

HALF THE SKY FOUNDATION AND SUBSIDIARY

**Consolidated Financial Statements
December 31, 2007 and 2006**

**Together with
Independent Auditors' Report**

HALF THE SKY FOUNDATION AND SUBSIDIARY

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Half the Sky Foundation and Subsidiary
Berkeley, California

We have audited the accompanying consolidated statement of financial position of Half the Sky Foundation and Subsidiary, as of December 31, 2007 and 2006, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Half the Sky Foundation (Asia) Limited, a wholly owned subsidiary, which reflect total assets of approximately \$224,000 and \$200,000 as of December 31, 2007 and 2006, respectively, and total revenues of approximately \$981,000 and \$240,000, respectively, for the years then ended. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for Half the Sky Foundation (Asia) Limited, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Half the Sky Foundation and Subsidiary, as of December 31, 2007 and 2006, and the related consolidated statements of activities and changes in net assets and of cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



San Jose, California
July 11, 2008

HALF THE SKY FOUNDATION AND SUBSIDIARY
Consolidated Statement of Financial Position

ASSETS

	December 31,	
	2007	2006
Assets:		
Cash and cash equivalents	\$ 1,606,712	\$ 906,893
Cash, other	6,916	472,495
Pledges receivable, net	1,572,431	2,142,883
Other receivables	253,053	357
Investments	815,085	545,117
Prepaid program expenses	6,773	34,393
Property and equipment, net	18,521	13,582
Inventory	101,001	141,305
Deposits	<u>24,191</u>	<u>14,509</u>
Total assets	<u>\$ 4,404,683</u>	<u>\$ 4,271,534</u>

LIABILITIES AND NET ASSETS

Liabilities:		
Accounts payable	\$ 66,949	\$ 28,643
Accrued expenses	<u>3,420</u>	<u>13,952</u>
Total liabilities	<u>70,369</u>	<u>42,595</u>
Commitments		
Net assets:		
Unrestricted	1,443,397	1,111,708
Designated by the Board for endowment	<u>209,394</u>	<u>150,000</u>
Total unrestricted net assets	1,652,791	1,261,708
Temporarily restricted	2,106,354	2,432,668
Permanently restricted	<u>575,169</u>	<u>534,563</u>
	<u>4,334,314</u>	<u>4,228,939</u>
Total liabilities and net assets	<u>\$ 4,404,683</u>	<u>\$ 4,271,534</u>

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

HALF THE SKY FOUNDATION AND SUBSIDIARY
Consolidated Statement of Activities and Changes in Net Assets

	For the Years Ended December 31,							
	2007				2006			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains, and other support:								
Contributions	\$ 2,175,622	\$ 1,855,933	\$ 40,606	\$ 4,072,161	\$ 1,964,455	\$ 2,609,892	\$ 264,098	\$ 4,838,445
Contributed services and materials	157,537	-	-	157,537	89,742	-	-	89,742
Merchandise sales	46,725	-	-	46,725	73,881	-	-	73,881
Investment income	93,309	-	-	93,309	33,617	-	-	33,617
Net realized and unrealized gains on investments	2,638	-	-	2,638	24,844	-	-	24,844
Net assets released from restriction	2,182,247	(2,182,247)	-	-	980,300	(980,300)	-	-
Total revenues, gains, and other support	4,658,078	(326,314)	40,606	4,372,370	3,166,839	1,629,592	264,098	5,060,529
Expenses:								
Program services	3,483,917	-	-	3,483,917	2,524,699	-	-	2,524,699
Fundraising	335,571	-	-	335,571	273,697	-	-	273,697
Merchandise costs	40,304	-	-	40,304	28,148	-	-	28,148
Management and general	407,203	-	-	407,203	275,037	-	-	275,037
Total expenses	4,266,995	-	-	4,266,995	3,101,581	-	-	3,101,581
Change in net assets	391,083	(326,314)	40,606	105,375	65,258	1,629,592	264,098	1,958,948
Net assets, beginning of year	1,261,708	2,432,668	534,563	4,228,939	1,196,450	803,076	270,465	2,269,991
Net assets, end of year	\$ 1,652,791	\$ 2,106,354	\$ 575,169	\$ 4,334,314	\$ 1,261,708	\$ 2,432,668	\$ 534,563	\$ 4,228,939

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

HALF THE SKY FOUNDATION AND SUBSIDIARY
Consolidated Statement of Cash Flows

	For the Years Ended December 31,	
	2007	2006
Cash flows from operating activities:		
Change in net assets	\$ 105,375	\$ 1,958,948
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	9,379	12,352
Net realized and unrealized gains on investments	(2,638)	(24,844)
Decrease (increase) in assets:		
Cash, other	465,579	(159,891)
Pledges receivable, net	570,452	(1,184,957)
Other receivables	(252,696)	79,580
Prepaid program expenses	27,620	(34,393)
Inventory	40,304	(2,314)
Deposits	(9,682)	(2,059)
Accounts payable	38,306	27,812
Accrued expenses	(10,532)	9,407
Lease payable	-	(5,282)
Net cash provided by operating activities	<u>981,467</u>	<u>674,359</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(14,318)	(2,666)
Purchases of investments	(370,589)	(502,663)
Proceeds from sale of investments	<u>103,259</u>	<u>534,820</u>
Net cash provided (used) by investing activities	<u>(281,648)</u>	<u>29,491</u>
Increase in cash and cash equivalents	699,819	703,850
Cash and cash equivalents, beginning of year	<u>906,893</u>	<u>203,043</u>
Cash and cash equivalents, end of year	<u>\$ 1,606,712</u>	<u>\$ 906,893</u>

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

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2007

Note 1 - Organization and operations:

Half the Sky Foundation (“the Foundation”), a non-profit public benefit corporation was incorporated in November 1998, with its corporate office located in Berkeley, California.

Half the Sky Foundation (Asia) Limited (“Asia Ltd.”), a supporting organization of the Foundation, was incorporated in Hong Kong on March 18, 2006. The consolidated financial statements include the accounts of the Foundation and Asia Ltd.

The Foundation was created in order to enrich the lives and enhance the prospects for orphaned children in China. The Foundation creates and operates infant nurture and early education programs, provides personalized learning for older children, and establishes loving permanent family care and guidance for children whose disabilities prevent them from finding adoptive families. It is the Foundation’s goal to ensure that every orphaned child has a caring adult in her life and a chance at a bright future. The Foundation works in 38 state-run welfare institutions in 13 provinces and municipalities and offers four primary programs:

The Baby Sisters Infant Nurture Program - In this program, designed to give infants 0-18 months a healthy start in life, the Foundation employs “nannies,” retired or laid-off workers from the local community, to cuddle, love and provide orphaned babies (0-2 years) the physical and emotional stimulation essential to normal development. The Foundation renovates rooms in the welfare institutions and provides training, salaries and other program expenses and supervision of staff.

The Little Sisters Preschool Program - In this program, the Foundation-trained teachers use a unique and progressive curriculum that blends principles of the Reggio Emilia approach to early childhood education with contemporary Chinese teaching methods. The program is designed not only to prepare the children (2-7 years) to succeed in Chinese schools, but also to help develop the “whole child”, facilitating healthy emotional and physical development as well as cognitive. The Foundation renovates rooms in the welfare institution and provides training, salaries and other program expenses and supervision of staff.

The Big Sisters Program - In this program, individualized learning opportunities are provided for older children (8-21 years) who remain in the institutions. The Foundation tailors each program to the specific child, offering such services as tutoring prior to entrance exams, tuition to vocational schools, funds for music, dance, computer or art classes, and tutors for learning a second language. The Foundation also provides school fees for a growing number of orphans to attend universities throughout China.

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2007

Note 1 - Organization and operations (continued):

The Family Village Program - In this program, children whose disabilities or special needs preclude adoption, live in permanent foster families in comfortable apartments in or nearby the welfare institution. This program enables children, who will never be adopted, to grow up knowing the love of family while also receiving the support services that the welfare institution and the Foundation programs provide. The children attend the Foundation preschools and then go on to enjoy the enrichment opportunities of the Big Sisters Program. The Foundation partners with local governments to renovate apartments, provides furnishings, a small stipend for foster parents, ongoing training and miscellaneous fees.

The Foundation is a not-for-profit organization that is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and classified by the Internal Revenue Service as other than a private foundation, and is exempt from California franchise taxes under Revenue and Taxation Code Section 23701(d). Asia Ltd. has been granted tax exempt status by the Hong Kong Inland Revenue Department.

Note 2 - Summary of significant accounting policies:

Principles of consolidation - The accompanying consolidated financial statements include the accounts of the Foundation and its supporting organization, Asia Ltd. Inter-organization transactions and balances have been eliminated upon consolidation.

Foreign currency - Assets and liabilities denominated in foreign currencies are translated into United States of America dollars, the reporting currency, at exchange rates in effect on reporting dates, and revenue and expenses are translated at rates which approximate those in effect on transaction dates. A significant amount of the Foundation's expenses were paid for using the Chinese Renminbi for the years ended December 31, 2007 and 2006. Translation gains and losses were not material to the financial statements taken as a whole and therefore are not reflected in the financial statements.

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2007

Note 2 - Summary of significant accounting policies (continued):

Basis of presentation - The consolidated financial statements have been prepared on the accrual basis of accounting which recognizes revenue and support when earned and expenses when incurred and accordingly, reflect all significant receivables, payables, and other liabilities.

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board (“FASB”) in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Foundation is required to report information regarding its financial position and activities according to permanently restricted, temporarily restricted, and unrestricted net assets with the change in each of these classes of net assets to be presented in the consolidated statement of activities and changes in net assets. Unrestricted net assets have no donor-imposed restrictions and include those revenues and expenses associated with program and supporting services. Permanently restricted net assets are restricted by the donor for investment in perpetuity, such as endowments. The income from such invested assets is available to support the activities of the Foundation.

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

Cash and cash equivalents - The Foundation considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Cash, other - The Foundation is unable to maintain a Chinese bank account under their name and has setup two accounts maintained by the Managing Director of Programs. Overseas program operations, such as employee salaries, are funded through wire transfers from the Foundation’s Berkeley office.

Investments - The Foundation invests in marketable securities and money market funds. All debt securities and equity securities are carried at quoted market prices as of the last trading date of the Foundation’s fiscal year. Contributions of public stock are recorded at quoted market prices at the date of donation. The Foundation sells donated securities received as soon as reasonably possible. Gains and losses that result from market fluctuations are recognized in the period such fluctuations occur. Realized gains or losses resulting from sales or maturities are calculated on an adjusted cost basis. Adjusted cost is the estimated fair value of the security at the beginning of the year, or the cost if purchased during the year. Dividend and interest income are accrued when earned.

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2007

Note 2 - Summary of significant accounting policies (continued):

Pledges receivable, net - Pledges receivable are associated with contributions from donors who have pledged funds to be received after the year-end. Pledges that are expected to be collected after one year are evaluated at a discount rate of 5%. Pledges are also evaluated for collectability. Such present value and collectability reserves are recorded only if material to the financial statements.

Other receivables - Other receivables include interest and stock sale settlements.

Inventory - Inventory consists principally of merchandise sold in the Foundation's on-line store and is stated at the lower of weighted average cost or market value.

Property and equipment, net - Acquisitions of property and equipment in excess of \$500 are capitalized. Purchased property and equipment are stated at cost. Significant donated property and equipment are recorded at their estimated fair value on the date of receipt. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to ten years.

Contributed services and materials - Contributed services and materials are recognized in accordance with Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made*. Contributed goods are recorded at estimated fair value at the date of receipt and have been recorded at their estimated fair market value of \$3,823 and \$75,644 for the years ended December 31, 2007 and 2006, respectively. The Foundation received contributed services of pro bono legal services donated in China, for the years ended December 31, 2007 and 2006. The Foundation recorded the legal services at their estimated fair market value of \$53,714 and \$14,098 for the years ended December 31, 2007 and 2006, respectively. During 2007, the Foundation received contributed services for a Director of Development in Hong Kong. The Foundation recorded the contributed service at the estimated fair market value of \$100,000. Due to the nature of government owned locations in the People's Republic of China, within which the Foundation runs operations, the Foundation has not been able to determine a reasonable basis to estimate the fair value of the donated use of facilities for the years ended December 31, 2007 and 2006.

Revenue recognition - Contributed support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other contributed support is recognized as revenue when received or un-conditionally promised. The Foundation reports gifts of cash and other assets as restricted support if such gifts are received with donor stipulations that limit the use of the donated assets. When such restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions.

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2007

Note 2 - Summary of significant accounting policies (continued):

Functional expense allocations - The costs of providing the various program and supporting services have been summarized on a functional basis in the Consolidated Statement of Activities and Changes in Net Assets. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Fair value of financial instruments - Financial instruments included in the Foundation's Consolidated Statement of Financial Position as of December 31, 2007 and 2006 include cash and cash equivalents, investments, receivables, and accrued expenses. For cash and cash equivalents, receivables, and accrued expenses, the carrying amounts represent a reasonable estimate of the corresponding fair values. Investments are reflected in the accompanying Consolidated Statement of Financial Position at their estimated fair values using methodologies described above.

Concentration of credit risk - Financial instruments that potentially subject the Foundation to credit risk consist primarily of cash and cash equivalents, investments, and pledges receivable. The Foundation maintains cash and cash equivalents with commercial banks and other major financial institutions. Cash equivalents include overnight investments, and money market funds. At times, such amounts might exceed Federal Deposit Insurance Corporation ("FDIC") limits. The Foundation's investments have been placed with high quality financial institutions. The Foundation monitors these investments and has not experienced significant credit losses. The credit risk in pledges receivable is mitigated by the fact that the Foundation evaluates the pledges based on the knowledge of the donors. Additionally, any pledges that are expected to be collected after one year have been discounted and are reflected in the consolidated financial statements at their net present value. It is the Foundation's opinion that it is not exposed to any significant credit risks.

Recent accounting pronouncements

Accounting for Uncertainty in Income Taxes - In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, which prescribes a comprehensive model for how an organization should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the organization has taken or expects to take on a tax return. FIN 48 is effective for fiscal periods beginning on or after December 15, 2007. The Foundation is currently in the process of evaluating the effect of FIN 48 on its Consolidated Financial Statements.

HALF THE SKY FOUNDATION AND SUBSIDIARY
Notes to Consolidated Financial Statements
December 31, 2007

Note 2 - Summary of significant accounting policies (continued):

Fair Value Measurements - In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements*, (effective for fiscal years beginning after November 15, 2008). This new standard provides guidance for measuring fair value of assets and liabilities. The Foundation does not anticipate that the adoption of FAS No. 157 will have a material impact on the Foundation's consolidated financial position, results of operations, or cash flows.

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115*, (effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The Foundation is currently evaluating what effect, if any, the adoption of FAS No. 159 will have on the Foundation's Consolidated Financial Statements.

Other accounting standards that have been issued or proposed by FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Foundation's consolidated financial statements upon adoption.

Note 3 - Pledges receivable, net:

Pledges receivable are recorded after discounting the future cash flows to present value using a discount rate of 5%. The maturities of these receivables are as follows:

Years Ending December 31,	Amount
2008	\$ 901,979
2009	342,524
2010	307,524
2011	95,812
2012	10,000
Thereafter	10,000
	<hr/> 1,667,839
Less: discount for present value	<hr/> (95,408)
Total	<hr/> \$ 1,572,431

Amounts related to conditional receivables are \$2,603,335 and \$1,966,000 for the years ended December 31, 2007 and 2006, respectively.

HALF THE SKY FOUNDATION AND SUBSIDIARY
Notes to Consolidated Financial Statements
December 31, 2007

Note 4 - Investments:

The Foundation's investments consisted of the following at December 31:

	<u>2007</u>	<u>2006</u>
Marketable securities	\$ 771,241	\$ 487,321
Certificates of deposit	24,564	39,049
Bonds	<u>19,280</u>	<u>18,747</u>
Total	<u>\$ 815,085</u>	<u>\$ 545,117</u>

The following schedule summarizes the investment returns for the years ended December 31:

	<u>2007</u>	<u>2006</u>
Net realized and unrealized gains	\$ 9,786	\$ 27,426
Investment related expenses	<u>(7,148)</u>	<u>(2,582)</u>
	<u>\$ 2,638</u>	<u>\$ 24,844</u>
Interest and dividend income	<u>\$ 93,309</u>	<u>\$ 33,617</u>

As of December 31, 2007 and 2006, the Board has designated approximately \$209,000 and \$150,000, respectively, for re-investment in the endowment.

Note 5 - Property and equipment, net:

Property and equipment consisted of the following at December 31:

	<u>2007</u>	<u>2006</u>
Equipment	\$ 55,847	\$ 47,549
Furniture and fixtures	<u>16,995</u>	<u>10,975</u>
	<u>72,842</u>	<u>58,524</u>
Less: accumulated depreciation	<u>(54,321)</u>	<u>(44,942)</u>
Property and equipment, net	<u>\$ 18,521</u>	<u>\$ 13,582</u>

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2007

Note 6 - Temporarily restricted net assets:

Temporarily restricted net assets were available for the following purposes at December 31:

	<u>2007</u>	<u>2006</u>
Guangzhou and Shenzhen	\$ 655,172	\$ 953,938
Tianjin and Guangzhou center		
& 8 additional Foster Villages	650,223	719,624
To other programs (Hangzhou)	150,000	-
Shaoguan	112,238	94,592
Maonan	77,184	112,380
Jia Fellowship	74,973	131,873
Chengdu	59,401	-
Blue Sky	48,544	-
Lianyungang	44,951	37,534
Sponsorships	43,146	89,730
Changzhou	37,874	-
Fuzhou	31,581	13,522
Maoming	27,955	83,000
Wuhan	23,438	-
Chenzhou	20,413	-
Chongqing	20,372	-
Yiyang	14,816	20,862
Yueyang	8,205	-
Nanning	5,214	-
Xiangtan	654	17,563
Nanjing	-	54,790
Luoyang	-	29,905
New Harmony	-	28,891
Yibin	-	17,802
Wuzhou	-	13,700
Guangdong	-	10,200
Guangzhou Extension	-	2,762
Total temporarily restricted net assets	<u>\$ 2,106,354</u>	<u>\$ 2,432,668</u>

Net assets of \$2,182,247 and \$980,300 were released from restrictions by incurring expenses satisfying the restricted purposes during the years ended December 31, 2007 and 2006, respectively.

HALF THE SKY FOUNDATION AND SUBSIDIARY
Notes to Consolidated Financial Statements
December 31, 2007

Note 7 - Permanently restricted net assets:

Permanently restricted net assets consist of endowment fund cash and cash equivalents and investments that represent the principal amounts of gifts and bequests accepted with donor stipulation that the principal be maintained intact in perpetuity, with only the income to be utilized for operations.

Note 8 - Commitments:

The Foundation leases an office facility in the United States, an apartment unit in Beijing, People's Republic of China, and an office facility in Hong Kong. The operating leases expire at various dates through February 2010. Rent paid under these leases was approximately \$57,000 and \$58,000, for the years ended December 31, 2007 and 2006.

Years Ending December 31,	Amount
2008	\$ 32,000
2009	32,000
2010	3,000
	<hr/> <hr/>
	\$ 67,000

Subsequent to December 31, 2007, the Foundation entered into a new operating lease for their Beijing office facility under similar terms and conditions.

Note 9 - Affiliated parties:

Half the Sky Foundation Canada (Foundation HTS du Canada) is an independent charitable entity, registered with the Canadian government, which raises funds and makes unrestricted donations to the Foundation.

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2007

Note 10 – Major contributions:

For the year ended December 31, 2007, the Foundation had no donors with contributions of 5% or more of contributions and one donor accounted for 31% of contributions for the year ended December 31, 2006.

Note 11 – Subsequent events:

In early 2008, the Foundation entered into a cooperation agreement with the Ministry of Civil Affairs of the People’s Republic of China (“PRC”) known as the “Blue Sky Plan.” Under this agreement, the Foundation will work with the PRC to establish cooperative model centers and to develop relevant care and education programs in each of the provinces in the PRC.

Half the Sky Foundation (UK) Limited, a supporting organization of the Foundation, was incorporated in England and Wales on April 25, 2008. The tax exempt status by HM Revenue & Customs is currently pending.