\$	+10	(29,862)	+10	(29,361)	+10	413,528

Capital management

The primary objective of the Company's capital management is to ensure that it maintains healthy capital ratios in order to support its business and maximize shareholder value.

The Company manages its capital structure and makes adjustments to it in light of changes in business conditions. No changes were made in the objectives, policies or processes during the years ended December 31, 2010 and 2009. Capital comprises paid-in share capital, statutory reserve and retained earnings, and is measured at U.S. \$ 75,768,777 and U.S. \$ 74,986,394 as at December 31, 2010 and 2009, respectively.

27. Concentration of Risk in Geographic Area

PEC and of its subsidiary are carrying out all of their activities in Gaza. Assets, which mainly comprise property, plant and equipment, are located in Gaza. The political and economical situation in the area increases the risk of carrying out business and could adversely affect their performance and impacts the recoverability of their assets from operation.