

Development Bank of Zambia
Directors' Report and Financial Statements
for the year ended 31 December 2005

**Development Bank of Zambia
Directors' Report and Financial Statements
for the year ended 31 December 2005**

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**Development Bank of Zambia
Report of the directors
for the year ended 31 December 2005**

The directors submit their report together with the audited financial statements for the year ended 31 December 2005, which disclose the state of affairs of Development Bank of Zambia ('the Bank').

Registered office address

Development Bank of Zambia was incorporated in Zambia under the Development Bank of Zambia Act and is domiciled in Zambia. The Company is also licensed under the Zambia Banking and Financial Services Act 1994, (as amended) to conduct banking services. The address of its registered office is:

Development House
Katondo Street
Lusaka
Zambia

Principal activities

The principal activities of the Bank continued to be the provision of short, medium and long term finance for development purposes.

In the opinion of the directors, all the activities of the Bank fall within the financial services sector.

Share capital

The changes in the issued share capital during the year were as follows:

	Number of shares (thousands)	Amount K'Million
At beginning of year	4,080	20,028
Allotment of new shares	<u>1,946</u>	<u>9,341</u>
At end of year	<u>6,026</u>	<u>29,369</u>

The new shares were issued at par.

No arrangements have been put in place to enable the directors to acquire shares.

Operating results and dividends

	2005	2004
Net interest income	<u>4,499</u>	<u>3,191</u>
Net profit for the year	<u>242</u>	<u>918</u>

The net profit for the year has been added to retained earnings. No dividend was paid during the year. (2004: K nil)

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Average number and remuneration of employees

The total remuneration of employees during the year amounted to **K 4,312 million** (2004: K 4,001 million) and the average number of employees was 28.

The Bank recognises its responsibility regarding the occupational health, safety, and welfare of its employees and has put in place measures to safeguard them.

Gifts and donations

During the year the Bank made donations of **K 4.85 million** (2004: K12.9 million).

Exports

The Bank did not make any exports from Zambia during the year.

Property, plant and equipment

The Bank purchased property, plant and equipment amounting to **K 616 million** (2004: K 402 million) during the year.

In the opinion of the directors, there was no significant difference between the carrying value of property and its market value.

Research and development

During the year the Bank did not conduct any research and development activities.

Related party transactions

As required by the Zambia Banking and Financial Services Act, 1994, (as amended) related party transactions are disclosed in the financial statements.

Directors' emoluments and interests

Directors' emoluments and interests are disclosed in the financial statements in accordance with the Zambia Banking and Financial Services Act, 1994, (as amended).

There were no directors' interests within the meaning of Section 35 of the Zambia Banking and Financial Services Act, 1994, (as amended).

Prohibited borrowings or lending

There were no prohibited borrowings or lending as defined under Sections 72 and 73 of the Zambia Banking and Financial Services Act, 1994, (as amended).

Risk management and control

The Bank, through its normal operations, is exposed to a number of risks, the most significant of which are credit, market, operational and liquidity risks.

The directors have approved policies to mitigate the above risks by introducing controls that are designed to safeguard the bank's assets while allowing sufficient freedom for the normal conduct of business. The asset and liability committee carries out independent reviews to ensure compliance with financial and operational controls.

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Compliance function

The Bank has in place a compliance function whose responsibility is to monitor compliance with the regulatory environment and the various internal control processes and procedures.

Know your customer and anti-money laundering policies.

The Bank has adopted “know your customer” (KYC) and anti-money laundering policies and adheres to current legislation in these areas.

Directors

The directors who held office during the year and to the date of this report were:

Mr. Saviour H Konie	-	Chairman
Dr. Bwalya KE Ng'andu	-	Managing director
Mr. Johnstone F Chizinga	-	Director
Dr. John Mulwila	-	Director
Dr. Situmbeko Musokotwane	-	Director
Mr. Parmod Kumar Bajaj	-	Director
Mr. Sanjeev Kumar Pawar	-	Director
Mr. R.M.V. Raman	-	Director

Auditors

The Bank's auditors, PricewaterhouseCoopers, have indicated their willingness to continue in office and a resolution for their re-appointment will be proposed at the annual general meeting.

By order of the Board

**A M Musukwa
Bank Secretary**

Lusaka

2006

Development Bank of Zambia
Directors' responsibilities and statement

Directors' responsibilities

The directors are required to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Bank and of the profit or loss and cash flows for that year. In preparing those financial statements, the directors select suitable accounting policies and then apply them consistently, make judgements and estimates that are reasonable and prudent and follow International Financial Reporting Standards.

The directors are responsible for ensuring that the Bank keeps proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank. The directors are also responsible for safeguarding the assets of the Bank and taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' statement on the financial statements

The directors of Development Bank of Zambia are of the opinion that:

- (a) the profit and loss account is drawn up so as to give a true and fair view of the profit of the Bank for the year ended 31 December 2005;
- (b) the balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank at 31 December 2005; and
- (c) there are reasonable grounds to believe that the Bank will be able to pay debts as and when they fall due.

Signed on their behalf by:

.....

Director

.....

Director

2006

Report of auditors to the members of Development Bank of Zambia

We have audited the financial statements of Development Bank of Zambia for the year ended 31 December 2005 as set out on pages 6 to 37.

Respective responsibilities of the directors and auditors

As described on page 4, these financial statements are the responsibility of the Bank's directors. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis of opinion

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

Opinion

In our opinion, the statements included in the financial statements give a true and fair view of the financial position of the Bank as of 31 December, 2005 and of the results of operations and cash flows for the year then ended in accordance with International Financial Reporting Standards, the Zambia Banking and Financial Services Act, 1994 (as amended) and the Development Bank of Zambia Act 2001 (as amended).

Chartered Accountants

**Richard Mazombwe
Partner**

2006

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(all amounts are in millions of kwacha unless otherwise stated)

Profit and loss account

	Notes	2005	2004
Interest income	3	4,572	3,244
Interest expense	4	<u>(73)</u>	<u>(53)</u>
Net interest income		4,499	3,191
Commission income		<u>843</u>	<u>1,392</u>
		<u>5,342</u>	<u>4,583</u>
Dividend income		2,053	2,275
Other operating income		<u>254</u>	<u>962</u>
Operating income		7,649	7,820
Operating expenses	5,6	<u>(6,960)</u>	<u>(6,493)</u>
Profit before income tax		689	1,327
Income tax expense	7	<u>(447)</u>	<u>(409)</u>
Profit for the year		<u>242</u>	<u>918</u>

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Balance sheet

	Notes	2005	2004
Assets			
Deposits and balances due from banking institutions	8	648	1,291
Investments:			
- held to maturity	9	14,893	9,947
- available for sale	10	5,700	6,545
Loans and advances	11	14,408	19,960
Amounts due from Government of Zambia	12	4,563	7,686
Property, plant and equipment	13	21,383	21,563
Current taxation recoverable	7	1,103	834
Other assets	15	<u>1,413</u>	<u>512</u>
Total assets		<u><u>64,111</u></u>	<u><u>68,338</u></u>
Liabilities			
Finance leases	17	68	335
Borrowings	18	513	457
Government of Zambia debenture	25	-	9,341
Other liabilities	16	<u>6,498</u>	<u>9,911</u>
Total liabilities		<u><u>7,079</u></u>	<u><u>20,044</u></u>
Shareholders' equity			
Share capital	19	29,369	20,028
Revaluation reserve	20	19,161	20,609
Other reserves	21	6,570	7,234
Retained earnings		<u>1,932</u>	<u>423</u>
Total shareholders' equity		<u><u>57,032</u></u>	<u><u>48,294</u></u>
Total equity and liabilities		<u><u>64,111</u></u>	<u><u>68,338</u></u>

The financial statements on pages 6 to 37 were approved for issue by the board of directors on 2006 and signed on its behalf by:

.....
Director

.....
Director

.....
Director

.....
Secretary

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Statement of changes in equity

	Notes	Share capital	Revaluation reserve	Other reserves	Retained earnings	Total
Year ended 31 December 2004						
At start of the year		11,744	3,546	-	194	15,484
Net gains from changes in fair value		-	-	6,545	-	6,545
Issue of share capital		8,284	-	-	-	8,284
Revaluation		-	17,063	-	-	17,063
Profit for the year		-	-	-	918	918
Transfer to statutory reserve		-	-	459	(459)	-
Transfer to reserve fund		-	-	230	(230)	-
At end of year		<u>20,028</u>	<u>20,609</u>	<u>7,234</u>	<u>423</u>	<u>48,294</u>
Year ended 31 December 2005						
At start of year		20,028	20,609	7,234	423	48,294
Net losses from changes in fair value		-	-	(845)	-	(845)
Issue of share capital	19	9,341	-	-	-	9,341
Profit for the year		-	-	-	242	242
Transfer to statutory reserve		-	-	121	(121)	-
Transfer to reserve fund		-	-	60	(60)	-
Revaluation surplus realised	20	-	(1,196)	-	1,196	-
Transfer of excess depreciation, net of tax	20	-	(252)	-	252	-
At end of year		<u>29,369</u>	<u>19,161</u>	<u>6,570</u>	<u>1,932</u>	<u>57,032</u>

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Cash flow statement

	Notes	2005	2004
Cash flows from operating activities			
Interest receipts		4,572	3,244
Interest payments		(73)	(53)
Net fee and commission receipts		843	1,392
Dividends received		2,053	2,275
Other income received		254	962
Payments to employees and suppliers		(6,164)	(6,104)
Profit on disposal of property and equipment		-	(42)
Income tax paid	7	<u>(716)</u>	<u>(1,075)</u>
Cash flows from operating activities before changes in operating assets and liabilities		769	599
Changes in operating assets and liabilities:			
- investment held to maturity		(4,946)	9,621
- loans and advances		5,552	(18,520)
- other assets		(901)	413
- other liabilities		<u>(3,353)</u>	<u>7,734</u>
Net cash from operating activities		<u>(2,879)</u>	<u>(153)</u>
Cash flows from investing activities			
Purchase of property, plant and equipment	13	(616)	(402)
Proceeds from sale of property, plant and equipment		<u>-</u>	<u>42</u>
Net cash used in investing activities		<u>(616)</u>	<u>(360)</u>
Cash flows from financing activities			
Finance leases repayments		(267)	(222)
Issue of ordinary shares	19	-	8,284
Borrowings (repaid) / received	18	(4)	400
Decrease / (increase) in amounts due from GRZ		<u>3,123</u>	<u>(7,699)</u>
Net cash from financing activities		<u>2,852</u>	<u>763</u>
Net (decrease)/ increase in cash and cash equivalents		(643)	250
Cash and cash equivalents at beginning of year		<u>1,291</u>	<u>1,041</u>
Cash and cash equivalents at end of year	8	<u><u>648</u></u>	<u><u>1,291</u></u>

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Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS). The financial statements are presented in the functional currency, kwacha (K), rounded to the nearest million, and prepared under the historical cost convention as modified by the revaluation of property, available-for-sale investment securities and financial assets.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the financial statements, are disclosed in note 2.

Adoption of new and revised standards

In 2005 several new and revised standards became effective for the first time and have been adopted by the Bank where relevant to its operations. The adoption of these new and revised standards had no material effect on the Bank's accounting policies or disclosures, except as follows:

- IAS 16 (revised 2003) has required the disclosure of comparative figures for movements in property and equipment;
- IAS 24 (revised 2003) has affected the identification of related parties and some other related party disclosures.
- IAS 39 (revised 2003) has resulted in a change in accounting policy relating to the classification of financial assets.

All changes in accounting policies have been made in accordance with the transitional provisions in the respective standards. Most of the new and revised standards require retrospective application, the main relevant exception being:

- IAS 39 does not require the classification of financial assets as at 'fair value through profit or loss' of previously recognised financial assets;

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Accounting policies (continued)

(b) Interest income and expense

Interest income and expense are recognised in the profit and loss account for all interest bearing instruments measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

When loans and advances become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

(c) Fees and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

(d) Translation of foreign currencies

The accounting records are maintained in the currency of the primary economic environment in which the Bank operates, Zambian Kwacha ("the functional currency"). Transactions in foreign currencies during the year are converted into the functional currency using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account.

(e) Financial assets

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss; loans, advances and receivables; held-to-maturity investments; and available-for-sale assets. Management determines the appropriate classification of its investments at initial recognition.

- ***Financial assets at fair value through profit or loss***

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading.

- ***Loans, advances and receivables***

Loans, advances and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading the receivable.

Accounting policies (continued)

- ***Held-to maturity***
Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. Were the Bank to sell more than an insignificant amount of held-to-maturity assets, the entire category would have to be reclassified as available for sale.
- ***Available-for-sale***
Available-for-sale investments are those non-derivative financial assets that are not classified under any of the three categories.

Purchases and sales of financial assets at fair value through profit or loss, held-to-maturity and available-for-sale are recognised on trade-date – the date on which the Bank commits to purchase or sell the asset. Financial assets are initially recognised at fair value plus, for all financial assets except those carried at fair value through profit or loss, transaction costs. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

(f) Financial assets

Loans, advances and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Available-for-sale financial assets and financial assets at fair value through profit or loss are carried at fair value. Gains and losses arising from changes in the fair value of 'financial assets at fair value through profit or loss' are included in the profit and loss account in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the profit or loss account. However, interest calculated using the effective interest method is recognised in the profit and loss account. Dividends on available-for-sale equity instruments are recognised in the profit and loss account when the right to receive payment is established.

Fair values of quoted investments in active markets are based on quoted bid prices. Fair values for unlisted equity securities are estimated using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants. Equity securities for which fair values cannot be measured reliably are recognised at cost less impairment.

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Accounting policies (continued)

(g) Impairment of financial assets

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as default or delinquency in interest or principal repayments;
- the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - adverse changes in the payment status of borrowers in the group; or
 - national or local economic conditions that correlate with defaults on the assets in the group.

(i) Assets carried at amortised cost

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instrument's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit and loss account. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash

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flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Accounting policies (continued)

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the profit and loss account.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit and loss account.

(ii) Assets carried at fair value

In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the profit and loss account. Impairment losses recognised in the profit and loss account on equity instruments are not reversed through the profit and loss account. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the profit and loss.

(h) Offsetting

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

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Accounting policies (continued)

(i) Property, plant and equipment

All categories of property, plant and equipment are initially recorded at cost. Buildings are subsequently shown at market value, based on regular valuations by external independent valuers, less subsequent depreciation. All other property and equipment is stated at historical cost less depreciation.

Increases in the carrying amount arising on revaluation are credited to a revaluation reserve. Decreases that offset previous increases of the same asset are charged against the revaluation reserve; all other decreases are charged to the profit and loss account. Each year the difference between depreciation based on the re-valued carrying amount of the asset (the depreciation charged to the profit and loss account) and depreciation based on the asset's original cost is transferred from the revaluation reserve to retained earnings.

Depreciation is calculated on the straight line basis to write down the cost of each asset, or the re-valued amounts, to its residual values over its estimated useful life as follows:

- Buildings 50 years
- Fixtures, fittings and equipment 5 years
- Plant and Machinery 10 years
- Computer Equipment 3 years
- Motor vehicles 4 years

The Bank assesses at each reporting date whether there is any indication that any item of property, plant and equipment is impaired. If any such indication exists, the Bank estimates the recoverable amount of the relevant assets. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Gains and losses on disposal of property, plant and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. On disposal of re-valued assets, amounts in the revaluation reserve relating to that asset are transferred to retained earnings.

(j) Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

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Accounting policies (continued)

(k) Income tax

Income tax expense is the aggregate of the charge to the profit and loss account in respect of current income tax and deferred income tax.

Current income tax is the amount of income tax payable on the taxable profit for the year determined in accordance with the relevant tax legislation.

Deferred income tax is provided in full, using the liability method, on all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates enacted or substantively enacted at the balance sheet date and are expected to apply when the related deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

(l) Dividends payable

Dividends on ordinary shares are charged to equity in the period in which they are declared.

(m) Derivative financial instruments

Derivative financial instruments including foreign exchange contracts and forward rate agreements and other derivative financial instruments, are initially recognised in the balance sheet at cost (including transaction costs) and subsequently are remeasured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value with unrealised gains and losses reported in the profit and loss account. The derivatives do not qualify for hedge accounting.

Changes in the fair value of derivatives held for trading are recognised immediately in the profit and loss account.

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Accounting policies (continued)

(n) Accounting for leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. All other leases are classified as finance leases.

(i) with the Bank as lessee

To date, all leases entered into by the Bank are finance leases. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding.

(ii) with a Bank as lessor

When assets are leased out under a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before income tax), which reflects a constant periodic rate of return.

(o) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days to maturity from date of acquisition including cash in hand, balances held in current accounts.

(p) Retirement benefits

(i) Retirement benefit obligations

The Bank and all its employees contribute in the state run National Pension Scheme Authority (NAPSA), a defined contribution retirement benefit scheme for its employees.

A defined contribution scheme is a pension plan under which the Bank pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods.

The Bank's contributions to the defined contribution scheme are charged to the profit and loss account in the year to which they relate. The Bank has no further obligation once the contributions have been paid.

(ii) Other entitlements

The estimated monetary liability for employees' accrued annual leave entitlement at the balance sheet date is recognised as an expense accrual.

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Notes to the financial statements

1 Financial risk management

The Bank, through its normal operations, is exposed to a number of risks, the most significant of which are credit, market, operational and liquidity risks.

The directors have approved policies to mitigate the above risks by introducing controls that are designed to safeguard the Bank's assets while allowing sufficient freedom for the normal conduct of business. The asset and liability committee carries out independent reviews to ensure compliance with financial and operational controls.

(a) Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counter party will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the balance sheet date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration of the Bank's portfolio, could result in losses that are different from those provided for at the balance sheet date. Management therefore carefully manages its exposure to credit risk.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to annual or more frequent review. Limits on the level of credit risk by product and industry sector are approved quarterly by the Board of Directors.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

(b) Concentrations of risk

At 31 December 2005	Loans and advances
	%
Transport and communications	13
Agriculture	49
Tourism	8
Agro-processing	11
Trading	2
Forestry	5
Manufacturing	7
Staff	5
	<u>100</u>
At 31 December 2004	
Transport and communications	20
Agriculture	55
Tourism	1
Agro-processing	18
Staff	6
	<u>100</u>

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(c) Currency risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure, which are monitored daily.

The Bank had the following foreign currency positions (all are US \$ amounts expressed in millions of Zambian Kwacha):

At 31 December 2005

Assets

Deposits and balances due from banking institutions	2,352
Loans and advances to customers	5,780
	<hr/>
Total assets	8,132

Liabilities

Finance Lease	68
Other liabilities	5,421
	<hr/>
Total liabilities	5,489

Net on-balance sheet position	2,643
	<hr/> <hr/>

Net off-balance sheet position	-
	<hr/> <hr/>

Overall net position	2,643
	<hr/> <hr/>

At 31 December 2004

Total assets	9,519
Total liabilities	9,473
	<hr/>

Net on-balance sheet position	46
	<hr/> <hr/>

Net off-balance sheet position	-
	<hr/> <hr/>

Overall net position	46
	<hr/> <hr/>

(d) Interest rate risk

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The board of directors sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily.

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Notes to the financial statements (continued)

(d) Interest rate risk (continued)

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates. All figures are in millions of Zambian Kwacha.

At 31 December 2005	Up to 1 month	1-3 months	3-12 months	Over 1 year	Non- interest bearing	Total
Assets						
Deposits and balances due from banking institutions	647	-	-	-	1	648
Investments held to maturity	1,751	8,530	4,612	-	-	14,893
Amounts due from GRZ	-	-	-	-	4,563	4,563
Loans and advances to customers	-	-	6,965	7,443	-	14,408
Investment available for sale	-	-	-	-	5,700	5,700
Property and equipment	-	-	-	-	21,383	21,383
Taxation recoverable	-	-	-	-	1,103	1,103
Other assets	-	-	-	-	1,413	1,413
Total assets	2,398	8,530	11,577	7,443	34,163	64,111
Liabilities and shareholders funds						
Finance leases	-	-	68	-	-	68
Borrowings	-	-	-	400	-	400
Other liabilities	-	-	-	-	6,611	6,611
Shareholders' funds	-	-	-	-	57,032	57,032
Total liabilities and shareholders' funds	-	-	68	400	63,643	64,111
Interest sensitivity gap	2,398	8,530	11,509	7,043	(29,480)	-
At 31 December 2004						
Total assets	7,594	8,817	9,973	4,812	37,142	68,338
Total liabilities and shareholders' funds	-	-	252	483	67,603	68,338
Interest sensitivity gap	7,594	8,817	9,721	4,329	(30,461)	-

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Notes to the financial statements (continued)

(d) Interest rate risk (continued)

The effective interest rates by major currency for monetary financial instruments not carried at fair value through profit or loss at 31 December 2005 and 2004 were in the following ranges:

	2005		2004	
	In K	In US\$	In K	In US\$
Assets				
Deposits with banking institutions	12 - 18	3 - 6.5	7 - 14	2 - 5
Loans and advances to customers	23 - 27	8 - 12	21 - 22	8
Liabilities				
Borrowings	15	-	15	-

(e) Liquidity risk

The Bank is exposed to weekly calls on its available cash resources from suppliers, debt servicing, and other operational needs. The Bank does not maintain cash resources to meet all of these needs as experience shows that cash outflows can be predicted with a high level of certainty. The board sets limits on the minimum and maximum liquidity ceiling at any point in time.

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at 31 December 2005 to the contractual maturity date. All figures are in millions of Zambian Kwacha.

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
At 31 December 2005						
Assets						
Deposits and balances due from banking institutions	648	-	-	-	-	648
Investments held to maturity	1,751	8,530	4,612	-	-	14,893
Amounts due from GRZ	-	-	-	4,563	-	4,563
Loans and advances to customers	-	-	6,965	7,443	-	14,408
Investment available for sale	-	-	-	5,700	-	5,700
Property and equipment	-	-	-	-	21,383	21,383
Taxation recoverable	-	-	-	1,103	-	1,103
Other assets	-	-	-	1,413	-	1,413
Total assets	2,399	8,530	11,577	20,222	21,383	64,111
Liabilities and shareholders' funds						
Finance leases	-	-	68	-	-	68
Borrowings	-	-	-	400	-	400
Other liabilities	-	-	-	6,611	-	6,611
Shareholders' funds	-	-	-	-	57,032	57,032
Total liabilities and shareholders' funds	-	-	68	7,011	57,032	64,111
Net liquidity gap	2,399	8,530	11,509	13,211	(35,649)	-
At 31 December 2004						
Total assets	7,596	8,817	10,398	14,395	27,132	68,338
Total liabilities and shareholders' funds	-	-	1,026	9,677	57,635	68,338
Net liquidity gap	7,596	8,817	9,372	4,718	(30,503)	-

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Notes to the financial statements (continued)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain terms and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

(f) Fair values of financial assets and liabilities

The fair values of the Bank's financial assets and liabilities approximate the respective carrying amounts, due to the generally short periods to contractual re-pricing or maturity dates as set out above. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the Bank at the balance sheet date.

2 Critical accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Impairment of available for-sale equity investments

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

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Notes to the financial statements (continued)

2 Critical accounting estimates and judgements in applying accounting policies (continued)

(c) *Held-to-maturity investments*

The Bank follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturing as held-to-maturity. This classification requires significant judgement. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to classify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortised cost. If the entire class of held-to-maturity investments were tainted, the fair value would increase by K311 million, with a corresponding entry in the fair value reserve in shareholders' equity. This is because of the nature of the held to maturity assets (i.e. government securities).

3 Interest income	2005	2004
Loans and advances	2,700	1,619
Cash and short term funds	<u>1,872</u>	<u>1,625</u>
	<u>4,572</u>	<u>3,244</u>
4 Interest expense	2005	2004
European Union – Apex Fund	69	53
Development Bank of Southern Africa	<u>4</u>	<u>-</u>
	<u>73</u>	<u>53</u>
5 Operating expenses	2005	2004
The following items are included within operating expenses		
Employee benefits expense (note 6)	4,067	4,001
Depreciation (note 13)	796	194
Loss on sale of property and equipment	<u>-</u>	<u>43</u>
	<u>4,863</u>	<u>4,238</u>

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Notes to the financial statements (continued)

6 Employee benefits expense	2005	2004
The following items are included within employee benefit expense:		
Retirement benefit costs:		
– Retirement benefit costs		670
– National Pension Scheme Authority	20	33
	<u>51</u>	<u> </u>

7 Income tax expense

Current income tax	<u>447</u>	<u>409</u>
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The tax on the Bank's profit before income tax differs from the theoretical amount that would arise using the statutory income tax rate as follows:

	2005	2004
Profit before income tax	<u>689</u>	<u>1,327</u>
Tax calculated at the statutory income tax rate of 35% (2004: 35%)	241	465
Tax effect of:		
Income taxed at a lower rate - dividends	(410)	(455)
Expenses not deductible for tax purposes	174	52
Deferred tax movement not recognised in current year	<u>442</u>	<u>347</u>
Income tax expense	<u>447</u>	409

Current income tax movement in the balance sheet

At start of year	834	168
Current income tax charge	(447)	
Withholding taxes suffered		(409)
	<u>716</u>	<u>1,075</u>
At end of year	<u>1,103</u>	834

Income tax assessments have been agreed with the Zambia Revenue Authority (ZRA) up to and including the year ended 31 December 2002. A self-assessment system for income tax was introduced for periods subsequent to 31 December 2002. Income tax returns have been filed with the ZRA for the years ended 31 December 2003 and 2004. There were no quarterly tax payments for the year ended 31 December 2005. This is because the Bank has significant brought forward tax losses to offset tax liabilities.

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Notes to the financial statements (continued)

8 Cash and cash equivalents	2005	2004
Cash in hand	1	2
Current accounts	<u>647</u>	<u>1,289</u>
	<u>648</u>	<u>1,291</u>

9 Treasury bills and government bonds

Term deposits (Between 3 – 12 months)	<u>14,893</u>	<u>9,947</u>
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Treasury bills and government bonds are debt securities issued by the Zambian Central bank (The Bank of Zambia) for a term of three months, six months or a year. All bills are subject to variable interest rate risk.

10 Investment securities

2005
2004

Securities available-for-sale

Equity securities – at fair value		
– Unlisted equity investments	<u>5,700</u>	<u>6,545</u>

The movement in investment securities available-for-sale may be summarised as follows (kwacha '000):

	2005	2004
At start of year	6,545,421	671
(Losses)/gains from changes in fair value transferred to equity (note21)	(845,421)	6,544,750
	<u>5,700,000</u>	<u>6,545,421</u>

In the prior year financial assets at fair value through profit or loss, other than those held for trading, were classified as available-for-sale and had a carrying amount of K 5,700 million (2004: K6,545million). These represented shares held in Kaleya Small Holdings Limited, The assets have been written down to a carrying amount of K 5,700 based on a sale of the same number of shares held by another investor.

The Bank has not designated at initial recognition any financial liability as at fair value through profit or loss.

11 Loans and advances

2005 **2004**

Commercial loans	13,887	18,749
Staff loans and advances	<u>521</u>	<u>1,211</u>
Gross loans and advances	14,408	19,960
Less-allowance for impairment	<u>-</u>	<u>-</u>
Net loans and advances	<u>14,408</u>	<u>19,960</u>

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Notes to the financial statements (continued)

12 Amounts due from Government of the Republic of Zambia

Following the enactment of the Development Bank of Zambia (Amendment) Act, 2001, all loans deemed to be non-performing at the effective date of this Act were transferred to the Government of the Republic of Zambia (GRZ). Non performing loans for this purpose were defined as: " all loans advanced by the Bank and in each case, in respect of which any payment of interest, on commencement of the Act, were in arrears in excess of one hundred and eighty days, and the amount of equity investment by the Bank in any Company or entity which, for three years or more immediately before commencement of the Act, had not made a declaration of dividend". The Bank was given the responsibility of managing this portfolio on behalf of GRZ, under the following terms and conditions:

- The Bank is responsible for the overall supervision and management of the non performing portfolio;
- The Bank is required to outsource the management of the non performing portfolio from outside specialists through a tender process and charge against the proceeds collected all the direct costs incurred in the management of the portfolio;
- The Bank earns a commission of 30% per annum on proceeds realised; and
- The proceeds collected less the Bank's commission and direct costs will require to be kept in a special account to be capitalised in favour of Government on a half yearly basis.

The movement in amounts due from/ (to) GRZ are as follows:

	2005	2004
Balance at 1 January	7,686	(13)
Government of Zambia portfolio collections for the year	(2,940)	(4,640)
Commissions due to the Bank	843	1,392
Reimbursable direct costs related to managing portfolio	749	2,428
Amounts paid to GRZ	(1,775)	-
Amounts claimable from Government of Zambia (note 16)	-	7,520
	<u>4,563</u>	<u>6,687</u>
Balance before capitalisation	4,563	6,687
Amount capitalised into shares	-	999
Balance at 31 December	<u>4,563</u>	<u>7,686</u>

There was no capitalisation in the year under review (2004: **K999,094,931**) in favour of GRZ as follows:

	2005	2004
Collections to December	2,940	3,313
Commission due to the Bank	(843)	(999)
Direct expenses (including amounts paid to GRZ)	(2,097)	(1,315)
	<u>-</u>	<u>999</u>
Amount capitalised	-	999

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Notes to the financial statements (continued)

13 Property, plant and equipment

	Buildings	Fixtures, fittings and equipment	Motor vehicles	Computer equipment	Total
At 1 January 2004					
Cost or valuation	4,062	428	1,423	612	6,525
Accumulated depreciation	(544)	(399)	(551)	(544)	(2,038)
Net book amount	3,518	29	872	68	4,487
Year ended 31 December 2004					
Opening net book amount	3,518	29	872	68	4,487
Revaluation surplus	16,438	-	-	-	16,438
Additions	-	362	40	-	402
Disposals	-	-	42	-	42
Depreciation write back / (charge)	544	(19)	(287)	(44)	194
Closing net book amount	20,500	372	667	24	21,563
At 31 December 2004					
Cost or valuation	20,500	790	1,421	612	23,323
Accumulated depreciation	-	(418)	(754)	(588)	(1,760)
Net book amount	20,500	372	667	24	21,563
Year ended 31 December 2005					
Opening net book amount	20,500	372	667	24	21,563
Additions	4	36	161	415	616
Re-classification	225	(294)	-	69	-
Depreciation charge	(415)	(23)	(278)	(80)	(796)
Closing net book amount	20,314	91	550	428	21,383
At 31 December 2005					
Cost or valuation	20,729	532	1,583	1,096	23,940
Accumulated depreciation	(415)	(441)	(1,033)	(668)	(2,557)
Net book amount	20,314	91	550	428	21,383

In the opinion of the directors, there has been no impairment of property, plant and equipment

Buildings were last re-valued as at 31 December 2004, by Government Valuation Department, registered valuers. Valuations were made on the basis of the open market value. The book values of the properties were adjusted to the re-valued amounts and the resultant surplus was credited to the revaluation reserve in shareholders' equity.

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Notes to the financial statements (continued)

13 Property, plant and equipment (continued)

If the buildings were stated on the historical basis, the amounts would be as follows:

	2005	2004
Cost	1,317	1,088
Accumulated depreciation	<u>(139)</u>	<u>(113)</u>
Net book amount at end of year	<u>1,178</u>	<u>975</u>

Motor vehicles include the following amounts where the Bank is a lessee under a finance lease

	2005	2004
Cost – capitalised finance leases	636	636
Accumulated depreciation	<u>(477)</u>	<u>(318)</u>
Net book amount at end of year	<u>159</u>	<u>318</u>

14 Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 35% (2004: 35%). The movement on the deferred income tax account is as follows:

	Movements in year not recognised				31.12.2005
	1.1.2005 not c/forward	Adjustments for losses	Charged/ (credited) to P/L	Charged/ (credited) to equity	
Deferred income tax liabilities					
Revaluation surplus	(5,972)	-	554	-	(5,418)
Deferred revenue	-	61	-	-	61
Excess accelerated capital allowances over depreciation	(81)	(1,009)	(514)	-	(1,604)
Gains from changes in fair value	<u>(2,291)</u>	-	-	296	<u>(1,995)</u>
	<u>(8,344)</u>	<u>(948)</u>	40	296	<u>(8,956)</u>
Deferred income tax assets					
Tax losses carried forward	51,048	20,831	335	-	72,214
Other temporary differences	-	211	47	-	258
	<u>51,048</u>	<u>21,042</u>	382	-	<u>72,472</u>
Net deferred income tax asset	42,704	20,094	422	296	63,516

Deferred income tax asset of K63,516 (2004: K42,704) at the year-end has not been recognised in the financial statements in accordance with accounting policy (k).

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Notes to the financial statements (continued)

15 Other assets	2005	2004
Accounts receivable	43	87
Deferred income-upfront fees	1,021	-
Prepayments	88	170
Other	261	255
	<u>1,413</u>	<u>512</u>

16 Other liabilities		
Provision and accrual	471	247
Payroll liabilities	593	526
Amount due to third party	5,434	9,138
	<u>6,498</u>	<u>9,911</u>

The amount due to third party relates to a provision made for a claim to the Bank of US \$ 1.9 million relating to a guarantee provided by the Bank. As this claim relates to a guarantee provided prior to the enactment of the Development Bank of Zambia amendment Act of 2001, the Bank has recourse to the Government of the Republic of Zambia and consequently a receivable of the equivalent amount has been recognised in these financial statements. The movement on the provision was as follows

At start of year	9,138	1,671
Provision made during the year (with recourse to GRZ)	-	7,520
Payments	(1,775)	-
Revaluation	(1,929)	(53)
At end of year	<u>5,434</u>	<u>9,138</u>

17 Finance lease obligations	2005	2004
-------------------------------------	-------------	-------------

Finance lease obligations shown in the balance sheet may be analysed as follows:

Finance lease liabilities – minimum lease payments:

Not later than 1 year	68	310
Later than 1 year and not later than 5 years	-	147
	<u>68</u>	<u>457</u>
Future finance charges on finance leases	-	(122)
Present value of finance lease liabilities	<u>68</u>	<u>335</u>

The present value of finance lease liabilities is as follows:

Not later than 1 year	68	229
Later than 1 year and not later than 5 years	-	106
Present value of finance lease liabilities	<u>68</u>	<u>335</u>

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Notes to the financial statements (continued)

The leases are denominated in United States dollars and are repayable in 36 equal monthly instalments at an effective rate of interest of 12% per annum.

18 Borrowings	2005	2004
Bank of Zambia (i)	-	4
European Union-Apex fund (ii)	513	453
	<u>513</u>	<u>457</u>

(i) The loan was repaid in the year under review.

(ii) This is an unsecured loan repayable in one lump sum in 2007. The effective interest rate on the loan is 15 %

(iii) During the year, the Bank signed a loan agreement with the Development Bank of Southern Africa (DBSA) for a US\$10 million line of credit. The Bank had not made any drawdowns against this facility at 31 December 2005.

19 Share capital	Number of issued shares (thousands)	Value of shares (K million)
	Class A	
Balance at 1 January 2005	2,675	13,211
Issue of ordinary shares	<u>1,946</u>	<u>9,341</u>
Balance at 31 December 2005	<u>4,621</u>	<u>22,552</u>
	Class B	
Balance at 31 December 2005	1,404	6,813
Golden share	1	4
Total issued shares	<u><u>6,026</u></u>	<u><u>29,369</u></u>

The total authorised number of ordinary shares is 700,000 with a par value of US\$1,000 per share. The kwacha value of the shares is determined using the exchange rate ruling at the date of issue of the shares. All issued shares are fully paid. There were no movements in the class B shares and the golden share categories during the year.

20 Revaluation reserve	2005	2004
At start of year	20,609	3,546
Revaluation surplus	-	17,063
Write off of revaluation surplus	(1,196)	-
Transfer of excess depreciation	<u>(252)</u>	-
At end of year	<u>19,161</u>	<u>20,609</u>

The revaluation reserve is non-distributable.

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21 Other reserves

	Fair value revaluation reserve	Reserve fund	Statutory reserve	Totals
At start of year	6,545	230	459	7,234
Net loss from changes in fair value	(845)	-	-	(845)
Transfer to statutory reserve	-	-	121	121
Transfer to reserve fund	-	60	-	60
At end of year	5,700	290	580	6,570

The reserve fund is established in accordance with Section 21 of the Development Bank of Zambia Act (As amended), which requires the Bank to provide against any anticipated losses by establishing and maintaining a reserve fund. Current regulation stipulates that a bank shall transfer to its reserve fund:

- a) 25% of the net profit of each year until the total sum standing to the credit of such reserve fund equals the paid up share capital of the Bank; or
- b) 12.5% of the net profit of each year if the total sum standing to the credit of the reserve fund equals or exceeds the paid up share capital of the Bank.

The statutory reserve is established in accordance with Chapter VI Section 69 of the Zambian Banking and Financial Services Act, 1994 (as amended). Current regulation stipulates that a bank shall maintain a reserve account and before declaring any dividend, shall transfer to its reserve account, 50% of the net profit of each year after due provision has been made for tax, to a maximum of the issued share capital.

22 Off balance sheet financial instruments, contingent liabilities and commitments

In common with other banks, the Bank conducts business involving acceptances, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties

Contingent liabilities	2005	2004
Guarantee and performance bonds	<u>60</u>	<u>-</u>

This represents a guarantee written by the Bank to support performance by a customer to a third party. The Bank will only be required to meet these obligations in the event of the customer's default.

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Financial Statements
for the year ended 31 December 2005
(all amounts are in millions of kwacha unless otherwise stated)

Notes to the financial statements (continued)

23 Off balance sheet financial instruments, contingent liabilities and commitments (continued)

Other commitments	2005	2004
Approved loans	18,455	-
Purchase of property and equipment-approved but not contracted for	<u>938</u>	<u>876</u>
	<u>19,393</u>	<u>876</u>

Nature of commitments

Commitments to lend are agreements to lend to a customer in future subject to certain conditions. Such commitments are normally made for a fixed period. The bank may withdraw from its contractual obligation for the un-drawn portion of agreed loan amounts by giving reasonable notice to the customer.

24 Related party transactions

The Government of the Republic of Zambia is currently the major shareholder in the Bank with just over 70 % of the shares while the Exim Bank of India holds 23 %. As a result, they are institutions that are related to Development Bank of Zambia through common shareholdings or common directorships. However, there were no related party transactions in the period under review with the exception of those disclosed below:

i) Loans to employees

Advances to customers at 31 December 2005, included loans to employees amounting to K 642 (2004: K 1,211). Loans to employees are repayable monthly over a period of between 3 and 28 years and have interest rates of between 0% and 12.5%.

	2005	2004
Interest income earned	<u>72</u>	<u>44</u>

No provisions have been recognised in respect of loans given to employees. (2004: nil). These loans have been fair valued in accordance with accounting policy (f).

	2005	2004
ii) Key management compensation		
Salaries and other short-term employment benefits	1,246	1,268
Termination benefits	<u>461</u>	<u>670</u>
	<u>1,707</u>	<u>1,938</u>
iii) Directors' remuneration		
Fees for services as a director		
	<u>111</u>	<u>92</u>

25 Government of Zambia debenture

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The Government of the Republic of Zambia authorised the capitalisation of the debenture and the debenture was converted into ordinary shares in the year under review.

Development Bank of Zambia
Capital adequacy computation
at 31 December 2005

(all amounts are in millions of kwacha unless otherwise stated)

Part 1 - Calculation of risk weighted assets

(Under first schedule of Banking and Financial Services Act 1994, as amended, - regulations 21 and 24)

	(1) Risk Weight %	(2) Balance (net of allowance for losses)	(3) Risk- weighted assets (1 x 2)
Assets			
Notes and coins			
- Zambian notes and coins	0	1	0
- other notes and coins	0	-	-
Balances held with the Bank of Zambia			
- statutory reserves	0	-	-
- other balances			
Balances with commercial banks in Zambia			
- with residual maturity of up to 12 months	20	15,540	3,108
- with residual maturity of more than 12 months	100	-	-
Balances with commercial banks abroad			
- with residual maturity of up to 12 months	20	-	-
- with residual maturity of more than 12 months	100	-	-
Assets in transit			
- from other commercial banks	50	-	-
- from branches to reporting bank	20	-	-
Investment in debt securities			
- treasury bills	0	-	-
- other government securities	20	-	-
- issued by local government units	100	-	-
- private securities	100	-	-
Loans and advances			
- portion secured by cash or treasury bills	0	-	-
- loans to or guaranteed by the government of Zambia	50	-	-
- loans repayable in instalments and secured by a mortgage on owner- occupied residential property	50	-	-
- loans to or guaranteed by local government units	100	-	-
- loans to parastatals	100	-	-
- other	100	14,408	14,408
Inter-bank advances and loans/advances			
- guaranteed by other banks			
- with a residual maturity of 12 months	20	-	-
- with residual maturity of more than 12 months	100	-	-
Bank premises	100	21,383	21,383
Acceptances	100	-	-
Other assets	100	7,079	7,079
Investment in equity of other companies	100	<u>5,700</u>	<u>5,700</u>
Total risk-weighted assets (on balance sheet)		<u>64,111</u>	<u>51,678</u>

Development Bank of Zambia
Capital adequacy computation
at 31 December 2005

(all amounts are in millions of kwacha unless otherwise stated)

Part 2 - Off balance sheet obligations

(Under first schedule of Banking and Financial Services Act 1994, as amended, - regulations 21 and 24)

	(1) Risk Weight %	(2) Balance (net of allowance for losses)	(3) Risk- weighted assets (1 x 2)
Letters of credit			
- sight import letters of credit	20	-	-
- portion secured by cash/treasury bills	0	-	-
- standby letters of credit	100	-	-
- portion secured by cash/treasury bills	0	-	-
- export letters of credit confirmed	20	-	-
Guarantees and Indemnities			
- guarantees for loans, trade and securities	100	60	60
- portion secured by cash/treasury bills	0	-	-
- performance bonds	50	-	-
- portion secured by cash/treasury bills	0	-	-
- securities purchased under resale agreement	100	-	-
- other contingent liabilities	100	-	-
- net open position in foreign currencies	100	-	-
Total risk-weighted assets (off balance sheet)		<u>60</u>	<u>60</u>
Total risk-weighted assets (on and off balance sheet)		<u>64,171</u>	<u>51,738</u>

Development Bank of Zambia
Capital adequacy computation
at 31 December 2005

(all amounts are in millions of kwacha unless otherwise stated)

Computation of capital position

(Under first schedule of Banking and Financial Services Act 1994, as amended, - regulations 7)

I Primary (tier 1) capital

(a) Paid up common shares	29,369
(b) Eligible preferred shares	-
(c) Contributed surplus	-
(d) Retained earnings	1,932
(e) General reserves	-
(f) Statutory reserves	6,570
(g) Minority interests (common shareholders' equity)	-
(h) Shareholders' loan capital	-
(i) Sub-total	37,871

Less

(j) Goodwill and other intangible assets	-
(k) Investments in unconsolidated subsidiaries and associates	(5,700)
(l) Lending of a capital nature to subsidiaries and associates	-
(m) Holding of other bank's or financial institutions' capital instruments	-
(n) Assets pledged to secure liabilities	-
Sub-total (A) (items i to m)	-

Other adjustments

Provisions (note 2)	-
Assets of little or no realisable value (note 3) - specify details or use separate list if necessary	-
Other adjustments (specify)	-
(o) Sub-total (B) (Sub-total A above + other adjustments)	-
(p) Total primary capital (h - n)	32,171

Development Bank of Zambia
Capital adequacy computation
at 31 December 2005

(all amounts are in millions of kwacha unless otherwise stated)

Computation of capital position (continued)

(Under first schedule of Banking and Financial Services Act 1994, as amended, - regulations 7)

II Secondary (tier 2) capital

(a) Eligible preferred shares (regulations 13 and 17)	-
(b) Eligible subordinated term debt (regulation 17 (b))	-
(c) Eligible loan stock/capital (regulation 17(b))	160
(d) Revaluation reserves (regulation 17 (a)) (Max. is 40% of rr)	7,610
(e) Other (regulation 17 (c)) Specify	-
(f) Total secondary capital	<u>7,770</u>

III Eligible secondary capital

(the maximum amount of secondary capital is limited to 100% of primary capital)

-

IV Eligible total capital (i (o) + III) (K millions)

(Regulatory capital)

45,777

V Minimum capital requirement:

(10% of total on and off balance sheet risk-weighted assets as established in the first schedule, or K2,000 million, whichever is the higher)

5,174

VI Excess – (IV minus V)

40,603

Development Bank of Zambia
Capital adequacy computation
at 31 December 2005

(all amounts are in millions of kwacha unless otherwise stated)

Statement of investments in fixed assets of a bank or financial institution incorporated in Zambia

(Under first schedule of Banking and Financial Services Act 1994, as amended, - regulations 7)

1. Total regulatory capital		
(As calculated by Capital adequacy Schedule and Financial Services (Capital Adequacy) Regulations, 1995).		45,777
Less revaluation reserves included in the regulatory capital calculation		<u>(7,610)</u>
Regulatory capital (net of revaluation reserves)		<u>38,167</u>
2. Fixed assets (Acquisition cost)		
(a) Buildings (including land)	1,178	
(b) Furniture fixtures and equipment	91	
(c) Vehicles	550	
(d) Computer	428	
(e) Other	-	
Total		<u>2,247</u>
3. Investments in corporations holding fixed assets of the reporting bank or financial institution		
(a) Stock	-	
(b) Bonds	-	
(c) Debentures	-	
(d) Obligations	-	
Total		<u>-</u>
4. Advances/loans made to or on the security of the stock of the reporting bank or financial institution		
(a) Advances		
(b) Loans	-	
Total		<u>-</u>
5. Total investment in fixed assets (items 2+3+4)		<u>40,414</u>
6. Total regulatory capital (line 1) as a percentage of investment in fixed assets (line 5)		<u>94 %</u>