

MULTINATIONAL FORCE AND OBSERVERS

Rome, Italy

REPORT OF INDEPENDENT ACCOUNTANTS
SEPTEMBER 30, 2003 and 2002

REPORT OF INDEPENDENT ACCOUNTANTS

Director General
Multinational Force and Observers
Rome, Italy

We have audited the accompanying statement of financial position of the Multinational Force and Observers (MFO) as of September 30, 2003 and 2002 and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the MFO's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the MFO as of September 30, 2003 and 2002 and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended in conformity with generally accepted accounting principles as set forth by the organization in Note 2 accompanying the financial statements.

November 21, 2003

MULTINATIONAL FORCE & OBSERVERS
STATEMENT OF REVENUES, EXPENSES AND CHANGES OF NET ASSETS
as at September 30
(in thousands of U.S. dollars)

ASSETS	<u>2003</u>	<u>2002</u>
Non-current Assets		
Marketable Securities (Notes 2 & 3)	2,589	6,438
Fixed Assets (Notes 2 & 4)	<u>1,870</u>	<u>1,947</u>
Total Non-current Assets	4,459	8,385
Current Assets		
Cash and Cash Equivalents	4,863	3,993
Marketable Securities (Notes 2 & 3)	8,485	5,247
Pledges (Notes 2 & 6)	9,111	8,667
Prepaid Expenses and Other Receivables (Note 5)	<u>2,422</u>	<u>2,264</u>
Total Current Assets	24,881	20,171
 TOTAL ASSETS	 <u>29,340</u>	 <u>28,556</u>
 LIABILITIES & NET ASSETS		
Current Liabilities		
Accounts Payable and Accrued Expenses (Note 8)	15,819	16,361
Unearned Support Contribution	<u>0</u>	<u>166</u>
Total Current Liabilities	15,819	16,527
Net Assets		
Unrestricted:		
General	786	425
Unrealized Net Gain on Marketable Securities (Notes 2 and 3)	<u>95</u>	<u>616</u>
Total Unrestricted	881	1,041
Temporarily Restricted:		
Self Insurance Fund (Note 11)	6,150	6,150
Capital Asset Replacement Fund (Note 12)	<u>6,491</u>	<u>4,838</u>
Total Restricted	<u>12,641</u>	<u>10,988</u>
Total Net Assets	13,522	12,029
 TOTAL LIABILITIES & NET ASSETS	 <u>29,340</u>	 <u>28,556</u>

The accompanying notes are an integral part of these financial statements

MULTINATIONAL FORCE & OBSERVERS
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
as at September 30
(in thousands of U.S. dollars)

	2003				
	<u>Unrestricted</u>		<u>Temporarily</u>		<u>2002</u>
	<u>General</u>	<u>Unrealized Gains (Losses)</u>	<u>Restricted</u>	<u>Total</u>	
Revenue:					
Support (Notes 1 & 2)					
Egypt	16,354	0	0	16,354	16,250
Israel	16,354	0	0	16,354	16,249
United States	16,354	0	0	16,354	16,249
Germany	306	0	0	306	273
Japan (Note 7)	0	0	500	500	800
Switzerland	166	0	0	166	151
Other Income (Note 2)	867	0	0	867	698
Release of Temporarily Restricted Reserve (Note 7)	<u>500</u>	<u>0</u>	<u>(500)</u>	<u>0</u>	<u>0</u>
Total Support	50,901	0	0	50,901	50,670
Expenses (Note 9):					
Program Services:					
Peacekeeping Mission (Note 10)	44,617	0	0	44,617	48,630
Support Services:					
Management & General (Note 10)	3,845	0	0	3,845	3,644
Total Support Services	<u>3,845</u>	<u>0</u>	<u>0</u>	<u>3,845</u>	<u>3,644</u>
Total Expenses	<u>48,462</u>	<u>0</u>	<u>0</u>	<u>48,462</u>	<u>52,274</u>
Excess/(Deficit) of Revenues over Expenses	2,439	0	0	2,439	(1,604)
Net Assets at Beginning of Year	425	616	10,988	12,029	13,755
Allocation to CARF (Note 12)	(1,653)		1,653	0	613
Unrealized Gain or (Losses) on Marketable Securities (Note 3)	0	(521)	0	(521)	(33)
Allocation of Prior Year Surplus to Funds Contributing States	<u>(425)</u>	<u>0</u>	<u>0</u>	<u>(425)</u>	<u>(702)</u>
Net Assets at End of Year	<u><u>786</u></u>	<u><u>95</u></u>	<u><u>12,641</u></u>	<u><u>13,522</u></u>	<u><u>12,029</u></u>

The accompanying notes are an integral part of these financial statements

MULTINATIONAL FORCE & OBSERVERS
STATEMENT OF FUNCTIONAL EXPENSES
as at September 30
(in thousands of U.S. dollars)

	<u>2003</u>			
	<u>Total Expenses</u>	<u>Peacekeeping Services</u>	<u>Management & General</u>	<u>Total Support</u>
Personnel (Note 9)	18,033	15,779	2,254	2,254
Supplies net of vehicle and miscellaneous sales proceeds of \$439,000 (Note 2)	9,324	8,704	620	620
Contractual Services	5,267	5,267	0	0
Troop Rotation	4,844	4,844	0	0
Equipment & Furnishings (Notes 2 & 4)	3,279	3,180	99	99
Petroleum, Oil, Lubricants	2,467	2,460	7	7
Transportation	1,037	1,032	5	5
Communications	622	517	105	105
Rents	794	447	347	347
Buildings & Facilities (Notes 2 & 4)	1,597	1,332	265	265
Travel	596	497	99	99
Utilities	<u>602</u>	<u>558</u>	<u>44</u>	<u>44</u>
Total Expenses	<u>48,462</u>	<u>44,617</u>	<u>3,845</u>	<u>3,845</u>
		92%		8%

	<u>2002</u>			
	<u>Total Expenses</u>	<u>Peacekeeping Services</u>	<u>Management & General</u>	<u>Total Support</u>
Personnel (Note 9)	17,287	15,255	2,032	2,032
Supplies, net of vehicle and miscellaneous sales proceeds of \$603,168 (Note 2)	12,953	12,232	721	721
Contractual Services	5,781	5,781	0	0
Troop Rotation	4,821	4,821	0	0
Equipment & Furnishings (Notes 2 & 4)	3,834	3,755	79	79
Petroleum, Oil, Lubricants	2,299	2,290	9	9
Transportation	1,491	1,484	7	7
Communications	577	433	144	144
Rents	743	454	289	289
Buildings & Facilities (Notes 2 & 4)	1,366	1,180	186	186
Travel	656	523	133	133
Utilities	<u>466</u>	<u>422</u>	<u>44</u>	<u>44</u>
Total Expenses	<u>52,274</u>	<u>48,630</u>	<u>3,644</u>	<u>3,644</u>
		93%		7%

MULTINATIONAL FORCE & OBSERVERS
STATEMENT OF CASH FLOWS
for the years ended September 30
(in thousands of U.S. dollars)

	<u>2003</u>	<u>2002</u>
Cash Provided by Operating Activities		
Excess / (Deficit) of Revenue Over Expenses	2,439	(1,604)
Depreciation of Fixed Assets	78	78
Unrealized Gains on Marketable Securities	(521)	(33)
Allocation of Prior Year Surplus to Funds		
Contributing States	(425)	(702)
CARF Projects	--	613
Change in Current Assets & Liabilities:		
Decrease (Increase) in Pledges	(445)	94
Decrease (Increase) in Prepaid Expenses and Other Receivables	(158)	401
(Decrease)/Increase in Accounts Payable and Accrued Expenses	(708)	364
Increase in Unearned Support Contributions	<u>0</u>	<u>166</u>
Net Cash Provided/(Used) by Operating Activities	260	(623)
Cash Provided/(Used) by Investing Activities		
Purchases of Available for Sale Securities	(6,456)	(3,410)
Sale of Available for Sale Securities	3,366	454
Maturities of Available for Sale Securities	<u>3,700</u>	<u>2,226</u>
Net Cash Provided/(Used) by Investing Activities	610	(730)
Cash & Cash Equivalents at Beginning of Year	<u>3,993</u>	<u>5,346</u>
Cash & Cash Equivalents at End of Year	<u>4,863</u>	<u>3,993</u>
Supplemental Data:		
Cash Received – Interest	<u>868</u>	<u>697</u>

The accompanying notes are an integral part of these financial statements

NOTE 1 - THE ORGANISATION

The Multinational Force & Observers (MFO) is an international organisation established by the Protocol signed by the Governments of Egypt and Israel (the Receiving States) and witnessed by the United States on August 3, 1981. The MFO's function is to supervise the implementation of key security provisions of the Treaty of Peace between Egypt and Israel dated March 26, 1979. The MFO received its initial funding on September 9, 1981. Each of the Receiving States and, subject to annual appropriations, the United States, agreed to contribute equally to the annual operating expenses of the MFO.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the MFO are prepared on the accrual basis. The accounting principles consistently applied by the organization are in accordance with Chapter III of the MFO's Administrative and Financial Regulations which are based on United States generally accepted accounting principles for commercial and governmental organizations. For matters not regulated by the organization's Administrative and Financial Regulations the organization employs generally accepted accounting principles as defined by the American Institute of Certified Public Accountants, specifically SOP 78-10 (as amended by SOP 94-3) and SFAS 116 and 117.

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue Recognition

Apart from interest, dividends and realized gains/losses on the disposal of marketable securities which are recognised on an accrual basis and unrealized gains/losses on marketable securities which are recorded in unrestricted net assets, all of the MFO's revenues are derived from support contributions by the Receiving States and the United States plus the Governments of Japan, Germany and Switzerland. Support is recognised from amounts pledged to the MFO. The principle of equal contributions by the three Funds Contributing States (Note 1) pursuant to the Protocol to the Treaty and related side letters is maintained in the distribution of surpluses.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Pledges

The conditional pledge of the Government of Japan and the unconditional pledges of the Funds Contributing States and of the Governments of Germany and Switzerland have been shown in the financial statements as revenue in accordance with SFAS 116. Conditional pledges have been recognised as revenue upon receipt and unconditional pledges have been recognised as revenue upon notification.

Buildings, Equipment & Furnishings

The HQ office space owned by the MFO is recorded as a fixed asset on the balance sheet at its historic cost, net of the accumulated depreciation. It is being depreciated over thirty years using the straight-line method.

The cost of equipment and furnishings is charged to expense as incurred because it is improbable that equipment and furnishings can be economically removed from the Sinai once delivered. The MFO does not capitalize, with the exception of the Rome HQ offices, any of its fixed assets because total fixed assets with any net recoverable value are immaterial to the balance sheet, because the recognition of depreciation expense against write-off would not have a material effect on the income statement or net assets and because the recognition of depreciation expense would create a funding problem for the MFO, as Funds Contributing States provide funding based on the level of annual expenditure and not based on the level of "use" of the longer term assets.

Supplies & Stores Inventory

Costs of supplies and stores items are charged to expense as they are received, net of proceeds from vehicle and miscellaneous sales.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Foreign Exchange

Exchange adjustments arising from the translation of foreign currencies are included in the results of current operations.

Marketable Securities

Marketable securities, which are available for sale relate to funds deposited in a fixed income portfolio management account and are stated at market value.

NOTE 3 - MARKETABLE SECURITIES

A breakdown of the cost of marketable securities, which are available for sale by maturity is as follows (in thousands of U.S. dollars):

	<u>2003</u>	<u>2002</u>
Maturing within 1 year	8,485	5,247
Maturing between 1-5 years	2,207	5,325
Maturing beyond 5 years	382	1,113
Non current portion	2,589	6,438
Total	<u>11,074</u>	<u>11,685</u>

Realized gains and losses on sales of marketable securities during the year ended September 30, 2003 were \$263,884 and \$3,008 respectively. Realized gains and losses on sales of marketable securities during the year ended September 30, 2002 were \$7,293 and \$14,813 respectively. Realized gains and losses are included in other income.

At September 30, 2003 marketable securities, which are available for sale are summarized below (in thousands of U.S. dollars):

MULTINATIONAL FORCE & OBSERVERS
 NOTES TO FINANCIAL STATEMENTS
 for the years ended September 30, 2003 and 2002

NOTE 3 - MARKETABLE SECURITIES (CONTINUED)

	<i><u>Amortized Cost</u></i>	<i><u>Unrealized Gains</u></i>	<i><u>Unrealized Losses</u></i>	<i><u>Fair Value</u></i>
Floating rate notes maturing: within 1 year	-	-		-
U.S. Government securities maturing:				
within 1 year	3,136	13	(30)	3,119
between 1-5 years	<u>1,845</u>	<u>15</u>	<u>(3)</u>	<u>1,857</u>
Sub-total	4,981	28	(33)	4,976
U.S. Agency securities maturing: within 1 year	4,759	62	(71)	4,750
U.S. Corporations maturing: within 1 year	330	20	-	350
Eurodollar bonds maturing: within 1 year	597	18	-	615
Non-US Corporations maturing: beyond 5 years	<u>312</u>	<u>71</u>	<u>-</u>	<u>383</u>
Total	<u>10,979</u>	<u>199</u>	<u>(104)</u>	<u>11,074</u>

MULTINATIONAL FORCE & OBSERVERS
NOTES TO FINANCIAL STATEMENTS
for the years ended September 30, 2003 and 2002

NOTE 3 - MARKETABLE SECURITIES (CONTINUED)

At September 30, 2002 marketable securities, which are available for sale are summarized below (in thousands of U.S. dollars):

	<i><u>Amortized Cost</u></i>	<i><u>Unrealized Gains</u></i>	<i><u>Unrealized Losses</u></i>	<i><u>Fair Value</u></i>
Floating rate notes maturing:				
within 1 year	-	-		-
U.S. Government securities maturing:				
within 1 year	2,727	12		2,739
between 1-5 years	<u>2,054</u>	<u>96</u>		<u>2,150</u>
Sub-total	4,781	108		4,889
U.S. Agency securities maturing:				
within 1 year	2,476	32		2,508
between 1-5 years	<u>983</u>	<u>99</u>		<u>1,082</u>
Sub-total	3,459	131		3,590
U.S. Corporations maturing:				
within 1 year	-	-		-
beyond 5 years	<u>-</u>	<u>-</u>		<u>-</u>
Sub-total	-	-		-
Eurodollar bonds maturing:				
between 1-5 years	1,938	155		2,093
Asset backed securities maturing:				
between 1-5 years				
beyond 5 years				
Sub-total	<u>891</u>	<u>222</u>		<u>1,113</u>
	<u>891</u>	<u>222</u>		<u>1,113</u>
Total	<u>11,069</u>	<u>616</u>		<u>11,685</u>

MULTINATIONAL FORCE & OBSERVERS
 NOTES TO FINANCIAL STATEMENTS
 for the years ended September 30, 2003 and 2002

NOTE 4 - BUILDINGS, EQUIPMENT AND FURNISHINGS

The MFO acquired part of a building in Rome, Italy, for use as the headquarters of the organisation for \$2,337,000 on September 16, 1997.

The depreciation expense for the year ended September 30, 2003 is \$78,000 (2002 - \$78,000).

The building and accumulated depreciation are composed as follows as of September 30 (in thousands of U.S. dollars):

	<u>2003</u>	<u>2002</u>
Cost	2,337	2,337
Accumulated depreciation	<u>(467)</u>	<u>(390)</u>
Net book value	<u>1,870</u>	<u>1,947</u>

The expenditures for equipment and furnishings are included in the statement of functional expenses.

NOTE 5 - PREPAID EXPENSES AND OTHER RECEIVABLES

The schedule below provides an analysis of the prepaid expenses and other receivables balance as at September 30 (in thousands of U.S. dollars):

	<u>2003</u>	<u>2002</u>
Force Exchange	594	155
Prepaid insurance	1,087	1,216
Other prepaids	310	363
Prepaid morale support	159	146
Other receivables and advances	<u>272</u>	<u>384</u>
Total	<u>2,422</u>	<u>2,264</u>

The MFO operates, on a not-for-profit basis, a Force Exchange in the Sinai for the benefit of participating troops and civilian personnel. Force Exchange surpluses are used to fund morale support expenditure. Force Exchange operations, for which working capital is provided by the MFO, have not been incorporated into the MFO financial statements as they are distinct and autonomous from those of the MFO and such inclusion is deemed immaterial.

The Force Exchange operates using its own bank accounts and financial accounting records. Should Force Exchange operations significantly increase it may be consolidated into the MFO financial statements. Such an increase in operations is not envisioned in the foreseeable future.

NOTE 6 - PLEDGES

The amounts of budgeted contributions that have not been drawn upon or made available are shown in the financial statements as pledges, which are partly supported by letters of credit and are partly unsecured, as at September 30, are as follows (in thousand of U.S. dollars):

	<u>2003</u>	<u>2002</u>
Pledges supported by letters of credit	5,675	5,221
Unsecured pledges	<u>3,436</u>	<u>3,446</u>
Total	<u>9,111</u>	<u>8,667</u>

NOTE 7 - CONTRIBUTIONS MADE BY THE GOVERNMENTS OF JAPAN, GERMANY AND SWITZERLAND

Since 1988 the Government of Japan has made annual contributions to the MFO and in 2003 contributions amounted to \$500,000 (2002 - \$800,000). As specified by the Government of Japan these contributions have been applied exclusively, and conditionally, to pay for food costs and civilian personnel salaries and therefore appear as "Temporarily Restricted Revenue" in the statement of Revenues Expenses and Changes in Net Assets. Net assets were released from donor restrictions by incurring expenses thus satisfying those restrictions and have been entirely absorbed by the food and civilian personnel salary accounts.

The MFO has also received unrestricted contributions from the Government of Germany since 1994 and from the Government of Switzerland since 1995. The contributions received which have been included in the accompanying financial statements are summarized as follows (in U.S. dollars):

	<u>2003</u>	<u>2002</u>
Germany	<u>306,039</u>	<u>273,373</u>
Switzerland	<u>166,334</u>	<u>151,094</u>

NOTE 8 - ACCOUNTS PAYABLE AND ACCRUED EXPENSES

The schedule below provides an analysis by cost allocation of accounts payable and accrued expenses as at September 30 (in thousands of U.S. dollars):

	<u>2003</u>	<u>2002</u>
Personnel	9,101	9,288
Supplies	2,068	3,939
Troop rotation	4,281	2,798
Other	<u>369</u>	<u>336</u>
	<u>15,819</u>	<u>16,361</u>

NOTE 9 - CONTRIBUTED SERVICES & FACILITIES

Contributed Services

For troop contingents provided by developed nations, the MFO reimburses the cost of special pay and allowances required by applicable national legislation for troops serving abroad. The MFO does not pay fixed base pay and salaries, and receives a credit for certain costs that troop contributors would have incurred had their troops remained at home. These credits are not separately identified within the financial statements, and the stated expense for these personnel is net of these credits. The value of the contributed services of soldiers is not included in the financial statements as such services are not obtainable from the general market place.

In the case of the United States, France and Italy, the MFO is furnished at no cost with capital equipment for the mission, with agreed maintenance and support arrangements that effectively allocate such costs between the MFO and the contributing country. Stated expenses for equipment and supplies are net of agreed credits relating to maintenance and support arrangements. A precise valuation of these capital contributions themselves, either in terms of cost to contributors and not reimbursed by the MFO and/or in avoided costs of potentially more costly alternate sourcing of such assets, while obviously substantial and

NOTE 9 - CONTRIBUTED SERVICES & FACILITIES (CONTINUED)

appreciated by the MFO, would be very speculative based on the limited information available to the MFO. In accordance with SFAS 116, the MFO has not recognized as a contribution such equipment as the MFO, as stated above, has no reasonable basis for the determination of value.

For fiscal years 2003 and 2002, the total value of credits from the United States Department of Defense totaled \$5,866,000 and \$5,508,000 respectively. These amounts are offset against amounts otherwise due to the Department of Defense from the MFO for special pay and various allowances, helicopter parts, and goods and services ordered by the MFO. Credits are based on the 1982 MFO-United States Participation Agreement and are calculated on the understandings reached in the signed Memorandum of Understanding (MOU) between the MFO and the United States Government, dated November 10, 1994.

The MFO wishes to note its appreciation for donations of excess equipment and material from Participating States, notably in recent years from the United States; the value of such donations net of any handling and transportation costs incurred by the MFO are properly not herein reflected, but such donations are duly notified to the three Funds Contributing States.

Contributed Facilities

The MFO does not have title to the buildings and facilities that are located in the Sinai. The MFO receives the use of the North and South Camps in the Sinai rent-free. These sites and related facilities are provided by the Government of Egypt; all improvements to the facilities have been made possible through the contributions of the Funds Contributing States.

NOTE 10 - ALLOCATION OF EXPENSES

MFO Management have determined, in compliance with SFAS 116, that all costs relating to the Rome Headquarters will be regarded as support costs. All costs relating to the MFO field offices in Tel Aviv and Cairo and the Force deployed in the Sinai have been reported as program costs as defined by SFAS 116. It should be noted that some HQ costs are truly program specific, whilst some Tel Aviv and Cairo office costs could be regarded as support costs. The cost of tracking and reallocating these costs separately would not provide the user of the accounts with a greater understanding of them. Management thus determined the most cost-effective way of complying with the standard is the adopted method of cost allocation. However, it should be noted that all costs are related to the purposes for which the MFO has received contributions, i.e., the conduct and support of its peacekeeping mission.

NOTE 11 - SELF INSURANCE FUND

At the Trilateral Conference held on November 27, 1989, it was agreed that a self-insurance fund would be created. During FY 2003 and FY 2002 the MFO did not allocate any further funds to the Self Insurance Fund. The authorized amount of the fund is set at \$6,150,000. The interest earned on the Self Insurance Fund investments is returned to the Funds Contributing States (Note 2). In accordance with SFAS 117, the Self Insurance Fund is considered "Temporarily Restricted" because the Funds Contributing States have approved its use for specific objectives and the Fund can only be utilised for such objectives.

NOTE 12 - CAPITAL ASSET REPLACEMENT FUND

At the Trilateral Conference held on November 26, 1990, it was agreed that a Capital Asset Replacement Fund (CARF) would be created to finance projects of a non-routine, non-recurring nature (within 5 years) with a projected cost in excess of \$250,000. In 2002, \$650,000 was allocated to the CARF towards the financing of the connection of the MFO North Camp to the Egyptian commercial power grid. In 2003, an additional \$850,000 was allocated to the CARF to complete the financing of the connection of the MFO North Camp to the Egyptian commercial power grid. A further \$803,000 was allocated to the CARF in 2003 towards the transition cost of the MFO's helicopter fleet. The allocations are a temporary measure and the CARF will be returned to the originally authorized amount of \$4,190,000 as circumstances permit. In accordance with SFAS 117, the Capital Asset Replacement Fund is considered "Temporarily Restricted" because the Funds Contributing States have approved its use for specific objectives and the Fund can only be utilised for such objectives. The interest earned on the Capital Asset Replacement Fund investments is returned to the Funds Contributing States (Note 2).