

**BANK
OF
BOTSWANA**

ANNUAL REPORT

2004

blank page 2



BANK OF BOTSWANA

Governor's Office
Tel : (267) 360-6371/67/79
Fax : (267) 371231

Private Bag 154
Gaborone
Botswana

Ref: RD 10/1/1

March 31, 2005

Honourable B. Gaolathe
Minister of Finance and Development Planning
Private Bag 008
Gaborone

Honourable Minister

In accordance with Section 57 (1) of the Bank of Botswana Act, 1996, I have the honour to submit, herewith, the *Annual Report* of the Bank of Botswana for 2004, which covers:

- (i) a report on the operations and other activities of the Bank during 2004;
- (ii) a copy of the Bank's annual accounts for the year ended December 31, 2004 certified by the external auditors and approved by the Board on March 22, 2005; and
- (iii) a review of the economy in 2004, a theme chapter on *Improved Productivity – The Key To Sustained Growth and Higher Living Standards for All* and a statistical section.

Yours sincerely

Linah K. Mohohlo
GOVERNOR

BOARD MEMBERS
as at December 31, 2004



L. K. Mohohlo
Governor and Chairman of the Board



G. K. Cunliffe
Board Member



J. Sentsho
Board Member



S. S. G. Tumelo
Board Member



B. Moeletsi
Board Member



U. Corea
Board Member

DEPUTY GOVERNORS



O. A. Motshidisi



K. R. Jefferis

BOARD MEMBERS
as at December 31, 2004

L. K. Mohohlo
Governor and Chairman of the Board

S. S. G. Tumelo
Board Member

G. K. Cunliffe
Board Member

J. Sentsho
Board Member

B. Moeletsi
Board Member

U. Corea
Board Member

CONTENTS – PART A

Statutory Report on the Operations and Financial Statements of the Bank in 2004

	Page
1. An Overview of the Bank	15
Objectives of the Bank	15
Functions of the Bank	15
Structure of the Bank	16
Strategies	17
2. Report on the Bank's Operations	19
Introduction	19
External Relations	20
Management and Administration of the Bank	20
Monetary Policy Implementation	21
Reserve Management	21
Domestic Market Operations	21
Banking, Currency and Payment System Issues	21
Banking Supervision	22
Agency Role	22
Information Technology	22
Protective Services	23
3. Annual Financial Statements	25

CONTENTS – PART B

		Page
1.	The Botswana Economy in 2004	51
	Output, Employment and Prices	51
	Public Finance	57
	Exchange Rates, Balance of Payments and International Investment Position	60
	Money and Capital Markets	64
2.	Improved Productivity – The Key to Sustained Growth and Higher Living Standards for All	73
	Introduction	73
	Productivity And Economic Growth	75
	Issues in Measuring Productivity	83
	Enhancing and Maintaining Productivity Growth: The Case of Botswana	90
	Productivity, Sustained Growth and Higher Living Standards for All	102
	Conclusion	109
	Appendix A: Data Sources and Growth Accounting Methodology	111

FIGURE, CHARTS, AND TABLES

Figure	Page
Figure 2.1: The Stages of Technological Progress	79
Charts	
Chart 1.1 Growth in Real Gross Domestic Product	51
Chart 1.2 Economic Growth by Sector	51
Chart 1.3 Botswana Inflation	56
Chart 1.4 CPI Inflation by Tradeability	56
Chart 1.5 International Inflation	56
Chart 1.6 Nominal and Real Effective Exchange Rates and Relative Prices	61
Chart 1.7 NEER and Nominal Exchange Rate Indices Against Selected Currencies	61
Chart 1.8 Outstanding Bank of Botswana Certificates (BoBCs)	66
Chart 1.9 Yield to Maturity on BoBCs and Government Bonds	67
Chart 1.10 Real Interest Rates: International Comparisons	68
Chart 1.11 Annual Growth Rates of Credit	68
Chart 2.1 Real GDP, Real GDP Less Mineral Rents, and Growth Rates of GDP and GDP per Capita (3-Year Moving Averages)	84
Chart 2.2 Labour Force and Capital Stock	85
Chart 2.3 Real Recurrent Expenditure on Health and Education and 3-Year Moving Average Growth Rates	86
Chart 2.4 Sectoral Share in GDP: 1974/75	87
Chart 2.5 Sectoral Share in GDP: 2002/03	87
Chart 2.6 Sectoral Share in GDP	87
Chart 2.7 Total Factor Productivity Growth	88
Tables	
Table 1.1 The Government Budget: 2003/04 – 2005/06 (P million)	58
Table 1.2 Pula Exchange Rates Against Selected Currencies	60

	Page	
Table 1.3	Balance of Payments: 2000–2004 (P million)	62
Table 1.4	Major Exports (P million)	62
Table 1.5	Levels of Foreign Investment in Botswana by Industry (P million as at 31 December 2003)	65
Table 1.6	Levels of Foreign Investment in Botswana by Country (P million as at 31 December 2003)	65
Table 1.7	Structure of Bank of Botswana Certificate Holdings	67
Table 1.8	Nominal Yields to Maturity on BoBCs and Government Bonds (Percent)	67
Table 2.1	Percentage Shares of Factor Payments to Capital, Skilled Labour and Unskilled Labour: 1985/86, 1992/93 and 1996/97	85
Table 2.2	Total Factor Productivity Growth, 1974/75 to 2004/05	90
Table 2.3	Sources of Real GDP Growth for Selected Countries and Country Groupings	91
Table 2.4	Trends in Income Inequality, 1985/86 – 2002/03 (gini coefficient)	105
Table 2.5	Real Income Growth, 1993/94 – 2002/03 (percent)	105
Table 2.6	Poverty in Botswana (percent of population)	106
Table 2.7	Economically Active Population 1991 – 2001 ('000)	107
Table 2.8	Unemployment by Settlement Type, 2002/03 (Percent)	107
Table A.1	Factor Inputs and Output: 1974/75 to 2004/05 (1993/94 prices)	112
Table A.2	Growth Competitiveness Index (GCI) Rankings for Selected Countries: 2003	113
Table A.3	The Networked Readiness Index (NRI) Rankings for Selected Countries: 2003–2004	114
Table A.4	Trade Competitiveness Rankings for Selected African Countries: 1980–2001	115
Table A.5	Indicators of Ease or Difficulty of Doing Business in Selected Countries: 2004	116

ABBREVIATIONS USED IN THE REPORT

AGOA	Africa Growth Opportunity Act
ATM	Automated Teller Machine
BCI	Business Competitiveness Index
BoBCs	Bank of Botswana Certificates
BDC	Botswana Development Corporation
BEDIA	Botswana Export Development and Investment Agency
BIDPA	Botswana Institute for Development and Policy Analysis
BMC	Meat Commission
BNPC	Botswana National Productivity Centre
BOTEC	Botswana Technology Centre
BSB	Botswana Savings Bank
BSE	Botswana Stock Exchange
BURS	Botswana Unified Revenue Services
CSO	Central Statistics Office
CEDA	Citizen Entrepreneurial Development Agency
DCEC	Directorate on Corruption and Economic Crime
DPCF	Debt Participation Capital Funding
ECH	Electronic Clearing House
EFT	Electronic Funds Transfer
FAP	Financial Assistance Policy
FDI	Foreign Direct Investment
FIAS	Foreign Investment and Advisory Service
FTA	Free Trade Area
GC	Gini Coefficient
GCI	Growth Competitiveness Index
GDP	Gross Domestic Product
HIES	Household Income and Expenditure Survey
ICT	Information and Communications Technology
IFSC	International Financial Services Centre
IIP	International Investment Position
IMF	International Monetary Fund

KBL	Kgalagadi Breweries Limited
MDGs	Millennium Development Goals
MEI	Macroeconomic Environment Index
NDB	National Development Bank
NEER	Nominal Effective Exchange Rate
NPS	National Payment System
NRI	Network Readiness Index
NTBs	Non-Tariff Barriers
OCC	Olympia Capital Corporation Limited
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum Exporting Countries
PDSF	Public Debt Service Fund
PMS	Performance Management System
PMP	Privatisation Master Plan
PRI	Productive Resource Index
QPI	Quality and Public Institutions Index
REER	Real Effective Exchange Rate
REI	Rigidity Employment Index
RIIC	Rural Industries Innovation Centre
RTGS	Real Time Gross Settlement
SADC	Southern African Development Community
SDR	Special Drawing Right
SSA	Sub-Saharan Africa
VAT	Value Added Tax
TFP	Total Factor Productivity
TCI	Trade Competitiveness Index
TEI	Trade-Enabling Environment Index
TI	Technology Index
UN	United Nations
UNDP	United Nations Development Programme
WEF	World Economic Forum

BLANK PAGE 12 NOT NUMBERED

PART A

STATUTORY REPORT ON THE OPERATIONS AND FINANCIAL STATEMENTS OF THE BANK, 2004

BANK OF BOTSWANA

HEADS OF DEPARTMENT
as at December 31, 2004



R. H. Nlebesi
Banking Department



E. T. Rakhudu
*Administration Department
(Acting)*



O. Mabusa
Banking Supervision Department



N. A. Mabe
Accounting Department



A. M. Motsomi
Research Department



J. Ghanie
Information Technology Department



O. Modisa
Financial Markets Department

STATUTORY REPORT ON THE OPERATIONS OF THE BANK IN 2004

1. AN OVERVIEW OF THE BANK

Objectives of the Bank

- 1.1. The primary objective of the Bank, as stated in the Mission Statement, is to promote and maintain monetary stability. The Bank also ensures that the payments system is efficient and that the banking system is sound. These functions of the Bank support the broad national macroeconomic objectives, including the promotion of sustainable economic diversification. The Bank's main responsibilities, its organisational structure and the framework for its activities are described below.

The Bank's primary objectives are to promote monetary stability, ensure an efficient payments system and a sound banking sector

Functions of the Bank

- 1.2 As prescribed by the Bank of Botswana Act (CAP 55:01) the major responsibilities of the Bank include the conduct of monetary policy; provision of banking services to the Government, banks and selected public sector organisations; regulation and supervision of banks and other financial institutions; issuance of currency; implementation of exchange rate policy; management of foreign exchange reserves; and provision of monetary and financial policy advice to the Government.

Primary responsibilities are prescribed by legislation

- (a) Monetary Policy implementation is directed mainly at achieving the primary responsibility of the Bank, which is the promotion and maintenance of monetary stability. This requires the achievement of low and sustainable inflation, which contributes to the promotion and maintenance of domestic and external monetary and financial stability. This objective, together with fiscal, wage, trade and exchange rate policies, fosters macroeconomic stability, which is a crucial precondition for achieving sustained development, high rates of employment and rising standards of living for Botswana.
- (b) Central Banking and Payment System Services are mainly provided for the Government, commercial banks and other selected institutions. The Bank also operates a clearing system for the banking sector.
- (c) Issuance of Currency (banknotes and coin) of high quality is an essential ingredient of an efficient payments system as it fosters confidence in the legal tender which, in turn, facilitates transactions and economic activity in general.
- (d) Supervision of Banks and Other Financial Institutions is conducted in accordance with the Banking Act (CAP 46:02) and other relevant statutes. The purpose of prudential regulation and supervision is to ensure the safety, solvency and efficient functioning of the banking system and the overall financial sector.
- (e) Exchange Rate Policy is implemented on behalf of the Government in the overall context of sound macroeconomic management. The objective of the policy is to promote export competitiveness without compromising macroeconomic stability. The Bank buys and sells foreign exchange at rates determined in accordance with the exchange rate policy.

Minister of Finance reports to Parliament on the Bank's operations

The Board has overall responsibility over the Bank's operations

The nine-member Board is required to meet at least once each quarter

The Governor is the Bank's chief executive officer, supported by the Executive Committee

- (f) Official Foreign Exchange Reserves are managed by the Bank on behalf of the Government. The Bank ensures their safety and return by diversifying the investments within a framework of acceptable risks.
- (g) Economic Analysis and Policy Advice are covered in periodic reports, published research papers and statistical documents. Most of the materials are distributed to other institutions and the public. The Bank is also represented on a number of Government-led committees and task forces.

Structure of the Bank

- 1.3 The Bank of Botswana falls under the purview of the Minister of Finance and Development Planning, who appoints members of the Board, except the ex-officio Chairman (Governor of the Bank), who is appointed by His Excellency the President. The Minister reports to Parliament on the Bank's operations and financial performance.

The Board

- 1.4 Under the Bank of Botswana Act and the Bank's Bye-Laws, overall responsibility for the operations of the Bank is vested in the Board of the Bank. The Board is responsible for ensuring that the principal objectives of the Bank, as set out in the Act, are achieved. It also ensures that appropriate policies, management and administrative systems as well as financial controls are in place at all times in order for the Bank to achieve its objectives in an efficient and effective manner. Accordingly, the Board has a direct role in the strategic planning of the Bank, and in determining the broad policy framework. In this regard, the Board approves the annual budget, monitors the financial and operational performance, reviews reports of the external auditors and may call for any policy review.
- 1.5 The Board comprises nine members and is chaired by the Governor as required under the Bank of Botswana Act. As at the end of 2004, six members were in place and there were three vacancies. The Permanent Secretary of the Ministry of Finance and Development Planning is an ex-officio member; the other members are drawn from the public service (not more than two), the private sector and academia in their individual capacities.
- 1.6 The Board is required to meet at least once each quarter, although typically it meets more frequently. The Audit Committee of the Board is chaired by a non-executive Board member, and its main responsibility is to ensure that accounting policies, internal controls and financial practices are based on established rules and regulations. The Governor submits a report, after approval by the Board, on the operations and the audited financial statements of the Bank to the Minister of Finance and Development Planning within three months of the end of the Bank's financial year.¹

The Governor

- 1.7 In addition to chairing the Board, the Governor is the chief executive officer of the Bank, and is responsible for the prompt and efficient implementation of the decisions

¹ The Bank's financial year coincides with the calendar year.

or resolutions of the Board. The Governor manages the Bank on a day-to-day basis, and represents the institution in its relations with the Government, domestic financial and other institutions as well as external organisations.

The Executive Committee

- 1.8 The Executive Committee, which is chaired by the Governor, comprises the Deputy Governors and Heads of Department; it may include co-opted senior staff. Its responsibility is to advise the Governor on the day-to-day management of the Bank as well as the development of the Bank's medium- and long-term plans.

Departments and Divisions

- 1.9 In order to carry out its functions and supporting activities, the Bank is organised into Departments and Divisions. At the end of 2004, the Bank's seven Departments comprised Administration, Accounting, Banking, Banking Supervision, Financial Markets, Information Technology and Research, while the three Divisions were the Board Secretariat, Security and Internal Audit. The Heads of Department report through the Deputy Governors to the Governor, as do the Heads of Security and the Board Secretariat. The Internal Audit Division reports directly to the Governor.

Strategies

- 1.10 In pursuing its principal objectives of maintaining monetary stability as well as ensuring the soundness and efficiency of the financial system, the Bank regularly reviews and adapts its strategies to deal with the changing conditions prevailing in the financial sector. The Bank's activities are mainly in the following areas:

Monetary Operations, Reserve Requirements and the Bank Rate

- 1.11 Monetary stability is mainly reflected in low and stable inflation. Since inflation is fundamentally influenced by monetary and credit factors, the Bank's anti-inflation strategy focuses on the control of banking system credit as an intermediate target. However, controlling inflation in a small open economy such as Botswana's, with trading partners that have often experienced volatile inflation is a major challenge.
- 1.12 In implementing monetary policy, the Bank uses indirect policy instruments, particularly open market operations and the Bank Rate. The Bank may also use banking regulations and moral suasion to achieve monetary policy objectives. However, the use of Bank of Botswana Certificates (BoBCs), in both the primary and secondary markets, to control the liquidity of the financial system and influence short-term interest rates, plays a prominent role in maintaining monetary stability.
- 1.13 In addition to the Secured Lending Facility (SLF), the Bank also uses Repurchase Agreements (Repos) to manage short-term and overnight liquidity fluctuations in the banking system.
- 1.14 The Bank incorporates data on fiscal and other policies of the Government in the design of a monetary policy framework and its implementation strategy in order to ensure macroeconomic stability. Therefore, whenever necessary, monetary policy

The Bank had seven Departments and three Divisions in 2004

Maintaining monetary stability and a sound and efficient financial system are key objectives

may need to be restrictive in order to counteract expansionary fiscal and wage policies that may erode monetary stability and, therefore, the nation's prospects for sustainable economic development. The broad framework of monetary policy is presented to the public in the annual *Monetary Policy Statement*.

Banking Services to the Government and Commercial Banks

- 1.15 The Bank serves as the banker to the Government, commercial banks as well as certain other institutions, and has provided a payment, clearing and settlement system for the financial sector. In this regard, the Bank has promoted, coordinated and successfully implemented a programme that enhances the efficiency and security of the payments system. It is also a lender of last resort to the financial institutions under its supervisory purview.

Implementing the Banking Act and Regulations

- 1.16 Through ongoing banking supervision and regulatory activities, the Bank seeks to achieve a sound and stable financial system. Accordingly, the Bank ensures that the mechanisms for sustaining the safety and soundness of licensed financial institutions are appropriate and that the institutions are managed in a prudent and safe manner. To that end, the Bank enforces prudential standards with respect to capital adequacy, liquidity, asset quality and corporate governance of the banks.
- 1.17 In addition to its focus on the safety and soundness of licensed financial institutions, the Bank is responsible for ensuring that banks maintain high professional standards in their operations in order to provide efficient customer service in a transparent manner. The Bank also has a surveillance responsibility with regard to breaches of the Banking Act by the public, especially in the form of activities that involve unauthorised deposit taking and use of banking names.
- 1.18 Under the provisions of the Banking Act, the Bank has specific responsibilities relating to money laundering. Accordingly, banks are required to adhere to 'know your customer' provisions when opening accounts, retain appropriate records, report suspicious activities and cooperate fully with law enforcement agencies in an effort to combat financial crimes and, in particular, money laundering.
- 1.19 The Bank is also responsible for the regulation and supervision of the International Financial Services Centre (IFSC) entities as well as the administration of the Collective Investment Undertakings (CIU) Act (CAP56:09).
- 1.20 The Bank monitors commercial bank compliance with primary reserve requirements and ensures that clearing and settlement activities are conducted safely and efficiently. As the volume and value of financial transactions managed by the financial system increases, and Botswana's linkages with international financial markets expand, the Bank has to guard against systemic risks that may arise. It is for this reason that the Bank continually collaborates with private sector institutions, international organisations and the Government in introducing improvements to the safety and efficiency of the payments system.

Supervision and regulation of financial institutions are necessary for confidence and stability

The Bank also has responsibility for anti-money laundering policy and regulation of international financial services

Implementing Exchange Rate Policy

- 1.21 The Bank acts as the Government's agent in implementing the exchange rate policy. Under the Bank of Botswana Act, the President, on the recommendation of the Minister of Finance and Development Planning, and after consultation with the Bank, sets the framework for the determination of the external value of the Pula. At present, the Pula is pegged to a basket of currencies comprising the South African rand and the Special Drawing Right (SDR - the unit of account of the International Monetary Fund). Based on the basket, the Bank calculates the exchange rate for each business day, and quotes the buying and selling rates for major international currencies to the banks. The Bank monitors the Pula exchange rate developments regularly with a view to advising the Government on maintaining export price competitiveness of domestically produced goods.

Managing Foreign Exchange Reserves

- 1.22 As Botswana's foreign exchange reserves have continued to grow, the Bank has subdivided the reserves into two portfolios to meet different objectives. A large proportion of the reserves is invested in long-term assets (Pula Fund) with a view to maximising long-term return, while the remainder comprises the Liquidity Portfolio, which is invested in money market instruments and short-term bonds.

Foreign exchange reserves are managed to meet specific objectives

Advice on Economic Policy, Provision of Statistics and Public Education

- 1.23 In addition to its responsibilities of formulating and implementing monetary policy, the Bank serves as economic and financial advisor to the Government on a wide range of issues. These include exchange rate policy, financial sector development, borrowing, taxation, industrial development and trade.
- 1.24 The Bank conducts annual briefings on economic trends and publishes economic and financial statistics and a research bulletin. The Bank has also formulated and is implementing a public education programme on banking and financial matters.

The Bank serves as advisor to Government

Meeting the Needs for Banknotes and Coin

- 1.25 The availability of a safe and convenient currency is essential for an efficient payments system. For this reason, the Bank routinely ensures that there is an adequate supply of high quality notes and coin in circulation by withdrawing soiled and damaged currency and replacing it with new notes and coin. The Bank maintains stringent standards in the design and production of both notes and coin to ensure their acceptance as a medium of exchange and to deter counterfeiting and other forms of debasement.

The Bank is the sole supplier of notes and coin

2. REPORT ON THE BANK'S OPERATIONS

Introduction

- 2.1 This section highlights key developments relating to the Bank's functions during 2004.

The Bank continued to enjoy good relationships with regional and international organisations

Voluntary HIV/AIDS testing exercise for staff conducted successfully

The Bank produced a number of publications during the year

Public initiatives were sustained

External Relations

- 2.2 The Bank continued to enjoy good relationships with regional and international organisations in 2004, during which period it attended and participated in seminars, workshops and conferences hosted by international institutions. Such conferences and seminars included the SADC Committee of Central Bank Governors, the Association of African Central Banks, the Bank for International Settlements, the International Monetary Fund (IMF) and the World Bank. The Bank enjoyed continued assistance from the IMF through long-term regional advisors, short-term technical assistance and staff placements. As usual, the Bank held annual economic briefings for a range of stakeholders, including the media, senior Government officials, representatives of the private and parastatal sectors and diplomats.

Management and Administration of the Bank

- 2.3 The Bank's authorised establishment was unchanged at 559 positions, with 535 occupied positions and 22 vacancies at the end of the year. Of the occupied positions, 14 were held by staff members on various long-term training programmes at local, regional and overseas universities. In addition, a large number of staff took part in various short term training programmes during the year.
- 2.4 The Staff Health Clinic continued to provide primary health care and to assist in the implementation of the HIV/AIDS in the Workplace programme, which focuses on promoting awareness of the HIV/AIDS infection and associated dangers, and developing a culture of tolerance and combating the stigma of HIV/AIDS. To this end, both educational and promotional activities were carried out, including a successful voluntary HIV/AIDS testing exercise for staff, conducted by Tebelopele Voluntary Counselling and Testing Centre. The challenge for the Bank is to continue to support those affected by HIV/AIDS in order for all to benefit from improved quality of life, thereby sustaining a respectable level of productivity.
- 2.5 The Bank produced a number of publications during the year, including the 2003 *Annual Report*, the 2003 *Banking Supervision Annual Report*, the 2004 *Monetary Policy Statement (MPS)* and its Mid-Year Review, the *Research Bulletin* and the monthly *Botswana Financial Statistics*.
- 2.6 The Bank undertook numerous public relations activities and maintained close relations with the media. It also undertook community service programmes through the Donations Advisory Group; financial and 'in-kind' donations were made to a number of deserving charities and non-governmental organisations. As part of its Public Education Programme, the Bank participated in the Botswana Confederation of Commerce Industry and Manpower and Botswana Annual Financial Trade Fairs and various school career fairs. The Bank also produced a third booklet in the *Tsa Madi* comic series and facilitated schools visits, radio broadcasts and TV magazine programmes.
- 2.7 On internal audit matters, 33 scheduled audits and three special audits were completed based on risk-based auditing, and the reports were rated according to the significance of the findings. The audits provide a means to continuously assess internal controls and improve ways of communicating findings while ensuring

that the Departments and Divisions achieve their objectives in the most efficient manner.

Monetary Policy Implementation

- 2.8 The Monetary Policy Committee met six times in 2004 and there was no change in interest rates, indicating maintenance of a tight policy stance. This stance was necessitated by the desire to attain the inflation objective of 4 – 7 percent, as announced in the 2004 *Monetary Policy Statement*, in a period during which there were upside risks to inflation as a result of the devaluation of the Pula in February 2004, substantial government salary increases, upward adjustment of some administered prices and rising international oil prices.
- 2.9 To enhance the capacity to undertake economic analysis in support of policy formulation, the Bank continued to work on developing an inflation model for Botswana, and considerable progress has been made with the assistance of an IMF-sponsored technical assistance mission comprising staff of the Czech National Bank. A near-term forecasting framework was finalised, while development of a core model for medium-term forecasting was initiated towards the end of the year. Work on a biannual business expectations survey progressed well with the first report produced towards the end of 2004; going forward, this should provide timely and substantive information on the real sector.
- 2.10 With respect to statistics, the implementation of the recommendations of the August 2003 IMF technical assistance mission on monetary statistics is continuing. A follow-up mission was hosted during the year and laid the groundwork for introducing an expanded depository corporations survey in 2005.

Restrictive monetary policy stance maintained

The Bank continued to work on developing an inflation model for Botswana

The implementation of the recommendations to improve monetary statistics continued

Reserve Management

- 2.11 The Management conducted a review of reserve management policies and guidelines and these were approved by the Board in November 2004. The principles underlying the Bank's reserve management policies were reaffirmed, but some adjustments were made to portfolio sizes and asset allocations.

Board approves reserve management policies and guidelines

Domestic Market Operations

- 2.12 In November 2004, the Bank introduced 14-day Bank of Botswana Certificates (BoBCs) to increase the efficiency of monetary policy implementation. The 14-day and 91-day BoBCs are auctioned on a weekly basis to market participants; the supply of the 91-day paper was gradually reduced, as the market participants accepted the new 14-day instrument, which is expected to play a progressively more important role in the Bank's monetary operations.

The Bank introduced 14-day Bank of Botswana Certificates

Banking, Currency and Payments System Issues

- 2.13 The National Clearance and Settlement System (NCSS) Regulations were finalised, as a result of which the NCSS Act came into force on March 1, 2005. Agreement was reached for the transfer of the electronic clearing house to the commercial banks; this was necessitated by the NCSS Act, which requires the separation of operational and supervisory responsibilities for clearing systems. Preparations

The National Clearance and Settlement System (NCSS) Regulations were finalised

The Bank experienced a problem of dye-stained banknotes

- continued for the implementation of the Real Time Gross Settlement (RTGS) system project in 2005.
- 2.14 The Bank experienced a problem of dye-stained banknotes which were linked to robberies during the year. A series of measures were taken to ensure that dye-stained banknotes were removed from circulation.
- 2.15 Agreement has been reached on the transfer of the Letlole National Savings Certificates (LNSCs) scheme to the Botswana Savings Bank (BSB) early in 2005.
- 2.16 New P100 notes with improved security features were introduced towards the end of the year.

Banking Supervision

Enterprise Banking Group (Pty) Limited was issued with a banking licence

- 2.17 The financial condition of banks was assessed through regular bilateral and trilateral meetings, on-site examinations, risk profiling and 'early warning' management reports. There were no issues of supervisory concern with regard to banks' capital, profitability, liquidity and management.
- 2.18 Enterprise Banking Group (Pty) Limited was issued with a banking licence to operate in the International Financial Services Centre (IFSC). Enterprise will provide banking services to non-residents through its subsidiaries. As at December 31, 2004, there were three licensed offshore banks in the centre. Furthermore, nine companies were issued with Exemption Certificates in accordance with IFSC rules. Stanbic Investment Management Services (Pty) Limited (SIMS) was granted a licence to manage unit trusts under the CIU Act.

The total number of licensed and operating bureaux de change as at December 31, 2004 was 34.

- 2.19 The total number of licensed and operating bureaux de change as at December 31, 2004 was 34. On-site inspections were conducted on seven bureaux and, in general, they were found to be operating satisfactorily with no major issues of prudential concern. The new Bureaux de Change Regulations became effective during the year.

Agency Role

The Bank hosted visits by the international credit rating agencies

- 2.20 As agent of the Government in terms of Section 43 of the Bank of Botswana Act, the Bank hosted two annual review missions for Botswana's sovereign credit rating by the two international credit rating agencies (Standard and Poor's and Moody's Investors Service). The credit ratings, first assigned to Botswana by both agencies in 2001, were reconfirmed.
- 2.21 In addition, the Bank continued to act as agent for the Government in the administration of the Government Bond Programme. Debt Participation Capital Funding (DPCF) Limited, a special purpose investment company established in March 2004 to purchase from the Government the Public Service Debt Fund (PDSF) loan book, made 7 new listings.

Information Technology

Bankmaster core banking system replaced with Globus

- 2.22 The major IT project implemented during the year was the replacement of existing Bankmaster core banking system with Globus. Implementation work started in May 2004 and the system went live in February 2005. In addition, the SWIFT

system was successfully migrated to the SWIFTNet platform, which will be used to support the RTGS implementation.

2.23 A revamped Bank website was launched in June 2004, providing a much broader range of information about the Bank as well as economic and financial data. The website carries a range of news items and is one of the Bank's primary means of communicating with its stakeholders.

A revamped Bank website was launched

2.24 Protection of the Bank's network against viruses has been improved with the installation of a new anti-virus software engine. Software for filtering and blocking unwanted email messages, commonly referred to as junk mail or 'spam', was acquired and installed on the Bank's e-mail system. The Bank acquired and configured an alternative firewall to enhance protection against hackers.

A new anti-virus software engine was installed

Protective Services

2.25 The banking system in general, and the Bank of Botswana in particular, continued to experience attempted cheque frauds. Of particular concern to the Bank was the discovery of high quality forged Government cheques which criminals were attempting to use to withdraw large sums of money from Government accounts. The suspects were arrested and the cases are currently before the courts.

The Bank continued to experience attempted cheque frauds

In March 2004, a large number of counterfeit P100 banknotes were discovered. Investigations established that the production and circulation of the counterfeits was the work of a well organised group. After a vigorous public education drive, the problem was brought under control.

A large number of counterfeit P100 banknotes were discovered

BLANK PAGE 24, NOT NUMBERED



ANNUAL FINANCIAL STATEMENTS

2004

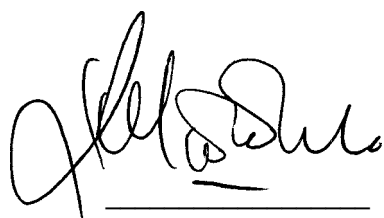
BANK OF BOTSWANA

BLANK PAGE 26 NOT NUMBERED

CONTENTS

	Page
Report of the Independent Auditors	28
Balance Sheet	29
Income Statement	30
Cash Flow Statement	31
Statement of Changes in Shareholder's Funds	32-33
Accounting Policies	34-39
Notes to the Annual Financial Statements	40-47

The Annual Financial Statements set out on pages 29 to 47 were approved by the Board on March 22, 2005 and signed by:



Linah K. Mohohlo
Governor



Nozipho A. Mabe
Director, Accounting Department

Deloitte

PO Box 778
Gaborone
Botswana

Deloitte & Touche
Assurance & Advisory Services
Certified Public Accountants
(Botswana)
Deloitte & Touche House
Plot 50664
Fairgrounds Office Park
Gaborone
Botswana

Tel : +(267) 395 1611
Fax: +(267) 397 3137
www.deloitte.com

REPORT OF THE INDEPENDENT AUDITORS

TO THE MEMBERS OF THE BOARD OF BANK OF BOTSWANA

We have audited the accompanying financial statements of Bank of Botswana as set out on pages 29 to 47 for the year ended December 31, 2004. These financial statements are the responsibility of the Bank's Board. 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 also includes assessing the accounting principles used and significant estimates made by the 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:

- (i) the Bank has kept proper books of account with which the financial statements are in agreement; and
- (ii) the financial statements give a true and fair view of the state of the Bank's affairs as of December 31, 2004 and of the result of its operations, its changes in shareholder's funds, and cash flows for the year then ended, in accordance with International Financial Reporting Standards and in the manner required by the Bank of Botswana Act (CAP 55:01).


Deloitte & Touche
Certified Public Accountants

GABORONE
March 22, 2005

Audit . Tax . Consulting . Financial Advisory .

A member firm of
Deloitte Touche Tohmatsu

National Executive Partners: V Naidoo Chief Executive RMW Dunne Chief Operating Officer
TJ Brown Audit DL Kennedy Tax GG Gelink Consulting MG Crisp Financial Advisory IRM Law
NT Mtoba Chairman of the Board J. Rhynes Deputy Chairman of the Board
Resident Partners: JY Stevens Senior Partner FC Els M Marinelli P Naik DL O'Connor

BALANCE SHEET

December 31, 2004

ASSETS	Notes	2004 P'000	2003 P'000
Property and Equipment	1	130 244	126 645
Foreign Exchange Reserves			
Liquidity Portfolio	2.1	3 727 352	3 910 508
Pula Fund	2.2	20 013 213	19 245 850
International Monetary Fund			
Reserve Tranche	3.1	134 084	197 373
Holdings of Special Drawing Rights	3.2	226 327	219 210
Administered Funds	3.4	99 219	144 031
Total Foreign Exchange Reserves		<u>24 200 195</u>	<u>23 716 972</u>
Government of Botswana Bonds	4	108 229	111 723
Advances to Banks	5	11 900	–
Other Assets	6	42 513	53 983
TOTAL ASSETS		<u><u>24 493 081</u></u>	<u><u>24 009 323</u></u>
LIABILITIES			
Notes and Coin in Circulation	7	910 858	817 995
Bank of Botswana Certificates	8	9 649 272	8 739 346
Deposits	9	1 684 555	1 599 776
Allocation of Special Drawing Rights (IMF)	3.3	28 584	28 379
Liabilities to Government (IMF Reserve Tranche)	10	134 084	197 373
Dividend to Government	11	97 025	188 750
Other Liabilities	12	26 370	26 774
Total Liabilities		<u>12 530 748</u>	<u>11 598 393</u>
SHAREHOLDER'S FUNDS			
Paid-up Capital	13	25 000	25 000
Government Investment Account			
Pula Fund and Liquidity Portfolio		8 936 740	9 680 966
Currency Revaluation Reserve		129 893	153 138
Market Revaluation Reserve		1 270 700	951 826
General Reserve	14	1 600 000	1 600 000
Total Shareholder's Funds		<u>11 962 333</u>	<u>12 410 930</u>
TOTAL LIABILITIES AND SHAREHOLDER'S FUNDS		<u><u>24 493 081</u></u>	<u><u>24 009 323</u></u>
FOREIGN EXCHANGE RESERVES IN US DOLLARS ¹		5 660 426	5 338 690
FOREIGN EXCHANGE RESERVES IN SDR ²		3 700 210	3 642 927
Note: Bid (2003-mid) rates of exchange used at year-end			
¹ Pula/United States dollar		0.2339	0.2251
² Pula/SDR		0.1529	0.1536

INCOME STATEMENT
Year ended December 31, 2004

	Notes	2004 P'000	2003 P'000
INCOME			
Interest – Foreign exchange reserves		634 184	719 686
Interest – Debt Participation Capital Funding Limited Loan	23	19 989	–
Interest – Government of Botswana Bonds		10 996	8 626
Net market gains on disposal of securities		439 742	21 284
Dividends		171 156	151 715
Commissions		4 625	5 159
Unrealised currency revaluation gains – Liquidity Portfolio	15	6 872	9 758
Other income		9 263	5 704
		1 296 827	921 932
EXPENSES			
Interest	16	1 174 385	1 237 173
Administration costs		164 868	131 751
Realised currency revaluation losses	15	341 837	1 778 989
Depreciation		11 604	11 488
Unrealised market revaluation losses – Liquidity Portfolio		8 844	20 459
		1 701 538	3 179 860
NET LOSS FOR THE YEAR		(404 711)	(2 257 928)
TRANSFER FROM CURRENCY REVALUATION RESERVE	15	338 065	1 766 708
NET LOSS BEFORE TRANSFER FROM GOVERNMENT INVESTMENT ACCOUNT		(66 646)	(491 220)
TRANSFER FROM GOVERNMENT INVESTMENT ACCOUNT		454 746	1 246 220
NET INCOME AVAILABLE FOR DISTRIBUTION		388 100	755 000
APPROPRIATIONS			
DIVIDEND TO GOVERNMENT FROM PULA FUND		(388 100)	(755 000)

CASH FLOW STATEMENT
Year ended December 31, 2004

	Notes	2004 P'000	2003 P'000
OPERATING ACTIVITIES			
Cash generated by operations	18	871 845	1 063 542
INVESTING ACTIVITIES			
(Net foreign investments purchased)/Net proceeds from disposal of foreign investments		(81 584)	4 210 781
Loan to Debt Participation Capital Funding Limited		(800 000)	–
Loan Repayment by Debt Participation Capital Funding Limited		800 000	–
Purchase of Government of Botswana Bonds		–	(101 903)
Proceeds from disposal of property and equipment		404	215
Purchase of property and equipment	1	(16 107)	(11 628)
NET CASH (USED IN)/FROM INVESTING ACTIVITIES		(97 287)	4 097 465
FINANCING ACTIVITIES			
Dividend to Government	11	(479 825)	(823 475)
Government Withdrawals		(387 596)	(4 396 452)
NET CASH USED IN FINANCING ACTIVITIES		(867 421)	(5 219 927)
NET INCREASE IN CURRENCY IN CIRCULATION		(92 863)	(58 920)
CURRENCY IN CIRCULATION AT THE BEGINNING OF THE YEAR		(817 995)	(759 075)
CURRENCY IN CIRCULATION AT THE END OF THE YEAR		(910 858)	(817 995)

STATEMENT OF CHANGES IN SHAREHOLDER'S FUNDS
Year ended December 31, 2004

	Paid-up Share Capital P'000	Currency Revaluation Reserve P'000	Market Revaluation Reserve P'000	General Reserve P'000
Balance at January 1, 2003	25 000	2 449 842	–	1 600 000
Unrealised currency losses for the year	–	(1 767 738)	–	–
Unrealised market gains for the year	–	–	1 573 082	–
Transfers to/(from) Government Investment Account:				
Unrealised market gains for the year	–	–	(621 256)	–
Unrealised currency losses for the year	–	1 237 742	–	–
Government withdrawals	–	–	–	–
Net (losses)/gains not recognised in the Income Statement for the year	–	(529 996)	951 826	–
Net loss for the year	–	–	–	–
Transfer from Currency Revaluation Reserve	–	(1 766 708)	–	–
Dividend to Government from Pula Fund	–	–	–	–
Transfers to/(from) the Income Statement for the year:				
Deficit of Government Pula Fund income over Pula Fund Dividend	–	–	–	–
To cover residual deficit	–	–	–	–
Balance at December 31, 2003 as previously stated	25 000	153 138	951 826	1 600 000
Prior year adjustments resulting from changes in accounting policies	–	(7 975)	(28 667)	–
Balance at December 31, 2003 as restated	25 000	145 163	923 159	1 600 000
Transfer to Income Statement of currency gains realised on repayment of loan by the IMF's Poverty Reduction & Growth Facility (PRGF) Administered Fund	–	(17 229)	–	–
Unrealised currency gains for the year	–	373 309	–	–
Net unrealised market gains for the year	–	–	427 730	–
Transfers to/(from) Government Investment Account:				
Unrealised market gains for the year	–	–	(80 189)	–
Unrealised currency gains for the year	–	(33 285)	–	–
Government withdrawals	–	–	–	–
Net gains/(losses) not recognised in the Income Statement for the year	–	322 795	347 541	–
Net loss for the year before realised currency gains on the IMF's PRGF Administered Fund loan repayment	–	–	–	–
Currency gains realised on loan repayment by the IMF's PRGF Administered Fund	–	–	–	–
Transfer from Currency Revaluation Reserve	–	(338 065)	–	–
Dividend to Government from Pula Fund	–	–	–	–
Transfers to/(from) the Income Statement for the year:				
Deficit of Government Pula Fund Income over Pula Fund Dividend	–	–	–	–
To cover residual deficit	–	–	–	–
Balance at December 31, 2004	25 000	129 893	1 270 700	1 600 000

1. The Government Investment Account, which represents the Government's share of the Pula Fund and the Liquidity Portfolio, was established on January 1, 1997.
2. The dividend to the Government of P388 100 000 for the year was made from the Government's capital investment in the Pula Fund.

Government Investment Account	Accumulated Profit	Total	
P'000	P'000	P'000	
15 940 124	–	20 014 966	Balance at January 1, 2003
–	–	(1 767 738)	Unrealised currency losses for the year
–	–	1 573 082	Unrealised market gains for the year
			Transfers to/(from) Government Investment Account:
621 256	–	–	Unrealised market gains for the year
(1 237 742)	–	–	Unrealised currency losses for the year
(4 396 452)	–	(4 396 452)	Government withdrawals
(5 012 938)	–	(4 591 108)	Net (losses)/gains not recognised in the Income Statement for the year
–	(2 257 928)	(2 257 928)	Net loss for the year
–	1 766 708	–	Transfer from Currency Revaluation Reserve
–	(755 000)	(755 000)	Dividend to Government from Pula Fund
			Transfers to/(from) the Income Statement for the year:
			Deficit of Government Pula Fund income over Pula Fund Dividend
(494 888)	494 888	–	To cover residual deficit
(751 332)	751 332	–	
9 680 966	–	12 410 930	Balance at December 31, 2003 as previously stated
(15 358)	–	(52 000)	Prior year adjustments resulting from changes in accounting policies
9 665 608	–	12 358 930	Balance at December 31, 2003 as restated
			Transfer to Income Statement of currency gains realised on repayment of loan by the IMF's Poverty Reduction & Growth Facility (PRGF) Administered Fund
–	–	(17 229)	
–	–	373 309	Unrealised currency gains for the year
–	–	427 730	Net unrealised market gains for the year
			Transfers to/(from) Government Investment Account:
80 189	–	–	Unrealised market gains for the year
33 285	–	–	Unrealised currency gains for the year
(387 596)	–	(387 596)	Government withdrawals
(274 122)	–	396 214	Net gains/(losses) not recognised in the Income Statement for the year
			Net loss for the year before realised currency gains on the IMF's PRGF Administered Fund loan repayment
–	(421 940)	(421 940)	Currency gains realised on loan repayment by the IMF's PRGF Administered Fund
–	17 229	17 229	Transfer from Currency Revaluation Reserve
–	338 065	–	Dividend to Government from Pula Fund
–	(388 100)	(388 100)	Transfers to/(from) the Income Statement for the year:
			Deficit of Government Pula Fund Income over Pula Fund Dividend
(94 210)	94 210	–	To cover residual deficit
(360 536)	360 536	–	
8 936 740	–	11 962 333	Balance at December 31, 2004

ACCOUNTING POLICIES

December 31, 2004

BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

The financial statements are prepared on the historical cost basis as modified to include the revaluation of investments in domestic and foreign assets, liabilities, and the result of the activities of the Pula Fund. The financial statements comply with International Financial Reporting Standards.

CHANGES IN ACCOUNTING POLICIES

In terms of International Accounting Standard No. 39 'Financial Instruments: Recognition and Measurement', investments held at year end are required to be valued at bid market prices and liabilities held, at offer/ask market prices. In accordance with this standard, resultant market values were translated using the bid rates of exchange, for assets held, and the offer/ask exchange rates for liabilities held. Up until December 31, 2003, all investments and liabilities were valued at middle market prices, and the resultant market values were translated to Pula using the middle rates of exchange at the balance sheet date, as required in terms of International Accounting Standard No. 21 'Effects of Changes in Foreign Exchange Rates'. The effect on the Currency Revaluation Reserve, the Market Revaluation Reserve and the Government Investment Account as at December 31, 2003 as a result of the changes in accounting policies referred to above is as follows:

	P'000
Currency Revaluation Reserve:	
Increase in Pula Fund unrealised currency losses	(10 652)
Increase in International Monetary Fund (IMF) reserves unrealised currency losses	(1 239)
	<u>(11 891)</u>
Transfer to Government Investment Account	3 916
Net decrease at December 31, 2003	<u><u>(7 975)</u></u>
Market Revaluation Reserve:	
Decrease in unrealised market gains	(40 109)
Transfer to Government Investment Account	11 442
Net decrease at December 31, 2003	<u><u>(28 667)</u></u>
Government Investment Account:	
Transfer to Currency Revaluation Reserve	(3 916)
Transfer to Market Revaluation Reserve	(11 442)
Decrease at December 31, 2003	<u><u>(15 358)</u></u>

The cumulative impact of the changes in accounting policies on the income statement as at December 31, 2003 of P413 000 was adjusted during the current year.

The bid rates of exchange for the Pula/United States dollar and the Pula/SDR as at December 31, 2003 were 0.2254 and 0.1538, respectively.

ACCOUNTING POLICIES (continued)

FINANCIAL INSTRUMENTS

General

Financial instruments carried on the balance sheet include all assets and liabilities, including derivative instruments, but exclude property and equipment, and notes and coin in circulation.

Short-term Investments (Liquidity Portfolio)

The Bank has designated the Liquidity Portfolio as a fund in which money market instruments and bonds are invested to facilitate payments for regular transactions.

Securities invested in this portfolio are initially recognised at cost and are subsequently remeasured at market value based on bid prices. All related realised and unrealised gains and losses are taken to the income statement.

All purchases and sales of investment securities in the portfolio are recognised at trade date, which is the date the Bank commits to purchase or sell the investments. All other purchases and sales are recognised as derivative forward transactions until settlement.

Long-term Investments (Pula Fund)

This is a long-term fund intended to maximise returns and is invested in foreign financial instruments with a long-term duration. These investments, which may be sold in response to needs for liquidity, changes in interest rates, exchange rates, etc. are classified as available-for-sale. These securities are initially recognised at cost (which includes transaction costs) and are subsequently remeasured at market value, based on bid prices.

Unrealised gains and losses arising from changes in the market value of the instruments classified as available-for-sale are recognised in the Currency Revaluation Reserve or the Market Revaluation Reserve as may be appropriate. When these instruments are disposed of or impaired, the related accumulated market value adjustments are included in the income statement as gains and losses from investment securities.

All purchases and sales of investment securities in the fund are recognised at trade date, which is the date that the Bank commits to purchase or sell the investments. All other purchases and sales are recognised as derivative forward transactions until settlement.

Derivative Instruments

Derivative financial instruments are recognised in the balance sheet at cost (including transaction costs) and are subsequently remeasured at market value, based on bid prices for assets held or liabilities to be issued, and ask/offer prices for assets to be acquired or liabilities held. The treatment of market value movements in derivative instruments depends on whether they are designated as part of the Pula Fund or the Liquidity Portfolio.

FOREIGN CURRENCY ACTIVITIES

During the year ended December 31, 2004, transactions denominated in foreign currencies were translated to Pula using the middle rates of exchange at the transaction date. With effect from December 31, 2004, transactions denominated in foreign currencies will be translated using bid and offer rates of exchange, as described in the Changes in Accounting Policies note above.

ACCOUNTING POLICIES (continued)

All monetary assets and liabilities denominated in foreign currencies are translated to Pula using the bid and offer rates of exchange, respectively, at the close of the financial year. All exchange gains/losses realised on disposal of instruments and unrealised exchange gains/losses on the short-term investments are taken to the income statement. However, all those gains and losses relating to disposals whose proceeds are reinvested in foreign assets, and unrealised gains/losses on short-term investments, are appropriated to the Currency Revaluation Reserve.

BANK OF BOTSWANA CERTIFICATES

As one of its tools for maintaining monetary stability in the economy, the Bank of Botswana issues its own paper, Bank of Botswana Certificates (BoBCs), to absorb excess liquidity in the market and thereby to influence the rate of monetary growth, and also interest rates. BoBCs are issued at a discount to counterparties.

The Bank's liability in respect of BoBCs is stated at market value, based on offer prices, with movements in matured and unmatured discount recognised in the income statement.

GOVERNMENT OF BOTSWANA BONDS

The Bank acquired Government of Botswana Bonds for purposes of facilitating orderly trading in the local bond market. The bonds, which may be sold in response to needs to intervene in the market, are classified as available-for-sale securities.

The bonds are initially recognised at cost and are subsequently remeasured at market value, based on bid prices. All unrealised gains and losses arising from changes in the market value are recognised in the Market Revaluation Reserve. When these instruments are disposed of or impaired, the related accumulated market value adjustments are included in the income statement as gains and losses from Government of Botswana Bonds.

All regular purchases and sales of bonds are recognised at trade date, which is the date that the Bank commits itself to purchase or sell the bonds.

SECURED LENDING FACILITY

Under the Secured Lending Facility (SLF), the Bank provides emergency and intermittent funding to solvent financial institutions, intended to bridge overnight liquidity shortages. The advances are secured by Government of Botswana Bonds and Bank of Botswana Certificates (BoBCs), valued at market prices on the date of the transaction. The Bank has the right to call for additional collateral, should the value of the security decline during the tenure of the facility. Interest earned on the advances is credited to the income statement while advances outstanding as at the balance sheet date are recorded under the heading 'Advances to Banks'.

REPURCHASE AND REVERSE REPURCHASE AGREEMENTS

This facility is one of the mechanisms designed to deal with short-term liquidity fluctuations in the domestic money market. It is available to solvent institutions licensed and supervised by the Bank.

Securities purchased under agreement to resell (Repurchase Agreement) are recorded as funds receivable under the heading 'Advances to Banks'.

ACCOUNTING POLICIES (continued)

Only high quality, marketable and freely transferable paper with a minimum amount of risk is acceptable as security at the discretion of the Bank. Government and Government guaranteed securities of any maturity and other eligible paper with a remaining life of 184 days or less are also acceptable as security.

Securities sold under agreement to repurchase (Reverse Repurchase Agreement) are disclosed as deposits received.

The term of the repurchase agreement and reverse repurchase agreement varies from overnight to one month, depending on the liquidity conditions in the domestic market.

Interest earned by the Bank on repurchase agreements is credited to the income statement while interest paid by the Bank on reverse repurchase agreements is charged to the income statement.

ASSETS, LIABILITIES AND PROVISIONS RECOGNITION

Assets

Assets are recognised when the Bank obtains control of a resource as a result of past events, and from which future economic benefits are expected to flow to the Bank.

Contingent Assets

The Bank discloses a contingent asset arising from past events where, it is highly likely that economic benefits will flow from it, but this will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events outside the control of the Bank.

Liabilities and Provisions

The Bank recognises liabilities (including provisions) when:

- (i) it has a present legal obligation resulting from past events;
- (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle this obligation; and
- (iii) a reliable estimate of the amount of the obligation can be made.

Derecognition of Assets and Liabilities

The Bank derecognises a financial asset when it loses control over the contractual rights that comprise the asset and transfers substantially all the risks and benefits associated with the asset. This arises when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is legally discharged.

INCOME AND EXPENSE RECOGNITION

Interest income and expense and dividend income are recognised in the income statement on an accrual basis.

ACCOUNTING POLICIES (continued)

OFFSETTING FINANCIAL INSTRUMENTS

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

- (i) there is a legally enforceable right to set off;
- (ii) there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously;
- (iii) the maturity date for the financial assets and liability is the same; and
- (iv) the financial asset and liability is denominated in the same currency.

In view of the fact that the Bank values its foreign exchange investments on a portfolio basis, assets and liabilities within each portfolio have been set off.

GENERAL RESERVE

Under Section 7(1) of the Bank of Botswana Act, (CAP 55:01), the Bank of Botswana is required to establish and maintain a General Reserve sufficient to ensure the sustainability of future operations of the Bank. The Bank may transfer to the General Reserve funds from other reserves, which it maintains, for the purposes of maintaining the required level of the General Reserve.

CURRENCY REVALUATION RESERVE

Any changes in the valuation, in terms of Pula, of the Bank's assets and liabilities in holdings of Special Drawing Rights and foreign currencies as a result of any change in the values of exchange rates of Special Drawing Rights or foreign currencies are transferred to the Currency Revaluation Reserve.

The proportion directly attributable to the Government Investment Account is transferred to such investment account.

MARKET REVALUATION RESERVE

Any changes in the value of the Bank's long-term investments held in foreign currencies as a result of any change in the market values of such investments are transferred to the Market Revaluation Reserve.

The proportion directly attributable to the Government Investment Account is transferred to such investment account.

PROPERTY AND EQUIPMENT AND DEPRECIATION

Property and equipment are stated at cost less related accumulated depreciation.

No depreciation is provided on land. All other property and equipment are depreciated on a straight line basis at the following annual rates:-

	Percent
Buildings	2.50
Furniture, fixtures and equipment	20-50
Computer hardware	33.33
Computer software	100.00
Motor vehicles – Commercial	25.00
– Bullion Truck	5.00

ACCOUNTING POLICIES (continued)

RETIREMENT BENEFITS

Pension benefits are provided for employees through the Bank of Botswana Defined Contribution Staff Pension Fund, which is governed in terms of the Pension and Provident Funds Act (CAP 27:03). Contributions are at the rate of 21.5 percent of pensionable emoluments of which pensionable employees of the Bank pay 4 percent. Other than the contributions made, the Bank has no further commitments or obligations to this Fund.

FINANCE LEASES

The Bank classifies leases of land, property and equipment where it assumes substantially all the benefits and risks of ownership as finance leases. Finance leases are capitalised at the estimated net present value of the underlying lease payments. The Bank allocates each lease payment between the liability and finance charges to achieve a constant periodic rate of interest on the finance balances outstanding for each period. The interest element of the finance charges is charged to the income statement over the lease period. The land, property and equipment acquired under finance leases are depreciated over the useful lives of the assets, on the basis consistent with similar property and equipment.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

December 31, 2004

1. PROPERTY AND EQUIPMENT	Free- hold Land P'000	Lease- hold Land P'000	Buildings P'000	Capital Works in Progress P'000	Other Assets P'000	Total P'000
Cost or Valuation						
Balance at the beginning of the year	607	3 486	129 556	1 347	64 873	199 869
Additions	–	–	–	5 499	10 608	16 107
Disposals	–	–	(1 128)	–	(7 249)	(8 377)
Transfers	–	–	261	(261)	–	–
Balance at the end of the year	607	3 486	128 689	6 585	68 232	207 599
Accumulated Depreciation						
Balance at the beginning of the year	–	–	27 789	–	45 435	73 224
Charge for the year	–	–	3 231	–	8 373	11 604
Disposals	–	–	(331)	–	(7 142)	(7 473)
Balance at the end of the year	–	–	30 689	–	46 666	77 355
Net book value at December 31, 2004	607	3 486	98 000	6 585	21 566	130 244
Net book value at December 31, 2003	607	3 486	101 767	1 347	19 438	126 645

2. FOREIGN EXCHANGE RESERVES

	2004	2003
	P'000	P'000

2.1 Liquidity Portfolio

Bonds	2 059 241	1 166 785
Amounts due from Pula Fund	417 235	782 254
Net Payables	–	(720)
Cash and Cash Equivalents	1 250 876	1 962 189
	<u>3 727 352</u>	<u>3 910 508</u>

2.2 Pula Fund

Equities	8 445 392	8 356 889
Bonds	11 068 919	10 008 682
Amounts due to Liquidity Portfolio	(417 235)	(782 254)
Net Payables	(70 566)	(42 466)
Cash and Cash Equivalents	986 703	1 704 999
	<u>20 013 213</u>	<u>19 245 850</u>

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (continued)

Pula Fund Balance Sheet	2004 P'000	2003 P'000
<i>Capital Employed</i>		
Government	8 892 951	9 506 781
Bank of Botswana	11 120 262	9 739 069
	<u>20 013 213</u>	<u>19 245 850</u>
<i>Employment of Capital</i>		
Investments	<u>20 013 213</u>	<u>19 245 850</u>
Investments expressed in US dollars ('000)	<u>4 681 091</u>	<u>4 332 241</u>
Investments expressed in SDR ('000)	<u>3 060 020</u>	<u>2 956 163</u>
Pula Fund Income Statement		
<i>Income</i>		
Interest and dividends	665 291	685 904
Realised market gains	446 027	–
Sundry income	19	49
	<u>1 111 337</u>	<u>685 953</u>
<i>Expenses</i>		
Realised currency revaluation losses	(356 836)	(1 177 036)
Net realised market losses	–	(11 878)
Administration charges	(60 211)	(53 668)
	<u>(417 047)</u>	<u>(1 242 582)</u>
<i>Net Income/(Loss) for the year</i>	694 290	(556 629)
Transfer from Currency Revaluation Reserve	<u>356 836</u>	<u>1 177 036</u>
<i>Net income before transfer from Government Investment Account</i>	1 051 126	620 407
Transfer from Government Investment Account	<u>94 210</u>	<u>494 888</u>
<i>Net income available for distribution</i>	1 145 336	1 115 295
Appropriations		
Dividend to Government	<u>(388 100)</u>	<u>(755 000)</u>
Bank of Botswana's share of net income	<u>757 236</u>	<u>360 295</u>

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (continued)

	2004	2003
	P'000	P'000
3. INTERNATIONAL MONETARY FUND (IMF)		
3.1 Reserve Tranche		
This asset represents the difference between Botswana's Quota in the IMF and IMF Holdings of Pula. Botswana's Quota is its membership subscription, of which at least 25 percent was paid for in foreign currencies and the balance in Pula. The holdings of Pula by the IMF, which initially were equal to 75 percent of the quota, have changed from time to time as a result of the use of Pula by the IMF in its lendings to member countries.		
Quota (SDR 63 000 000)	412 034	410 156
Less IMF Holdings of Pula	(277 950)	(212 783)
Reserve Position in IMF	<u>134 084</u>	<u>197 373</u>
The IMF Holdings of Pula are represented by a Non-Interest Bearing Note of P165 324 035 (2003 – P165 324 035) issued by the Government of Botswana in favour of the IMF, maintenance of value currency adjustments and the amount in current account held at the Bank (included in other deposits in Note 9).		
3.2 Holdings of Special Drawing Rights	<u>226 327</u>	<u>219 210</u>
The balance on the account represents the value of Special Drawing Rights allocated and purchased less utilisation to date.		
3.3 Allocation of Special Drawing Rights (IMF)		
This is the liability of the Bank to the IMF in respect of the allocation of SDRs to Botswana.	<u>28 584</u>	<u>28 379</u>
3.4 Administered Funds		
(i) Poverty Reduction & Growth Facility (PRGF) Trust	–	45 275
The amount representing the equivalent of SDR6 893 680 (and interest accrued thereon) lent on July 1, 1993 to the Poverty Reduction & Growth Facility (formerly Enhanced Structural Adjustment Facility Trust), a fund administered in trust by the IMF, which was repaid in March 2004.		
(ii) Poverty Reduction & Growth Facility/Heavily Indebted Poor Countries (PRGF/HIPC) Trust	99 219	98 756
The amount represents SDR 15 065 760 (and interest accrued thereon) lent on August 31, 2002, to the Poverty Reduction & Growth Facility/Heavily Indebted Poor Countries Trust Fund, a fund administered in trust by the IMF.		
	<u>99 219</u>	<u>144 031</u>

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (continued)

	2004	2003
	P'000	P'000
4. GOVERNMENT OF BOTSWANA BONDS		
(i) Purchased on May 26, 2003, maturing on June 1, 2005, bearing interest at the rate of 10.75 percent, receivable semi-annually in arrears:		
Market value	19 935	20 125
Interest accrued	179	179
	<u>20 114</u>	<u>20 304</u>
(ii) Purchased on March 31, 2003, maturing on March 1, 2008, bearing interest at the rate of 10.25 percent, receivable semi-annually in arrears:		
Market value	85 166	88 471
Interest accrued	2 949	2 948
	<u>88 115</u>	<u>91 419</u>
	<u>108 229</u>	<u>111 723</u>
5. ADVANCES TO BANKS		
Secured Lending Facility	11 900	–
6. OTHER ASSETS		
Staff Loans and Advances	37 743	30 022
Uncleared Effects	–	16 496
Prepayments	1 059	2 244
Other	3 711	5 221
	<u>42 513</u>	<u>53 983</u>
7. NOTES AND COIN IN CIRCULATION		
Notes	854 062	766 382
Coin	56 796	51 613
	<u>910 858</u>	<u>817 995</u>
Notes and coin in circulation held by the Bank as cash in hand at the end of the financial year have been netted off against the liability for notes and coin in circulation to reflect the net liability to the public.		
8. BANK OF BOTSWANA CERTIFICATES		
Face Value	9 755 220	8 870 460
Unmatured Discount	(105 948)	(131 114)
Market Value	<u>9 649 272</u>	<u>8 739 346</u>

Bank of Botswana Certificates are issued at various short-term maturity dates and discount rates.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (continued)

	2004	2003
	P'000	P'000
9. DEPOSITS		
Government	481 230	848 503
Bankers	350 977	520 347
Other	852 348	230 926
	<u>1 684 555</u>	<u>1 599 776</u>

These represent current accounts lodged by Government, commercial banks, parastatal bodies and others, which are repayable on demand and are interest free.

The Government balance includes P2 043 479 (2003 – P2 139 258) in respect of the Letlole National Savings Certificate Scheme, which was launched by the Bank on behalf of the Government in 1999 as a means of encouraging savings.

This is analysed as follows:

Issues of National Savings Certificates	5 551	4 769
Redemptions	(3 517)	(2 623)
Net issues	2 034	2 146
Amounts awaiting collection from/ (by) agents	9	(7)
Amount due to Government on behalf of the Scheme	<u>2 043</u>	<u>2 139</u>

10. LIABILITIES TO GOVERNMENT (IMF RESERVE TRANCHE)

	134 084	197 373
--	---------	---------

This balance represents the Bank's liability to the Government in respect of the Reserve Tranche position in the IMF (Note 3.1)

11. DIVIDEND TO GOVERNMENT

Balance due at the beginning of the year	188 750	257 225
Dividend to Government from Pula Fund	388 100	755 000
Paid during the year	(479 825)	(823 475)
Balance due at the end of the year	<u>97 025</u>	<u>188 750</u>

The final instalment of the pre-set dividend of P97 025 000 unpaid at December 31, 2004 was provided for in accordance with Section 6 of the Bank of Botswana Act (CAP 55:01), which requires that all profits of the Bank be distributed to the shareholder, the Government.

12. OTHER LIABILITIES

Accounts payable	1 076	1 875
Other creditors and accruals	25 294	24 899
	<u>26 370</u>	<u>26 774</u>

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (continued)

	2004	2003
	P'000	P'000
13. CAPITAL		
Authorised and paid-up capital	25 000	25 000
The paid-up capital is the amount subscribed by the Government in accordance with Section 5 of the Bank of Botswana Act (CAP 55:01).		
14. GENERAL RESERVE	1 600 000	1 600 000
In the opinion of the Board, the General Reserve, taken together with other reserves which the Bank maintains, is sufficient to ensure the sustainability of future operations of the Bank.		
15. CURRENCY REVALUATION (LOSSES)/GAINS TAKEN TO INCOME STATEMENT		
Total realised losses	(341 837)	(1 778 989)
Unrealised gains – Liquidity Portfolio	6 872	9 758
Total taken to income statement	(334 965)	(1 769 231)
Appropriated to Currency Revaluation Reserve:		
Realised and reinvested in foreign assets	344 937	1 776 466
Unrealised – Liquidity Portfolio	(6 872)	(9 758)
	338 065	1 766 708
Net credited/(charged) to income statement	3 100	(2 523)
16. INTEREST EXPENSE		
Bank of Botswana Certificates (BoBCs)	1 123 103	1 182 199
Debswana Tax Holding Account	38 703	39 161
Reverse Repurchase Agreements	12 359	15 624
National Savings Certificates	220	189
	1 174 385	1 237 173
17. CASH FLOW STATEMENT		

This has been prepared under International Accounting Standard No. 7 – Cash Flow Statements (Revised 1992). The definition of cash in the Standard is not wholly appropriate to the Bank. Due to its role in the creation and withdrawal of currency in circulation, the Bank has no cash balances on its balance sheet (also see Note 7). However, it has the ability to create cash when needed.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (continued)

	2004	2003
	P'000	P'000
18. CASH GENERATED BY OPERATIONS		
Net loss for the year	(404 711)	(2 257 928)
Adjustments for:		
Unrealised exchange losses	338 065	1 766 708
Depreciation of property and equipment	11 604	11 391
Loss on disposal of property and equipment	500	15
Operating cash flows before movements in working capital	(54 542)	(479 814)
Increase in Deposits – banks and other	452 052	174 735
(Decrease)/Increase in Deposits – Government	(367 273)	244 277
Increase in Bank of Botswana Certificates	909 926	1 075 889
(Increase)/Decrease in other assets	(497)	1 720
(Decrease)/Increase in other liabilities	(67 821)	46 735
Cash generated by operations	<u>871 845</u>	<u>1 063 542</u>
19. CAPITAL COMMITMENTS		
Approved and contracted for	6 451	1 609
Approved but not contracted for	31 958	38 631
	<u>38 409</u>	<u>40 240</u>

These capital commitments will be funded from internal resources.

20. GOVERNMENT OF BOTSWANA BOND AGENCY

In accordance with Sections 45 and 46 of the Bank of Botswana Act (CAP 55:01), the Bank acts as agent of the Government for the issuance and management of the Government Bonds. An analysis of the three bonds issued is provided below:

GOVERNMENT OF BOTSWANA BONDS ISSUED AS AT DECEMBER 31, 2004 (P'000)

Bond Detail	BW 001	BW 002	BW 003	Total Since Inception
Date of Issue	May 26, 2003	March 31 and December 1, 2003	May 6 and November 3, 2003	
Date of Maturity	June 1, 2005	March 1, 2008	October 31, 2015	
Interest Rate (per annum)	10.75 percent	10.25 percent	10.25 percent	
Nominal Value	750 000	850 000	900 000	2 500 000
Net Discount	(30 401)	(21 029)	(32 571)	(84 001)
Net Proceeds	719 599	828 971	867 429	2 415 999
Interest Paid	120 938	112 750	117 875	351 563
Interest Accrued	6 719	29 042	15 375	51 136

Net proceeds realised from the issue of the bonds were invested in the Government Investment Account.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (continued)

Interest is payable on all bonds on a semi-annual basis in arrears. Total cumulative interest payments of P351 563 000 made to December 31, 2004 (2003 – P91 563 000) were funded from the Government's current account maintained with the Bank.

21. COMPARATIVES

Where necessary, comparative figures have been restated to conform with changes in presentation in the current year. The adjustments required as a result of the changes in accounting policies are reflected in the Statement of Accounting Policies and the Statement of Changes in Shareholder's Funds.

22. RISK MANAGEMENT POLICIES IN RESPECT OF FINANCIAL INSTRUMENTS

The risk management policies of the Bank regarding financial instruments are dealt with in regular reviews of the Bank's reserve management policies. The main risk areas are market, currency, credit and interest rates. The Bank invests in investment grade currencies (AA/Aa2) and above. Interest rate risk is managed by using modified duration, while credit risk is controlled by dealing with the best quality institutions or counterparties, as determined by international rating agencies.

23. RELATED PARTY TRANSACTIONS

The Bank provides several services to its shareholder, the Government, and to other Government-owned institutions. The main services during the year to December 31, 2004 were:

- (i) provision of banking services, including holding of the principal accounts of the Government;
- (ii) management of the Notes and Coin issue, including printing and minting of notes and coin, respectively; and
- (iii) being the Government's agent in issuing of bonds.

The aggregate balances in Government and other public sector accounts are disclosed in Notes 9 to 11.

No charge is made to the Government for provision of these services, except for commissions charged on domestic foreign exchange transactions, which are included in 'Commissions' in the income statement.

During the year, the Bank lent P800 000 000 to Debt Participation Capital Funding Limited, which was fully guaranteed by the Government and was repaid in full during the same year. The Bank earned interest on the loan at the interest rate of 14.25 percent per annum. The interest income earned has been appropriately disclosed in the income statement.

The Bank also earns interest on its holding of the Government of Botswana Bonds, which is included in the income statement. Unrealised market value movements in the bonds have been included in the Market Revaluation Reserve.

Blank page 48