



**INCA**

—ANNUAL REPORT 2006—

INFRASTRUCTURE FINANCE CORPORATION LIMITED





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*Celebrating 10 years  
of being more than just a source of funding*

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	ibc Administration

# FINANCIAL *Highlights*

## Financial Highlights for 2006:

- Successfully redeemed R1 770 million IN02 bonds.
- Interest and similar income exceeded R1 000 million.
- Saving of 9% on core operating costs.
- Total shareholder interest increased to R491 million.
- Net asset value up 44%.
- Cash flow generated by operations up 16% to R73,6 million.

	12 months June 2006	12 months June 2005
<b>PERFORMANCE</b>		
Net profit for the year (R'000)	174 132	70 601
Earnings per share (cents)	21 590	8 718
Net profit after tax per employee (R'000)	3 628	1 496
<b>SELECTED RETURNS</b>		
Return on weighted average shareholders' funds (per cent)	54.18	25.50
Operating costs to total income (per cent)	43.70	42.91
<b>CAPITAL ADEQUACY</b>		
Funds distributed after capital redemptions (statutory body assets) (R'000)	5 362 183	6 514 449
Total shareholders' interest (R'000)	490 522	340 152
Capital adequacy ratio (capital/advances) (per cent)	11.03	7.99
<b>OFFICIAL RATINGS</b>		
Official credit rating – senior debt (Fitch)	<b>A</b>	AA -
– senior debt (Global Credit Ratings)	<b>A+</b>	AA
– senior debt (Moody's)	<b>A1</b>	N/A
– junior debt (Fitch)	<b>A-</b>	A+
– junior debt (Global Credit Ratings)	<b>A1</b>	A
– junior debt (Moody's)	<b>N/A</b>	N/A
<b>VALUE</b>		
Net asset value per share (Rands)	<b>608</b>	422

## Financial Highlights of the past 10 years:

- Loan book to infrastructure providers increased nearly 8 fold in 10 years to R5 362 million.
- Total shareholder funds increased nearly 10 fold to R491 million.
- No funds lent to municipalities written off in 10 years.
- More than R2 000 million international funding mobilised and invested in infrastructure.
- Average return on equity of 22%.

6 months June 2004	12 months December 2003	12 months December 2002	12 months December 2001	12 months December 2000	12 months December 1999	12 months December 1998	12 months December 1997
32 701	64 977	31 146	28 107	29 818	13 979	4 616	2 409
4 055	8 056	3 862	3 329	3 549	1 683	842	526
785	2 096	1 038	1 007	1 335	1 012	490	482
12.53	40.37	19.93	19.47	24.68	12.86	7.70	5.10
38.34	34.07	41.38	29.32	24.65	33.05	44.10	50.80
5 660 130	5 171 451	4 229 603	3 968 516	3 417 255	2 929 069	1 138 177	684 153
293 600	260 899	168 471	171 242	150 615	120 961	103 504	51 544
6.57	6.56	5.88	7.32	7.28	5.66	9.10	7.50
AA -	AA -	AA -	AA -	AA -	AA -	AA -	AA -
AA -	AA -	AA -	AA -	AA -	N/A	N/A	N/A
N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
A+	A+	A+	A+	N/A	N/A	N/A	N/A
A-	A-	A-	A-	A-	N/A	N/A	N/A
N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
364	323	209	222	179	144	130	103

NINETEEN-NINETY-SIX  
TWO-THOUSAND-&-SIX

# OUR PEOPLE *along* THE WAY





2005

2006

*a Tribute*  
TO THE LATE ERIC MOLOBI

05 JUNE 1945 - 04 JUNE 2006



When Eric was born 61 years ago in Alexandra township, and began his education in Orlando West - Soweto, he was an ordinary son of South Africa. Few could have predicted the unique role he would play in helping to shape South Africa's future.

Eric's involvement in the Black Consciousness Movement, his sentence in 1974 and imprisonment of 6 years on Robben Island (during which he obtained his BA degree through UNISA), his involvement in the United Democratic Front (UDF), and his close relationship with Oom Beyers Naudé, are testimony to his commitment to the principles he believed in.

Eric's founding role in the National Education Crisis Committee (NECC), his role in the National Housing Finance Corporation (NHFC), his initiative to establish Kagiso Trust and then as CEO of the Kagiso Trust Investments (KTI) in 1994, speak volumes for his strategic abilities and vision, qualities that were widely acknowledged and led to his directorships of a number of companies.

He won numerous awards, including:

- The Kohl International Peace prize, given by the Kohl Foundation in Chicago for his work in helping to resolve educational problems, particularly in Soweto, following school boycotts in the late 1980s;
- The Ordre National de la Legion D'Honneur, presented by the French Government for his work in promoting development in South Africa; and
- The Presidential Award from the Institute of Personnel Management as an acknowledgement of his role in people management.

TO A MAN WHO DID THE RIGHT THINGS  
FOR THE RIGHT REASONS

*Thank-you Eric*

... AND YOU SAID, WITH YOUR HAND ON YOUR CHEST, "YOU KNOW, INCA  
AND ITS WORK WERE ALWAYS CLOSE TO ME."

— Eric Molobi, 2003

But his ultimate accolade was being called the "Champion of Broad Based Black Economic Empowerment" in South Africa.

It was foreseeable that, in time, he who had committed his life to mobilising people and resources to improve the life of ordinary South Africans, would also become the chairperson of INCA.

Since that morning, (in early 2003) when we approached Eric to become the major share- and stakeholder in INCA, and he said with his hand on his chest - "you know, INCA and its work were always close to me", we knew that we had a leader who would insist on our continuing to behave the right way and do business the right way. His guidance over the past two years and the specific direction he provided during our visit to INCA's international share and stakeholders in France and Luxembourg in April 2005, will inspire all of us at INCA as we build the business and extend our activities. This we will do not for self enrichment nor to 'do business at all cost' and not through personal connections, but because we are motivated by a belief that by doing the right things for the right reasons, we are contributing to making South Africa a better place for all its people.

Eric, your legacy will be our guide!

**Attie Van Zyl**  
Chief Executive Officer

# DIRECTORATE & SHAREHOLDERS



## DIRECTORATE

FROM LEFT TO RIGHT

AH Arnott Director •#†◇ FirstRand  
 IM Ayob Director Chanson Investments  
 RN Boqo Executive Director † INCA  
 MS Brown Director #◇ FutureGrowth  
 AC Canter Director (American) \* FutureGrowth  
 RW de Korte Director (Dutch) Independent  
 D du-Pont-Bouma Executive Director (Dutch) \* INCA

M Hesketh Director # Rand Merchant Bank  
 L Klein Director (French) Proparco  
 MA Lallemand-Flucher Director (French) Dexia Crédit Local  
 J Matlala Director \* Kagiso  
 MJN Njeke Director † Kagiso  
 PE Rackstraw Director • FutureGrowth  
 J Stals Director † Kagiso  
 PGM Truyens Director (Dutch) †\*◇ Independent  
 EG van den Berg Director #◇ Kagiso  
 AJ van Zyl Chief Executive Officer •#†\*◇ INCA

## ALTERNATES

K Moloko FutureGrowth  
 LP Collet Rand Merchant Bank  
 M Mokhele Proparco

- Member of human resources committee
- # Member of credit committee
- † Member of audit committee
- \* Member of asset liability committee
- ◇ Member of market value verification committee



## SHAREHOLDERS

Chanson Investment Holdings (Proprietary) Limited	2,0%
Dexia Crédit Local	4,42%
FirstRand Bank Limited	17,68%
INCA Share Incentive Trust	4,95%
Kagiso Financial Services Limited	43,96%
Momentum Group Limited (held by FutureGrowth [Proprietary] Limited)	26,98%
Societe De Promotion Et De Participation Pour La Cooperation Economique SA (Proparco)	0,01%
	<hr/> 100,00%

# Chief Executive's REPORT



## INTRODUCTION

It is 10 years since the registration of INCA in 1996. In reflecting on the company's first decade, we note balance sheet growth from R1 million on 31 December 1996 to R6 628 million on 30 June 2006. This performance is indeed a reason to celebrate. We have done well!

In this annual report, in which we also pay tribute to our chairman of the last two years, the late Eric Molobi, we celebrate ten years of being more than just a source of funding. INCA may have originally been established as a response to the South African Government's call on the private sector to supplement the fiscus in funding the infrastructure backlog in South Africa, but the role INCA has played and as reflected in this report, clearly indicates that the company is much more than just a source of funding.

In the annual report of 2001, which marked the end of our first five years, we emphasised the importance of doing the right things right. Five years on, in 2006, we would like to emphasise the importance of doing the right things for the right reasons.

The quest for performance that stands out, a contribution that is acknowledged, and innovation and courage that shows the way, needs to be underpinned by the right motivation to be sustainable. In this respect, it is not the Financial Sector Charter scorecard, or the special focus of the last few years by companies to prove that they are "sustainability sensitive", that drives the business philosophy of INCA. In reflecting on the company's activities since inception and during the period under review, it is clear

“PERFORMANCE THAT STANDS OUT, A CONTRIBUTION THAT IS ACKNOWLEDGED, AND *innovation & courage* THAT SHOW THE WAY NEED TO BE UNDERPINNED BY THE RIGHT MOTIVATION TO BE SUSTAINABLE.”

that the staff, board of directors and shareholders believe that a fair return can be made by applying sound business practices to the business of development.

The business environment within which INCA operated during the 2005/6 financial year made it difficult to excel. As will be reflected on later in this report, it was a challenging year for INCA. The Financial Sector Charter has, rightly, resulted in nearly all financial institutions competing keenly for the business of funding infrastructure projects.

Looking to the future, we are confident that INCA will continue to provide returns above the expectations of its shareholders, and will continue to contribute to the acceleration of development in South Africa, and in a limited way in Southern Africa.

Driven by a belief that we have a contribution to make, we will keep on doing the right things for the right reasons; – working for a better, more equitable South and Southern Africa for all our people.

## A REFLECTION ON THE FIRST TEN YEARS

INCA was launched with seed capital of R1 million from First National Bank, four staff members, and a mandate to test whether a private-sector development fund could be created to show how business, and specifically First National Bank, could contribute to the then newly announced Reconstruction and Development Programme (RDP).

A number of factors have changed in the past ten years, as was to be expected in a dynamic market like South Africa's. On the other hand, developmental challenges cannot be met within a period of ten years. In a world of decentralised governance, it is important to reflect on the past. It is reflecting on past experiences that make an accurate analysis of the current situation possible, which is important to ensure that the correct actions are taken in the future.

Three of the original four staff members still work for INCA, and will speak with passion about the highlights, as well as the difficult times, during INCA's first decade.

At inception, investors and shareholders became involved in the INCA initiative because of the focus on the Reconstruction and Development Programme (RDP) of the new government. International institutions found the INCA concept interesting, and a means of supporting development in South Africa through an institution that promised accountability. Local institutions found investment in INCA an acceptable risk to take in supporting development. The question of how viable an entity like INCA could be in the face of competition from International Development Finance Institutions (DFI's), the Development Bank of Southern Africa (DBSA) and the “corporate social responsibility funds” of the large corporations, was asked from inception. However, the need for additional financial resources (to fund

## CHIEF EXECUTIVE'S REPORT

the infrastructure backlog) and the acceptability of the INCA model enabled it to successfully issue the second listed corporate bond in South Africa and mobilise local and international shareholders.

Today, more than 35 corporate bonds are listed on the South African Bond Exchange. Shareholders and investors not only refer to the success of INCA, but are also actively pursuing opportunities in their own right to increase their involvement in infrastructure finance.

To a certain extent, however, as was the case with the RDP ten years ago, the Financial Sector Charter is currently having an abnormal influence. Questions on the role of the DFI's and the DBSA and the extent to which they mobilise or compete directly with private sector initiatives continue to be asked. The focus on infrastructure development has increased and the role of local government in effective service delivery is now openly described as being essential.

Actions taken by the national government, whether in the form of legislation or through a more transparent multi-year fiscal transfer/redistribution programme, have created a local government environment that presents a more acceptable risk profile. The demarcation of municipal boundaries and the consolidation of 853 municipalities into 284, has also enhanced the financial strength of individual entities.

Ask staff members of INCA about the past ten years and they will confirm that:

- INCA has invested R8 000 million in infrastructure, of which R2 000 million was mobilised from international institutions;
- 46% of INCA's shares are owned by BEE shareholders;
- INCA has not written off any funds lent to municipalities;
- INCA has seen its bond spreads more than double and then seen them contract by the same percentage;
- The ability to provide funding for municipal infrastructure projects has slowed down remarkably, owing to procedures introduced through new legislation;
- It was necessary to explain to investors why they were not issued with INCA bonds following very successful auctions;
- On other occasions, personal visits were made to investors to ask for funds to finance transactions;
- Staff members were instrumental in persuading decision makers to accept that the best way to deal with HIV/AIDS is not only to ask a health department to become involved;
- INCA, through its capacity building fund, has contributed to the training of more than 2 000 municipal officers.

A discussion with INCA staff will also reveal the frustrations in dealing, as a private sector institution, with the government sector. They will remark on the capacity constraints in local government and the lack of decision-making ability. They will share their view that INCA's goal is not to make the maximum profit, but to accept a reasonable return and to take pride in making a contribution to development.

The most important insight that INCA staff members have gained over the past ten years is that it is possible to invest in development projects, based on commercial principles, and receive an acceptable return on your investment. But to keep on doing it for ten years, you need to be investing for the right reasons. The correct degree of tension between input, risk, duration and reward needs to be sustained.

## THE YEAR UNDER REVIEW

From an operational point of view, the year under review proved to be the most testing since INCA's inception. The process of extending credit to the municipal sector not only slowed considerably, but an over supply of funding and a limited number of projects to invest in created a very competitive market. In the face of this heightened competition, the effect of an unexpected downgrade by FitchRatings on 18 November 2005 had to be weathered. It was necessary to maintain exceptionally high levels of liquidity to ensure that INCA would be in a position to redeem in full its IN02 Bonds with a nominal value of R1 770 million during the year.

However, the performance of the company under challenging conditions, demonstrate the resilience of a business built on sound commercial principles. It also emphasises the fact that INCA's rapport with local and international investors is transparent and sound, and the quality of its advances book of a very high standard.

## ASSET GENERATION AND PORTFOLIO MANAGEMENT

As alluded to in the interim statements, asset growth for the year was lower than in the previous two financial years. As expected, the second half-year performance proved stronger, resulting in a total of R503,1 million being disbursed for the year. Of these new advances, R174,8 million or 35% went to asset finance transactions, while R328,3 million was advanced as new term-loans mainly to municipalities or municipal entities. During the year, the total value of loans maturing totalled R883,2 million. As at 30 June 2006, the value of INCA's advance portfolio stood at R5 362 million.

The portfolio is still dominated by municipal advances (76,5%), of which advances to the metropolitan municipalities constituted 41% of the total advances portfolio. The largest single exposure in INCA's portfolio remains its loans to the city of Tshwane. This concentration was, however, reduced by R269 million after INCA sold part of its exposure to a third party. The ten largest advances in the portfolio as at 30 June 2006 constitute 54,6% of the portfolio, compared with 56,7% a year ago.

Although the rental and lease discount part of the business continues to show promise, it still remains a relatively small part of INCA's total advance portfolio. We increased our credit exposure to other non-municipal public sector entities and will continue to diversify INCA's risk exposure away from one sphere of government.

In accordance with stated policy, all exposures are reviewed at least once every 18 months, and during the past year all credit exposures of substance, with the exception of one municipality, have been reviewed. The credit quality of the advance portfolio remained high. The fact that no defaults were registered on a total capital and interest amount payable of R827,8 million on INCA's term-loan book at year end, is a practical indication of the quality of the assets.

The quality of the portfolio, based on INCA's annual credit review process, which closely mirrors that of the rating agencies at year-end, are reflected below:

Approximate credit risk	Percentage of advances
AAA to AA-	34%
A+ to A-	44%
BBB+ to BBB-	19%
Non-investment grade (BB + and lower)	3%

As part of the business plan approved by the board and supported by shareholders, INCA joined various consortia to tender for project finance transactions. These transactions have a much longer lead-time than the general debt obligation infrastructure loans that characterise INCA's current portfolio, but should add renewed impetus to efforts to grow the advance portfolio.

The price competitive environment that led to credit spread contractions is expected to remain in place for the best part of the next financial year. INCA is convinced that this is an abnormal phase and is not sustainable. Contributing factors are the need for banks to increase their exposure to the municipal sector because of the "Financial Sector Charter push factor", together with the DBSA's strategy of protecting their market share through an aggressive pricing policy and mixing concessional funding with more market-related funding.

From a purely business perspective, and to realise part of the market value reflected in INCA's advance portfolio, part of these advances may, in future, be offered to asset-hungry third parties.

## FUNDING AND TREASURY

From a funds mobilisation and capital market perspective, the 2005/6 financial year was the most eventful to date. INCA's treasury division performed exceptionally well.

In accordance with its funding strategy, INCA successfully redeemed in full its IN02 bond issue in the South African capital market on 30 June 2006. In fact, after FitchRatings downgraded INCA's long-term rating on 18 November 2005, at the end of January 2006, INCA cancelled R620 million of IN02 bonds already bought back from the market. Through this action, the IN02 bond liability was reduced to R1 150 million and investors in INCA bonds were given a clear indication that the redemption strategy had been executed as planned.



## CHIEF EXECUTIVE'S REPORT

Resulting from the FitchRatings downgrade, INCA held detailed discussions with all investors in INCA bonds to reassure them that provision had been made (through high levels of liquidity and close interaction with borrowers) to meet all redemption requirements. The fact that only a few INCA Bonds were sold by investors after the rating downgrade is proof of our level of support from the investor community, as well as the benefit of maintaining an open and continuous channel of communication with investors.

The rating downgrade, however, resulted in an increase in the spread at which INCA Bonds traded in the market. In this respect, the spreads on the IN03 and IN04 bonds before the downgrade were 85bp and 94bp over the benchmark government bonds respectively, and widened to 110bp and 127bp respectively at financial year-end.

The abnormal experience during this financial year, where credit spreads on INCA Bonds widened while credit spreads on the underlying municipalities that INCA had invested in contracted, was a primary contributing factor to the increase in unrealised profits reflected in these financial statements.

During the year, the process of issuing shorter-dated paper to the market (up to 12 months) in the form of IN06 bonds, begun in the previous year, was taken further. A total of R617 million was raised in this manner and R350 million of short-dated debt was also redeemed at the end of March 2006. In addition to the short-dated paper, INCA also drew down R238,4 million of a 15-year European Investment Bank loan, and placed R100 million IN04 bonds (maturing 15 March 2015) in the South African market.

At financial year end, the fair value of the company's total long-term liabilities (inclusive of the IN06 12 month floating rate notes) came to R5 671 million. Of these liabilities, the value of the IN03 bonds, (that is included in the all bond index), was R2 885 million, that of the IN04 bonds was R212 million and the various IN06 bonds, R615 million. Having redeemed R80 million subordinated debt on 30 June 2006, the value of outstanding subordinated debt (maturing in September 2011) at year end was R101 million.

In anticipation of the IN02 redemption on 30 June 2006, as well as other redemptions, it was necessary to maintain abnormally high levels of liquidity throughout the year. This level of liquidity, which averaged around R1 000 million throughout the year, was further bolstered by a dedicated R500 million liquidity facility raised from FirstRand Bank Limited. This facility, as well as the R200 million general banking facility available to INCA, was, however, not utilised during the period of major debt redemptions; its purpose was purely to provide additional comfort to investors in INCA Bonds.

In future, INCA will continue to maintain adequate levels of liquidity, raise the bulk of its funding on the local capital market and, where appropriate, raise international funding on balance sheet or from co-funding sources to fund its asset generation activities. It is also anticipated that the spread at which INCA Bonds are traded over the government's funding curve vis-à-vis the rate at which institutions are prepared to fund the assets that INCA has invested, will move towards a more realistic risk pricing equilibrium.

The Financial Sector Charter Council has developed an infrastructure index to be used by institutions from 2006 onwards to quantify the level of development in an area, and to form the basis of scoring the transformational infrastructure-funding performance. The municipal index is used to establish the charter ratings for INCA. INCA is currently in the process of obtaining a verified rating on which the score for 2006 onwards can be based. As INCA had no verified rating in 2005, institutions wishing to calculate their transformational infrastructure-funding performance score for 2005 can use a generic score for INCA of 40% according to a guidance note issued by the Financial Sector Charter Council.

## FINANCIAL RESULTS

The consolidated income statement reflects a net profit of R174,1 million for the financial year ended 30 June 2006 (R70,3 million for 2004/5 financial year). Contributing to this profit is an unrealised fair value adjustment of R179 million, resulting mainly from the widening of INCA's bond spreads, due mainly to the rating downgrade and the simultaneous credit spread narrowing of INCA's municipal advances during the year. (See note 16.2 to financial statements)

The R41,2 million in fair value realised during the year came mainly from the trading of credit stock and selling part of INCA's exposure to Tshwane which unlocked value and lowered the company's concentration risk to the metropolitan council.

The R220 million in fair value adjustments was the main contributing factor that increased net income before operational expenditure to R273 million.

The decline in net interest income for the year to R52,4 million (R60,6 million in 2004/5 financial year), was a direct result of the lower interest rate environment impacting on investment income, as well as the higher than normal interest cost associated with the high levels of liquidity. The high level of liquidity built up during the year to deal with the IN02 was an abnormal situation which resulted in a negative carry cost for the year of about R10 and R12 million. The negative impact of liquidity requirements will not effect the net interest income to the same extent during the next financial year. With the IN02 bond fully redeemed, the interest expense is also expected to be proportionally lower for the next year, which will more than compensate for the pressure on interest income. Given the stability in the INCA portfolio, an improved net interest income figure for next year is predicted.

The operational expenditure of R41,4 million for the year included a provision of R7,6 million to cover the market value of the staff share incentive scheme. The normal operational cost of the company, excluding cash incentive bonuses to staff, was curtailed to a level of R28,8 million. This direct operational cost compared favourably with those of previous years.

The decrease in advances, resulting from maturities during the year and the lower growth in new assets, resulted in the value of advances as at 30 June 2006 being R5 362 million, 17,7% lower than at the end of the previous financial year. Given the 44% increase in shareholder interest to R491 million and available subordinated debt of R101 million, the capital adequacy ratio at year end increased to 11,03%, compared to 7,99% the previous year.

A dividend of R25 million was declared, of which R23,7 million was distributed to shareholders during September 2005. Given the performance of the company, and there being a high level of certainty regarding the strong interest turn generated by the portfolio for the 2006/7 financial year, a similar dividend will be recommended for distribution during October 2006. The ability to distribute a dividend of about R25 million was also made possible through the positive cash flow of R73,6 million generated by the business during the year.

## ADMINISTRATION AND OPERATIONAL SYSTEMS

The decision taken two years ago to invest in a new deal-management system (Quantum) is now beginning to show the anticipated benefits. With the exception of a selected few instruments that reflect unique characteristics for which the system needs to be modified, Quantum is now fully operational. During the year, the training of staff in the effective use of the Quantum system received attention and the efficiency gains became clear from our having the required management accounts available on a monthly basis.

In support of the treasury function, the introduction of a treasury risk-management system (QRisk) progressed well. Towards year end, the first comparisons between results generated through Quantum and those generated by QRisk were undertaken. It is expected that QRisk will become fully operational in the next financial year, which will greatly assist the risk management abilities and operations of treasury.

The financial administration division has managed to work through the short-term rental and lease discount book of INCA's subsidiary (INCA Asset Finance). This resulted in an increase in the efficiency of collecting arrears normally associated with monthly rental and lease payments. Except for the book of one broker, who acted fraudulently and for which INCA had to write off an amount of approximately R2 million, the current rental book can be expected to perform well. A change in approach away from discounting transactions brought to the company by a broad spectrum of intermediaries, towards a focus on those from a few key institutions, also proved to be more beneficial.

The focus over the past two years on financial administration and operational systems provided the platform for increased activities and deal flows. This year brought us another step closer to being more systems- than people dependent from a deal processing point of view.

## RISK MANAGEMENT AND CORPORATE GOVERNANCE

A high standard of corporate governance and transparency was maintained throughout the year. At board level, the independent directors, shareholder representative directors and executive directors actively participated and worked well together in guiding the company. Quarterly board meetings were well attended, and the board, at these meetings considered the operational performance of the company against the approved business plan and budget.



## CHIEF EXECUTIVE'S REPORT

Whereas the board focuses more on strategic and policy matters, the five operational sub-committees of the board have the responsibility of monitoring and ensuring that the operations of the company are undertaken within acceptable risk limits set by the board and delegated to these committees. These sub-committees of the board, of which the credit committee is the most active, are chaired by non-executive directors and staffed by a combination of executive and non-executive directors. The scheduled meetings of these sub-committees were all well attended, with no occasion recorded of a quorum not being available.

The audit committee meetings were attended by the external auditors of the company who also took note of the specific process followed by the market verification committee in determining the curves created to value the non-listed assets of the company.

ALCO executed its mandate through the year and ensured that the treasury division did not take unauthorised positions and adhered to the risk guidelines and liquidity limits approved by the board.

A capital adequacy ratio much higher than that stipulated in the bond trust deal and higher than the 7,5% - 8,0% guideline provided by the board was maintained throughout the year. This, together with exceptionally high levels of liquidity, serves as an additional risk mitigating factor.

In November 2005, FitchRatings downgraded INCA's long-term domestic rating from AA- to A and its subordinated debt from A to A-. In December 2005, Global Credit Ratings (GCR) changed INCA's long-term rating from AA to AA-.

Following on these rating reviews, Moody's were commissioned to provide a rating for INCA. In June 2006, Moody's Al.za/Prime-I.za national scale issuer ratings assigned to INCA were published.

### A COMMITMENT TO EFFECTIVE AND EFFICIENT LOCAL GOVERNANCE IN SUPPORT OF LONGER TERM SUSTAINABILITY

The INCA Capacity Building Fund, (the Fund), is a joint venture established in 1998 between Infrastructure Finance Corporation Ltd (INCA) and Agence Française de Développement (AFD) as a non-profit section 21 Company. The main objective of the Fund is to "make a meaningful and visible contribution to effective and efficient local governance in South Africa".

Over the years, the Fund has been focusing strongly on training to assist with the building of the necessary skills and capacity within the local government sector. Various focused training programmes, driven by the needs expressed by local government officials, are provided to ensure that people are better equipped for the positions they fill. The Fund's flagship training initiative remains the prestigious annual Local Government Capacity Building Summer School presented in Johannesburg. Over the past 6 years, 164 senior and executive municipal employees have attended the intensive training programmes. The various themes of the Summer School have focused on service delivery, law, human resources, finance and development – issues that are of concern to executive and senior local government officials. As an extension of the Summer School, 52 practitioners who had attended the school, visited France as part of an annual study tour. The main purpose of the tour is to provide local practitioners with international experience and to benefit from French best practice. This initiative gives delegates an opportunity to exchange views with some of their French counterparts. To maximise the benefit of the Summer School, some of the main topics were also presented at a regional level in Limpopo Province, KwaZulu-Natal and the Western Cape.

The Fund, however, does not only concentrate on building capacity at executive and senior management level, but also supports programmes focusing on basic financial skills training, which includes aspects such as basic accounting, VAT and bank reconciliation at an elementary level. To date, the basic financial skills training programme has been attended by more than 1100 delegates. The principles in financial management programme, presented in partnership with the Institute of Municipal Finance Officers, trained 210 delegates in risk management, supply chain management, cash management and budgetary control.

The conversion of municipalities to the new GRAP accounting format necessitated additional training. The GRAP training began at a basic level and escalated in partnership with IMFO to a more advanced level. Currently, a partnership with the Department of Provincial Government has been established to provide a programme to assist municipalities with the actual conversion process. The first phase of 15 pilot municipalities, fully supported by the Fund, is being followed by a second phase of a further 60 municipalities, for which the department is making funds available. The release of a Municipal and

Accounting publication towards the latter part of 2006, is also a first for South Africa. After some research in the sector, the need for such a publication was identified, and the Fund provided financial support to the authors. This book which will also be prescribed by certain higher education institutions, covers various key areas within local government such as legislation, municipal finance, inter-governmental relations and annual financial statements.

Over the years, the Fund has awarded several bursaries to disadvantaged students wishing to further their studies in public administration and finance. Some of these students were seconded to municipalities during recess periods, and have since been permanently employed. In 2004, the scheme was broadened with the assistance of the French Embassy in South Africa to also provide support to Masters and Doctorate students. In pursuance of its objectives (effective and efficient local governance), the Fund will also shortly launch an inter-governmental toolkit which will give municipalities practical guidelines on improving co-operation between themselves and provincial and national government, and includes the drafting of suitable inter-governmental agreements.

One of the distinctive challenges facing South Africa and, more specifically, local government, is to deal effectively with the impact of the HIV/AIDS pandemic. This prompted the Fund five years ago, to partner the Medical Research Council of South Africa in providing direction and practical guidance. The project has three distinct phases culminating in a national roll-out of a practical toolkit at municipal level. The focus of Phase 1, started in 2001, highlighted the impact of HIV/AIDS on local government as a service provider and employer. The severe effect which the epidemic could have on service delivery as a result of absenteeism and loss through death or illness of staff, was highlighted in detail, as was the potential impact of the disease on the ability of households to survive the loss of breadwinners.

The conclusions drawn from Phase 1 prompted a continuation of research in Phase 2, to develop a local level response and the implementation of a toolkit to counter the effects of the pandemic on municipalities. The toolkit aims to ensure that HIV/AIDS education forms an integral part of the planning process of municipalities. This phase, which is nearing completion, included prevalence testing and sampling in Capricorn District Municipality while the results of the testing done in Buffalo City were also included in the sample data. Phase 3 will see a multi-million Rand national roll-out of the toolkit. Negotiations are currently in progress with national government to have the toolkit integrated into its HIV Response Framework. This phase will further focus on the mobilisation of institutional partnerships and potential stakeholders in order to commence the roll-out in early 2007. The successful application of this toolkit at municipal level will certainly result in major dividends for municipalities, related stakeholders and the country at large.

During the last two years the Fund has made a concerted effort to invest in community upliftment projects. In 2004, in partnership with the Fairest Cape Association, a Waste Management Programme was launched. Through this programme, children and teachers of 110 schools were educated about the benefits of recycling waste. The success of this programme is evident in the fact that some parents have started their own plastic bag business and some schools have even provided employment to individuals as a direct result of the project. In addition, schools are reaping the financial benefits from the resale of paper and bottles. At the same time, childrens' creative abilities are stimulated when they are taught to make gifts and other articles from recycled waste. The use of community radio as a communication medium was explored in 2004, with the Fund investing in a community radio drama that was broadcast over 60 community radio stations. The aim of this drama series was to encourage communities to pay for good municipal service delivery.

The success of the first project led to the Fund co-funding in 2005 a R4,3 million community radio project in partnership with the Departments of Provincial and Local Government, and Communication. This 13-episode broadcast covered various election issues and encouraged people to cast their vote.

The promotion of local economic development as a vehicle to create employment and wealth within communities was given impetus through the launch of a pilot project in Mossel Bay Municipality. The conclusion of this project will be the production of a toolkit aimed at assisting municipalities with the identification and successful implementation of sustainable local economic development projects.

The workings of the INCA Capacity Building Fund is an indication of the benefits to be reaped from effective co-operation between local and international institutions that are committed to sustainable development in South Africa. It also illustrates, in an action-orientated way, INCA's continuing commitment to making a contribution, not only as a source of funding, but also as a responsible private sector partner to all spheres of government and to international sources of development finance.

## CHIEF EXECUTIVE'S REPORT

### RESPONSIBLE BUSINESS PRACTICES

INCA's commitment to municipal capacity building and specifically to the training of individuals to equip them to perform their tasks more effectively, is also applied within the company.

INCA's staff study programme enabled 9 staff (19% of employees) to further their studies and better equip them for their careers.

During the year, three young graduates also joined INCA's internship programme, which provides an opportunity to those from previously disadvantaged communities to enter the financial sector and gain practical work experience within a primary financial institution. After 18-months, these interns may apply for positions in other institutions, knowing that their 18-months at INCA enhanced their prospects of finding a permanent job.

From a staff equity perspective, 56% of all staff at financial year-end were of colour, and from a gender perspective, 58% of the staff component were women.

A specific programme through which dedicated mentorship/coaching is provided to young black professionals as part of an accelerated development programme under the direct supervision of the CEO, was also introduced.

At year end, 45,96% of INCA's shareholding was held by BEE shareholders, who also had the right to vote the 4,95% interest of the Staff Share Incentive Trust.

Although INCA is not required to comply with the Charter because of its small staff complement, it has voluntarily done so. It is a matter of pride that the company already exceeds the targets. Other requirements will also be met within the timeframe provided.

### LOOKING TO THE FUTURE

The emphasis on infrastructure investment, whether social or economic, to accelerate economic growth and contribute to a more equitable quality of life for all, will be maintained.

The additional financial resources flowing to the fiscus over the past few years, because of a higher growth rate and efficiency gains by the revenue services, will continue to assist the government in implementing its programme of redistribution to the most vulnerable of society.

Following the international community's new-found determination to meet the African development challenge, substantial financial resources are expected to be earmarked for investments in Africa. The funding of infrastructure will be a specific focus and countries capable of utilising these international investment flows will benefit substantially.

South Africa will experience strong competition between international finance houses and local companies for investment opportunities. Being remote from current geo-political conflict and not targeted by fundamentalists, South Africa could benefit from its "relative safe-haven" image. The need for political stability, good governance and effective action to combat crime will, however, remain preconditions for long-term overseas direct investment flows.

Given the current momentum of economic growth and the need to accelerate the efforts of the past few years, the pressure on capacity and specifically on the skills base is set to increase. The pressure on the private sector and the state to deliver and perform will increase. This anticipated business environment will bring with it heightened tension and frustrations, but also opportunities.

INCA is well positioned to benefit from the focus on infrastructure investment. Its activities during the last ten years clearly indicates that it is a key institution in the field of infrastructure finances and will continue to be a logical partner for international infrastructure investors. The depressed credit margins and local funding available to infrastructure providers, together with aggressive risk pricing from the DBSA, are expected to remain for some time. The aggressive pricing is, however, not sustainable.

The historically low margins at which financial institutions are prepared to provide funding to municipalities for extended loan terms, have however, prompted INCA to become more efficient and to focus also on product development.

More asset financing activities and project finance transactions will be needed to complement INCA's traditional term loan business. Those undertaken in the year under review have already shown the potential to contribute to earnings.

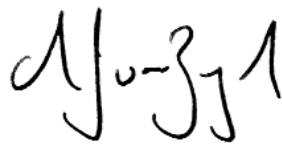
All major organisational and staff changes have been implemented. Management has now begun to refocus on the staff to extend their abilities, unlock potential and create an institution with a culture of learning and responsiveness to a challenging environment.

In my tribute to Eric Molobi, I thanked him for his guidance. I would also like to thank JJ Njeke, who stood in for Eric for most of the year. Once again, the directors individually and as a board worked effectively to ensure that the company was steered in the right direction. I thank them for their contributions.

To our shareholders, who remain committed to the work of INCA and the difference we are making, I express my appreciation, and commit the company to providing you with good returns on your investments.

To all INCA staff, especially those who have been with me in the company for ten years, this year's results and those of the previous years would not have been possible without the contributions that each one of you has made. Thank you.

It is most pleasing to think that our performance next year will in all likelihood be better than the sound performances of the past.



**Attie van Zyl**

Chief Executive Officer



# Chief Financial OFFICER'S REPORT

The business challenges faced during the financial year under review have been highlighted in the CEO's report. From a financial reporting viewpoint, the new reporting framework presented its own challenges. The group adopted the International Financial Reporting Standards (IFRS) as its financial reporting framework with effect from 01 July 2005. The conversion from South African Generally Accepted Accounting Practice (SA GAAP) to IFRS put additional pressure on the finance department to identify and implement the new financial reporting requirements, particularly as far as disclosure is concerned.

The group formally elected to measure most of the balance sheet line items at fair value through profit or loss. These line items include the advances (excluding the lease receivables), investments (excluding investments in subsidiaries), and subordinated and long-term liabilities. Overall reporting in accordance with IFRS did not result in material adjustments to the financial statements, but comprehensive disclosures were included in the financial statements.

The adoption of IFRS necessitated a review of the group's accounting policies for compliance with the international standards. The review resulted in some changes to our accounting policies. The group adopted a new impairment policy that complies with the requirements of IAS39 Financial Instruments: Recognition and Measurement. The key difference between the new and the old impairment policy was that the old policy only considered the actual outstanding cash flows, and did not take into account the entire exposure when assessing whether impairment was required. The adoption of the new impairment policy did not materially impact on the impairment figures reported in previous years.

Interest and similar income breached the “psychological” R1 billion mark for the first time. This feat could not have been achieved in a more appropriate year, since the group is currently celebrating its tenth-year of operations. The unrealised fair value adjustments of R179 million are a net result of both financial assets and liabilities being reported at fair value through profit or loss. The group maintains a hedged position as far as interest rate risk is concerned, in accordance with its ALM policy. The fair value gains can thus be primarily attributed to a combination of the passing of time, maturities, as well as credit spread movements on both financial assets and liabilities.

In arriving at fair values for financial assets and liabilities, the group uses observable market data at balance sheet date as direct input into the Quantum system for listed securities. For unlisted securities that make up most of the advances portfolio, the group obtains, where possible, observable market data, including details of recent transactions concluded in the open market as well as professional estimates and judgements of the credit spread movements of unlisted securities. These estimates and professional judgements are subjected to external audit and the market value verification committee for review and approval. The approved data are used as input in generating the fair values of unlisted securities, using discounted cash flow techniques.

Owing to the volatility brought to the income statement by the fair value adjustments, a sensitivity analysis was performed, where credit spreads were increased by 25 basis points on the advances and kept constant on the liabilities, to illustrate the sensitivity of the portfolio to credit spread movements. In the event of such a scenario, the result would be a negative unrealised fair value adjustment before tax of R49 million. At balance sheet date, the advances portfolio was most sensitive in the INCA credit rating category 2 (CAT 2) (A- to A+) for a 25 basis point increase in credit spreads. Based on the scenario mentioned above, 37% of the fair value adjustment of R49 million was attributable to CAT 2 advances, where most of tier 2 municipalities and state-owned entities are included. Additional information is disclosed in note 22.8 of the annual financial statements.

The group's strategy of keeping a tight control over operational costs has continued to bear satisfactory results in the year under review. During the year, a revised staff incentive scheme was implemented, retrospectively with effect from 01 July 2004. The scheme was accounted for in accordance with IAS19 Employee Benefits. The total expenditure, excluding the provision for the staff incentive scheme amounted to R33,7 million (2005: R37 million). The 9% saving is a direct result of the group's operations being streamlined, including bringing operations previously performed in subsidiaries into the company. The cost-to-income ratio, as reported, includes the staff share appreciation rights costs, reflecting a deterioration when compared to the 42,9% reported in 2005. Excluding the staff share appreciation rights costs, the efficiency ratio would be 35,9%.

The group's balance sheet size reduced significantly mainly because of the redemption of IN02, with a nominal value of R1,7 billion, as well as advances primarily funded by the proceeds of the IN02 bond. Also, subordinated liabilities of R80 million were repaid on 30 June 2006.

During the year under review, the group continued to generate positive cash flows, which increased with 16% over the previous year to R73,6 million.

Looking ahead, the group will continue improving its accounting policies and implementing new financial reporting requirements introduced but not yet due for implementation by INCA. Further challenges in the forthcoming financial year in terms of getting internal processes geared up for compliance with the new accounting statements, such as IFRS 7 can be anticipated. In these financial statements INCA has, to some extent, expanded its disclosure in preparation for the new accounting statements applicable in the 2007 financial year.



**Reggie Boqo**  
Chief Financial Officer

# *Corporate* GOVERNANCE

## INTRODUCTION

Since inception, the company has maintained a high level of corporate discipline and transparency. The 2005/6 financial year was no exception. The directors endorsed the King Code of Corporate Practices and Governance (“the code”) as set out in the first and second King Reports.

The directors, who include non-executive shareholder representatives, executive directors and non-executive independent directors, specifically reports on the following matters:

## FINANCIAL STATEMENTS

It is the directors’ responsibility to prepare financial statements that fairly present the financial position of the group, its operations and cash flows. The independent external auditors are responsible for independently reviewing and reporting on these financial statements.

The annual financial statements set out in this report have been prepared by management in accordance with International Financial Reporting Standards. Management have consistently applied appropriate accounting policies supported by reasonable and prudent judgments and estimates in preparing the financial statements.

## BOARD OF DIRECTORS

The board of directors retains full and effective control over the group, monitors executive management and ensures that any decisions on material matters are subject to board approval.

All directors are entitled to have access to, and the advice of, the company secretary. In addition, directors are entitled to seek independent professional advice about the group’s affairs at the expense of the specific company on which advice is sought.

The company has appointed two non-executive independent directors to provide a measure of balance and independence to the board.

Details of executive and non-executive directors are provided on page 8 of this report.

## AUDIT COMMITTEE

The Audit Committee is composed of the chief executive officer, the chief financial officer and four non-executive directors (one of whom acts as chairperson). The external auditors attend meetings of this committee by invitation. External auditors are responsible for reporting on the fair presentation of the financial statements, the application of accounting policies, the effectiveness of risk management processes, management information systems and other systems of internal control.

The external auditors are appointed each year by the shareholders based on the recommendations of the audit committee.

## CREDIT COMMITTEE

The primary responsibility of the credit committee is to control the extent of credit exposure to any entity or related group of entities. This committee has standard scheduled meetings that take place twice a month. The credit committee consists of the chief executive officer and four non-executive directors, one of whom acts as chairperson of the committee.

Credit approvals must be carried unanimously, effectively giving any member of the credit committee a veto.

Decisions on credit exposures of less than R5 million, or increases of 10% in existing exposures, have been delegated to the chief executive officer, who approves these exposures after consultation with the executive.

## ASSET LIABILITY COMMITTEE (“ALCO”)

INCA’s ALCO meets quarterly and is chaired by a non-executive director, with two further non-executive directors, the chief executive officer and the executive director Treasury serving on the committee. The chief financial officer also attends all committee meetings.

The mandate of the committee is to ensure that liquidity risks, interest rate risks and currency risks for the group are identified, measured, managed and appropriately reported in a prudent fashion. The company’s funding strategy is also tabled at the quarterly ALCO meetings.

## INTERNAL AUDIT

Given the number of permanent staff employed by the company, a decision to utilise external expertise to perform an internal audit function was implemented during the year. The audit programme implemented by these external experts focuses on key business risk aspects to ensure that the main risk factors are closely monitored. This programme is submitted to the audit committee for its perusal and approval.

## MARKET VALUE VERIFICATION COMMITTEE

This committee was convened for the first time in 2004. The committee was established to address market valuation issues emanating from the implementation of IAS39. The committee consists of at least three non-executive directors and the chief executive officer. A member is drawn from credit, audit and ALCO committees.

The committee meets twice a year before the finalisation of interim and annual financial statements, and has done so in January and July.

The committee is mandated with the responsibility of:

- Reviewing and approving management's procedure of generating discount rates for use in determining fair values of non-listed assets and liabilities.
- Ensuring that the abovementioned procedure is properly documented and is applied on a consistent basis.
- Ensuring that any change required to the procedure (due to changes in market conventions, benchmarks, the passing of time, the use of new instruments etc) has been considered and implemented appropriately.
- Ensuring that any subjectivity within the procedure is kept to a minimum.
- Ensuring that the application of the procedure, as approved, has been audited by the external auditors.

## HUMAN RESOURCES COMMITTEE

Four non-executive directors as well as the chief executive officer serve on the human resources committee. This committee is responsible for ensuring that:

- labour legislation is complied with;
- INCA staff remuneration is comparable with other institutions;
- key staff are retained;
- INCA upholds and supports the principle of equity in the work place; and
- succession planning is adequate to support continuing operations.

## EMPLOYMENT EQUITY

The INCA Group is strongly committed to empowering all staff at all levels within the group and providing them with the necessary training and support to ensure that they are capable of achieving their highest aspirations.

A key driver behind the staff appointment process is ensuring that the staff composition will ultimately mirror the demographics of the country. Significant progress has been made in this regard at all levels within the group.

INCA's internship programme has continued to provide members of previously disadvantaged communities with the opportunity to enter the financial sector and gain work experience. Three interns were accepted on the programme in February 2006.

## INTERNAL CONTROL

The directors have the responsibility for maintaining an effective system of internal control, which provides reasonable assurance of effective and efficient operations and internal financial control.

Risk management is dealt with within an integrated approach by the chief executive officer and the executive team, with regular reporting to the responsible sub-committees of the board of directors.

## GOING CONCERN

The annual financial statements are prepared on a going concern basis and nothing has come to the attention of the board or management to indicate that the company or its subsidiaries will not remain a going concern.



# a Glimpse OF WHAT HAS BEEN

- In 1997, INCA issued the second corporate bond on the Bond Exchange of South Africa. Today, the number of corporate bond issuers totals more than 35.
- In 1999, INCA stepped into the vacuum in private-sector funding to municipalities, completing a municipal asset swap transaction with Sanlam Investment Managers, valued at R1 370 million. In 2004 INCA concluded a similar transaction with the PIC, valued at R508 million. Today, nearly all banks and life officers are willing to lend to municipalities again.
- In 2002, INCA was named the Best Non-Listed Company in South Africa.
- In 2003, INCA decided to report its assets and liabilities at “fair value”, including its non-listed municipal assets.
- In 2004, INCA was the overall winner of the Johannesburg Business of the Year competition, sponsored by the Beeld and the GJCC.
- In May 2004, Kagiso became the single biggest shareholder (43,96%) in INCA.
- In its 10 years of existence, INCA has lent more than R8 000 million to infrastructure providers and mobilised nearly R2 000 million in international loan-funding for municipal infrastructure.
- In early 2006, INCA had R5 402 million worth of bonds listed on the Bond Exchange of South Africa.
- Since inception, INCA has fully redeemed R2 400 million in bonds issued to the market.
- The INCA Capacity Building Fund has acted as a change agent and has played a major role in the training of municipal officials. The Fund has also taken a practical approach to municipalities responding to the impact of HIV/AIDS.

—FINANCIAL STATEMENTS 2006—  
INFRASTRUCTURE FINANCE CORPORATION LIMITED



A CONTINUOUS CHALLENGE  
TO MAKE FINANCIAL STATEMENTS

*understandable & transparent*

TO ALL OUR STAKEHOLDERS

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## DIRECTORS' RESPONSIBILITY STATEMENT

The directors are responsible for the financial statements and the integrity of the information included in this annual report. The financial statements are prepared in all material respects in accordance with International Financial Reporting Standards. The financial statements are based on the appropriate accounting policies that are consistently applied, except as otherwise stated, and supported by reasonable and prudent judgements and estimates.

The directors believe that the group will be a going concern in the year ahead. Based on this belief, the group annual financial statements are prepared on a going-concern basis.

The controls throughout the group are directed towards risk areas. These areas are identified by management and include risk-based systems of accounting and administrative controls. All controls relating to critical risk areas are closely monitored by management and the board.

The external auditors are responsible for reporting on the fair presentation of the annual financial statements.

The directors report that the group's internal financial controls are designed to provide reasonable assurance as to the integrity and reliability of the annual financial statements, to adequately safeguard, verify and maintain accountability of assets and to prevent and detect material fraudulent financial reporting. Such controls are based on written policies and procedures. They are implemented by trained, skilled personnel with an appropriate segregation of duties, and are monitored throughout the group. All employees are required to maintain the highest ethical standards and the group's business practices are required to be conducted in a manner, which is above reproach.

Nothing has come to the attention of the directors to indicate that any material breakdown in the functioning of these internal financial controls occurred during the period.

The financial statements which appear on pages 28 to 66 were considered by the audit committee on 14 September 2006 and subsequently approved by the board of directors on 29 September 2006 and are signed on its behalf by:

**JJ Njeke**  
Chairman: Audit Committee

**AJ van Zyl**  
Chief Executive Officer

## CERTIFICATE BY THE COMPANY SECRETARY

2005 – 2006

In terms of Section 268G(d) of the Companies Act, 61 of 1973, as amended, I certify that, to the best of my knowledge and belief, the company has lodged with the Registrar of Companies, for the financial year ended 30 June 2006, all such returns as are required by a public company in terms of the Companies Act, and that all such returns are, to the best of my knowledge and belief, true, correct and up to date.

**VS Ndlovu**  
Company Secretary  
Attorney of the High Court of the Republic of South Africa BA LLB

29 September 2006



## INDEPENDENT AUDITOR'S REPORT

### TO THE MEMBERS OF INFRASTRUCTURE FINANCE CORPORATION LIMITED

We have audited the annual financial statements and group financial statements of Infrastructure Finance Corporation Limited that are set out on pages 28 to 66 for the year ended 30 June 2006. These financial statements are the responsibility of the company's directors. Our responsibility is to express an opinion on these financial statements based on our audit.

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 includes also assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the company and of the group at 30 June 2006 and the results of their operations and cash flows for the year then ended, in accordance with International Financial Reporting Standards and in the manner required by the Companies Act of South Africa.

**DELOITTE & TOUCHE**

Per Babalwa Ngonyama  
Partner

29 September 2006



## DIRECTORS' REPORT

### NATURE OF BUSINESS

Infrastructure Finance Corporation Limited (INCA or "the company") is a public company incorporated in the Republic of South Africa.

INCA's main business remains that of providing largely unsecured debt finance to infrastructure providers and the providers of services normally rendered by the public sector. The financing of movable assets that do not fall within the domain of consumables became more prevalent this year.

### OPERATING RESULTS

The group reflected net profits after tax of R174 million on a fair value basis (2005: R70 million) and the company returned net profits after tax of R171 million (2005: R68 million) for the 2006 financial year. The reported fair values incorporated independent market information and transparent pricing where available. In addition, and consistent with the previous reporting periods, in the case of valuations of advances where no transparent market pricing exists, management applied discounted cash flow valuation techniques using internally-generated historical data, recent transaction data, experienced judgment and market comparisons. The processes followed to determine fair value are the specific focus areas of the Market Value Verification Committee.

### ADOPTION OF IFRS

The group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). These are the group's first consolidated financial statements in accordance with IFRS. The adoption of IFRS has not had a significant impact on the group's financial results.

### AUTHORISED AND ISSUED SHARE CAPITAL

The company's authorised and issued share capital remained unchanged in the period under review (2005: no change). Details of the authorised and issued share capital appear in note 12 of the annual financial statements.

### SUBORDINATED LIABILITIES

At 30 June 2006, R80 million of subordinated debt raised in the market in 1999 and 2000 matured and was redeemed in full. The fair value of the total subordinated liabilities in issue at financial year end amounted to R101 million (2005: R181 million) and the maturity date of these subordinated liabilities is 2011.

### DIVIDENDS

A dividend of R25 million (2005: R25 million) was declared, of which R23 764 000 (net of dividend to share trust) was distributed to shareholders in September 2005. A dividend payment of R25 million was proposed by management and approved by the board and the shareholders on 29 September 2006 and will be paid to shareholders.

### DIRECTORS

The following changes to the board of directors occurred during the year under review and up to the date of publishing this report:

	<b>Position as director</b>
W Stals resigned on 09 March 2006	Non-executive director
J Matlala appointed on 09 March 2006	Non-executive director
E Molobi passed away on 04 June 2006	Chairman Non-executive director

### SECRETARY AND REGISTERED OFFICE

The address of the secretary, VS Ndlovu, and of the registered office of the company is recorded on the inside back cover of this report.



## SUBSIDIARY COMPANIES

INCA's 100% holding of the issued shares in INCA Bond Rehabilitation Company (Proprietary) Limited and INCA Asset Finance did not change during the period under review. Details relating to INCA's subsidiary companies are reflected in note 4 of the financial statements. The interest of INCA in the after tax profits of its subsidiary companies for the year is R6 576 000 (2005: R4 980 000).

## OWNERSHIP OF COMPANY

	PERCENTAGE HOLDING	
	30 June 2006 R'000	30 June 2005 R'000
Chanson Investment Holdings (Pty) Ltd	2,00	2,00
Dexia Credit Local	4,42	4,42
FirstRand Bank Limited	17,68	17,68
INCA Share Incentive Trust*	4,95	4,95
Momentum Group Limited (FutureGrowth Portfolio)	26,98	26,98
Proparco	0,01	0,01
Kagiso Financial Services Limited	43,96	43,96
	<b>100,00</b>	<b>100,00</b>

As reflected above, shareholdings in the company did not change during the year.

### \*INCA SHARE INCENTIVE TRUST

It was decided to make the previous staff share scheme paid up and the scheme was closed effective 30 June 2004. A newly revised staff incentive scheme was introduced during the current financial year to apply retrospectively with effect from 01 July 2004. The details of the revised staff incentive scheme are disclosed on note 9.1. A total of 42 007 (2005: 42 007) INCA ordinary shares are currently held by the INCA Share Incentive Trust. Members of the HR committee are trustees of the INCA Share Incentive Trust and VS Ndlovu is the compliance officer.

## BORROWING POWERS

The company has unlimited borrowing powers.

## SUBSEQUENT EVENTS

On 31 August 2006 INCA issued R200 million in senior notes maturing 31 August 2007. There were no other events subsequent to period end which would impact on the reported figures.



## BALANCE SHEETS

as at 30 June 2006

	Notes	GROUP		COMPANY	
		30 June 2006 R'000	30 June 2005 R'000	30 June 2006 R'000	30 June 2005 R'000
<b>ASSETS</b>					
Cash and short-term funds	2	154 965	425 407	141 979	390 898
Other assets	3	146 440	127 658	144 437	142 056
South African Revenue Services		17 235	6 638	16 821	6 224
Investments	4	886 236	1 376 274	920 834	1 343 871
Derivative financial instruments	10	59 471	102 096	59 471	109 055
Advances	5	5 362 183	6 514 449	5 309 083	6 401 532
Equipment	6	1 021	1 399	997	1 061
<b>Total assets</b>		<b>6 627 551</b>	<b>8 553 921</b>	<b>6 593 622</b>	<b>8 394 697</b>
<b>EQUITY AND LIABILITIES</b>					
Share capital	12	807	807	849	849
Share premium	13	99 057	99 057	105 988	105 988
Retained earnings		390 658	240 288	367 288	221 590
		490 522	340 152	474 125	328 427
<b>Minority interest</b>	11	–	–		
<b>Total equity</b>		<b>490 522</b>	<b>340 152</b>	<b>474 125</b>	<b>328 427</b>
Subordinated liabilities	7	100 786	180 540	100 786	180 540
Long-term liabilities	8	5 671 239	7 211 528	5 671 239	7 078 555
Accounts payable and other liabilities	9	232 548	597 809	218 844	585 908
South African Revenue Services		616	303	–	–
Derivative financial instruments	10	60 152	214 413	60 152	214 413
Deferred taxation	18.3	71 688	9 176	68 476	6 854
<b>Total liabilities</b>		<b>6 137 029</b>	<b>8 213 769</b>	<b>6 119 497</b>	<b>8 066 270</b>
<b>Total equity and liabilities</b>		<b>6 627 551</b>	<b>8 553 921</b>	<b>6 593 622</b>	<b>8 394 697</b>

Approximate rates of exchange ruling at the end of the period:

USD 1 = ZAR 7,1500 (2005 – USD 1 = ZAR 6,6830)

EUR 1 = ZAR 9,1248 (2005 – EUR 1 = ZAR 8,0825)



## INCOME STATEMENTS

for the year ended 30 June 2006

	Notes	GROUP		COMPANY	
		2006 R'000	2005 R'000	2006 R'000	2005 R'000
Interest and similar income	14	<b>1 038 256</b>	963 386	<b>1 012 512</b>	930 615
Interest expense and similar charges	15	<b>985 824</b>	902 799	<b>968 340</b>	879 764
<b>Net interest income</b>		<b>52 432</b>	60 587	<b>44 172</b>	50 851
Impairment on lease receivables and advances	5.8	<b>762</b>	5 342	<b>1 285</b>	3 920
<b>Net interest income after impairment</b>		<b>51 670</b>	55 245	<b>42 887</b>	46 931
Fair value gains – realised	16.1	<b>41 204</b>	34 112	<b>41 237</b>	33 010
– unrealised	16.2	<b>179 072</b>	47 081	<b>173 321</b>	47 145
Fee and other income		<b>1 031</b>	1 830	<b>2 583</b>	2 518
Negative goodwill		–	316	–	–
<b>Net income before operating expenditure</b>		<b>272 977</b>	138 584	<b>260 028</b>	129 604
Operating expenditure	17	<b>41 374</b>	41 560	<b>33 560</b>	36 272
<b>Profit before taxation</b>		<b>231 603</b>	97 024	<b>226 468</b>	93 332
Taxation	18	<b>57 471</b>	26 423	<b>55 770</b>	25 114
<b>Profit for the year</b>		<b>174 132</b>	70 601	<b>170 698</b>	68 218
<b>Attributable to:</b>					
Equity holders of the parent		<b>174 132</b>	70 316	<b>170 698</b>	68 218
Minority interest		–	285	–	–
		<b>174 132</b>	70 601	<b>170 698</b>	68 218
Earnings per share (cents)	24	<b>21 590</b>	8 718		
Dividend per share (cents)		<b>2 946</b>	2 946		



## STATEMENTS CHANGES IN EQUITY

for the year ended 30 June 2006

	Share capital R'000	Share premium R'000	Retained earnings R'000	Total equity R'000
<b>GROUP</b>				
Balance at 30 June 2004	807	99 057	193 736	293 600
Dividend paid net of dividend to Share Trust	–	–	(23 764)	(23 764)
Profit for the year <sup>(1)</sup>	–	–	70 316	70 316
<b>Balance at 30 June 2005</b>	<b>807</b>	<b>99 057</b>	<b>240 288</b>	<b>340 152</b>
Dividend paid net of dividend to Share Trust	–	–	(23 762)	(23 762)
Profit for the year	–	–	174 132	174 132
<b>Balance at 30 June 2006</b>	<b>807</b>	<b>99 057</b>	<b>390 658</b>	<b>490 522</b>
<b>COMPANY</b>				
Balance at 30 June 2004	849	105 988	178 372	285 209
Dividend for 2004	–	–	(25 000)	(25 000)
Profit for the year	–	–	68 218	68 218
<b>Balance at 30 June 2005</b>	<b>849</b>	<b>105 988</b>	<b>221 590</b>	<b>328 427</b>
Dividend for 2005	–	–	(25 000)	(25 000)
Profit for the year	–	–	170 698	170 698
<b>Balance at 30 June 2006</b>	<b>849</b>	<b>105 988</b>	<b>367 288</b>	<b>474 125</b>

<sup>(1)</sup> Represents profit for the year attributable to equity holders of the parent



## CASH FLOW STATEMENTS

for the year ended 30 June 2006

	Notes	GROUP		COMPANY	
		2006 R'000	2005 R'000	2006 R'000	2005 R'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Cash receipts from borrowers and customers	A.1	782 255	746 041	768 339	720 475
Cash paid to lenders, employees and suppliers	A.2	(1 007 469)	(912 309)	(982 211)	(884 123)
Cash receipts from investments and cash balances	A.3	298 797	229 903	288 190	223 227
Cash generated by operations	A.6	73 583	63 635	74 318	59 579
Normal taxation paid	A.4	(3 433)	(28 187)	(2 936)	(25 003)
Secondary taxation on companies paid		(1 809)	(973)	(1 809)	(973)
Dividends paid	A.5	(23 762)	(23 764)	(25 000)	(25 000)
<b>CHANGES IN OPERATING FUNDS</b>					
Decrease/(increase) in income earning assets	A.7	1 288 081	(878 691)	1 169 223	(900 301)
Increase in non-income earning assets	A.8	(18 782)	(7 955)	(2 381)	(29 860)
(Decrease)/increase in accounts payable and other liabilities	A.9	(1 584 002)	893 420	(1 459 812)	959 430
Net change in operating funds		(314 703)	6 774	(292 970)	29 269
Cash (utilised by)/inflows from operating activities		(270 124)	17 485	(248 397)	37 872
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Purchase of equipment		(340)	(925)	(522)	(851)
Proceeds from sale of equipment		22	–	–	–
Cash flows utilised by investing activities		(318)	(925)	(522)	(851)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Purchase of minority shareholders shares		–	(203)	–	(203)
Cash flows utilised by financing activities		–	(203)	–	(203)
Net (decrease)/increase in cash and cash equivalents		(270 442)	16 357	(248 919)	36 818
Cash and cash equivalents at the beginning of period		425 407	409 050	390 898	354 080
Cash and cash equivalents at the end of period		154 965	425 407	141 979	390 898



## NOTES TO THE CASHFLOW STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000	2005 R'000	2006 R'000	2005 R'000
<b>A. CASH FLOW INFORMATION</b>				
<b>A.1 Cash receipts from borrowers and customers</b>				
Interest income	756 983	730 646	740 813	704 838
Realised profits on advances	21 408	8 986	21 408	7 884
Fee income	1 101	1 584	2 583	1 035
Add: amortisation of discount income	2 763	4 825	3 535	6 718
Total cash receipts from borrowers and customers	782 255	746 041	768 339	720 475
<b>A.2 Cash paid to lenders, employees and suppliers</b>				
Interest expense	(985 824)	(902 799)	(968 340)	(879 764)
Realised (losses)/profits on long-term liabilities and derivatives	(8 623)	4 334	(8 623)	4 334
Add: amortisation of discount expense	27 726	26 780	27 726	26 780
Total operating expenses	(966 721)	(871 685)	(949 237)	(848 650)
Total cash paid to lenders, employees and suppliers	(40 748)	(40 624)	(32 974)	(35 473)
<b>A.3 Cash receipts from investments and cash balances</b>				
Interest income	263 577	220 383	254 003	213 420
Preference and ordinary dividends	17 696	12 603	17 696	13 840
Realised profits on investments	28 419	20 792	28 452	20 792
Less: amortisation of discount income	(10 895)	(23 875)	(11 961)	(24 825)
Total cash receipts from investments and cash balances	298 797	229 903	288 190	223 227
<b>A.4 Normal taxation paid</b>				
Amounts due at the beginning of the year	6 638	2 560	6 224	3 317
Income statement charge	(2 585)	(24 109)	(2 088)	(22 096)
Under deduction from prior year	9 749	–	9 749	–
Amounts due at the end of the year	(17 235)	(6 638)	(16 821)	(6 224)
Normal tax paid	(3 433)	(28 187)	(2 936)	(25 003)
<b>A.5 Dividends paid</b>				
Amounts unpaid at the beginning of the year	–	–	–	–
Dividend	(23 762)	(23 764)	(25 000)	(25 000)
Amounts unpaid at the end of the year	–	–	–	–
Dividends paid	(23 762)	(23 764)	(25 000)	(25 000)



## NOTES TO THE CASHFLOW STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000	2005 R'000	2006 R'000	2005 R'000
<b>A.6 Reconciliation of income before tax to cash generated by operations</b>				
Profit before taxation	231 603	97 024	226 468	93 332
Non-cash charges:				
Depreciation	626	934	586	799
Impairment losses	762	5 342	1 285	3 920
Amortisation of discount income	(8 132)	(19 050)	(8 426)	(18 107)
Amortisation of discount expense	27 726	26 780	27 726	26 780
Revaluation of investments and advances	361 593	(500 207)	353 404	(497 265)
Revaluation of subordinated debt and long-term liabilities	(425 175)	417 014	(418 202)	417 069
Revaluation of derivative financial instruments	(1 15 572)	36 196	(108 612)	33 135
Revaluation of repurchase agreements	81	(82)	89	(84)
Loss on disposal of equipment	70	–	–	–
Negative goodwill	–	(316)	–	–
Cash generated by operations	73 583	63 635	74 318	59 579
<b>A.7 Decrease/(increase) in income earning assets</b>				
Investments	490 038	(537 319)	423 037	(530 617)
Advances	1 152 266	(855 293)	1 092 449	(881 136)
Add: amortisation of discount income	8 132	19 050	8 426	18 107
Revaluation of advances and investments	(361 593)	500 213	(353 404)	497 265
Impairment on advances	(762)	(5 342)	(1 285)	(3 920)
Net decrease/(increase) in income earning assets	1 288 081	(878 691)	1 169 223	(900 301)
<b>A.8 Decrease/(increase) in non-income earning assets</b>				
Accrued interest	54 835	(17 453)	54 323	(17 660)
Decrease/(increase) in other debtors	(73 617)	9 505	(56 704)	(12 200)
Revaluation of other assets	–	(7)	–	–
Net increase in non-income earning assets	(18 782)	(7 955)	(2 381)	(29 860)
<b>A.9 (Decrease)/increase in accounts payable and other liabilities</b>				
(Decrease)/increase in long-term liabilities and derivative financial instruments	(1 651 925)	1 234 858	(1 511 993)	1 287 686
Add: amortisation of discount expense	(27 726)	(26 780)	(27 726)	(26 780)
Revaluation of long-term liabilities and derivative financial instruments	533 718	(443 866)	519 778	(440 805)
(Decrease)/increase in subordinated liabilities	(79 754)	109 315	(79 754)	109 315
Revaluation of subordinated liabilities	6 947	(9 315)	6 947	(9 315)
(Decrease)/increase in accounts payable	(365 262)	29 208	(367 064)	39 329
Net (decrease)/increase in accounts payable and other liabilities	(1 584 002)	893 420	(1 459 812)	959 430



# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

## **I. ACCOUNTING POLICIES**

The group adopts the following accounting policies in preparing its consolidated financial statements.

### **I.1 Basis of presentation**

The group's consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB, and the requirements of the South African Companies Act. These are the group's first consolidated financial statements prepared in accordance with IFRS. In prior years the group's consolidated financial statements were prepared in accordance with South African Statements of Generally Accepted Accounting Practice (SA GAAP). There has been no significant changes in the financial statements due to the conversion from SA GAAP to IFRS.

At the date of authorisation of these financial statements, the following relevant Standard was in issue but not yet effective:

- IFRS7, Financial Instruments: Disclosure

The directors anticipate that the adoption of this Standard in future periods will have no material impact on the financial statements of the group, other than for significant additional disclosure.

The financial statements are prepared on the fair value basis except for equipment and lease receivables that are stated at cost.

### **I.2 Consolidation**

The consolidated financial statements include the assets, liabilities and results of the operations of the holding company and its subsidiaries. Subsidiaries are companies in which the group, directly or indirectly, has a long-term interest and the power to exercise control over the operations.

The group uses the purchase method of accounting to account for the acquisition of subsidiaries. Subsidiaries are consolidated from the date on which the group acquires effective control. Consolidation is discontinued from the effective date of disposal. The group recognises assets and liabilities acquired in its balance sheet at their estimated fair values at the date of acquisition. It eliminates all intercompany transactions, balances and unrealised surpluses and deficits on transactions between group companies.

### **I.3 Revenue recognition**

#### **I.3.1 Interest income and expense**

The group recognises interest income and expense on an accrual basis in profit or loss using the effective interest method taking into account the expected timing and amount of cash flows. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or expense over the relevant period. Interest income and expense include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis.

#### **I.3.2 Fair value gains and losses (realised and unrealised)**

The group includes gains, losses and fair value adjustments on financial instruments, both realised and unrealised, in income as earned.

#### **I.3.3 Fee and other income**

The group recognises fee and other income on an accrual basis when the service is rendered to clients and the amount of revenue from the transaction or service can be reliably measured. The group recognises revenue for services rendered to customers based on the estimated outcome of the transactions. When the outcome can be reliably estimated, transaction revenue is recognised by reference to the stage of completion of the transaction at the balance sheet date. The stage of completion is measured based on the amount of work performed. When the outcome cannot be reliably estimated, revenue is recognised only to the extent of the expenses incurred that are recoverable.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

### 1.3.4 Dividends

The group recognises dividends on the date of declaration for unlisted shares. Dividend income includes scrip dividends, irrespective of whether there is an option to receive cash instead of shares.

### 1.4 Foreign currency transactions

The group converts transactions in foreign currencies to South African Rand at the spot rate on the transaction date. Monetary assets and liabilities in foreign currencies are translated to South African Rand using the rates of exchange ruling at the balance sheet date. Exchange differences on monetary financial assets and liabilities measured at fair value are included in the income statement for the year.

### 1.5 Direct and indirect taxation

Direct taxes include South African jurisdiction corporate tax payable, as well as secondary tax on companies (STC) and capital gains tax.

The charge for current tax is based on the results for the year as adjusted for items, which are non-taxable or disallowed. It is calculated using taxation rates that have been enacted or substantively enacted by the balance sheet date.

STC credits are recognised as an asset.

### 1.6 Recognition of assets, liabilities and provisions

#### 1.6.1 Assets

The group recognises assets when it obtains control of a resource as a result of past events, and from which future economic benefits are expected to flow to the enterprise.

#### 1.6.2 Contingent assets

The group discloses a contingent asset where, as a result of past events, it is highly likely that economic benefits will flow to it, but this will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events which are not wholly within the group's control.

#### 1.6.3 Liabilities and provisions

The group recognises liabilities, including provisions when:

It has a present legal or constructive obligation as a result of past events, and

- It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
- A reliable estimate of the amount of the obligation can be made.

#### 1.6.4 Contingent liabilities

The group discloses a contingent liability where:

- It has a possible obligation arising from past events, the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise, or
- It is not probable that an outflow of resources will be required to settle an obligation, or
- The amount of the obligation cannot be measured with sufficient reliability.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

### 1. ACCOUNTING POLICIES *(continued)*

#### 1.6.5 Sale and repurchase agreements

The group financial statements reflect securities sold subject to a linked repurchase agreement ("repos") or investment stock. These instruments are measured at fair value, with changes in fair value reported in the income statement. The counterparty liability is included in long-term liabilities at fair value on the balance sheet date.

Securities purchased under agreements to resell ("reverse repos") are recorded in other assets. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

The group recognises all sale and repurchase agreements on trade date.

#### 1.7 Offsetting financial instruments

The group offsets financial assets and liabilities and reports the net balance in the balance sheet where:

- There is a legally enforceable right to set off, and
- There is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously, and
- The maturity date for the financial asset and liability is the same, and
- The financial asset and liability is denominated in the same currency.

#### 1.8 Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprise:

- Coins and bank notes, and
- Money at call and short notice.

#### 1.9 Financial instruments

Financial instruments carried on the balance sheet include all assets and liabilities, including derivative instruments, but exclude investments in subsidiary and associated companies, fixed assets, deferred taxation, taxation payable, finance lease receivables and intangible assets. Financial Instruments are accounted for in accordance with IAS39, Financial Instruments: Recognition and Measurement and IA32, Financial Instruments: Disclosure and Presentation.

##### 1.9.1 Initial recognition and measurement

The group recognises financial instruments on the balance sheet when it becomes a party to the contractual provisions of a financial instrument. Financial assets that require delivery within the time frame established by regulation or market convention are recognised at trade date, which is the date on which the group commits to purchase the asset. Transactions that are not considered to have a market convention delivery date are treated as derivatives until settlement takes place.

Financial instruments are initially recognised at fair value plus, in the case of a financial asset or financial liability not designated at fair value through profit or loss, transaction costs that are incremental to the group and directly attributable to the acquisition or issue of the financial asset or financial liability.

##### 1.9.2 Subsequent measurement

Financial instruments are measured at fair value:

- Financial assets and financial liabilities at fair value through profit or loss

Financial instruments at fair value through profit or loss consist of derivative financial instruments and instruments that the group has elected, on initial recognition date, to designate as fair value through profit or loss.

The groups derivative transactions include foreign exchange contracts, interest rate and currency swaps.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

Financial assets and financial liabilities that the group has elected, on initial recognition date, to designate as at fair value through profit or loss are those that meet any one of the following criteria:

- Where fair value through profit or loss designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from using different bases to measure and recognise the gains and losses on financial assets and financial liabilities; or
- The instrument forms part of a group of financial instruments that is managed, evaluated and reported on using a fair value basis in accordance with a documented risk management or investment strategy; or
- The financial instrument contains an embedded derivative, which significantly modifies the cash flows of the host contract or where the embedded derivative would clearly require separation.
- Financial assets and financial liabilities at fair value through profit or loss are measured at fair value, with fair value gains or losses reported in fair value adjustments as they arise. Impairment losses calculated on the amortised cost basis are recognised in the income statement in impairment losses on lease receivables and advances. The majority of the group's financial assets and financial liabilities are classified as at fair value through profit or loss.

### 1.9.3 Lease and other receivables

Lease and other receivables are non-derivative financial assets with fixed or determinable cash flows that are not quoted in an active market. Financial assets classified as lease and other receivables are carried at amortised cost, with the interest revenue recognised in the income statement.

### 1.9.4 Embedded derivatives

Certain derivatives embedded in other financial and non-financial instruments are treated as separate derivatives and recognised on a standalone basis, 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 profit or loss. If it is not possible to determine the fair value of the embedded derivative, the entire hybrid instrument is categorised as at fair value through profit or loss and measured at fair value, with changes in fair value being recognised in profit or loss.

### 1.9.5 Measurement basis of financial instruments

- Amortised cost

Amortised-cost financial assets and financial liabilities are measured at fair value on initial recognition, plus or minus the cumulative amortisation of discount or premium using the effective interest rate method of any difference between the initial amount and the maturity amount, less any cumulative impairment losses.

- Fair value

Direct and incremental transactions cost are included in the initial fair value of financial assets and financial liabilities, other than those at fair value through profit or loss. The best evidence of the fair value of a financial asset or financial liability at initial recognition is the transaction price, unless the fair value of the instrument is evidenced by comparison with other current observable market transactions in the same instrument or based on a valuation technique whose variables include mainly market observable data.

Where quoted market prices or rates are available, such market data is used to determine the fair value of financial assets and financial liabilities that are measured at fair value. Bid-offer prices are used to measure fair value of financial assets and financial liabilities except for the listed instruments.

Where quoted prices are not available, the fair value of financial assets and financial liabilities is estimated using the discounted cash flow techniques. The future cash flows are based on the contractual agreements and the discount rate used is a market-related rate at the balance sheet date for an instrument with similar terms and conditions.



# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

## I. ACCOUNTING POLICIES (continued)

### 1.9.6 Derecognition of financial instruments

All financial assets and financial liabilities are derecognised on trade date, which is when the group commits to selling a financial asset or redeeming a financial liability. The group derecognises a financial asset when and only when:

- The contractual rights to the cash flows arising from the financial asset have expired or have been forfeited by the group; or
- It transfers the financial asset, including substantially all the risks and rewards of ownership of the asset; or
- It transfers the financial asset, neither retaining nor transferring substantially all the risks and rewards of ownership of the asset, but no longer retains control of the asset.

The group derecognises a financial liability when and only when the liability is extinguished. (when the obligation specified in the contract is discharged, cancelled or has expired)

### 1.9.7 Impairment of financial assets and lease receivables

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

- A breach of contract, such as a default or delinquency in interest or principal payments;
- Significant financial difficulty of the issuer or obligor;
- It becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- The group, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the group would not otherwise consider;
- The disappearance of an active market for that financial asset because of financial difficulties;
- Observable data indicating that there is 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.

#### Financial assets carried at amortised cost

If there is objective evidence that an impairment loss 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 lease receivables original effective interest rate.

The group first assesses whether there is objective evidence of impairment individually for lease receivables that are individually significant, and individually or collectively for lease receivables that are not individually significant. If the group determines that there is no objective evidence of impairment for an individually assessed financial asset, whether significant or not, it includes the asset in a group of lease receivables with similar credit risk characteristics and collectively assesses them for impairment.

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 borrower's credit rating), the previously recognised impairment loss is reversed by adjusting the financial asset. The amount reversed will not cause the carrying value of the asset to exceed its carrying value that would have existed had the impairment not been originally recognised. The reversal is recognised in profit or loss for the period.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

### 1.10 Equipment

The group carries property and equipment at cost less accumulated depreciation.

It depreciates equipment on a straight-line basis at rates calculated to reduce the book value of these assets to estimated residual values over their expected useful lives. Management reviews useful lives annually to evaluate their appropriateness and current and future depreciation charges are adjusted accordingly.

The periods of depreciation used are as follows:

Computer equipment	3 – 5 years
Furniture and fittings	3 – 10 years
Motor vehicles	5 years
Office equipment	3 – 6 years

The group impairs an asset to its estimated recoverable amount where there is a permanent diminution in its carrying value. Repairs and maintenance costs are charged to the income statement as they are incurred. Gains or losses on disposals are determined by reference to the carrying amount of the asset and the net proceeds received, and are recognised in the income statement in the period of the disposal.

### 1.11 Intangible assets

#### 1.11.1 Computer software development costs

The group generally expenses computer software development costs in the year incurred. However, where computer software development costs can be clearly associated with a strategic and unique system which will result in a benefit for the group exceeding the costs incurred for more than one accounting period, the group capitalises such costs and recognise them as an intangible asset, subject to the requirements of IAS38, Intangible assets.

The group carries capitalised software assets at cost less amortisation and any impairment losses. It amortises these assets on a straight-line basis at a rate applicable to the expected useful life of the asset, but not exceeding 3 years. Management reviews the carrying value on an annual basis. Carrying value is written down to estimated recoverable amount when a permanent decrease in value occurs. Any impairment is recognised in the income statement when incurred.

#### 1.11.2 Other intangible assets

The group does not attribute value to internally developed trademarks, concessions, patents and similar rights and assets, including franchises and management contracts. It charges costs incurred on trademarks, concessions, patents and similar rights and assets, whether purchased or created by it, to the income statement in the year in which the costs are incurred.

Amortisation of and impairments of intangible assets are reflected under operating expenditure in the income statement.

### 1.12 Deferred taxation

The group calculates deferred taxation on the comprehensive basis using the liability method on a balance sheet based approach. It calculates deferred tax liabilities or assets by applying corporate tax rates to the temporary differences existing at each balance sheet date between the tax values of assets and liabilities and their carrying amount, where such temporary differences are expected to result in taxable or deductible amounts in determining taxable income for future periods when the carrying amount of the assets or liabilities are recovered or settled.

The group recognises deferred tax assets if the directors of the company consider it probable that future taxable income will be available against which the unused tax losses and deductible temporary differences can be used. Temporary differences arise primarily from unrealised fair value adjustments and prepaid expenses.



# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

## **I. ACCOUNTING POLICIES** *(continued)*

### **I.13 Employee benefits**

#### **I.13.1 Post-employment benefits**

The group contributes to a defined contribution scheme for the benefit of all employees. Employees are responsible for their own retirement planning and as such are members of various South African Pension and Provident Fund Schemes. These funds are registered in terms of the Pension Funds Act, 1956. The group does not administer any Pension Fund Scheme and has no obligation in relation to any of the abovementioned funds. The group expenses current service costs in the period in which it is incurred.

#### **I.13.2 Termination benefits**

The group recognises termination benefits as a liability in the balance sheet and as an expense in the income statement when it has a present obligation relating to termination.

#### **I.13.3 Leave pay accrual**

The group recognises in full employees' rights to annual leave entitlement in respect of past service as a liability in the balance sheet and an expense in the income statement.

### **I.14 Related party transactions**

All related party transactions are at arm's length and incurred in the ordinary course of business.

### **I.15 Fiduciary activities**

The group excludes assets and the income thereon, together with related undertakings to return such assets to customers, from these financial statements where it acts in a fiduciary capacity such as nominee, trustee or agent.

### **I.16 Borrowing costs**

Borrowing costs are recognised in profit or loss in the period in which they are incurred.

### **I.17 Key assumptions concerning the future, and key sources of estimation**

In preparing the financial statements the group has assumed certain key sources of estimation in recording various assets and liabilities as set out below:

#### **I.17.1 Fair value through profit or loss**

For valuation methodologies utilised in determining the fair value of financial instruments through profit or loss refer to notes 1.9.2 and 1.9.5

#### **I.17.2 Impairment of lease receivables and advances**

Credit impairment is based on estimation of discounted future cash flows on an asset, where such objective evidence of impairment exists. Refer to note 1.9.7.

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## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000 30 June	2005 R'000 30 June	2006 R'000 30 June	2005 R'000 30 June
<b>2. CASH AND SHORT-TERM FUNDS</b>				
Bank balances	154 965	55 871	141 979	35 150
Call deposits with financial institutions	–	369 536	–	355 748
	<b>154 965</b>	<b>425 407</b>	<b>141 979</b>	<b>390 898</b>
<b>3. OTHER ASSETS</b>				
Accrued interest	59 331	114 166	59 239	113 562
Other debtors	87 109	13 492	85 198	28 494
	<b>146 440</b>	<b>127 658</b>	<b>144 437</b>	<b>142 056</b>
<b>4. INVESTMENTS</b>				
<b>Long-term loans:</b>				
4.1 Rand Merchant Bank International (EIB)	370 721	328 162	370 721	328 162
4.2 Loan to INCA Share Incentive Trust			22 816	22 816
Loan to INCA Capacity Building Fund	58	(46)	58	(46)
4.3. Zero coupon bonds	117 987	120 850	117 987	120 850
Capital market stock	300 684	628 075	300 684	589 940
Old Mutual Credit Linked Notes	–	157 620	–	157 620
<b>Other investments:</b>				
4.4 Preference shares	76 767	59 945	76 767	59 945
<b>Investments in and loans to subsidiaries:</b>				
4.5 – INCA Bond Rehabilitation Company (Proprietary) Limited				
• Investment in ordinary shares			14 000	14 000
• Inter-company loan			(2 476)	3 746
4.6 – INCA Asset Finance (Proprietary) Limited				
Investment in ordinary shares			253	253
• Inter-company loan			23	(243)
4.7 – Infrastructure Finance Corporation Initiative (Proprietary) Limited				
• Investment in ordinary shares			1	1
• Inter-company loan			–	153
<b>Money market investments with other banks:</b>				
• Maturing after 1 month but within 3 months	20 019	34 994	20 000	–
• Maturing after 3 months but within 2 years	–	29 309	–	29 309
4.8 Retentions deposits held	–	17 365	–	17 365
	<b>886 236</b>	<b>1 376 274</b>	<b>920 834</b>	<b>1 343 871</b>

Except for investments in and loans to subsidiaries, the above financial instruments in note 4 are designated at fair value through profit or loss.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

### 4. INVESTMENTS (continued)

- 4.1 INCA received a loan of EUR 40 million from the European Investment Bank. These funds were deposited with and pledged to Rand Merchant Bank International.
- 4.2 The company made an interest free loan, secured by the shares held in the trust, to the INCA Share Incentive Trust to acquire shares in the company. The loan has no fixed terms of repayment.
- 4.3 The zero coupon bonds represent deposits with financial institutions. These investments are partially offset by zero coupon liabilities to municipalities (See note 8.3). The zero coupon bonds have the same maturity date and maturity value as the capital due in respect of bond profile advances made to specific borrowers. On maturity, the proceeds of the zero coupon bonds will be used to settle the principal balance due to INCA by the borrowers.
- 4.4 On 19 April 2002 INCA invested in R57 045 000 in cumulative redeemable preference shares in Metcap 3 (Proprietary) Limited. These shares were redeemed on 30 June 2006. On 29 July 2005 INCA invested in R73 116 000 in non-cumulative redeemable preference shares in Sechold Financial Services (Proprietary) Limited. These shares will be redeemed on 20 March 2017.
- 4.5 The company acquired a one hundred percent interest in INCA Bond Rehabilitation Company (Proprietary) Limited on 09 January 2000. The company is involved in the acquisition of non-investment grade municipal stock in the secondary market, which it will hold until rehabilitated and thereafter such stock will be realised. The issued ordinary capital of the company is R1 000.
- 4.6 On 20 November 2002, Infrastructure Asset Finance (Proprietary) Limited was incorporated and on 13 February 2003, INCA subscribed for 51,000 shares out of a total of 90,000 shares issued (56,7%) at a total cost of R51,000. The company discounts movable asset related rental agreements in the statutory sector.
- INCA acquired the remaining shares from the minority shareholders with effect from 15 December 2004 to increase its shareholding to 100%.
- 4.7 Infrastructure Finance Corporation Initiative (Proprietary) Limited commenced operations in January 2004. The 1,000 shares in issue are all held by INCA who subscribed for the shares at par.
- 4.8 The amount was withheld from service providers in respect of the rental portfolio. This amount is invested on behalf of the third parties and paid out when the service is provided to our clients.
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## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000 30 June	2005 R'000 30 June	2006 R'000 30 June	2005 R'000 30 June
<b>5. ADVANCES</b>				
<b>5.1 Valuation profile</b>				
Advances at fair value	5 073 829	6 264 887	5 019 830	6 150 548
Lease receivables at cost	310 658	271 104	310 658	271 104
Impairment on advances	(22 304)	(21 542)	(21 405)	(20 120)
	<b>5 362 183</b>	<b>6 514 449</b>	<b>5 309 083</b>	<b>6 401 532</b>
The fair value of lease receivables is R318,580,706 (2005: R285,456,000).				
<b>5.2 Maturity profile</b>				
Maturing in 2006	–	976 069	–	949 143
Maturing in 2007 to 2008	211 183	371 730	236 947	366 428
Maturing in 2009 to 2010	659 222	759 265	650 940	750 764
Maturing in 2011	1 311 122	1 351 767	1 249 768	1 286 947
Maturing after 2011	3 180 656	3 055 618	3 171 428	3 048 250
	<b>5 362 183</b>	<b>6 514 449</b>	<b>5 309 083</b>	<b>6 401 532</b>
<b>5.3 Geographic profile</b>				
Eastern Cape	252 431	246 433	250 943	245 091
Free State	131 482	303 846	107 414	275 388
Gauteng	2 195 095	2 722 594	2 189 961	2 677 157
Kwazulu-Natal	919 912	987 084	913 293	980 949
Limpopo Province	86 569	88 832	86 570	83 188
Mpumalanga	394 915	450 221	394 915	450 690
Northern Cape	27 009	740	27 009	505
North West Province	267 332	218 606	249 994	192 471
Western Cape	497 653	576 178	497 526	576 178
Southern African Development Community	1 029	2 297	1 029	2 297
Other:				
– National Government	75 514	258 165	77 187	258 165
– State Owned Enterprises	513 242	659 453	513 242	659 453
	<b>5 362 183</b>	<b>6 514 449</b>	<b>5 309 083</b>	<b>6 401 532</b>
<b>5.4 Repayment profile</b>				
Bonds (bullet payment profile)	1 840 043	2 927 628	1 805 545	2 838 773
Amortised loans	3 522 140	3 586 821	3 503 538	3 562 759
	<b>5 362 183</b>	<b>6 514 449</b>	<b>5 309 083</b>	<b>6 401 532</b>



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000 30 June	2005 R'000 30 June	2006 R'000 30 June	2005 R'000 30 June
<b>5. ADVANCES</b> <i>(continued)</i>				
<b>5.5 Loan commitments to advance funds</b>				
Tshwane Metropolitan Municipality (2004 – 2006)	–	180 000	–	180 000
Tshwane Metropolitan Municipality (2006)	–	100 000	–	100 000
	–	280 000	–	280 000
	<b>30 June</b>		<b>30 June</b>	
	<b>2006</b>	<b>% of</b>	<b>2005</b>	<b>% of</b>
	<b>R'000</b>	<b>Advances</b>	<b>R'000</b>	<b>Advances</b>
<b>5.6 Concentration profile (Group and Company)</b>				
<b>Ten largest exposures (Face value)</b>				
Tshwane Metropolitan Municipality	<b>599 857</b>	<b>11,2</b>	892 439	13,7
Ekurhuleni Metropolitan Council	<b>455 413</b>	<b>8,5</b>	574 409	8,8
eThekweni Municipality	<b>442 550</b>	<b>8,3</b>	469 523	7,2
City of Johannesburg Metropolitan Municipality	<b>428 278</b>	<b>8,0</b>	654 700	10,1
South African Airways	<b>344 414</b>	<b>6,4</b>	385 528	5,9
City of Cape Town	<b>248 372</b>	<b>4,6</b>	295 802	4,5
Buffalo City Local Municipality	<b>120 553</b>	<b>2,2</b>	123 429	1,9
Sedibeng Water Board	<b>99 454</b>	<b>1,9</b>	99 487	1,5
Mhlathuze Water Board	<b>94 500</b>	<b>1,8</b>	– <sup>1</sup>	–
Msunduzi Municipality	<b>93 700</b>	<b>1,7</b>	101 841	1,6
Mogale City Local Council	– <sup>2</sup>		100 000	1,5
Total	<b>2 927 071</b>	<b>54,6</b>	3 697 158	56,7
Capital secured	<b>(782 674)</b>	<b>(14,6)</b>	(975 717)	(15,0)
Net exposure	<b>2 144 397</b>	<b>40,0</b>	2 721 441	41,7

<sup>1</sup>.The exposure to Mhlathuze Water Board of R99 million in 2005 was excluded because it did not qualify as one of the ten largest advances.

<sup>2</sup>.The exposure to Mogale City Local Council of R60 million in 2006 is excluded because it does not qualify as one of the ten largest advances.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000 30 June	2005 R'000 30 June	2006 R'000 30 June	2005 R'000 30 June
<b>5. ADVANCES</b> <i>(continued)</i>				
<b>5.7 Capital repayments secured</b>				
Secured by cession of a zero coupon bond or set off against a deposit with the company	1 441 377	1 507 766	1 441 377	1 454 780
Percentage of total book value before impairment	26,9%	23,1%	27,1%	22,7%

The company has ceded and pledged advances of R51,6 million (2005: R70,9 million) to FirstRand Bank Limited made with the proceeds of the Euro loan from Agence Francaise de Developpement as security for a guarantee. (See note 8.2) The company has also ceded to the European Investment Bank advances of R225 million and R250 million made to the eThekweni Metropolitan Municipality and Tshwane Metropolitan Municipality respectively. (See note 8.2)

The company obtained a committed liquidity facility from FirstRand Bank Limited of R500 million which is secured by metropolitan municipalities advances with a combined face value of R506 million.

Due to the sector that the group largely lends to, there are very limited observable market rates for the advances therefore the fair value of advances is arrived at using the discounted cash flow valuation technique. The cash flows and the duration of advances can be reliably measured however the discount rates or yield curves required to discount the cash flows requires various inputs mainly from the market and some professional judgement from management. The entire valuation process is managed and monitored by a Board subcommittee namely the Market Valuation Verification Committee (MVVC) chaired by a non-executive director. The MVVC reviews and approves the estimated credit spreads based on the policy adopted. The key element of the policy is to ensure that a significant part of the inputs is obtained from observable market and there is minimal assumptions and estimates included in the valuation process. The policy was adopted to ensure consistency and adequate governance on valuation inputs, particularly where estimates are required.

<b>5.8 Impairment on lease receivables and advances</b>				
Balance beginning of the year	21 542	–	20 120	–
Impairment charge for the year	2 387	21 542	2 387	20 120
Impairment reversals for the year	(1 625)	–	(1 102)	–
Balance end of the year	22 304	21 542	21 405	20 120

Included in 2005 figures is an impairment amount of R16,2 million relating to the Koekedouw Irrigation Board exposure that was previously included in fair value adjustment.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

				<b>Accumulated</b>	<b>Net carrying</b>	
				<b>Cost</b>	<b>depreciation</b>	
				<b>R'000</b>	<b>R'000</b>	
					<b>value</b>	
					<b>R'000</b>	
<b>6. EQUIPMENT</b>						
<b>6.1 Group – 2006</b>						
Computer equipment				2 606	1 947	659
Furniture and fittings				763	504	259
Leasehold improvements				1 254	1 254	–
Motor vehicles				140	37	103
				<b>4 763</b>	<b>3 742</b>	<b>1 021</b>
<b>Group – 2005</b>						
Computer equipment				2 372	1 542	830
Furniture and fittings				956	675	281
Leasehold improvements				1 253	1 096	157
Motor vehicles				140	9	131
				<b>4 721</b>	<b>3 322</b>	<b>1 399</b>
	<b>30 June 2005</b>		<b>Disposal</b>	<b>Profit</b>		<b>30 June 2006</b>
	<b>Carrying value</b>	<b>Additions</b>	<b>proceeds</b>	<b>/(loss)</b>	<b>Depreciation</b>	<b>Carrying value</b>
	<b>R'000</b>	<b>R'000</b>	<b>R'000</b>	<b>R'000</b>	<b>R'000</b>	<b>R'000</b>
<b>Movements: 2005 to 2006</b>						
Computer equipment	830	290	(14)	(70)	(377)	659
Furniture and fittings	281	48	–	–	(70)	259
Leasehold improvements	157	2	(8)	–	(151)	–
Motor vehicles	131	–	–	–	(28)	103
	1 399	340	(22)	(70)	(626)	1 021
<b>Movements: 2004 to 2005</b>						
Computer equipment	711	480	–	–	(361)	830
Furniture and fittings	335	177	–	–	(231)	281
Leasehold improvements	362	128	–	–	(333)	157
Motor vehicles	–	140	–	–	(9)	131
	1 408	925	–	–	(934)	1 399



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	Cost R'000	Accumulated depreciation R'000	Net carrying value R'000
<b>6. EQUIPMENT</b> <i>(continued)</i>			
<b>6.2 Company – 2006</b>			
Computer equipment	2 492	1 857	635
Furniture and fittings	763	504	259
Leasehold improvements	1 254	1 254	–
Motor Vehicle	140	37	103
	<b>4 649</b>	<b>3 652</b>	<b>997</b>
Company – 2005			
Computer equipment	2 147	1 525	622
Furniture and fittings	597	434	163
Leasehold improvements	1 248	1 103	145
Motor Vehicle	140	9	131
	<b>4 132</b>	<b>3 071</b>	<b>1 061</b>
	<b>30 June 2005</b>		<b>30 June 2006</b>
	<b>Carrying value</b>	<b>Additions</b>	<b>Disposal</b>
	<b>R'000</b>	<b>R'000</b>	<b>proceeds</b>
			<b>Profit</b>
			<b>/(loss)</b>
			<b>Depreciation</b>
			<b>R'000</b>
			<b>Carrying value</b>
			<b>R'000</b>
<b>Movements: 2005 to 2006</b>			
Computer equipment	622	350	(1)
Furniture and fittings	163	166	–
Leasehold improvements	145	6	–
Motor Vehicle	131	–	–
	<b>1 061</b>	<b>522</b>	<b>(1)</b>
			<b>Profit</b>
			<b>/(loss)</b>
			<b>Depreciation</b>
			<b>R'000</b>
			<b>Carrying value</b>
			<b>R'000</b>
<b>Movements: 2004 to 2005</b>			
Computer equipment	484	430	–
Furniture and fittings	175	153	–
Leasehold improvements	350	128	–
Motor Vehicle	–	140	–
	<b>1 009</b>	<b>851</b>	<b>–</b>
			<b>Profit</b>
			<b>/(loss)</b>
			<b>Depreciation</b>
			<b>R'000</b>
			<b>Carrying value</b>
			<b>R'000</b>



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP				COMPANY			
	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000
<b>7. SUBORDINATED LIABILITIES</b>								
<b>Dexia Credit Local</b>								
Loan of 5 million Euro repaid on 30 June 2006 interest payable quarterly at JIBAR plus 4,34%.	-	-	40 412	40 412	-	-	40 412	40 412
<b>Proparco</b>								
Loan of 1,6 million Euro repaid on 30 June 2006 interest payable quarterly at JIBAR plus 4,34%.	-	-	12 932	12 932	-	-	12 932	12 932
<b>Kiwane Capital Holdings Limited</b>								
The loan bears interest at a fixed rate of 17,265%, payable six monthly in arrears on 31 December and 30 June. Capital was repaid on 30 June 2006.	-	-	10 000	10 911	-	-	10 000	10 911
<b>Investec Bank Limited</b>								
The loan bears interest at a fixed rate of 16,86%, payable six monthly in arrears on 30 June and 31 December. The capital was repaid on 30 June 2006.	-	-	10 000	10 873	-	-	10 000	10 873
<b>INCA Bonds issued to the market</b>								
INJ01 bond – redeemed 21 September 2011 Semi-annual coupon of 10.96% Coupons payable on 21 September and 21 March	100 000	100 786	100 000	105 412	100 000	100 786	100 000	105 412
	<b>100 000</b>	<b>100 786</b>	173 344	180 540	<b>100 000</b>	<b>100 786</b>	173 344	180 540

The loans are irrevocably subordinated to all present and future concurrent obligations of the Company.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP				COMPANY			
	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000
<b>8. LONG-TERM LIABILITIES</b>								
<b>8.1 INCA Bonds issued to the market:</b>								
IN02 bonds – redeemed 30 June 2006 Semi-annual coupons of 13,5%.	–	–	1 678 625	1 721 575	–	–	1 678 625	1 721 575
IN03 bonds – redeemable 30 June 2011 Semi-annual coupons of 14,0%.	<b>2 468 231</b>	<b>2 885 233</b>	2 427 506	3 068 951	<b>2 468 231</b>	<b>2 885 233</b>	2 427 506	3 068 951
INO4 note – redeemable 15 March 2015 Semi-annual coupons of 8,9%.	<b>250 000</b>	<b>211 801</b>	150 000	149 137	<b>250 000</b>	<b>211 801</b>	150 000	149 137
INO601 note – redeem- able 31 March 2006 Interest is payable quarterly at jibar plus 14 basis points.	–	–	350 000	350 266	–	–	350 000	350 266
INO602 note – redeem- able 31 August 2006 Interest is payable quarterly at jibar plus 12 basis points.	<b>200 000</b>	<b>199 216</b>	–	–	<b>200 000</b>	<b>199 216</b>	–	–
INO603 note – redeema- ble 31 October 2006 Interest is payable annually at jibar plus 13 basis points.	<b>217 000</b>	<b>216 298</b>	–	–	<b>217 000</b>	<b>216 298</b>	–	–
INO604 note – redeem- able 27 February 2007 Interest is payable quarterly at jibar plus 25 basis points.	<b>200 000</b>	<b>199 661</b>	–	–	<b>200 000</b>	<b>199 661</b>	–	–
	<b>3 335 231</b>	<b>3 712 209</b>	4 606 131	5 289 929	<b>3 335 231</b>	<b>3 712 209</b>	4 606 131	5 289 929



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP				COMPANY			
	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000
<b>8. LONG-TERM LIABILITIES</b> <i>(continued)</i>								
<b>8.2 Long-term foreign loans:</b>								
• <b>Agence Francaise de Developpement (AFD)</b> EUR 22,9 million. Capital is repayable in 16 equal semi-annual instalments commencing on 31 October 2000 and ending 30 April 2008. Bears interest at 3,5% per annum (see note 5).	<b>51 679</b>	<b>49 315</b>	69 308	70 935	<b>51 679</b>	<b>49 315</b>	69 308	70 935
• <b>Blaylock &amp; Partners (USAID) – USD</b> 49 200 000. Interest payable semi-annually (26 March and 26 September) and principal on 26 March 2009. Interest varies from 5,06% to 5,94%. The loan is guaranteed by USAID.	<b>349 320</b>	<b>344 313</b>	328 804	328 789	<b>349 320</b>	<b>344 313</b>	328 804	328 789
• <b>European Investment Bank</b> R100 million, interest at 15% payable annually, capital repayable on 23 February 2009. R50 million, interest at 15,3% payable annually, capital repayable on 28 January 2004. R100 million, interest at 13,8% payable annually, capital repayable on 19 May 2009.	<b>200 000</b>	<b>221 511</b>	200 000	240 332	<b>200 000</b>	<b>221 511</b>	200 000	240 332



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP				COMPANY			
	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000
<b>8. LONG-TERM LIABILITIES</b> <i>(continued)</i>								
<b>8.2 Long-term foreign loans:</b> <i>(continued)</i>								
• <b>European Investment Bank</b> Euro 40 million interest at Eibor payable semi-annually, the capital is repayable in semi annual instalments commencing on 15 March 2008 and ending on 15 March 2017.	<b>361 601</b>	<b>357 211</b>	323 300	326 542	<b>361 601</b>	<b>357 211</b>	323 300	326 542
• <b>European Investment Bank</b> R238 230 000 interest at Jibar payable semi-annually, the capital is repayable in equal semi annual instalments commencing on 15 September 2009 and ending on 15 March 2019.	<b>238 230</b>	<b>229 062</b>	238 230	225 648	<b>238 230</b>	<b>229 062</b>	238 230	225 648
• <b>Agence Francaise de Developpement (AFD)</b> EUR 15 882 353. Capital repayable in 16 equal Semi-annual instalments commencing on 31 October 2003 and ending 30 April 2011. Bears interest at 3.5% per annum.	<b>89 736</b>	<b>84 696</b>	96 277	99 304	<b>89 736</b>	<b>84 696</b>	96 277	99 304



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP				COMPANY			
	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000
<b>8. LONG-TERM LIABILITIES</b> <i>(continued)</i>								
<b>8.2 Long-term foreign loans:</b> <i>(continued)</i>								
• <b>Agence Francaise de Developpement (AFD)</b> EUR 4 117 647. Capital repayable in 16 equal Semi-annual instalments commencing on 31 October 2003 and ending 30 April 2011. Bears interest at 3.5% per annum.	<b>23 265</b>	<b>21 958</b>	24 961	25 745	<b>23 265</b>	<b>21 958</b>	24 961	25 745
• <b>European Investment Bank R225 000 000</b> interest at Jibar payable semi-annually, the capital is repayable in semi annual instalments commencing on 15 September 2005 and ending on 15 March 2020.	<b>215 1091</b>	<b>205 899</b>	225 000	212 247	<b>215 109</b>	<b>205 899</b>	225 000	212 247
• <b>European Investment Bank R238 419 000</b> interest at Jibar payable semi-annually, the capital is repayable in semi annual instalments commencing on 15 December 2005 and ending on 15 June 2020.	<b>230 7532</b>	<b>220 525</b>	–	–	<b>230 753</b>	<b>220 525</b>	–	–



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP				COMPANY			
	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000
<b>8. LONG-TERM LIABILITIES</b> <i>(continued)</i>								
<b>8.3 Long-term domestic loans:</b>								
• <b>Investec Bank Limited</b> Interest payable semi-annually on 31 January and 31 July and principal on 30 June 2006. The loan bears interest at 12,22% on the first R40 million and 12,79% on the balance of R30 million. The loan is guaranteed by USAID.	-	-	70 000	73 044	-	-	-	-
• <b>Mettle Limited</b> Interest payable semi-annually on 30 June and 31 December and principal on 30 June 2006. The loan bears interest at 18%.	-	-	56 000	59 929	-	-	-	-
• <b>Infrastructure Software (Proprietary) Limited</b> Interest and capital payable in 10 instalments commencing on 10 December 2002 and ending on 10 June 2007. Bears interest at 13.13% per annum.	7 199	7 417	17 137	18 187	7 199	7 417	17 137	18 187
• <b>Metway 3 (Proprietary) Limited</b> Interest is capitalised semi-annually and payable with capital in 30 June 2006. Bears interest at 12.28% per annum.	-	-	27 745	29 230	-	-	27 745	29 230
• <b>Aludi</b>	140	140	280	284	140	140	280	284



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP				COMPANY			
	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000	30 June 2006 Face value R'000	30 June 2006 Fair value R'000	30 June 2005 Face value R'000	30 June 2005 Fair value R'000
<b>8. LONG-TERM LIABILITIES</b> <i>(continued)</i>								
<b>8.3 Long-term domestic loans:</b> <i>(continued)</i>								
• <b>Zero coupon liabilities to municipalities</b> (See note 4.3)	333 264	216 983	333 697	211 383	333 264	216 983	333 697	211 383
	<b>5 435 527</b>	<b>5 671 239</b>	6 616 870	7 211 528	<b>5 435 527</b>	<b>5 671 239</b>	6 490 870	7 078 555

- INCA has ceded the eThekweni Metropolitan Municipality advance with an initial face value of R225 million to the European Investment Bank as collateral for the loan.
- INCA has ceded the Tshwane Metropolitan Municipality advance with an initial face value of R250 million to the European Investment Bank as collateral for the loan.

#### 8.4 INCA bonds information

INCA Bonds were issued in terms of a prospectus and incur interest at a fixed rate linked to the government bond rate at the time of issue as follows: INO2 bonds: R152/R194, INO3 bonds: R153, INO4 bonds: R157, INJO1 bond: R153 and INO601: Jibar.

Bond	Cost Date	Face value R'000	Proceeds R'000
<b>Bond issues (company)</b>			
The following INCA Bonds and Notes were issued in 2006:			
INO 602	26 August 2005	200 000	200 000
INO 603	26 October 2005	217 000	217 000
INO 4	09 December 2005	100 000	102 375
INO 604	23 February 2006	200 000	200 000
The following INCA Bonds and Notes were issued in 2005:			
INO 3	26 August 2004	100 000	120 181
INJO 1	16 September 2004	100 000	100 000
INO 4	02 March 2005	150 000	149 706
INO 604	28 June 2005	350 000	350 000
	<b>GROUP</b>	<b>COMPANY</b>	
	2006	2006	2005
	R'000	R'000	R'000
	30 June	30 June	30 June
<b>Turnover in INCA bonds</b>			
INO 2	3 380 509	4 051 017	3 380 509
INO 3	13 561 454	15 684 450	13 561 454
INO 4	3 450 000	1 193 000	3 450 000
	<b>20 391 963</b>	20 928 467	<b>20 391 963</b>



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000 30 June	2005 R'000 30 June	2006 R'000 30 June	2005 R'000 30 June
<b>9. ACCOUNTS PAYABLE AND OTHER LIABILITIES</b>				
Interest accrued on long-term loans	75 294	61 799	75 279	58 149
Leave pay accrual	1 125	1 205	1 125	1 205
Share appreciation rights obligation	9 700	2 083		
Other accounts payable	109 823	38 864	105 834	32 696
Funding under repurchase agreements	36 606	493 858	36 606	493 858
	<b>232 548</b>	<b>597 809</b>	<b>218 844</b>	<b>585 908</b>

### 9.1. Share appreciation rights obligation

During the year the group implemented an employee incentive scheme whereby 42 007 share appreciation rights were made available to certain employees. The incentive scheme was implemented retrospectively to commence on 1 July 2004. The current incentive scheme was introduced to replace the old scheme that was discontinued on 30 June 2004. In terms of the new scheme, a third of the rights vest after a period of three years from the date they were granted and a third in the fourth and the fifth years respectively. The employees are allowed to hold the rights for a period not exceeding five years after which the share appreciation rights will become available to be newly granted. The share appreciation rights are on maturity settled in cash.

The "exercise price" of the share appreciation rights varies depending on the compounded annual growth rate (CAGR) target achieved, as expressed in the form of total shareholder return. The group share price for purposes of the incentive scheme will be determined using the net asset value as reported from time to time in the audited financial statements multiplied by 1,3.

The "exercise price" will be determined in accordance with the rules and targets of the incentive scheme as follows:

Target CAGR	Exercise price
13%	Issue price
14%	70% of issue price
15%	40% of issue price
16%	20% of issue price
17%	R1 (One Rand)

As at year-end the group had granted 25 350 rights with effect from 01 July 2004 a third of which will vest on 30 June 2007. The share appreciation rights obligation is calculated using the option price valuation technique. The following inputs were used in the valuation model to quantify the obligation:

Volatility 15%

Risk Free Rate 8.71%

Net Asset Value multiplied by 1,3

The inputs to the valuation model are subject to changes in market conditions and therefore will fluctuate from time to time.

### 9.2. FUNDING UNDER REPURCHASE AGREEMENTS

Funding received under repurchase agreements is payable within seven days from the balance sheet date.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	<b>Notional</b>	Notional	<b>GROUP</b>		<b>COMPANY</b>	
	<b>30 June</b>	30 June	<b>30 June</b>	30 June	<b>30 June</b>	30 June
	<b>2006</b>	2005	<b>2006</b>	2005	<b>2006</b>	2005
	<b>R'000</b>	R'000	<b>R'000</b>	R'000	<b>R'000</b>	R'000
<b>10. DERIVATIVE FINANCIAL INSTRUMENTS</b>						
<b>Derivative assets</b>						
Currency swaps	<b>342 309</b>	98 514	<b>14 374</b>	18 946	<b>14 374</b>	18 946
Forward starting loans	–	280 000	–	36 302	–	36 302
Interest rate swaps	<b>1 241 198</b>	546 978	<b>45 097</b>	46 848	<b>45 097</b>	53 807
	<b>1 583 507</b>	925 492	<b>59 471</b>	102 096	<b>59 471</b>	109 055
<b>Derivative liabilities</b>						
Currency swaps	<b>128 072</b>	457 575	<b>17 590</b>	99 536	<b>17 590</b>	99 536
Interest rate swaps	<b>1 060 184</b>	1 577 108	<b>41 574</b>	113 599	<b>41 574</b>	113 599
Foreign Exchange Contracts	<b>4 509</b>	4 938	<b>988</b>	1 278	<b>988</b>	1 278
	<b>1 192 765</b>	2 039 621	<b>60 152</b>	214 413	<b>60 152</b>	214 413

The notional principal gives an indication of the group's activity in the derivative market and represents the aggregate size of total outstanding contracts at period end. This figure cannot be used in assessing the market risk associated with positions.

	<b>GROUP</b>		<b>COMPANY</b>	
	<b>30 June</b>	30 June	<b>30 June</b>	30 June
	<b>2006</b>	2005	<b>2006</b>	2005
	<b>R'000</b>	R'000	<b>R'000</b>	R'000
<b>11. MINORITY INTEREST</b>				
Balance at the beginning of the year	–	234		
Share of after tax (losses)/profits of INCA Asset Finance (Pty) Ltd	–	285		
New issue of 5 000 shares at a premium of R14	–	–		
Negative goodwill	–	(316)		
Purchase of minority shares during the year	–	(203)		
Balance at the end of the year	–	–		
<b>12. SHARE CAPITAL</b>				
<b>Authorised</b>				
1 000 000 ordinary shares of R1 each (2004: 1 000 000 ordinary shares of R1 each)	<b>1 000</b>	1 000	<b>1 000</b>	1 000
<b>Issued</b>				
848 532 ordinary shares of R1 each (2005: 848 532 ordinary shares of R1 each)	<b>849</b>	849	<b>849</b>	849
Shares held by the INCA Share Incentive Trust 42 007 ordinary shares of R1 each (2005 – 42 007)	<b>(42)</b>	(42)		
Balance at the end of the year	<b>807</b>	807	<b>849</b>	849

In terms of the shareholders' agreement, shareholders have the power to issue the unissued shares.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	30 June 2006 R'000	30 June 2005 R'000	30 June 2006 R'000	30 June 2005 R'000
<b>13. SHARE PREMIUM</b>				
Share premium relating to the shares held by the INCA Share Incentive Trust	99 057	105 988	105 988	105 988
	–	(6 931)	–	–
Balance at the end of the year	99 057	99 057	105 988	105 988
<b>14. INTEREST INCOME</b>				
Advances	756 983	730 646	740 813	704 838
Investments	93 366	98 304	89 321	95 740
Cash and short-term funds	29 997	21 365	23 767	18 733
Preference share dividend	17 696	12 357	17 696	12 357
Repurchase agreements	4 662	5 865	4 677	5 568
Intercompany	–	–	–	10
Derivative financial instruments	135 552	93 081	136 238	91 601
Interest income from insurance investments	–	1 768	–	1 768
	1 038 256	963 386	1 012 512	930 615
<b>15. INTEREST EXPENDITURE</b>				
INCA bonds	594 891	585 411	594 891	585 411
Long-term loans	149 099	128 497	131 220	109 516
Intercompany	–	–	394	8
Subordinated liabilities	17 497	14 801	17 497	14 801
Repurchase agreements	11 406	3 353	11 406	3 352
Derivative financial instruments	212 931	170 737	212 932	166 676
	985 824	902 799	968 340	879 764
<b>16. FAIR VALUE GAINS</b>				
<b>16.1 Fair value gains – realised</b>				
1. Advances	21 408	8 986	21 408	7 884
Investments	28 419	20 792	28 452	20 792
2. INCA bonds	(5 385)	5 809	(5 385)	5 809
3. Long-term loans	(3 238)	(1 475)	(3 238)	(1 475)
	41 204	34 112	41 237	33 010
<b>16.2 Fair value gains – unrealised</b>				
4. Advances	(301 152)	409 042	(293 228)	406 366
5. Investments	(60 442)	91 165	(60 176)	90 900
6. INCA bonds	341 151	(312 155)	341 151	(312 155)
7. Long-term loans	77 077	(95 544)	70 104	(95 600)
8. Subordinated liabilities	6 947	(9315)	6 947	(9 315)
9. Derivative financial instruments	115 572	(36 196)	108 612	(33 135)
Repurchase agreements	(81)	84	(89)	84
	179 072	47 081	173 321	47 145



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

### 16. FAIR VALUE GAINS (continued)

#### 16.2 Fair value gains – unrealised (continued)

##### Fair value on liabilities

The total fair value adjustments resulting from liabilities amounted to R425 million. Of the total fair value adjustment of R425 million, changes in the base interest rates accounted for R146 million and R48,5 million was due to changes in credit spreads. The balance was due to the increasing maturity of the liabilities (“pull to par”). Included in the credit spreads movement is approximately R38 million due to INCA’s downgrade in November 2005.

##### Supplementary information relating to note 16

1. Realised fair value adjustments on advances relate to the early settlement of certain advances. These amounts include breakage costs to compensate for the early settlement. The positive realised fair value adjustments on investments relate primarily to capital market stock that is liquidated during the year under review for mainly treasury management reasons.
2. Realised fair value adjustments on INCA bonds relate to capital gains and losses made on the buy-back and re-issue of bonds to the market. The company does not trade its bonds for speculative reasons.
3. The realised loss on long-term loans relates to certain once off costs relating to the raising of long-term loans.
4. The base interest rates increased during the period under review resulting in a negative unrealised fair value adjustment. The negative fair value adjustment was however reduced by the fact that the credit spreads on advances contracted by between 15 and 50 basis points during the year.
5. Unrealised fair value adjustments on investments relate to the generally upward movement of base rates during the current year. The group is hedged for interest rate movements in accordance to its Asset and Liability Management process.
6. INCA bond spreads widened on by between 29 and 35 basis points during the period resulting in positive unrealised fair value adjustments. The widening of the credit spreads on the INCA bonds were significantly influenced by the downgrade experienced by the company in November 2005.
7. Liabilities are marked-to-market at INCA funding spreads hence a fair value gain was reflected. (see note 6 above)
8. The positive unrealised fair value adjustment on subordinated debt is attributable to the redemption of the R70 million liability during the year. The remaining subordinated is valued using INCA’s funding curve hence the positive unrealised fair value adjustment.
9. Derivative financial instruments are used to hedge general market movements (movements in the credit spreads of assets and liabilities are not hedged). During the year currency swaps with a combined nominal of Eur 6,6 million matured and the fair value adjustments from prior years reversed in the current year.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	30 June 2006 R'000	30 June 2005 R'000	30 June 2006 R'000	30 June 2005 R'000
<b>17. OPERATING EXPENDITURE</b>				
Operating expenditure includes the following items:				
<b>17.1 Auditors' remuneration</b>				
Audit fees	1 767	1 479	1 768	1 000
Prior year under accrual	100	448	100	413
Other services	21	–	21	–
	<b>1 888</b>	<b>1 927</b>	<b>1 799</b>	<b>1 413</b>
<b>17.2 Depreciation</b>				
Computer equipment	377	361	337	291
Furniture and fittings	70	231	70	165
Leasehold improvements	151	333	151	334
Motor vehicles	28	9	28	9
	<b>626</b>	<b>934</b>	<b>586</b>	<b>799</b>
<b>17.3 Lease expenses</b>				
Office premises	1 317	1 299	1 317	1 274
Furniture and fittings	–	85	–	85
Computer software	354	710	354	710
	<b>1 671</b>	<b>2 094</b>	<b>1 671</b>	<b>2 069</b>
<b>17.4 Professional fees</b>				
Technical and other services	2 890	1 491	2 753	1 210
	<b>2 890</b>	<b>1 491</b>	<b>2 753</b>	<b>1 210</b>
<b>17.5 Retirement benefits</b>				
Company provident fund contributions	269	278	269	278
	<b>269</b>	<b>278</b>	<b>269</b>	<b>278</b>
<b>17.6 Other staff costs excluding directors</b>				
Salaries and incentive payments	12 376	13 269	12 376	10 506
	<b>12 376</b>	<b>13 269</b>	<b>12 376</b>	<b>10 506</b>
<b>17.7 Directors' emoluments</b>				
Non-executive directors' fees	1 087	1 026	1 087	1 026
Executive directors' emoluments				
- salaries and incentive payments	5 732	5 500	5 732	5 456
- payments made under INCA Staff Share Scheme	7 617	6 719	–	–
	<b>14 436</b>	<b>13 245</b>	<b>6 819</b>	<b>6 482</b>
<b>17.8 Other</b>				
Other sundry expenditure	7 218	8 322	7 287	13 515
Total expenditure	<b>41 374</b>	<b>41 560</b>	<b>33 560</b>	<b>36 272</b>



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000	2005 R'000	2006 R'000	2005 R'000
<b>18. TAXATION</b>				
<b>18.1 Taxation charge for the period</b>				
<b>18.1.1 Current period</b>				
South African current taxation				
Normal	2 585	23 997	2 088	22 095
Deferred	61 696	2 092	60 492	2 685
Under deduction from prior year	(9 749)	–	(9 749)	–
Secondary tax on companies paid	1 809	973	1 809	973
Secondary tax on companies debits/(credits)	1 130	(639)	1 130	(639)
Total current period	57 471	26 423	55 770	25 114
<b>18.2 Tax rate reconciliation</b>	%	%	%	%
Effective tax rate	24,8	27,2	24,6	26,9
Adjusted for:				
Disallowed expenditure	(8,4)	(3,2)	(8,5)	(3,5)
Under deduction from prior year	4,2	–	4,3	–
Non-taxable income	7,6	4,3	7,8	4,9
Secondary tax on companies	0,8	0,7	0,8	0,7
Standard tax rate	29,0	29,0	29,0	29,0
<b>18.3 Analysis of deferred taxation</b>	R'000	R'000	R'000	R'000
Differences between tax and book values of:				
Income and expenditure accruals	(14 687)	(12 723)	(11 612)	(10 390)
Unrealised profits and losses on assets and liabilities	86 375	23 029	80 088	18 374
Secondary tax on companies credits	–	(1 130)	–	(1 130)
	71 688	9 176	68 476	6 854
<b>18.4 Movement in deferred taxation</b>				
Balance at the beginning of the year	9 176	8 138	6 854	4 809
Change in tax rate	–	(415)	–	(227)
Charge through the income statement	56 225	2 092	55 335	2 911
Under deduction from prior year	5 157	–	5 157	–
Secondary tax on companies credits	1 130	(639)	1 130	(639)
Balance at the end of the year	71 688	9 176	68 476	6 854
<b>18.5 Movement in STC</b>				
Balance at the beginning of the year	1 130	1 997	1 130	1 997
Applied in dividends paid	(1 130)	(1 997)	(1 130)	(1 997)
Credits from dividends received	–	1 130	–	1 130
Balance at the end of the year	–	1 130	–	1 130



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000	2005 R'000	2006 R'000	2005 R'000
<b>19. DIVIDENDS</b>				
A dividend of R25 million (2005: R25 million) is proposed for 2006.				
<b>20. CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES</b>				
<b>20.1 Capital commitments</b>				
Authorised and contracted for: Operating lease rentals for office premises, furniture, fittings and software license fees:				
2006	–	1 710	–	1 710
2007	978	1 946	978	1 946
2008	773	2 275	773	2 275
2009	869	2 512	869	2 512
2010 (and after – 2005)	858	2 901	858	2 901
2011 (and after – 2006)	1 515	–	1 515	–
	<b>4 993</b>	<b>11 344</b>	<b>4 993</b>	<b>11 344</b>
Commitments will be funded from the group's own resources.				
<b>20.2 Contingent liabilities</b>				
I. Guarantee	29 295	21 567	29 295	21 567
	<b>29 295</b>	<b>21 567</b>	<b>29 295</b>	<b>21 567</b>
I. This guarantee is in respect of interest payments on a loan by a third party to Koekedouw Irrigation Board. The guarantee is secured by a deposit of R20 million. (See note 5.7)				
<b>21. RELATED PARTY TRANSACTIONS</b>				
<b>Loans to shareholders</b>				
Rand Merchant Bank International (EIB)	370 721	328 162	370 721	328 162
	<b>370 721</b>	<b>328 162</b>	<b>370 721</b>	<b>328 162</b>
<b>Loans from shareholders</b>				
Agence Francaise de Developpement	49 315	(70 935)	49 315	(70 935)
Agence Francaise de Developpement	106 654	(125 049)	106 654	(125 049)
Dexia Credit Local	–	(40 412)	–	(40 412)
Proparco	–	(12 932)	–	(12 932)
	<b>155 969</b>	<b>(249 328)</b>	<b>155 969</b>	<b>(249 328)</b>
Other intercompany balances are reflected under Investments (note 4) and Accounts Payable (note 9).				



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	GROUP		COMPANY	
	2006 R'000	2005 R'000	2006 R'000	2005 R'000
<b>21. RELATED PARTY TRANSACTIONS (continued)</b>				
<b>Key management personnel</b>				
Remuneration paid to directors is disclosed in note 17.7. The total remuneration paid to key management personnel for the financial year under review amounted to R8 531 000 (2005: R7 064 000.) During the current financial year 25 350 share appreciation rights were awarded to executive management. These rights were awarded retrospectively with effect from 01 July 2004. There were no share appreciation rights awarded to executive management subsequent to year end. The details of the share appreciation rights are disclosed on note 9.1.				
Mr PGM Truijens (independent director) rendered management consultation services to the company during the year for a fee of R10 000 (2005: nil).				
<b>Management by a third party</b>				
None of the business of the group has been managed by a third party in which a director had an interest during the financial period under review.				
<b>Contracts</b>				
FirstRand Bank Limited also act as bankers to the group. All of these related party transactions were concluded on an arm's length basis. At no stage during the financial period were any contracts concluded by the group in which a director had an interest except as disclosed above.				
The group identifies related party transactions at the conclusion of each transaction. Significant related party transactions are reviewed by the Board subcommittees and the executive management prior to conclusion.				
<b>22. FINANCIAL RISK MANAGEMENT</b>				
<b>22.1 Foreign currency management</b>				
Foreign liabilities are hedged on a back to back basis with foreign assets or are swapped out, which effectively eliminates any currency exposure.				
<b>22.2 Derivative instruments</b>				
The company does not use derivative instruments for speculative purposes. The primary derivative instruments used are interest rate and currency swaps.				
<b>22.3 Liquidity risk</b>				
The group has a policy of retaining liquidity equivalent to six month's operational costs plus interest, coupon and capital payments due over the next six months minus the risk-adjusted cash inflows from advances for the next six months. In addition, the group holds sufficient cash, short-term assets and readily marketable liquid assets and maintains credit lines with various major banks.				
<b>22.4 Loans receivable</b>				
The terms and conditions of loans to the INCA Share Incentive Trust are included in note 4. The maturity profile for advances is set out in note 5.2.				



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

### 22. FINANCIAL RISK MANAGEMENT (continued)

#### 22.5 Credit risk

Financial assets, which potentially subject the company to concentrations of credit risk, consist principally of cash, short-term deposits and advances. The company's cash equivalents and short-term deposits are placed with high credit quality financial institutions.

The INCA credit evaluation model, which has been specifically developed to provide a shadow rating of each potential borrower prior to investment, provides the primary technique for mitigating against credit risk. The model focuses on all the major components that impact on the ability of the borrower to meet its commitments to the group. The shadow rating provided by the INCA credit evaluation model is continuously compared and where necessary adjusted to the observable official credit ratings in the market.

Credit risk is being minimised through the continued diversification of the lending portfolio. The carrying amounts of financial assets included in the balance sheet represents the group's exposure to credit risk in relation to these assets but excludes any potential reduction for collateral security.

The Credit Committee chaired by a non-executive director, oversees the annual credit reviews and approves the credit policy as well as reviewing credit portfolios and impairments.

#### 22.6 Interest rate risk

The group manages its interest rate risk with standard analytical techniques to measure interest rate sensitivity on a consolidated portfolio basis. This includes static re-PRICE gap analysis and a point-in-time interest income stress test for parallel interest rate moves. In addition, "twists"-scenarios are used to focus on the impact on the value of the portfolio caused by changes to the shape of the yield curve. All hedging activities and balance sheet mismatches are monitored by the Group's Asset and Liability Committee ("ALCO"), chaired by a non-executive director.

#### 22.7 Market risk

ALCO independently reviews and monitors the market risks reports used by management for the day-to-day market risk management. Significant market risks decisions are reported to ALCO and all market risk limits are recommended by ALCO to the Board for approval.

#### 22.8 Sensitivity analysis

Realised fair value adjustments relate primarily to the sale of some advances and capital market stock sold for treasury reasons. Unrealised fair value adjustments represent the yearly marked-to-market revaluation movement of financial assets and financial liabilities that are measured at fair value in the balance sheet. The group hedges its portfolio for interest rates movements in terms of the ALCO policy, however, credit spread movements are not hedged. The fair value adjustments generally result from the interest rate movements, the passing of time and the credit spread movements. Because the group does not hedge itself for credit spread movements, any unequal credit spread movements on the financial assets and financial liabilities results in positive or negative fair value adjustments. The group has remained within the ALCO limits in terms of its interest rate movement hedge, therefore, a significant portion of the fair value adjustments of R179 million is attributable to the unequal credit spread movements on the financial assets and the financial liabilities that are measured at fair through profit or loss.

In the financial year currently under review, advances credit spreads contracted by between 15 and 50 basis points which resulted in positive fair value adjustments. The credit spreads on the liabilities and INCA bonds in particular, widened by between 29 and 35 basis points mainly as a result of the credit downgrade of INCA experienced in November 2005. The impact of the downgrade on the INCA bonds was an immediate credit spread widening of approximately 26 basis points that resulted in R38 million positive fair value adjustments included in the amount mentioned above. The widening of the liabilities credit spreads resulted in further positive fair value adjustments being reported in the current financial year. The fair value adjustments are expected to reverse in the future provided that the financial assets and financial liabilities are held until maturity by the group.



## NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

**22. FINANCIAL RISK MANAGEMENT** (continued)**22.8 Sensitivity analysis** (continued)

As evidenced in the current financial year's reported fair value adjustments, a significant increase in credit spreads of the financial assets of the group, without a corresponding increase in the credit spreads of the financial liabilities will result in significant volatility on the income statement. To illustrate the sensitivity for such an event, the following scenario utilising the figures at year-end was run:

o Credit spreads on a substantial part of the advances portfolio were increased by 25 basis points whilst credit spreads on liabilities were kept constant. In the event of such occurrence, a negative unrealised loss before tax of R49 million. The group is most sensitive for credit spread movements of advances in risk category 2 (A to A+) as illustrated below. A 25 basis points credit spread movement on the advances per risk category has the following outcome:

INCA Credit Rating Category	Fair Value Adjustment (R'000)
Category 1 (AA- to AAA)	465
Category 2 (A- to A+)	18 334
Category 3 (BBB)	7 153
Metropolitan municipalities (A to AA)	23 286
<b>Total</b>	<b>49 238</b>

Details of the fair value adjustments that arose during the year under review are disclosed in note 16.

**22.9 Liquidity Maturity Analysis**

Analysis as at 30 June 2006

	<1 yr	1 – 2 yrs	2 – 5 yrs	5 – 8 yrs	> 8yrs
R'000					
<b>Assets</b>					
Interest Receivable	826 457	781 752	1 934 800	878 165	283 082
Capital Receivable	885 359	427 984	2 702 503	1 342 766	756 709
	1 711 816	1 209 736	4 637 303	2 220 931	1 039 791
<b>Liabilities</b>					
Interest Payable	(772 861)	(728 838)	(1 937 388)	(537 844)	(242 053)
Capital Payable	(1 075 637)	(68 746)	(3 784 131)	(572 890)	(357 068)
	(1 848 498)	(797 584)	(5 721 519)	(1 110 734)	(599 121)
<b>Net Cash Flows</b>	<b>(136 682)</b>	<b>412 152</b>	<b>(1 084 216)</b>	<b>1 110 197</b>	<b>440 670</b>

After successfully redeeming the IN02's, Treasury's focus has shifted to the 5 yr maturity bracket with the next bond (IN03) redemption of R2,5 billion. Incorporated in the current funding plan are initiatives to shift the "gap" which reflects the bullet liabilities versus the amortizing advances.

The liquidity maturity analysis reflects the group's cash flows and not the fair value as reported in the balance sheet.

**23. RETIREMENT BENEFITS**

The company contributes to a defined contribution scheme for the benefit of employees. Employees are responsible for their own retirement planning and as such are members of various South African Pension and Provident Fund Schemes. South African Pension Funds are governed by the Pension Funds Act of 1956. The company does not administer any Pension Fund Scheme and has no obligations in relation to any of the abovementioned funds.

**24. EARNINGS PER SHARE**

The earnings per share has been calculated on the net profit attributable to ordinary shareholders of R174 132 000 (2005: R70 316 000) and the weighted average number of issued ordinary shares during the period of 806 525 shares (2005: 806 525 shares). Prior to the consolidation of the INCA Share Incentive Trust 848 532 shares were used in the calculation.

## ADMINISTRATION

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