

**Non-Government Organization
Micro Development Fund, Belgrade**

**Audit Report on Financial Statements
for the year ended on December 31, 2004**

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for the year ended on December 31, 2004**

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Auditor's Opinion

We have audited the accompanying special purpose financial statements of Non-Government Organization Micro Development Fund, Belgrade, comprising of the Balance Sheet as of December 31, 2004 and the Income Statement for the year then ended.

The financial statements were prepared in accordance with Disclosure Guidelines for Financial Reporting by Microfinance Institutions issued by the Consultative Group to Assist the Poorest (CGAP). In accordance with these guidelines the annual Financial Statements were prepared on the basis of cash receipts and disbursements of donor funds, whereby all cash receipts were recorded as revenue on the date received and all cash disbursements were recorded as expenses on the date paid.

These special purpose financial statements set out on pages 2 to 3 are the responsibility of the Non-Government Organization Micro Development Fund 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 issued by International Federation of Accountants and instructions contained in a Handbook for External Audits of Microfinance Institutions issued by the Consultative Group to Assist the Poorest (CGAP). International Standards on Auditing require that we plan and perform the audit to obtain reasonable assurance about whether the special purpose financial statements are free of material misstatements. An audit includes examining, on a test basis, the evidence supporting the amounts and disclosure in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Management of Micro Development Fund, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion

In our opinion, the special purpose financial statements give true and fair view of the state of Non-Government Organization Micro Development Fund's affairs as of December 31, 2004 and of its results for the year then ended in accordance with Disclosure Guidelines for Financial Reporting by Microfinance Institutions issued by the Consultative Group to Assist the Poorest (CGAP).

June 13, 2005

"MGI AUDITING & ACCOUNTING"

Managing Director

.....
Bogoljub Aleksic,
Certified Auditor



Micro Development Fund

Exchange rate YUD:EUR(31.12.04)

62

78.6473

| Balance Sheet/31.12.2004 | EUR | EUR | EUR | EUR | EUR |
|------------------------------------------------------------|------------------|------------------|----------------|----------------|------------------|
| | 2003 | UN | DA | ICRC | 31.12.04 |
| ASSETS | | | | | |
| <u>Current Assets:</u> | | | | | |
| Cash & Bank Current Accounts | | | | | |
| Bank Current Accounts (UNHCR) | 158,556 | 69,211 | | | 69,211 |
| Bank Current Accounts (DANIDA) | 70,931 | | 12,110 | | 12,110 |
| Other Current Accounts (DANIDA) | 18,694 | | 0 | | 0 |
| Bank Current Accounts (ICRC) | 38,744 | | | 31,633 | 31,633 |
| <u>Loans Outstanding:</u> | | | | | |
| Current(UNHCR) | 938,240 | 994,600 | | | 994,600 |
| Current(DANIDA) | 456,687 | | 578,291 | | 578,291 |
| Current(ICRC) | 11,605 | | | 147,694 | 147,694 |
| Loans Outstanding (Gross) | 1,406,532 | 994,600 | 578,291 | 147,694 | 1,720,585 |
| (Loan Loss Reserve-UNHCR) | (23,456) | (22,876) | | | (22,876) |
| (Loan Loss Reserve-DANIDA) | (9,134) | | (13,301) | | (13,301) |
| (Loan Loss Reserve-ICRC) | (232) | | | (2,954) | (2,954) |
| Net Loans Outstanding | 1,373,710 | 971,724 | 564,990 | 144,740 | 1,681,454 |
| Total Current Assets | 1,660,636 | 1,040,935 | 577,100 | 176,373 | 1,794,408 |
| Long-term Investments | | | | | |
| <u>Fixed Assets</u> | 0 | 0 | 0 | 0 | 0 |
| Cost | | | | | |
| (Accumulated Depreciation) | | | | | |
| Net Fixed Assets | 0 | 0 | 0 | 0 | 0 |
| Other Long-term Assets - deposit in Meridian Bank (Danida) | | | 168,361 | | 168,361 |
| Other Long-term Assets - deposit in Meridian Bank (ICRCa) | | | | 8,866 | 8,866 |
| Total Long-term Assets | 0 | 0 | 168,361 | 8,866 | 177,227 |
| TOTAL ASSETS | 1,660,636 | 1,040,935 | 745,461 | 185,239 | 1,971,635 |
| LIABILITIES | | | | | |
| <u>Current Liabilities:</u> | | | | | |
| Short-term borrowing | | | | | |
| Borrowed loan capital | | 0 | | | |
| Borrowed capital for fixed assets | | 0 | | | |
| Client Savings | | 0 | | | |
| Other Current Liabilities (UNRF) | 0 | 0 | 0 | 0 | 0 |
| Total Current Liabilities | 0 | 0 | 0 | 0 | 0 |
| Long-term Debt: | | | | | |
| Concessional rate | | 0 | | | |
| Commercial rate | | 0 | | | |
| Deferred Revenue | | 0 | | | |
| Other Long-term Liabilities (client ration) | 898 | 0 | | 0 | 0 |
| Total Long-term Liabilities | 898 | 0 | 0 | 0 | 0 |
| TOTAL LIABILITIES | 898 | 0 | 0 | 0 | 0 |
| NET WORTH | | | | | |
| <u>Donated Equity:</u> | | | | | |
| Loan Fund Capital (UNHCR) | 0 | 0 | | | 0 |
| Loan Fund Capital (DANIDA) | 228,948 | | 159,300 | | 159,300 |
| Loan Fund Capital (ICRC) | 50,000 | | | 131,150 | 131,150 |
| Cumulative Grants for Operations(UNHCR) | 555,839 | 424,294 | | | 424,294 |
| Cumulative Grants for Operations(DANIDA) | 263,302 | | 492,250 | | 492,250 |
| Cumulative Grants for Operations(ICRC) | 0 | | | 50,000 | 50,000 |
| Other capital accounts (RF - UN) - cumulative | 219,903 | 171,482 | | | 171,482 |
| <u>Retained Net Surplus/(Deficit):</u> | | | | | |
| Prior Periods | 161,267 | 254,260 | 22,183 | (4,922) | 271,521 |
| Adjustment on Prior Period Retained Net Surplus /(Deficit) | | 207,721 | | | 207,721 |
| Current Period | 180,479 | (16,822) | 71,728 | 9,011 | 63,917 |
| TOTAL NET WORTH | 1,659,738 | 1,040,935 | 745,461 | 185,239 | 1,971,635 |
| TOTAL LIABILITIES + NET WORTH | 1,660,636 | 1,040,935 | 745,461 | 185,239 | 1,971,635 |
| Check: TA = TL + NW ? | 0 | 0 | (0) | 0 | 0 |

Prepared by,

Approved by,

Verified by MGI Auditing and
Accounting,

Micro Development Fund

Average Exchange rate EUR:YUD for 2004

78.6473

72.7913

0.7344

| Income Statement/01.01.04-31.12.04 | EUR | EUR | EUR | EUR | USD |
|-----------------------------------------------|-----------------|----------------|---------------|-----------------|----------------|
| | UN | DA | ICRC | 01.01.-31.12.04 | |
| FINANCIAL INCOME: | | | | | |
| Interest on Current & Past Due Loans (UNHCR) | 252,182 | | | 252,182 | 343,385 |
| Interest on Current & Past Due Loans (DANIDA) | | 119,653 | | 119,653 | 162,926 |
| Interest on Current & Past Due Loans (ICRC) | | | 12,636 | 12,636 | 17,206 |
| Penalties (UNHCR) | 25,176 | | | 25,176 | 34,281 |
| Penalties (DANIDA) | | 7,321 | | 7,321 | 9,969 |
| Penalties (ICRC) | | | 236 | 236 | 321 |
| Loans recovery | 3,363 | 441 | | 3,804 | 5,179 |
| Interest on current assets | | 279 | 205 | 484 | 659 |
| Costs recovery | | 3,472 | | 3,472 | 4,728 |
| Total Financial Income | 280,721 | 131,166 | 13,077 | 424,964 | 578,655 |
| FINANCIAL COSTS: | | | | | |
| Taxes | 14,953 | 8,353 | 1,312 | 24,618 | 33,521 |
| Bank Fees | 180 | 146 | 88 | 414 | 564 |
| Total Financial Costs | 15,133 | 8,499 | 1,400 | 25,032 | 34,084 |
| GROSS FINANCIAL MARGIN | 265,588 | 122,668 | 11,677 | 399,932 | 544,570 |
| Provision for Loan Losses | 27,679 | 14,190 | 2,722 | 44,591 | 60,718 |
| NET FINANCIAL MARGIN | 237,909 | 108,478 | 8,955 | 355,341 | 483,853 |
| OPERATING EXPENSES: | | | | | |
| Salaries and benefits (UR) | 203,101 | | | 203,101 | 276,554 |
| Salaries and benefits (DANIDA) | | 12,968 | | 12,968 | 17,658 |
| Salaries and benefits (ICRC) | | | 6,971 | 6,971 | 9,493 |
| Travel costs (UR) | 16,497 | | | 16,497 | 22,463 |
| Travel costs (DANIDA) | | 515 | | 515 | 701 |
| Travel costs (ICRC) | | | 760 | 760 | 1,035 |
| Office Rent (UR) | 10,895 | | | 10,895 | 14,836 |
| Office Rent (DANIDA) | | 3,780 | | 3,780 | 5,147 |
| Office Rent (ICRC) | | | 915 | 915 | 1,246 |
| Communication costs (UR) | 7,170 | | | 7,170 | 9,764 |
| Communication costs (DANIDA) | | 1,009 | | 1,009 | 1,374 |
| Communication costs (ICRC) | | | 102 | 102 | 139 |
| Services (UR) | 2,477 | | | 2,477 | 3,373 |
| Local staff training (DANIDA) | | 1,731 | | 1,731 | 2,357 |
| Office Supplies (UR) | 4,417 | | | 4,417 | 6,014 |
| Office Supplies (DANIDA) | | 111 | | 111 | 151 |
| Vehicle maintenance (UR) | 8,569 | | | 8,569 | 11,668 |
| Vehicle maintenance (DANIDA) | | 896 | | 896 | 1,220 |
| Office utilities (UR) | 1,605 | | | 1,605 | 2,185 |
| Office utilities (DANIDA) | | 82 | | 82 | 112 |
| Total Operating Expenses | 254,731 | 21,092 | 8,748 | 284,571 | 387,488 |
| NET INCOME FROM OPERATIONS | (16,822) | 87,386 | 206 | 70,770 | 96,364 |
| NO OPERATING EXPENSES: | | | | | |
| Provision for clients (ICRC) | | | 346 | 346 | 471 |
| Total No operating expenses | 0 | 0 | 346 | 346 | 471 |
| Grant Revenues for Operations (ICRC) | | | 9,584 | 9,584 | 13,050 |
| Debt on client account at Meridian Bank | | (15,657) | (434) | (16,091) | (21,910) |
| Grant Revenues for Loan Fund Capital | | 159,300 | 131,150 | 290,450 | 395,493 |
| (- Transfer of Loan Fund Grant to Net Worth) | | (159,300) | (131,150) | (290,450) | (395,493) |
| Excess of Revenues over Expenses | (16,822) | 71,728 | 9,011 | 63,917 | 130,854 |

Prepared by,

Approved by,

Verified by MGI Auditing
and Accounting,

1. Micro Development Fund Establishment, Management and Activity

1.1. Establishment and Management

Non-Governmental Organization Micro Development Fund (Micro Development Fund) was established as a association of citizens on January 23, 2001 and registered with the Federal Ministry of Justice, according to the applicable law.

Since 1997 Danish Refugee Council (hereafter referred to as DRC) has been implementing self-reliance activities in Serbia – initially directly but since 2001 via its captive agency, Micro Development Fund (hereafter referred to as MDF). Since 2001 the capacity of MDF has been progressively enhanced in a gradual process towards independence.

On December 12, 2003, DRC and MDF signed the Memorandum of Understanding that defined the spin-off of the DRC's self-reliance program in Serbia to the MDF.

According to the Memorandum of Understanding, after finalisation of the spin-off process, MDF has taken over full management and ownership of DRC's self-reliance activities and established its independence.

MDF Head Office is located in Belgrade with the address Kneginje Zorke 11a. As of December 31, 2004, MDF has regional offices in the following towns: Niš, Kraljevo and Užice.

Board is the highest governing body of MDF, consists of four Board members with voting power. The Board is represented by the Chairman. Functioning of the Board is defined by the Statute. The Executive Director reports to the Board and votes only in case of the tied vote by the Board. The role of the Board is to monitor the activities, give guidelines, propose changes and help in resolving strategic issues.

The Supervisor is independent control body who reports to the Board. The Supervisor in non-voting advisor to the Board.

Management consists of Executive Director – Ms. Milena Gojković, Finance Manager, Credit Coordinator, Office & HR Manager and two Branch Managers.

MDF has twenty-one employees.

1.2. Activity

MDF has supported improvements in the social and economic living standards of economically active and poor people in Serbia. MDF's target group includes refugee, Internally Displaced Persons, and smaller part of local entrepreneurs. Targeting the entrepreneurs' business ideas for start up or enhancing existing business, MDF supports business initiatives in areas of production, crafts, service and agricultural activities.

During 2004, MDF performed the following Self-reliance programs:

I. Micro Loan Program, with the funds of following donors:

- ◆ United Nations High Commissioner for Refugees (hereafter referred to as UNHCR);
- ◆ Danish International Development Assistance (hereafter referred to as DANIDA);
- ◆ International Committee of the Red Cross (hereafter referred to as ICRC).

Micro Loan Program provides financial support to entrepreneurs with skills and ideas for start up or development of existing business as to create or sustain jobs. The program provides clients with continued access to funding in order to enhance gradual businesses strengthening and secure its sustainability.

Within 2004 year, MDF disbursed 2,105 loans.

II. Vocational Training Program with the financial support of UNHCR.

III. In-kind Grant Program with the financial support of UNHCR.

1.3. The Micro Loan Activities

During 2003, DRC as non-resident INGO had a legal obstacles of activating non-UNHCR funds due to Foreign Currency Law. For the use of UNHCR funds during 2003, DRC had special approval given by National Bank of Serbia, due to the bilateral agreement between UNHCR and the Federal Government. The solution for non-UNHCR funds was found by signing a Contract with Meridian Banka AD, Novi Sad which fulfills all legal requirements of National Bank of Serbia. In 2004, after DRC handed over the programs to MDF, the MDF received better offer (cheaper and operationally easier) by another bank. Therefore MDF signed the Commission Contract with Komercijalna banka AD, Beograd, on February 13, 2004.

Over 2004, the significant number of the loans (2,052 out of 2,105) was issued in cooperation with Komercijalna Banka AD, Beograd.

Operationally, Commission Contracts function in the following way:

- ◆ MDF has opened bank account for the special purpose of disbursement and repayment of the loans (“Commission” account);
- ◆ The micro loans are disbursed from the MDF financial sources;
- ◆ MDF appraises, approves micro loans and then submits the list of approved beneficiaries to Komercijalna Banka AD;
- ◆ Komercijalna Banka AD concludes the contract with each beneficiaries and issues micro loans in its own name but on the behalf of MDF;
- ◆ MDF has the obligation to follow up on the beneficiaries.

During the first two months of 2004 (up to the concluding the Contract with Komercijalna banka AD), MDF issued loans through Meridian Banka AD, Novi Sad, after that only the repayments of the loans issued have been performed through this bank.

All loans are disbursed only through the bank and all loan repayments have to be made in the bank. No cash transactions between loan officers and clients are allowed.

1.4. Description of Donors and Programs

1.4.1. The Micro Loan Program

The MDF Micro Loan Program has been accomplished based on the following contracts that the MDF signed with the following donors:

- ◆ UNHCR - Local Settlement/Self Reliance assistance for refugees and IDPs in Serbia, Income Generating Programme, Sub-Project Symbol: 04/AB/SCG/LS/470;
- ◆ DANIDA - Micro Loan Program;
- ◆ ICRC – Micro- Credit Project;

Local Settlement/Self Reliance assistance for refugees and IDPs in Serbia Income Generating Programme, (Project Symbol: 04/AB/SCG/LS/470) financed by UNHCR is based on Agreement concluded on February 25, 2004 between UNHCR and the MDF. The two Supplementary Agreements were signed during 2004 (the first - on May 11, 2004 and the second on November 23, 2004).

DRC was the budget holder of the UNHCR funds which were used for financing of the micro loan program until December 31, 2003. From January 01, 2004 MDF became direct Implementing Partner of UNHCR in the Income Generating Program. The right of use of the Revolving Fund Capital was transferred from DRC to MDF on January 1, 2004.

According to the Agreement, UNHCR provided the Revolving Loan Fund of the estimated value of CSD 67,632,354 (capitalization in local currency). This included funds which were already collected and deposited in the separate bank accounts (relating to UNHCR funds) of the MDF and other funds which were in the form of payments due from loans provided to the beneficiaries.

The income generated from loans disbursed to clients was used for covering of operational expenses. Surplus remaining after covering of operational expenses belonged to UNHCR and were reinvested into new loan disbursements.

The targeted beneficiaries of the micro-loan program were: refugees, ex-refugees who obtained citizenships as of 1998 and IDPs. However, targeting of all disadvantaged groups, including disadvantaged local population in consultation with UNHCR. The loans are disbursed and repaid in CSD by using EUR as index currency.

On February 2, 2005, the Agreement on Hand Over of the Revolving Fund was signed between UNHCR and MDF. By this Agreement UNHCR transferred to MDF the right of ownership and use of the Revolving Fund. The total amount of the Revolving Fund that was transferred for ownership was equal to CSD 67,329,178 (equivalent to USD 1,100,510 with the applied exchange rate of 61.18). The amount of CSD 67,329,178 included funds which were already collected and deposited in the separate bank accounts (relating to UNHCR funds) of the MDF and other funds which were in the form of payments due from loans provided to the beneficiaries.

“The Micro Loan Program”, financed by DANIDA is based on Self-Reliance Subcontract signed on February 04, 2004 between DRC and MDF, which was based on the Memorandum of Understanding between DRC and MDF (explained in Note 1.1.). This Subcontract was concluded in order to achieve the self-reliance objectives laid out in the current DANIDA funding to MDF Serbia (referred to as UMF-kode 605.1670.02 503-554). DRC and MDF entered into Subcontract agreement from January 01, 2004 to July 31 2004 (following the extension of DANIDA's funding of DRC in Serbia, DRC extended the Subcontract until December 31, 2004).

According to this Subcontract, the right of use of DANIDA sourced microfinance revolving fund was transferred to MDF valued at: gross outstanding portfolio EUR 462,258 and free cash available for loans EUR 89,625 (the figures were defined in EUR currency, by Subcontract).

Over 2004, the fresh loan capital in amount of EUR 159,300 was funded to MDF by DANIDA. The bank exchanged EUR into CSD so that MDF received funds in CSD currency.

As of December 31, 2004, DANIDA's Loan Fund amounted to EUR 745,461 and it included EUR 651,550 in initial loan fund capital plus EUR 93,911 in retained interest and principal income from loan activity. The income generated from loan activities remained at disposal of MDF and this income was used for covering of operational expenses. Surplus remaining after covering of operational expenses were reinvested into new loan disbursements.

DANIDA funds were used for financing loans for IDPs, refugees and local population with the entrepreneurial skills and ideas to start up or develop small-scale profit making business. The loans were disbursed and repaid in CSD by using EUR as index currency.

On April 8, 2005, the Asset Transfer Contract was signed between DRC and MDF. By this Contract DRC transferred the ownership of assets (Loan Fund and Physical Assets) to MDF on January 1, 2005. The value of the Loan Fund transferred was EUR 745,461(the figures were defined in EUR currency, by Contract).

“Micro-Credit Project ” financed by ICRC was based on: Co-operation Agreement signed on September 24, 2003 (this Agreement was valid from the date of signing by both parties until December 31, 2004), Amendment of this Agreement signed on June 04, 2004 and Addendum on this Agreement signed on November 11, 2004.

In 2003, according to Co-operation Agreement, ICRC provided fresh loan fund capital in the amount of EUR 50,000.

Over 2004, according to the Amendment and Addendum of this Agreement, ICRC provided the fresh loan fund capital in the amount of EUR 131,500.

The ICRC provided loan fund capital in CSD worth the equivalent of EUR above mentioned.

The income generated from loans disbursed to clients (interests, penalties etc) remained at disposal of MDF and this income was used for covering of operational expenses. Surplus remaining after covering of operational expenses belonged to MDF and were reinvested into new loan disbursements.

As of December 31, 2004 the total amount of the initial loan capital made available by ICRC was EUR 181,500.

Beneficiaries (target group) of this project were Internally Displaced Persons who were obliged to leave Kosovo during or after 1999. The loans were provided to individuals, men and women, for creation, improvement or expansion of self-employment or an enterprise. The loans were disbursed and repaid in CSD by using EUR as index currency.

On May 31, 2005, the Agreement on the Transfer of Revolving Loan Funds was signed between ICRC and MDF. By this Agreement ICRC handed over to MDF the Revolving Fund. The total amount of the funds that was transferred transferred to MDF ownership was EUR 181,500 (the figure was defined in EUR currency, by Agreement)..

1.4.2. Vocational Trainings Program

The aim of the vocational training, funded by UNHCR was to upgrade the educational and/or apprenticeship skills of the trainees (refugees/IDPs and the host community) so enhancing their employment prospects in the local labor market or within their own business. Self-employment can be realized through the MDF loan program or within the private/public sectors, often within the companies where the trainees obtained their apprenticeship.

1.4.3. In-kind Grant Program

In-kind Grant Program aimed at providing material support (production inputs) for setting-up small-scale businesses for the most vulnerable IDPs, capable to contribute to their own self-provisions. The beneficiaries of the in-kind grant program were enabled to develop their activities that will lead them to more stable financial situation and their own self-activation through developing their business ideas into successful projects.

2. Basis of Preparation of the Financial Statements

2.1. Accounting Policy

The accompanying financial statements have been prepared in accordance with Disclosure Guidelines for Financial Reporting by Microcredit Institutions prepared by the Consultative Group to Assist the Poorest (CGAP). These guidelines are voluntary norms recommended by a consultative group of international donors. Thus an institution's failure to comply with the CGAP's guidelines would not necessarily imply that the institution or its financial statements are in violation of any legal or other authoritative accounting or reporting standard.

2.2. Basis of Accounting

The financial statements of the MDF have been prepared on a cash basis. Under this convention, transactions are recognized when cash is received (and recorded as revenue) or paid (and recorded as expenses), not when they occur.

MDF uses Loan Tracking System (LTS) which is MIS with the main purpose to provide information relevant to the administration of the portfolio, including:

- ◆ Identity of the client;
- ◆ Amount disbursed;
- ◆ Loan terms, such as interest rate, penalty, maturity;
- ◆ Repayment schedule-amounts and timing;
- ◆ Amount and timing of payments received;
- ◆ Amount and aging of delinquency;
- ◆ Outstanding balance.

Some of the data generated by LTS flow directly into the accounting system and financial statements- such as disbursements, repayments, interests, penalties, loans recovery, but some of them flow only indirectly- such as delinquency that is used to estimate provisions in the accounting system. This information feeds into the financial statements such as following positions: Loans Outstanding (Gross and Net), Financial Income, Provision for Loan Loss. EUR currency is the index currency of the LTS, used for calculation of all transaction connecting to micro loans.

2.3. Reporting and Accounting Currency

The financial statements of the MDF have been prepared in EUR currency whereas the functional currency was CSD. Accordingly these financial statements should not be considered as being fully consistent with the result of financial position, which would be shown if they have been presented in the functional currency.

Non-Governmental Organization Micro Development Fund, Belgrade
Notes to the Financial Statements

According to MDF accounting policy, buying official exchange rate (EUR:CSD) prevailing on the date of transaction is used for calculating of all transactions denominated in CSD currency, during the year. This relates to the transactions recorded in LTS that are explained in the Note -2.2.

Some items of the Income Statement such as Operating Expenses, Financial Costs, etc denominated in CSD currency are expressed in EUR. The EUR amounts have been calculated by applying the average exchange rate of 1EUR:72,7913CSD, which was computed by MDF (the sum of the buying official exchange rates prevailing at the last day of each month was divided by twelve).

Some items of the Balance Sheet denominated in CSD are expressed in EUR at the buying official exchange rate prevailing at the balance sheet date – 1EUR: 78,6473.

2.4. Comparative Information

The comparative numerical information in previous period has been disclosed in the Financial Statements.

The financial statements for 2003 were prepared in USD whereas the functional currency was CSD. For the purpose of comparative numerical information for the Financial Statements of 2004, USD amounts disclosed in the Financial Statements for 2003 were expressed in EUR by applying the buying exchange rate prevailing at the Balance Sheet date. Certain reclassifications of comparative items in the Balance Sheet were made. Accordingly these comparative information disclosed in the Financial Statements should not be considered as being fully comparable.

3. Summary of Significant Accounting Policies

3.1. Financial Income

Financial income represents: interest on loans, penalties, interest on current assets, cost recovery, and recovery from written of loans which has been recorded when received.

3.2. Provision for Loan Losses

Provision for loan losses represents expenses related to actual or anticipated loan losses. Provision for loan losses are shown separately from other expenses in the Income Statement. The MDF policy is to write off the loans with more than 180 days late.

3.3. Operating Expenses and Financial Costs

Operating expenses and financial costs represent all expenses related to generating operating income, i.e. financial income and to the operation of the MDF. They consist of personnel expenses, office rent, communication costs, services, other administrative expenses, taxes, bank fees, incurred and paid in the current accounting period. Allocation of all operating expenses relating to the donors is presented in the Income Statement.

3.4. Grant Revenues

Grant revenues are shown separately from income generated by micro loan activity so that the financial performance (profit or loss) from operations can be determined. Grants for loan funds capital to be used in the current operating period are recorded in the Income Statement, below the net income from operations. Grants are separated as non-operational income in the Income statement and they are also disclosed in the Balance sheet, as Loan Fund Capital. The source and amount of current period grants are disclosed clearly.

3.5. Loans

Gross outstanding loan portfolio is the amount of loans that has been disbursed but has not been repaid or written off. Net outstanding loans are stated as the amount of principle outstanding less reserves for loan impairment. Provision for loan impairment is provided as described in Note 3.6.

Loans are disbursed in CSD as the equivalent of an agreed amount in foreign currency EUR by using buying official exchange rate prevailing on the date of transaction. Repayment of loans is in CSD and also is indexed to foreign currency EUR using buying official exchange rate prevailing on the date of transaction.

3.6. Provision for Loan Reserves

Provision for uncollectible loans is recognized as an expense, charged against income and deducted from the total amount of loans.

Non-Governmental Organization Micro Development Fund, Belgrade
Notes to the Financial Statements

The main measure of loan delinquency is based on aging portfolio at risk ratio derived from the Loan Tracking System. From the Financial Statements it is seen that at the end of the fiscal year, MDF computes a provision for doubtful loans. The reserve is determined by applying predicted loss percentages to aged loans grouped by lateness of payments. A loan becomes late as soon as a scheduled installment is missed. The predicted loss percentages are based on management's analysis of historical outcomes of late loans.

Loan loss reserve is an amount set aside in the Balance Sheet to recognize probable future loan losses so that the true value of the loan portfolio is fairly stated. The amount of the loan loss reserve is shown, as a negative asset deducted from the loan portfolio.

The reserve is increased by additional loan loss provision expense. Expenses related to actual or anticipated loan losses are shown separately from other expenses in the Income Statement.

Loans are separated into classes depending on how many days overdue they are. MDF calculates loan loss reserve according to the following policy:

| Days late | Percentage for reserve |
|------------------|-------------------------------|
| 1-30 | 5.00% |
| 31-60 | 25.00% |
| 61-90 | 50.00% |
| 90-180 | 75.00% |
| >180 | 100.00% |

Based on the experience from the previous periods MDF has defined the percentage stated in the above table as the basis for the calculation of the loan loss reserve.

A loan is first considered late after the first missed payment. Once a loan has been defined as late, for it to enter write-off status it has to be over 180 days late.

Balance Sheet

4. Cash and Bank Current Accounts

Cash and Bank Current Accounts represent all cash available on December 31, 2004.

MDF has bank accounts in CSD currency held with Komercijalna banka AD, Beograd and Meridian banka AD Novi Sad.

As of December 31, 2004

| Bank accounts | EUR |
|---------------------------------------------------------------|----------------|
| <i>Komercijalna banka AD, Beograd</i> | |
| UNHCR – bank account for disbursement and repayment of loans | 57,774 |
| UNHCR – bank account for funds transferring | 2,616 |
| UNHCR – bank account for operating expenses | 4,676 |
| UNHCR - bank account for repayment of loans approved by DRC | 4,145 |
| Subtotal UNHCR | 69,211 |
| <i>ICRC</i> | |
| ICRC – bank account for disbursement and repayment of loans | 7,918 |
| ICRC – bank account for funds transferring | 22,448 |
| ICRC – bank account for operating expenses | 1,267 |
| Subtotal ICRC | 31,633 |
| <i>DANIDA</i> | |
| DANIDA – bank account for disbursement and repayment of loans | 9,109 |
| DANIDA – bank account for funds transferring | 2,174 |
| DANIDA – bank account for operating expenses | 720 |
| <i>Meridian banka AD Novi Sad</i> | - |
| DANIDA | 107 |
| Subtotal DANIDA | 12,110 |
| Total | 112,954 |

Disclosed EUR amounts represent the equivalents of CSD amounts which were calculated by applying buying official exchange rate prevailing at the Balance Sheet date.

5. Loans Outstanding

The balance of the net loans outstanding disclosed in the Balance Sheet amounts EUR 1,681,454 and relates to the following:

As of December 31, 2004

| Donor | Gross value | Loan loss reserves | Net value |
|--------------|--------------------|---------------------------|------------------|
| | EUR | EUR | EUR |
| UNHCR | 994,600 | (22,876) | 971,724 |
| DANIDA | 578,291 | (13,301) | 564,990 |
| ICRC | 147,694 | (2,954) | 144,740 |
| Total | 1,720,585 | (39,131) | 1,681,454 |

Gross Loans Outstanding represents outstanding principal with MDF clients as of December 31, 2004. MDF is using Loan Tracking System (LTS) and index currency for calculation of outstanding principle, as well as for all transaction connecting to micro loans, is EUR. All contracts with MDF clients from January 1, 2004 provided EUR as index currency.

Loan loss reserve is the calculated category representing the funds allocated to cover written off loans.

Disclosed EUR amounts were generated by LTS, and fed into Financial Statements.

5.1. Changes on Outstanding Principal Per Donors during 2004

As of December 31, 2004

| | UNHCR | DANIDA | ICRC | Total |
|----------------------------------------------|----------------|----------------|----------------|--------------------|
| | EUR | EUR | EUR | EUR |
| Opening balance | 938,240 | 456,687 | 11,605 | 1,406,532 |
| Amounts resulting from reconciliation of LTS | (11,566) | (720) | (7) | (12,293) |
| Disbursements | 1,476,340 | 820,352 | 207,500 | 2,504,192 |
| Repayment | (1,380,155) | (688,006) | (71,404) | (2,139,565) |
| Total write off | (28,259) | (10,022) | - | (38,281) |
| Closing balance | 994,600 | 578,291 | 147,694 | 1,720,585 |

5.2. Calculation of Loan Loss Reserves Per donors During 2004

As of December 31, 2004 the total amount of Loan Loss Reserves disclosed in the Balance Sheet was EUR 39,131. The accounting policy for calculation of loan loss reserves is explained in Note 3.6.

| | UHHCR | DANIDA | ICRC | Total |
|----------------------------------------|-----------------|-----------------|----------------|-----------------|
| | EUR | EUR | EUR | EUR |
| At the beginning of the period | (23,456) | (9,135) | (232) | (32,823) |
| Loans written off during the year | 28,259 | 10,024 | - | 38,283 |
| Write offs exceeding loan loss reserve | (4,803) | (889) | - | (5,692) |
| At the end of the period | (22,876) | (13,301) | (2,954) | (39,131) |
| Provision for loan loss | (27,679) | (14,190) | (2,722) | (44,591) |

Provision for loan losses amounts to EUR 44,591 for the year ending on December 31, 2004, and it is disclosed in the Income Statement.

Total write off for the year ending on December 31, 2004 is EUR 38,283 and it exceeds the value of the Loan loss reserve at the beginning period, for EUR 5,692 (this amount is included in the total amount of Provision for loan loss).

6. Other Long Term Assets – Deposit in Meridian Bank

As of December 31, 2004

| | EUR |
|--------------|----------------|
| DANIDA | 168,361 |
| ICRC | 8,866 |
| Total | 177,227 |

The method of the loans issuing to the MDF clients defined by the Contract with Meridian Bank was: Bank disbursed loans from its own funds (sources) on the bases of the value of the mandatory guarantee fund which was deposited to the bank, by MDF.

Disclosed amounts represent the value of the mandatory guarantee fund at MDF disposal on December 31, 2004.

Non-Governmental Organization Micro Development Fund, Belgrade
Notes to the Financial Statements

7. Net Worth

Net Worth represents the aggregate of accumulated donations and retained earnings or losses and it consists of:

As of December 31, 2004

| Equity | UNHCR | DANIDA | ICRC | Total |
|--------------------------------------------------|------------------|----------------|----------------|------------------|
| | EUR | EUR | EUR | EUR |
| Donated Equity | 595,776 | 651,550 | 181,150 | 1,428,476 |
| Loan Fund Capital | - | 159,300 | 131,150 | 290,450 |
| Cumulative Grants for Operations | 424,294 | 492,250 | 50,000 | 966,544 |
| Other capital accounts (RF-UN) - cumulative | 171,482 | - | - | 171,482 |
| Retained Net Surplus (Deficit) | 445,159 | 93,911 | 4,089 | 543,159 |
| Prior Periods | 254,260 | 22,183 | (4,922) | 271,521 |
| Adjustments on prior period retained Net Surplus | 207,721 | - | - | 207,721 |
| Current Periods | (16,822) | 71,728 | 9,011 | 63,917 |
| Total | 1,040,935 | 745,461 | 185,239 | 1,971,635 |

7.1. Donated Equity

Loan Fund Capital - disclosed amounts represent the value of the fresh loan fund capital provided by donors during 2004.

DANIDA granted EUR 159,300 which MDF received in CSD. This amount is disclosed also in the Income Statement as Grant Revenues for loan fund capital.

ICRC granted EUR 131,500 which MDF received in CSD. This amount is disclosed also in the Income Statement as Grant Revenues for loan fund capital.

Cumulative Grants for Operations – disclosed amounts represent the value of the loan fund capital provided by donors in the prior periods.

The value of the loan fund capital granted by DANIDA and ICRC has been defined in EUR currency, whereas the value of the UNHCR grants have been defined in CSD currency.

Other capital accounts (RF-UN), cumulative - disclosed amount represents the value of the loan fund capital for SOFT loans provided by UNHCR in the prior periods. SOFT loans were issued till 2001, after then this fund was transferred gradually into revolving fund of the non-SOFT loans. Therefore, it represents the cumulative grant for operations which has been separately disclosed because of its primary purpose.

7.2. Retained Net Surplus

Retained Net Surplus represents the funds accumulated by MDF from the micro loan activities.

Retained Net Surplus (Deficit) from the prior period is transferred from the results of the previous years.

Retained Net Deficit from the current period is caused with negative result relating to UNHCR funds.

7.2.1. Adjustments on Prior Period Retained Net Surplus

Adjustments on prior period retained Net Surplus relates to the UNHCR funds. This adjustment resulted from the following:

The estimated value of the UNHCR Revolving Loan Fund was defined as capitalisation in local currency. This included funds which have been already collected and deposited in the separate bank accounts (relating to UNHCR funds) of the MDF and other funds which have been in the form of payments due from loans provided to the beneficiaries. The value of the loan outstanding was determined in CSD irrespective of the facts that all contracts with MDF clients provided EUR as index currency (MDF uses EUR as a index currency for disbursing micro loans and their repayments), so that the loan outstanding has to be determined in EUR currency (that is it equivalent in CSD at effective exchange rate). Considering, the increase of exchange rate between EUR:CSD in prior period, the defined value in CSD of loan outstanding was underestimated for gains/potential gains arising from movements in exchange rates. The adjustment between these two values was performed and amount of difference was included in the Financial Statements.

Income Statement

8. Financial Income

The total of Financial Income disclosed in Income Statement amounts to EUR 424,964 and consists of:

For the year ended December 31, 2004

| | UNHCR | DANIDA | ICRC | Total |
|----------------------------|----------------|----------------|---------------|----------------|
| | EUR | EUR | EUR | EUR |
| Interest on loans | 252,182 | 119,653 | 12,636 | 384,471 |
| Penalties | 25,176 | 7,321 | 236 | 32,733 |
| Loans recovery | 3,363 | 441 | - | 3,804 |
| Interest on current assets | - | 279 | 205 | 484 |
| Cost recovery | - | 3,472 | - | 3,472 |
| Total | 280,721 | 131,166 | 13,077 | 424,964 |

Interest on loans represents the most significant part of financial income, it was generated from micro loan activity by using donor funds. Interest on loans is collected with monthly loan repayment.

Penalties are charges for late payments - 0.2% per day.

Cost recovery represents the refund for paid salaries to employee who was on maternity leave, made by Authorities.

Loans Recovery is the result of collected loans that were written off.

Disclosed EUR amounts except for Cost Recovery were generated by LTS, and fed into Income Statements.

9. Financial Costs

The total of Financial Costs disclosed in Income Statement amount to EUR 25,032 and consist of:

For the year ended December 31, 2004

| | UNHCR | DANIDA | ICRC | Total |
|--------------|---------------|--------------|--------------|---------------|
| | EUR | EUR | EUR | EUR |
| Taxes | 14,953 | 8,353 | 1,312 | 24,618 |
| Bank fees | 180 | 146 | 88 | 414 |
| Total | 15,133 | 8,499 | 1,400 | 25,032 |

Non-Governmental Organization Micro Development Fund, Belgrade
Notes to the Financial Statements

According to the Serbian Law on Sale Tax which was in force till December 31, 2004, MDF paid Sales tax on its services.

On January 01, 2005 the Law on Value Added Tax entered into force. This Law provides tax exemption for the services that MDF provides.

10. Operating Expenses

The total of Operating Expenses disclosed in Income Statement amounts to EUR 284,571 and consists of:

For the year ended December 31, 2004

| | UNHCR | DANIDA | ICRC | Total |
|----------------------|----------------|---------------|--------------|----------------|
| | EUR | EUR | EUR | EUR |
| Salaries | 203,101 | 12,968 | 6,971 | 223,040 |
| Travel Costs | 16,497 | 515 | 760 | 17,772 |
| Office Rent | 10,895 | 3,780 | 915 | 15,590 |
| Communication Costs | 7,170 | 1,009 | 102 | 8,281 |
| Services | 2,477 | - | - | 2,477 |
| Local Staff Training | - | 1,731 | - | 1,731 |
| Office Supplies | 4,417 | 111 | - | 4,528 |
| Vehicle Maintenance | 8,569 | 896 | - | 9,465 |
| Office Utilities | 1,605 | 82 | - | 1,687 |
| Total | 254,731 | 21,092 | 8,748 | 284,571 |

MDF had to cover operating expense from financial income during the year. ICRC supported MDF by covering a part of operating expenses in the amount of EUR 9,584.