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United Nations relief and
works agency for Palestine
refugees in the near east

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CERTIFICATION OF THE ANNUAL FINANCIAL STATEMENTS

Microfinance Department

The annual financial statements and notes from page 1 to 38 were prepared by the Director, Microfinance Department and the Chief of Finance (MD) and certified by UNRWA Director of Finance. The accompanying notes on pages 5 to 38 are an integral part of the annual financial statements.

Alex Pollock
Director Microfinance Department

Wissam Saeed
Chief of Finance (MD)

Pursuant to financial regulation 11.4 and 12.1, I have the honour to submit UNRWA's Microfinance Department (MD) Annual Financial Statements for the year ended 31 December 2010.

I certify that all transactions have been properly recorded on the accrual basis of accounting in the accounting records and properly reflected in the MD's financial accounts and appended statements, which I hereby certify as accurate and representative of the MD's operating activities and the financial state of affairs as of 31 December 2010.

Director of Finance
Bernard Laufenberg

DFIN / Accounts
Budget / Finance Unit
11 APR 2011
Ref: 104
Prov. Fund / Treasury



**United Nations Relief and Works Agency
For Palestine Refugees in the Near East**

Microfinance Department

West Bank, Gaza, Jordan and Syria

Annual Financial Statements

31 December 2010

**United Nations Relief and Works Agency
For Palestine Refugees in the Near East**

Microfinance Department

West Bank, Gaza, Jordan and Syria.

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United Nations Relief and Works Agency
For Palestine Refugees in the Near East
Microfinance Department

Statement of Financial Position
As of 31 December 2010

Assets	Note	2010 USD	2009 USD
<i>Non-Current Assets</i>			
Intangible Assets	6.2	150,000	60,000
Property, Plant and Equipment	6.1	1,002,533	882,469
Gross Loans Receivable, Net	5	2,513,954	1,261,519
		3,666,487	2,203,988
<i>Current Assets</i>			
Gross Loans Receivable, Net	5	19,355,256	16,860,267
Pledges Receivable	9.3	106,434	270,956
Prepayments and Other Receivables		268,053	183,422
Cash and Cash Equivalents	4	8,543,570	9,289,724
		28,273,313	26,604,370
<i>Total Assets</i>		31,939,800	28,808,358
<i>Equity</i>			
Retained Earning	14	(4,084,868)	(5,228,209)
Fund Held For Training		88,182	121,219
Board Designated Fund/MIS System		20,209	20,209
Temporary Restricted	9.2	441,616	-
Loan Revolving Fund	10	22,981,798	22,862,698
<i>Total Equity (Statement-C)</i>		19,446,937	17,775,917
<i>Non-Current Liabilities :</i>			
Retirement Benefit Obligations	11.1	1,201,875	797,328
Liability - OFID Pal Fund Trust Fund	8.1	9,875,000	8,875,000
		11,076,875	9,672,328
<i>Current Liabilities</i>			
Payables and Accruals		638,659	658,017
Staff Leave Obligation	11.2	266,092	253,776
Bills Payable to UNRWA	7	511,237	448,318
<i>Total Current Liabilities</i>		1,415,988	1,360,111
<i>Total Liabilities</i>		12,492,863	11,032,440
<i>Total Equity and Liabilities</i>		31,939,800	28,808,358

United Nations Relief and Works Agency
For Palestine Refugees in the Near East
Microfinance Department

Statement of Comprehensive Income
For the Year Ended 31 December 2010

	Note	2010 USD	2009 USD
<i>Interest and Other Operating Income:</i>			
Interest on Loans	5.9.2	7,681,636	6,584,317
Accrued Interest Revenue		128,356	117,818
Interest on bank deposits and other revenues		17,510	15,858
Grants Funds for Operations	12	228,907	153,779
Other Income		43,234	88,951
Training Income		78,569	139,069
<i>Total Operating Revenues</i>		8,178,212	7,099,792
<i>Impairment Losses On Loans</i>			
Provision for Impaired Loans		(883,500)	(834,466)
Recoveries from Written off Loans	5.9.2	524,703	505,930
<i>Net Impairment Losses on Loans</i>		(358,797)	(328,535)
<i>Operating Expenses:</i>			
Salaries and Related Expenses	5.10.3	4,340,894	3,417,494
Audit Fees Expenses		112,750	85,118
Special Service Contracts		294,274	213,354
Other Contractual Expenses		368,081	151,025
Occupancy	13	400,294	325,616
Communication		141,863	147,283
Stationary and Supplies		120,335	109,679
Minor Equipment and Maintenance		120,730	64,088
Travel and Transportation		322,405	267,712
Depreciation	6.1	243,199	240,915
Program Support Costs		37,499	76,907
Training Costs		124,697	94,338
Other Costs		45,055	18,179
<i>Total Operating Expense</i>		(6,672,076)	(5,211,706)
<i>Operating Income (Loss) for the Year</i>		1,147,339	1,559,551
<i>Gain (Loss) on Difference of Currency</i>		(37,036)	(8,599)
<i>Net Year Income (Loss) / Year (Statement – C)</i>		1,110,303	1,550,952

United Nations Relief and Works Agency
For Palestine Refugees in the Near East
Microfinance Department

Statement of Equity
For the year ended 31 December 2010

	Retained Earning	Board Designated Fund		Temporary Restricted Fund	Revolving Loan Fund	Total
		Fund Held for Training	MIS System			
	USD	USD	USD	USD	USD	USD
<i>Net Assets as at 1st January 2009</i>	(6,732,766)	74,824	23,428	-	22,815,665	16,181,151
Operating Profit (Loss) for Year 2009 (Statement – B)	1,504,557	46,395				1,550,952
Additional Fund for the Period			(3,219)	47,033		43,814
Releases to Revolving Loan Fund				(47,033)	47,033	-
<i>Net Assets at Beginning of Year 2010</i>	(5,228,209)	121,219	20,209	-	22,862,698	17,775,917
Operating Profit (Loss) for Year 2010 (Statement - B)	1,143,340	(33,037)				1,110,303
Additional Fund for the Period			-	560,716		560,716
Releases to Revolving Loan Fund				(119,100)	119,100	-
<i>Net assets at end of year (Statement -A)</i>	(4,084,868)	88,182	20,209	441,616	22,981,798	19,446,937

United Nations Relief and Works Agency
For Palestine Refugees in the Near East
Microfinance Department

Statement of Cash Flows
For the year ended 31 December 2010

	Note	2010 USD	2009 USD
<i>Cash Flows from Operating Activities:</i>			
Contributions Received		560,716	27,386
Interest on Loans and Other Revenues		8,284,821	7,152,499
Loans Issued net of Collections		(4,630,928)	(3,080,578)
Cash Paid to Employees and Suppliers		(5,509,542)	(4,820,696)
<i>Net cash utilised by operating activities</i>	19	<u>(1,294,933)</u>	<u>(721,389)</u>
<i>Cash Flows from Investing Activities:</i>			
Procurement Intangible Assets _MIS		(90,000)	(60,000)
Procurement of Fixed Assets	6.1	(363,263)	(157,450)
		<u>(453,263)</u>	<u>(217,450)</u>
<i>Cash Flows from Financing Activities:</i>			
Liability to - OFID Pal Fund Trust Fund	8.1	1,000,000	2,000,000
		<u>1,000,000</u>	<u>2,000,000</u>
<i>Currency Exchange on Cash and Banks</i>			
		<u>2,042</u>	<u>1,756</u>
<i>Net Cash Movement</i>		<u>(746,154)</u>	<u>1,062,917</u>
Cash at Beginning of the Year	4	9,289,724	8,226,807
<i>Cash on Hand and Deposits at the end of Year</i>		<u>8,543,570</u>	<u>9,289,724</u>
Restricted Cash and Banks during the period		3,246,996	1,826,458
Increase (Decrease) in Cash and Banks During the Period		<u>(3,993,150)</u>	<u>(763,541)</u>
<i>Net Cash Movement</i>		<u>(746,154)</u>	<u>1,062,917</u>

**United Nations Relief and Works Agency
For Palestine Refugees in the Near East
Microfinance Department**

**Notes to the Annual Financial Statements
31 December 2010**

(Amounts are expressed in US Dollars)

1. Microfinance and Other Activity

A - Microfinance Department

The Microfinance Department (MD) is a department of the United Nations Relief and Works Agency for Palestine in the Near East (UNRWA), which provides inclusive financial services for Palestine refugees and others. UNRWA was established by United Nations General Assembly resolution 302 (IV) of 8 December 1949 as a separate entity within the United Nations System and it began operations on 1 May 1950. The mandate of UNRWA has been renewed continuously, most recently by the General Assembly in its resolution A/RES/65/98 of 10 December 2010, when it was extended until 30 June 2014.

UNRWA's Commissioner-General reports directly to the General Assembly to which s/he submits an annual report. A general review of UNRWA programmes and activities is undertaken several times a year by the 24 member Advisory Commission, which includes representatives of the Agency's donors and host authorities, as well as three observers who are the Palestine Liberation Organisation, the League of Arab States and the European Union.

The headquarters of the MD is located in East Jerusalem in UNRWA's West Bank Field Office, while its credit operations are located in field offices and branch offices throughout the region. The principal place of business of the department is:

Microfinance Department
UNRWA
Ammunition Hill
Zalman Sharagi Street
P.O. Box 19149
Sheikh Jarrah
East Jerusalem

The Microfinance Department prepares and presents separate annual financial statements that are certified by UNRWA's Director of Finance.

Established as a programme in the occupied Palestinian territory in June 1991, UNRWA's MD has promoted small business development, created employment, improved the income of microenterprises and reduced poverty through the establishment of a number of targeted credit products aimed at small businesses,

microenterprises, women, youth, consumers and householders. In 2003, the department also expanded its microfinance operations into Jordan and Syria.

The department is run on a profitable business model and organizes its lending through a revolving loan fund that serves the operations in all fields. It supports businesses varying in size from micro-vendors, employing just one or two individuals to small industrial firms and aims to satisfy a variety of needs for capital funding and working capital financing. It also provides non-business financial services to working class consumers and poor households. As a United Nations agency it is normally exempt from taxes.

The department's credit finances customers through seven credit facilities. These are: Microenterprise Credit (MEC); Microenterprise Credit Plus (MEC+); Solidarity Group Lending (SGL); Women's Household Credit (WHC); Small-Scale Enterprise (SSE); Consumer Lending Product (CLP); and Housing Loan Product (HLP).

These financial services are retailed through a network of 20 branch offices, of which eight are located in the West Bank, three in Gaza, five in Syria and four in Jordan. In 2010, two new offices were opened in Syria in Aleppo and Douma (Damascus) and another was opened in Jericho in the West Bank, although it will not begin retailing credit until January 2011. The branch offices are supported by four field offices in West Bank, Gaza, Jordan and Syria.

B- Small Microenterprise Training Programme (SMET)

UNRWA's MD also provides business training in Gaza only through its Small and Microenterprise Training (SMET) programme that only operates in Gaza. The main goal of the training programme is to contribute to the economic development of the Gaza Strip, through supporting small businesses and encouraging entrepreneurship. The programme's outreach grew in 2010. The programme has its own separate expenses and budget. The programme income is generated from trainee's fees and donor contributions as indicated in Statement of Comprehensive Income by Services note 16.1.

The training programme aims to provide a range of business training courses to the business community in Gaza; to promote an entrepreneurial spirit with requisite business 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-date subject matter; to develop a business curriculum that is relevant to the state of the local microenterprise economy and to make training material and resources more readily available; to promote co-operation and co-ordination among institutions engaged in small and microenterprise development, through contact groups and workshops; and to enable small businesses in the Gaza Strip to compete in regional and global markets.

The financial activities of the programme comprising training fees charged and direct costs of the programme, are presented in its separate Statement of Comprehensive Income for the year ended 31 December 2010.

2. Adoption of New and Revised Standards

New and revised standards adopted for reporting the annual financial statements were:

IAS (1) (revised) Presentation of Financial Statements

Terminological changes were introduced to revise titles for the annual financial statements since 2009, with changes in the format and content of the annual financial statements. This included:

- Renaming the “Balance Sheet” to be called “Statements of Financial Position”;
- Renaming the “Statement of Income” to be termed “Statement of Comprehensive Income”; and
- Renaming the “Statement of Net Assets” to the “Statement of Equity”.

IFRS (8) (new) Operating Segments

This new disclosure standard requires operating segments to be identified on the basis of internal reports about components of the entity that are regularly reviewed in order to allocate resources to the segments and assess their performance. This is in contrast to IAS (14) on Segment Reporting that required an entity to identify two sets of segments (business and geographical), which are still included in the notes for information purposes.

IAS (7) (revised) Statement of Cash flows

This requires reclassifying cash and cash equivalents into restricted and unrestricted balances held with banks with maturities of less than three months, which are subject to insignificant risk of changes in their fair value.

IAS (20) (revised) Grants

Grants are not recognized until there is reasonable assurance that the department will comply with the conditions attaching to them and that the grants will be received. Grants whose primary condition is that the department should purchase, construct or otherwise acquire non-current assets are recognized as deferred revenue in the Statement of Financial Position and transferred to profit and loss on a systematic and rational basis over the useful life of the related asset. Other grants are recognized as revenue over the period necessary to match them with the cost for which they are intended to compensate, on a systematic basis. Grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the department with future related costs are recognized in the profit or loss in the period in which they become receivable.

IFRS (7) (revised) Financial Instruments: Disclosures

The amendments expand disclosures required in respect to Financial Instruments fair value measurement and liquidity risk. For the department, Currency Risk is disclosed and calculated to:

- include a note about monetary assets and liabilities denominated in foreign currency;
- denominate the assets in a foreign currency template; and
- conduct foreign currency sensitivity analysis.

New and revised standards adopted for reporting the financial statements in 2010 were:

IAS (17) (revised) Leases

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

IAS (36) (revised) Impairment of Assets

To ensure that assets are not carried at an amount that is greater than their recoverable amount.

3. Summary of Significant Accounting Policies and Preparation

3.1 Preparation of the Annual Financial Statements

The MD prepares its annual financial statements in accordance with International Financial Reporting Standards (IFRS) using the accrual basis of accounting. The MD works in three countries where four different currencies are legal tender. It uses three functional currencies. In Syria, it uses Syrian pounds (SYP), in Jordan, it uses Jordanian dinar (JOD), in West Bank, it uses Jordanian dinar and, in Gaza, it uses US dollars (USD). The presentational currency is in US dollars. The presentation of figures in the annual financial statements is in numerically exact units, with no rounding except for decimals.

3.2 Use of Estimates and Judgments

In the preparation of annual financial statements and implementation of accounting policies, the MD management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. The estimates and underlying assumptions will be reviewed on an ongoing basis.

3.3 Funds of MD and changes therein are classified and reported as follows:

- *Retained Earnings* – Utilization of net assets by MD is not subject to donor-imposed restrictions. It includes earnings or losses from operations.

- *Temporary restricted net assets* - Net assets whose use by MD is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and released by actions of MD pursuant to those donor-imposed stipulations.
- *Revolving Loan Fund* - Restricted contributions received for on-lending purposes, which were expended in loans are included in the Revolving Loan Fund once repayments are received and restrictions ended.
- *Grants and Donations* – Grants are not recognised until there is reasonable assurance that the MD will comply with the conditions attached to them and that the grants will be received.
 - Grants whose primary condition is that the MD should purchase, construct or otherwise acquire non-current assets are recognised as deferred revenue in the statement of financial position and transferred to profit or loss on a systematic and rational basis over the useful lives of the related assets.
 - Other grants are recognized as revenue over the periods necessary to match them with the costs for which they are intended to compensate, on a systematic basis. Grants that are receivable as compensation for expenses or losses already incurred, or for the purpose of giving immediate financial support to the MD with no future related costs, are recognized in profit or loss in the period in which they become receivable.

3.4 Loans Receivable and Allowance for Loan Losses

3.4.1 Provision for Impairment of Loans

Each quarter the department assesses whether a loan asset or group of loan assets is impaired. A group of loan assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred ("loss event") after the initial recognition of the asset and that loss event (or events) had an impact on the estimated future cash flows of the loan asset or group of loan assets that can be reliably estimated.

Criteria used to determine that there is objective evidence of an impairment loss may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, breach of loan covenants or conditions, deterioration in the value of collateral, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

The department first assesses whether impairment exists through determining all loans with a principal outstanding balance of more than or equal to USD 3,000 in Gaza, JOD 2,000 in the West Bank and Jordan and SYP 30,000 in Syria that are late by more than ninety days within the period. Each of these loans is then assessed separately to determine if there is objective evidence of impairment loss. If there is, then the whole amount of the principal loan outstanding balance is impaired. The remaining balance of the asset shall be reduced through use of an allowance account. The amount of the loss shall be recognized in the income statement.

If, in the subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the

previously recognized impairment loss is increased or reduced by adjusting the allowance account.

3.4.2 Allowance for Loan Losses

As the Department moved its accounting approach to the full accrual method in 2006, management adjusted FTI No. 42 in order that the provision for bad debts is based on a new "aged portfolio at risk report" (see below) that makes the provision for bad debt on the total amount outstanding on the loan. Based upon empirical experience, historical record and market knowledge, it was determined that the following general provision is required for delinquent and defaulting loans.

Loan Status	Allowance (percent)	
Current	1 %	General Provision
1 – 30 days overdue	5 %	General Provision
31 – 60 days overdue	10 %	General Provision
61 – 90 days overdue	25 %	General Provision
91 – 120 days overdue	50 %	General Provision
121 – 180 days overdue	75 %	General Provision
181 – 360 days overdue	100%	General Provision

Based upon the above percentages, if a loan is not serviced, an increasing reserve should be provided for. This provision will be shown in the income statement for the period. On a monthly basis, adjustment is made to reflect the changes in the General Provision. After a loan is in arrears for 360 or more and has been fully provisioned in the general provision and accrued interest in suspense, a write-off will take place. Write-offs are only an accounting entry; they do not mean that the department has relinquished the legal claim to recover those loans. Recovery of written-off loans will continue to be pursued through the collection and compliance section of the Microfinance Department.

3.4.3. Related-Party (“insider”) Loans

The MD provides credit facilities to staff, but not to the executive director or advisory board members, effective 2007. The conditions and interest charged to staff-clients are identical to those of other customers. Such loans are provided for consumption and housing.

3.4.4. Accrued Interest on loans

Effective 2006, the interest income on loans financed is accounted for on the accrual basis in compliance with IAS 18. This is done by accruing interest up to 90 days by debiting accrual receivables and crediting interest revenue. After 90 days, all uncollected accrual receivables are transferred to Interest in Suspense by debiting the interest revenue and crediting interest in suspense. After 360 days all bad debts that have past due are written off.

3.4.5 Recoveries

Any recoveries of previously written off loans are taken to the statement of profit and loss in the period they are received.

3.4.6 Cash and Cash Equivalents

Cash and Cash Equivalents comprise cash balances on-hand and short-term highly liquid investments with maturities of three months or less when purchased

3.5 Property Plant and Equipment:

3.5.1 Fixed Assets

Fixed assets are stated at cost net of accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful life of the respective assets, based on historical experience, management maintained a policy for fixed assets as follows:

	<u>Years</u>
Furniture and Equipment	10
Computers and Printers	3
Vehicles	7
Leasehold Improvements	5

3.5.2 In-kind Donations

No in-kind donations of Property Plant and Equipment (PPE) were received during the financial year 2010.

3.6 Employee Separation Benefits

3.6.1 Provident Fund

All area staff members of MD participate in the UNRWA provident fund (PF) contributory scheme. Staffs' monthly contributions into the scheme are set at 7.5 percent of base salary and the UNRWA contribution is set at 15 percent. Under the PF rules, staff members are allowed to make additional voluntary contributions up to a maximum of 50 percent of monthly payroll. All participants receive the 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.

3.6.2 Retirement Benefit Obligation

Since 2005, the department has booked provisions for "Retirement Benefits Obligations".

UNRWA staff were in the past categorized as "A" and "X" staff:

"A" category: refers to staff contracted before the year 1990

"X" category: refers to staff contracted after 1990

Effective January 1, 2007 UNRWA's Commissioner-General approved the equalization of Termination Indemnity between category A and X to ensure parity between all area staff members through which both categories were entitled to the same termination indemnity benefits .

Effective January 1, 2010 UNRWA's Commissioner-General approved an amendment to Area Staff Rule 109.2 on Retirement Benefits and Early Voluntary Retirement through Transmittal Memorandum No. 127, which resulted in:

- a. An increase in the retirement benefit of UNRWA staff from 8.5 percent to 10 percent of ending salary for each year of qualifying service;
- b. A decrease in the Early Voluntary Retirement (EVR) age from 50 to 45 years of age for staff members with at least 10 years of qualifying services;
- c. A decrease in the number of qualifying years of service for EVR at any age from 25 to 20 years of service; and,
- d. Delegation of authority to Field Office Directors and the Director of Human Resources for certain exceptional extensions beyond retirement age.

In order to effect the change in policy in the determination of the provision of termination indemnity, staff were classified into three groups:

Group 1: Those with less than 10 years of service and/or less than 46 years of age;

Group 2: Those with more than or equal to 10 years of service and aged between 46 and 55;

Group 3: Those fully eligible for 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: 0.10 * Total Years in Service * Annual Base Salary

In order to secure the availability of funds to implement the policy, the MD management has established a restricted internal cash reserve of 10 percent of the annual provision requirement to manage staff receiving their end of term entitlements each year.

3.6.3 Staff Leave Accruals

In accordance with UNRWA staff rule 105.1 concerning annual leave, staff are entitled to carry forward up to 10 working days for duty stations with a 5-day working week, and 12 working days for duty stations with a 6-day working week for unutilised leave. Accrued annual leave may be accumulated and carried forward from one calendar year to the next on or after the first day of January of the following year, to a maximum of 37.5 working days for duty stations with 5-day working week, and 45 working days for duty stations with 6-day working week. As all MD staff are working five days a week the accrued annual leave shall be calculated on the base salary by using UNRWA equation to calculate the accrued leave on termination which is: $\text{base salary} / (4.3333 * 5) * \text{Number of days due}$.

3.7 Foreign Currency Transactions

The books of account 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 comprehensive income. All other assets and liabilities are presented in USD equivalent at their historical values.

3.8 Recognition

Held-to-maturity assets, originated loans and receivables are recognised on the day they are transferred to the department.

3.9 De-recognition

A financial asset is de-recognised when the department loses control over the contractual rights that comprise the asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is de-recognised when it is extinguished.

Held-to-maturity instruments, originated loans and receivables are de-recognised on the day they are transferred by the department.

3.10 Measurement

Financial instruments are measured initially at cost. All non-trading financial liabilities, originated loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method.

3.11 Income and Expenses

Income and expenses are recognised in the statement of comprehensive income as they accrue, taking into account the effective yield of the asset.

3.12 Regrouping Accounts

Two accounts in the statement of comprehensive income were regrouped from two to four line items to give a more detailed breakdown of expenses. The change is reflected below as they appeared in 2009 and as they appear in 2010:

2009

- Special Service Contracts
- Stationary and Supplies

Regrouped in 2010 to four line items:

- Audit Fees Expenses
- Special Service Contracts
- Other Contractual Expenses
- Stationary and supplies

3.13 Intangible Assets

3.13.1 Research and Development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognized in profit or loss as incurred. Development activities include a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized only if the development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and MD intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use, and capitalized borrowing costs. Other development expenditure is recognized in profit or loss as incurred: Capitalized development expenditure is measured at cost, less accumulated amortization and accumulated impairment losses.

3.13.2 Lease Payments

Payments made under operating leases are recognized as profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

4. Cash and Cash Equivalents

The year end currency exchange rates of one US dollar against the functional currencies used were:

	<u>2010</u>	<u>2009</u>	<u>Change</u> %
Jordanian Dinar	0.708	0.708	0.00 %
Israeli Shekel	3.63	3.76	-3.50 %
Syrian Pound	46.01	45.60	1.00 %

The composition of cash at year-end was:

	<u>31 December</u>	
	<u>2010</u>	<u>2009</u>
	<u>USD</u>	<u>USD</u>
<u>Unrestricted Cash</u>		
Banks and Cash in Jordanian Dinar	2,845,842	2,771,760
Banks and Cash in New Israeli Shekel	71,430	66,798
Banks and Cash in US Dollar	1,552,040	4,101,080
Banks and Cash in Syrian Pound	<u>827,263</u>	<u>523,628</u>
Total Unrestricted Cash and Cash Equivalents	<u>5,296,575</u>	<u>7,463,266</u>
<u>Restricted Cash</u>		
OFID Pal Fund Trust	2,581,931	1,796,458
Palestinian Monetary Authority (PMA)	30,000	30,000
Bank of Jordan in US Dollar for Staff benefits	635,064	-
Total Restricted Cash and Cash Equivalents	<u>3,246,995</u>	<u>1,826,458</u>
Total Cash	<u>8,543,570</u>	<u>9,289,724</u>

The OFID contract requires that the MD maintains the fund in a separate bank account to lend microenterprise loans in the West Bank and Gaza.

Palestinian Monetary Authority (PMA) in accordance with the agreement with the MD provides credit bureau services for which the MD has to deposit a sum of USD 30,000 in the account of the PMA. This is a special deposit guarantee to ensure the MD's commitment to adhere to the terms of the agreement. The interest rates on this account are paid to the MD.

The MD maintains a US dollar bank account as a reserve to meet staff benefits and indemnities.

5. Gross Loans Receivable, Net

Loans receivable include loans outstanding from funds disbursed through both an initial donor contribution (first time loans) and from revolving loan funds.

Loan receivable outstanding as 31 December 2010 as per the functional and presentational currencies was:

<u>Field</u>	<u>Functional currency</u>	<u>Presentational currency</u> <u>USD</u>
Gaza	USD 4,992,616	4,992,616
West Bank	JOD 6,009,205	8,487,578
Jordan	JOD 3,476,833	4,910,781
Syria	SYP 216,600,068	4,707,674
Total		23,098,649

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

	<u>2010</u> <u>Net Loans</u> <u>USD</u>	<u>2009</u> <u>Net Loans</u> <u>USD</u>
Maturities Less than one year	19,355,256	16,860,267
Maturities over than one year	2,513,954	1,261,519
Total	21,869,210	18,121,787

5.1 Net Gross Loans Receivable is as follows:

	<u>31 December 2010</u>			<u>31 December 2009</u>		
	<u>Loans</u> <u>USD</u>	<u>Allowance</u> <u>USD</u>	<u>NET</u> <u>USD</u>	<u>Loans</u> <u>USD</u>	<u>Allowance</u> <u>USD</u>	<u>NET</u> <u>USD</u>
SSE Loans	71,485	(715)	70,770	82,304	(5,981)	76,323
MEC Loans	11,169,941	(769,815)	10,400,126	11,498,939	(847,837)	10,651,102
MEC+	1,807,105	(75,434)	1,731,671	1,528,907	(37,305)	1,491,602
SGL Loans	359,966	(21,950)	338,016	266,093	(13,500)	252,593
WHC	1,828,165	(33,784)	1,794,381	585,174	(11,178)	573,996
CLP Loans	4,260,623	(259,904)	4,000,719	3,243,979	(188,675)	3,055,304
HLP Loans	3,601,363	(67,835)	3,533,528	2,047,482	(26,614)	2,020,868
Total	23,098,649	(1,229,437)	21,869,210	19,252,877	(1,131,090)	18,121,787

Net loans receivable represent the outstanding balance as of December 31, 2010 and 2009 less the calculated provision for un-collectable loans as of the same date. Net loans receivable is the net realizable value of loans disbursed.

5.2 Changes in Gross Loans Receivable Balances during year 2010 are as follows:

	<u>Beginning</u> <u>USD</u>	<u>Issued</u> <u>USD</u>	<u>Repaid</u> <u>USD</u>	<u>Written Off</u> <u>USD</u>	<u>Total</u> <u>USD</u>
Gaza					
SSE Loans	82,304	51,000	58,903	2,916	71,485
MEC Loans	531,837	1,479,200	1,340,804	28,415	641,819
MEC+ Loans	55,734	418,000	167,290	-	306,444
SGL Loans	266,093	867,800	767,187	6,739	359,966
CLP Loans	431,878	1,513,000	1,195,148	1,021	748,709
HLP Loans	1,670,462	2,752,400	1,555,751	2,919	2,864,192
Sub Total	3,038,308	7,081,400	5,085,083	42,010	4,992,616

<u>West Bank</u>					
MEC Loans	4,314,047	8,254,520	8,448,947	124,350	3,995,269
MEC+ Loans	1,339,159	1,378,531	1,598,044	4,860	1,114,787
WHC Loans	40,401	907,627	388,871	-	559,158
CLP Loans	2,094,050	3,983,616	3,940,860	55,613	2,081,193
HLP Loans	377,020	660,169	300,019	-	737,171
Sub Total	<u>8,164,677</u>	<u>15,184,463</u>	<u>14,676,740</u>	<u>184,823</u>	<u>8,487,578</u>
<u>Jordan</u>					
MEC Loans	4,451,372	7,545,056	7,919,436	471,047	3,605,946
MEC+ Loans	134,013	499,011	247,151	-	385,874
WHC Loans	-	114,407	33,315	-	81,092
CLP Loans	404,645	1,504,237	1,053,613	17,400	837,870
Sub Total	<u>4,990,030</u>	<u>9,662,712</u>	<u>9,253,514</u>	<u>488,447</u>	<u>4,910,781</u>
<u>Syria</u>					
MEC Loans	2,201,683	6,560,606	5,774,391	60,991	2,926,907
WHC Loans	544,772	2,660,606	2,013,177	4,286	1,187,916
CLP Loans	313,407	1,102,165	818,120	4,599	592,851
Sub Total	<u>3,059,862</u>	<u>10,323,377</u>	<u>8,605,688</u>	<u>69,876</u>	<u>4,707,674</u>
Grand Total	<u>19,252,877</u>	<u>42,251,952</u>	<u>37,621,024</u>	<u>785,155</u>	<u>23,098,649</u>

5.3 Percentage of Gross Loans Receivable by Area

	<u>31 December 2010</u>		<u>31 December 2009</u>	
	<u>USD</u>	<u>%</u>	<u>USD</u>	<u>%</u>
Gaza	4,992,616	22 %	3,038,308	16 %
West Bank	8,487,578	37 %	8,164,677	42 %
Jordan	4,910,781	21 %	4,990,030	26 %
Syria	<u>4,707,674</u>	<u>20 %</u>	<u>3,059,862</u>	<u>16 %</u>
	<u>23,098,649</u>	<u>100 %</u>	<u>19,252,877</u>	<u>100 %</u>

5.4 Percentage of Gross Loans Receivable by Type

	<u>31 December 2010</u>		<u>31 December 2009</u>	
	<u>USD</u>	<u>%</u>	<u>USD</u>	<u>%</u>
SSE Loans	71,485	0.3 %	82,304	0.4 %
MEC Loans	11,169,942	48.4 %	11,498,939	59.6 %
MEC+ Loans	1,807,105	7.8 %	1,528,907	8.0 %
SGL Loans	359,966	1.5 %	266,093	1.0 %
WHC Loans	1,828,165	8.0 %	585,174	3.0 %
CLP Loans	4,260,623	18.5 %	3,243,979	17.0 %
HLP Loans	<u>3,601,363</u>	<u>15.5 %</u>	<u>2,047,482</u>	<u>11.0 %</u>
	<u>23,098,649</u>	<u>100 %</u>	<u>19,252,877</u>	<u>100 %</u>

5.5 Changes in the General Loan Loss Reserve during year 2010 are as follows:

	<u>Beginning</u> <u>USD</u>	<u>Additions</u> <u>(Releases)</u> <u>USD</u>	<u>Total</u> <u>USD</u>
<u>Gaza</u>			
SSE Loans	5,981	(5,266)	715
MEC Loans	35,612	15,831	51,443
MEC + Loans	557	2,507	3,064
SGL Loans	13,500	8,450	21,950
CLP Loans	7,626	3,096	10,723
HLP Loans	<u>21,787</u>	<u>26,680</u>	<u>48,467</u>
Sub Total	<u>85,063</u>	<u>51,298</u>	<u>136,362</u>
<u>West Bank</u>			
MEC Loans	268,243	19,043	287,285
MEC+ Loans	33,941	28,731	62,672
WHC Loans	404	7,542	7,946
CLP Loans	151,598	6,923	158,521
HLP Loans	4,828	14,540	19,368
Sub Total	<u>459,013</u>	<u>76,778</u>	<u>535,792</u>
<u>Jordan</u>			
MEC Loans	444,189	(82,835)	361,355
MEC+ Loans	2,807	6,891	9,698
WHC Loans	-	811	811
CLP Loans	<u>20,008</u>	<u>57,343</u>	<u>77,350</u>
Sub Total	<u>467,004</u>	<u>(17,791)</u>	<u>449,213</u>
<u>Syria</u>			
MEC Loans	99,794	(30,061)	69,733
WHC Loans	10,774	14,253	25,027
CLP Loans	9,442	3,868	13,310
Sub Total	<u>120,010</u>	<u>(11,940)</u>	<u>108,070</u>
Grand Total	<u>1,131,090</u>	<u>98,346</u>	<u>1,229,437</u>

5.6 Percentage of Written Off Loans

	<u>31 December 2010</u>		<u>31 December 2009</u>	
	<u>USD</u>	<u>%</u>	<u>USD</u>	<u>%</u>
SSE Loans	2,916	-	52,423	13 %
MEC Loans	684,802	87 %	304,767	78 %
MEC+ Loans	4,860	1 %	-	-
SGL Loans	6,739	1 %	7,601	2 %
WHC	4,286	1 %	274	-
CLP Loans	78,633	10 %	27,669	7 %
HLP Loans	<u>2,919</u>	-	-	-
	<u>785,155</u>	<u>100 %</u>	<u>392,734</u>	<u>100 %</u>

5.7 Gross Loans Receivable, as at 31 December 2010, Distributed by Sector are as follows:

	Agriculture	Commerce	Industry	Service	Consumer	Housing	Total
<u>Gaza</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>
SSE	-	14,440	24,152	32,893	-	-	71,485
MEC	46,767	352,884	26,542	215,626	-	-	641,819
MEC+	4,432	216,106	11,959	73,948	-	-	306,445
SGL	93,557	184,474	48,319	33,617	-	-	359,966
HLP	-	-	-	-	-	2,864,193	2,864,193
CLP	=	=	=	=	748,707	=	748,708
Sub-Total	<u>144,756</u>	<u>767,904</u>	<u>110,972</u>	<u>356,084</u>	<u>748,707</u>	<u>2,864,193</u>	<u>4,992,616</u>
<u>West Bank</u>							
MEC	329,750	1,375,183	432,870	1,857,466	-	-	3,995,269
MEC+	9,998	511,949	153,133	439,707	-	-	1,114,787
WHC	111,876	77,301	119,218	23,700	227,063	-	559,158
CLP	-	-	-	-	2,081,193	-	2,081,193
HLP	-	-	-	-	-	737,170	737,170
Sub Total	<u>451,624</u>	<u>1,964,433</u>	<u>705,221</u>	<u>2,320,874</u>	<u>2,308,256</u>	<u>737,170</u>	<u>8,487,578</u>
<u>Jordan</u>							
MEC	1,911	1,643,422	393,473	1,567,140	-	-	3,605,946
MEC+	-	256,465	36,236	93,173	-	-	385,874
WHC	102	57,919	15,410	4,633	3,028	-	81,092
CLP	=	=	=	=	837,869	-	837,869
Sub Total	<u>2,013</u>	<u>1,957,807</u>	<u>445,119</u>	<u>1,664,945</u>	<u>840,897</u>	<u>=</u>	<u>4,910,781</u>
<u>Syria</u>							
MEC	1,043	1,314,629	425,755	1,185,480	-	-	2,926,907
WHC	557	104,855	93,395	34,316	954,792	-	1,187,916
CLP	-	-	-	-	592,851	-	592,851
Sub Total	<u>1,600</u>	<u>1,419,484</u>	<u>519,151</u>	<u>1,219,796</u>	<u>1,547,643</u>	<u>=</u>	<u>4,707,674</u>
Grand Total	<u>599,992</u>	<u>6,108,922</u>	<u>1,780,463</u>	<u>5,561,699</u>	<u>5,470,325</u>	<u>3,577,248</u>	<u>23,098,649</u>

5.8 Percentage of Gross Loans Receivables Distributed by Sector is as follows:

	<u>31 December 2010</u>		<u>31 December 2009</u>	
	<u>USD</u>	<u>%</u>	<u>USD</u>	<u>%</u>
Agriculture	599,992	3 %	386,313	2 %
Commerce	6,108,922	26 %	5,886,801	30 %
Industry	1,780,463	8 %	1,688,498	9 %
Service	5,561,699	24 %	5,627,783	29 %
Consumer	5,470,325	24 %	3,616,000	19 %
Housing	3,577,248	15 %	2,047,482	11 %
Total	<u>23,098,649</u>	<u>100 %</u>	<u>19,252,877</u>	<u>100 %</u>

*CLP and HLP loans are disbursed to individuals for household improvements and development and are not distributed among any enterprise sector.

5.9.1 Gross Loans Receivable, as at 31 December 2010 distributed by Geographical Area is as follows:

	SSE	MEC	MEC+	WHC	SGL	CLP	HLP	Total	
<u>Gaza</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>
Gaza Area	69,821	251,290	145,714	-	133,164	360,494	1,501,803	2,462,286	
Middle Area	-	133,515	29,794	-	89,925	199,236	731,280	1,183,750	
Southern Area	<u>1,664</u>	<u>257,014</u>	<u>130,937</u>	-	<u>136,877</u>	<u>188,978</u>	<u>631,110</u>	<u>1,346,580</u>	
Total Gaza	<u>71,485</u>	<u>641,819</u>	<u>306,445</u>	-	<u>359,966</u>	<u>748,708</u>	<u>2,864,193</u>	<u>4,992,616</u>	
<u>West Bank</u>									
Nablus	-	729,200	289,882	176,661	-	393,452	156,575	1,745,770	
Tulkarm	-	484,723	31,073	121,387	-	178,647	68,733	884,564	
Jenin	-	627,611	2,740	50,166	-	206,502	8,999	896,017	
Qalqilya	-	162,466	56,595	62,520	-	128,936	35,259	445,777	
Ramallah	-	631,230	402,109	-	-	311,212	28,989	1,373,540	
Bethlehem	-	726,234	204,094	42,422	-	452,055	261,812	1,686,617	
Hebron	-	<u>633,804</u>	<u>128,293</u>	<u>106,003</u>	-	<u>410,389</u>	<u>176,805</u>	<u>1,455,294</u>	
Total W.B	-	<u>3,995,269</u>	<u>1,114,787</u>	<u>559,158</u>	-	<u>2,081,193</u>	<u>737,170</u>	<u>8,487,578</u>	
<u>Jordan</u>									
Wehdat	-	1,025,093	125,881	-	-	150,452	-	1,301,427	
Al-Balad	-	1,056,376	87,462	-	-	266,497	-	1,410,335	
Bayader	-	774,722	156,994	-	-	318,326	-	1,250,042	
Al-Zarqa	-	<u>749,754</u>	15,537	81,092	-	102,594	-	<u>948,977</u>	
Total Jordan	-	<u>3,605,946</u>	<u>385,874</u>	<u>81,092</u>	-	<u>837,869</u>	-	<u>4,910,781</u>	
<u>Syria</u>									
Yarmouk	-	920,214	-	378,054	-	146,058	-	1,444,326	
Al-Ameen	-	1,273,819	-	396,943	-	265,098	-	1,935,860	
Saida Zeynab	-	421,732	-	358,346	-	112,749	-	892,826	
Douma	-	142,204	-	12,774	-	68,946	-	223,924	
Aleppo	-	<u>168,938</u>	-	<u>41,800</u>	-	-	-	<u>210,738</u>	
Total Syria	-	<u>2,926,907</u>	-	<u>1,187,916</u>	-	<u>592,851</u>	-	<u>4,707,674</u>	
Grand Total	<u>71,485</u>	<u>11,169,942</u>	<u>1,807,106</u>	<u>1,828,166</u>	<u>359,966</u>	<u>4,260,621</u>	<u>3,601,363</u>	<u>23,098,649</u>	

5.9.2 MD internal reports, decisions, and performance assessments include interest income and recovery income from different loan products based on geographical segments as follows:

	SSE	MEC	MEC+	WHC	SGL	CLP	HLP	Total	Location Ratio
	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	
Interest on Loans									
Gaza	14,077	244,208	48,970	-	133,591	260,289	361,773	1,062,908	13.80 %
West Bank	-	1,517,862	497,192	101,759	-	1,011,145	97,845	3,225,803	42.00 %
Jordan	-	1,454,720	97,664	9,822	-	262,309	-	1,824,515	23.75 %
Syria	-	<u>993,088</u>	-	<u>398,631</u>	-	<u>176,691</u>	-	<u>1,568,410</u>	<u>20.45 %</u>
Total	14,077	4,209,878	643,826	510,212	133,591	1,710,434	459,618	7,681,635	
Product Ratio	0.20 %	54.80 %	8.38 %	6.64 %	1.73 %	22.26 %	5.99 %		
Recoveries from Written loans									
Gaza	46,342	48,723	-	-	35,379	-	12,369	142,813	27.21 %
West Bank	12,030	219,378	-	5	-	31,155	-	262,568	50.04 %
Jordan	-	96,341	-	-	-	445	-	96,786	18.44 %
Syria	-	<u>21,708</u>	-	<u>613</u>	-	<u>215</u>	-	<u>22,536</u>	4.31 %
Total	58,373	386,150	-	618	35,379	31,815	12,369	524,704	
Product Ratio	11.12%	73.59 %	-	0.11 %	6.74 %	6.06 %	2.38 %		

5.10.1 Related Parties, with 362 staff, during 2010 some 28 loans were lent to the MD staff in Gaza, West Bank, Jordan and Syria in the form of consumer loans with a value of USD 47,927.00 the outstanding balance of these loans at the end of the year was:

	<u>2010</u> <u>USD</u>	<u>2009</u> <u>USD</u>
Loans Disbursed	47,927	16,600
Repayments	(16,729)	(5,698)
End Of Year Outstanding Balance	<u>31,198</u>	<u>10,902</u>

5.10.2 Key Management Staff

The MD paid salaries and related benefits to seven of its key senior management staff during 2009 and 2010 as follows:

	<u>2010</u> <u>USD</u>	<u>2009</u> <u>USD</u>
Amount paid during the year	<u>487,277</u>	<u>373,057</u>

5.10.3 Salaries and Related Expenses

	<u>2010</u> <u>USD</u>	<u>2009</u> <u>USD</u>
Salaries and Wages	3,320,602	2,880,627
Provident Fund Contribution	346,056	300,168
Increase in liability for staff Leave	12,316	52,454
Death benefits and Leave Paid	32,029	-
Increase in staff retirement benefit obligation	404,547	82,947
Exchange difference arising from personnel expense	<u>225,344</u>	<u>101,298</u>
Total Salaries and Related Expenses	<u>4,340,894</u>	<u>3,417,494</u>

5.11 MD's loan collateral is determined according to the loan product, loan size and the legal requirements in each area of operations.

Product	Min-Max loan amount	Collateral
Gaza		
SGL	USD 200 - 4,000	Loan contract plus notarial deed
CLP	3 times monthly salary	Loan contract plus post-dated cheques
HLP	USD 2,500 -15,000	Guarantor (UNRWA employee) plus loan contract plus post-dated cheques
MEC	USD 400 - 8,000	loan contract plus post-dated cheques
MEC+	USD 5,000 - 21,000	Loan contract plus post-dated cheques (non-blank cheques) for value of loan and date or blank cheques, plus guarantor(UNRWA Staff)
SSE	USD 3,000 - 70,000	Guarantor (UNRWA employee) plus loan contract plus post-dated cheques

West Bank		
MEC	JOD 200 - 8,000	Loan contract plus post-dated cheques (non-blank cheques) for value of loan and date or blank cheques, plus promissory note, plus social guarantor
CLP	3 times monthly salary	Loan contract plus post-dated cheques (non-blank cheques) for value of loan and date or blank cheques, plus promissory note, plus social guarantor
MEC+	JOD 6,100 – 15,000	Loan contract plus post-dated cheques (non-blank cheques)for value of loan and date or blank cheques, plus promissory note, plus social guarantor
HLP	JOD 4,000 - 12,000	Loan contract plus post-dated cheques (non-blank cheques) for value of loan and date or blank cheques, plus promissory note, plus social guarantor
WHC	JOD 200 – 1,500	Loan Contract plus promissory note plus social guarantor.
Jordan		
MEC	JOD 200 - 6,000	Loan contract plus post-dated cheques (non-blank cheques) for value of loan and date or blank cheques.
CLP	3 times monthly salary	Loan contract plus post-dated cheques (non-blank cheques) for value of loan and date or blank cheques.
MEC+	JOD 6,100 - 15,000	Loan contract plus post-dated cheques (non-blank cheques) for value of loan and date or blank cheques plus notarial deed for new clients.
WHC	JOD 200-1500	Loan contract plus post dated cheques (non blank cheques) for value of loan and date, plus promissory note signed by the client and the guarantor.
Syria		
WHC	SYP 10,000 - 150,000	Loan contract plus notarial deed. Post-dated cheques for loans above SYP 100,000
CLP	SYP 10,000 - 150,000	Loan contract plus notarial deed. Post-dated cheques for loans above SYP 100,000
MEC	SYP10,000 - 300,000	Loan contract plus notarial deed. Post-dated cheques for loans above SYP 100,000

6. Property, Plant and Equipment

6.1 Composition for 2010

	Furniture And Equipment USD	Computers And Hardware USD	Vehicles USD	Leasehold Improvements USD	Total USD
Cost :					
Balance Jan. 1	<u>592,628</u>	<u>375,909</u>	<u>551,636</u>	<u>354,688</u>	<u>1,874,861</u>
Additions	100,088	79,808	83,613	99,755	363,263
Disposals					
Balance Dec. 31	<u>692,716</u>	<u>455,717</u>	<u>635,249</u>	<u>454,443</u>	<u>2,238,124</u>
Accumulated Depreciation					
Balance Jan. 1	223,812	300,037	241,454	227,088	992,391
Depreciation	53,650	55,646	83,506	50,397	243,199
Disposals					
Balance Dec. 31	<u>277,462</u>	<u>355,683</u>	<u>324,960</u>	<u>277,485</u>	<u>1,235,590</u>
Net Book Value	<u>415,254</u>	<u>100,033</u>	<u>310,289</u>	<u>176,958</u>	<u>1,002,533</u>

Composition for 2009:

	Furniture And Equipment USD	Computers And Hardware USD	Vehicles USD	Leasehold Improvements USD	Total USD
Cost :					
Balance Jan. 1	518,755	371,738	542,017	327,812	1,760,322
Additions	73,873	47,082	9,619	26,876	157,450
Disposals	-	(42,911)	-	-	(42,911)
Balance Dec. 31	<u>592,628</u>	<u>375,909</u>	<u>551,636</u>	<u>354,688</u>	<u>1,874,861</u>
Accumulated Depreciation					
Balance Jan. 1	173,553	282,762	166,723	170,740	793,778
Depreciation	50,259	60,186	74,731	56,348	241,524
Disposals	-	(42,911)	-	-	(42,911)
Balance Dec. 31	<u>223,812</u>	<u>300,037</u>	<u>241,454</u>	<u>227,088</u>	<u>992,391</u>
Net Book Value	<u>368,816</u>	<u>75,872</u>	<u>310,182</u>	<u>127,600</u>	<u>882,469</u>

6.2 Intangible Assets

The MD contracted Infracsoft Technologies FZ LLC to develop, supply, configure, customise, enhance and install the InfracsoftTech web-based centralised software system (OMNIEnterprise Loan Management System) for an amount of USD 600,000. To-date the development incurred an amount of USD 150,000 on the development of the software. Development costs are capitalized as intangible asset as costs are incurred. Amortization will begin when development of the software is complete and utilised.

<u>Computer Software</u>	<u>2010</u>	<u>2009</u>
	<u>USD</u>	<u>USD</u>
Balance 1 January	60,000	0
Additions	90,000	60,000
Balance 31 December	<u>150,000</u>	<u>60,000</u>

7. Bills Payable to UNRWA

Represents expenses paid by UNRWA on behalf of the MD in respect of the operating expenses incurred by MD, which are billed on a monthly basis. Beginning in November 2009 the MD began to directly settle its accounts payable through the MD bank accounts. This includes all expenses except staff salaries and procurement which continues to be paid by UNRWA field offices and charged to the MD on a monthly basis. Also excluded are donations which are also settled by UNRWA and not the MD.

	<u>2010</u>	<u>2009</u>
	<u>USD</u>	<u>USD</u>
Expenses Paid on Behalf of MD	511,237	448,318
Total amount due to UNRWA	<u>511,237</u>	<u>448,318</u>

8. OFID PalFund Trust Fund

8.1 OFID Liability

On June 15, 2004, UNRWA signed an "Administration Agreement" with the OPEC Fund for International Development (OFID) to administer the PalFund Trust Fund. Funds were provided to UNRWA, as an administrator, in the sum of USD 2,500,000 to be used exclusively for the promotion of microenterprise through loans for the Palestinians in the occupied Palestinian territory. The PalFund Trust Fund is held in a non-interest bearing current bank account according to the conditions of the agreement.

In consideration of the Administrator performing the services, the agreement specified that the Administrator may deduct programme support costs of up to 5 percent from the original fund only. The Administrator may also charge such reasonable fees or other charges under the client loan agreements to cover such costs to the Administrator as directly and reasonably incurred in connection with the conclusion of borrower loan agreements. UNRWA transferred responsibility for the administration of the trust fund activities to the MD.

By December 31, 2004, MD received the first instalment in the amount of USD 500,000 was received by UNRWA. Programme support costs of USD 25,000 were deducted by UNRWA and the balance of USD 475,000 financed loans through the MD.

In 2005, UNRWA received a second instalment of USD 2,000,000. An amount of USD 500,000 was received by the department in Gaza, and another USD 1,500,000 was received by the department in the West Bank. An amount of USD 100,000 was collected by UNRWA as Programme Support Cost (PSC) calculated at 5 percent of the amount received. The balance of USD 1,900,000 represents the net liability to

UNRWA under the second instalment bringing the total accumulated liability to USD 2,375,000 as of 31 December 2007.

During 2007 a letter of agreement was signed with OFID, which increased the PalFund Trust Fund by a further sum of USD 4,500,000, with no PSC deducted from this amount. It was agreed with OFID that the funds will be paid in two separate instalments of USD 2,000,000 and USD 2,500,000, upon submission and approval of a list of proposed PalFund Projects submitted by MD to OFID. No proposed PalFund Projects were submitted to OFID during year 2007, although the MD submitted the list in February for projects that were financed in the last quarter of 2007.

During 2008 the department have received a further USD 4,500,000, which increased the total liability to USD 6,875,000 as the end of 2008.

In 2009 UNRWA signed a new letter of agreement with OFID for a further pledge of USD 3,000,000 to the PalFund trust Fund. By the end of 2009 the department has received USD 2,000,000, raising the total liability to OFID to USD \$8,875,000 as end of 2009, with a pledge of USD 1,000,000 outstanding.

In 2010 the MD has received the last outstanding pledge of USD 1,000,000, raising the total liability to OFID to USD 9,875,000 as the end of 2010.

A summary of amount received from OFID is as follows:

	<u>2010</u>	<u>2009</u>
	USD	USD
OFID Liability balance as of 1 January	8,875,000	6,875,000
Fund Received During the Year	1,000,000	2,000,000
OFID Liability Balance as of 31 December	<u>9,875,000</u>	<u>8,875,000</u>

8.2 OFID Gross Loan Receivable, net

The position of OFID Gross Loans Receivable in the market, Net of the allowances at end year was as the following:

	<u>2010</u>	<u>2009</u>
Gross Loan Receivable	6,878,532	6,474,750
Allowance 31/12/2010	<u>(432,433)</u>	<u>(323,528)</u>
OFID Gross Loans Receivable, Net	<u>6,446,099</u>	<u>6,151,222</u>

9. Grants and Donations

9.1 Grand Duchy of Luxemburg

During 2008, an agreement was signed between UNRWA and the Grand Duchy of Luxemburg for a project for “Microfinance Development and Capacity Building: Supporting Economic Recovery and Rehabilitation through Microenterprise and Consumer Lending”. The MD was financed to undertake the following activities:

	<u>USD</u>
Fund Agreement	1,479,290
Less: UNRWA(HQ) - P.S.C	<u>(96,777)</u>
Net For the Following Use :	<u>1,382,513</u>
a. Loan Capital	1,029,258
- Spent in Gaza	(213,800)
- Spent in West Bank	<u>(815,458)</u>
Fund Balance 31/12/2009	<u>0</u>
b. Establishment of Qalqilya Branch	257,396
- Spent for Running Cost and Fixed Assets (2008-2009)	(235,424)
Fund Balance 31/12/2009	<u>21,972</u>
- Spent during 2010	<u>(21,972)</u>
	<u>0</u>
c. Procurement of Saving Module	35,503
-Spent during 2008 and 2009	<u>35,503</u>
Fund Balance 31/12/2009	<u>0</u>
d. Business Plan	30,178
-Spent during 2008 and 2009	<u>30,178</u>
Fund Balance 31/12/2009	<u>0</u>
e. Impact assessment Study	30,178
-Spent during 2008 and 2009	<u>(30,178)</u>
Fund Balance 31/12/2009	<u>0</u>
Pledges Receivable 31/12/2010	<u>0</u>

In 2009, additional financing of USD 365,973 was received from the Grand Duchy of Luxemburg to support the SMET programme in Gaza and capacity-building activities. These included the following activities:

a. Gaza SMET	101,423
- Transferred from West Bank	15,695
- Spent during 2009	<u>(97,039)</u>
Gaza Fund Balance 31/12/2009	20,079
- Gaza spent during 2010	(20,079)
	<u>0</u>
b. MD Studies	
-Transformation Plan and Feasibility Study	132,275
- Product Development	52,910
- Social Performance Management	79,365
- Spent during 2009	(19,950)
- Transferred to Gaza	<u>(15,695)</u>
MD West Bank Pledges Receivable 31/12/2009	228,905
- Spent During 2010	(228,905)
Total Pledges Receivable 31/12/2010	<u>0</u>

9.2 Gaddafi International Charity and Development Foundation

In 2010 an agreement was signed between UNRWA and the Gaddafi International Charity and Development Foundation (GICDF). Through this agreement, GICDF undertook to make available to UNRWA a financial contribution in the amount of USD 600,000 of which MD received USD 560,716 net, after UNRWA (HQ) deducted its P.S.C. This represents an allocation to support a project for “Sustainable Rural Livelihoods through Microfinance” for a 12 month period following the receipt of the contribution by UNRWA. The position of the fund at 31/12/2010 was:

	<u>USD</u>
Fund Agreement	600,000
Less: UNRWA (HQ) P.S.C	<u>(39,284)</u>
Net fund for loan disbursement:	<u>560,716</u>
Loan Disbursement (Gaza) 2010	<u>(119,100)</u>
Net fund balance (Gaza) 31/12/2010	<u>441,616</u>

9.3 United Nations Trust Fund for Human Security

During 2010, an agreement was signed between UNRWA and United Nations Trust Fund for Human Security under reference number FAO-ME-09-076, the fund of USD 197,436 will finance the establishment and running costs for one year of a new branch office in Jericho to provide support to extend the outreach of the department to this agricultural region. The position of the fund as at 31/12/2010:

	<u>USD</u>
Fund Agreement	197,436
Less: UNRWA (HQ) P.S.C.	<u>(12,916)</u>
Net fund for Jericho branch expenses:	<u>184,520</u>
Jericho Branch establishment expenses used during 2010	<u>(78,086)</u>
Net fund balance 31/12/2010	<u>106,434</u>

10. Revolving Loan Fund

Restricted contributions received for on-lending purposes are transferred to the Revolving Loan Fund upon repayment of the original loan.

Composition of this fund by funding source as at December 31, 2010 is as follows:

	<u>Gaza</u>	<u>West Bank</u>	<u>Syria</u>	<u>2010</u>	<u>2009</u>
	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>
Australia	619,272	-	-	619,272	619,272
Canada	200,370	170,220	-	370,590	370,590
Germany	1,682,252	1,276,323	-	2,958,575	2,958,575
Italy	725,750	218,500	-	944,250	944,250
Japan	357,142	223,199	-	580,341	580,341
New Zealand	122,822	-	-	122,822	122,822
Norway	2,794,013	340,968	-	3,134,981	3,134,981
UNRWA	80,000	-	-	80,000	80,000
AGFUND	131,400	-	53,571	184,971	184,971
CIDA	943,350	-	-	943,350	943,350
Netherlands	2,626,458	1,676,694	-	4,303,153	4,303,153
USAID	4,237,197	-	-	4,237,197	4,237,197
AAID	1,207,391	1,150,848	-	2,358,239	2,358,239
SMART	-	949,011	-	949,011	949,011
Luxemburg	213,800	862,147	-	1,075,947	1,075,947
GICDF	119,100	=	-	<u>119,100</u>	=
Grand Total	<u>16,060,317</u>	<u>6,867,910</u>	<u>53,571</u>	<u>22,981,798</u>	<u>22,862,698</u>

11. Staff Retirement Benefit Obligations

	<u>2010</u> <u>USD</u>	<u>2009</u> <u>USD</u>
11.1 Retirement Benefits	1,201,875	797,328
11.2 Staff Leave Accruals	266,092	253,776

The MD accrues unused accumulated staff leave up to 37.5 working days as determined by UNRWA staff rule 105.1.

12. Grant Funds for Operations

The total expenditure on grant funds for operating expenses for the years 2009 and 2010 are as follows:

<u>Donor</u>	<u>2010</u> <u>USD</u>	<u>2009</u> <u>USD</u>
Duchy of Luxemburg	228,907	153,779
Total	<u>228,907</u>	<u>153,779</u>

13. Operating Leases

Minimum Lease Payments	<u>2010</u> <u>USD</u>	<u>2009</u> <u>USD</u>
Not latter than one year	327,980	241,460
Later than one year and not later than five years	608,872	321,253
Later than five years	<u>172,825</u>	<u>81,549</u>
Total minimum Lease Payments	<u>1,109,677</u>	<u>644,262</u>

14. Correction of Prior Year Errors

An amount of USD 60,000 for the development of a new LMIS, as per note 6.2, was erroneously expensed in 2009 instead of being capitalized as part of the development cost of the intangible asset. This error resulted in the operating profit for 2009 being understated by USD 60,000 and the retained loss being overstated by the same amount. The effect of the error has been corrected retroactively.

15. Reclassification Adjustment

An obligation to the OFID PalFund Trust Fund with a balance of USD 8,875,000 at 31 December 2009 and USD 9,875,000 at 31 December 2010 with undermined repayment terms was previously categorized as current liability instead of non-current liability. In addition, Staff Leave Accruals were previously included in Retirement Benefit Obligation as a non-current liability instead of current liability. Both have been properly adjusted.

16. Geographical Segments

MD operates out of four principal 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.

16.1 Statement of Comprehensive Income by Services:

	Financial Services	Financial Services	Training Services	Training Services
	2010	2009	2010	2009
	USD	USD	USD	USD
<i>Interest and Other Operating Income:</i>				
Interest on Loans	7,681,636	6,584,317		
Accrued Interest Revenue	128,356	117,818		
Interest on bank deposits and other revenues	17,510	15,858		
Grants Funds for Operations	228,907	153,779		
Other Income	43,234	88,951		
Training Income	-		78,569	139,069
<i>Total Operating Revenues</i>	8,099,643	6,960,723	78,569	139,069
<i>Impairment Losses On Loans</i>				
Provision for Impaired Loans	(883,500)	(834,466)		
Recoveries from Written Loans	524,703	505,930		
<i>Net Impairment Losses on Loans</i>	(358,797)	(328,535)		
<i>Operating Expenses:</i>				
Salaries and Related Expenses	4,280,106	3,371,591	60,788	45,903
Audit Fees Expenses	112,750	85,118		
Special Service Contracts	263,870	184,515	30,404	28,839
Other Contractual Expenses	368,081	151,025		
Occupancy	400,294	325,616		
Communication	140,063	146,385	1,800	898
Stationary and Supplies	117,327	102,424	3,008	7,255
Minor Equipment and Maintenance	120,245	64,088	485	
Travel and Transportation	322,405	267,712		
Depreciation	243,199	240,915		
Program Support Costs	37,499	76,907		
Training Costs	109,576	84,559	15,121	9,778
Other Costs	45,055	18,179		
<i>Total Operating Expense</i>	(6,560,470)	(5,119,033)	(111,606)	(92,674)
<i>Operating Income (Loss) for the Year</i>	1,180,376	1,513,155	(33,037)	46,396
<i>Gain (Loss) on Difference of Currency</i>	(37,036)	(8,599)		
<i>Net Year Income (Loss) / Year</i>	1,143,340	1,504,557	(33,037)	46,396

16.2 Statement of Financial Position by Geographical Segment

Assets	Gaza		West Bank		Jordan		Syria		Total	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
	USD	USD	USD	USD	USD	USD	USD	USD	USD	USD
Non-Current Assets:										
Intangible Assets			150,000	60,000					150,000	60,000
Property, Plant and Equipment	95,028	116,935	466,751	374,661	156,463	193,843	284,291	197,029	1,002,533	882,469
Loans Receivable, Net	1,558,404	735,601	777,321	509,675	175,419	16,243	2,810	-	2,513,954	1,261,519
	1,653,432	852,536	1,394,072	944,336	331,882	210,086	287,101	197,029	3,666,487	2,203,987
Current Assets :										
Loan Receivable , Net	3,297,850	2,217,643	7,174,464	7,195,989	4,286,148	4,506,783	4,596,794	2,939,852	19,355,256	16,860,267
Pledges Receivable	-	20,079	106,434	250,877	-	-	-	-	106,434	270,956
Prepayment and other Receivables	40,516	3,594	157,265	118,119	54,188	45,777	16,084	15,932	268,053	183,422
Cash and Cash Equivalents	3,242,195	3,996,725	2,818,463	3,412,120	1,528,309	1,069,063	954,603	811,816	8,543,570	9,289,724
	6,580,561	6,238,042	10,256,626	10,977,105	5,868,645	5,621,623	5,567,481	3,767,600	28,273,313	26,604,370
Total Assets	8,233,993	7,090,578	11,650,698	11,921,441	6,200,527	5,831,710	5,854,582	3,964,629	31,939,800	28,808,358
Equity										
General Undesignated	(3,995,574)	(3,906,756)	(810,875)	(1,567,087)	311,407	61,574	410,174	184,060	(4,084,868)	(5,228,209)
Fund Held for Training	88,182	121,219		-					88,182	121,219
Board Designated Fund/MIS System	20,209	20,209		-					20,209	20,209
Temporary Restricted Fund	441,616	-		-					441,616	-
Revolving Loan Fund	16,060,317	15,941,217	6,867,910	6,867,910			53,571	53,571	22,981,798	22,862,698
Total Equity	12,614,750	12,175,889	6,057,035	5,300,823	311,407	61,574	463,745	237,631	19,446,937	17,775,917
Non-Current Liabilities										
Retirement Benefit Obligations	622,071	428,594	443,921	283,219	54,039	48,030	81,844	37,485	1,201,875	797,328
Liability to UNRWA-OFID PalFund	4,074,736	2,914,062	5,800,264	5,960,938	-	-	-	-	9,875,000	8,875,000
	4,966,807	3,342,656	6,244,185	6,244,157	54,039	48,030	81,844	37,485	11,076,875	9,672,328
Current Liabilities :										
Payables and Accruals	107,482	91,172	424,024	508,382	54,395	31,941	52,758	26,522	638,659	658,017
Staff Leave Accruals	72,385	73,035	128,266	138,792	37,543	22,933	27,898	19,017	266,092	253,777
Inter-Office Accounts	(9,381,417)	(8,677,103)	(1,420,562)	(498,445)	5,668,455	5,584,701	5,133,524	3,590,848	-	-
Bills Payable to UNRWA	123,986	84,929	217,750	227,731	74,688	82,530	94,813	53,127	511,237	448,318
Total Current Liabilities	(9,077,564)	(8,427,967)	(650,522)	376,460	5,835,081	5,722,105	5,308,993	3,689,513	1,415,988	1,360,112
Total Liabilities	(4,380,757)	(5,085,310)	5,593,663	6,620,617	5,889,120	5,770,136	5,390,837	3,726,998	12,492,863	11,032,440
Total Equity and Liabilities	8,233,993	7,090,578	11,650,698	11,921,441	6,200,527	5,831,710	5,854,582	3,964,629	31,939,800	28,808,358

16.3 Statement of Comprehensive Income by geographical Segment

	Gaza		West Bank		Jordan		Syria		Central Office		Total	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
	USD	USD	USD	USD	USD	USD	USD	USD	USD	USD	USD	USD
Interest and Other Operating Income												
Interest on Loans	1,062,908	867,615	3,225,803	3,070,831	1,824,515	1,594,047	1,568,410	1,051,824			7,681,636	6,584,317
Accrued Interest Revenue	8,095	3,501	69,044	58,000	41,129	45,777	10,088	10,540			128,356	117,818
Interest On Banks Deposits	1,257	1,477	6,857	8,295	9,396	6,086	-	-			17,510	15,858
Grant Funds for Operations	-	-	-	-	-	-	-	-	228,907	153,779	228,907	153,779
Other revenues	17,267	23,540	38,008	10,129	2,846	1,099	(14,887)	54,183			43,234	88,951
Total Operating Revenues	1,089,527	896,132	3,339,712	3,147,255	1,877,886	1,647,009	1,563,611	1,116,547	228,907	153,779	8,099,643	6,960,723
Impairment Losses On Loans												
Provision Expenses for Impaired Loans	(93,308)	(25,425)	(261,602)	(254,805)	(468,319)	(456,676)	(60,271)	(97,559)			(883,500)	(834,466)
Recoveries from Written Loans	142,813	117,161	262,568	341,755	96,786	42,461	22,536	4,553			524,703	505,930
Net Impairment Losses On Loans	49,505	91,736	966	86,950	(371,533)	(414,216)	(37,735)	(93,006)			(358,797)	(328,535)
Operating Expense												
Salaries and Related Exp.	811,423	620,772	1,558,831	1,260,064	622,998	495,793	566,244	370,017	720,610	624,945	4,280,106	3,371,591
Audit Fees Expenses	-	-	-	-	-	-	-	-	112,750	85,118	112,750	85,118
Special Service Contracts	27,133	25,318	110,780	41,778	22,100	25,436	21,142	22,439	82,715	69,544	263,870	184,515
Other Contractual Expenses	6,328	7,920	32,558	30,415	68,474	50,160	9,567	13,790	251,154	48,740	368,081	151,025
Occupancy	41,324	50,448	136,214	136,191	52,548	51,000	155,644	80,929	14,564	7,048	400,294	325,616
Communication	10,967	13,968	33,955	70,676	39,954	35,173	41,041	21,112	14,146	5,456	140,063	146,385
Stationary and Supplies	8,356	10,886	49,221	37,408	20,630	17,885	28,272	19,347	10,848	16,897	117,327	102,423
Minor Equipment & Maintenance	24,949	16,232	28,858	1,123	9,575	18,275	53,847	9,335	3,016	19,123	120,245	64,088
Travel and Transportation	33,497	19,863	124,784	116,056	57,647	49,333	47,358	17,717	59,119	64,744	322,405	267,712
Depreciation	26,981	34,161	76,717	67,693	48,366	52,456	66,486	50,944	24,649	35,660	243,199	240,914
Loss on Exchange Difference	(1,595)	8,909	29,768	2,634	2,285	832	6,578	(3,775)	-	-	37,036	8,599
Program Support Cost	5,766	10,199	10,577	21,197	1,960	13,248	14,206	11,786	4,990	20,477	37,499	76,907
Training	20,808	21,650	19,131	12,963	12,315	2,473	48,693	13,393	8,629	34,081	109,576	84,559
Others	3,514	1,700	18,563	8,948	6,808	1,915	15,306	3,333	864	2,283	45,055	18,179
Total Operating Expenses	(1,019,451)	(842,027)	(2,229,957)	(1,807,145)	(965,660)	(813,978)	(1,074,384)	(630,367)	(1,308,054)	(1,034,115)	(6,597,506)	(5,119,033)
Allocation of Central Office Operating Expenses	(208,399)	(176,930)	(430,563)	(304,899)	(247,879)	(244,631)	(192,306)	(153,876)	(1,079,147)	(880,336)		-
Allocation of Jerusalem Office			76,054	63,095	(42,981)	(37,857)	(33,073)	(25,238)				
Net Income (Loss) for the Period	(88,818)	(31,088)	756,212	1,185,257	249,833	136,327	226,113	214,061	-	-	1,143,340	1,504,557

17. Risk Management:

Risk management framework

The inherent risks in the department's microfinance activities are managed, measured and monitored continuously by different offices to ensure that risks are within authorised limits and benchmarks, with risk responsibilities distributed among employees linked to their functions in the spheres of credit, operations, marketing and liquidity. The department's key management team is responsible for identifying and ensuring that risks are controlled. Failure to contain these risks will affect the department's reputation, revenues and sustainability. As the department has no corporate board of directors, ultimate responsibility for effective management of risks rests with the Director of the Microfinance Department.

In the past, the risk management focus of the department have been diverse and reported on separately based on functional responsibilities. But as the programme has grown significantly in scope and scale over the past three years, in 2010, a decision was made to establish a specialised risk management unit in the department. A new senior management post of Senior Risk Manager was established to bring central focus to the risk management process by developing risk strategies with principles, frames and limits, which will be measured, monitored, controlled and reported systematically to ensure emerging and key risks are identified early so that threats can be contained through corrective action by management.

Complimentary to the establishment of the risk management unit has been the strengthening of the department's internal audit or verification function. In 2010, the headquarter Verification Officer post was upgraded to Senior Verification Officer, with four new Verification Officer posts established in each field, who report directly to the Senior Verification Officer. This will provide more intensive, more frequent and wider coverage of potential risks in each field stemming from non-compliance with procedures, limits, collaterals and guarantees.

Credit Risk and Concentration of Assets

Credit risk is the risk that counterparty will not settle their obligations in accordance with the agreed terms. The department works on credit risk management by:

- Establishing ceilings on amounts of direct credit for each product linked to the cash flow of each client (see note 5.11);
- Providing a range of products to different sectors and segments to spread credit and reduce concentration (see notes 5.1, 5.2, 5.3, 5.4, 5.5, 5.6, 5.7, 5.8, 5.9.1, 5.9.2, 16.1, 16.2 and 16.3);
- Formulating credit policies by product covering collateral requirements, credit compliance with regulatory requirements in each jurisdiction;
- Establishing the authorization structure for the approval and renewal of credit facilities;
- Reviewing and assessing credit risk in excess of designated limits prior to facilities being committed to customers. Renewals of facilities are subject to the same process;
- Developing and maintaining risk grading system in order to categorize exposure according when impairment provisions are required against specific credit exposures;

- Provide guidance and training to improve skills of staff to promote best practices in the management of credit risk

Country Risk

Country risk is the threat that client is unable to meet their contractual obligations as a result of adverse economic conditions or actions taken by government in the relevant country. The department faced significant country risk in Gaza following the Israeli withdrawal from the Gaza Strip in September 2005, the subsequent Hamas electoral victory and subsequent military coup in 2006, which was followed by the Israeli blockade of Gaza which has now been ongoing for over three years. The initial result of this political crisis was that thousands of businesses closed as they were unable to trade or secure raw materials.

During this period, the department had to write off 5,412 loans valued at USD 1.93 million, which it has been recovering very slowly as most of these former businesses owners are unemployed and living in poverty, with most of them dependent upon humanitarian assistance and make work programmes to meet the basic needs of their families. Since that period, the annual outreach of the programme has fallen from almost 13,000 to 3,600 loans each year.

Despite this decline, the credit operations are now stable, with the second lowest portfolio-at-risk of any field operation at three percent. Despite this, the programme in Gaza is not able to cover its costs (currently 93 percent) due to its limited portfolio. The major obstacle preventing it fully covering its costs and growing the portfolio is the present policy of UNRWA not to work with the legal system in Gaza, in compliance with the international boycott of Hamas. If this ruling was lifted, then the programme would be able to offer thousands of additional legally sanctioned loans that would significantly improve the cost recovery of the programme.

Operational and Other Risks

Operational risk is a threat resulting from direct and indirect losses arising from a particular failure of systems or mistakes made by employees. The department reduces these risks as much as possible within the framework of its policies, procedures, manuals and controls, which it uses to assess, monitor and manage these risks. This also requires establishing effective segregation of duties, authorities and compliance procedures. This is supported by increasing employees' awareness and understanding of such risks and by invoking appropriate disciplinary procedures for harmful breaches of policy and procedure.

Other risks include reputational risk, which relates to the reputation of the department and UNRWA. This is managed through analysis of issues and behaviours that relate to department's reputation. This requires the appropriate client service orientation by staff, transparency in lending and appropriate and professional loan collection practices and behaviours.

Currency Risk

Currency risk is the danger that an unfavourable change in the value of currency will result in an unpredictable decrease in earning, cash flow or value. Currency risk is a significant factor in the MD operations as the department lends in different currencies in each field, with the United States Dollar (USD) used in Gaza, the Jordanian Dinar

(JOD) used in Jordan and the West Bank and the Syrian Pounds (SYP) used in Syria. Exchange rate losses/gains are reported in the annual financial statement and MD management attempts to mitigate potential losses by maintaining cash that is not required for operations in USD, and maintaining JOD and SYP required for loan financing with a low threshold in banks.

The carrying amount of the department's foreign currency denominated monetary assets and monetary liabilities at the end of the reporting period are as follows:

	<u>Liabilities</u>		<u>Assets</u>	
	2010	2009	2010	2009
	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>
Jordanian Dinar	663,768	549,476	16,244,201	15,926,467
Syrian Pound	-	-	5,534,937	3,583,390
Total	<u>663,768</u>	<u>549,476</u>	<u>21,779,138</u>	<u>19,509,857</u>

The main currency exposure is with JOD and SYP, although the JOD is considered stable against the USD by the financial system in the region. The following table details the department's sensitivity to a 10 percent increase and decrease in the US dollar (reporting currency) against the relevant foreign currencies. Ten percent is the sensitivity rate benchmark used to report foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end period for a 10 percent change in foreign currency rates on the net exposure. The sensitivity analysis includes loans. A positive number below indicates an increase in profit where the US Dollar strengthens 10 percent against the relevant currency. For a 10 percent weakening of the US Dollar against the relevant currency, there would be a comparable impact on the profit, and the balances below would be negative.

A 10 percent sensitivity analysis at the end of the reporting period produces a gain/loss variant as follows:

<u>Currency</u>	<u>Percentage</u>	<u>Gain / Loss</u>	
		2010	2009
	%	<u>USD</u>	<u>USD</u>
Jordanian dinar (JOD)	+/- 10%	1,558,043	1,537,699
Syrian pounds (SYP)	+/- 10%	553,494	358,339

Market Risk

Market risk is the threat that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates. Microfinance activities, especially those like UNRWA working in multiple currencies, are mainly exposed to foreign exchange rates. The department works to control the level of exposure by maintaining the bulk of its cash reserves in USD and by working with sufficient other currencies to maintain its operational requirements. As the department does not borrow commercially, it is not subject to significant risk from interest rate fluctuations.

Liquidity Risk

Liquidity risk is the danger that funds will not be available to meet liabilities as they fall due. This has not been a significant issue for the programme since it has maintained a significant balance of liquid assets that have been able to meet its liabilities and portfolio expansion. However, this positive liquidity has been maintained at the cost of constraining the outreach of profitable, longer term credit facilities that rotate much slower than short term products and could create a liquidity crisis if such products (housing and small-scale enterprise loans) were brought to scale without securing the requisite capital.

However, even so, with its business plan and growth projections to the end of the year, the liquidity of the programme will start to shrink quite rapidly which will require tighter cash flow planning and control on credit operations, and will require increasing the loan capital through additional donations.

18. Portfolio Quality:

18.1 Portfolio at Risk Ratio

The portfolio-at-risk (PAR) ratio (balance of loans in arrears / value of Gross loans Receivables) measures amount of default risk in portfolio. An increasing portfolio at risk is negative. As can be seen from the table below there was a marginal improvement in the PAR during 2010, but this is still above the regional benchmark and this ideally should be below three percent.

Portfolio at Risk

	2010		2009	
	Principal Outstanding	Portfolio at Risk Ratio	Principal Outstanding	Portfolio at Risk Ratio
	USD		USD	
Current	19,381,125		15,713,234	
1 to 30	1,939,500		1,927,030	
31 to 60	530,428	2.30 %	443,417	2.30 %
61 to 90	283,497	1.23 %	251,956	1.31 %
91 to 120	188,332	.82 %	187,240	.97 %
121 to 180	244,731	1.06 %	239,683	1.24 %
181 to 360	531,036	2.3 %	490,316	2.55 %
	23,098,649		19,252,877	
Portfolio at Risk > 30 Days		7.71 %		8.37 %

18.2. Portfolio in Arrears Ratio

Portfolio in arrears ratio (Value of Payments in Arrears / Value of Gross Loans Receivables), the ratio indicates amount of loan payments past due. An increasing portfolio in arrears is negative. Value of loans in arrears equals the value of payments due (unpaid loan instalments). As the table below shows there was a marginal improvement in portfolio in arrears ratio that was built on the back of a growing portfolio. The ideal situation would be to bring this below three percent.

Portfolio in Arrears

	2010		2009	
	Payments in Arrears	Portfolio in Arrears Ratio	Payments in Arrears	Portfolio in Arrears Ratio
	USD	Percent	USD	Percent
1 to 30	385,990	1.67 %	376,351	1.95 %
31 to 60	205,978	0.89 %	193,407	1.00 %
61 to 90	144,822	0.63 %	138,940	0.72 %
91 to 120	120,837	0.52 %	117,523	0.61 %
121 to 180	191,634	0.83 %	188,070	0.98 %
181 to 360	284,588	1.23 %	265,004	1.38 %
	1,333,849	5.77 %	1,279,295	6.64 %

18.3. Operational Self-Sufficiency Ratio

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

	<u>2010</u>	<u>2009</u>
	<u>USD</u>	<u>USD</u>
Interest and recovery	8,624,347	7,466,653
Operating expenses	<u>7,481,008</u>	<u>6,022,771</u>
Operating Self-Sufficiency Ratio	<u>115 %</u>	<u>124 %</u>

The Operational Self-Sufficiency rate for each field for the years 2010 and 2009 were as follows:

Field	<u>2010</u>	<u>2009</u>
Gaza	93 %	97 %
West Bank	127 %	148 %
Jordan	114 %	109 %
Syria	117 %	124 %

A number of factors contributed to the reduction in OSS rate during this period, including:

- A change in administrative policy that increased end of term indemnities from 8.5 percent to 10 percent affected OSS. As this was a change in administrative and not accounting policy, it could not be adjusted against previous years and was charged against this year's expenditure. This increased expenses by over USD 400,000 and mainly affected Gaza and the West Bank, who had the longest serving staff.
- In West Bank the OSS declined as a result of adding additional new staff towards the end of the year, coupled with decline loan officer productivity.
- Increased expenses were incurred in Syria to finance the establishment and running cost of two new branch offices in Douma (Damascus) and Aleppo.

These branches did not start operations until the end of the year and thus these costs were not offset with a consequent rise in income from lending.

18.4. 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.

	<u>2010</u>	<u>2009</u>
Number of active borrowers	26,306	21,604
Number of loans officers	<u>159</u>	<u>119</u>
Loan Officer Productivity	<u>165</u>	<u>182</u>

19. Net Cash Utilised by Operating Activities

Adjustments to Reconcile Changes in Net Assets to net Cash Provided by Operating Activities:

	<u>2010</u>	<u>2009</u>
	<u>USD</u>	<u>USD</u>
Change in Net Assets	1,633,986	1,586,168
Currency Exchange	34,994	6,843
Provision for Loan Losses	785,155	392,734
Changes in Provision for bad debts	98,346	446,639
Depreciation expenses	243,199	241,525
Loans Extended	(42,251,952)	(37,136,856)
Loans Collection	37,621,024	34,056,268
Increase in Pledges receivable	164,522	(78,091)
Decrease in Prepaid Expenses	(84,631)	(52,208)
Decrease in Payables and Accruals	(19,358)	85,794
Decrease Accrued Staff Leave	12,316	52,454
Decrease in Bills Payable to UNRWA	62,919	(405,615)
Increase in End of Year services	<u>404,547</u>	<u>82,947</u>
Total	<u>(1,294,933)</u>	<u>(721,389)</u>

20. Post Balance Sheet Events/Going Concern

At the beginning of 2011 a series of popular protest actions broke out across the Middle East region calling for an end to authoritarian government and arbitrary policing by security forces. This led to significant transformation of government in Tunisia and Egypt, with rising anti-government violence in Yemen and civil war in Libya. The momentum of such calls recently reached Jordan and the Syrian Arab Republic, where a series of demonstrations have occurred in a few locations over the last weeks of March. In coordination with its staff on the ground, the MD management is monitoring these events very closely in order to gauge their potential impact on credit operations and future risks in each country. Further escalation in Jordan seems unlikely at this point in time, while the actions in Syria are still quite localised to areas where the MD is not operating. In both countries, such demonstrations have not gained widespread appeal and demands have been much more moderate with demonstrators calling for reform rather than the overthrow of the leaders.