FIRST MERCHANT BANK LIMITED

GROUP FINANCIAL STATEMENTS

For the year ended

31ST DECEMBER 2005

FIRST MERCHANT BANK LIMITED

GROUP FINANCIAL STATEMENTS
For the year ended 31st December 2005

FIRST MERCHANT BANK LIMITED

DIRECTORS' REPORT
For the year ended 31st December 2005

The directors have pleasure in submitting their report together with the group financial statements of First Merchant Bank Limited for the year ended 31st December 2005.

Nature of business

First Merchant Bank Limited is a private limited company incorporated in Malawi under the Malawi Companies Act, 1984 and is registered as a commercial bank under the Banking Act 1989. Its wholly owned subsidiary, The Leasing and Finance Company of Malawi Limited is engaged in the provision of lease finance.

The physical address of the holding company's registered office is:-

Livingstone Towers
Private Bag 122
Glyn Jones Road
Blantyre
Malawi

Financial performance

The results and state of affairs of the company are set out in the accompanying income statements, statements of changes in equity, balance sheets, statements of cash flows and associated accounting policies and notes.

Dividends

Last year's final dividend of MK22 million and an interim dividend for this year of MK178 million were paid during the year representing **K2.00** per ordinary share (2004: K1.50 per ordinary share). The directors propose a final dividend of **MK40 million** for this year (2004: MK22 million).

Directorate and Secretary

The following directors and secretary served during the year:

Mr. R.C. Kantaria	Chairman
Mr. H.N. Anadkat	Vice Chairman
Mr. K. N. Chaturvedi	Managing Director
Mr. N.G. Anadkat	Director
Mr. J.M. O'Neill	Director
Mr. A. Abdallah	Director
Mr. V.K.Shetty	Director – Member of Audit Committee
Mr. M. Msisha	Director - Chairman of Audit Committee
Mr. S. Srinivasan	Secretary (Deputy Managing Director from 22nd October 2005)

In accordance with the company's Articles of Association, all directors are retiring at the forthcoming Annual General Meeting, but being eligible for re-appointment, offer themselves for re-election.

Board Committees

Board Committees have been established to ensure that the board discharges its duties effectively, in accordance with principles of good corporate governance. All board committees have terms of reference and report to the main board.

FIRST MERCHANT BANK LIMITED

DIRECTORS' REPORT
For the year ended 31st December 2005

Audit Committee
The Audit Committee is responsible for reviewing the reports of both internal and external auditors, as well as the adequacy and effectiveness of internal and accounting controls. The committee consists of two non-executive directors. Both internal and external auditors have unlimited access to the Audit Committee.

Credit Committee
The committee approves all applications for loans and advances that are above the Managing Director's discretionary limits. This committee consists of two non-executive directors and one executive director.

Appointment and Remuneration Committee
The committee is appointed by the Board to review the terms and conditions of service and the salaries of staff members. The committee consists of three non-executive directors.

Auditors
A resolution will be proposed at the forthcoming Annual General Meeting to re-appoint KPMG, Certified Public Accountants (Malawi) as auditors in respect of the company's 31st December 2006 financial statements.

....	....
DIRECTOR	DIRECTOR

18th February 2006

FIRST MERCHANT BANK LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES
For the year ended 31st December 2005

The Companies Act, 1984, requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the operating results for that year.

The Act also requires the directors to ensure the company keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act, 1984.

In preparing the financial statements, the directors accept responsibility for the following:

- Maintenance of proper accounting records;
- Selection of suitable accounting policies and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Compliance with applicable accounting standards, when preparing financial statements, subject to any material departures being disclosed and explained in the financial statements; and
- Preparation of financial statements on a going concern bases unless it is inappropriate to presume that the company will continue in business.

The directors also accept responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and group and to maintain adequate systems of internal controls to prevent and detect fraud and other irregularities.

Nothing has come to the attention of the directors to indicate that the company and group will not remain a going concern for at least the next twelve months from the date of this statement.

The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the company and group and of their operating results.

Director: ____

Director: ____

Date: **18 February 2006**

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF FIRST MERCHANT BANK LIMITED

Scope

We have audited the consolidated financial statements of First Merchant Bank Limited set out on pages 4 to 26 for the year ended 31st December 2005.

Respective responsibilities of directors and auditors

These financial statements are the responsibility of the directors of the Company. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the accounts are free from material misstatement. An audit includes; examining, on a test basis, of evidence supporting the amounts and disclosures in the financial statements; assessing the accounting policies used and the significant estimates made by the directors in the preparation of the financial statements, and evaluating the overall presentation of the financial statements.

We have obtained all the information and explanations that to the best of our knowledge and belief were necessary for the purpose of our audit and believe that our audit provides a reasonable basis for our opinion.

Audit opinion

In our opinion, the consolidated financial statements are properly drawn up in accordance with the provisions of the Companies Act 1984, and in conformity with International Financial Reporting Standards, so as to give, in all material respects, a true and fair view of the financial position of the Group and the Company at 31st December 2005 and of the results of their operations and cash flows for the financial year ended on that date, as far as concerns the members of the Company.

KPMG
Certified Public Accountants (Malawi)
Blantyre

20th February 2006

FIRST MERCHANT BANK LIMITED

CONSOLIDATED INCOME STATEMENTS
For the year ended 31st December 2005
In thousands of Malawi Kwacha

	Note	GROUP 2005	GROUP 2004 As restated	COMPANY 2005	COMPANY 2004 As restated
INCOME					
Interest on loans and advances		**615,932**	435,381	**610,309**	435,103
Interest on placements with other banks		**90,561**	75,801	**88,375**	74,777
Income from lease finance		**129,837**	90,051	**-**	-
Income from treasury bills		**296,920**	526,260	**217,360**	434,884
Income from investments	2	**213,948**	128,066	**213,948**	128,066
Total income		**1,347,198**	1,255,559	**1,129,992**	1,072,830
Interest payable on deposits and other accounts		**(364,693)**	(405,188)	**(256,318)**	(314,284)
Net interest income		**982,505**	850,371	**873,674**	758,546
Fees and commissions receivable		**189,906**	163,402	**185,485**	159,786
Other income	3	**397,800**	268,925	**393,695**	268,127
Total net income		**1,570,211**	1,282,698	**1,452,854**	1,186,459
EXPENDITURE					
Staff and training costs	4	**320,110**	293,179	**303,593**	280,830
Recurrent expenditure on premises and equipment		**88,364**	80,128	**88,364**	77,801
Depreciation	23	**89,499**	55,446	**86,859**	53,640
Other operating costs	5	**252,950**	174,594	**239,535**	158,892
Total expenditure		**750,923**	603,347	**718,351**	571,163
Profit before provision for doubtful debts		**819,288**	679,351	**734,503**	615,296
Provision for doubtful debts		**(97,138)**	(6,625)	**(97,774)**	(4,580)
Profit before income tax expense		**722,150**	672,726	**636,729**	610,716
Income tax expense	6	**(111,858)**	(195,703)	**(85,860)**	(182,900)
NET PROFIT FOR THE YEAR		**610,292**	477,023	**550,869**	427,816
Basic earnings per share (MK)	7	**6.10**	4.77	**5.51**	4.28

The financial statements are to be read in conjunction with the accounting policies on pages 9 to 14 and notes on pages 15 to 26.

The auditor's report is on page 4.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the year ended 31st December 2005
In thousands of Malawi Kwacha

GROUP	Share capital	Property Revaluation reserve	Investment Revaluation reserve	Loan loss reserve	Retained earnings	Total
Balance at 1st January 2004	100,000	57,911	-	-	513,763	671,674
Reversal and transfer of general provision to loan loss reserve	-	-	-	33,747	-	33,747
Restated at 1st January 2004	**100,000**	**57,911**	**-**	**33,747**	**513,763**	**705,421**
Profit for the year	-	-	-	-	477,023	477,023
Transfer to investment revaluation	-	-	85,663	-	(85,663)	-
Deferred tax on investment revaluation surplus	-	-	(25,699)	-	25,699	-
Transfer to loan loss reserve	-	-	-	13,446	(13,446)	-
Dividends paid	-	-	-	-	(150,000)	(150,000)
Balance at 31st December 2004	**100,000**	**57,911**	**59,964**	**47,193**	**767,376**	**1,032,444**
Balance at 1st January 2005	100,000	57,911	59,964	47,193	767,376	1,032,444
Profit for the year	-	-	-	-	610,292	610,292
Transfer to investment revaluation	-	-	142,316	-	(142,316)	-
Deferred tax on investment revaluation surplus	-	-	24,106	-	(24,106)	-
Transfer to loan loss reserve	-	-	-	19,413	(19,413)	-
Surplus on property revaluation	-	85,086	-	-	-	85,086
Deferred tax on property revaluation	-	(1,585)	-	-	-	(1,585)
Change in deferred tax on opening revaluation	-	(759)	-	-	-	(759)
Dividends paid	-	-	-	-	(200,000)	(200,000)
Balance at 31st December 2005	**100,000**	**140,653**	**226,386**	**66,606**	**991,833**	**1,525,478**

COMPANY	Share capital	Property Revaluation reserve	Investment Revaluation reserve	Loan loss reserve	Retained earnings	Total
Balance at 1st January 2004	100,000	57,911	-	-	489,908	647,819
Reversal and transfer of general provision to loan loss reserve	-	-	-	36,634	-	36,634
Restated at 1st January 2004	**100,000**	**57,911**	**-**	**36,634**	**489,908**	**684,453**
Profit for the year	-	-	-		427,816	427,816
Transfer to investment revaluation	-	-	85,663		(85,663)	-
Deferred tax on investment revaluation	-	-	(25,699)		25,699	-
Transfer to loan loss reserve	-	-	-	8,400	(8,400)	-
Dividends paid	-	-	-	-	(150,000)	(150,000)
Balance at 31st December 2004	**100,000**	**57,911**	**59,964**	**45,034**	**699,360**	**962,269**
Balance at 1st January 2005	100,000	57,911	59,964	45,034	699,360	962,269
Profit for the year	-	-	-	-	550,869	550,869
Transfer to investment revaluation	-	-	142,316	-	(142,316)	-
Deferred tax on investment revaluation	-	-	24,106	-	(24,106)	-
Transfer to loan loss reserve	-	-	-	12,000	(12,000)	-
Surplus on property revaluation	-	69,216	-	-	-	69,216
Deferred tax on property revaluation	-	1,271	-	-	-	1,271
Dividends paid	-	-	-	-	(200,000)	(200,000)
Balance at 31st December 2005	**100,000**	**128,398**	**226,386**	**57,034**	**871,807**	**1,383,625**

Share capital

	Ordinary shares	
	2005	2004
In issue as at 1 January – fully paid	**100,000**	100,000
In issue as at 31 December – fully paid	**100,000**	100,000

The financial statements are to be read in conjunction with the accounting policies on pages 9 to 14 and notes on pages 15 to 26.

The auditor's report is on page 4.

FIRST MERCHANT BANK LIMITED

CONSOLIDATED BALANCE SHEETS
At 31st December 2005
In thousands of Malawi Kwacha

		GROUP		COMPANY	
	Note	**2005**	2004 As restated	**2005**	2004 As restated
LIABILITIES AND EQUITY					
Liabilities					
Current and savings accounts		**3,950,141**	2,988,982	**3,956,945**	2,995,514
Foreign currency accounts		**1,006,120**	1,556,358	**1,006,120**	1,556,358
Term deposits accounts		**1,866,074**	1,460,590	**1,052,360**	919,624
Total liabilities to customers	9	**6,822,335**	6,005,930	**6,015,425**	5,471,496
Income tax payable		**83,489**	66,949	**66,029**	63,116
Balances due to other financial institutions		**128,000**	491,500	**128,000**	491,500
Other payables	10	**429,351**	679,154	**416,157**	678,988
Deferred tax liabilities	11	**44,062**	95,267	**30,985**	82,663
Total liabilities		**7,507,237**	7,338,800	**6,656,596**	6,787,763
Equity					
Issued capital	12	**100,000**	100,000	**100,000**	100,000
Property revaluation reserve	13	**140,653**	57,911	**128,398**	57,911
Investment revaluation reserve	14	**226,386**	59,964	**226,386**	59,964
Loan loss reserve	15	**66,606**	47,193	**57,034**	45,034
Retained earnings		**991,833**	767,376	**871,807**	699,360
Total equity		**1,525,478**	1,032,444	**1,383,625**	962,269
Total equity and liabilities		**9,032,715**	8,371,244	**8,040,221**	7,750,032
ASSETS					
Cash and cash equivalents	16	**4,497,995**	4,570,565	**4,030,777**	4,247,794
Cheques in course of clearing		**80,600**	139,420	**80,600**	139,420
Other receivables	17	**94,011**	165,518	**91,662**	164,795
Loans and advances to customers	18	**2,553,142**	2,172,711	**2,520,280**	2,177,855
Finance leases	19	**524,020**	351,235	-	-
Quoted investments	21	**437,741**	322,816	**437,441**	322,516
Investment in subsidiary	22	**-**	-	**65,911**	65,911
		8,187,509	7,722,265	**7,226,671**	7,118,291
Property, plant and equipment	23	**845,206**	648,979	**813,550**	631,741
Total assets		**9,032,715**	8,371,244	**8,040,221**	7,750,032

The financial statements of the company were approved for issue by the Board of Directors on **18th February 2006** and were signed on its behalf by:

…………………………………………Director

…………………………………………Director

The financial statements are to be read in conjunction with the accounting policies on pages 9 to 14 and notes on pages 15 to 26.

The auditor's report is on page 4.

FIRST MERCHANT BANK LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the year ended 31st December 2005
In thousands of Malawi Kwacha

	Note	GROUP 2005	GROUP 2004	COMPANY 2005	COMPANY 2004
OPERATING ACTIVITIES					
Interest and fees received		**1,636,096**	1,603,039	**1,409,522**	1,408,595
Interest paid		**(368,883)**	(429,028)	**(255,495)**	(330,139)
Cash paid to suppliers and employees		**(637,344)**	(540,021)	**(609,978)**	(504,641)
		629,869	633,990	**544,049**	573,815
(Decrease)/increase in net customer balances		**(329,873)**	1,046,305	**(401,928)**	1,175,261
Cash generated from operations		**299,996**	1,680,295	**142,121**	1,749,076
Income taxes paid		**(148,866)**	(138,885)	**(133,354)**	(136,302)
Cash flows from operating activities		**151,130**	1,541,410	**8,767**	1,612,774
INVESTING ACTIVITIES					
Proceeds from sale of shares and other investments		**162,776**	275	**162,776**	-
Proceeds from sale of equipment		**3,301**	5,141	**15**	3,120
Acquisition of property and equipment	23	**(204,096)**	(290,607)	**(202,894)**	(284,238)
Gross dividend received		**36,311**	16,843	**36,311**	16,843
Purchase of shares in listed companies	21	**(21,992)**	(191,853)	**(21,992)**	(191,853)
Cash outflows applied to investing activities		**(23,700)**	(460,201)	**(25,784)**	(456,128)
FINANCING ACTIVITIES					
Dividend paid		**(200,000)**	(150,000)	**(200,000)**	(150,000)
Cash flows from financing activities		**(200,000)**	(150,000)	**(200,000)**	(150,000)
Net increase in cash and cash equivalents		**(72,570)**	931,209	**(217,017)**	1,006,646
Cash and cash equivalents at 1st January		**4,570,565**	3,639,356	**4,247,794**	3,241,148
Cash and cash equivalents at 31st December	16	**4,497,995**	4,570,565	**4,030,777**	4,247,794

ADDITIONAL STATUTORY INFORMATION

	GROUP 2005	GROUP 2004	COMPANY 2005	COMPANY 2004
Increase/(decrease) in net working capital	**279,307**	57,036	**222,047**	(259,197)

The financial statements are to be read in conjunction with the accounting policies on pages 9 to 14 and notes on pages 15 to 26.

The auditor's report is on page 4.

SIGNIFICANT ACCOUNTING POLICIES
For the year ended 31st December 2005

First Merchant Bank Limited is a private limited company incorporated in Malawi. The consolidated financial statements for the year ended 31st December 2005 comprise the Bank and its subsidiary, Leasing and Finance Company of Malawi Limited, (together referred to as the "Group")

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

(b) Adoption of new and revised international financial reporting standards

In the current year, the group has adopted all of the new and revised IFRSs and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on 1 January 2005. The adoption of these new and revised Standards and Interpretations has resulted in changes to the group's accounting policies in the following areas that have affected the amounts reported for the current or prior years:

- Property, Plant and Equipment (IAS 16); and
- Financial instruments: Recognition and Measurement (IAS 39).

The impact of these changes in accounting policies is discussed in detail below. The impact on basic earnings per share is disclosed in note 7.

At the date of authorisation of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

- IFRS 6 Exploration for and Evaluation of Mineral Resources.
- IFRS 7 Financial Instruments: Disclosures.
- IFRIC 4 Determining whether an Arrangement contains a Lease.
- IFRIC 5 Right to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds.
- IFRIC 6 Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic References.

The directors anticipate that other than the adoption of IFRS 7, these Standards and Interpretations in future periods will have no material impact on the financial statements of the group. The adoption of IFRS 7 will impact the disclosure and presentation of these financial statements.

IAS 16 (revised) Property, Plant and Equipment

IAS 16 (revised) effective for years beginning on or after 1 January 2005 has been adopted. The revised standard requires the group to assess the estimated remaining useful life and residual value of assets annually.

IAS 39 Financial Instruments: Recognition and measurement

IAS 39, effective for year beginning on or after 1 January 2005, disallows the creation of a general provision against financial assets as required by the Reserve Bank of Malawi. In addition, the prudential guidelines issued by the Reserve Bank of Malawi with regard to specific provisioning are no longer compatible with the requirements of IAS 39.

(c) Basis of preparation

The financial statements are presented in Malawi Kwacha, rounded to the nearest thousand. They are prepared on the historical cost basis except for land and buildings which are revalued and financial instruments which are stated at their fair value. Recognised assets and liabilities that are hedged are stated at fair value in respect of the risk that is being hedged. No other procedures are adopted to reflect the impact on the financial statements of specific changes or changes in the general level of prices. The accounting policies have been consistently applied by the group and are consistent with those used in the previous year.

(d) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the bank and its subsidiary, The Leasing and Finance Company of Malawi Limited.

Consolidation is based on 31st December 2005 audited financial statements. Inter-group balances and transactions and any unrealised gains arising from intra-group transactions other than arm's length transactions in the normal course of business are eliminated in preparing the consolidated financial statements.

(e) Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated to Malawi Kwacha at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Malawi Kwacha at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Malawi Kwacha at foreign exchange rates ruling at the dates the values were determined.

(f) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost or latest valuation and subsequent costs less accumulated depreciation (see below) and impairment losses (refer accounting policy (j)).

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

All properties are subject to revaluation every two years, with surpluses on revaluation being transferred to a non-distributable fixed assets revaluation reserve. On disposal of the asset, the appropriate portion of the non-distributable reserve is transferred to retained earnings.

(ii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property and equipment that is accounted for separately, including major inspection and overhaul expenditure, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

Generally, costs associated with information technology are recognised as an expense when incurred.
However, information technology development costs of a strategic nature are capitalised as part of computer equipment.

(iii) Depreciation

During the year, the group has adopted IAS 16 Property, Plant and Equipment (revised). This has given rise to a change in accounting policy.

Where previously fixed assets were depreciated on the straight-line basis at rates that would reduce book amounts to residual values, estimated at purchase, over the initially anticipated useful lives of the assets, the group now re-assesses both the useful lives and the residual values of the assets annually. Any future changes in either useful lives or estimated residual values will be accounted for prospectively as a change in accounting estimate in accordance with IAS 16 *Property, Plant and Equipment* (revised).

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of items of property and equipment, and major components that are accounted for separately. Land is not depreciated. The following depreciation rates are in use:

▪ leasehold properties	2.5% (or period of lease the shorter of)
▪ freehold properties	2.5%
▪ motor vehicles	25%-50%
▪ furniture, fixtures and fittings, computers, office equipment	25%-100%

(g) Investments

Investments in debt and equity securities

The fair value of investments held for trading is their quoted bid price at the balance sheet date.

Investments in equity are recognised at cost.

Investments held for trading are recognised/derecognised by the group on the date it commits to purchase/sell the investments. Investments held-to-maturity are recognised/derecognised on the day they are transferred to/by the group.

(h) Financial instruments

Financial assets and financial liabilities are recognised on the company's balance sheet when the company becomes a party to the contractual provisions of the instrument.

<u>Other receivables</u>

Other receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

Other receivables comprise interbranch accounts, interest receivables, prepayments, staff advances and office assets and are stated at their cost less impairment losses (refer accounting policy (j).

<u>Investments</u>

Investments are initially measured at fair value, plus directly attributable transaction costs.

At subsequent reporting dates, debt securities that the group has the expressed intention and ability to hold to maturity (held-to-maturity debt securities) are measured at amortised cost using the effective interest rate method, less any impairment loss recognised to reflect irrecoverable amounts. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the investment's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition. Impairment losses are reversed in subsequent periods when an increase in the investment's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to the restriction that the carrying amount of the investment at the date the impairment is reversed shall not exceed what the amortised cost would have been had the impairment not been recognised.

Investments other than held-to-maturity debt securities are classified as either investments held for trading or as available-for-sale, and are measured at subsequent reporting dates at fair value. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in the income statement for the period. For available-for-sale investments, gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the income statement for the period. Impairment losses recognised in income statement for equity investments classified as available-for-sale are not subsequently reversed through income statement. Impairment losses recognised in income statement for debt instruments classified as available-for-sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

Cash and cash equivalents
Cash and cash equivalents comprise cash on hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Financial liabilities and equity
Financial liabilities and equity instruments issued by the group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. The accounting policies adopted for specific financial liabilities are set out below.

Bank borrowings
Interest-bearing bank loans and overdrafts are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings in accordance with the company's accounting policy for borrowing costs (see above).

Other payables
Other payables are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

(i) Income from leasing

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for services provided in the normal course of business, net of sales related taxes.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

(j) Impairment

At each balance sheet date, the company reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately for assets carried at cost and for those carried at a re-valued amount, the impairment loss is treated as a revaluation decrease.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(k) Leases

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

The group as a lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the company's net investment outstanding in respect of the leases.

The group as a lessee

Rentals payable under operating leases are charged to income statement on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

(l) Provisions and other liabilities

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(m) Pension Scheme and other post retirement benefits

The bank operates a Defined Contribution Pension Scheme. Contributions to this fund, which are based on pensionable earnings are charged to income statement as they fall due.

(n) Revenue recognition

(i) Net interest income

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis, using the effective yield method. Interest income is suspended when the collection of loans becomes doubtful. Such income is excluded from income until received.

(ii) Other non-interest income

Other non-interest income includes fees and commissions from customers, other banks and related transactions, net income from exchange and securities dealing and net gains on the sale of assets.

Fees and commissions are recognised when the related service is performed.

(iii) Dividends

Dividends are recognised in the income statement when the company has an unconditional right to receive them.

(o) Expenses

(i) Terminal benefits

Accruals are made for terminal benefits and gratuities for those employees who are not covered by the Pension Fund and are charged to income statement up to the date of the balance sheet.

(ii) Off balance sheet transactions

The bank enters into off -balance sheet transactions such as forward exchange contracts and currency swaps. At the year end, unrealised gains and losses are dealt with through the income statement.

(p) Income tax

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates ruling at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates ruling at the balance sheet date.

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

(q) Basic earnings per share

Basic earnings per share is calculated by dividing net profit attributable to ordinary shareholders by the number of ordinary shares in issue at the balance sheet date.

(r) Critical accounting judgements and key sources of estimation uncertainty

Critical judgements in applying the company's accounting policies

No critical judgements were made by management during the current period which would have a material impact on the financial statements.

Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Specific provisions

Loans and advances are recognised when cash is advanced to borrowers.

A provision for loan impairment is established if there is objective evidence that the company will not be able to collect all amounts due according to the original contractual terms of loans. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of loans.

A general provision for loan impairment is established to cover losses that are judged to be present in the lending portfolio at the balance sheet date, but which have not been specifically identified as such. This provision is based on the directors' assessment of the latent risk of default known to be present in the portfolio of the Bank's advances.

When a loan is deemed uncollectable, it is written off against the related provision for impairments. Subsequent recoveries are credited to the provision for loan losses in the profit and loss account.

If the amount of the impairment subsequently decreases due to an event occurring after the write-down, the release of the provision is credited as a reduction of the provision for impairment in the profit and loss account.

Valuation of properties

The assumptions and method of revaluing properties are disclosed in note 23.

FIRST MERCHANT BANK LIMITED

In thousands of Malawi Kwacha

1. RESTATEMENT OF PRIOR FIGURES

In prior periods the carrying values of loans, advances and finance leases were reduced by a non-specific loss provision which was charged to income statement net of the related deferred tax effect. This accounting policy has been changed to comply with the requirements of IAS39 and, accordingly, prior period results have been restated by reversing non specific provisions made and adjusting the deferred tax charge.

	GROUP		COMPANY	
2. INCOME FROM INVESTMENTS	**2005**	2004	**2005**	2004
Interest from local registered stocks	**18,000**	18,000	**18,000**	18,000
Dividend income (gross)	**42,791**	24,403	**42,791**	24,403
Increase in fair value of investments	**153,157**	85,663	**153,157**	85,663
	213,948	128,066	**213,948**	128,066
3. OTHER INCOME				
Profit on foreign exchange transactions	**196,590**	211,120	**196,590**	211,120
Profit on disposal of motor vehicle and equipment	**3,287**	2,600	**15**	869
Asset management income	**10,147**	8,269	**10,147**	8,269
Profit on disposal of shares	**102,552**	-	**102,552**	-
Miscellaneous recoveries	**85,224**	46,936	**84,391**	47,869
	397,800	268,925	**393,695**	268,127
4. STAFF AND TRAINING COSTS				
Salaries, wages and training costs	**311,432**	286,479	**295,513**	274,573
Contributions to defined contribution plans (Note 25)	**8,678**	6,700	**8,080**	6,257
	320,110	293,179	**303,593**	280,830
5. OTHER OPERATING COSTS				
Auditor's remuneration -Current audit fees	**5,798**	4,222	**3,500**	2,800
-Underprovision in previous year	**113**	426	-	-
-Other services and surtax	**1,035**	943	**613**	620
Directors' fees	**18,023**	16,060	**17,837**	16,010
Telephone/telex/fax/postage	**24,479**	18,966	**22,379**	17,264
Printing and stationery	**26,327**	24,461	**25,427**	22,835
Travel	**13,064**	-	**13,064**	11,310
Subscriptions	**10,009**	-	**10,009**	4,524
Legal & professional fees	**9,984**	-	**9,984**	4,566
Donations	**9,488**	-	**9,488**	5,038
Others	**134,630**	109,516	**127,234**	73,925
	252,950	174,594	**239,535**	158,892
6. INCOME TAX EXPENSE				
Recognised in the income statement				
Current tax expense				
Current year at **30%** (2004: 30%) based on profits	**163,472**	155,462	**134,333**	145,733
Dividend tax expense	**1,934**	1,445	**1,934**	1,445
Deferred tax (credit)/expense				
Origination and reversal of timing differences	**(53,548)**	38,796	**(50,407)**	35,722
Total income tax expense in income statement	**111,858**	195,703	**85,860**	182,900

In thousands of Malawi Kwacha

7. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share at 31st December 2005 was based on the consolidated net profit attributable to ordinary shareholders of **MK610 million** (2004: MK477 million) and number of ordinary shares outstanding as at 31st December 2005 of **100 million** (2004: 100 million).

Impact of changes in accounting policy
Changes in the group's accounting policies during the year are described in detail in note 13,17 and 22. To the extent that those changes have had an impact on results reported for 2005 and 2004, they have had an impact on the amounts reported for earnings per share. The following table summarises that impact on basic earnings per share:

	Impact on basic earnings per share (K)	
		As restated
	2005	2004
Charge in residual values and estimated useful lives of property, plant and equipment	-	-
Derecognition of general provision against finance leases	**0.65**	0.33
Derecognition of general provision against loans and advances	**1.20**	0.84
Total impact of changes in accounting policy	**1.85**	1.17

8. DIVIDENDS

Proposed dividends are accounted for as a separate component of equity until they have been ratified at an annual general meeting.

The directors propose a dividend of **MK40 million** for the year ended 31 December 2005 (2004: MK22 million).

Last year's final dividend of MK22 million and an interim dividend for this year of MK178 million were paid during the year. Payment of dividend is subject to withholding tax at a rate of 10%.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31st December 2005
In thousands of Malawi Kwacha

		GROUP		COMPANY	
9.	**LIABILITIES TO CUSTOMERS**	**2005**	2004	**2005**	2004
	Interest bearing deposits	**6,822,335**	6,005,930	**6,015,425**	5,471,496
	Payable as follows:				
	Maturing within 3 months	**6,657,769**	5,925,414	**5,987,035**	5,443,844
	Maturing between 3 and 12 months	**164,566**	80,516	**28,390**	27,652
		6,822,335	6,005,930	**6,015,425**	5,471,496
10.	**OTHER PAYABLES**				
	Interest payable	**10,517**	9,694	**10,517**	9,694
	Bankers cheques issued and uncleared	**33,871**	99,738	**33,871**	99,738
	Margins on letters of credit and forward contracts	**142,735**	389,738	**142,735**	389,738
	Others	**242,228**	179,984	**229,034**	179,818
		429,351	679,154	**416,157**	678,988

11. DEFERRED TAX (ASSETS) AND LIABILITIES

	Assets		Liabilities		Net	
	2005	2004	**2005**	2004	**2005**	2004
(i) **GROUP**						
Property and equipment	**(3,586)**	(9,342)	**-**	-	**(3,586)**	(9,342)
Accrued income	**-**	-	**15,031**	52,032	**15,031**	52,032
Revaluation surplus of property	**-**	-	**23,547**	25,449	**23,547**	25,449
Revaluation on investments	**-**	-	**1,593**	25,699	**1,593**	25,699
Other temporary differences	**(1,553)**	(1,968)	**9,030**	3,397	**7,477**	1,429
Tax (assets)/liabilities	**(5,139)**	(11,310)	**49,201**	106,577	**44,062**	95,267
(ii) **COMPANY**						
Property and equipment	**(3,387)**	(8,994)	**-**	-	**(3,387)**	(8,994)
Accrued income	**-**	-	**10,785**	43,108	**10,785**	43,108
Revaluation of property	**-**	-	**23,547**	24,818	**23,547**	24,818
Revaluation on investments	**-**	-	**1,593**	25,699	**1,593**	25,699
Gratuity	**(1,553)**	(1,968)	**-**	-	**(1,553)**	(1,968)
Tax (assets)/liabilities	**(4,940)**	(10,962)	**35,925**	93,625	**30,985**	82,663

12. SHARE CAPITAL

	Ordinary shares	
	2005	2004
In issue and fully paid at 31st December	**100,000**	100,000

At 31st December 2005 the authorised share capital comprised **100,000,000** (2004: 100,000,000) ordinary shares of K1 each.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

In thousands of Malawi Kwacha

13. PROPERTY REVALUATION RESERVE

This represents the increase in fair value of property, plant and equipment and is not available for distribution to the Bank's shareholders.

14. INVESTMENT REVALUATION RESERVE

This represents the increase in fair value of investments held for trading and is not available for distribution to the Bank's shareholders.

15. LOAN LOSS RESERVE

Arising from the changes to IAS 39: *Financial Instruments: Recognition and Measurement*, the 1% general provision against risky assets as required by the Reserve Bank of Malawi may no longer be offset against the gross value of the assets.

In order to comply with Reserve Bank of Malawi capital adequacy requirements, a statutory loan loss reserve has been created. The portion of the loan loss reserve which relates to this statutory requirement and is non distributable amounts to K26.9 million as at 31st December 2005. The balance of the loan loss reserve amounting to K39.71 million should be regarded as distributable.

16. CASH AND CASH EQUIVALENTS

	GROUP		COMPANY	
	2005	2004	**2005**	2004
Liquidity Reserve Deposits				
- Reserve Bank of Malawi	**328,079**	474,670	**328,079**	474,670
- Registered discount houses	**187,000**	129,000	**187,000**	129,000
	515,079	603,670	**515,079**	603,670
Placements with other banks	**1,200,000**	220,000	**1,200,000**	220,000
Balances with banks abroad	**1,096,777**	1,970,203	**1,096,777**	1,970,203
Malawi Government treasury bills	**1,114,603**	1,510,920	**647,820**	1,188,798
Reserve Bank of Malawi Bills	**202,965**	-	**202,965**	-
Balances with local banks	**3,181**	13,305	**2,746**	12,656
Cash balances	**365,390**	252,467	**365,390**	252,467
Cash and cash equivalents	**4,497,995**	4,570,565	**4,030,777**	4,247,794

In thousands of Malawi Kwacha

		GROUP		COMPANY	
17.	**OTHER RECEIVABLES**	**2005**	2004	**2005**	2004
	Dividends receivable	**14,040**	7,560	**14,040**	7,560
	Items in transit	**19,479**	131,371	**19,479**	131,371
	Interest receivable	**11,172**	10,069	**11,172**	10,037
	Prepayments	**5,286**	5,607	**2,969**	4,916
	Others	**44,034**	10,911	**44,002**	10,911
		94,011	165,518	**91,662**	164,795

18. LOANS AND ADVANCES TO CUSTOMERS

Loans and advances which are secured over the relevant assets are receivable as follows:-

	GROUP 2005	GROUP 2004	COMPANY 2005	COMPANY 2004
Maturing within 3 months	**834,945**	734,947	**821,936**	726,579
Maturing between 3 and 12 months	**1,767,885**	1,288,244	**1,749,003**	1,304,354
Maturing after 12 months	**169,820**	220,992	**168,849**	218,394
	2,772,650	2,244,183	**2,739,788**	2,249,327
Segmental analysis by industry:				
Agriculture	**209,358**	404,695	**209,358**	404,695
Finance and insurance	**45,111**	62,819	**31,091**	81,285
Government accounts	**21,745**	256,454	**21,745**	256,454
Individuals	**94,345**	95,709	**92,362**	95,709
Manufacturing	**352,450**	178,302	**352,450**	178,302
Wholesale and retail	**920,886**	271,196	**920,886**	271,196
Others	**1,128,755**	975,008	**1,111,896**	961,686
	2,772,650	2,244,183	**2,739,788**	2,249,327
Provision for losses:				
Specific Provision - At 1st January	**(22,504)**	(19,606)	**(22,504)**	(19,606)
New provision	**(105,296)**	(10,310)	**(105,296)**	(10,310)
Write offs	**-**	1,682	**-**	1,682
Recoveries	**7,522**	5,730	**7,522**	5,730
-At 31st December	**(120,278)**	(22,504)	**(120,278)**	(22,504)
Interest in suspense: At 1st January	**(48,968)**	(32,407)	**(48,968)**	(32,407)
New provision	**(50,262)**	(16,561)	**(50,262)**	(16,561)
At 31st December	**(99,230)**	(48,968)	**(99,230)**	(48,968)
Net loans and advances	**2,553,142**	2,172,711	**2,520,280**	2,177,855

The directors consider that the carrying amount of loans and advances approximates to their fair value.

All loans and advances are granted at variable interest rates and have been written down to their estimated recoverable amount.

Change in accounting policy

During the year the group adopted IAS 39 *Financial Instruments: Recognition and Measurement* (Revised). This adoption constitutes a change in accounting policy as discussed under note 15.

Effect of change in accounting policy:	**2005**	2004
Decrease in general provision	-	48,210
Tax effect	-	(14,463)
Net effect of the change in accounting policy	-	33,747

19. FINANCE LEASES

Lease debtors, which are secured over the relevant assets, are receivable as follows:-

	GROUP 2005	2004
Maturing within 3 months	**65,684**	66,611
Maturing between 3 and 12 months	**118,923**	90,188
Maturing after 12 months	**372,859**	237,780
	557,466	394,579
Specific provision at 1st January	**(27,568)**	(27,570)
New provision	**636**	(2,045)
Write offs	**3,514**	2,047
At 31st December	**(23,418)**	(27,568)
Interest in suspense at 1st January	**(12,966)**	(12,174)
New provision	**-**	(3,459)
Recoveries	**4,938**	2,667
At 31st December	**(8,028)**	(12,966)
Interest on overdue debts at 1st January	**(2,810)**	(4,900)
New provision	-	-
Recoveries	**810**	2,090
At 31st December	**(2,000)**	(2,810)
Net finance leases	**524,020**	351,235
Government sub-lease debtors	**18,446**	18,446
Rural motorised project	**(18,446)**	(18,446)
Total net finance leases	**524,020**	351,235

The directors consider that the carrying amount of lease debtors approximates to their fair value.

The group's credit risk is primarily attributed to its lease debtors. The amounts presented in the balance sheets are net of provisions for doubtful debts as shown above. The specific provision is estimated by management based on a review of objective evidence indicating an impairment of individual lease assets, taking into account prior experience and the current economic environment.

There is no significant concentration of credit risk, with exposure spread over a large number of counter parties and customers. The directors consider that the carrying amount of lease and other debtors approximates to their fair value.

20. GOVERNMENT OF MALAWI LEASES

The group is party to an agreement with the Government of Malawi in respect of vehicles which were leased from the Government and sublet to transporters. Under the terms of the lease agreements, the obligations of the group are restricted to payment to the Government of instalments received by the group from the sub-lessees and no liability exists in respect of unpaid instalments. At the balance sheet date, there was an offsetting asset and liability of **K18.4 million** (2004: K18.4 million).

In thousands of Malawi Kwacha

21. QUOTED INVESTMENTS

	GROUP				COMPANY			
	2005		2004		**2005**		2004	
	Cost	**Valuation**	Cost	Valuation	**Cost**	**Valuation**	Cost	Valuation
Investments in quoted companies	**164,462**	**392,441**	191,853	277,516	**164,462**	**392,441**	191,853	277,516
Local registered stocks	**45,300**	**45,300**	45,300	45,300	**45,000**	**45,000**	45,000	45,000
	209,762	**437,741**	237,153	322,816	**209,462**	**437,441**	236,853	322,516

All investments in quoted companies are held for trading. The increase in fair value is taken to income statement.

Movement of Quoted Investments	GROUP		COMPANY	
	Cost	Valuation	**Cost**	Valuation
Balance at 1st January 2005				
- Investments in quoted companies	**191,853**	**277,516**	**191,853**	**277,516**
- Local registered stocks	**45,300**	**45,300**	**45,000**	**45,000**
Shares bought during the year	**21,992**	**21,992**	**21,992**	**21,992**
Increase in fair value	**-**	**153,157**	-	**153,157**
Shares disposed of during the year	**(49,383)**	**(60,224)**	**(49,383)**	**(60,224)**
Balance at 31st December 2005	**209,762**	**437,741**	**209,462**	**437,441**

22. INVESTMENTS IN SUBSIDIARY (AT COST)

	SHAREHOLDING		COMPANY	
	2005	2004	**2005**	2004
The Leasing and Finance Company of Malawi Limited	**100%**	100%	**65,911**	65,911

FIRST MERCHANT BANK LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December 2005

In thousands of Malawi Kwacha

23. PROPERTY, PLANT AND EQUIPMENT

GROUP	Freehold property	Leasehold improvements	Motor Vehicles	Equipment Fixture & fittings	Capital work in progress	2005 Total	2004 Total
Cost or valuation							
Balance at 1st January	233,668	145,808	30,138	303,627	121,691	**834,932**	556,379
Additions	5,146	29,723	14,939	153,200	1,088	**204,096**	290,607
Transfers	11,089	90,808	-	16,353	(118,250)	**-**	-
Revaluation surplus	36,562	28,375	-	-	-	**64,937**	-
Disposals	-	-	(2,752)	(495)	(3,441)	**(6,688)**	(12,054)
Balance at 31st December	**286,465**	**294,714**	**42,325**	**472,685**	**1,088**	**1,097,277**	834,932
Depreciation and impairment losses							
Balance at 1st January	7,113	2,513	18,536	157,791	-	**185,953**	140,020
Charge for the year	6,712	3,836	5,685	73,266	-	**89,499**	55,446
Eliminated on revaluation	(13,825)	(6,324)	-	-	-	**(20,149)**	-
Released on disposal	-	-	(2,752)	(480)	-	**3,232**	(9,513)
Balance at 31st December	**-**	**25**	**21,469**	**230,577**	**-**	**252,071**	185,953
Carrying amount							
At 31st December	**286,465**	**294,689**	**20,856**	**242,108**	**1,088**	**845,206**	648,979

COMPANY	Freehold property	Leasehold improvements	Motor Vehicles	Equipment Fixture & fittings	Capital work in progress	2005 Total	2004 Total
Cost or valuation							
Balance at 1st January	223,478	145,808	23,463	286,077	121,691	**800,517**	524,083
Additions	5,146	29,723	14,939	151,998	1,088	**202,894**	284,238
Transfers	11,089	90,808	-	16,353	(118,250)	-	-
Revaluation surplus	21,482	28,375	-	-	-	**49,857**	-
Disposals and write offs	-	-	-	(39)	(3,441)	**(3,480)**	(7,804)
Balance at 31st December	**261,195**	**294,714**	**38,402**	**454,389**	**1,088**	**1,049,788**	800,517
Depreciation and impairment losses							
Balance at 1st January	6,548	2,513	14,762	144,953	-	**168,776**	120,689
Charge for the year	6,487	3,836	4,875	71,661	-	**86,859**	53,640
Eliminated on revaluation	(13,035)	(6,324)	-	-	-	**(19,359)**	-
Released on disposal	-	-	-	(38)	-	**(38)**	(5,553)
Balance at 31st December	**-**	**25**	**19,637**	**216,576**	**-**	**236,238**	168,776
Carrying amount							
At 31st December	**261,195**	**294,689**	**18,765**	**237,813**	**1,088**	**813,550**	631,741

Registers of land and building giving details as required under the Companies Act 1984, Schedule 3, Section 16 are maintained at the registered office of the company and are open for inspection by members or their duly authorised agents.

The freehold properties were last revalued on 31st December 2005 by Don Whayo BSc MRICS MSIM of Knight Frank, independent valuers, not connected with the group, on a market value basis. The resultant surplus of K85.086 million was credited to revaluation reserve. The valuations were prepared in accordance with RICS Appraisal and Valuation Standards.

Capital work in progress represents development costs on the bank's various branches.

In thousands of Malawi Kwacha

Change in accounting policy

During the year the group adopted IAS 16 *Property, Plant and Equipment* (revised), which requires the estimated residual values and useful lives of property, plant and equipment to be reassessed on an annual basis. This constitutes a change in accounting policy for the group.

The change in accounting policy did not have a material effect on the financial statements.

24. CONTINGENT ASSETS/LIABILITIES

	GROUP		COMPANY	
	2005	2004	**2005**	2004
Letters of credit	**343,411**	471,015	**343,411**	471,015
Guarantees	**1,073,631**	742,312	**1,073,631**	742,312
Travellers cheques	**189,411**	382,986	**189,411**	382,986
Foreign bills lodged	**742,863**	518,956	**742,863**	518,956
Forward sale contracts	**380**	-	**380**	-
	2,349,696	2,115,269	**2,349,696**	2,115,269

25. EMPLOYEE BENEFITS

Expense recognised in the income statement

Contributions to defined contribution plans (Note 4)	**8,680**	6,700	**8,080**	6,257

The Group Pension Scheme is First Merchant Bank Limited Group Pension and Life Assurance Scheme covering all employees in the permanent service of the group. The company, its subsidiary and employees contribute to a Deposit Fund established thereunder. The scheme is administered by NICO Life Insurance Company Limited and the deposit fund is managed by the Bank.

26. FINANCIAL INSTRUMENTS

Exposure to credit, interest rate and currency risk arises in the normal course of the group's business. Financial instruments are used to reduce exposure to fluctuations in foreign exchange rates and interest rates. While these are subject to the risk of market rates changing subsequent to acquisition, such changes are generally offset by opposite effects on the items being hedged.

Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers.

Investments are allowed only in liquid securities and only with well known counterparties.

On the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet. Throughout the year the group complied with the Reserve Bank of Malawi directive on credit concentration.

Foreign exchange risk

The Group incurs foreign currency risk on sales, purchases and borrowings that are denominated in a currency other than Malawi Kwacha. The currencies giving rise to this risk are primarily Pounds Sterling, US Dollars, South African Rand and Euro. All the transactions entered into during the year were within the foreign currency exposure and foreign currency lending directives of Reserve Bank of Malawi.

Liquidity risk
Liquidity risk arises where the operations of the Bank cannot be funded due to mismatches in the cash flows of assets and liabilities within the balance sheet. The Bank has an Asset and Liability Committee (ALCO) which reviews the potential for these mismatches, takes measures to alter certain maturity profiles where necessary with a view to minimising the impact of such mismatches.

Interest rate risk
Interest rate risk is generally referred to as the exposure of the Bank's net interest income to adverse movements in interest rates as a result of assets and liabilities re-pricing at different times and using different bases. The risk therefore has a direct impact on the Bank's net interest margin. The Bank's ALCO reviews the re-pricing gap periodically and appropriate action is taken to reduce the effect of the risk.

Operational risk
This is the risk of losses arising from the operations of the Bank. Losses can occur due to system malfunctioning or failure to follow procedures. Operational risk manifests itself in losses, customer complaints and claims. To mitigate the risk, management continuously reviews the controls and procedures in place. Internal audit department, periodically reviews and determines whether the controls in place are complied with and are commensurate with the risk involved.

Fair values and effective interest rates of financial assets and liabilities
In the opinion of directors, the fair values of the group's financial assets and liabilities approximate the respective carrying amounts, due to the generally short period to contractual repricing or maturity dates. Fair values are based on discounted cashflows using a discount rate based upon the borrowing rate that directors expect would be available to the group at the balance sheet date.

The effective interest rates for the principal financial assets and liabilities at 31st December 2005 and 2004 were in the following ranges:-

	2005	2004
	In MK	In MK
Assets:		
Government securities	**24-25%**	24-25%
Deposits with banking institutions	**18-24%**	24-25%
Loans and advances to customers	**24-31%**	24-31%
Liabilities		
Customer deposits	**8-13%**	8-13%

27. RELATED PARTY TRANSACTIONS

The Bank transacts part of its business on an arm's length basis with related parties. These include loans, deposits, rental payments and foreign currency transactions. As on 31st December 2005, advances to the Bank's subsidiary company, Leasing and Finance Company of Malawi Limited totalled **KNil million** (2004: K1.3 million). The last year's balance was fully secured by Treasury bills. Loans and advances to other related parties totalled **K8.3 million** (2004: K7.2 million) which were fully secured by fixed and floating charges.

During the year the group made payments of **K9.7 million** (2004: 1.6 million) to companies affiliated to its shareholders in respect of handling charges and rental payments for properties occupied by the group.

28. CAPITAL COMMITMENTS

	GROUP		COMPANY	
	2005	2004	**2005**	2004
Capital expenditure				
Authorised and contracted	**22,707**	140,039	**22,707**	140,039
Authorised but not contracted	**1,000**	59,569	**-**	58,689
	23,707	199,608	**22,707**	198,728

29. STATUTORY REQUIREMENTS

In accordance with Section 27 of the Banking Act 1989, the Reserve Bank of Malawi has established the following requirements as at the balance sheet date:

(i) Liquidity Reserve Requirement
The Bank is required to maintain a liquidity reserve ratio, calculated on a weekly average basis, of not less than **27.5%** (2004: 27.5%) of the preceding weeks total deposit liabilities. In the last week of December 2005, the liquidity reserve was **28%** (2004: 28%) of total customer deposits.

(ii) Capital Adequacy Requirement
The Bank's available capital is required to be a minimum of 10% of its risk bearing assets and contingent liabilities. At 31st December 2005, the Bank's available capital was **23%** (2004: 19%) of its risk bearing assets and contingent liabilities.

(iii) Loan loss provision
The cumulative loan loss provision in accordance with Reserve Bank of Malawi amounts to MK67 million. The amount of provisions included in the financial statements in accordance with IAS39 is MK220 million which is in excess of RBM requirements.

30. PRUDENTIAL ASPECTS OF BANK LIQUIDITY

The Reserve Bank of Malawi has issued the following guidelines on the management of liquidity:

- Liquidity Ratio 1: Net liquidity (total liquid assets less suspense account in foreign currency) divided by total deposits must be at least 30%.

- Liquidity Ratio 2: Net liquidity (total liquid assets less suspense account in foreign currency and cheques in the course of collection) divided by total deposits must be at least 20%.

As at 31st December 2005, the Bank's Liquidity Ratio 1 was **89%** (2004: 79%) and Liquidity Ratio 2 was **87%** (2004: 77%).

31. EXCHANGE AND INFLATION

The average of the year-end buying and selling rates of the major foreign currencies most affecting the performance of the group are stated below, together with the increase in the National Consumer Price Index, which represent an official measure of inflation.

Exchange rates	**2005**	2004	2003
	MK	MK	MK
Kwacha/GBP	**215.9**	210.6	193.7
Kwacha/Rand	**19.8**	19.9	16.7
Kwacha/US Dollar	**123.8**	108.9	108.4
Kwacha/Euro	**148.4**	148.8	136.7
Inflation rate %	**15.4%**	11.5%	9.6%

At the time of signing these financial statements the exchange rates had moved to:

Kwacha/GBP	**231.7**
Kwacha/Rand	**22.1**
Kwacha/US Dollar	**132.1**
Kwacha/Euro	**158.7**

32. INCORPORATION

First Merchant Bank Limited is a private company incorporated in Malawi under the Malawi Companies Act 1984 and is registered as a commercial bank under the Banking Act (1989).

33. SUBSEQUENT EVENTS

Subsequent to the Balance Sheet date no events have occurred necessitating adjustments to or disclosures in the financial statements.

FIRST MERCHANT BANK LIMITED