

Audit report on the UNRWA MMP

We have audited the accompanying financial statements of the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) Microfinance and Microenterprise Programme, comprising statements A to D, and the supporting notes for the financial year ended 31 December 2005. The financial statements are the responsibility of the Commissioner-General. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with the common auditing standards of the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency and with the International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing accounting principles used and significant estimates made by the Commissioner-General, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the audit opinion.

In our opinion, these financial statements present fairly, in all material respects, the financial position of UNRWA Microfinance and Microenterprise Programme as of 31 December 2005 and the results its operations and its cash flows for the period then ended in accordance with International Financial Reporting Standards.

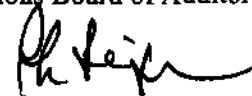
Furthermore, in our opinion, the transactions of the UNRWA Microfinance and Microenterprise Programme that have come to our notice or that we have tested as part of our audit have in all significant respects been in accordance with the Financial Regulations and legislative authority.



Shauket A. Fakie
Auditor-General of the Republic of South Africa
(Lead Auditor)


Guillermo N. Caragne

Chairman, Commission on Audit, Republic of the Philippines
Chairman, United Nations Board of Auditors



Philippe Séguin
First President of the Court of Accounts of France

28 July 2006

Note: The Board of Auditors has signed only the original English version of the audit opinion.

UNITED NATIONSRELIEF AND WORKS AGENCY FOR
PALESTINE REFUGEES IN THE NEAR EAST
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FI 540

9 May 2006

United Nations Board of Auditors
Room 2680D, Building DC-1
New York, NY 10017**Subject: Transmittal letter - MMP**

Pursuant to financial regulations 11.4 and 12.1, I have the honour to submit the Financial Statements of UNRWA's Microfinance and Microenterprise Programme (MMP) for the year ended 31 December 2005, which I hereby approve. The financial statements have been prepared and certified as correct by the Comptroller.

May I take this opportunity to also confirm to you and to the stakeholders of the Agency that UNRWA has:

a) An established and defined culture of accountability, an organizational architecture commensurate with the complexity faced in UNRWA operations, an internal control structure which is sound and functioning, and a managerial structure which is transparent and utilized to keep managers informed of UNRWA activities, challenges and developments.

b) Reporting processes that provide reasonable assurance that the MMP's financial statements present fairly, in all material aspects, the results of operation and the financial position of the MMP as at 31 December 2005.

c) Cost effective control systems, which provide reasonable assurance, that the MMP's operational and quality objectives will be achieved. These objectives include, but are not limited to, reliable external disclosures, safeguarding of assets, prevention of fraud, compliance with the rules and regulation, elimination of unnecessary costs and maximization of income.

d) On-going assessment and oversight processes, which review the significant internal control and risk issues, identified by UNRWA internal and external auditors. UNRWA has initiated steps to adjust or add controls in areas where the risks associated with the non-achievement of the MMP's operational and quality objectives were considered to be excessive and/or unacceptable.

Please accept, Sir, the assurances of my highest consideration.

Yours faithfully,


Karen Koning AbuZayd
Commissioner-General

UNITED NATIONS
RELIEF AND WORKS AGENCY FOR
PALESTINE REFUGEES IN THE NEAR EAST



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**CERTIFICATION OF THE FINANCIAL STATEMENTS
Microfinance and Microenterprise Programme**

FI 540

9 May 2006

Pursuant to financial regulations 11.4 and 12.1, I have the honour to submit UNRWA's Microfinance and Microenterprise Programme (MMP) Financial Statements for the year ended 31 December 2005.

I certify that all transactions have been properly recorded in the accounting records, properly reflected in the MMP's financial accounts and appended statements, which I hereby certify as accurate and representative of the MMP's operating activities and the financial state of affairs as at 31 December 2005.

Ramadan Al-Omari
Comptroller

**MICROFINANCE AND
MICROENTERPRISE
PROGRAMME**



**UNITED NATIONS RELIEF AND WORKS AGENCY
FOR PALESTINE REFUGEES IN THE NEAR EAST**

**MICROFINANCE AND MICROENTERPRISE PROGRAMME
BALANCE SHEET
As at 31 December 2005
(in USD)**

YEAR 2004	PARTICULARS	Note	YEAR 2005
	<u>ASSETS</u>		
	Non-Current Assets		
202,608	Property, Plant and Equipment	5	429,868
216,479	Loans Receivable, Net	4	159,680
419,087			589,548
	Current Assets		
5,567,868	Loans Receivable, Net	4	7,859,641
-	Pledges Receivable	8.1.2	943,396
702	Prepayments and Other Receivables		3,916
4,236,066	Cash and Cash Equivalents	3	7,494,612
9,804,636			16,301,565
10,223,723	Total Assets		16,891,113
	Equity		
(4,158,445)	General Undesignated		(4,660,194)
42,986	Fund Held For Training		19,296
-	Temporary Restricted	8.1.1	2,927,978
45,000	Board Designated Fund/MIS System		45,000
13,138,028	Loan Revolving Fund	9/8.1.3	14,619,249
9,067,569	Total Equity (Statement-C)		12,951,329
	Non-Current Liabilities :		
65,215	Retirement Benefit Obligations		73,650
65,215			73,650
	Current Liabilities :		
43,500	Payables and Accruals		46,612
572,439	Bills Payable to UNRWA	6	1,444,522
475,000	Liability to UNRWA – OPEC Pal Trust Fund	7	2,375,000
1,090,939	Total Current Liabilities		3,866,134
1,156,154	Total Liabilities		3,939,784
10,223,723	Total Equity and Liabilities		16,891,113

**UNITED NATIONS RELIEF AND WORKS AGENCY
FOR PALESTINE REFUGEES IN THE NEAR EAST**

**MICROFINANCE AND MICROENTERPRISE PROGRAMME
STATEMENT OF OPERATING ACTIVITIES
For the Year Ended 31 December 2005
(in USD)**

YEAR 2004	PARTICULARS	Note	YEAR 2005
	Interest and Other Operating Income:		
1,542,704	Interest on Loans		2,372,630
574,287	Recoveries from Written Off Loans		655,384
39,533	Interest on bank deposits and other revenues		44,529
39,354	Training income		45,291
2,195,878	Total Operating Revenues		3,117,834
	Operating Expense:		
1,808,672	Salaries and Related Expenses		2,129,801
120,062	Special Service Contracts		126,850
144,729	Occupancy		151,291
69,420	Communication		58,653
67,830	Stationary and Supplies		73,087
16,840	Minor Equipment and Maintenance		14,894
61,907	Travel and Transportation		112,557
59,546	Depreciation		93,989
37,592	Program Support Cost		52,580
289,900	Loans Written Off	4.3	732,168
-	Cash Losses		5,610
6,811	Training		5,459
77,173	Other Cost		52,639
2,780,482	Total Operating Expense		3,609,578
(564,604)	Operating Loss for the Year		(491,744)
6,072	Gain (Loss) on Difference of Currency		130
(558,532)	Net Operating Loss for the Year (Statement - C)		(491,614)

**UNITED NATIONS RELIEF AND WORKS AGENCY
FOR PALESTINE REFUGEES IN THE NEAR EAST**

**MICROFINANCE AND MICROENTERPRISE PROGRAMME
STATEMENT OF CHANGES IN NET ASSETS
For the Year Ended 31 December 2005
(in USD)**

PARTICULARS	Unrestricted Fund	Temporary Restricted	Training Fund	Board Designated/MIS	Revolving Loan Fund	Total
Net Assets as at 1st January 2004	(2,926,370)	-	25,586	96,602	13,131,426	10,327,243
Cumulative Effect of Terminating Benefits Obligations as of 1/1/2004	(57,215)	-	-	-	-	(57,215)
Opening Loss for Year 2004 (Statement - B)	(527,144)	-	(31,386)	-	-	(558,530)
Additional general reserves for bad debts	(643,929)	-	-	-	-	(643,929)
Releases to Revolving Loan Fund	-	-	-	(6,602)	6,602	-
Inter fund transfers	(3,767)	-	48,787	(45,000)	-	-
Net Assets at Beginning of Year	(4,158,445)	-	42,986	45,000	13,138,028	9,067,569
Operating Loss for the Year (Statement - B)	(467,924)	-	(23,690)	-	-	(491,614)
Releases from (additions) to general reserves for bad debts	(33,825)	-	-	-	-	(33,825)
Grants designated to capital	-	4,409,199	-	-	-	4,409,199
Releases to Revolving Loan Fund	-	(1,481,221)	-	-	1,481,221	-
Net assets at end of year (Statement -A)	(4,660,194)	2,927,978	19,296	45,000	14,619,249	12,951,329

STATEMENT D**UNITED NATIONS RELIEF AND WORKS AGENCY
FOR PALESTINE REFUGEES IN THE NEAR EAST****MICROFINANCE AND MICROENTERPRISE PROGRAMME
STATEMENT OF CASH FLOW
For the Year Ended 31 December 2005
(In USD)**

YEAR 2004	PARTICULARS	YEAR 2005
	Cash Flows from Operating Activities:	
	Contribution Received	3,465,802
2,195,878	Interest on Loans and Other Revenues	3,117,834
(2,816,696)	Loans Issued net of Collections	(3,000,967)
(1,851,872)	Cash Paid to Employees and Suppliers	(1,902,875)
(2,472,690)	Net cash Provided by operating activities	1,679,794
	Cash Flows from Investing Activities:	
(90,845)	Procurement of Fixed Assets	(321,248)
(90,845)		(321,248)
	Cash Flows from Financing Activities:	
475,000	Liability to UNRWA - OPEC Pal Trust Fund	1,900,000
475,000		1,900,000
(2,088,535)	Increase in Cash and Banks During the Period	3,258,546
6,324,601	Cash at Beginning of the Year	4,236,066
4,236,066	Cash on Hand and Deposits With Banks at the end of Year	7,494,612
	Adjustments to Reconcile Changes in Net Assets	
	to Net Cash Provided by Operating Activities:	
(1,202,462)	Change in Net Assets	3,883,760
289,900	Provision for Loans Losses	732,168
643,930	Change in general provisions for bad debts	33,825
59,546	Depreciation	93,989
(14,994,660)	Loans Extended	(23,367,190)
12,177,964	Loans Collection	20,366,223
	Decrease (Increase) in Pledges receivable	(943,397)
(368)	Decrease (Increase) in Prepaid Expenses	(3,214)
(432)	(Decrease) Increase in Payables and Accruals	3,112
545,892	(Decrease) Increase in Bills Payable to UNRWA	872,083
8,000	(Decrease) Increase in Termination Benefits Obligations	8,435
(2,472,690)		1,679,794

Microfinance and Microenterprise Programme

Notes to Financial Statements

31 December 2005

(Amounts in US Dollars)

1. Background

A- Microfinance and Micro enterprise Programme

Since June 1991, UNRWA's Microfinance and Micro enterprise Programme (MMP) in the West Bank and Gaza has helped promote small business development, create employment, improve the income of micro enterprises and reduce poverty through the establishment of a number of targeted credit programmes aimed at small businesses, micro enterprises and women. The MMP is organized around three revolving loan funds in Gaza and two in the West Bank. The programme supports businesses varying in size from micro vending, employing just one or two individuals, to small industries, and aims to satisfy a variety of needs such as capital funding and working capital financing.

MMP's funds are disbursed to borrowers under four credit program categories. They are Small-Scale Enterprise Credit (SSE), Solidarity-Group Lending (SGL), Consumer Lending Product (CLP) and Micro-Enterprise Credit (MEC).

Small-Scale Enterprise (SSE) was the original credit instrument. Its objective is to provide new existing small-scale enterprises with loans.

Micro-Enterprise Credit (MEC) was introduced in Gaza in February 1996 and in the West Bank in March 1998, to meet the demand for working capital needs with existing micro and small scale enterprises which were unable to secure credit from commercial institutions due primarily to lack of required collateral.

Solidarity-Group Lending (SGL) was introduced in Gaza in May 1994 to enable Palestinian women to participate in the local community.

The Consumer Lending Product (CLP) was established in 2002 in Gaza area. This product aims to help workers and employees to purchase house hold requirements, through loans that they can get from the MMP. Target clients are people who have fixed monthly income.

During year 2003 two new MMP branches were established in Syria (Yarmouk Branch) and Jordan (Wehdat Branch).The two branches disburse MEC loans only.

During 2004, Ramallah branch was opened in the West Bank.

B- Small Micro Enterprise Training Program (SMET)

UNRWA MMP also provides training through its Small Micro Enterprise Training Program (SMET). The main goal of the training programme is to contribute to the economic development of the Gaza Strip, through supporting small businesses and encouraging entrepreneurships. Without a natural resource base, Palestinians have to rely on their skill, entrepreneurship and industriousness to promote economic growth. To achieve this goal, the training programme aims:

- To provide a wide range of business training courses to the business community in Gaza;
- To promote an entrepreneurial spirit and the requisite skills;
- To develop a local training capacity through a team of trainers able to deliver courses using participatory, non-formal adult-education training techniques and technologies with up-to-subject matter;
- To develop a business curriculum that is relevant to the state of the local economy and to make training material and resources more readily available;
- To encourage trainers who have developed training skills in the programme to transfer their experience in both teaching methodology and curriculum development to the universities and vocational training institutions where they teach;
- To promote co-operation and co-ordination among institutions engaged in small and micro-enterprise development, through contact groups and workshops;
- To enable small businesses in the Gaza Strip to compete in regional and global markets.

To achieve these objectives, the programme includes the following activities:

1. Business Training: This is the core activity of the SMET program. It provides a range of business training courses that meet the practical training needs of the small business community in Gaza. The business service model adopted pursues a demand-led approach that is relevant to the business needs of clients. The training style is participatory and based on adult learning techniques and methodologies.

2. Start up Your Own Business: This training programme aims to encourage new business start-ups amongst women and new graduates from technical and vocational colleges and from universities. The encouragement of entrepreneurship and self-employment is an important tool for business development and both for economical and social development.

3. Curriculum Development: In order to meet the goal of establishing best practice in the training process, the programme strives to incorporate relevance and participation in developing training manuals and curricula based. The use of participatory and adult education techniques in developing curricula leads to the development of training courses that are most attractive to clients.

4. Building Local Training Capacity: The SMET programme works with a pool of 40 trainers who deliver its 92 training courses. Fifteen of these trainers form the core trainer's pool that conducts the bulk of the courses offered. The programme will continue to build the team of trainers capable of delivering courses in participatory, non-formal adult education training techniques and technologies, with up-to-date subject matter.

The financial activities of the programme comprising training fees charged and direct costs of the programme, are presented separately in the Statement of Activities for the year ended 31 December 2005 on page 3

2. Summary of Significant Accounting Policies:

The financial statements have been prepared in conformity with International Financial Reporting Standards and on the accrual basis of accounting except for

interest accrued on unpaid loan principal who is recognized as income on date of receipt. See note 2.2.

Summary of significant accounting policies is described below.

2.1 Basis of Presentation:

Funds of MMP and changes therein are classified and reported as follows:

- General Undesignated net assets – Utilization of net assets by MMP is not subject to donor-imposed restrictions. It includes retained earnings or losses from operations
- Temporary restricted net assets - Net assets whose use by MMP is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and released by actions of MMP pursuant to those donor-imposed stipulations.
- Revolving Loan Fund - Restricted contributions received for on lending purposes, which were expended in term of loans, are included in the Revolving Loan Fund.
- Grants and Donations – Unrestricted grants and donations are recorded in the income statement below the net profit (loss) in the period they are received. Capital grants for loan funds are recorded first in temporary restricted net assets and then transferred to capital when the purpose restriction is accomplished.

2.2 Loans Receivable and Allowance for Loan Losses

A) At each balance sheet date, management reviews the carrying amounts of its loan portfolio to determine whether there is any indication that these loans have suffered an impairment loss. Up to the end of the year 2004, indications for impairment losses, and accordingly the booking of specific provisions, have been determined on the basis of aging of the outstanding portfolio as shown below by booking a provision expense in the income statement against increasing the loan

loss reserve in the balance sheet. Loans outstanding for over 360 days were written off against the reserve for loan losses. Recoveries on loans previously written off were taken to the statement of profit and loss.

Up to end of 2004, provisions for loan losses were determined every quarter in order to maintain adequate levels of the allowance for loan losses by applying defined percentages to the outstanding balances in various aging categories as follows:

Over Due Days	1 – 30	31 – 60	61 – 90	91 – 120	121 – 180	181 – 360
Allowance (percent)	5%	10%	25%	50%	75%	100%

During 2005 management changed its policy and determined that impairment loss on the loan portfolio represented by loans written off that are over due over 360 days, and accordingly booked these amounts by charging the statement of the profit and loss and by crediting the loan asset.

At the same time, management decided to continue the policy of calculating provisions on the basis of loan aging categories as described above, by charging “general undesignated net assets” and by crediting the Allowance for loan losses. Figures presented for the prior year have been restated to reflect this change.

B) Recoveries of previously written off loans are taken to the statement of profit and loss in the period they are received.

C) Interest on loans

Interest income on loans provided is accounted for on the cash basis when payments are received. The accrual basis of accounting has not been applied in terms of IAS 18, paragraph 30 (a) which states that investment income shall be

recognized using the effective interest method as set out in IAS 39, paragraphs 9 and AG 5 -AG 8.

The MMP has not accrued for interest income on loans provided at the 2005 year end as the financial systems and policies in place do not facilitate compliance with IAS 18.

Therefore, the MMP was unable to accurately calculate the interest income not accrued for at year end per loan provided. This would however be corrected for the 2006 year to facilitate compliance with IAS 18.

The extent of deviation from IAS 18 has been estimated as indicated below based on three possible policies. The effect of this deviation is that interest income for loans provided is estimated to be understated as follows, where:

- a) Interest income is accrued for 30 days: USD 21,690
- b) Interest income is accrued for 60 days: USD 38,629
- c) Interest Income is accrued for 90 days: USD 80,294

2.3 Property Plant and Equipment:

Fixed assets are stated at cost net of accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the respective assets as follows:

Assets	Furniture and Equipment	Computers and Printers	Vehicles	Leasehold Improvements
Years	10	3	7	5

2.4 Employee Separation Benefits

a- Provident Fund

All area staff members of MMP/UNRWA staff participate in the provident fund (PF) contributory scheme. Staff monthly contributions into the scheme are set at 7.5% of basic salaries and UNRWA share contribution is set at 15%. Under the PF rules, staff members are allowed to make additional voluntary contributions up to a maximum of 50% of monthly payroll. All participants receive the lower of book or market value return on the fund for the period of membership in the PF. The PF is administered by the Provident Fund Secretariat (PFS) jointly with the supervision and guidance provided by two committees, the Provident Fund Committee and the Investment Advisory Committee.

b- Retirement Benefit Obligation

Starting with the year 2005, the Micro-finance Micro-enterprise program booked provisions for "retirement benefits obligations" towards its "A" category staff and according to the policy described below. Financial statement for 2004, was restated to reflect the effect of the provision for that year, and the cumulative effect for the prior years was presented under "Net assets".

UNRWA staffs are categorized under three categories of employment. These are

"A" category: Staff contracted before the year 1990

"X" category: Staff contracted between the years 1990 and 1995

"Z" category: Staff contracted after 1 September 1999

The MMP program includes 9 staff members under the "A" category, and the rest under the X and Z categories.

Only the "A" staff category are entitled to end of service benefits as follows:

For Termination Indemnity we have 3 groups :

Group 1 : Less Than 10 Years of Service Or Age less than 46

Group 2 : More than or equal 10 Years of Service and age between 46 and 55

Group 3 : Early Voluntary Retirement

The Indemnity for each group is as follow :

Group 1 : If Total Service = 1 --> 1 * Base Salary

If Total Service between 1.01 and 8.99 --> (Total Service - 1) * Base
Salary

if Total Service >= 9 --> 8 * Base Salary

Group 2 : If Age = 46 --> 8.25 * Base Salary

If Age = 47 --> 8.50 * Base Salary

If Age = 48 --> 8.75 * Base Salary

If Age = 49 --> 9.00 * Base Salary

If Age = 50 --> 9.25 * Base Salary

If Age = 51 --> 9.50 * Base Salary

If Age = 52 --> 9.75 * Base Salary

If Age = 53 --> 10.00 * Base Salary

If Age = 54 --> 10.25 * Base Salary

If Age = 55 --> 10.50 * Base Salary

Group 3 : 0.085 * Total Years in Service * Annual Base Sal

Movement in the liability for the years 2005 and 2004 is as follows:

Balance as at 1 January 2004	57,215
Add: Provision for 2004	8000
Balance as at 31 December 2004	65,215
Add provision for 2005	8,435
Balance as at 31 December 2005	73,650

2.5 Foreign Currency Transactions:

The books of accounts are maintained in U.S. Dollar. Transactions in other currencies are translated to USD at UN exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated to USD at the exchange rate ruling at that date. Exchange differences arising on translation are recognized in the statement of operating activities. All other assets and liabilities are presented in USD equivalent at their historical values:

Currency	2005	2004	Change
	USD	USD	%
One Jordanian Dinar	0.708	0.708	0.00%
One Israeli Shekel	4.6	4.3	6.97%

One Syrian Pound	52	52	0.00%
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3. Cash and Cash Equivalents

Composition:

Deposits	31 December 2005	31 December 2004
Deposits with Banks in Jordanian Dinar	652,179	1,125,551
Deposits with Banks in New Israeli Shekel	82,548	225,105
Deposits with banks in US Dollar	6,634,016	2,864,375
Deposits with Banks in Syrian Pound	125,869	21,035
Total Bank Balances	7,494,612	4,236,066

Deposit with Banks in US Dollar as at 31 December 2005 and 2004 include an amount of \$ 1,217,562 and 475,000 respectively from funds received from UNRWA designated for OPEC Pal Trust Revolving Fund.

4. Loans Receivable, Net:

Loans Receivable includes loans outstanding from funds disbursed through both initial donor contribution (first time loans) and from revolving loan funds.

Composition of loans receivable net of allowance for bad debts by maturity as at 31 December is as follows:

Period	31 December	31 December
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	2005	2004
Maturities less than 1 year	7,859,641	5,567,868
Maturities over than 1 year	159,680	216,479
Total	8,019,321	5,784,347

4.1 Net Loans Receivable is as Follows:

Product	31 December 2005			31 December 2004		
	Loans	Provision	NET	Loans	Provision	NET
SSE Loans	699,827	(140,585)	559,242	704,354	(156,727)	547,627
MEC Loans	6,332,973	(711,982)	5,620,991	4,762,005	(731,846)	4,030,159
SGL Loans	1,424,321	(155,531)	1,268,790	1,140,948	(124,475)	1,016,473
CLP Loans	632,098	(61,800)	570,298	213,113	(23,025)	190,088
Total	9,089,219	(1,069,898)	8,019,321	6,820,420	(1,036,073)	5,784,347

Net loans receivable represent outstanding balance as of December 31, 2005 and 2004 less the calculated provision for un-collectable loans as of the same date. Net loans receivable is the net realizable value of loans disbursed.

4.2 Changes in Loan Balances during year 2005 are as follows:

Area	Beginning	Issued	Repaid	Written Off	Total
Gaza :					
SSE Loans	704,354	463,500	(454,136)	(13,890)	699,828
MEC Loans	1,905,625	5,841,224	(5,478,461)	(185,806)	2,082,582
SGL Loans	1,140,948	3,220,650	(2,858,267)	(79,010)	1,424,321
CLP Loans	213,113	1,315,900	(880,635)	(16,281)	632,097
Total Gaza	3,964,040	10,841,274	(9,671,499)	(294,987)	4,838,828
West Bank:					
MEC Loans	1,928,400	8,737,429	(7,569,634)	(391,140)	2,705,055

Total West Bank	1,928,400	8,737,429	(7,569,634)	(391,140)	2,705,055
Jordan:					
MEC Loans	649,493	2,399,412	(2,053,331)	(42,609)	952,965
Total Jordan	649,493	2,399,412	(2,053,331)	(42,609)	952,965
Syria:					
MEC Loans	278,487	1,389,075	(1,071,759)	(3,432)	592,371
Total Syria	278,487	1,389,075	(1,071,759)	(3,432)	592,371
Grand Total	6,820,420	23,367,190	(20,366,223)	(732,168)	9,089,219

Percentage of Loans Receivable by Area:

Area	31 December 2005		31 December 2004	
	USD	%	USD	%
Gaza	4,838,828	53%	3,964,040	58%
West Bank	2,705,055	30%	1,928,400	28%
Jordan	952,965	10%	649,493	10%
Syria	592,371	7%	278,487	4%
Total	9,089,219	100%	6,820,420	100%

Percentage of Loans Receivable by Type:

Programme	31 December 2005		31 December 2004	
	USD	%	USD	%
SSE	699,828	7%	704,354	10%
MEC	6,332,973	70%	4,762,005	70%
SGL	1,424,321	16%	1,140,948	17%

CLP	632,097	7%	213,113	3%
Total	9,089,219	100%	6,820,420	100%

4.3 Changes in the allowance for loan losses during year 2005 are as follows:

Area	Beginning	Additions (Releases)	Total
Gaza:			
SSE Loans	156,727	(16,143)	140,584
MEC Loans	245,009	98,933	343,943
SGL Loans	124,476	31,055	155,531
CLP Loans	23,023	38,778	61,800
Total Gaza	549,235	152,623	701,858
West Bank:			
MEC Loans	448,042	(128,648)	319,394
Jordan:			
MEC Loans	32,823	8,137	40,960
Syria:			
MEC Loans	5,973	1,713	7,686
Grand Total	1,036,073	33,825	1,069,898

Percentage of Written off Loans:

Programme	31 December 2005		31 December 2004	
	USD	%	USD	%
SSE	13,890	2%	38,479	13%
MEC	622,987	85%	213,929	74%
SGL	79,010	11%	32,138	11%

CLP	16,281	2%	5,354	2%
	732,168	100%	289,900	100%

4.4 Loans Receivable, as at 31 December 2005, Distributed by Sector are as follows:

	Agriculture	Commerce	Industry	Service	Others	Total
Gaza						
SSE Loans	6964	-	461,660	231,204	-	699,828
MEC Loans	229,912	815,142	188,109	849,419	-	2,082,582
SGL Loans	424,898	637,347	254,939	107,137	-	1,424,321
Sub-Total	661,774	1,452,489	904,708	1,187,760	-	4,206,731
CLP Loans *	-	-	-	-	632,097	632,097
Sub-Total	661,774	1,452,489	904,708	1,187,760	632,097	4,838,828
West Bank						
MEC Loans	12,091	1,088,361	223,592	1,381,011	-	2,705,055
Sub-Total	12,091	1,088,361	223,592	1,381,011	-	2,705,055
Jordan						
MEC Loans	-	431,407	135,701	385,857	-	952,965
Sub-Total	-	431,407	135,701	385,857	-	952,965
Syria						
MEC Loans	-	342,864	69,011	180,496	-	592,371
Sub-Total	-	342,864	69,011	180,496	-	592,371
Grand Total	673,865	3,315,121	1,333,012	3,135,124	632,097	9,089,219

Percentage of Loans Receivables Distributed by Sector are as follows:

	31 December 2005		31 December 2004	
	USD	%	USD	%
Agriculture	673,865	7%	452,165	7%
Commerce	3,315,121	36%	2,647,950	39%
Industry	1,333,012	15%	1,178,548	17%
Service	3,135,124	35%	2,328,644	34%
CLP-Individuals	632,097	7%	213,113	3%
	9,089,219	100%	6,820,420	100%

*CLP Loans are loans disbursed to individuals for house hold improvements and are not distributed among any sector.

4.5 Loans Receivable, as at 31 December 2005 distributed by Geographical Area

are as follows:

Area	SSE Loans	MEC Loans	SGL Loans	CLP Loans	Total
Gaza					
Gaza Area	340,583	1,027,117	740,115	568,887	2,676,702
Middle Area	163,293	313,689	278,912	63,210	819,104
Southern Area	195,952	741,776	405,294	-	1,343,022
Total Gaza	699,828	2,082,582	1,424,321	632,097	4,838,828
West Bank					
Nablus	-	777,890	-	-	777,890
Tulkarem	-	418,338	-	-	418,338
Ramallah	-	1,027,539	-	-	1,027,539
Jenin	-	184,074	-	-	184,074
Hebron	-	297,214	-	-	297,214

Total WB		2,705,055	-	-	2,705,055
Jordan	-	952,965	-	-	952,965
Syria	-	592,371	-	-	592,371
Grand Total	699,828	6,332,973	1,424,321	632,097	9,089,219

5. Property, Plant and Equipment

Description	Furniture and Equipment	Computers and Printers	Vehicles	Leasehold Improvements	Total
Cost:					
Balance January 1	165,242	130,234	151,929	52,965	500,370
Additions	57,661	49,041	100,732	113,814	321,248
Disposals	-	-	49,527	-	49,527
Balance December 31	222,903	179,275	203,134	166,779	772,091
Accumulated depreciation:					
Balance January 1	65,179	74,072	123,087	35,423	297,761
Additions	18,187	35,290	14,757	25,755	93,989
Disposals	-	-	49,527	-	49,527
Balance December 31	83,366	109,362	88,317	61,178	342,223
Net Book Value	139,537	69,913	114,817	105,601	429,868

6. Bills Payable to UNRWA:

Represents expenses paid by UNRWA on behalf of MMP in respect of operating expenses incurred by MMP, billed on a monthly basis and advances against donor's pledges as follows:

Description	Amount
Expenses paid on behalf of MMP	484,779
Advances against donor's pledges	959,743
Total Amount Due to UNRWA	1,444,522

7. Liability to UNRWA - OPEC Pal-trust Fund

On 15 June 2004, United Nations Relief and Works Agency "UNRWA" for Palestine Refugees in the Near East had signed an "Administration Agreement" with the OPEC Fund for International Development (OFID) through which the fund will make available to UNRWA, as an administrator, an amount of US. \$2,500,000 to be used exclusively for the promotion of micro enterprise through loans for the Palestinians in the occupied territories.

In consideration of the Administrator performing the services specified in the agreement, the administrator may deduct program support costs of up to 5% from amounts disbursed by OFID into the Pal Fund. The administrator may also charge such reasonable fees or other charges under the Loan Agreement to cover such costs of the administrator as may directly and reasonably be incurred, in connection with the conclusion of loan agreements. UNRWA passed on the administration of the trust activities to the MMP department.

As of 31 December 2004, one installment in the amount of US \$500,000 was received by UNRWA. Program support costs of US \$25,000 were deducted by UNRWA and the balance of \$ 475,000 was loaned to the MMP to manage program activities.

During year 2005 UNRWA/MMP received a total of USD 2,000,000. An amount of USD 500,000 was received by Gaza Branch, and another USD 1,500,000 was received by the West Bank Branch. The amount of USD 100,000 was paid to UNRWA as Program Support Cost (PSC) calculated at 5% of the amount received. The balance of \$ 1,900,000 represents the net liability to UNRWA under the second installment bringing the total accumulated liability to \$ 2,375,000 as of 31 December 2005.

8. Grants and Donations

Summary of grants and donations during 2005 and 2004 is as follows:

8.1.1- Netherlands Minister for Development Cooperation

According to the Grant Agreement number *RAM0064625 Activity number 13168* signed on December 1, 2005 between the *Netherlands Minister for Development Cooperation* and *United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA)*, the amount of \$4,800,000 was earmarked to support UNRWA project proposal "*Microfinance and disengagement: supporting economic recovery and rehabilitation through micro enterprise and housing credit*, for the period from 1 December 2005 up to and including 1 December 2006. The funds shall be transferred in advance in installments amounting to a maximum of 72% of the total contribution of \$4,800,000 (not exceeding Euro 4

million). The final installment shall be paid after the definitive amount of the contribution has been determined in the final narrative and financial report.

The funds shall be administered and accounted for in accordance with UNRWA financial regulations and other applicable rules, procedures and practices and a separate records and accounts of the programme shall be maintained. In accordance with these regulations, UNRWA deducts 7% from funds available to MMP to cover program support costs (PSC).

According to the Grant budget, funding to MMP is as follows excluding UNRWA, PSC of 7%:

Description	Amount
Total MMP portion	4,800,000
(Less) UNRWA PSC	(314,019)
Net to MMP allocated to:	4,485,981
Revolving Fund Capital	4,285,981
Operating costs – Bethlehem branch	200,000
Amount received (Temporary Restricted):	
For Gaza MMP	1,659,987
For West Bank MMP	1,267,991
Total Restricted Fund	2,927,978
Gaza Disbursed Year 2005 (Note 9)	483,004
Total Fund Received	3,410,982

8.1.2- The Government of Canada

According to the Grant Agreement number 7041359 Project number Z-020711 signed on February 28, 2006 between the "Government of Canada as represented by the Minister for International Cooperation, acting through the Canadian International Development Agency (CIDA) and United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA), for the provision of micro-credit, job creation, and shelter rehabilitation activities that form part of UNRWA contribution to the Gaza Disengagement Plan. According to the budget, the amount allocated to the MMP programme was as follows:

Micro-finance lending	\$1,000,000
Micro-enterprise training (12 months)	\$ 200,000

The duration of implementation under the agreement was from date of signature on 28 February 2006 through 31 December 2007, however, management represented that CIDA allowed charging to the grant as from November 2005 on the Micro-finance component.

According to UNRWA financial policies and guidelines, the amount of 6% from MMP allocation is charged by UNRWA as Program Support Cost (PSC). The following is a detail of the pledge receivable that was recorded in the books as at 31 December 2005

MMP Allocation towards lending	\$ 1,000,000
Less 6% of the net amount (UNRWA PSC)	\$ 56,604
Net for lending	\$ 943,396

The amount was recognized on a confirmed pledge.

8.1.3- Arab Gulf Program for United Nations Development Organizations

In June 2003, UNRWA and the AGFUND concluded a grant agreement by which the donor pledged to contribute \$60,000 towards "Micro-Finance for Palestine Refugees in Syria. The amounts shown below represent MMP allocation net of UNRWA program support costs of 12%. The project is implemented and the full amounts shown below have been released to Loan Revolving Fund Capital

2004	\$26,785
2005	<u>\$26,786</u>
Total	<u>\$53,571</u>

9. Revolving Loan Fund:

Revolving Loan Fund - Restricted contributions received for on lending purposes, which were expended in term of loans, are included in the Revolving Loan Fund.

Composition of this fund by funding source as at 31 December 2005 is as follows:

Donor	Gaza	West Bank	Syria	Total
Australia	619,272	-	-	619,272
Canada	200,370	170,220	-	370,590
Germany	1,682,252	1,276,323	-	2,958,575
Italy	725,750	218,500	-	944,250
Japan	357,142	223,199	-	580,341
New Zealand	122,822	-	-	122,822
Norway	2,794,013	340,968	-	3,134,981
UNRWA	80,000	-	-	80,000
AGFUND	91,250	-	53,571	144,821
CIDA	943,396	-	-	943,396
Netherlands	483,004	-	-	483,004

USAID	4,237,197	-	-	4,237,197
Total	12,336,468	2,229,210	53,571	14,619,249

10. Geographical Segments

MMP operates out of four principle field offices located in the West Bank, Gaza, Jordan, and Syria. In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of borrowers. Segment assets are based on the geographical location of assets.

Equity										
General Undesignated	(1,427,992)	(1,051,696)	(3,163,236)	(2,903,906)	29,892	(89,721)	(98,858)	(113,122)	(4,660,194)	(4,158,445)
Fund Held for Training	19,296	42,986	-	-	-	-	-	-	19,296	42,986
Temporary Restricted Fund	1,659,987	-	1,267,991	-	-	-	-	-	2,927,978	-
Board Designated Fund/MIS System	45,000	45,000	-	-	-	-	-	-	45,000	45,000
Revolving Loan Fund	12,336,468	10,878,818	2,229,210	2,229,210	-	-	53,571	30,000	14,619,249	13,138,028
Total Equity	12,632,759	9,915,108	333,965	(674,696)	29,892	(89,721)	(45,287)	(83,122)	12,951,329	9,067,569
Non-Current Liabilities										
Retirement Benefit Obligations	40,980	36,629	32,670	28,586	-	-	-	-	73,650	65,215
	40,980	36,629	32,670	28,586	-	-	-	-	73,650	65,215
Current Liabilities :										
Payables and Accruals	10,875	10,875	12,700	10,875	12,112	10,875	10,925	10,875	46,613	43,500
Inter-Office Accounts	(4,815,923)	(4,335,898)	2,768,380	2,938,354	1,130,511	994,249	917,032	403,295	-	-

Bills Payable to UNRWA	1,056,371	174,003	333,213	304,226	36,761	46,195	18,177	48,015	1,444,522	572,439
Liability to UNRWA-OPEC Pal Trust Fund	1,438,707	475,000	936,293	-	-	-	-	-	2,375,000	475,000
Total Current Liabilities	(2,309,970)	(3,676,020)	4,050,586	3,253,455	1,179,384	1,051,319	946,134	462,185	3,866,134	1,090,939
Total Liabilities	(2,268,990)	(3,639,391)	4,083,256	3,282,041	1,179,384	1,051,319	946,134	462,185	3,939,784	1,156,154
Total Equity and Liabilities	10,363,769	6,275,717	4,417,221	2,607,345	1,209,276	961,598	900,847	379,063	16,891,113	10,223,723

10.2 Statement of Profit and Loss by geographical Segment

	Gaza		West Bank		Jordan		Syria		Central Office		Total	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Interest and Operating Income :												
Interest on Loans	1,208,916	958,757	699,751	353,288	313,122	165,829	150,841	64,830	-	-	2,372,630	1,542,704
Recovery from Written Off Loans	311,467	334,300	339,128	239,987	4,620	-	169	-	-	-	655,384	574,287
Interest on Deposit & other revenues	30,145	22,458	7,415	13,086	4,720	2,698	2,249	1,291	-	-	44,529	39,533
Total Operating revenues.	1,550,528	1,315,515	1,046,294	606,361	322,462	168,527	153,259	66,121	-	-	3,072,543	2,156,524

Operating Expense												
Salaries and Related Exp.	1,029,220	965,235	647,096	716,814	94,835	86,774	55,369	39,849	275,603	-	2,102,123	1,808,672
Special Service Contracts	35,135	32,035	40,931	51,650	20,345	17,587	16,914	18,790	13,525	-	126,850	120,062
Occupancy	59,682	62,119	63,731	52,452	8,745	10,708	16,102	19,450	3,031	-	151,291	144,729
Communication	23,763	37,864	23,112	22,775	6,024	5,781	3,058	3,000	2,696	-	58,653	69,420
Stationary and Supplies	25,546	28,732	35,924	33,370	3,281	1,705	1,699	4,023	6,637	-	73,087	67,830
Minor Equipment & Maint.	6,220	14,701	6,821	1,522	827	47	1,026	570	-	-	14,894	16,840
Travel and Transportation	49,151	32,897	33,521	25,196	2,491	2,579	8,624	1,235	18,770	-	112,557	61,907
Depreciation	23,592	15,703	28,581	30,042	8,804	7,810	13,063	5,991	19,949	-	93,989	59,546

Loss on Exchange Difference	2,070	(7,242)	(4,382)	1,310	544	-	1,638	(140)	-	-	(130)	(6,072)
Loans written off	294,987	199,145	391,140	87,371	42,609	3,384	3,432	-	-	-	732,168	289,900
Program Support Cost	15,739	14,755	28,799	13,535	3,934	3,770	4,108	5,532	-	-	52,580	37,592
Cash Losses	-	-	385	-	-	-	5,225	-	-	-	5,610	-
Training	2,395	3,473	1,000	3,338	837	-	1,227	-	-	-	5,459	6,811
Others	2,476	4,516	1,463	1,605	1,436	101	5,797	211	164	-	11,336	6,433
Total Operating Expenses	1,569,976	1,403,933	1,298,122	1,040,980	194,712	140,246	137,282	98,511	340,375	-	3,540,467	2,683,670
Allocation of Central Office Operating	204,225	-	136,150	-					(340,375)			

11.Risk:

Risk is inherent in the Microfinance Industry. The effective risk management is seen as the only way for Microfinance Institutions to keep functioning.

Ultimate responsibility for effective management of risks rests with the Director of the Microfinance Micro enterprise Program.

Several types of Risks apply to the MMP, these are:

- ***Credit Risk*** is the risk that counterparty will not settle its obligations in accordance with the agreed terms.
- ***Country Risk*** is the risks that counterparty is unable to meet its contractual obligations as a result of adverse economic conditions or actions taken by government in the relevant country.
- ***Market Risk*** is the exposure created by the potential changes in market prices.
- ***Liquidity Risk*** is the risk that funds will not be available to meet liabilities as they fall due.
- ***Operational and Other Risks*** is the risk of direct and indirect loss due to an event or action causing the risks having operational risk impact.
- ***Political Risk*** is the risk that an existing political situation makes it difficult for Microfinance Institutions to function for example war situations.

In Palestine, because of the present circumstances, Political Risk, Country Risk and Credit Risk are very high. To mitigate the risk, management did the following;

- a. SSE Loans were significantly reduced starting with 2001. In this category the amount of loans is relatively high, which bears a high risk factor because of the

present situation. Management decided to significantly reduce its activities under this program in both Gaza and West Bank.

- b. Management concentrated on expanding activities under MEC and SGL programs categories. These loans, range between \$1,000 to \$8,000 and \$400 to \$4,000 respectively, and aim at distributing the risk to a larger number of borrowers.
- c. An effective internal control system and procedures were implemented. Constant follow-up and loan-monitoring procedures were introduced to reduce Credit Risk of borrowers.

12. Restatement of Prior Years Balances:

Prior years' balances were restated and reclassified to confirm with year 2005 classifications. See statement of changes in net assets

13. Portfolio Quality:

a. Portfolio at Risk Ratio:

Portfolio at risk ratio (balance of loans in arrears / value of loans outstanding) measures amount of default risk in portfolio. An increasing portfolio at risk is negative.

Value of loans in arrears = is the outstanding balance (principal remaining to be paid) of loans that are at higher risk because a Payment is late

Portfolio at Risk

	2005		2004	
	Principal Outstanding	Portfolio at Risk Ratio	Principal Outstanding	Portfolio at Risk Ratio
	USD		USD	
Current	4,561,900		3,806,981	
1 to 30	2,340,629	25.75%	1,279,583	18.71 %
31 to 60	647,270	7.12 %	404,931	5.94 %
61 to 90	375,012	4.12 %	267,288	3.92 %
91 to 120	233,638	2.57 %	279,242	4.09 %
121 to 180	298,994	3.28 %	305,597	4.48 %
181 to 360	631,776	6.95 %	476,798	6.99 %
	9,089,219	49.79 %	6,820,420	44.18 %
Portfolio at risk over 30 days		24.05%		25.42%

b. Portfolio in Arrears Ratio:

Portfolio in arrears ratio (Value of Payments in Arrears / Value of Loans Outstanding), the ratio indicates amount of loan payments past due. An increasing portfolio in arrears is negative.

Value of loans in arrears = is the value of payments due (unpaid loan installments).

Portfolio in Arrears

	2005		2004	
	Payments in Arrears	Portfolio in Arrears Ratio	Payments in Arrears	Portfolio in Arrears Ratio
	USD	Percent	USD	Percent
1 to 30	404,036	4.45 %	380,225	5.57 %
31 to 60	216,405	2.38 %	228,569	3.35 %
61 to 90	144,965	1.59 %	172,097	2.52 %
91 to 120	119,083	1.31 %	240,744	3.53 %
121 to 180	177,247	1.95 %	220,466	3.23 %
181 to 360	323,624	3.56 %	134,428	1.97 %
	1,385,360	15.24 %	1,376,529	20.17 %

c. Operating Self Sufficiency Ratio:

Operating Self Sufficiency ratio (Interest and Recovery / Operating expenses and additional provision for loan losses), the ratio measures how well the MMP covers its cost through its operating activities. An increasing operating self sufficiency ratio is positive.

	2005	2004
Interest and Recovery	3,028,014	2,116,991
Operating Expenses	3,540,467	2,683,670
Operating Self Sufficiency Ratio	86 %	79 %

d. Loan Officer Productivity:

Loan Officer Productivity (Number of Active Borrowers / Number of Loan Officers), the ratio measures the average caseload of each loan officer. An increasing Loan Officer Productivity ratio is positive.

	2005	2004
Number of Active Borrowers	14,726	11,628
Number of Loan Officers	126	110
Loan Officer Productivity	117	106