

Notes to the financial statements

Credit Guarantee Insurance Corporation of Africa Limited is domiciled in South Africa. These financial statements were authorised for issue by the directors on 8 February 2006.

1 Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below:

1.1 Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations issued by the International Accounting Standards Board (IASB). These are the company's first financial statements and IFRS 1 has been applied.

The disclosures required by IFRS 1 concerning the transition from South African Statements of Generally Accepted Accounting Practice to IFRS are given in note 3.

1.2 Basis of preparation

The financial statements are presented in rand, rounded to the nearest thousand. The financial statements are prepared on the historical-cost basis, modified by the revaluation of certain properties and financial instruments to fair value and the application of the equity method of accounting for investments in associate companies.

Non-current assets held for sale are stated at the lower of carrying amount and fair value less costs to sell.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

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

Judgements made by management in the application of IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are disclosed in note 2.

The accounting policies set out below have been applied consistently to all years presented in these financial statements and in preparing an opening IFRS balance sheet at 1 July 2003 for the purposes of the transition to IFRS.

The company changed its year end during 2004, and the current year's comparative figures represent an 18-month period. Therefore these figures are not entirely comparable to the current year's figures.

1.3 Classification of insurance contracts

Contracts under which the company accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts. Insurance risk is risk other than financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Insurance contracts may also transfer some financial risk.

Contracts under which the transfer of insurance risk to the company from the policyholder is not significant, are classified as investment contracts. Credit guarantee business is regarded as an insurance contract and is therefore accounted for in terms of insurance contracts.

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1.4 Recognition and measurement of insurance contracts

Premiums

Premiums written comprise the premiums on insurance contracts entered into during the year, irrespective of whether they relate in whole or in part to a later accounting period. Premiums are disclosed gross of commission to intermediaries and exclude taxes and Value Added Tax. Premiums written include adjustments to premiums written in prior accounting periods. Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct insurance or inwards reinsurance business. The earned portion of premiums received, including unclosed business, is recognised as revenue. Premiums on unclosed business are brought into account, based upon the pattern of booking of renewals and new business. Premiums are earned from the date of attachment of risk, over the indemnity period, based on the pattern of risks underwritten. Outward reinsurance premiums are recognised as an expense in accordance with the pattern of reinsurance service received.

Unearned premium provision

The provision for unearned premiums comprises the proportion of gross premiums written which is estimated to be earned in subsequent financial years, computed separately for each insurance contract using the daily pro rate method.

Claims incurred

Claims incurred consist of claims paid during the financial year together with movements in the provision for outstanding claims.

Claims outstanding comprise provisions for the company's estimate of the ultimate cost of settling all claims incurred but unpaid at the balance sheet date whether reported or not, and an appropriate sufficiency margin. Claims outstanding are assessed by reviewing individual claims and making allowance for claims incurred but not yet reported, the effect of both internal and external foreseeable events, such as changes in claims handling procedures, inflation, judicial trends, legislative changes and past experience and trends. Anticipated reinsurance recoveries are disclosed separately as assets. Reinsurance and other recoveries are assessed in a manner similar to the assessment of claims outstanding.

Whilst the directors consider that the gross provisions for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made, and disclosed separately if material. The methods used, and the estimates made, are reviewed on a monthly basis by the reserving committee.

Unexpired risk provision

Provision is made for unexpired risks arising where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premium provision in relation to such policies after the deduction of any deferred acquisition costs.

Reinsurance

Premiums ceded and benefits reimbursed are presented in the income statement and balance sheet on a gross basis.

Amounts recoverable under reinsurance contracts are assessed for impairment at each balance sheet date. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the company may not recover all amounts due and that the event has a reliably measurable impact on the amounts that the company will receive from the reinsurer.

The company ceded reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Reinsurance arrangements do not relieve the company from its direct obligations to its policyholders.

Only contracts that give rise to a significant transfer of insurance risk are accounted for as insurance. Amounts recoverable under such contracts are recognised in the same year as the related claim. Contracts that do not transfer significant insurance risk (i.e. financial reinsurance), are recorded using the deposit method of accounting.

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Reinsurance assets include balances due from reinsurance companies for ceded insurance liabilities. Premiums on reinsurance assumed are recognised as revenue and accounted as if the reinsurance was considered direct business, taking into account the product classification of the reinsured business. Amounts recoverable from reinsurers' are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy.

Deferred acquisition costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. Deferred acquisition costs represent the proportion of acquisition costs incurred which corresponds to the unearned premium provision.

Liabilities and related assets under liability adequacy test

The net liability recognised for insurance contracts are tested for adequacy by discounting current estimates of all future contractual cash flows and comparing this amount to the carrying value of the liability net of deferred acquisition costs. Where a shortfall is identified, an additional provision is made and the company recognises the deficiency in income for the year.

Contingency reserve

A reserve in equity is made for the full amount of the contingency reserve in terms of the Short-term Insurance Act, 1998. Transfers to and from this reserve are treated as appropriations of net income.

1.5 Recognition and measurement of investment contracts

Receipts and payments under investment contracts are not classified as insurance transactions in the income statement but are deposit accounted in the balance sheet. The deposit liability recognised in the balance sheet represents the expected amounts payable to the holders of the investment contracts inclusive of allocated investment income.

1.6 Foreign currency translation

Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to rand at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to rand at foreign exchange rates ruling at the dates the fair value was determined.

Financial statements of foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to rand at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to rand at the appropriate transaction date rates for the period. Foreign exchange differences arising on translation are recognised directly in a separate component of equity.

1.7 Property and equipment

Land and buildings held for use for administrative purposes are stated at revalued amounts, determined from market-based evidence by appraisals undertaken by professional valuers, less any subsequent accumulated depreciation and

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subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase arising on the revaluation of such land and buildings is credited to the properties revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in the carrying amount arising on the revaluation of such land and buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the properties revaluation reserve relating to a previous revaluation of that asset.

Land is not depreciated. Depreciation on revalued buildings to residual value is charged to income. Buildings are depreciated over a period of 20 years. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the properties revaluation reserve is transferred directly to accumulated profits.

Furniture and equipment are stated at cost less accumulated depreciation and any recognised impairment loss. Depreciation is charged over their estimated useful lives, using the straight-line method, on the following bases:

Furniture and equipment	16% - 50%
Buildings	5%
Motor vehicles	25%
Computer equipment	33,3%

Both the useful lives and the residual value (if not insignificant) are reassessed annually.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the assets and are included in the underwriting result.

Repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits will flow to the company.

1.8 Intangible assets

Expenditure associated with research activities, regarding developing computer software programmes, are recognised as an expense when incurred. Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially new processes, which will be controlled by the company, which are technically and commercially feasible and where sufficient resources are available to complete development, are recognised as an intangible asset. Other development expenditure is recognised as an expense when incurred.

Computer software costs recognised as assets are amortised using the straight-line method over a two-year period.

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other subsequent expenditure is expensed as incurred.

1.9 Impairment

The carrying amounts of the company's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If there is any indication that an asset is impaired, its recoverable amount is estimated. The recoverable amount is the higher of its fair value less selling costs and its value in use. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the expected future cash flows from the asset are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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For intangible assets with an identifiable useful life and intangible assets not yet available for use, the recoverable amount is estimated at each balance sheet date.

A previously recognised impairment loss is reversed if the recoverable amount increases as a result of a change in the estimates used to determine the recoverable amount, but not to an amount higher than the carrying amount than would have been determined (net of amortisation) had no impairment loss been recognised in prior years.

1.10 Financial instruments

Recognition

Regular way purchases and sales of financial assets are recognised on trade date – the date on which the company commits to purchase or sell the asset.

Investments

Listed investments, classified as fair value through profit and loss, are carried at fair value, which is calculated by reference to stock exchange quoted bid prices at the close of business on the balance sheet date. Unlisted investments are shown at fair value which are calculated on bases that best present the estimated proceeds to be realised from a sale to an informed purchaser under normal market conditions.

Trade and other receivables

Trade and other receivables are stated at cost less impairment losses.

Cash and cash equivalents

Cash and cash equivalents are measured at fair value.

Trade and other payables

Trade and other payables are stated at cost.

Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of financial instruments are included in net profit or loss in the period in which the change arises.

Offset

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when the company has a legally enforceable right to set off the recognised amounts, and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

1.11 Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case the related income tax is also recognised in equity.

Current tax comprises tax payable calculated on the basis of the expected taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment of tax payable for previous years.

Deferred tax is provided using the balance sheet liability method, based on temporary differences. Temporary differences are differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax base. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged to the income statement except to the extent that it relates to a transaction that is recognised directly in equity, or a business combination. The effect on deferred tax of any changes in tax rates is recognised in the income statement, except to the extent that it relates to items previously charged or credited directly to equity.

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A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the associated unused tax losses and deductible temporary differences can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Secondary tax on companies (STC) is charged to the income statement when the related dividend is declared. Unused STC credits are recognised as a deferred tax asset, when it is probable that it will be realised.

1.12 Employee benefits

Short-term employee benefits

The cost of all short-term employee benefits is recognised during the period in which the employee renders the related service.

The provision for employee entitlements to salaries and annual leave represent the amount which the company has a present obligation to pay, as a result of employees' services provided up to the balance sheet date. The provision has been calculated at undiscounted amounts based on current salary rates.

Termination benefits

Termination benefits are payable whenever an employee's employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The company recognises termination benefits when it is demonstrably committed either to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are discounted to present value.

Bonus plans

A liability for employee benefits in the form of bonus plans is recognised in current provisions when there is no realistic alternative but to settle the liability, and at least one of the following conditions is met:

- there is a formal plan and the amounts to be paid are determined before the time of issuing the financial statements; or
- past practice has created a valid expectation by employees that they will receive a bonus and the amount can be determined before the time of issuing the financial statements.

Liabilities for bonus plans are expected to be settled within 12 months and are measured at the amounts expected to be paid when they are settled.

Post employment benefits

Defined contribution pension plan

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred. The defined contribution pension plan is a plan under which the group pays fixed contributions into a separate fund and will have no constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Defined benefit pension plan

The company's obligation in respect of the defined benefit pension plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior years. The benefit is discounted to determine the present value of the obligation, and the fair value of any plan assets are deducted. The calculation is performed by a qualified actuary using the projected unit credit method as it is more appropriate for a fund closed to new entrants and with less than 5% of the company members participating in the fund.

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Defined-plan medical benefit

The company provides post-retirement medical benefits to qualifying employees by way of subsidising medical scheme contributions. The expected costs of these benefits are assessed in accordance with advice of qualified actuaries, using the projected unit credit method, and the actuarial gain or loss is charged to the income statement in full.

1.13 Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Where the effect of discounting to present value is material, provisions are adjusted to reflect the time value of money.

Where the company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain.

1.14 Revenue recognition

Interest income

Interest income is recognised as it accrues, using the effective interest method.

Dividend income

Dividends are recognised when the right to receive payment is established.

1.15 Dividends payable

Dividends payable and the related taxation thereon are recorded in the company's financial statements in the period in which the shareholders' rights to receive payment have been established.

1.16 Leases

Operating leases

Leases where the lessor retains the risks and rewards of ownership of the underlying asset are classified as operating leases. Payments made under operating leases are charged against income on a straight-line basis over the period of the lease.

Finance leases

Leases of fixed property and equipment where the company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased equipment or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant interest rate on the finance of the liability outstanding.

The corresponding rental obligations, net of finance charges, are included in liabilities. The interest element of the finance cost is charged to the income statement over the lease period according to the effective interest method. The equipment acquired under the finance leases is depreciated over the shorter of the useful life of the asset and the lease term.

1.17 Reporting by segment

The principal segments of the company have been identified on a primary basis by market segment, being domestic and export. The basis is representative of the internal structure for management purposes. Segment results include revenue and expenses directly attributable to a segment and the relevant portion of enterprise revenue and expenses that can be allocated on a reasonable basis.

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1.18 Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise cash on hand and bank balances, all of which are available for use by the company unless otherwise stated.

1.19 Contingencies and commitments

Transactions are classified as contingencies where the company's obligations depend on uncertain future events. Items are classified as commitments where the company commits itself to future transactions with external parties.

1.20 Discontinued operations

The board of directors announced that the company had discontinued the reinsurance inwards operation with effect from 1 January 2003. The operation will effectively be in run-off as from the said date, and where possible, future liabilities under these contracts will be commuted. The results of the discontinued operations have been disclosed separately in note 34.

2 Accounting estimates and judgements

Certain critical accounting judgements in applying the company's accounting policies are described below:

Policyholder claims and benefits

The company's estimates for reported and unreported losses and establishing resulting provisions and related reinsurance recoverables are continually reviewed and updated, and adjustments resulting from this review are reflected in income. The process relies upon the basic assumption that past experience, adjusted for the effect of current developments and likely trends, is an appropriate basis for predicting future events.

Defined medical benefits

The estimations used to calculate the company's future liability to employees eligible for post-retirement benefits can be summarised as follows: Future liabilities have been discounted at 9% per annum compound. This rate is based on the market yield obtainable on government bonds at the valuation date as contemplated in IAS19.

Future medical scheme contribution rates have been assumed to increase by 7% per annum compound. Although rates may fluctuate widely in the short term, a net discount rate (i.e. the discount rate net of medical scheme contribution inflation) of 2% per annum is deemed to be a realistically sustainable level.

3 First-time application of international financial reporting standards

The company adopted International Financial Reporting Standards (IFRS) for the first time for these financial statements, being the period ending 31 December 2005. In order to show comparative balances, the period ended 31 December 2004 is also shown under IFRS. The date of transition to IFRS is 1 July 2003.

As permitted by IFRS 1, *First-time Adoption of International Financial Reporting Standards*, the company has elected to use the following exemptions from the retrospective application of certain parts of other IFRSs:

Cumulative translation differences

The first-time adopter is not required to comply with the requirements of IAS 21: *The effects of Changes in Foreign Exchange Rates* for cumulative translation differences that existed at the date of transition to IFRSs, consequently the cumulative translation differences are deemed to be zero at the date of transition.

Business combinations

The company has elected not to apply the retrospective application requirements of IFRS 3: *Business Combinations*, for combinations that occurred prior to 1 July 2003.

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Fair value as deemed cost

The company has elected to measure motor vehicles at the date of the transition to IFRS at its fair value and use that fair value as its deemed cost at that date.

	Assets		Liabilities		Equity	
	1 July	31 Dec	1 July	31 Dec	1 July	31 Dec
	2003	2004	2003	2004	2003	2004
Reconciliation of equity						
As reported under SA GAAP	817 424	972 813	534 865	554 526	282 563	418 287
Adjustments for:						
Revaluation of owner occupied property at 1 July 2003	17 742	17 742	4 216	4 137	13 526	13 605
Fair value adjustment:						
Other fixed assets	-	743	-	-	-	743
Depreciation on building	-	(1 521)	-	-	-	(1 521)
Other	-	-	-	62	-	(62)
As reported under IFRS	835 166	989 777	539 081	558 725	296 089	431 052

The basis of the material adjustments between SA GAAP and IFRS, as shown in the reconciliation of equity and net income, is noted below. The adjustments are net of the tax impact:

Net income as previously reported	223 665
Adjusted for depreciation	-778
Operating lease	-58
Taxation	75
Restated net income	222 904

Revaluation of owner occupied property

Owner occupied buildings which were previously carried at historical cost are now carried at depreciated fair value in terms of IAS 16, *Property, Plant and Equipment*. Fair value adjustments are taken directly to equity reserves. There were therefore no adjustment in the net income of the company.

Operating leases

Operating lease costs which were previously expensed as paid under South African GAAP, are now spread evenly over the period of the lease.

Residual value of assets

The depreciable amount for property and equipment is no longer cost, but rather the difference between cost and residual value.

Reclassifications

The company has reclassified certain financial assets as "at fair value through profit and loss", which was classified under SA GAAP as "available-for-sale". This was merely a balance sheet reclassification as the company previously did take all fair value adjustments through the income statement. This reclassification has no impact on equity or the income statement.

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Cash flow statement

There have been no material adjustments to the cash flow statement in respect of cash utilised by operating activities before taxation (although the composition has changed), cash flows from investing activities and cash flows from financing activities as a result of the adoption of IFRS.

4 Insurance risk management

Risk management objectives and policies for mitigating risk

The primary insurance activity carried out by the company assumes the risk of loss from small business to large corporates that are directly subject to the risk. Such risks may relate to credit, alternative risk transfer or other perils that may arise from an insurable event. As such the company is exposed to the uncertainty surrounding the timing and severity of claims under the contract. The company also has exposure to market risk through its insurance and investment activities.

The company manages its insurance risk through underwriting limits, approval procedures for transactions that involve new products or that exceed mandate limits, pricing guidelines, centralised management of reinsurance and monitoring of emerging issues.

The company uses several methods to assess and monitor insurance risk exposures for individual types of risks insured. These methods include internal risk measurement models, sensitivity analysis and scenario analyses.

The principal risk is that the frequency and severity of claims is greater than expected. Insurance claims are, by their nature, random, and the actual number and size during any one year may vary from those estimated.

Experience shows that the larger the portfolio of similar contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected across the board by a change in the portfolio. The company has developed its insurance underwriting strategy to diversify the type of insurance risk accepted and within each of these categories to achieve a sufficient large population of risks to reduce the variability of the expected outcome.

The internal audit function is outsourced, and makes regular reviews to assess the degree of compliance with the company's procedures.

Underwriting strategy

The company's underwriting strategy strives to ensure a balanced portfolio and is based on a large number of similar risks both in the domestic and international markets. It is believed that this diversity reduces the variability of the outcome. The underwriting strategy is set out by the executive credit committee which gives guidelines to management and underwriters to what levels the company should be exposed.

Adherence to the underwriting authorities is measured through a series of exception reports that are produced on a daily basis covering unusual movements in any particular risk. There are several underwriting committees which meet on a weekly basis to review management information including any specific as well as industry and country concerns.

Reinsurance strategy

The company reinsures a portion of the risks it underwrites in order to control its exposures to losses and protect capital resources. The company buys a combination of proportional and non-proportional reinsurance treaties to reduce the net exposure to the company. In addition, underwriters are allowed to buy facultative reinsurance in certain specified circumstances.

Ceded reinsurance contains credit risk, and such reinsurance recoverables are reported after deductions for known insolvencies and uncollectible items. The company monitors the financial condition of reinsurers on an ongoing basis and reviews its reinsurance arrangements periodically.

Reinsurance requirements are placed with the world's leading reinsurers who offer the best security, as they are highly rated by international agencies.

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Terms and conditions of insurance contracts

The terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts, are set out below.

Nature of risk covered

The company's main business is that of credit insurance. Credit insurance is a highly specialised industry and, in many jurisdictions, only specialised companies are authorised to write credit and surety business. Underwriting is complex and requires specialised staff, and the same applies to the claims assessors, where staff is not only required to process complex claims, but are also intensely involved in recovering losses from collateral securities and litigation. The nature of claims and the longer tail of business make the calculation of reserves a critical element in the credit insurer's accounting records.

The company underwrites small business to large corporates. An extended understanding of the nature of the business can be obtained from the managing director's operational report on pages 6 to 9.

The return to shareholders under this product arises from the total premiums charged to policyholders less the amounts paid to cover claims and the expenses incurred by the company. There is also certain limited scope for the company to earn investment income owing to the time delay between the receipt of premiums and the payment of claims.

The event giving rise to a claim usually occurs with the insolvency, liquidation and protracted default of a buyer, or a political event in a foreign country that gives rise to default payment. The claim will be notified to the company in terms of the specific policy conditions. The company's business can be classified as short to medium-term business, because the company could only be notified of a claim six months or longer after the company has accepted the risk.

Management of risks

The key risks are underwriting risk, competitive risk and claims experience. The company will also be exposed to the risk of dishonest actions by policyholders.

Underwriting risk is the risk that the company does not charge premiums appropriate for the different credit risks it insures.

This risk is managed primarily through sensible pricing, product design, risk selection, appropriate investment strategy, rating and reinsurance. The company therefore monitors and reacts to changes in the general economic and business environment in which it operates.

Insurance companies are exposed to the risk that the insured will make false or invalid claims, or exaggerate the amount claimed following a loss. Sophisticated software and fraud detection measures are also in place to improve the company's ability to proactively detect fraudulent claims.

Within the insurance process, concentrations of risk may arise where a particular event or series of events could impact heavily upon the company's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

Concentrations of insurance risk

The recognition of losses due to such events will accurately reflect the events taking place. However, it is important to understand the wider relevant cash flows relating to, for example, a high severity risk such as liquidations of major players in a specific industry.

The company sets out the total aggregate exposure that it is prepared to accept in certain industries. The aggregate position is reviewed on an ongoing basis and procedures are in place to make sure that the reinsurance programmes are properly structured to cover the company against its exposures.

Exposure relating to catastrophe events

The company sets out the total aggregate exposure that it is prepared to accept within the parameters of its reinsurance arrangements with its lead reinsurers. The exposures are evaluated at least once a year by trained financial analysts and approved by the executive credit committee who stress-tests the financial information of the single/cumulative risk. Regular updated information is collected during the 12-month period.

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Exposure to single incidents

The company would consider that its most significant exposure would arise in the event of substantial bank rate increases. Highly geared companies are identified, managed and monitored throughout financial periods.

Exposure to stop-loss non-linearities

The company's policies for mitigating risk exposure include the use of both proportional and excess-of-loss features against certain insurance risks.

Claims development

The company is liable for all insured events that occurred during the term of the contract, even if the loss is discovered after the end of the contract term, subject to pre-determined time scales dependent on the nature of the insurance contract. The company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. The claims liability comprises a provision for claims not yet paid, a provision for claims incurred but not yet reported ("IBNR") and a provision for unexpired risks at the balance sheet date.

The cost of claims reported and not yet paid is easily determined. The calculation of the IBNR is complex, and the company makes use of statistical models like the basic chain-ladder model and Bornhuetter-Ferguson model to calculate the IBNR.

5 Financial risk

Transactions in financial instruments result in the company assuming financial risks. These include market risk, foreign currency, credit risk and liquidity risk. Each of these financial risks is described below, together with a summary of the ways in which the company manages these risks.

Market risk

Market risk can be described as the risk of change in fair value of a financial instrument due to changes in interest rates, equity prices or foreign currency exchange rates.

Asset/liability matching

A distinction is drawn between insurance and shareholder funds and the following strategies are adopted for each:

Insurance funds

The overall philosophy governing the investment of policyholder funds will be driven by liquidity considerations and a strong emphasis on capital preservation. The maturity profile of investments will approximate the average term of operational liabilities. To this end funds will be invested predominately in cash and fixed interest bearing investments.

Shareholder funds

Shareholder funds will be invested in a broader spread of investments (including equities), reflecting the more stable nature of the fund pool and the need for strong real returns over the long term. The spread of investments will however need to be constructed in such a manner as to guarantee operational capacity (solvency margin) at all times. The extent of investment in equities will be expressed as a ratio of shareholders' funds as determined by the Board from time to time, taking into consideration solvency issues and shareholder expectations.

Interest rate risk

Fluctuations in interest rates impact on the value of short-term cash investments, giving rise to price risk. Other than ensuring optimum money market rates for deposits, the company does not make use of financial instruments to manage this risk. Formal policies, procedures and limits have been put in place for derivative instruments.

The company's fixed interest borrowings are insignificant and therefore do not give rise to interest rate risk.

At 31 December 2005 it was estimated that a 1% rise in interest rates would increase the company's income before tax by R1,2 million.

Notes to the financial statements

Equity price risk

The company's portfolio of marketable equity securities, which it carries on its balance sheet at fair value, has exposure to price risk. This risk is defined as the potential loss in market value resulting from an adverse change in prices. The company's objective is to earn competitive relative returns by investing in a diverse portfolio of high quality, liquid securities. Portfolio characteristics are analysed regularly and equity price risk is actively managed through a variety of modelling techniques. The company's holdings are diversified across industries, and concentrations in any one company or industry are limited by parameters established by senior management, as well as by statutory requirements. The company's largest investment in any one company comprises 8% of its total assets.

At 31 December 2005, marketable equity securities were recorded at their fair value of R522 million. A hypothetical 10% decline in each stock's price would have decreased income before tax by R52,2 million.

Foreign exchange risk

The company discontinued its reinsurance inwards division with effect from 01 January 2003. This portfolio is currently in run-off and revenue income is mainly in the form of salvages received in respect of claims paid. Claims are still being paid on an ongoing basis. Revenue and claim payments are received and paid in two main currencies (United States dollar (US\$) and euro) and assets are held in a similar proportion to the outstanding liabilities.

The company maintains onshore euro and US\$ accounts, as well as offshore premium and claim reserves in terms of regulatory requirements. Experience has shown that this matches the currency requirements of the claims profile. In addition, the company's operations are subject to local regulatory requirements in many jurisdictions which prescribe the type, quality and concentration of assets, as well as the level of assets that should be maintained in local currency in order to meet local insurance liabilities.

At 31 December 2005 and 2004, respectively, approximately 12% and 14% of our invested assets were denominated in foreign currencies. Invested assets denominated in euro comprised approximately 8% of our total invested assets at 31 December 2005. We have determined that a hypothetical 10% reduction in the value of the euro would have been an approximate euro 7 million reduction in the value of our assets, although there would be a similar offsetting change in the value of the related insurance provisions. No other individual foreign currency accounts for more than 4% of our invested assets.

Notes to the financial statements

Concentrations of assets and liabilities (Rand equivalent) – 2004 (Rm)

	ZAR	Euro	US\$	Other	Total
Assets					
Property, equipment and intangible assets	31 779	-	-	-	31 779
Investments	488 174	-	6 022	-	494 196
Investment in associated companies	-	37 952	-	-	37 952
Deferred taxation	15 532	-	-	-	15 532
Technical assets	99 317	-	-	-	99 317
Trade and other receivables	81 171	55 610	103	1 322	138 206
Cash and cash equivalents	136 834	11 828	24 133	-	172 795
Total assets	852 807	105 390	30 258	1 322	989 777
Liabilities					
Post retirement medical aid provision	16 700	-	-	-	16 700
Interest bearing loan	8 074	-	-	-	8 074
Deferred taxation	40 010	-	-	-	40 010
Technical provisions	300 426	76 879	1 587	1 584	380 476
Accounts payable and provisions	111 249	1 301	915	-	113 465
Total liabilities	476 459	78 180	2 502	1 584	558 725
Net assets / (liabilities)	376 348	27 210	27 756	(262)	431 052

Concentrations of assets and liabilities (Rand equivalent) – 2005 (Rm)

	ZAR	Euro	US\$	Other	Total
Assets					
Property, equipment and intangible assets	30 048	-	-	-	30 048
Investments	525 848	-	6 847	-	532 695
Deferred taxation	18 112	-	-	-	18 112
Technical assets	59 173	-	-	-	59 173
Trade and other receivables	96 521	56 275	105	522	153 423
Cash and cash equivalents	82 867	13 947	32 495	-	129 309
Total assets	812 569	70 222	39 477	522	922 760
Liabilities					
Post retirement medical aid provision	16 700	-	-	-	16 700
Interest bearing loan	2 984	-	-	-	2 984
Deferred taxation	50 558	-	-	-	50 558
Technical provisions	236 334	82 515	2 001	2 733	323 583
Accounts payable and provisions	105 428	7 057	745	104	113 334
Total liabilities	412 004	89 572	2 746	2 837	507 159
Net assets/(liabilities)	400 565	(19 350)	36 731	(2 315)	415 601

Notes to the financial statements

Credit risk

The company has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the company is exposed to credit risk are:

- reinsurers' share of insurance liabilities,
- amounts due from reinsurers in respect of claims already paid, and
- amounts due from insurance policyholders.

The company structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparties, and to geographical and industry segments. Such risks are subject to an annual or more frequent review. No collateral is required in respect of financial assets.

Mechanisms are in place to monitor the risk of default by individual policyholders. Exposures to individual policyholders and groups of policyholders are collected within the ongoing monitoring of the controls associated with regulatory solvency. Where there exists significant exposure to individual policyholders, or homogenous groups of policyholders, a financial analysis equivalent to that conducted for reinsurers is carried out by the company's risk department.

Liquidity risk

The company is exposed to daily calls on its available cash resources mainly from claims arising. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The company sets limits on the minimum proportions of maturing funds available to meet such calls and unexpected levels of demand.

6 Reinsurance risk

Under the terms of its reinsurance agreements, the reinsurer agrees to reimburse the ceded amount in the event a claim is paid. However the company remains liable to its policyholders with respect to ceded insurance if any reinsurer fails to meet the obligations it assumes.

Reinsurance is used to manage insurance risk. This does not, however, discharge the company's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the company remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered regularly by reviewing their financial strength prior to the finalisation of any contract.

When selecting a reinsurer, the company considers their relative security. The security of the reinsurer is assessed from public rating information and from internal investigations.

Credit ratings of reinsurance as per Standard & Poor's latest credit rating

Reinsurers' share of insurance contract provisions and reinsurers' balances

	2004		2005	
	Exposure %	Premium %	Exposure %	Premium %
AA	23	23	27	23
AA-	18	18	18	18
A+	31	31	38	35
A	24	24	14	20
A-	4	4	3	4
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>

Notes to the financial statements

7 Property and equipment

	Land	Buildings	Furniture and equipment	Motor vehicles	Computer equipment	Total
Cost	R'000	R'000	R'000	R'000	R'000	R'000
Balance at 30 June 2003	654	9 905	11 103	2 525	11 715	35 902
Revaluation	7 376	10 366	-	-	-	17 742
Additions	-	-	530	-	794	1 325
Disposals	-	-	(260)	-	(459)	(719)
Balance at 31 Dec 2004	8 030	20 271	11 373	2 525	12 050	54 250
Additions	-	-	366	155	567	1 088
Disposals	-	-	(35)	(159)	(88)	(282)
Balance at 31 Dec 2005	8 030	20 271	11 704	2 521	12 529	55 056
Accumulated depreciation						
Balance at 30 Jun 2003	-	-	(8 866)	(1 614)	(9 242)	(19 722)
Depreciation	-	(1 520)	(592)	(603)	(1 802)	(4 517)
Eliminated on revaluation	-	-	-	743	-	743
Disposals	-	-	-	-	459	458
Balance at 31 Dec 2004	-	(1 520)	(9 458)	(1 474)	(10 585)	(23 038)
Depreciation	-	(1 014)	(489)	(82)	(943)	(2 528)
Disposals	-	-	33	159	59	251
Balance at 31 Dec 2005	-	(2 534)	(9 914)	(1 397)	(11 469)	(25 315)
Net book value						
Balance at 30 June 2003	654	9 905	2 237	911	2 473	16 180
Net additions	-	-	270	-	794	1 064
Revaluation	7 376	10 366	-	-	-	17 742
Depreciation	-	(1 520)	(592)	140	(1 802)	(3 774)
Balance at 31 Dec 2004	8 030	18 751	1 915	1 051	1 465	31 212
Net additions	-	-	364	155	538	1 057
Depreciation	-	(1 014)	(489)	(82)	(943)	(2 528)
Balance at 31 Dec 2005	8 030	17 737	1 790	1 124	1 060	29 741

The land and buildings consist of an office block situated on Erf 690 and 1769, 31 Dover Street, Randburg, Gauteng. The land and buildings were purchased in 1983 and last revalued at 1 July 2003 by JHI Real Estate Ltd, a registered professional valuer. Valuations were made on the basis of open market value. The revaluation surplus net of applicable deferred income taxes was credited to a property revaluation reserve in shareholders' equity. Land and buildings are leased in terms of a financial lease (note 19). Had the cost model been applied, the carrying amount of land and buildings would have been R654 000 and R9 905 000 respectively.

Notes to the financial statements

	2005 R'000	2004 R'000
8 Intangible assets		
Computer software purchased		
Cost	10 050	9 783
– Balance at beginning of the period	9 783	9 049
– Current year purchased	267	735
Amortisation	9 743	9 216
– Balance at beginning of the period	9 216	8 184
– Current year amortisation	527	1 032
Balance at end of year	<u>307</u>	<u>567</u>

8 Intangible assets

Computer software purchased

Cost
– Balance at beginning of the period
– Current year purchased

Amortisation
– Balance at beginning of the period
– Current year amortisation

Balance at end of year

9 Investments at fair value through profit and loss

9.1 Non-current

9.1.1 At cost

Preference shares - listed	25 220	15 020
Ordinary shares - listed	169 117	183 153
Asset swap	10 191	10 191
Endowment policies	-	9 430
Government securities	3 558	3 558
	<u>208 086</u>	<u>221 352</u>

9.1.2 At fair value

Preference shares - listed	29 175	17 040
Ordinary shares - listed	493 010	452 520
Asset swap	6 847	6 022
Endowment policies	-	14 871
Government securities	3 663	3 743
	<u>532 695</u>	<u>494 196</u>

10 Investments

Non-current government securities represent R153 (RSA 13%) stocks. Interest rates on this government security is 13% (2004: 13%), maturing August 2009.

10.1 Listed ordinary and preference shares by sector

Resources	147 794	182 667
Financial	176 346	137 433
Industrial	198 045	149 460
	<u>522 185</u>	<u>469 560</u>

10.2 Major equity investments

The company's most significant listed equity investments at 31 December 2005 are set out in Appendix A on page 60.

Notes to the financial statements

	2005 R'000	2004 R'000
11 Investment in associated company		
Investment at cost	-	33 462
Share of post acquisition income	-	3 391
Translation reserve	-	1 099
	<hr/>	<hr/>
	-	37 952
Balance at beginning of the period	37 952	37 300
Share of net income after tax	2 952	4 719
Disposal of associated company	(43 073)	-
Translation reserve movement	(1 099)	(4 067)
Profit on sale of investment	3 268	-
	<hr/>	<hr/>
Balance at end of period	-	37 952

Details of associated company

Mapfre America Caucion y Credito SA is a short-term insurer

Percentage of shares held in associate	0%	25,0%
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Post-acquisition retained earnings of associate

Share of opening retained earnings	36 853	33 462
Current year: Share of associates' income after tax	2 952	3 391
	<hr/>	<hr/>
Share of closing retained earnings	39 805	36 853

Summarised financial statements of associate

Assets	-	287 889
Liabilities	-	141 991
Gross premiums written	-	118 468
Profit before taxation	-	15 086
Taxation	-	5 081
Profit after taxation	-	10 005

12 Deferred taxation

Balance at beginning of the period	24 478	(13 214)
Deferred tax liabilities	40 010	4 372
Deferred tax assets	(15 532)	(17 586)
	<hr/>	<hr/>
Charged to income statement	7 968	37 692
Temporary differences	8 786	33 550
Charged against equity	-	4 142
Rate adjustment	(818)	-
	<hr/>	<hr/>
Balance at end of the period	32 446	24 478
Deferred tax liabilities	50 558	40 010
Deferred tax assets	(18 112)	(15 532)

Notes to the financial statements

	2005 R'000	2004 R'000
Analysis of major temporary differences		
Provisions	(9 881)	(6 892)
Medical aid liability	(4 843)	(5 010)
Deferred income	(2 644)	(3 170)
Capital gains tax	26 321	11 781
Unrealised gains on investments	19 526	23 621
Property revaluation	3 700	3 986
Other	267	162
	32 446	24 478
13 Insurance contract provisions		
Provision for unearned premiums	58 605	56 426
Outstanding claims	196 688	214 166
	255 293	270 592
Total insurance contract provision		
Current	255 293	270 592
Insurance liabilities and reinsurance assets		
Gross:		
– Claims reported	119 027	118 646
– Claims incurred but not reported	128 028	185 023
– Unearned premiums	67 411	66 240
Total insurance liabilities - gross	314 466	369 909
Recoverable from reinsurers		
– Claims reported	21 330	26 465
– Claims incurred but not reported	29 037	63 038
– Unearned premiums	8 806	9 814
Reinsurers' share in technical provisions	59 173	99 317
Net		
– Claims reported	97 697	92 181
– Claims incurred but not reported	98 991	121 985
– Unearned premiums	58 605	56 426
Total insurance liabilities – net	255 293	270 592

Notes to the financial statements

Analysis of movements in outstanding claims

	2005			2004		
	Gross	Reinsured	Net	Gross	Reinsured	Net
Balance at beginning of period						
Claims reported	118 646	(26 465)	92 181	189 947	(37 961)	151 986
Incurred but not reported	185 023	(63 038)	121 985	130 802	(57 715)	73 087
	<u>303 669</u>	<u>(89 503)</u>	<u>214 166</u>	<u>320 749</u>	<u>(95 676)</u>	<u>225 073</u>
Current year claims paid	(220 019)	128 382	(91 637)	(404 590)	248 040	(156 550)
Increase in outstanding claims reserves	162 987	(89 246)	73 740	397 073	(241 867)	155 206
Foreign currency translations	418	-	418	(9 563)	-	(9 563)
Balance as at 31 December	<u>247 055</u>	<u>(50 367)</u>	<u>196 687</u>	<u>303 669</u>	<u>(89 503)</u>	<u>214 166</u>

Assumptions and sensitivities for general insurance

Process used to determine the assumptions

The company makes use of the following statistical methods, which remained unchanged from last year, to calculate the IBNR reserves:

- Basic chain ladder model and
- Bornhuetter-Ferguson model.

These methods assume that there has been a stable pattern of claims in the past and that the pattern will continue into the future.

The past development for a given underwriting year does not necessarily provide a better clue to future claims than the more general loss ratio.

To the extent that these methods use historical claims development information they assume that the historical claims development pattern will occur again in the future. There are reasons why this may not be the case, which, insofar as they can be identified, have been allowed for by modifying the methods. Such reasons include:

- Changes in processes that affect the development / recording of claims paid and incurred;
- economic, legal, political and social trends;
- changes in mix of business; and
- random fluctuations including the impact of large claims.

It is therefore essential to determine an estimated loss ratio, which merely estimates an ultimate loss ratio per underwriting year. The underlying rationale for this method is that the reserving committee approves the expected loss ratio based on current conditions. This is done during a monthly formal meeting attended by senior management of the different operating and finance divisions. This estimate is done independently of the result of any other projection methods.

Credit insurance has a very close relationship with the economic conditions. It is therefore essential that the economic indicators form the base when a final decision on the loss ratio is made.

Important economic indicators considered are:

- Interest rate
- Liquidations
- Insolvencies
- Inflation index
- Commodity prices (eg. steel, oil etc)
- Exchange rate.

Notes to the financial statements

Once the loss ratio has been approved, the results of the models are considered, and the reserving committee will then approve the final result.

Assumptions

The assumptions that have the greatest effect on the measurement of insurance contract provisions are the expected loss ratios for the most recent underwriting years. These are used for assessing the IBNR and unexpired risk provisions for the 2004 and 2005 underwriting years. The expected ultimate loss ratio assumed for the underwriting years 2005 is 45% and 50% respectively for Domestic and Export respectively. (2004 : 70% and 60% respectively)

Changes in assumptions and sensitivities to changes in key variables

The significant decrease in this year's loss ratios can be mainly attributed to:

- Continuous improved economic conditions
- Interest rates at 25-year low
- Liquidations and insolvencies are also at very low levels
- A stable exchange rate.

The company however does believe that caution needs to be exercised to ensure that the reserves do allow for any defaults that may be incurred because of the following factors:

- High oil price
- Strong currency which impacts negatively on especially the clothing and textile sector
- Unstable governments in Africa and South America.

An analysis of sensitivity around various scenarios provides an indication of the adequacy of the company's estimation process. The company believes that the liability for claims reported in the balance sheet is adequate. However, it recognises that the process of estimation is based upon certain variables and assumptions which could differ when claims arise.

The tables presented below demonstrate the sensitivity of insured liability estimates to particular movements in assumptions used in the estimation process.

Impact on reported profits of changes in key variables (with other assumptions remaining constant):

Change in variable	Change in liability
10%	R36 million

	2005 R'000	2004 R'000
14 Other accounts receivable		
Premium debtors	64 724	64 984
Value added tax	429	2 565
Staff loans	3 308	2 018
Other	6 024	4 422
	<u>74 485</u>	<u>73 989</u>

15 Cash and cash equivalents

Cash at bank and in hand	47 652	28 184
Call and fixed deposits	81 657	144 611
	<u>129 309</u>	<u>172 795</u>

Notes to the financial statements

	2005 R'000	2004 R'000
16 Share capital and share premium		
16.1 Authorised		
3 000 000 ordinary shares of R1 each	<u>3 000</u>	<u>3 000</u>
16.2 Issued		
2 649 333 (2004: 2 729 333) shares of R1 each	2 649	2 729
Share premium	-	240
	<u>2 649</u>	<u>2 969</u>
16.3 Share reconciliation		
Balance as at beginning of period	2 729 333	2 729 333
Share buy-back	(80 000)	-
Balance as at end of period	<u>2 649 333</u>	<u>2 729 333</u>

Notes to the financial statements

17 Non-distributable reserves

	R'000
Movement in contingency reserve	
At 1 July 2003	26 025
Reserve released	(5 646)
	<hr/>
At 1 January 2005	20 379
Reserve created	4 037
	<hr/>
At 31 December 2005	<u>24 416</u>
<p>The statutory contingency reserve is regarded as a non-distributable reserve. The reserve is maintained at 10% of the net premium income.</p>	
Movements in the property revaluation reserve were as follows:	
At 1 July 2003	13 526
Revaluation	17 742
Revaluation - tax	(4 216)
Amortisation	(777)
Amortisation - tax	231
	<hr/>
At 1 January 2005	12 980
Amortisation	(519)
Amortisation - tax	150
	<hr/>
At 31 December 2005	<u>12 611</u>
Movement in translation reserve	
At 1 July 2003	5 165
Currency translation differences:	
– Associate	(4 066)
	<hr/>
At 1 January 2005	1 099
Disposal of associate	(1 099)
	<hr/>
At 31 December 2005	<u>-</u>

Notes to the financial statements

	2005 R'000	2004 R'000
18 Distributable reserves		
The retained income balance represents the amount available for dividend distribution to the shareholders of the company prior to any withholding tax liabilities	<u>375 925</u>	<u>393 625</u>
19 Long-term liabilities		
Finance lease liability	<u>8 074</u>	<u>12 014</u>
	<u>8 074</u>	<u>12 014</u>
The lease liability is in respect of the sale and leaseback of land and buildings (refer note 7). The lease is payable over a 10-year period in bi-annual payments at an effective interest rate of 18,9%. The last instalment will be on 15 June 2007.		
Finance lease liabilities - minimum lease payments		
Not later than 1 year	6 205	5 737
Later than 1 year and not later than 5 years	<u>3 223</u>	<u>9 428</u>
	<u>9 428</u>	<u>15 165</u>
Minimum lease payments	<u>9 428</u>	<u>15 165</u>
The present value of finance lease liabilities is as follows:		
Not later than 1 year	5 090	3 940
Later than 1 year and not later than 5 years	<u>2 984</u>	<u>8 074</u>
	<u>8 074</u>	<u>12 014</u>
20 Provisions		
20.1 Post-retirement medical benefits		
Balance at beginning of the period	16 700	8 900
Provisions raised during the period	-	7 800
Balance at end of the period	<u>16 700</u>	<u>16 700</u>
20.2 Current provisions		
Leave and bonus provision:		
Balance at beginning of the period	8 051	12 637
Utilisation of provision	<u>(4 393)</u>	<u>(8 839)</u>
Provisions raised during the period	9 376	4 253
Balance at end of the period	<u>13 034</u>	<u>8 051</u>
21 Revenue		
Comprises gross premiums written, credit limit and rapid response fees, information sales and excludes value-added tax	<u>476 414</u>	<u>732 826</u>

Notes to the financial statements

2005	2004
R'000	R'000

22 Gross premiums written

Gross premiums written	436 873	678 556
– Credit risk business	427 697	659 923
– Alternative risk transfer business	9 176	18 633
Premiums received from foreign sources amounted to R1 649 000 (2004: R8 759 000)		

23 Claims incurred net of reinsurance

Claims paid	69 677	124 419
Gross amount less salvages received	160 199	310 123
Reinsurers' share	(90 522)	(185 704)
Change in provision for outstanding claims	(17 896)	(10 907)
Gross amount	(57 032)	(17 080)
Reinsurers' share	39 136	6 173
Claims incurred	51 781	113 512

24 Commission received

Reinsurance commission	72 040	120 856
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25 Brokerage paid

Brokerage paid	25 431	37 435
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Notes to the financial statements

2005
R'000

2004
R'000

26 Management expenses

26.1 Management and claims administration expenses include:

Staff costs	73 930	111 401
Salaries	61 251	87 714
Employer contribution to retirement fund	5 984	8 338
Other	6 695	15 349
Audit fees	1 075	874
Depreciation and amortisation	3 055	4 806
– Furniture and equipment	489	592
– Land and buildings	1 014	1 520
– Motor vehicles	82	(140)
– Computer software amortisation	527	1 032
– Computer Equipment	943	1 802
Profit on sale of property and equipment	(66)	(21)
Repairs and maintenance of property and equipment	1 189	2 496
Information recoveries	(39 541)	(54 270)
Rentals under operating leases	647	960
Office equipment	184	323
Property	463	637
Executive directors - for managerial remuneration	3 435	4 713
Non-executive directors - for services rendered	649	783

Notice periods in respect of the executive directors do not exceed one year. Non-executive directors are not bound by service contracts.

26.2 Directors' emoluments: 2005 (12 months) – R'000

	Fees	Basic salary	Other	Bonus	Pension contrib.	Total
M C Truter *	-	1 188	68	594	139	1 989
W H Lategan*	-	873	34	436	103	1 446
K T M Saggars	126	-	-	-	-	126
M Akoob	66	-	-	-	-	66
C T L Leisewitz	55	-	-	-	-	55
A R Martin	104	-	-	-	-	104
M J Reyneke #	88	-	-	-	-	88
P Bezuidenhout #	34	-	-	-	-	34
M W Oeschger #	77	-	-	-	-	77
J J Ngulube #	55	-	-	-	-	55
B Campbell #	44	-	-	-	-	44
	649	2 061	102	1 030	242	4 084

Notes to the financial statements

26.2 Directors' emoluments: 2004 (18 months) – R'000

	Fees	Basic salary	Other	Bonus	Pension contrib.	Total
M C Truter *	-	1 635	94	817	192	2 738
W H Lategan*	-	1 201	32	601	141	1 975
K T M Saggars	173	-	-	-	-	173
M Akoob	90	-	-	-	-	90
J Coetzee #	96	-	-	-	-	96
P R Gent #	20	-	-	-	-	20
U Khumalo #	33	-	-	-	-	33
C T L Leisewitz	75	-	-	-	-	75
A R Martin	143	-	-	-	-	143
M J Reyneke #	105	-	-	-	-	105
P Bezuidenhout #	24	-	-	-	-	24
M W Oeschger #	12	-	-	-	-	12
J J Ngulube #	12	-	-	-	-	12
	<u>783</u>	<u>2 836</u>	<u>126</u>	<u>1 418</u>	<u>333</u>	<u>5 496</u>

Remuneration payable to the company by whom the director is employed, and not to the individual.

* Executive director.

2005 R'000	2004 R'000
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26.3 Foreign exchange

Foreign exchange (profit)/loss	(2 512)	19 283
– Realised	1 599	6 567
– Unrealised	(4 111)	12 716

27 Investment income

27.1 Dividends, interest and property income

Dividends - listed investments	17 667	18 853
Interest and rentals received	13 573	21 168
Interest paid	(5 568)	(7 718)
	<u>25 672</u>	<u>32 303</u>

27.2 Realised and unrealised surplus on investments

Relating to current year disposals	111 289	27 463
Current year fair value changes	50 940	114 816
Unrealised foreign exchange gains/(losses)	648	(1 836)
	<u>162 877</u>	<u>140 443</u>
Net investment income	<u>188 549</u>	<u>172 746</u>

Notes to the financial statements

28 Taxation

28.1 South African and foreign

	2005 R'000	2004 R'000
Current	62 748	44 730
Income taxation	58 992	43 845
Prior year adjustment	(320)	-
Capital gains taxation	4 076	885
Deferred	7 968	33 475
Current year	8 786	33 475
Change in tax rate	(818)	-
Secondary tax on companies	31 161	8 136
Paid	31 161	8 136
	101 877	86 341

28.2 Reconciliation of tax rate

Effective rate	28,6%	27,4%
Non-taxable income	9,0%	5,1%
Disallowed expenditure	0,0%	-0,0%
Tax saving on other taxes	0,0%	0,1%
Secondary tax on companies and withholding tax	(8,8%)	(2,6%)
Tax rate adjustment	0,2%	0,0%
Standard rate	29,0%	30,0%

29 Earnings per share

29.1 Basic earnings per share (cents)

Basic earnings per share are calculated on the net income of R257 196 000 (2004: R227 623 000). The weighted average number of shares in issue during the period was 2 662 666 (2004: 2 729 333).

29.2 Headline earnings per share (cents)

Headline earnings per share are calculated on the net income of R257 130 000 (2004: R227 602 000). The weighted average number of shares in issue during the period was 2 662 666 (2004: 2 729 333).

Reconciliation of headline earnings

	R'000	R'000
Net income	257 196	227 623
Profit on sale of property and equipment	(66)	(21)
Headline earnings	257 130	227 602

Earnings per share: Discontinued operations

Basic earnings per share are calculated on the net loss of R163 000 (2004: Profit R9 570 000)

	Cents	Cents
Basic cents per share	(6)	350

Notes to the financial statements

	2005 R'000	2004 R'000
30 Cash generated by operations		
Reconciliation of income before taxation to cash generated by operations	356 121	309 245
Adjusted for:		
Depreciation and amortisation of property and equipment	3 055	4 806
Provision for bad debts	(1 219)	(2 506)
Accrued dividends	790	89
Unrealised exchange (gains)/loss	(2 195)	5 197
Unrealised profits on investments	(53 508)	(112 980)
Profit on sale of investments, property and equipment	(109 435)	(27 484)
Other	(5)	250
Insurance provisions	(16 749)	(12 404)
Investment income	(25 672)	(32 303)
Operating profit before working capital changes	<u>151 183</u>	<u>131 910</u>
Changes in working capital:	14 761	(10 853)
(Decrease)/increase in net agents' and reinsurers' balances	(12 389)	15 480
Decrease/(increase) in other receivables	586	(2 674)
Net increase/(decrease) in deposits with / by reinsurers	16 402	(7 414)
Decrease/(increase) in other payables	10 162	(16 245)
	<u>165 944</u>	<u>121 057</u>
31 Taxation paid		
Amounts unpaid at the beginning of the year	(37 263)	(2 823)
Amounts per income statement	(101 877)	(86 341)
Deferred tax movement	7 971	33 475
Amount unpaid at end of period	10 568	37 263
Total taxation paid	<u>(120 601)</u>	<u>(18 426)</u>
32 Dividends paid		
Dividends declared	(260 668)	(88 594)
Total dividends paid	(260 668)	(88 594)
33 Total listed share purchases		
Net (decrease)/increase in cost in listed shares	(3 838)	58 388
Cost of listed shares sold	36 421	9 820
Total acquisitions	<u>32 583</u>	<u>68 208</u>
34 Discontinued operations		

The board of directors decided to discontinue the reinsurance inwards operation with effect from 1 January 2003. The decision was made because of excessive losses experienced due to ongoing high claims and the volatility of the rand exchange rate against major currencies. It was felt that the company could not afford to be exposed to this volatility, and that no treaties be renewed with foreign cedants. The effect would be that the business would be placed into run-off.

Notes to the financial statements

The South African Government terminated its reinsurance agreement with the company with effect from 1 July 2001. The company still administers all policies issued before that date. The underwriting result relating to policies, the risks of which were reinsured by the SA Government before 1 July 2001, is regarded as discontinued business. The previous year's figures have been adjusted accordingly.

The results of both divisions are as follows:

	2005 R'000	2004 R'000
Gross premiums	26 994	79 881
Less: Reinsurance	25 320	71 122
	<u>1 674</u>	<u>8 759</u>
Provision for unearned income	567	1 626
Net premiums earned	2 241	10 385
Less insurance expenditure:	4 208	4 216
– Net claims incurred	8 656	1 094
– Net reserve movement	934	-
– Commission received	(6 176)	(17 070)
– Management expenses	3 375	8 594
– (Profit)/loss on foreign currencies	(2 581)	11 598
Underwriting result	(1 967)	6 169
Interest received	1 592	1 721
(Loss)/income before taxation	(375)	7 890
Taxation	(22)	(2 367)
(Loss)/income after taxation	(397)	5 523
Transfer from contingency reserve	234	4 047
Net (loss)/income for the year	<u>(163)</u>	<u>9 570</u>
Cashflows		
Cashflows from operating activities	(163)	9 570
Adjust for –		
Unrealised exchange (profit)/loss	(4 128)	5 148
Insurance provisions	(367)	23 384
Net cashflows from operating activities	<u>(4 658)</u>	<u>38 102</u>

The carrying amounts of the assets and liabilities of Reinsurance Inward division were as follows:

Assets

Current Assets	70 533	66 859
Cash resources	13 947	11 828
Reinsurance inwards accounts receivable	56 586	55 031

Equity and liabilities

Equity: Contingency reserve	(167)	(401)
Technical provisions	(96 678)	(97 762)
Gross unearned premium	(29)	(596)
Gross outstanding claims	(87 532)	(86 598)
Deferred income	(9 117)	(10 568)
Current liabilities	(7 512)	(969)
Reinsurance inwards accounts payable	(7 512)	(969)

Notes to the financial statements

35 Related party transactions

During the year, the company, in the ordinary course of business, entered into various transactions with the holding company and associated companies. These transactions occurred under terms that are no less favourable than those arranged with third parties. The ultimate holding company of Credit Guarantee is Old Mutual plc.

2005	2004
R'000	R'000

35.1 Transactions with related parties

Mutual & Federal (parent)

Premium paid for insurance cover	(642)	(978)
Dividends Paid	(136 912)	(42 975)

Nedbank (fellow subsidiary)

Interest received	725	1 798
Dividends received	728	846
Bank charges paid	(323)	(539)

Old Mutual plc (ultimate parent)

Dividends received	358	436
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Santam (associate)

Dividend paid	(87 469)	(25 898)
Underwriting agreement	833	1 673

35.2 Year-end balances with related parties

Payable to related parties		
Mutual & Federal	266	-
Nedcor	9	10
	<u>275</u>	<u>10</u>

35.3 Doubtful debts

There was neither a provision for doubtful debts, nor any bad debt written off during the year, that relates to related parties.

35.4 Remuneration of key management personnel

Refer to note 26.2 for remuneration paid to the directors.

36 Employee benefits

36.1 Retirement funds

The company operates pension funds for all permanent staff and there is currently a defined contribution pension plan and a defined benefit pension plan in operation, both governed by the Pension Fund Act, 1956.

Under the pension plans the employees are entitled to retirement benefits on attainment of a retirement age of between 55 and 65. The most recent actuarial valuations of plan assets and the present value of the defined benefit obligation was carried out on 1 January 2003. The present value of the defined benefit obligation, the related current service cost and the past service cost, was measured using the attained age valuation method.

Notes to the financial statements

Key assumptions:

	Valuation at 2003 (%)
Discount rate	3,8
Consumer price inflation	6,0
Expected return on plan assets	10,0
Rate of compensation increase	7,0
Pension increase	4,8

In complying with the Pension Funds Second Amendment Act plans for the distribution of the surpluses will be submitted by 30 April 2006. The determination of the distributable surplus is well progressed and includes the identification and determination of minimum benefit amounts due to prior members and pensioners.

36.2 Post-retirement medical benefit

The company has an obligation to provide post-retirement medical aid benefits to eligible employees. An actuarial valuation as at 1 January 2004 indicated a liability of R16 700 000. The next valuation will be performed during the 2006 financial year.

37 Operating lease commitments

The company leases certain of its office buildings and office equipment in terms of operating leases. The company does not have an option to acquire the assets at termination of the lease. There are escalation clauses imposed on the property leases, but none on the office equipment.

	2005 R'000	2004 R'000
Total future minimum lease payments under non-cancellable operating leases	600	374
Not later than 1 year	248	333
Between 1 and 5 years	352	41

38 Contingent liabilities

Collateral security provided to employees in terms of the company's Housing Assistance Scheme

Letters of guarantees issued in favour of:

Department of Home Affairs	7	7
Calypso Ridge Properties	35	35
SA Post Office	30	30
Provisional liquidators, Retail Apparel Group	-	7 362
	218	7 592

39 Solvency ratios

The solvency ratios have been calculated on two bases:

39.1	The statutory surplus asset ratio representing net insurance assets as a percentage of net premium income (gross premium income less reinsurances as defined by the Short-term Insurance Act, Act 53 of 1998)	161,8%	150,7%
39.2	The solvency margin in terms of international reporting guidelines representing shareholders' funds as a percentage of net premium income (gross premium income less total reinsurances)	170,2%	205,3%

Appendix A: Share portfolio

Ordinary and preference shares	Shares held		Total cost		Market value	
	2005	2004	2005 R'000	2004 R'000	2005 R'000	2004 R'000
Absa Group Ltd	0	115 000	0	5 910	0	8 739
Anglo American plc	290 000	563 512	15 753	27 152	61 915	75 229
Anglo American Platinum Corp Ltd	0	145 000	0	10 610	0	30 015
AVI Ltd	500 000	330 000	5 997	6 528	7 575	7 590
Barloworld Ltd	100 000	100 000	6 528	6 528	11 053	10 630
BHP Billiton plc	455 000	553 409	8 654	9 888	47 093	36 525
FirstRand B preference shares	50 000	5 000	5 000	5 000	5 695	5 600
FirstRand B1 preference shares	100 000	0	10 200	0	11 400	0
Imperial Holdings Ltd	204 050	220 000	8 706	10 018	28 689	22 880
Investec Ltd	21 090	21 090	4 203	4 203	5 821	3 817
Investec plc	35 910	35 910	7 157	7 157	9 917	6 513
Liberty Group Ltd	163 212	163 212	5 458	5 458	12 159	10 870
Massmart Holdings Ltd	165 000	120 000	5 484	3 594	8 506	5 435
Nedbank Group Ltd	189 125	189 125	11 116	11 116	18 780	14 714
Nedbank preference shares	470 000	470 000	5 020	5 020	5 993	5 640
Old Mutual plc	570 256	570 256	8 152	8 152	10 208	8 155
Pick 'n Pay Stores Ltd	900 000	900 000	6 666	6 666	25 650	20 880
Remgro Ltd	330 000	330 000	3 501	3 501	40 260	31 139
Richemont Securities AG	1 150 000	1 600 000	1 206	1 206	31 568	30 080
SABMiller plc	315 000	315 000	9 822	9 822	36 855	30 067
Sanlam Ltd	990 000	1 100 000	8 059	8 606	14 999	14 300
Sasol Ltd	172 000	338 000	7 883	13 247	38 786	40 898
Spar Group Ltd	248 000	0	5 447	0	7 601	0
Standard Bank Group Ltd	462 071	462 071	12 104	12 104	35 030	30 404
Standard Bank preference shares	50 000	50 000	5 000	5 000	6 088	5 800
Telkom SA Ltd	110 000	70 000	9 992	5 695	14 823	6 860
Tiger Brands Ltd	100 800	50 000	9 123	4 193	14 666	4 845
Other shares individually comprising less than 1% of the total market value of the portfolio			8 106	1 799	11 055	1 935
TOTAL			194 337	198 173	522 185	469 560

Specialist brokers

Alexander Forbes
Aon South Africa
Cinque Funding Solutions
Credit Insurance & Legal Consultants
@Credit Solutions
Glenrand MIB Credit Insurance Brokers
GSK Credit Insurance Brokers
LSG Business Services
Nateng Brokers
Niche International Brokers
Marsh SA
Prestige Credit Insurance Consultants
Randburg Financial Consultancy
Risk Management Insurance Consultants
Thompson Credit Insurance Consultants
Top Cover
Willis SA

Semi-specialist brokers

Building Credit Management
Complete Credit Solutions
Corinth Capital
Debtsource
E D Little Credit Management Consultant
Ferdinand Nel Insurance Brokers
Helgran Insurance Brokers
Londeka Uhuru Financial Services
Motosure
Multi Risk Managers
Pegasus Brokers
Surety Solutions
Tucker Davis Insurance

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Reg No 1956/000368/06

Accredited financial services provider # 17691

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