

**Deloitte.**

**SMALL AND MICRO ENTERPRISE  
PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)**

**FINANCIAL STATEMENTS**

**31 DECEMBER 2005**

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2005

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SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

CORPORATE INFORMATION

DIRECTORS

Mr J Muriu	-	Chairman
Mr A Ngugi	-	Honorable Treasurer
Rev M Musyimi		
Mr S Awuor		
Mrs V Awori		
Prof R Mutiso		
Mr T Matianyi		

CHIEF EXECUTIVE OFFICER

B Nkungi

SECRETARY

L Ndolo  
P O Box 45099  
00100 GPO  
Nairobi

REGISTERED OFFICE

Kirichwa Road  
LR No. 2/187  
P O Box 64063  
00200 City Square  
Nairobi

AUDITORS

Deloitte & Touche  
"Kirungii", Ring Road, Westlands  
P O Box 40092  
00100 GPO  
Nairobi

PRINCIPAL BANKERS

The Co-operative Bank of Kenya Limited  
P O Box 48231  
00200 City Square  
Nairobi

Kenya Commercial Bank Limited  
P O Box 30081  
00100 GPO  
Nairobi

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

REPORT OF THE DIRECTORS

The directors have pleasure in presenting their report and the audited financial statements of the company for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The company focuses on poverty alleviation and employment creation through the support of micro and small enterprises, and is a national network with operations in all the Kenya provinces.

RESULTS

	Sh
Surplus for the year	<u>13,364,688</u>

DIVIDENDS

As the company is not for profit, no payment of dividends is recommended.

DIRECTORS

The present directors are shown on page 2.

AUDITORS

Deloitte & Touche, having expressed their willingness, continue in office in accordance with Section 159(2) of the Companies Act.

BY ORDER OF THE BOARD

Secretary

Nairobi

2006

SMALL AND MICRO ENTERPRISE PROGRAMME  
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STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Kenya Companies Act requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the operating results of the company for that year. It also requires the directors to ensure the company keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the company. They are also responsible for safeguarding the assets of the company.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenya Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the company and of its operating results. The directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

Nothing has come to the attention of the directors to indicate that the company will not remain a going concern for at least the next twelve months from the date of this statement.

.....  
Director

.....  
Director

2006

**INDEPENDENT AUDITORS' REPORT  
TO THE MEMBERS OF SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)**

We have audited the financial statements on pages 6 to 20 for the year ended 31 December 2005 and have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

**Respective responsibilities of directors and auditors**

As described on page 4, the directors are responsible for the preparation of the financial statements. Our responsibility is to express an opinion on those financial statements based on our audit.

**Basis of opinion**

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance as to 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, assessing the accounting principles used and significant estimates made by the directors, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

**Opinion**

In our opinion, proper books of account have been kept by the company and the financial statements, which are in agreement therewith, give a true and fair view of the state of affairs of the company at 31 December 2005 and of its surplus and cash flows for the year then ended in accordance with International Financial Reporting Standards and comply with the Kenyan Companies Act.

2006

SMALL AND MICRO ENTERPRISE PROGRAMME  
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INCOME STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2005

	Note	2005 Sh	2004 Sh
INTEREST INCOME	2	104,288,162	82,079,802
INTEREST EXPENSE	3	(25,493,970)	(25,164,535)
NET INTEREST INCOME		78,794,192	56,915,267
Fees income	4	22,793,906	23,830,808
Other operating income	5	2,265,554	1,966,225
OPERATING INCOME		103,853,652	82,712,300
OPERATING EXPENSES	6	(86,378,040)	(80,194,128)
BAD AND DOUBTFUL DEBTS		(4,110,924)	(2,449,631)
OPERATING SURPLUS		13,364,688	68,541
GRANT INCOME	8	-	42,647,668
SURPLUS FOR THE YEAR		13,364,688	42,716,209

SMALL AND MICRO ENTERPRISE PROGRAMME  
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BALANCE SHEET  
31 DECEMBER 2005

	Note	2005 Sh	2004 Sh
<b>ASSETS</b>			
Bank and cash balances		89,533,942	17,273,726
Short term deposits	9	59,817,909	106,207,053
Treasury bills	10	42,050,000	79,565,158
Loans to customers	11	411,837,584	373,715,253
Other receivables	12	2,652,492	4,881,445
Stationery inventory		596,814	1,539,271
Property and equipment	13	21,435,908	23,404,068
		<hr/>	<hr/>
<b>TOTAL ASSETS</b>		<u>627,924,649</u>	<u>606,585,974</u>
<b>RESERVES AND LIABILITIES</b>			
<b>LIABILITIES</b>			
Group loan collateral savings	14	216,537,035	164,946,774
Accruals and other liabilities	15	5,052,144	7,850,568
Borrowings	16	198,105,155	247,723,005
Revolving loan fund	17	13,600,000	4,800,000
		<hr/>	<hr/>
<b>TOTAL LIABILITIES</b>		<u>433,294,334</u>	<u>425,320,347</u>
<b>RESERVES</b>			
Accumulated surplus		194,630,315	181,265,627
		<hr/>	<hr/>
<b>TOTAL RESERVES AND LIABILITIES</b>		<u>627,924,649</u>	<u>606,585,974</u>

The financial statements on pages 6 to 20 were approved by the board of directors on  
and were signed on its behalf by:

2006

)  
)  
) Directors  
)  
)

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

STATEMENT OF CHANGES IN ACCUMULATED FUND  
FOR THE YEAR ENDED 31 DECEMBER 2005

	Accumulated surplus Sh
At 1 January 2004	138,549,418
Surplus for the year	42,716,209
At 31 December 2004	<u>181,265,627</u>
At 1 January 2005	181,265,627
Surplus for the year	13,364,688
At 31 December 2005	<u>194,630,315</u>

SMALL AND MICRO ENTERPRISE PROGRAMME  
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CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2005

	Note	2005 Sh	2004 Sh
Cash generated from/(used in) operations	18(a)	30,456,753	(28,821,451)
Grants for support costs received		-	42,647,668
		<u>30,456,753</u>	<u>13,826,217</u>
<b>INVESTING ACTIVITIES</b>			
Purchase of property and equipment		(1,282,989)	(9,120,468)
Proceeds on disposal of property and equipment		-	450,000
		<u>(1,282,989)</u>	<u>(8,670,468)</u>
<b>FINANCING ACTIVITIES</b>			
Loans received		82,477,427	140,900,000
Loans repayment		(71,962,575)	(38,232,933)
Revolving loan fund receipts		5,200,000	4,800,000
		<u>15,714,852</u>	<u>107,467,067</u>
Net cash generated from financing activities		15,714,852	107,467,067
Net increase in cash and cash equivalents		44,888,616	112,622,816
Cash and cash equivalents at 1 January		141,988,842	29,366,026
Cash and cash equivalents at 31 December	18(b)	<u><u>186,877,458</u></u>	<u><u>141,988,842</u></u>

SMALL AND MICRO ENTERPRISE PROGRAMME  
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NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2005

1 ACCOUNTING POLICIES

The financial statements have been prepared in accordance with International Financial Reporting Standards. The principal accounting policies adopted remain unchanged from the previous year. However, there were changes in International Financial Reporting Standards as stated below:

**Adoption of new and revised International Financial Reporting Standards (IFRS)**

In 2005 several new and revised standards became effective for the first time and have been adopted by the company where relevant to its operations. The adoption of these new and revised standards had no effect on the amounts reported for the current or prior years. This only resulted in changes in presentation and disclosure:

- IAS 16 has required the disclosure of comparative figures for movements in property and equipment
- IAS 24 has required the disclosure of the compensation of key management personnel

At the date of authorisation of these financial statements IFRS 6 on Exploration for and Evaluation of Mineral Assets and IFRS 7 on Financial Instruments Disclosures were in issue but not yet effective. The adoption of these standards, when effective, will have no material impact on the financial statements of the company.

**Basis of accounting**

The company prepares its financial statements on the historical cost basis of accounting.

**Income recognition**

Interest income is recognised for all interest bearing instruments on an accrual basis taking into account the effective yield on the asset. Fees and commissions income are recognised at the time of effecting the transactions.

**Grants and donations**

Grants and donations are recognised in the period in which they are received.

**Translation of foreign currencies**

Transactions in foreign currencies during the year are translated into Kenya Shillings at the rates ruling at the transaction dates. Assets and liabilities at the balance sheet date, which are expressed in foreign currencies, are translated into Kenya Shillings at the rates ruling at that date. The resulting differences are dealt with in the income statement in the year in which they arise.

**Inventory**

Inventory represents stocks of stationery and is stated at cost.

**Property and equipment**

Freehold land is stated at cost. All the other property and equipment is stated at cost less accumulated depreciation and accumulated impairment losses where applicable.

SMALL AND MICRO ENTERPRISE PROGRAMME  
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NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

**Depreciation**

Freehold land is not depreciated.

Depreciation for all the other property and equipment is calculated on a straight line basis at annual rates estimated to write off the cost of the assets over their expected useful lives. The annual rates used are as follows:

Permanent buildings	2.5%
Prefabricated buildings	20%
Motor vehicles	25%
Computers	33.33%
Office furniture, fittings and equipment	12.5%

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are dealt with in the income statement in the year they arise.

**Financial instruments**

A financial asset or liability is recognised when the company becomes party to the contractual provisions of the instrument.

*Loans receivable*

Loans to customers are recognised when cash is advanced to borrowers. They are stated net of provision for doubtful loans.

*Bad and doubtful debts*

Specific provisions are made against loans and advances when in the opinion of management the company will not be able to collect all amounts due according to the original contractual terms of the loans and advances. In addition, general provisions are maintained based on management's evaluation of the portfolio and advances and other exposures in respect of losses, which although not specifically identified are known from experience to be present in any such portfolio.

When a loan is deemed uncollectable, it is written off against the related provision. Subsequent recoveries of amounts written off are credited to the income statement.

*Held to maturity*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. Where a sale occurs other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and classified as available for sale.

*Bank borrowings*

Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges are accounted for on an accrual basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

*Group loan collateral savings*

Group loan collateral savings represent amounts deposited by customers as security for loans advanced and are interest bearing.

SMALL AND MICRO ENTERPRISE PROGRAMME  
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NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

**Impairment of assets**

At each balance sheet date, the company reviews the carrying amount of its financial assets, tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the asset's recoverable amount is estimated and an impairment loss is recognised in the income statement whenever the carrying amount of the asset exceeds its recoverable amount.

**Leases**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made by way of penalty is recognised as an expense in the period in which termination takes place.

**Taxation**

The company is not a profit making organisation and has applied to the Kenya Revenue Authority for tax exemption. Provisions for taxation have thus not been made in these financial statements as, in the opinion of the directors, the tax exemption will be granted given the charitable nature of the company's principal activities.

**Retirement benefits**

The company operates a provident fund for its employees. The scheme is administered independently by Insurance Company of East Africa and is funded by contributions from both the company and employees.

The company also makes contributions to the National Social Security Fund (NSSF), which is a statutory defined contribution pension scheme. The scheme is registered under the National Social Security Act. The company's obligations under the scheme are limited to specific contributions legislated from time to time and are currently limited to Sh 200 per employee per month. The company's contributions are charged to the income statement as they fall due.

	2005 Sh	2004 Sh
2 INTEREST INCOME		
Interest on loans	94,141,769	75,607,135
Interest on treasury bills and short term deposits	10,146,393	6,472,667
	<hr/>	<hr/>
	104,288,162	82,079,802
	<hr/> <hr/>	<hr/> <hr/>
3 INTEREST EXPENSE		
Interest on loans	19,983,772	17,924,870
Interest on group collateral savings	4,863,498	1,831,028
Interest on bank overdraft	646,700	5,408,637
	<hr/>	<hr/>
	25,493,970	25,164,535
	<hr/> <hr/>	<hr/> <hr/>

SMALL AND MICRO ENTERPRISE PROGRAMME  
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NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2005 Sh	2004 Sh
4 FEE INCOME		
Loan disbursement fees	13,198,969	11,778,332
Loan application fees	7,143,761	6,209,376
Management fees	845,500	4,144,500
Membership fees	1,605,676	1,698,600
	<u>22,793,906</u>	<u>23,830,808</u>

Management fees relates to fees charged for administration of Micro Enterprise Development Project (MEDP) - note 17.

	2005 Sh	2004 Sh
5 OTHER OPERATING INCOME		
Sundry income	1,896,827	1,379,069
Bad debts recovered	368,727	137,156
Gain on disposal of property and equipment	-	450,000
	<u>2,265,554</u>	<u>1,966,225</u>

6 OPERATING EXPENSES		
Staff costs (note 7)	53,769,200	48,454,466
Travel and transport costs	4,058,826	4,009,764
Bank charges	3,832,686	3,204,116
Programme costs	3,491,601	4,622,234
Depreciation	3,251,149	3,513,287
Office rent	3,164,561	3,086,588
Printing and stationery	3,035,949	2,507,883
Communication expenses	2,602,219	2,481,722
Office expenses	2,278,649	2,174,367
Loans receivable insurance	1,928,979	2,400,000
Legal and professional fees	1,368,391	916,805
Auditors' remuneration - company	885,000	660,000
- USAID project	-	72,000
Provident fund liquidation expenses	600,000	-
Personnel insurance	575,521	311,341
Computer expenses	538,738	549,134
Office equipment maintenance	339,259	226,963
Fidelity insurance	228,590	227,622
Subscriptions and donations	209,500	363,147
General insurance	139,346	119,227
Advertising costs	79,876	293,462
	<u>86,378,040</u>	<u>80,194,128</u>

SMALL AND MICRO ENTERPRISE PROGRAMME  
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NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2005 Sh	2004 Sh
7 STAFF COSTS		
Basic salaries	31,497,722	28,504,855
House allowances	15,552,858	14,008,137
Provident fund contributions	2,781,615	2,201,021
Medical expenses	1,520,297	1,745,527
Staff training	88,340	219,037
NSSF contributions	222,000	207,225
Leave pay/allowance	314,437	187,595
Casual wages	305,383	110,242
Other staff costs	1,486,548	1,270,827
	<u>53,769,200</u>	<u>48,454,466</u>

The average number of employees during the year was 94 (2004 - 88).

8 GRANT INCOME		
United States of America Agency for International Development (USAID)	-	41,119,667
Evangelischer Entwicklungsdienst e.V. (EED)	-	1,528,001
	<u>-</u>	<u>42,647,668</u>

In 2004, Sh 41,119,667 was in respect of collateralized funds granted by USAID as collateral for the Cooperative Bank Limited overdraft. In accordance with the terms of lending, the amount would be treated as grant on expiry of the contract period. The contract period expired in 2004.

	Maturity date	Interest rate	2005 Sh	2004 Sh
9 SHORT TERM DEPOSITS				
<b>Held to maturity:</b>				
The Co-operative Bank of Kenya Limited	11/01/06	8.25%	8,000,000	-
The Co-operative Bank of Kenya Limited	15/01/06	8.30%	37,397,174	-
The Co-operative Bank of Kenya Limited	16/02/06	7.80%	8,167,365	-
The Co-operative Bank of Kenya Limited	7/03/06	7.80%	5,103,466	-
The Co-operative Bank of Kenya Limited	7/01/05	6.00%	-	45,361,022
The Co-operative Bank of Kenya Limited	15/01/05	4.00%	-	30,000,000
The Co-operative Bank of Kenya Limited	15/03/05	9.00%	-	30,500,000
			<u>58,668,005</u>	<u>105,861,022</u>
Add: Accrued interest			1,149,904	346,031
			<u>59,817,909</u>	<u>106,207,053</u>

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2005 Sh	2004 Sh
10		
TREASURY BILLS		
<b>Held to maturity:</b>		
Face value - maturing within 90 days	42,050,000	80,000,000
Less: unearned discount	-	(434,842)
	<u>42,050,000</u>	<u>79,565,158</u>

The treasury bills held as at 31 December 2005 matured on 1 January 2006. The unearned discount was therefore negligible.

The weighted average effective interest rate on treasury bills as at 31 December 2005 was 8.45% (2004 - 3.5%).

	2005 Sh	2004 Sh
11		
LOANS RECEIVABLE		
Loans to customers	413,683,508	373,980,037
Staff loans	6,491,401	7,381,136
Less: Provision for doubtful loans	(8,337,325)	(7,645,920)
	<u>411,837,584</u>	<u>373,715,253</u>

The maturity periods for loans to customers range from 26 to 78 weeks from the date of the loan disbursements. The loans are disbursed to micro and small enterprises and the effective interest rate at 31 December 2005 was 20% (2004 - 20%).

The maturity periods for staff loans range from 1 to 3 years from the date of the loan disbursements. Interest is charged as per the fringe benefit tax rates prescribed by Income Tax Department.

	2005 Sh	2004 Sh
12		
OTHER RECEIVABLES		
Staff receivables	1,412,227	1,399,966
Due from National Council of Churches of Kenya (NCCK)	563,136	1,412,818
Deposits and prepayments	408,026	338,191
Withholding tax recoverable	233,653	233,653
Insurance claims	35,450	391,317
Administration fees - Micro Enterprise Development Project (MEDP)	-	1,105,500
	<u>2,652,492</u>	<u>4,881,445</u>

SMALL AND MICRO ENTERPRISE PROGRAMME  
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NOTES TO THE FINANCIAL STATEMENTS (Continued)

13 PROPERTY AND EQUIPMENT

	Freehold land Sh	Buildings Sh	Motor vehicles Sh	Equipment, furniture and and fittings Sh	Total Sh
<b>COST</b>					
At 1 January 2004	11,241,263	5,044,829	5,348,648	13,130,905	34,765,645
Additions	-	1,300,000	7,313,025	507,443	9,120,468
Disposals	-	-	(1,489,228)	-	(1,489,228)
At 1 January 2005	11,241,263	6,344,829	11,172,445	13,638,348	42,396,885
Additions	-	461,420	-	821,569	1,282,989
At 31 December 2005	11,241,263	6,806,249	11,172,445	14,459,917	43,679,874
<b>DEPRECIATION</b>					
At 1 January 2004	-	1,328,546	5,348,648	10,291,564	16,968,758
Charge for the year	-	449,727	1,673,613	1,389,947	3,513,287
Eliminated on disposal	-	-	(1,489,228)	-	(1,489,228)
At 1 January 2005	-	1,778,273	5,533,033	11,681,511	18,992,817
Charge for the year	-	222,547	1,673,697	1,354,905	3,251,149
At 31 December 2005	-	2,000,820	7,206,730	13,036,416	22,243,966
<b>NET BOOK VALUES</b>					
At 31 December 2005	11,241,263	4,805,429	3,965,715	1,423,501	21,435,908
At 31 December 2004	11,241,263	4,566,556	5,639,412	1,956,837	23,404,068

Included in property and equipment are assets with a cost of Sh 6,573,324 (2004 - Sh 6,573,324) which were fully depreciated. The normal depreciation charge on these assets would have been Sh 1,773,731 (2004 - Sh 1,773,731).

14 GROUP LOAN COLLATERAL SAVINGS

Group loan collateral savings represent amounts deposited by customers as collateral for loans advanced to the groups.

The weighted average effective interest rate on group loan collateral savings as at 31 December 2005 was 2.3 % (2004 - 0.05%).

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2005 Sh	2004 Sh
15 ACCRUALS AND OTHER LIABILITIES		
Accruals	4,038,511	6,698,955
Sundry payables	1,013,633	1,151,613
	<u>5,052,144</u>	<u>7,850,568</u>
16 BORROWINGS		
<b>Loans:</b>		
The Co-operative Bank of Kenya Limited	73,000,000	117,000,000
Jitegemee Trust Limited	66,660,762	49,401,514
Micro Enterprises Support Programme Trust (MESPT)	43,750,000	-
Plan International	10,170,000	16,000,000
Micro Enterprise Development Project (MEDP)	-	3,600,000
NCKK Advocacy Programme	-	664,396
	<u>193,580,762</u>	<u>186,665,910</u>
<b>Bank overdraft (secured)</b>	4,524,393	61,057,095
	<u>198,105,155</u>	<u>247,723,005</u>
Due within one year	(90,694,391)	(113,490,879)
Due after one year	<u>107,410,764</u>	<u>134,232,126</u>
<b>Movement in loan balances:</b>		
At 1 January	186,665,910	83,998,843
Transferred to revolving loan fund (note 17)	(3,600,000)	-
Receipts in the year	82,477,427	140,900,000
Repayments in the year	(71,962,575)	(38,232,933)
At 31 December	<u>193,580,762</u>	<u>186,665,910</u>

**Details of security and interest rate for loans and bank overdraft**

- a) The Co-operative Bank of Kenya Limited - Interest rate at 11 % (2004 - 11%) p.a. is repayable within 5 years with effect from 2004 on a quarterly basis. The loan is secured by a USAID guarantee amounting to Sh 60 million (US\$ 750,000) and a floating debenture over all assets of the company.

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

16 BORROWINGS (Continued)

**Details of security and interest rate for loans and overdrafts (Continued)**

- b) Jitegemee Trust Limited - Repayable in 3 years and is secured by an unlimited irrevocable guarantee by the NCKK and a debenture on all the assets of the company. The effective interest rate as at 31 December 2005 was 10% (2004 - 7%).
- c) Plan International - The loan is interest free and unsecured. It is repayable within a period two years with effect from April 2005.
- d) The loan from NCKK Advocacy Programme was interest free and unsecured.
- e) Bank overdraft - It is secured by a deposit of Sh 30,000,000 and a lien on all the company's Co-operative Bank of Kenya Limited bank accounts. The effective interest rate as at 31 December 2005 was 13% (2004 - 13%).

17 REVOLVING LOAN FUND

In October 2004, SMEP entered into an agreement with the Ministry of Labour and Manpower Development, Micro Enterprise Development Project (MEDP) supported by DANIDA for a revolving loan fund to aid farming activities in Taita/Taveta district.

The project will run for a period of five years to year 2009.

	2005 Sh	2004 Sh
<b>Movement in revolving loan fund:</b>		
At 1 January	4,800,000	-
Transferred from main loans (note 16)	3,600,000	-
Receipts in the year	5,200,000	4,800,000
	<hr/>	<hr/>
At 31 December	13,600,000	4,800,000
	<hr/> <hr/>	<hr/> <hr/>

18 NOTE TO THE CASH FLOW STATEMENT

(a) Reconciliation of operating surplus to cash used in operations		
Operating surplus	13,364,688	68,541
Adjustments:		
Depreciation	3,251,149	3,513,287
Gain on disposal of property and equipment	-	(450,000)
	<hr/>	<hr/>
Cash generated from operations before working capital changes	16,615,837	3,131,828
Increase in loans receivable	(38,044,872)	(107,830,962)
Decrease in other receivables	2,151,494	1,966,349
Decrease/(increase) in inventory	942,457	(642,842)
Increase in group loan collateral savings	51,590,261	117,319,280
(Decrease)/increase in accruals and other liabilities	(2,798,424)	1,886,896
Decrease in designated funds	-	(44,652,000)
	<hr/>	<hr/>
Cash generated from /(used in) operations	30,456,753	(28,821,451)
	<hr/> <hr/>	<hr/> <hr/>

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2005 Sh	2004 Sh
18	NOTE TO THE CASH FLOW STATEMENT (Continued)	
	(b) CASH AND CASH EQUIVALENTS	
	Bank and cash balances	89,533,942
	Short term deposits	17,273,726
	Treasury bills	59,817,909
	Bank overdraft	106,207,053
		42,050,000
		79,565,158
		(4,524,393)
		(61,057,095)
	186,877,458	141,988,842

For the purpose of the cash flow statement, cash equivalents include short term liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from the banks repayable within three months from the dates of advance.

	2005 Sh	2004 Sh
19	CAPITAL COMMITMENTS	
	Authorised but not contracted for	34,746,000
		1,130,431

The authorised capital commitments relate to computer hardware and software for a new accounting system, a generator and office equipment.

	2005 Sh	2004 Sh
20	OPERATING LEASE COMMITMENTS	
	Non-cancellable future lease obligations payable in respect of rented premises:	
	Within one year	399,800
	In the second to fifth year inclusive	388,800
	After five years	1,596,520
		1,945,520
		-
		14,800
	1,996,320	2,349,120

21 CONTINGENT LIABILITY

The company has applied to Kenya Revenue Authority for tax exemption in view of its principal activities, which are not for profit making. In 2005, the Authority disputed the company's application arguing that the company's activities are taxable under the current interpretation of the Income Tax Act. The directors have contested the Authority's position on this matter but the final outcome of the application has not yet been determined.

No provision has been made in the financial statements for the tax liability as, in the opinion of the directors, the waiver will be granted.

SMALL AND MICRO ENTERPRISE PROGRAMME  
(A COMPANY LIMITED BY GUARANTEE)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

22 RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

All transactions with related parties are at arm's length in the normal course of business, and on terms and conditions similar to those applicable to other customers.

- a) SMEP is a company limited by guarantee of NCCCK. During the year the following transactions took place with NCCCK.

	2005 Sh	2004 Sh
Interest earned on loan	437,500	-
	<u>437,500</u>	<u>-</u>

The loan balance at year end was nil.

The balance in the current account with NCCCK is disclosed on note 12.

- b) Key management compensation

The remuneration of members of key management during the year were as follows:

	2005 Sh	2004 Sh
Salaries and other benefits	10,770,000	7,820,000
	<u>10,770,000</u>	<u>7,820,000</u>

The average number of key management during the year was 6 (2004 - 5).

23 COUNTRY OF INCORPORATION

The company is domiciled and incorporated in Kenya under the Companies Act.

24 CURRENCY

The financial statements are presented in Kenya shillings (Sh).