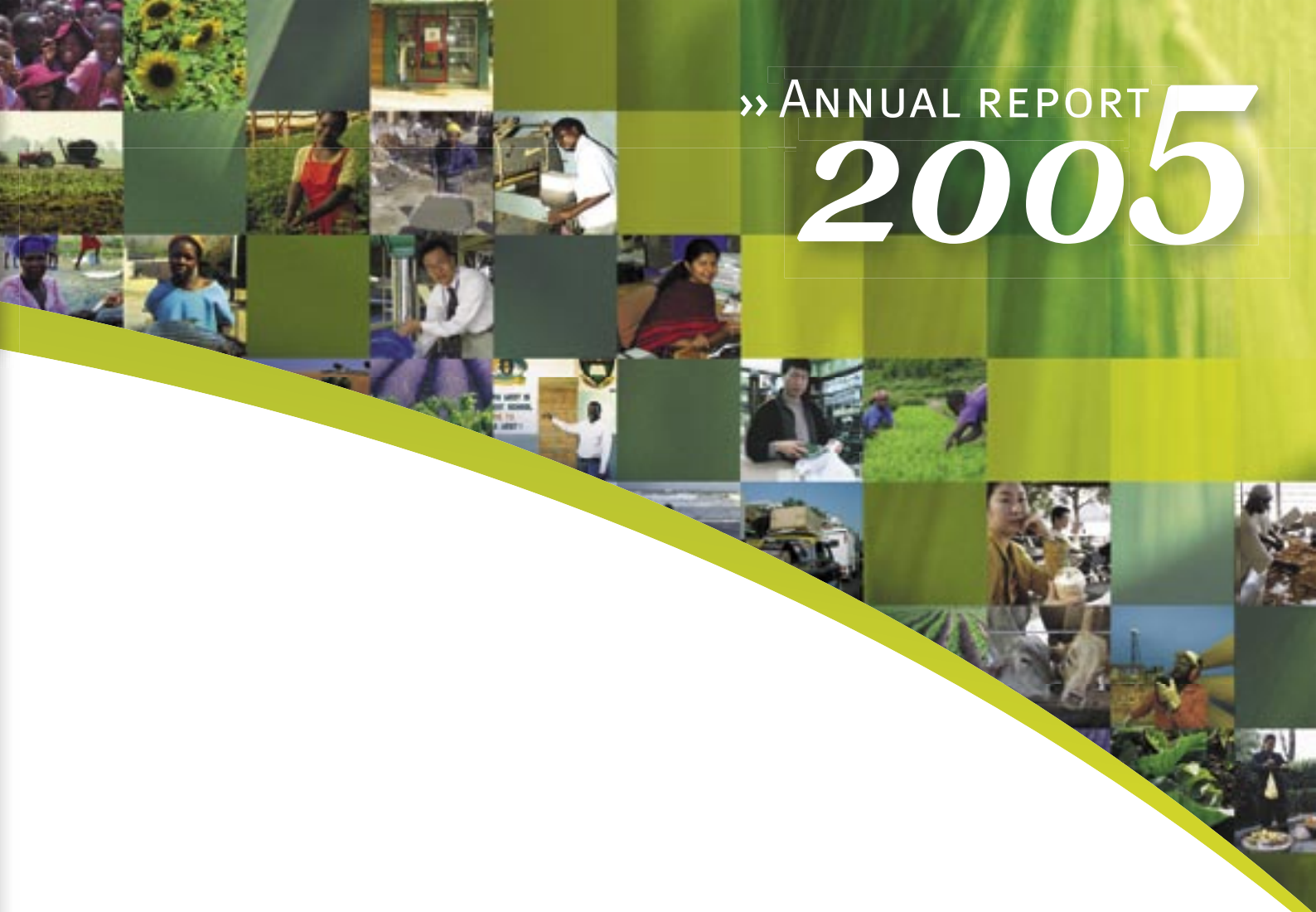


» ANNUAL REPORT
2005



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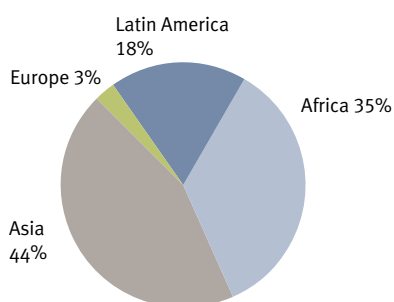
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KEY FIGURES

NOK million	2005	2004	2003	2002	2001	2000
Profit/loss	93.9	(9.2)	47.7	36	27	3
Capital supplied by owner	485	485	485	395	225	150
Capital base (31 Dec) ¹	2914	2 361	1 905	1 400	1 010	543
Employees (31 Dec)	26	23	23	21	17	10

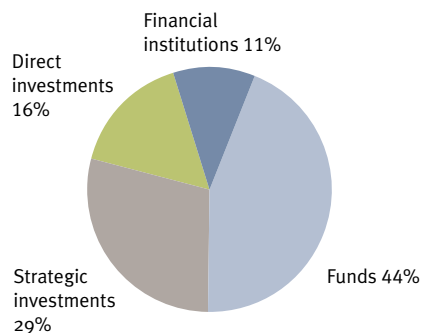
¹ Norfund's book equity at 31 December 2005 of NOK 2 816 million, plus the estimated value of the loan portfolio transferred from Norad on 1 January 2001.

INVESTMENT BY REGION *

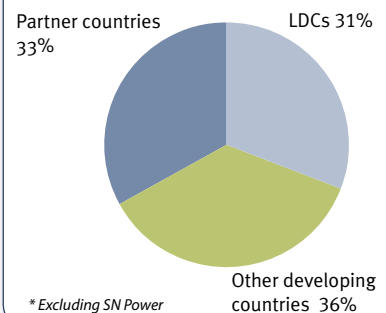


* Excluding SN Power

INVESTMENT BY CATEGORY



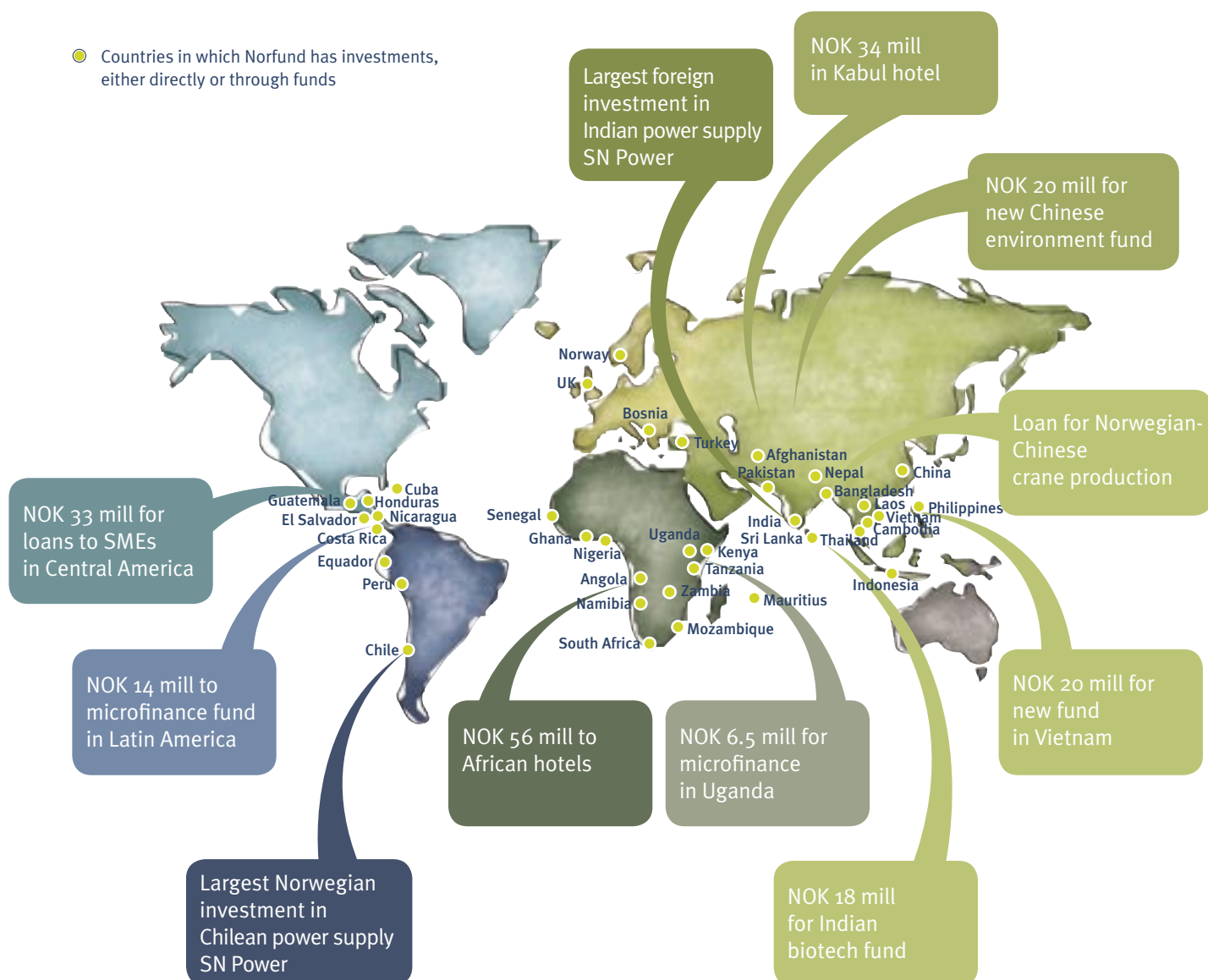
INVESTMENT BY LEAST DEVELOPED COUNTRIES (LDCs), NORWAY'S OTHER PARTNER COUNTRIES AND OTHER DEVELOPING COUNTRIES *



* Excluding SN Power

Norfund in 2005

new investment agreements



A partner for business in developing countries

Businesses in developing countries can only make progress if they have access to risk capital. We invest in and encourage cooperation on the development of profitable new activities which create jobs and reduce poverty. Through partnership, co-financing with other investors and an active local presence, we help to create a vigorous business community.

Capital at work

The fifth anniversary of the adoption of the UN's millennium development goals was reached in 2005. Through these objectives, the world's leaders and nations undertook to strengthen the global drive against poverty, for improved health and to promote peace, human rights and sustainable development.

Norfund in brief

The Norwegian Investment Fund for Developing Countries (Norfund) is a hybrid state-owned company established by law with limited liability. It was created by the Storting (parliament) in 1997. Its board of directors is appointed by the government. Norfund's capital is provided by

appropriations over the government's development assistance budget, and its operations form an integrated element in Norwegian development cooperation. At 31 December 2005, Norfund had total assets of NOK 3 billion.

ACTIVITIES

Strategic investments
Norfund is co-owner of three fund management companies which channel investment capital through a number of separate funds in Africa, Central America, and south and south-east Asia. Through its 50 per cent holding in Statkraft Norfund Power Invest AS (SN Power), the institution helps to build, modernise and operate hydropower facilities in developing countries.

Funds and direct investment
Norfund invests both indirectly through local equity capital funds and directly together with Norwegian or local partners.

Creating viable public and private sector jobs in developing countries is essential for achieving a lasting reduction in poverty. This will only happen in the private sector if a positive return can be obtained on capital invested. Our goal is to contribute risk capital for investment and knowledge to help enhance value creation in the private sector. Attention is focused on those countries which have made least development progress, where our capital will have the biggest effect.

Discussion in our part of the world frequently focuses on how foreign investment in developing countries can be increased. Such spending often helps to create jobs and positive spin-offs in the local economy. However, new experience indicates that business development is more sustainable when rooted in local capital and entrepreneurial skills.

Development of and growth in local business activity requires that governments ensure acceptable frame conditions, and that risk and loan capital is available. In addition to investing directly and indirectly in individual companies in developing countries, we have therefore made a growing commitment to cooperation with local banks. This is pursued both by becoming a shareholder and thereby strengthening the relevant bank's capital base and progress, and by offering risk loans to small enterprises through selected local partner banks. Our involvement with microfinance is also expanding. We are particularly proud to have invested in Uganda Microfinance Limited, which in addition to being a leading Ugandan microfinance institution also plans to expand its operations in the wider region.



Photo: Christian Hatt

Our part-ownership of Aureos Capital and investment in equity capital funds managed by this company remain a cornerstone of our strategy. Offering equity capital to local small and medium-sized enterprises, Aureos Capital is represented in more than 15 countries. That ensures the transfer of expertise and close monitoring of investments in a local context. In addition, local expertise in

equity management is built up.

Developing countries face growing energy costs which will restrict economic growth in many of them. In that context, our commitment to renewable energy development through SN Power represents an important contribution to reducing the dependence of developing countries on oil and coal. Capital is in very short supply in this area, and SN Power's investments in India are the largest so far made by a foreign company in that country's hydropower sector. This is also an area where we can draw on world-class Norwegian expertise.

We are expanding, and look forward to continued cooperation with all our local and international partners to help in the attainment of the millennium development goals.

Per Emil Lindøe

Managing director, Norfund

Financial institutions

Norfund invests in and makes loans to banks and financial institutions, including microfinance providers, in order to develop capital markets and give small and medium-sized enterprises better access to capital. A loan portfolio transferred from the Norwegian Directorate for Development Cooperation (Norad) in 2001 is part of this activity.

Coordinator: Norfund is part of an international network of investment funds and finance institutions oriented towards developing countries, and contributes to a coordination which makes it possible to reach more widely and achieve greater effect than the institution could alone.

Trigger: As a co-owner of fund management companies, Norfund helps to raise capital from a large number of investors and thereby serves as a trigger for far greater investments than it could provide with its own funds.

Collaborator: Through collaboration in part with Norwegian companies and in part with business players in developing countries, Norfund combines its funds with technical specialists, active ownership and local networks.

Operations by business area in 2005

Norfund's operations are divided into three business areas: strategic investment, funds and direct investments, and financial institutions. Activities in these areas during the year are outlined below.

STRATEGIC INVESTMENTS

Helping to develop local ownership and capital markets is a key objective for Norfund. Encouraging competent local funds through a commitment to active management accordingly forms an important part of its strategy.

Norfund's most important investment in fund management is Aureos Capital Ltd, which focuses on small and medium-sized enterprises (SMEs) in developing countries. This company was founded in 2001 together with Britain's CDC, which transferred its shareholding in 2004 to Actic LLP. At 31 December, about USD 300 million (NOK 2 billion) was under active management through 16 local and regional equity capital funds in Africa, Central America and south and south-east Asia.

The institution is also engaged in fund management companies Angola Capital Partners (ACP) and Lafise Investment Management (LIM) in Nicaragua.

Norfund has a 50 per cent holding in Statkraft Norfund Power Invest AS (SN Power), which invests in, builds and operates hydropower stations in developing countries. At 31 December, SN Power had an equity of USD 162 million (NOK 1.1 billion).

FUND MANAGEMENT » The regional Aureos funds made satisfactory progress in 2005.

Covering eastern, western and southern Africa respectively, these three funds have total assets of USD 140 million (NOK 950 million) and are developing largely as planned. Investment activity in southern Africa has been a little behind schedule, but is now picking up.

The ASEAF fund for south-east Asia has USD 60 million (NOK 406 million) available for investment in SMEs in Thailand, the Philippines, Indonesia and the Mekong region. Its capital

base is expected to increase somewhat during the first half of 2006. Bringing in local investors has taken longer than expected, and investment activity is a little behind schedule.

With USD 36.3 million (NOK 245 million) under management, the ACAF fund in Central America has also lagged behind the planned investment pace, but is now showing satisfactory results.

An interim fund of USD 10 million (NOK 68 million) has been created for Sri Lanka in order

important for attracting other private investors to the funds managed by Aureos.

In Central America, Norfund owns 20 per cent of Nicaragua's Lafise Investment Management (LIM). Established with Latin America's LAFISE financial institution in 1999, LIM manages the CASEIF fund which has made satisfactory progress.

Norfund was a prime mover in establishing Angola Capital Partners (ACP) in 2004. This company is owned one-third each by Norfund, Angola's

Banco Africano de Investimentos (BAI) and Angolan state oil company Sonangol. ACP launched the African country's first investment fund – Fundo de Investimentos Privados (FIPA) – in 2004, but securing the necessary local approvals has prove a bigger challenge than expected. FIPA has accordingly been unable to begin its investment activity.

ENERGY » After its third full year of operation, SN Power is now involved in power generation in Peru, Sri Lanka and India. Fifteen hydropower stations with a total capacity of 207 megawatts (MW) are in operation, and two more with a planned combined capacity

of 347 MW are under construction in Chile and India. A 60-MW thermal reserve power station is also being built in Chile. Four small power stations in Uganda are at the planning stage, and further project opportunities are being pursued in Peru, Chile, Mozambique, India and the Philippines.

The company had a high level of activity in 2005 and made satisfactory progress. Its project team totals just under 20 staff in Norway.

Full financing of about USD 272 million (NOK 1.8 billion) was secured in October 2005 for the



Building a road to Allain Duhangan, the largest foreign investment in Indian hydropower.

to exploit opportunities until the new Aureos South Asia Fund (ASAF) is established. This also covered the increased need for capital following the tsunami disaster of Christmas 2004.

The Aureos Capital Ltd management company again broke even in 2005. Its older funds, established in 1995-98, are fully invested and work on selling off the portfolio is under way.

A letter of intent signed in 2005 invites the Aureos management to become minority shareholders in the company. CDC will also return as an owner in that connection. This is seen as

155-MW La Higuera run-of-river power station in Chile, owned by SN Power and Australia's Pacific Hydro. Development work has begun, and the power station is due to be on line in the autumn of 2008. This represents the largest investment made by any Norwegian company in South American electricity supply. Preparations to construct more power stations in the area are under way.

Through its ownership of Cahua SA in Peru, SN Power operates 12 power stations totalling 114 MW. These facilities include a thermal reserve facility.

The company has a 49 per cent holding in India's Malana Power Company (MPC), which operates the 86-MW Malana power station in the northern part of the country. MPC initiated construction in 2005 of the 192-MW Allain Duhangan run-of-river station in the same area. Capital spending on these two facilities totals roughly USD 300 million (NOK 2 billion), which represents the largest investment so far made by a foreign company in the Indian hydropower sector.

In the Philippines, SN Power initiated a collaboration in 2005 with Aboitiz Equity Ventures Inc aimed at participating in the reconstruction of the Filipino electricity market. The Nividhu power utility in Sri Lanka, owned 30 per cent by SN Power, operates two mini-power stations with a combined capacity of 6.1 MW and is planning several more units of this kind to reduce dependence on oil-fired generation.

SN Power is assessing the construction of several mini-power stations in the 5-40 MW range. These would form part of an energy development programme supported by the World Bank which seeks to give 400 000 households access to electricity within a decade.

Discussions are under way in Mozambique on a model for private-public partnership to refurbish, own and operate two hydropower stations which currently operate very unreliably.

PROSPECTS FOR 2006 » With increased activity in most Aureos markets, this company is expected to continue making good progress in 2006. Good results from investments are important for ensuring that Aureos has the resources to



Photo: AKDN
The Kabul Serena Hotel, an investment which contributes to the restructuring of Afghanistan.

establish new regional funds.

Work on the ASAF was pursued in 2005. This fund was established in February 2006 with a capital base of USD 40 million (NOK 270 million), and the aim is to increase this to around USD 100 million (NOK 675 million) in the course of a year. The fund will cover Sri Lanka, India and Bangladesh.

A secondary capitalisation of the ASEAF is expected in the first half of 2006.

Once these funds are fully subscribed, a portfolio will have been created which gives Aureos a good basis for breaking even.

The investment period for the CASEIF fund expired in October 2005, and the second-generation CASEIF 2 fund is due to be launched in 2006. Success here will be crucial for securing continued operation of LIM as a management specialist.

Angola Capital Partners faces a critical year in 2006. Securing the necessary approvals and a successful launch of the FIPA fund will be crucial for the future of this involvement.

SN Power is maintaining its strategy of a continued commitment to priority markets in Latin America, Asia and Africa, and expects activity to remain high in all these regions. Statkraft's interest in Nepal's Himal Power Ltd is due to be transferred to SN Power in the first half of 2006.

Work on transferring Statkraft's holding in a Laotian power station is continuing. This is conditional on third-party approval.

FUNDS AND DIRECT INVESTMENTS

Norfund's investments in SMEs are placed both directly with individual companies and indirectly through fund management companies. Most are channelled through funds because that makes it possible to reach a larger number of companies, triggers more capital from other investors, and provides a local operational presence which boosts the prospects of success in creating viable companies.

Activity was high in 2005. Norfund implemented or was close to concluding new investment agreements totalling about USD 60 million (more than NOK 400 million) during the year.

New direct investments agreed in 2005 totalled almost USD 27 million (NOK 182 million). At 31 December, Norfund had 12 direct investments with an overall exposure of USD 28 million (NOK 190 million) in the form of both loans and equity. The bulk are in fishing-related activities, technology and tourism. Direct investments are now held in eight countries – Afghanistan, Bangladesh, the Philippines, Indonesia, China, Nicaragua, Turkey and Vietnam.

New agreements on fund investments in 2005 totalled almost USD 9 million (some NOK 59 million). Norfund has now placed USD 127 million (NOK 858 million) with 21 funds for active management. This breaks down into USD 81 million (about NOK 546 million) in funds managed by Aureos and USD 46 million (NOK 312 million) in funds managed by others.

DIRECT INVESTMENTS » Norfund concluded a cooperation agreement in 2005 with its Nordic counterparts – the IFU in Denmark, Finnfund and Swedfund – and Rezidor SAS on developing hotel projects in Africa. This collaboration has a financing framework of EUR 35 million (about NOK 280 million), split equally between the five investors. That gives Norfund a 20 per cent interest in Afrinord Hotel Investment, which is expected to have 6-10 hotels operational in Africa within three-five years. Many of these will be in the continent's least-developed countries.

Another involvement in the same sector is an investment of USD 5 million (almost NOK 34 million) in a hotel in Kabul, Afghanistan. This gives Norfund a 17 per cent interest. The hotel forms part of the Serena chain, with the Aga Khan Fund for Economic Development as its main shareholder. Norfund's Dutch counterpart, the FMO, and the International Finance Corporation (IFC) are also involved in financing this project.

Afghanistan has a big shortage of suitable premises for accommodation and meetings, and the hotel investment has been made at the request of the Afghan authorities and as part of the rebuilding of civil society in the country.

Norfund agreed in 2005 to make a loan of USD 1.5 million (NOK 10 million) to a joint venture between Norway's TTS Marine ASA and a Chinese shipbuilding group for manufacturing maritime cranes in China. TTS is considering further investment in the region.

Fjord Marin Turkey faced a year of major challenges in terms of both management and market conditions. The company farms sea bass and sea bream, producing around 4 000 tonnes per year. It is owned 29.6 per cent by Norfund and 70.4 per cent by Norwegian parent company Fjord Marin ASA. The latter gained a new majority shareholder in 2005, and active efforts are now being made to strengthen the Turkish company's organisation and financial progress.

One of the companies in which Norfund has invested was investigated in 2005 over allegations of evading custom duties on imports. The alleged evasion mainly occurred before Norfund became a shareholder. Since the charges surfaced, Norfund has made an active contribution to clarifying the circumstances. This includes several meetings with the authorities. The company has paid the outstanding duties to the customs authorities as well as supplementary costs. Such conditions are a challenge in the markets in which the institution operates, and it is important to



Photo: Aune Martine Bjønness

New Indian biotechnology enterprises are being developed through the APIDC Biotech Fund.

have good routines in this area. This also underlines the need for players such as Norfund in these markets so that they can influence the development of business standards in the right direction.

Norfund sold its holding in Norfish Blagaj at the end of 2005. This fish farming company in Bosnia-Herzegovina has operated at a loss for

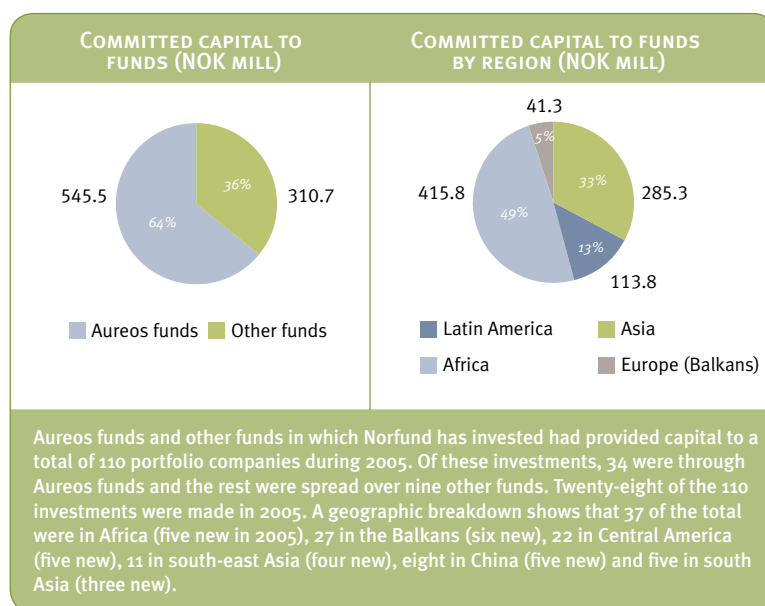
several years despite many efforts to reverse the negative trend. Norfund cannot see that it can contribute more as an owner of the company, and has therefore opted to transfer its stake to its Norwegian co-owner, who has been the majority shareholder throughout the period. Before Norfund sold out of the company, outstanding loans were repaid and the Norwegian partner undertook to inject additional capital to create the basis for continued operation in 2006.

INVESTMENT IN FUNDS >> Norfund concluded agreements during 2005 on investing EUR 2.5 million (almost NOK 20 million) in the Vietnam Equity Fund. That represented its first investment in this country apart from placements through the ASEAF. Norfund's contribution represents about 16.5 per cent of the new fund. Vietnam's capital market is little developed, and the fund will contribute to increased local business development through the privatisation process expected there.

Agreement was reached on investing USD 2.75 million (NOK 18.4 million) in the APIDC Biotech Fund, a new technology fund for India. This totals USD 35.7 million, and Norfund accordingly has a 7.8 per cent interest. The IFC is injecting 11 per cent of the capital, with local investors contributing 65 per cent. This fund invests in Indian

biotech companies focused both on domestic sales and international markets. Investments were made during 2005 in a new pharmacy chain and in enterprises involved in remote diagnostics, vaccine production, development of new medicines and production of biodiesel.

Norfund also agreed to invest USD 3 million (NOK 20 million) in the China Environment Fund, a second-generation fund focused on environmental protection and energy efficiency in SMEs. This is one of the first funds to specialise in



investing in environmental technology in China. It has a total capital of USD 31 million, which gives Norfund a 10 per cent interest. The largest investor is the Hong Kong-based Less environmental group. Other investors are the Asian Development Bank, the FMO, Calvert and Mitsui. China faces huge environmental problems, and measures to combat these are now attracting great attention. The market for environmental technology and services is expected to expand rapidly.

PROSPECTS FOR 2006 » After a year of major investment growth, 2006 will largely focus on ensuring good supervision of the portfolio in accordance with Norfund's requirement for active corporate governance. Environmental and social considerations are given great weight in this context. Norfund invest EUR 1.2 million (NOK 9.6 million) in early 2006 to secure a 15 per cent interest in a new fund aimed at small enterprises in Madagascar.

Work is continuing on creating the ASAF, assessing two new funds for SMEs in Central America, and investing in the African telecommunications sector.

FINANCIAL INSTITUTIONS AND LOAN PORTFOLIO

Norfund invests in and makes loans to banks and financial institutions in order to develop capital markets and improve access to capital both for SMEs and for enterprises at the micro level – right down to individuals. Equity investments are frequently accompanied by board participation, which provides the opportunity to influence further development of the financial institution concerned.

In 2001, Norfund took over a portfolio of loans made by the Norwegian Agency for Development Cooperation (Norad) to companies with Norwegian ownership in developing countries. This portfolio comprised 48 loans totalling NOK 402 million.

FINANCIAL INSTITUTIONS » At 31 December 2005, Norfund's investments in financial institutions totalled USD 30 million (NOK 203 million), including undisbursed commitments.

New investment agreements in 2005 totalled



Photo: Tim Lund, Norfund

Norfund agreed in 2005 to invest NOK 47 million in micro-enterprises and small companies in Latin America.

USD 7.8 million (NOK 53 million), loans or subordinated loans came to USD 5 million (NOK 33 million), and equity injections amounted to almost USD 3 million (NOK 21 million). The geographic breakdown of these amounts is out-lined below.

An agreement was concluded in 2005 with microfinance provider Uganda Microfinance Limited (UML) on investing USD 1 million (NOK 6.5 million). Founded in 1997 as the Uganda Microfinance Union, UML is one of Uganda's



leading microfinance institutions and has some 72 000 customers.

In Latin America, a subordinated loan of USD 5 million (NOK 33 million) was made to Corporacion Interfin SA, which runs the largest privately-owned bank in Costa Rica. This gives the bank the opportunity to increase lending to SMEs in Nicaragua, El Salvador and Guatemala.

Agreement has been reached on investing USD 2 million (NOK 14 million) in the Solidus Investment Fund SA, which offers subordinated loans to microfinance institutions in such countries as Nicaragua, Peru, Colombia, Chile and Bolivia.

Norfund arranged a club loan for Financiera Arrendadora Centroamericana SA (Finarca), which involves a four-year extension of an existing Norfund loan of USD 1.9 million (NOK 12 million) and additional financing of USD 5 million (NOK 34 million) from others.

LOAN PORTFOLIO » Six of the loans were terminated during 2005. The portfolio now consists of 27 loans. USD 8.6 million (NOK 58 million) was repaid during 2005, and USD 0.9 million (NOK 6.3 million) was paid in interest. This is NOK 30.1 million more than expected under agreed repayment plans. At 31 December 2005, the outstanding loans totalled USD 21.7 million (NOK 147 million).

PROSPECTS FOR 2006 » Work is under way to agree investments in Uganda, Mozambique and Tanzania. One of Norfund's objectives is that investment in the least-developed countries should form a growing share of its portfolio of financial institutions.

Another Norfund ambition is to increase the share of its portfolio relating to financial institutions. The aim is for this portfolio to total USD 50 million (about NOK 328 million) by 31 December 2006. ■



High oil prices:

Worst for (some) poor countries

High crude prices in recent years have boosted revenues for Norway and other petroleum producers, while oil-importing countries have lost out. The latter include many poor nations. Questions include the size of the extra bill for these countries, how large is it in relation to Norwegian development assistance, for instance, and what impact it has on growth prospects for the nations concerned.

By John Magne Skjelvik and Haakon Vennemo. Both authors are partners in Econ, and Vennemo is head of its development economics department. E-mail: jms@econ.no and hve@econ.no. Read more at www.econ.no.

Oil prices are now higher than many observers forecast a few years ago. The average price per barrel in 2005 was roughly USD 46. It was almost exactly half that amount in 2001. Countries exporting oil and gas are earning twice as much as they did four years ago. We assume that the price of natural gas has kept pace with that for oil. The result is a large-scale transfer to Norway and other exporters at the expense of the oil-importing nations.

Complex picture

Norway has 25 partner countries for development cooperation. This is a mixed group, ranging from big nations such as China and Indonesia to small states like East Timor. They include many oil importers, but also substantial oil exporters such as Nigeria and Angola. This means that higher oil prices will have very different consequences for Norwegian partner countries. Most lose out, but some win.

How big is this loss? We calculate that the price rise from 2001 to 2005 increased annual spending on oil by about NOK 135 million for the oil-importing partner countries. That compares with about the NOK 18 billion available annually for Norwegian development assistance. In other words, the extra bill is large compared with Norway's aid outlay.

The figure below shows the share of oil purchases in gross domestic product (GDP) for some Norwegian oil-importing partner countries in 2001 and 2004*. These 25 countries include seven main partners, which are grouped

on the left of the graph. All the latter are oil importers, and lose out from higher oil prices. We see that Eritrea in particular, but also some other countries, are much harder hit than the main partners. Two-thirds of the increased oil bill is paid by China, since its economy is by far the largest. At the same time, it ranks among those least affected by the price rise because oil-intensiveness is relatively low.

Nigeria, Angola, Indonesia and Vietnam are also Norwegian partner countries, but have been excluded from the graph because they are net oil exporters. They are collectively making about NOK 170 billion per year from the price rise.

A variety of reasons could explain why some oil importers are harder hit than others. They may have relatively limited access to renewable energy resources of their own. Electricity generation can be heavily dependent on oil. The transport sector is often the biggest single oil consumer, and may be less developed or energy-efficient in some nations. Few opportunities are available to most of these countries in the short term for reducing their oil dependence by converting to other energy bearers or using supplies more efficiently.

Future developments

Many observers predict that oil prices will remain high in coming years because of growing demand from such countries as India and China, instability and uncertainty in many oil-producing states and time lags for investment to expand production capacity. The Chinese

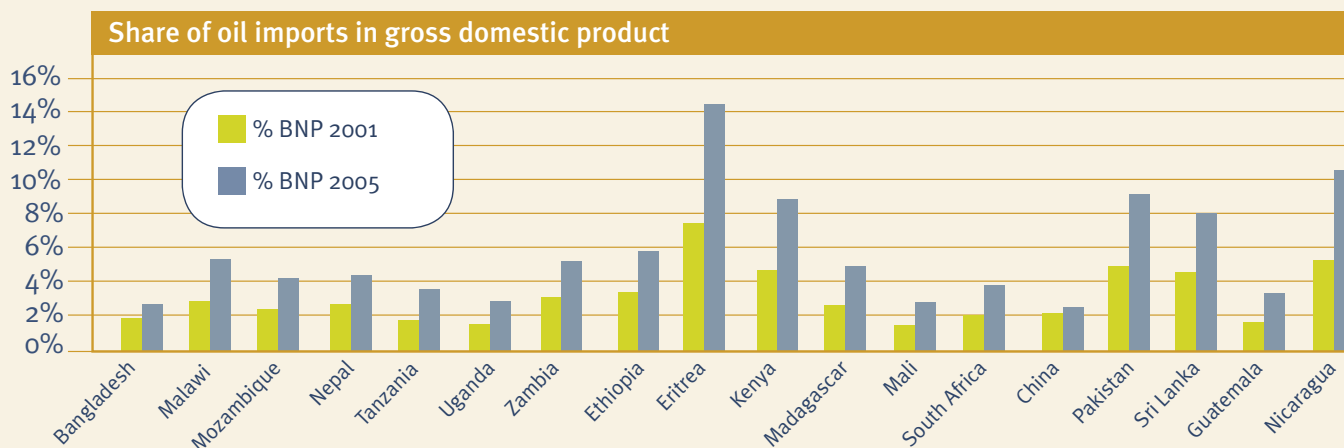
economy has been growing at a stable 10 per cent per annum for many years, and shows no signs of a slowdown at the moment. India's growth history is more recent and less stable, but could very well continue. Demand from these two countries will push oil prices up. The question then is whether supplies can be increased.

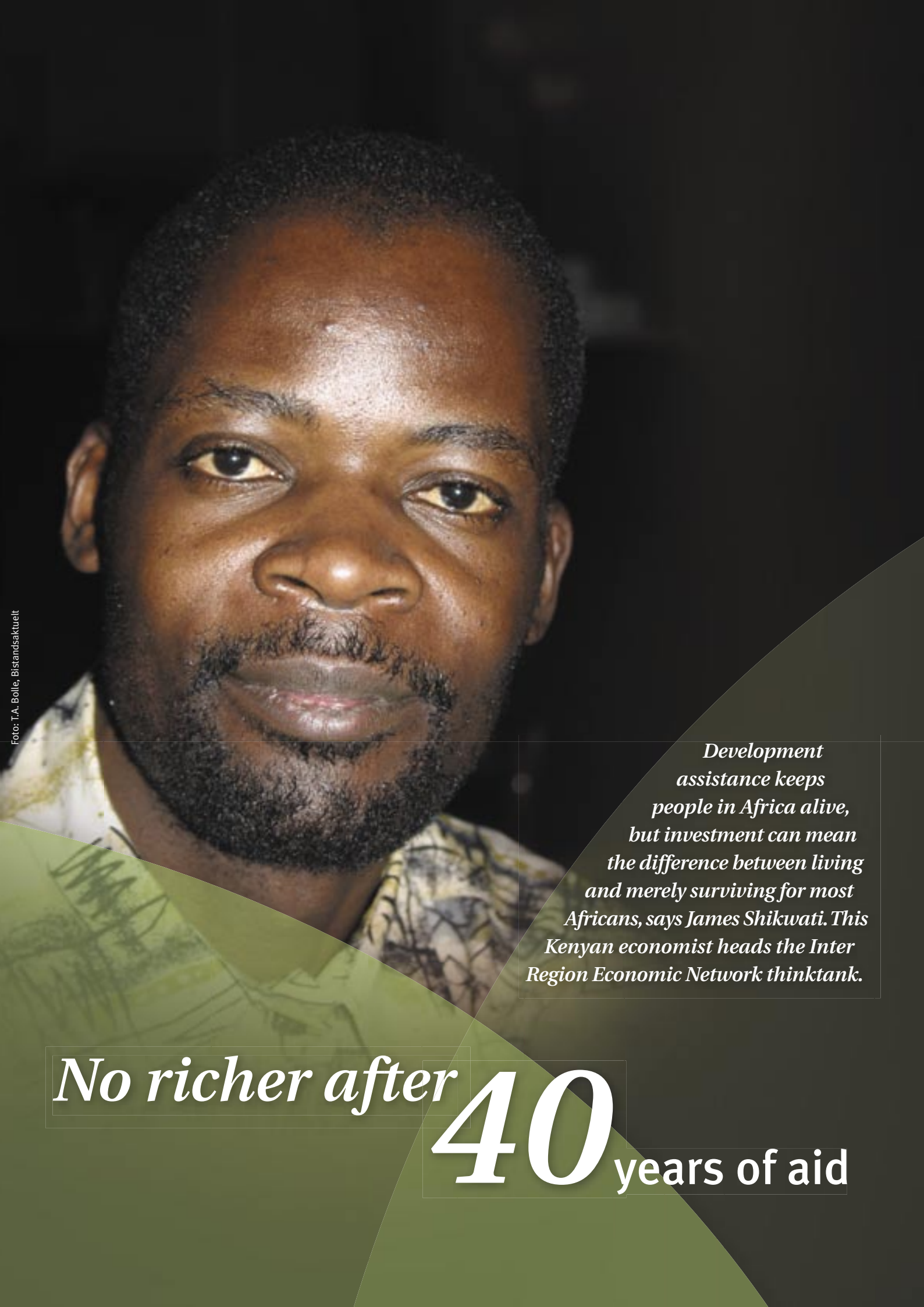
High Indian and Chinese growth is good news for the 50 per cent of the world's poor people who live in these nations, and make it clear that higher oil prices are no disadvantage for poor countries when they are partly a result of that country's own growth. Increased economic expansion in India and China is also good news for Norway and other oil exporters, but bad news when viewed in isolation for poor people in oil-importing countries. Estimates from the International Monetary Fund (IMF) indicate that a permanent USD 10 rise in the per-barrel oil price could cut GDP in the poorest and most indebted nations by 1.5 per cent after a year. The reduction could be as much as three per cent for sub-Saharan Africa.

Doubling oil prices from 2001 to 2005 could thereby mean an economic downturn for many of Norway's partner countries in the short term.

The oil-exporting partner countries will seemingly emerge well from the price rise. But it remains to be seen how far the increased revenues will boost economic growth which also benefits the great mass of their populations. ■

*These figures are based on Econ memo 024/2004. We have looked at new oil consumption – in other words, consumption less domestic production. Afghanistan and the Palestinian areas are excluded for data reasons. The USD 46 scenario assumes that oil consumption is unchanged from 2001.





Development assistance keeps people in Africa alive, but investment can mean the difference between living and merely surviving for most Africans, says James Shikwati. This Kenyan economist heads the Inter Region Economic Network thinktank.

No richer after **40** *years of aid*



Shikwati visited Norway in October 2005 in connection with a conference on poverty organised by the Norwegian Agency for Development Cooperation (Norad). His observations enlivened a large gathering of assistance workers.

“The nations which have received most development assistance over the past 40 years remain the poorest countries today,” he noted. “Despite the billions which have flowed into Africa, the continent remains poverty-stricken.”

At the same time, India and China have achieved the greatest reduction in the number of poor people in world history. This progress has had much more to do with direct foreign investment and the development of local industry and national enterprises than with aid.

“If development assistance were a private-sector industry, it would have been closed down because it was inefficient and unprofitable,” Shikwati observed. “There’s no better way of helping the poor than to ensure that those providing the aid also benefit economically. We Africans need industries and banks which can lend us money.”

Discourages development

He believes that traditional development assistance has several negative aspects, not least in making governments less dependent on their own populations and tax revenues. That in turn keeps bad leaders in power for longer and undermines democracy. According to Shikwati, aid contributes more to underdevelopment than to development.

“A huge bureaucracy is financed by assistance funds. Corruption and self-satisfaction are encouraged, and Africans get used to acting as beggars rather than as independent people. Development aid also weakens local markets and discourages the creativity Africa needs. It may sound absurd, but I believe that development aid adds to a number of Africa’s problems.”

From Norfund’s perspective, a major difficulty for people who want to start commercial activity in Africa is limited or non-existent access to credit. As in most developing countries, the credit market in Shikwati’s homeland is character-

ised by both formal and informal players. Until recently, the formal Kenyan market provided by the commercial banks was accessible only to the wealthy minority.

The majority of Africans, who live in the countryside, have no access to banking services. Rural businesses are also hampered by low population density, weak purchasing power and lower economic activity in general. Developing infrastructure and supporting business will be important for improving creditworthiness and access to loans for people in rural communities.



Africa needs banks which lend to new businesses, says James Shikwati.

High risk

Although African banks have implemented reforms in recent years, they still find it very difficult to build commercially-acceptable loan portfolios because the local private sector is often weak, with few creditworthy borrowers. Many African countries also have high inflation and vulnerable currencies, which increases risk for lenders.

Financial institutions responsible for investment in and loans to banks and similar enterprises represent one of Norfund’s business areas. Its aim is to help develop capital markets in developing countries and improve access to funding for small and medium-sized enterprises (SMEs).

“Africa offers a big market to players such as Norfund,” Shikwati

emphasised, and noted that many SMEs in the continent are related to the agricultural sector. He pointed out that investment in water supply, for instance, yields higher farm productivity. That in turn allows farmers to save money and become potential clients for a local bank.

“Emergency aid and cooperation are necessary with natural disasters, but Africa must take its first step towards a modern society on its own account,” said Shikwati. “We must change our mentality and stop seeing ourselves as beggars. In today’s world, very few people can even imagine an African business leader. To change this picture, I believe the aid organisations must depart.” ■



Photo: Shamsu Mupure

Being unable to gain access to credit and banking services imposes a general curb on economic progress in many developing countries.

Africa needs banks for ordinary people



Business growth is dependent on a well-functioning financial populations or to people on low incomes in many developing countries, particularly in Africa. They cannot even open an account with the large banks. That creates a big African demand for banking services aimed at “ordinary” customers.

Norfund has so far made or agreed investments totalling about NOK 200 million with financial institutions in developing countries.

This also allows it to influence corporate governance to the better and enhance environmental and social standards, both in the financial institutions themselves and among their clients.

In addition to supporting economic development, close contacts with local banks provide Norfund with valuable information on a country's business sector. Cooperation with financial institutions puts it in touch with useful partners who can support other projects in the same markets. They can also serve as valuable contacts for Norwegian companies who want to do business in these countries.

DFCU – a development partner

DFCU is a medium-sized commercial bank in Uganda which focuses mainly on small and medium-sized enterprises (SMEs). A listing on the Ugandan stock exchange was secured by DFCU Limited in 2004, and it now has about 4 000 shareholders.

Norfund also invested roughly NOK 17.5 million in this company during 2004 to secure a 10 per cent shareholding.

The institution's British counterpart, CDC, owns 60 per cent and accordingly ranks as the bank's principal shareholder.

Cooperation with DFCU improves Norfund's opportunities to invest in other east African projects. The bank has expanded rapidly, and more than 1 000 shareholders attended the 2005 annual general meeting.

Uganda has experienced an annual economic growth of more than six per cent in recent years.

Focused on small clients

DFCU concentrates on four business areas – commercial banking, term finance, mortgage finance and leasing – and is among the few Ugandan banks to offer such services to SMEs. As one of the country's fastest-growing commercial banks, it cooperates closely with the domestic private sector. It concentrates on such areas as trade and commerce, agriculture and

food processing, transport, tourism and hotels, the property market, schools and hospitals.

In addition to profitability, DFCU gives great weight to development potential when assessing an investment project. It constantly demonstrates through its commitments that development does not conflict with profit.

Uganda has experienced an annual economic growth of more than six per cent in recent years, but this expansion is concentrated in the largest cities. DFCU focuses on the SME market which other banks have avoided, partly because of the high risk involved. ■

Read more about DFCU at www.dfcugroup.com

Norfund commitment to African microfinance

Norfund signed an agreement in December 2005 to invest in micro-finance specialist Uganda Micro-finance Limited (UML). Norfund's total investment in UML is about USD 1 million (NOK 6.5 million).

Established in 1997, UML is a locally-run organisation which offers financial services to micro-entrepreneurs and low-income groups in

Uganda. Committed to reaching as many poor people as possible and to innovative product development, it has grown into one of Uganda's leading microfinancing institutions. Loans and other services are offered to some 72 000 customers in various parts of Uganda.

“Microfinance is an excellent way of making bank services accessible

to the majority of people in developing countries,” says Elizabeth Lee Marinelli, Norfund's director of investment in financial institutions.

“These countries have a poor range of banking services and weak economies. We want to help build up professional and commercial microfinance institutions which can secure lasting growth and reach the largest possible

number of customers.”

A large proportion of the population in the least-developed countries make their living from the provision of goods and services in the informal economy. Entrepreneurs in this sector often find that microfinance is their only way to secure loans for business expansion.

DFCU has revolutionised James Ogwal Olal's life. A leasing deal allowed him to build up a printing business which provides full-time work for eight families and employs 15 part-timers.

James Ogwal Olal's *printshop*

After teaching graphic design and art for more than a decade, Ogwal still loved his profession but was struggling financially. He cares for 21 children of five deceased relatives, including one killed in war and three who died of Aids.

He decided to start a print shop to supplement his teaching salary. Many of his former students had started their own businesses and were flourishing.

He teamed up with a friend in Kampala, teaching during the day and then heading to the print shop each afternoon. Competition was stiff, and the venture came to an abrupt end when his partner sold the printing equipment and fled with the proceeds.

Back home

But giving up was not an option. Ogwal moved the business to his home town, 350 kilometres from Kampala.

"The whole area only had one printshop, with machines which were always breaking down," he says. Local schools were unable to get their exam papers printed and most of the district council's administrative work was left undone.

A printshop was clearly needed, and Ogwal had the right expertise. But he lacked capital. He approached DFCU, which advised him to take out a lease.

This gave him the UGX 30 million (NOK 110 500) he needed to buy printing equipment in 2001. He also needed a computer, photocopiers and a generator.

"Local power supply problems meant we could only print at night," he explains. "We never met our deadlines, but now we've been able to acquire a generator and can print at any time."

Work for eight families

In just one year, Ogwal's production capacity doubled – and so did his profits. He was able to pay his monthly lease instalments comfortably and could purchase more equipment.

His B&J Printing Services company has had a big impact on the whole area, and now does work across the whole of northern Uganda. He handles most of the local printing work for the health ministry and local government. But schools in the region have been the greatest beneficiaries.

"They used to print their exam papers in Kampala, which was very cumbersome," Ogwal says. "Correcting mistakes was almost impossible. It's much easier now that we're so close."

He is devoting the proceeds from the printshop to building a two-storey building which will provide more space, and has applied to DFCU for UGX 100 million (about NOK 370 000) to complete the work. ■

Bosco Okello's laboratory and school

Bosco Okello always wanted to study a profession that would benefit those around him. His childhood dream was realised when he qualified as a lab technician. With DFCU's help, he now runs his own laboratory and has built up a primary school.

"As a laboratory technician, I help people by diagnosing diseases and giving them better lives," says Okello.

He worked initially in a missionary hospital which was very busy. His meagre salary was supplemented by free bed and board. As his family grew, he worried that his salary was not enough to pay school fees. It was a struggle to make ends meet, and he had big dreams for his four children.

He finally quit his job in search of better opportunities, leaving the hospital without money, home or even bedding. What seemed a foolish decision then has turned out to be the wisest in his life.

Okello found work at a government hospital, but it was poorly equipped. "We'd just sit in the laboratory the whole day, and after doing that for a few months I decided to leave," he recalls. But finding private work was not easy.

He was hired by a clinic in Lira, Uganda's third-largest city with 80 000 residents. When that business failed, he started providing laboratory services to local clinics and hospitals. His list of clients grew, and so did the need for better equipment. He had no idea where to get the necessary money.

"I needed over UGX 50 million (NOK 184 000)," he recalls.

The answer was a DFCU leasing deal, which has allowed him to acquire a computer, printer and photocopier which ease his recordkeeping and make his services faster and more efficient.

More than 60 people per day now use Okello's laboratory services. "Patients used to spend a full day going to Kampala for these tests," he says.

Next to his laboratory is a clinic with doctor. Lab and clinic give work to 30 people.

Profits to school

Okello has decided to reinvest his profits in another project – a school which he hopes DFCU will also help him to realise. Over three years, he has built this establishment up from nursery level to a fully-fledged primary school with 250 pupils and 31 teachers.

"I come from a region which has been hit by war," he explains. "If we don't invest in education, our children have no future. I'm half way through the construction work and need a mortgage from DFCU to finish off this school."

And Okello's own family? "My children attend good secondary schools and I'm training them to take over when I can't cope with this work any more," he says. ■



Profits from Bosco Okello's lab are being used to build a school.

Downtown Shanghai, 2005

In the course of a decade, Shanghai has become one of the world's most dynamic cities.

Integration in the global economy has created prosperity for many millions of people in India and China. But this economic success has done little to benefit the majority of the population. The two Asian giants are lagging behind in improving living standards for people in general.

Asia's . giants

Foreign direct investment

According to Unctad's World Investment Report for 2005, foreign direct investment in China reached a record USD 60.6 billion in that year. Spending by foreigners on research and development is a relatively new growth area for multinationals with subsidiaries in developing

countries, and has expanded quickly in Asia during recent years. India and China are particularly important for such investment. Both countries have large groups of well-qualified technical personnel.

Political differences

Although India and China have many similarities, the differences between them are also great. China has often ignored advice from the International Monetary Fund, the World Bank and foreign companies, while India has tied itself more closely to the west in recent years. Nevertheless,

if Chinese and Indian progress is to be hailed as a success, their big social and economic differences need to be evened out. In late 2004, India held an almost faultless general election which allowed 660 million people to cast their votes. The Chinese are still governed by a one-party regime.



If India's efforts to create greater social equality had been as dynamic and innovative as its involvement in the global technology market, the country could have been well on its way to meeting the UN's millennium development goals. With much lower incomes and economic growth, Bangladesh has made far greater progress in reducing infant mortality. Vietnam has overtaken China in the same way.

The Indian economy is flourishing, inflation is low and the stock market is approaching its highest-ever level. Over the past decade, India has enjoyed an average annual increase in gross domestic product of six per cent. Although that is low by comparison with China, it is formidable when set against the rest of the world. Together with the growth of an Indian middle class, this has earned India glowing praise at world economic conferences and in the media. But the globalisation success in India has not necessarily improved living standards for the majority.

Biotech boom

India is becoming increasingly popular as a venue for medical research among pharmaceutical groups looking in part for quicker and more efficient methods of testing medicines.

Some 120 000 chemists and chemical engineers are qualified in India every year, and the country is well supplied with able R&D personnel. It also has huge numbers of people suffering from the same medical conditions found in the industrialised world, including 30 million with heart disease, 25 million with type II diabetes and 10 million with

mental health problems.

It is estimated that moving R&D operations to India allows companies to reduce their costs by up to 30 per cent. The bulk of these savings come from hiring medical researchers, nurses and information technology personnel at less than a third of the cost in the west.

Through its agreement to invest USD 2,75 million in the APIDC Biotech Fund, Norfund is partly involved with diagnostic clinics which process X-rays for US hospitals as well as caring for local patients. These clinics are staffed by experts with first-class equipment who can make a thorough assessment of investigations regardless of the patient's location. This saves both time and money for American

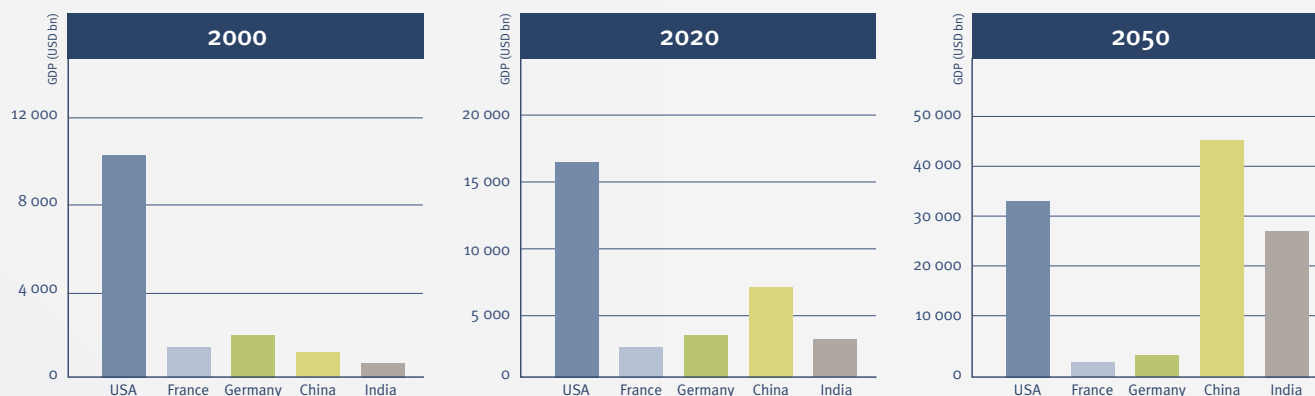
hospitals, while giving India access to advanced medical hardware.

Although India can claim a large number of well-educated chemists and biologists, the country has a problem with fake medicines. With more than 800 000 pharmacies, it has no way of knowing which are cheating. The biotech fund has also invested in the Medicine Shoppe chain, which guarantees correct and effective medicines while also pursuing customer education programmes to ensure that they know how to use the drugs.

As in China, the majority of poor Indians live in the country with limited access to doctors. The biotech fund regards this as an interesting market, and is working with a remote diagnostics company which supplies small mobile diagnosis units able to carry out an overall initial health check. This >>

The Indian economy is flourishing, inflation is low and the stock market is approaching its highest-ever level.

China and India are expected to become two of the world's largest economies



Source: Goldman Sachs

means that sick people do not have to travel far to receive the right diagnosis and the correct medicines.

Brain drain or brain gain

New career opportunities in multinational and local companies as a consequence of foreign investment could lead a reversal in the “brain drain” from developing countries.

Many scientists, engineers and entrepreneurs who went abroad to work are moving back to China and India.

They bring valuable scientific, research and developmental knowledge with them.



Photo: Anne Marthe Björnes

Well-educated Indians have promising prospects. Their country's booming economy is attracting foreign investment.

A number of those returning home start their own companies and contribute to innovation locally. Many employees in most of the companies in which Norfund has invested via local funds in China and India have returned after studying and working abroad, mainly in the USA.

The impact of a high brain drain on economic development is serious. Norfund considers that its role involves supporting a reversal of the brain drain from India and China. ■

The price of prosperity

Modern China conjures up images of Shanghai, skyscrapers, profits, rapid economic growth and above all an astonishing reduction in poverty. And all these are true – but not the whole truth.

China's rapid expansion is a driving force in the global economy, but also poses huge threats for the environment. Per capita, its population's access to fresh water is only a quarter of the world's estimated average. Five of its seven largest rivers are seriously polluted. And its government has pursued policies which widen the gap between rich and poor – both within local communities and between regions.

Rapid urbanisation

Chinese economic growth has fuelled an unparalleled urbanisation. More homes are built in the country every year than the whole European Union manages over a decade. Ten million people move to cities in China every year, with 10 million square metres of new houses built annually in Beijing. China's urban population is set to rise from roughly 430 million in 2001 to 850 million by 2015. The UN estimates that seven out of 10 Chinese will be urban dwellers in 2050. Responding to this growth presents a challenge for China's leaders. According to the government, every one per cent increase in urbanisation means constructing 300-400 million square metres of homes, providing 640 million kilowatts of energy and handling a billion cubic metres of waste water every year.

“It's really, really scary,” says Charlie Jang with reference to

the fact that 6 000 new cars are sold every month in Shanghai. The city has expanded 20-fold over the past five years.

Jiang is president of Emnetek, a company which manufactures equipment to reduce hazardous emissions from vehicles. A special filter can remove as much as 90 per cent of the dangerous fumes.

“Installing these filters adds to manufacturing costs,” he notes. “At the moment, we're producing only for export. But we expect China to follow suit and demand similar standards as Europe and the USA.”

Emnetek is one of the companies in which the China Environment Fund (CEF) has invested. Norfund in turn signed an agreement in 2005 to place USD 3 million with the CEF. The institution's Chinese involvement embraces three main strategies – investing in environmental technology, cooperating with Norwegian companies and investing in less developed regions.

Clearer skies

The sun used to be visible for just 10 days a year in Beijing. Clear skies can now be seen for 150 days a year.

“Since the aim is 365 days a year, we still have some way to go,” says Jiang with a laugh. >>

It is little more than three years since the Chinese authorities began to take environmental issues seriously. A ministry of the environment has been created, with a budget of USD 200 million for the next five-year period.

The most polluting western companies relocated to China during the 1980-95 period because no rules existed to limit emissions and discharges. However, legislation now curbs toxic emissions/discharges by both national and international enterprises. Stricter standards have also increased the need for investment capital, making Norfund's support for environmental technology all the more important.

"The problem is to ensure that the laws are enforced," says Jiang. "Government provisions are clear enough, but environmental issues are a question of money which local authorities often lack."

The CEF's business philosophy is that environmental protection should be profitable. Making a commitment in this area must be a paying proposition. That helps to counter environment-related corruption. Local government officials

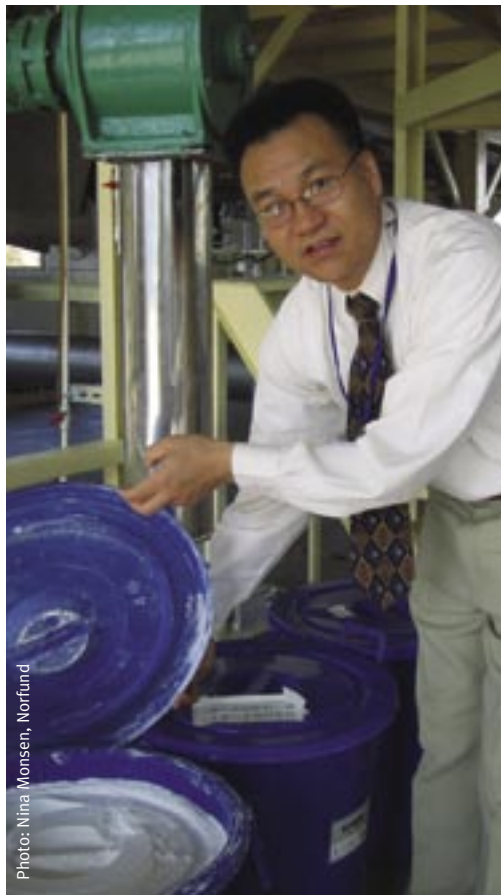


Photo: Nina Monsen, Norfund

Charlie Jiang, president of Emnetek, presents the powder used by his company to produce filters for cleaning car exhaust fumes.

must not be tempted to accept bribes to look the other way while a company breaks the environmental rules.

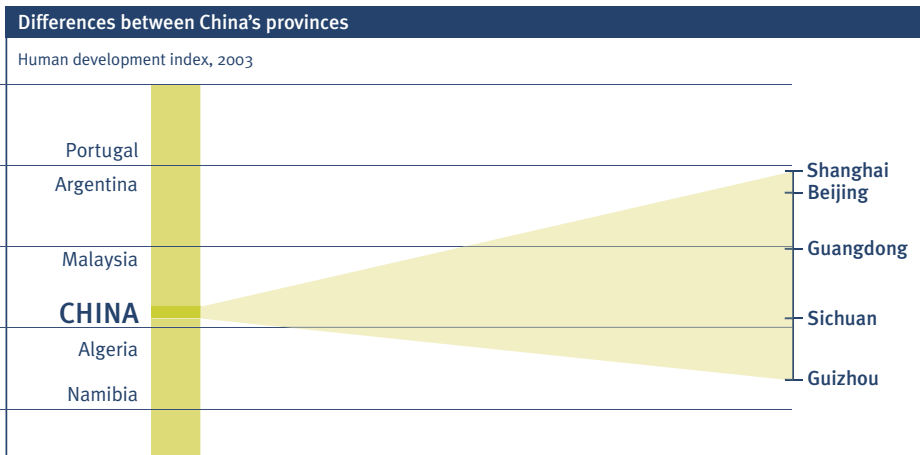
Differences

Developments in living standards vary greatly in China. The Guizhou and Shanghai regions are as far apart in economic terms as Namibia in southern Africa and EU member Portugal (see the table below).

According to figures from the World Bank, the number of poor people in China declined from 600 million in 1981 to around 200 million in 2001. But half of this progress occurred in the early 1980s. Although the Chinese economy is expected to grow by 9.2 per cent this year, official statistics show that 26 million people live in absolute poverty – in

other words, on less than USD 81 per year.

But the political willingness to change course appears to be increasing. The government has promised to reduce the gap between the urban rich – who have benefited most from China's 20-year economic boom – and the country's great majority of rural poor. ■



Source: Human Development Report 2005, UNDP

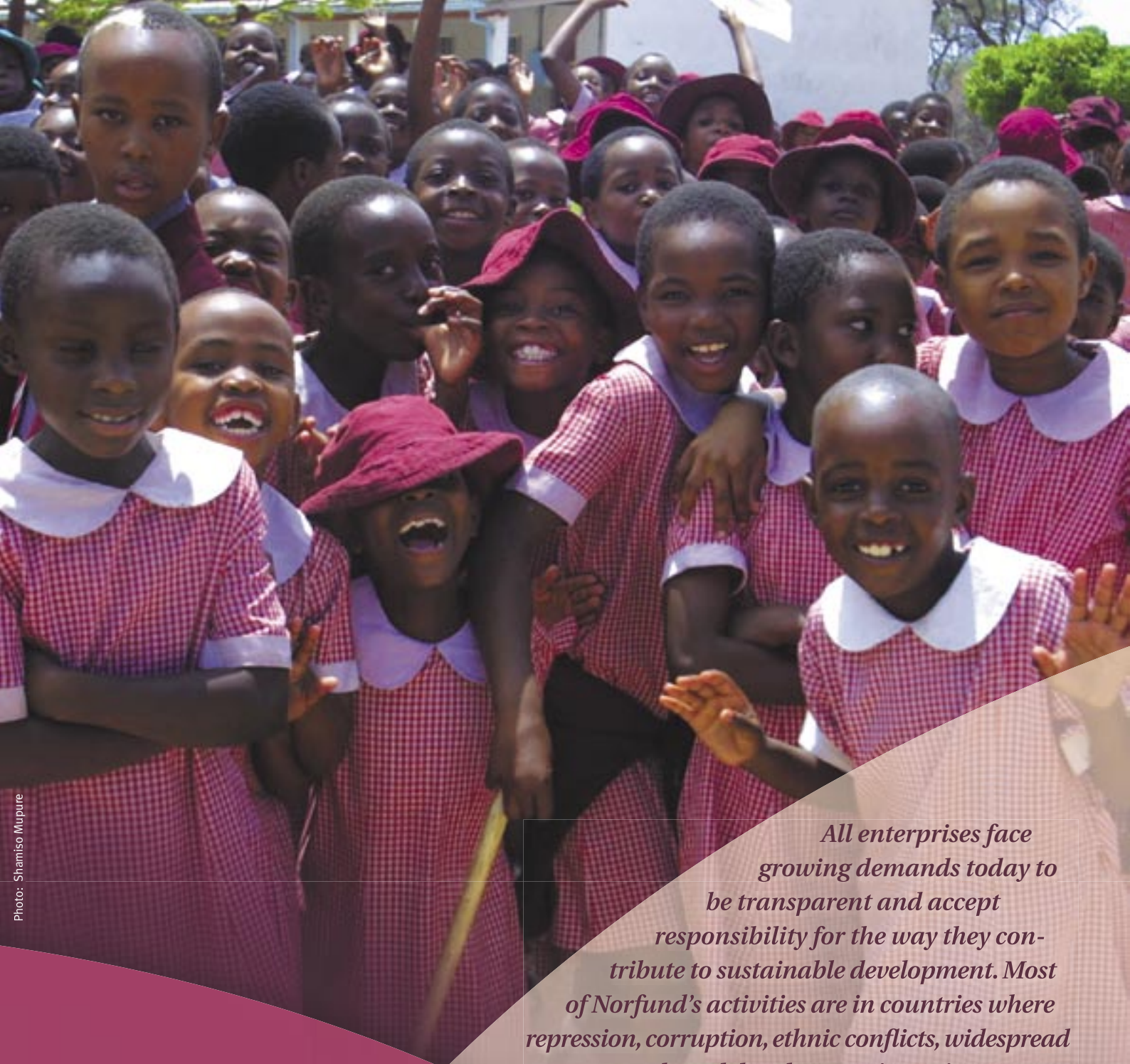


Photo: Shamiso Mupfema

All enterprises face growing demands today to be transparent and accept responsibility for the way they contribute to sustainable development. Most of Norfund's activities are in countries where repression, corruption, ethnic conflicts, widespread poverty and weak legal protection exist to a greater or lesser extent. That makes heavy demands on enhancing employee awareness, focusing on environmental and social conditions, good contracts and open reporting routines.

Significance of sustainable

development



Norfund's activities are dedicated to helping reduce poverty and contributing to sustainable business development in developing countries. The institution's unique role lies in facilitating and triggering investment in the most difficult markets, and in its focus on ensuring that companies behave responsibly on labour rights, environmental commitment and ethical standards.

Clear policy

Norfund is firmly committed to a policy that all investment projects must accord with recognised international standards for environmental and social conditions, as well as national requirements. Observing national laws and statutory regulations is an absolute condition for Norfund investment in an enterprise. International standards are defined as the World Bank and International Finance Corporation (IFC) guidelines as well as the International Labour Organisation (ILO) core conventions on child labour, forced labour, discrimination, freedom to organise and the right to negotiate.

However, this policy does not mean that Norfund will necessarily refrain from investing in companies which fail to meet the strictest environmental and social requirements. A substantial development effect lies in raising companies with an acceptable starting point to an international standard. This also applies to conditions relating to corporate governance. In such cases, an improvement programme will form a key element in the contract between the company and Norfund, with associated goals, action plans and budgets which are systematically followed up – usually through Norfund's representation on the board of directors. The institution has integrated sustainability assessments in its portfolio management systems. This means that risk classification, environmental and social conditions will be assessed and systematically monitored throughout the lifetime of the project.

Makes demands

Financial institutions are a priority sector for Norfund's investments. Helping to strengthen the capital market which finances small and medium-sized enterprises (SMEs) is a key motivation here. Among other requirements, Norfund expects financial institutions in which it invests to build up systems for assessing environmental and social risk and to make demands on its clients. Encouraging local banks and financial institutions in this way to influence their thousands of clients to pursue more responsible business activities has

a big development effect.

Norfund contributes to development at several levels. The choice of countries, sectors and investment instruments is also important. At the same time, Norfund's presence as a catalyst and risk-reducer is crucial for many projects. And its value-creation role in an investment is absolutely central for

securing long-term sustainable and profitable operation as well as good jobs. Achieving the maximum development effect is accordingly a matter both of profitability and of social and environmental conditions.

This must be followed up in Norfund's everyday operations in order to maximise the development effect. Emphasis is accordingly given to the line management's responsibility for project quality, defined in relation to a triple bottom line. Substantial work

was devoted to both system development and training during 2005, and these efforts will be maintained.

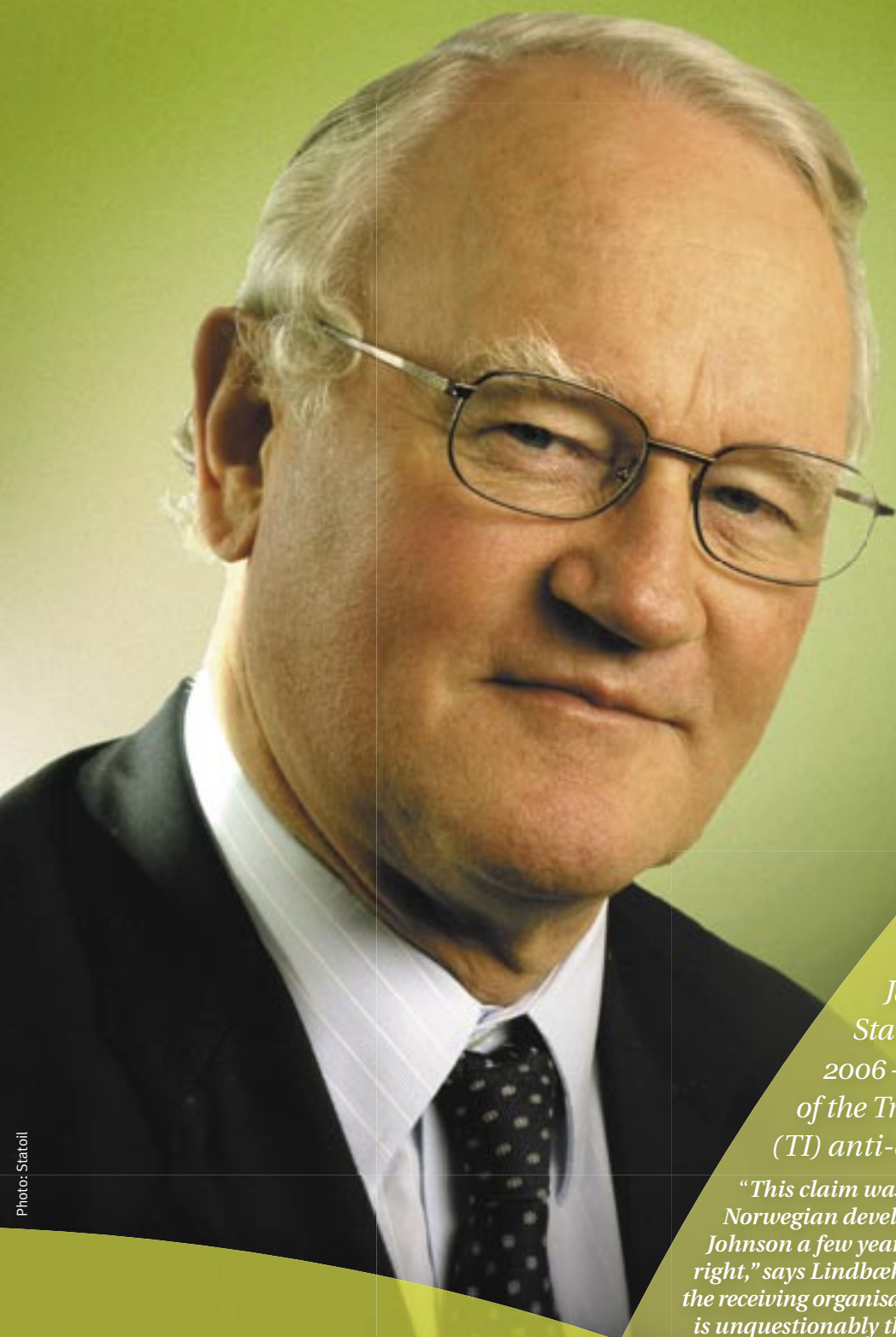
Measuring development effects

Value is created through on-going work with an investment. Norfund must accordingly monitor development-related indicators at project level in the same way it does with economic and financial conditions. Integrating measurements of development effects fully in its portfolio management system (PSS) was accordingly an important milestone in 2005. All projects will be systematically monitored for such considerations as jobs, taxes, transfer of knowledge and technology, consequences for women, work on good corporate governance and anti-corruption measures, the working environment, training, and observance of environmental and social standards.

Most of Norfund's activities are pursued in countries which suffer substantial corruption problems. These make an important contribution to sustaining poverty and are a barrier to combating it. The presence of corruption hampers development because funds are improperly allocated, the cost of doing business is boosted and investment is hampered. And it hits the poorest people hardest.

Norfund utilises its membership of Transparency International (TI) to participate in seminars and exchange experience with other enterprises in the TI network. Norfund's ethical guidelines have been updated and routines for whistleblowing put in place. All employees have also received training on ethics. Further work in this area will focus on how Norfund can play an active and positive role in its investments in order to secure good corporate governance and minimise corruption. ■

*Value is created
through on-going work
with an
investment.*



Development assistance creates corruption, believes Jannik Lindbæk, chair of Statoil and – until February 2006 – of the Norwegian branch of the Transparency International (TI) anti-corruption organisation.

“This claim was made in a speech by former Norwegian development minister Hilde Frafjord Johnson a few years ago, and I’m afraid she was right,” says Lindbæk. “It’s important to focus on how the receiving organisation can accept the money. Poverty is unquestionably the biggest problem facing the world, but I don’t believe you can do anything about it without economic growth. And there won’t be any growth without a dynamic private sector. Norfund’s strength lies in the fact that it invests in this sector in developing countries.”

INTERVIEW: JANNIK LINDBÆK

Self-interest against

corruption

Lindbæk has solid experience from top jobs both in Norway and internationally. These include chief executive of underwriter Storebrand, the Nordic Investment Bank in Helsinki and the International Finance Corporation (IFC). The last of these is the World Bank's organisation for the private sector.

"To create development, you've got to be pragmatic rather than ideological," he says. "An interaction must exist between interests in receiving countries and western companies. In that context, Norfund and the IFC can act as drivers for achieving things which wouldn't otherwise happen."

Rich countries have a responsibility for promoting the principle of ethical business operation, Lindbæk believes.

"Talk about 'them and us' is unacceptable. A number of developing countries, such as India, have well-developed requirements for social and environmental standards. The political processes underlying a project are often the same as in Norway. Our business community must understand that it's not just a question of 'going in and helping yourself' in poor countries."

He also emphasises that most companies from OECD nations who invest in developing countries do so on the basis of enlightened self-interest.

Weapon against corruption

According to Lindbæk, such self-interest is actually the weapon which works best in the fight against corruption. When Norway's Telenor adopts a policy of zero tolerance towards corruption, this is not only because it wants to be ethically superior, but also because it is the only approach which pays off in the long run.

Zero tolerance is not, incidentally, a phrase which people who have been fighting corruption for a decade are keen to hear. For it to have a content and be more than fashionable jargon, a company must have a clear policy, good guidelines and training in place. Lindbæk urges to observe the World Bank and IFC rules on environmental and social standards.

In his work with TI, Lindbæk focuses on how corruption hampers economic and social development. China has serious problems in this area, while developing at high speed. Norwegian companies need no guarantees and support schemes to invest in China. They hurl themselves into the ring of their own accord.

"An astonishing development is under way in China," says Lindbæk. "Millions of people have been lifted out of poverty, economic growth is high and many foreign companies are investing. Its form of government is not perhaps how we might wish it to be, but that also applies to many other countries. The most important consideration for Norfund

must be that its projects stay on the straight and narrow."

Internal investigation

Lindbæk's interest in corruption was stimulated while he worked with the World Bank in 1994-99.

"When I joined, the board still interpreted the articles of association to mean that corruption was something which affected individual member countries and not the bank itself," he recalls. "That view had prevailed for 50 years but was out-of-date – to put it mildly."

Peter Eigen, a World Bank veteran who had worked there for 25 years, went to the management around 1990 and demanded that the attitude to corruption be revised. The response was that "corruption is not an issue for the World Bank." Eigen quit and founded TI in 1993. Immediately afterwards, Jim

Wolfensohn was appointed as the bank's new head and joined forces with Eigen to get the board to appreciate that corruption was an important constraint on economic and social development.

"Norwegian and Nordic trust funds were also involved in the corruption scandal at the bank, and the process led to a necessary internal clean-up," says Lindbæk.

When he left the IFC in 1999, he was invited by Eigen to join him in Berlin on the TI staff. While that fitted badly with his personal plans, he took the initiative to establish a local branch in Norway in 2000.

"Over the years TI has existed, bribery has gone from being something companies entered as a tax deduction to a criminal act," says Lindbæk with a triumphant smile.

Big problem

TI has local branches today in more than 90 countries. Its activities include taking the lead on important international anti-corruption conventions. Norfund joined TI in Norway in 2004.

"Although much has happened in 12 years, corruption remains a big problem in many countries," says Lindbæk. Nigeria and Angola are two examples close to the heart of a Statoil chair and anti-corruption campaigner. Oil revenues account for the bulk of their national economies, which can create fertile soil for corruption.

One of the latest big victories for the anti-corruption movement is the new UN convention which binds member countries to identify and repatriate corruptly-acquired funds. After a long process, international banks recently began to pay back money salted away abroad by former Nigerian dictator Sani Abacha. Several hundred million dollars are involved.

"It's getting increasingly difficult to find a place to hide money derived from corruption," Lindbæk notes. ■

"To create development, you've got to be pragmatic rather than ideological."

Norfund's board of directors

Foto: Christian Hatt



EINAR STEENSNÆS (CHAIR)

Steensnæs became chair of Norfund on 1 October 2005. He has served as a minister in two governments – for church and education (1989-90), education and research (1990) and petroleum and energy (2001-04). Steensnæs was a member of the Storting (parliament) from 1993-05, where his offices included chair of the foreign affairs committee. He served as mayor of Haugesund in 1987-89 and 1991-93, and has held a number of directorships in industry and commerce. He is currently chair of the Norwegian Gas Centre.



GRETE FAREMO

Faremo is currently director for law and corporate affairs at Microsoft's western Europe region. She was an executive vice president at Storebrand in 1997-03, and has served as a minister in two consecutive governments – for development (1990-92), justice (1992-96) and petroleum and energy (1996). Faremo was a member of the Storting in 1993-97. With a law degree, she has broad experience from both private and public sectors. Her earlier positions include head of division at the Ministry for International Development (1984-86) and legal officer at Norad (1980-84).



BORGER A LENTH

Lenth is a lawyer and was affiliated with the Hjort DA law firm until 2006. He was previously chief executive of Christiania Bank, Eksportfinans and Norad, and secretary general at the Ministry of International Development. Lenth holds directorships in a number of Norwegian companies, including Norsk Hydro, BNbank and Treschow-Fritzøe. He is chair of Save the Children in Norway.



MARIANNE DAMHAUG

Damhaug is president of Norplan AS, a planning, finance and engineering consultancy. She earlier headed the Norwegian Trade Council's office in Washington DC and was employed by the Nordic Fund for Industrial Development. Damhaug has broad international experience of development work from various posts and assignments in this area over 19 years. She has also worked for Norad in Zambia. With a chemical engineering degree, she is currently chair of Norplan Uganda, deputy chair of the Norwegian Peace Corps, and deputy chair of the International Centre for Hydropower.



ÅSA SILDNES

Sildnes owns and runs Context Consult, which offer consultancy services to development assistance organisations and the private sector. She was earlier a project manager in the Strømme Foundation responsible for the commitment to small companies and company start-up programmes in Africa, Asia and Latin America. She has broad experience in microfinance, and has had assignments from such clients as the World Bank and the IFC. Her education includes an MBA from the University of Cape Town. She has lived and worked for a number of years in southern Africa.

Directors' report

HIGHLIGHTS OF 2005

- New committed direct investments totalling NOK 182 million
- Committed investments of NOK 59 million in equity capital funds in Vietnam, India and China
- Investments of NOK 53 million in Ugandan and Latin American financial institutions
- SN Power began building power stations in India and Chile which represent the largest power-generation investment by foreigners in India and by Norwegians in South America
- System for measuring development effects integrated in Norfund's portfolio management system
- Principles for corporate governance established

Norfund's goal is to combat poverty by investing risk capital in viable business activities in developing countries. Investments are made either directly in local companies together with industrial partners or indirectly through investment funds and financial institutions which are established and operated locally in a specific country or region.

Investing in profitable business activities helps to strengthen a country's development and have positive spin-offs for society. A well-functioning private sector and access to risk capital, supported by Norfund through partnership and co-financing, are important for developing countries to exploit their advantages and become optimally integrated in the world economy.

Norfund's mandate as an equity capital investor in developing countries means that the institution has a substantial risk exposure, and that its investments often have a long time horizon. Placements in local investment funds have an eight- to 10-year horizon. Return and development effects must therefore be measured over a long period. At 31 December 2005, Norfund had committed USD 287 million (NOK 1.9 billion) in investments with companies and investment funds, including jointly-controlled operations. Norfund's investments are primarily located in the poorest countries of Africa, Asia and Latin America.

Operations at Norfund are divided into three business areas: strategic investments, funds and direct investments, and financial institutions.

STRATEGIC INVESTMENTS

Assets under management by Aureos Capital Ltd totalled about USD 300 million (NOK 2 billion) at 31 December 2005, spread over 16 funds in Africa, Central America and Asia. Aureos was established in 2001 by CDC Group plc and Norfund. CDC transferred its interest to Actis LLP in 2004. A letter of intent on the re-acquisition of this holding by CDC was signed in 2005, and the intention is that CDC and Norfund will own equal shares while the Aureos employees will subscribe for a minority stake.

Angola Capital Partners and Lafise Investment Management (Nicaragua)

are other fund management companies in which Norfund is involved.

Statkraft Norfund Power Invest AS (SN Power) is now co-owner of 15 hydro-power stations with a combined generating capacity of 207 megawatts in Peru, Sri Lanka and India. Malana Power Company, owned 49 per cent by SN Power, started constructing a 192-MW power station in northern India during 2005. This project is costed at USD 200 million (NOK 1.3 billion). The company has an 86-MW power station operational in the same area. This represents the largest investment so far by a foreign company in Indian hydropower.

SN Power also made the biggest investment by a Norwegian company in the South American electricity sector during 2005. The 155-MW La Higuera power station in Chile was fully financed at a total cost of roughly USD 272 million (NOK 1.8 billion). It is owned 50-50 by SN Power and Australia's Pacific Hydro. Together with partners, SN Power is pursuing several development plans in Chile, Peru, India, the Philippines, Mozambique and Uganda.

FUNDS AND DIRECT INVESTMENTS

New investment commitments totalling USD 8.7 million (NOK 59 million) were concluded for the Vietnam Equity Fund, the APIDC Biotech Fund in India, and the China Environment Fund. The three Aureos funds in Africa, launched in 2003, had made 26 investments in various local companies at 31 December 2005.

Agreement was reached in 2005 with Rezidor SAS and Norfund's counterparts in Denmark, Finland and Sweden on creating the Afrinord Hotel Investment company to construct and operate new hotels in Africa. Each of the five partners has undertaken to invest EUR 7 million (NOK 56 million). At the request of the national authorities and in cooperation with the Aga Khan Fund for Economic Development, Norfund is investing USD 5 million (NOK 33.8 million) in the Kabul Serena Hotel in Afghanistan. A loan of USD 1.5 million (NOK 10 million) was also made to a joint venture between TTS Marine ASA and Chinese partners for manufacturing marine cranes.

Four investments were realised in 2005 for a combined sales sum of

NOK 7.9 million. This was NOK 36.6 million below the original outlay, but corresponded to the latest annual valuation so that the effect on Norfund's financial result was neutral.

FINANCIAL INSTITUTIONS

Agreements were concluded on new investments totalling USD 7.9 million (NOK 53.5 million) in three financial institutions. The extension of a USD 1.9 million (NOK 12.9 million) loan was also agreed. Total investment in the financial institutions business area is USD 30.1 million (NOK 203.6 million).

New agreements in 2005 included investments in Uganda Microfinance Ltd in Africa and in Solidus Investment Fund SA and Corporacion Interfin SA in Latin America for microfinance and loans to small enterprises. Norfund arranged a loan to Financiera Arrendadora Centroamericana SA (Finarca).

A loan to the Micro Kenya microfinance company was repaid in 2005 in accordance with the loan agreement.

At 31 December, NOK 146.7 million was outstanding on the portfolio of loans to companies in developing countries acquired from the Norwegian Agency for Development Cooperation (Norad) in 2001.

NORFUND'S DEVELOPMENT EFFECT

Norfund seeks to maximise development effects and poverty reduction in several ways. First, it gives particular weight to investment in the least-developed countries (LDCs) and in Africa. Norfund's goal is to have at least a third of its placements in LDCs, and this proportion was 31 per cent at 31 December 2005. Second, a key target is to reach small and medium-sized enterprises (SMEs) in developing countries, which are significant for economic growth and job creation. Priority is given to sectors such as financial institutions, renewable energy, new environmental technology and microfinance in order to achieve a direct development effect and the highest possible impact. Satisfying international standards for environmental protection, health and safety, and human rights is also important, not least for long-term value creation by companies and their ability to compete internationally.

Norfund integrated the measurement of development effects in its portfolio management system in 2005. This means that all projects are regularly assessed in relation to key factors such as jobs, tax revenues for the host country, market developments, training and technology transfer, quality of corporate governance, proportion of women employed, and social and environmental standards.

Investments by Norfund help to create or maintain employment. Its direct investments accounted for roughly 7 500 jobs at 31 December 2005, including some 2 600 at companies in the loan portfolio. A total

of 55 000 people worked in companies supported by the local funds in which Norfund had invested. The underlying projects covered by Norfund's investments, particularly in financial institutions, will also represent a substantial number of jobs. In addition come positive spin-offs and further jobs at sub-contractors and other industries which benefit from increased investment in the area.

THE ENVIRONMENT

Environmental considerations and social conditions are given great weight in Norfund's investment mandate, and are important for maximising the development effect. International environmental and social standards – primarily the environmental guidelines issued by the IFC and the World Bank as well as the core ILO conventions – form part of the contractual base for all new investments. Norfund requests annual reporting of the way such conditions are managed in the various direct investments and funds. It cooperates with Aureos and SN Power to ensure that its ambitions in this area are applied to their underlying projects. Norfund's international network of related organisations is very important for efforts to strengthen environmental and social considerations in its investment activities.

The largest environmental burden caused by Norfund's own business activities relates to travel and paper consumption. Carbon dioxide emissions from business travel by air amounted to roughly 250 tonnes in 2005. Paper consumption was about two tonnes, corresponding to 86 kilograms per employee.

CORPORATE GOVERNANCE

Norfund contributes risk capital to private enterprises in developing countries by taking direct and indirect equity positions in private companies. A number of these countries are characterised in part by inadequate legislation on business management as well as elements of corruption. Issues relating to corporate governance accordingly occupy a key place. Principles for corporate governance were adopted by Norfund in late 2005.

Detailed investigations are carried out by Norfund before an investment is made, and clear requirements are also set for partners and for business standards in the companies. In the institution's markets, however, the position is that no matter how thorough its preparatory work or how good its regulations, irregularities will be experienced. One of the portfolio companies in which Norfund has invested, was investigated during 2005 for evading customs duty on imports. Norfund has contributed actively to clearing up this position, and helped ensure that the company concerned reached a financial settlement with the authorities. This also underlines the need for players like Norfund in such markets, so that the development of business standards can be influenced in the right direction.

Seven board meetings were held during 2005. Changes to the composition of the board were made on 1 June. Sixty per cent of the directors are women.

HUMAN RESOURCES

Norfund had 26 employees at 31 December 2005. The number of work-years for the period was 23.6. Two staff were stationed abroad at 31 December – one in Costa Rica and one in South Africa – where they are monitoring investments and identifying new project opportunities. One employee has been loaned to the local Aureos management company in Vietnam. In addition, Norfund shares a local employee in South Africa with its Danish counterpart, the IFU. Consultancy services corresponding to 3.4 work-years were purchased during 2005 in connection with various assignments.

Measures were instituted in 2005 to reduce sickness absence, including an expanded assessment of the working environment and job satisfaction with the help of the company medical service. One result of this study has been greater tailoring of the physical working environment for each staff member. Sickness absence was reduced in 2005, and now stands at 2.8 per cent of total working hours. No personal injuries or damage to Norfund's material assets were suffered in 2005.

Equal opportunities for both genders represent an important element in Norfund's human resources policy. One object for its investments is creating more jobs for women and ensuring equal rights. Particular opportunities for making good progress have been discovered in micro-finance and small-enterprise financing.

Norfund's management team comprises two women and four men. Females account for 38 per cent of the company's workforce. Twenty-seven per cent of applicants for job vacancies advertised in 2005 were women, as were two of the three people engaged during the year. One employee left Norfund during the year. No special measures for promoting equal opportunities have been instituted.

Five people with a non-Norwegian background are employed by Norfund in Norway, including three from developing countries.

RISK

Norfund's investments are made in developing countries where structures, markets and companies are characterised by a high level of risk. This is additional to normal commercial risks associated with such investment in the industrialised part of the world. Future returns depend on the ability to assess these risks before making an investment, to institute risk-reducing measures, and to handle the opportunities and risks encountered during the life of the investment.

Norfund operates in poorly-functioning capital markets where

investments must be expected to have a long time horizon and where exit opportunities are limited. To reduce financial risk, the portfolio is spread across a number of regions and countries.

A substantial proportion of Norfund's investments in recent years have been made through local and regional funds, whose managements combine local knowledge with experience from developed capital markets. Access to such competence is important if Norfund is to manage risk in these markets in the best possible way.

Investments by Norfund are largely in USD, but will also be in other currencies in certain cases. Since Norfund keeps its accounts in NOK, its ongoing accounting profit will be heavily influenced by the exchange rate between the NOK and the USD or other relevant currency. The various investments made by Norfund are also subject to fluctuations between local currencies and the USD. The company's currency strategy aims to safeguard the value of the invested portfolio by hedging about 50 per cent of its future cash flow in USD.

Norfund is also affected by interest rate risk through liquid assets placed with the Bank of Norway. Interest charges on loans to projects can also be affected by interest rate risk, depending on the level of such rates in each country. Loans to projects are often tied to the variable London interbank offered rate (Libor) plus a margin. Norfund increased its commitment to lending over the past year, thereby reducing the risk presented by pure equity investments. Like equity investments, the risk posed by loans in these markets is also relatively high.

Non-financial considerations, including environmental and social conditions and corruption, can pose both financial and reputational risk for Norfund. Account is taken of this through a conscious "triple bottom line" approach in Norfund's projects. This approach will be further refined and made operational in 2006.

Norfund adopted principles and instructions for internal control in 2005 which will increase awareness and systematic risk management in the organisation. Ernst & Young has been engaged by the board to provide an internal audit function.

ACCOUNTS

The board is of the opinion that the annual accounts at 31 December 2005 provide a true and fair presentation of the company's financial position. At that date, Norfund had a capital base of NOK 3 billion, including the estimated value of the loan portfolio. A further NOK 485 million was allocated to the company in the central government budget for 2006, increasing its capital base to almost NOK 3.5 billion, including the estimated value of the loan portfolio. Exchange rates at 31 December 2005 have been applied in valuing Norfund's investments. Currency changes – particularly for the USD – increased the value of its

investments by NOK 52.4 million. Norfund's currency hedging yielded a loss of NOK 21.7 million, recorded as a financial expense. The net currency gain was accordingly NOK 30.7 million.

The net profit after the reversal of NOK 25.4 million in write-downs was NOK 93.9 million. In accordance with the instruction governing Norfund's operations, this profit has been transferred to Norfund's surplus fund.

GOING CONCERN

The board confirms the assumption of a going concern.

PROSPECTS

Since Norfund was created in 1997, it has exited from 10 projects representing a combined original investment of NOK 112 million, with an overall loss of NOK 56 million. Three of the investments gave a positive return, while two were written off in their entirety. The losses are concentrated in three direct investments made together with Norwegian companies in Norfund's first year. A number of losses are currency-related. Although the quality and breadth of the portfolio is different today, these outcomes illustrate the challenges involved in creating companies with long-term profitability in Norfund's markets. As described

above, a number of risks are associated with such investments which demand expertise and a close proximity to the investments. Maintaining work on professionalisation and continuous learning is accordingly important for increasing the level of success and reducing the various risks associated with investment in developing markets.

The strategic investments in Aureos and SN Power strengthen Norfund's prospects of success and create the basis for exerting broader influence than could be achieved through one-off investments. At the same time, these commitments impose a substantial capital requirement for Norfund. Today's pace of investment assumes that the capital provided by the government is at least on a par with the level of recent years.

Norfund has positioned itself as a central and respected player in the provision of risk capital for companies in developing countries. The need for such players is increasing, and the institution sees a big potential for further investment. With its key strategic positions, Norfund has a good basis for being able to meet its target of combating poverty by investing risk capital in viable business activities in developing countries. The authorities have expressed a desire for Norfund to establish a special scheme for small projects in the LDCs, and work is under way on a proposal for achieving this.

Oslo, 13 March 2006

Einar Steensnæs
Chair

Borger A Lenth
Deputy chair

Grete Faremo

Marianne Damhaug

Åsa Sildnes

Per Emil Lindøe
Managing director

Profit and loss account

(FIGURES IN NOK 1 000)	NOTE	2005	2004
OPERATING INCOME	1, 9	89 647	49 295
Operating expenses			
Payroll expenses	2	24 554	21 636
Depreciation tangible fixed assets	3	565	647
Currency regulation of project loans	8	(16 067)	13 622
(Reversal of write-down)/write-down of investment projects	8	(25 368)	26 929
Other operating expenses	2	21 749	23 937
Total operating expenses		5 433	86 722
OPERATING PROFIT/(LOSS)		84 214	(37 477)
Loss on investment in joint ventures	4	(4 461)	(15 975)
Gain on sale of securities		0	0
Other interest received		34 084	31 095
Other financial income	13	1 841	17 700
Other financial expenses	13	21 761	4 532
Net financial items		9 703	28 288
NET PROFIT/(LOSS)		93 916	(9 189)
Transfers			
Transferred to surplus fund	11	93 916	0
Transferred from surplus fund	11	0	9 189
Total allocations		93 916	(9 189)

Balance sheet

(FIGURES IN NOK 1 000)

	NOTE	2005	2004
ASSETS			
Fixed assets			
Tangible fixed assets			
Operating equipment, fixtures, fittings, tools, etc	3	1 520	1 584
Total tangible fixed assets		1 520	1 584
Financial fixed assets			
Investments in joint ventures	4	571 921	468 008
Loans to joint ventures	4	5 077	6 039
Pension funds	2	1 350	2 456
Total financial fixed assets		578 348	476 503
Total fixed assets		579 868	478 087
Current assets			
Accounts receivable			
Other accounts receivable	5	3 436	2 691
Loan portfolio		0	0
Total accounts receivable		3 436	2 691
Investments			
Loans to investment projects	6, 8	202 579	125 731
Equity investments	6, 8	353 561	248 347
Other market-based financial instruments	15	0	16 433
Total investments		556 140	390 512
Bank deposits, cash in hand and cash equivalents			
Liquid assets tied up in investments – committed, approved and sanctioned in principle	7, 10	1 281 845	702 856
Uncommitted liquid assets	7, 10	519 050	760 849
Total bank deposits, cash in hand and cash equivalents		1 800 895	1 463 705
Total current assets		2 360 472	1 856 908
TOTAL ASSETS		2 940 340	2 334 994

Balance sheet

(FIGURES IN NOK 1 000)	NOTE	2005	2004
EQUITY AND LIABILITIES			
Equity			
Called-up and fully-paid share capital			
Primary capital	11	1 862 500	1 521 250
Reserve capital	11	737 500	593 750
Total called-up and fully-paid share capital		2 600 000	2 115 000
Retained earnings			
Surplus fund	11	216 185	113 895
Total retained earnings		216 185	113 895
Total assets		2 816 185	2 228 895
LIABILITIES			
Other long-term liabilities			
Current liabilities			
Accounts payable	15	1 014	565
Unpaid government charges and special taxes		2 628	2 092
Unused funds (trust fund)	12	19 956	21 358
Other current liabilities	15	100 557	82 084
Total current liabilities		124 155	106 100
Total liabilities		124 155	106 100
TOTAL EQUITY AND LIABILITIES		2 940 340	2 334 994

Oslo, 13 March 2006

Einar Steensnæs
Chair

Borger A Lenth
Deputy chair

Grete Faremo

Marianne Damhaug

Åsa Sildnes

Per Emil Lindøe
Managing director

Cash flow statement

(FIGURES IN NOK 1 000)

	NOTE	2005	2004
CASH FLOW FROM OPERATING ACTIVITIES			
Profit/(loss) before tax		93 916	(9 189)
Loss/gain on sale of fixed assets		0	0
Ordinary depreciation	3	565	517
Write-down of fixed assets	3	0	130
(Reversal of write-down)/write-down of investment projects	8	(25 368)	26 929
Changes in stocks, accounts receivable/payable		0	(689)
Differences in pension costs and payments to/from pension funds		(833)	114
Result using equity and proportionate consolidation methods	4	4 461	15 975
Effect of exchange rate changes		(7 577)	4 628
Items classified as investments or financing activities			
Changes in other accruals		18 712	79 632
Total cash flow from operational activities		83 875	118 047
CASH FLOW FROM INVESTMENT ACTIVITIES			
Investments in tangible fixed assets	3	(501)	(1 275)
Proceeds from sale of shares/interests in other enterprises	9	7 850	0
Repaid proceeds from shares/interests recorded at cost price		46 238	8 105
Acquisition of shares/interests in other enterprises		(232 125)	(155 463)
Disbursement of loans for investment		(117 367)	(97 026)
Repayment of investment loans		54 756	4 767
Proceeds from sale of other investments		10 866	
Net cash flow from investment activities		(230 284)	(240 892)
CASH FLOW FROM FINANCING ACTIVITIES			
Proceeds from new short-term loans	12	9 000	23 000
Repayment of long-term loans		0	0
Repayment of short-term loans		(10 402)	(16 286)
Increase in/repayment of equity	11	485 000	485 000
Net cash flow from financing activities		483 598	491 715
CHANGES IN EXCHANGE RATES, CASH AND CASH EQUIVALENTS			
Net change in cash and cash equivalents		337 189	368 870
Cash and cash equivalents at 1 Jan		1 463 705	1 094 836
Cash and cash equivalents at 31 Dec	10	1 800 895	1 463 705

Accounting principles

THE FINANCIAL STATEMENTS FOR NORFUND CONSISTS OF THE FOLLOWING:

- profit and loss account
- balance sheet
- cash flow statement
- notes

The financial statements, which are prepared by management and the board of directors of the institution, must be read in relation to the director's report and the auditor's report.

Where actual figures are not available at the time the accounts were closed, generally accepted accounting principles require management to make estimates and assumptions regarding the effect of these items on the profit and loss account and the balance sheet. Actual results could differ from these estimates.

BASIC PRINCIPLES – ASSESSMENT AND CLASSIFICATION – OTHER ISSUES

The financial statements have been presented in compliance with the Norwegian Accounting Act and Norwegian generally accepted accounting principles in effect at 31 December 2005. The financial statement gives a true and fair view of assets and liabilities, financial standing and profit.

The financial statements have been prepared on the basis of fundamental principles governing historical cost accounting, comparability, continued operations, congruence and prudence. Transactions are recorded at their value at the time of the transaction. Income is recognised at the time of delivery of goods or services. Costs are expensed in the same period as the income to which they relate. Costs which cannot be directly related to income are expensed as incurred. Further comments on the various accounting principles are provided below.

Assets/liabilities related to current business activities and items which fall due within one year are classified as current assets/liabilities. Current assets/short-term debts are recorded at the lower/higher of acquisition cost and fair value. The definition of fair value is the estimated future sales price reduced by expected sales costs. Other assets are classified as fixed assets. Fixed assets are entered in the accounts at historical cost, with deductions for depreciation. In the event of a decline in value which is not temporary, the fixed asset will be subject to a write-down. The same principle applies to liabilities.

Generally accepted accounting standards provide some exemptions to the basic assessment and valuation principles. Comments on these exemptions can be found in the respective notes to the accounts. When applying the basic accounting principles and disclosure of transactions and other items, the "substance over form" rule is applied. Contingent losses which are probable and quantifiable are charged to the profit and loss account. In the notes to the accounts, segmental analyses by business and geographical area are presented. The geographical split is presented where it is of material importance to the users of the financial statements. The disclosure is based on the internal management and reporting system and on risk and earnings. Figures are reconciled with the institution's profit and loss account and balance sheet.

THE MOST IMPORTANT ACCOUNTING PRINCIPLES OBSERVED BY NORFUND ARE DESCRIBED BELOW

Operating income includes dividends, gain on the sale of shares/interests in other companies, interest on loans made to other companies, directors' fees, other project income, gain on the sale of fixed assets, and payments of interest and principal on the loan portfolio.

Gain on the sale of shares/interests in other companies is recorded in the year the sale takes place. Interest is recorded as and when earned. Other proceeds from shares/interests are deducted from the book value, and are accordingly not recorded as income.

Payments from the investment portfolio are recorded when received (the cash principle).

When loans to development projects are classified as doubtful, interest relating to the doubtful commitment is no longer recorded as income. Interest not paid owing to a default is reversed.

FINANCIAL INCOME AND EXPENSES

Interest on Norfund's liquidity reserve in the Bank of Norway, other Norwegian banks and certificates is recorded as financial income. Results from forward contracts for portfolio hedging which have fallen due are recorded in their entirety against other financial income or other financial expenses.

JOINT VENTURES

Joint ventures are activities controlled jointly by Norfund and one or more other companies. They are recorded in the accounts in accordance with the equity method. The institution's share of income from a joint venture is presented as a separate item in the accounts. Similarly, equity investments are presented as a separate item on the asset side of the balance sheet. Investments in Aureos Capital Ltd and Statkraft Norfund Power Invest AS are entered as joint ventures in accordance with generally-accepted accounting practice. Where final figures are unavailable, estimates are used for the expected result. Accounts for Aureos are compiled in USD, and the average annual exchange rate is used when recording the share of this company's results. Balance sheet figures relating to Aureos are also adjusted to the exchange rate prevailing at 31 December. Such exchange rate adjustments are recorded directly against equity in Norfund.

EQUITY INVESTMENTS

Norfund normally treats its investments in other companies as current assets. In other words, the equity method is not applied even though Norfund's equity interests provide it with considerable influence. This is because the purpose of the Fund's investments is to dispose of all or part of each commitment, normally after three-seven years as a rule. That accords with Norfund's object and generally-accepted accounting practice. Under generally-accepted accounting practice, such investments by their very nature are temporary and should therefore be included under current assets.

Equity investments in companies are valued at the lower of cost and market value, based on a specific assessment of each investment such that each investment is written down where this is considered necessary because of a permanent fall in value (specified loss provision). No general provision is made for losses. See the section below relating to the treatment of currency items. Committed investments mean that an external obligation exists to pay a designated amount, while investments sanctioned in principle and approved mean that the board has resolved to approve an investment under certain conditions, although no contracts have been signed.

When concluding an investment agreement, Norfund often employs various instruments to reduce risk – such as options, conversion options and so forth. The instruments are taken into account in the valuation of the individual investment.

LOANS

Norfund manages two types of loans:

- loans relating to Norfund's equity investments and made by the institution (project loans)
- loans to companies in developing countries acquired from Norad (loan portfolio)

Project loans are treated as current assets.

Loans are valued at the lower of face value and the anticipated final amount.

On the basis of the institution's strategy, the loan portfolio acquired from Norad is classified as a current asset and recorded in the accounts at historical cost, which is NOK o. Payments received from the loan scheme are therefore treated on a cash basis and recorded as income on receipt.

REALISED LOSSES

Losses recognised as a result of bankruptcy, the winding-up of a company and the like, and losses on the sale of shares are recorded as realised losses.

CURRENCY ITEMS

Bank deposits and loans are recorded at the exchange rate prevailing on 31 December. Unrealised gains/losses are posted as operating income/other operating expenses respectively. The assessment of changes in the value of investments (see above) also includes an assessment of changes caused by exchange rate movements.

BANK DEPOSITS, CASH IN HAND AND CASH EQUIVALENTS

Bank deposits, cash in hand and cash equivalents also include certificates and the like.

Norfund has opted to identify how much of its liquid assets were tied up in investments committed, approved and sanctioned in principle but unpaid at 31 December 2005. This is shown in the balance sheet under liquid assets tied up in investments – committed, approved and sanctioned in principle. The maximum amount has been recorded. Should investments not be made, this amount could be reduced. The remaining cash balance is shown as uncommitted liquid assets.

CURRENT RECEIVABLES

Current receivables are recorded at their estimated value and adjusted for irrecoverable items.

TANGIBLE FIXED ASSETS

Tangible fixed assets are entered at cost price reduced by commercial depreciation based on the estimated economic life of the asset in question.

EQUITY

Norfund's equity is divided into primary, reserve and surplus capital. This division is made on the basis of the frame conditions for Norfund's activities, which specify that the Ministry of Foreign Affairs must be notified if the institution's losses are so great that its primary capital is affected. Any net profit is added to surplus capital, while any net losses are deducted from this or from reserve capital if the former fund is insufficient to cover the net loss.

RELATED PARTIES

Norfund defines Aureos Capital Ltd and Statkraft Norfund Power Invest AS as related parties.

DEFERRED TAX AND TAX EXPENSE

Norfund is exempt from tax pursuant to a separate section in the Taxation Act.

CASH FLOW STATEMENT

The cash flow statement is compiled using the indirect method. Cash and cash equivalents include cash, bank deposits and other short-term investments with terms not exceeding three months which can be exchanged for cash immediately, and with no material exchange rate exposure.

PENSION COMMITMENTS AND EXPENSES

The company has a pension plan which entitles its members to defined future benefits, known as a defined benefit plan. The liability is calculated on a straight-line basis, taking into account assumptions regarding the number of years of employment, discount rate, future return on plan assets, future changes in salaries and pensions, the size of defined benefit contributions from the government, and actuarial assumptions regarding mortality, voluntary retirement and so on. Plan assets are stated at fair market values. Net pension liability comprises the gross pension liability less the fair value of plan assets. Net pension liabilities from underfunded pension schemes are included in the balance sheet as long-term interest-free debt, while overfunded schemes are included as long-term interest-free receivables if it is likely that the overfunding can be utilised.

The effect of changes in pension plans and estimates is recognised immediately in the profit and loss account.

Net pension cost, which consists of gross pension cost less estimated return on plan assets adjusted for the impact of changes in estimates and pension plans, is classified as an operating cost and presented in the payroll and related cost item.

Notes

01 SEGMENT INFORMATION

SEGMENT INFORMATION BY BUSINESS AREA:

Norfund has chosen to confine the presentation of segment information to profit and loss account items relating to its loan portfolio (LP). This is because the latter differs from other investment activities and has a different risk profile.

(FIGURES IN NOK 1 000)	2005			2004		
	NORFUND TOTAL	LOAN PORTFOLIO*	NORFUND EXCL LP	NORFUND TOTAL	LOAN PORTFOLIO*	NORFUND EXCL LP
Operating income	89 647	64 534	25 113	49 295	43 142	6 153
Operating expenses						
Payroll expenses	24 554	1 371	23 183	21 636	2 602	19 034
Depreciation of tangible fixed assets	565	33	532	647	82	565
Losses on sale of operating assets	0	0	0	0	0	0
Losses on sale of operating assets	(25 368)	0	(25 368)	26 929	0	26 929
Other operating expenses	5 683	805	4 877	37 560	2 575	34 985
Total operating expenses	5 433	2 209	3 224	86 772	5 259	81 513
Profit/(loss) from operations	84 214	62 324	21 889	(37 477)	37 883	(75 360)
Net financial items	9 703	0	9 703	28 288	0	28 288
Total profit/(loss)	93 916	62 324	31 592	(9 189)	37 883	(47 072)

* Income and expenses are partly directly attributable, and partly joint expenses allocated in accordance with a distribution formula based on the number of people employed.

SEGMENT INFORMATION BY GEOGRAPHICAL REGION:

No significant accounting assets or liabilities relate to the loan portfolio.

(FIGURES IN NOK 1 000)	AFRICA	ASIA	LATIN AMERICA	EUROPE	GLOBAL	WRITE-DOWNS	TOTAL
	Balance sheet						
Equity investments	169 444	147 632	67 821	30 372	31 225	(92 933)	353 561
Loans to investments	10 498	78 437	75 670	0	40 612	(2 638)	202 579
Total balance sheet	179 942	226 069	143 491	30 372	71 837	(95 571)	556 140
Operating income	26 414	47 649	12 837	250	2 497	0	89 647

02 PAYROLL EXPENSES

Pay and other payroll expenses

(FIGURES IN NOK 1 000)

	2005	2004
Pay	16 480	14 200
Directors' fees	317	380
Payroll taxes	3 153	2 640
Personnel insurance	350	323
Pension expenses	4 240	3 623
Other benefits	407	669
Payroll expenses refunded from trust fund	(392)	(200)
Total pay and other payroll expenses	24 554	21 636

Remuneration of senior personnel

(FIGURES IN NOK 1 000)

	MANAGING DIRECTOR	CHAIR
Pay/fees	1 169	80
Pension contributions	679	0
Other remuneration	27	0
Total	1 875	80

The managing director is not covered by any agreement to continue receiving pay the after termination of his employment beyond the ordinary three-month period of notice. The chair and the other directors have no contract for remuneration after leaving office. Nobody in Norfund has any bonus agreements.

The chair received NOK 80 000 for boardroom work on behalf of Norfund in 2005. This amount was divided between three persons. The deputy chair received a fee of NOK 73 333, including three months as acting chair. Other directors received fees of NOK 50 000 each for 2005, while the alternate directors received NOK 20 000 each. Directors fees' were proportionate to the period of the year that the relevant director served on the board.

NOK 866 575 was recorded for auditor's fees in 2005, which breaks down as follows:

Legally-required auditing	775 794
Other attestation services	0
Tax advice	0
Other non-auditing services	90 781
Total	866 575

All figures include VAT.

EMPLOYEES

The institution had 26 employees at 31 December 2005. The average number of employees for the year was 23.6.

PENSIONS

Norfund has a pension scheme which provides the right to defined future benefits. The size of these benefits will depend primarily on the number of pension-earning years, the level of pay at retirement and National Insurance benefits. The full pension entitlement is based on 30 pension-earning years and amounts to 70 per cent of pay.

Senior employees have a supplementary pension plan in addition to the general scheme. This provides for cover above 12 times the National Insurance base rate as well as a retirement age of 65. It is funded through Nordea Liv.

Pension expenses, pension funds and pension commitments have been calculated by the insurance company's actuary. Variances between the book value at 31 December of the previous year and the estimated value in the Natural Resources Systems Programme (NRSP) calculation at 1 January of the following year are entered directly in the profit and loss account. At 31 December 2005, 26 people were covered by the scheme.

Financial assumptions	2005	2004
Discount rate	5.5%	6.0%
Expected return on pension funds	6.5%	7.0%
Pay regulation	4.0%	4.0%
Pension regulation	3.0%	3.0%
Adjustment to NI base rate	3.0%	3.0%
Turnover	9.0%	9.0%
Expected early retirement at age 62 (AFP)	0.0%	0.0%
Payroll tax	14.1%	14.1%
Net pension expenses for the period (FIGURES IN NOK 1 000)	2005	2004
Net present value of pension accruals for the year		
Net present value of pension accruals at 1 January	3 183	2 144
Interest	878	469
Net present value of pension accruals	4 061	2 613
Interest cost of pension commitments		
Pension commitments at 1 January	15 572	7 812
Pensions paid	(299)	0
Average expected pension commitments	15 273	7 812
Discount rate	5.5%	6%
Interest paid	840	469
Expected return on pension funds		
Market value of pension funds at 1 January	17 115	8 968
Pensions paid	299	0
Payments received, including premiums	3 111	3 524
Expected return (%)	6.5%	7%
Expected return on pension funds	1 131	555
Amortisation of transfer effect	0	0
Amortisation or direct recording of variances	470	1 097
Net pension expenses	4 240	3 623
Pension commitments (FIGURES IN NOK 1 000)		
Opening balance accrued pension commitments	15 273	7 812
+ Net present value of pension accruals for the year	4 061	2 613
+ Interest on accrued pension commitments	840	469
- Pensions paid	(299)	0
Closing balance accrued pension commitments	19 875	10 893
Opening balance pension funds	17 115	8 968
+ Expected return	1 131	555
+ Payments received for the year	3 111	3 524
- Pensions paid	(299)	0
Closing balance pension funds	21 058	13 046

Reconciliation of net pension commitments against book value

(FIGURES IN NOK 1 000)

	2005	2004
Closing balance pension funds	21 058	13 046
Closing balance accrued pension commitments	(19 875)	(10 893)
Closing balance net pension funds	1 183	2 153
Payroll tax	167	304
Closing balance net pension funds, incl payroll tax	1 350	2 456

03 TANGIBLE FIXED ASSETS

(FIGURES IN NOK 1 000)

	OPERATING EQUIP- MENT, FIXTURES AND FITTINGS, ETC	PERMANENT OFFICE FIXTURES AND FITTINGS	CAR	ARTWORKS	TOTALS
Cost price, ordinary depreciation and write-downs					
Cost price at 1 Jan	4 386	273	341	67	5 067
+ acquisitions during the period	502	0	0	0	502
- disposals during the period	0	0	0	0	0
Cost price at 31 Dec	4 888	273	341	67	5 569
Accumulated ordinary depreciation at 1 Jan	3 199	91	13	0	3 303
+ ordinary depreciation for the period	474	40	51	0	565
- accum ordinary depreciation, operating assets sold	0	0	0	0	0
Accumulated ordinary depreciation at 31 Dec	3 673	131	64	0	3 868
Write-down of operating assets at 1 Jan	180	0	0	0	180
+ write-downs for the period	0	0	0	0	0
- accum depreciation, operating assets sold	0	0	0	0	0
Accum write-downs at 31 Dec	180	0	0	0	180
Book value for accounting purposes at 31 Dec	1 035	142	277	67	1 521

Operating equipment, fixtures and fittings and so forth are depreciated on a straight-line basis. The expected life of operating assets is three-four years. Office fixtures and fittings are depreciated over the life of the lease. Artworks are not depreciated. Cars are depreciated on a straight-line basis over eight years.

Operating assets not in use are written down to zero every year.

04 INVESTMENTS IN JOINT VENTURES

(FIGURES IN NOK 1 000)	AUREOS CAPITAL LTD	STATKRAFT NORFUND POWER INVEST AS	TOTAL
Formal information:			
Date of acquisition.	30.06.01	27.06.02	
Registered office	Mauritius	Oslo	
Shareholding	50%	50%	
Voting share	50%	50%	
Information relating to the date of acquisition			
Acquisition cost	18 339	600 000	
Equity capitalised at date of purchase (Norfund share)	18 339	600 000	
Excess/reduced value	0	0	
Goodwill	0	0	
Information relating to annual figures			
Opening balance at 1 Jan 05	3 377	464 631	468 008
Capital received in 2005	0	100 000	100 000
Deducted non-amortised excess value	0	0	0
Deducted non-amortised goodwill	0	0	0
Share of annual profit/(loss) ¹	10	(4 471)	(4 461)
Netting of previous year's result		0	0
Other changes during the year, exchange rate adjustment, etc	727	7 647	8 374
Closing balance, 31 Dec 05	4 114	567 807	571 921

¹Share of annual result is based on estimated figures from Aureos Capital Ltd and final figures from Statkraft Norfund Power Invest AS.

¹A loan of USD 1 000 000 was made to Aureos in 2004. Repayments were received on this loan during 2005, and the outstanding balance at 31 December 2005 was USD 750 000, corresponding to NOK 5 077 000.

An agreement between Statkraft and Norfund regulates the opportunity to transfer Statkraft's interests in two Asian power utilities – HPL in Nepal and THPC in Laos – to SN Power. Under a settlement with Statkraft in 2004, Statkraft has paid NOK 80 million to Norfund. Part or all of this amount could be recorded as income for Norfund. That depends on how the transfer of Statkraft's interests in HPL and THPC to SN Power will take place. The amount has been recorded as a current liability in the accounts. The effect of these equity holdings on the profit and loss account and their value have not been included in the 2004 and 2005 figures consolidated by Norfund from SN Power's activities.

KEY FIGURES FROM SN POWER INVEST'S CONSOLIDATED ACCOUNTS

(Key figures from SN Power Invest's consolidated accounts show key figures from the accounts as well as the way Norfund's accounts would have looked with a consolidation, given that SN Power Invest represents a large part of Norfund's business.)

Profit and loss account (FIGURES IN NOK 1 000)	SN POWER GROUP		NORFUND CONSOLIDATED WITH SN POWER (PROPORTIONAL CONSOLIDATION METOD ¹)	
	2005	2004	2005	2004
Operating income	162 995	150 887	171 145	124 739
Operating expenses	178 718	180 744	94 792	177 144
Operating loss	(15 723)	(29 857)	76 352	(52 405)
Net financial items	11 428	21 640	19 888	54 877
Ordinary loss before tax	(4 295)	(8 217)	96 240	2 472
Tax on ordinary loss	(4 647)	(23 321)	(2 324)	(11 661)
Ordinary loss	(8 942)	(31 538)	93 916	(9 189)
Net loss	(8 942)	(31 538)	93 916	(9 189)
Balance sheet				
ASSETS	2005	2004	2005	2004
Intangible fixed assets	7 232	12 401	3 616	6 201
Tangible fixed assets	367 843	377 010	185 442	190 089
Financial fixed assets	545 374	132 453	283 228	78 098
Total fixed assets	920 449	521 864	472 286	274 388
Goods	5 224	1 797	2 612	899
Receivables	52 950	26 152	29 911	15 767
Investments	0	17 053	556 140	399 038
Cash and cash equivalents	532 231	731 351	2 067 011	1 829 381
Total current assets	590 405	776 353	2 655 674	2 245 085
Total assets	1 510 854	1 298 217	3 127 960	2 519 473
Equity and liabilities	2005	2004	2005	2004
Called-up and fully-paid share capital	1 200 000	1 000 000	2 600 000	2 115 000
Retained earnings	(64 386)	(70 738)	216 185	113 895
Total equity	1 135 614	929 262	2 816 185	2 228 895
Provisions	82 053	80 194	41 027	40 097
Other long-term liabilities	201 669	220 674	100 835	110 337
Current liabilities	91 518	68 087	169 914	140 143
Total liabilities	375 240	368 955	311 775	290 578
Total equity and liabilities	1 510 854	1 298 217	3 127 960	2 519 473

¹The proportional consolidation method means that Norfund's 50 per cent share of the amounts in SN Power Invest's consolidated accounts is consolidated with Norfund's accounts, with all balances and transactions between the companies eliminated.

The annual accounts for these joint ventures are available from Norfund on request.

05 RECEIVABLES

The loan portfolio recorded under receivables was acquired from Norad without cost and has therefore been entered with a book value of NOK 0 in the accounts.

(FIGURES IN NOK 1 000)	OPENING LOAN BALANCE 1.1.05	REPAYMENTS RECEIVED 1.1-31.12	INTEREST RECEIVED 1.1.-31.12	DEPRECIA- TION DURING YEAR	CURRENCY REG DURING YEAR	CLOSING LOAN BALANCE 31.12.05
Book value	212 848 0	58 198	6 335	8 307	338	146 680 0

Two loans are recorded in USD and are thus subject to currency regulation. The other loans are booked in NOK. Norfund has estimated the value of its loan portfolio at 31 December 2005 to be to NOK 98 million.

Other receivables	31-12-05	31-12-04
Loans to joint ventures (see note 4)	0	0
Other receivables	3 436	2 691
Total receivables	3 436	2 691

Other receivables: all receivables fall due within one year.

06 LOANS TO COMPANIES IN THE INVESTMENT PORTFOLIO

LOANS SPECIFIED BY COUNTRY (FIGURES IN 1 000)	Number	Currency	BOOK VALUE ¹ (currency)	BOOK VALUE ¹ (NOK)	INTEREST RECEIVED (NOK)
Nicaragua	2	USD	3 140	21 254	1626
Ecuador	1	USD	39	267	0
Nepal	1	NOK	2 100	2 100	205
Turkey	1	NOK	2 960	2 960	2425
Tanzania	1	NOK	4 000	4 000	400
India	1	EUR	56	448	17
China	2	NOK	11 280	11 280	240
China	2	USD	81	549	0
China	1	CAD	31	181	0
Cuba	1	USD	3 000	20 306	1472
Bangladesh	1	USD	9 000	60 918	3759
Regional	2	USD	6 000	40 613	2465
Costa Rica	1	USD	5 000	33 844	34
Uganda	1	USD	960	6 498	0
Interest from realised projects					59
Total loans to companies				205 217	12 702
Provision for bad debts at 31 Dec 05				(2 638)	
Book value, loans/total interest received				202 579	12 702
Committed investments in loans					240 161
Investments in loans approved and sanctioned in principle					323 149
Loans committed, approved and sanctioned in principle (incl loans paid)					563 310

¹Figures at 31 December 2005 and prior to any write-downs.

07 EQUITY INVESTMENTS

Equity investments in funds

(FIGURES IN 1 000)	CURRENCY	OWNERSHIP STAKE	COMMITTED INVESTMENT (IN CURRENCY)	HISTORICAL COST PRICE ¹ (IN CURRENCY)	COMMITTED INVESTMENT (IN NOK)	HISTORICAL COST PRICE ¹ (IN NOK)
Horizonte BIH Enterprise Fund	EUR	3.0%	465	357	3 785	2 922
Minco	USD	15.8%	840	840	6 793	6 793
FEDHA Fund	USD	11.5%	1 373	492	10 325	4 362
LACIF	USD	23.2%	800	800	6 107	6 107
CAIF	USD	3.8%	1 000	787	7 891	6 450
African Infrastructure Fund	USD	1.2%	5 000	2 432	37 091	19 711
Indian Ocean II	USD	17.0%	3 000	1 237	24 320	12 390
SEAF Trans-Balkan Fund	USD	22.9%	5 000	1 482	38 260	14 448
CASEIF	USD	31.8%	5 000	2 567	37 283	20 816
Siam Investment Fund II	USD	8.7%	5 000	1 854	37 272	15 976
SEAF Sichuan SME Investment Fund	USD	13.3%	3 000	1 879	20 588	13 002
Horizon Tech Ventures	ZAR	18.1%	26 000	12 668	27 277	13 014
Aureos Central America Fund	USD	27.5%	10 000	3 705	68 757	26 151
Aureos East Africa Fund	USD	20.0%	8 000	2 938	54 563	20 301
Aureos West Africa Fund	USD	30.9%	15 425	6 841	104 612	46 513
Aureos Southern Africa Fund	USD	30.0%	15 000	4 094	100 733	26 917
Aureos South Asia Interim Fund ²	USD	50.0%	5 000	1 714	32 821	10 576
Aureos South East Asia Fund	USD	25.0%	20 000	1 987	134 730	12 809
APIDC Biotech Fund	USD	7.8%	2 750	871	18 426	5 707
Vietnam Equity Fund	EUR	16.5%	2 500	332	19 933	2 625
Fundo de Investimento Privado-Angola	USD	33.3%	7 500	0	50 765	0
China Environment Fund	USD	10.0%	3 000	0	20 306	0
Total invested in funds					862 637	287 588
Committed investments in funds						862 637
Investments in funds approved and sanctioned in principle						168 924
Investments in funds committed, approved and sanctioned in principle						1 031 561

A committed investment means that a binding agreement has been concluded to make the investment. Investments sanctioned in principle and approved mean that an in-house decision has been taken to make the investment under certain conditions, but no contracts have been signed. Conversion to NOK utilises the exchange rate at the time of payment for that part of the amount which has been paid. The exchange rate at 31 December 2005 is used for the unpaid component.

Equity investments in management companies

(FIGURES IN 1 000)	CURRENCY	OWNERSHIP	HISTORICAL COST PRICE ¹ (IN CURRENCY)	HISTORICAL COST PRICE ¹ (IN NOK)
AMSCO	EUR	4.8%	240	1837
Lafise Investment Management	USD	20.0%	2	17
Angola Capital Partners	USD	33.3%	0	0
Total invested in management companies				1 855
Committed investments in management companies				2 870
Investments in management companies approved and sanctioned in principle				0
Investments in management companies committed, approved and sanctioned in principle				2 870

Equity investments in companies

(FIGURES IN 1 000)

	CURRENCY	OWNERSHIP	COMMITTED INVESTMENT (IN CURRENCY)	HISTORICAL COST PRICE ¹ (IN CURRENCY)	COMMITTED INVESTMENT (IN NOK)	HISTORICAL COST PRICE ¹ (IN NOK)
Palnorec	USD	28.0%	400	320	3 138	2 596
Finarca	USD	18.0%	600	598	5 695	5 684
Genomar	NOK	8.1%	20 000	20 000	20 000	20 000
Pan Marine Quingdao	NOK	49.0%	18 490	18 490	18 490	18 490
Fjord Marine Tyrkia	NOK	29.6%	27 347	27 347	27 347	27 347
Pan Fish Shanghai	USD	27.5%	38	38	273	273
TC Trading	USD	27.5%	6	6	45	45
DFCU	UGS	10.1%	4 600 000	4 600 000	17 607	17 607
CIFI	USD	9.0%	5 000	5 000	31 225	31 225
Kabul Serena Hotel	USD	17.1%	5 000	5 000	33 785	33 785
Solidus	USD	10.4%	2 000	0	13 537	0
Afrinord Hotels Africa (ex SAS Rezidor Africa)	EUR	20.0%	7 000	0	55 895	0
Total invested in companies					227 036	157 052

Committed investments in companies

227 036

Investments in companies approved and sanctioned in principle

108 780

Investments in companies committed, approved and sanctioned in principle

335 816

Total book value of investments in funds, management companies and companies

446 494

Write-downs of investments at 31 Dec 05

(92 933)

Book value of investments

353 561

Investments committed, approved and sanctioned in principle, unpaid

(FIGURES IN 1 000)

	2005	2004
Investments in funds committed, approved and sanctioned in principle	1 031 561	826 487
+ Investments in management companies committed, approved and sanctioned in principle	2 870	2 761
+ Investments in companies committed, approved and sanctioned in principle	335 816	209 647
+ Loans committed, approved and sanctioned in principle	563 310	196 486
= Total investments committed, approved and sanctioned in principle	1 933 556	1 235 381
- Total equity investments	446 494	395 419
- Total loans for equity investments	205 217	137 105
= Investments committed, approved and sanctioned in principle, unpaid	1 281 845	702 856

¹ Figures at 31 December 2005 and prior to any write-downs.² The Aureos South Asia Interim Fund was created by CDC and Norfund in anticipation of the Aureos South Asia Fund, which became operational in January 2006. The interim facility will accordingly make no further investments, but only manage investments approved up to December 2005. Through the interim facility, Norfund and CDC jointly financed minority holdings in Sri Lankan companies. Norfund's share of each investment will accordingly be less than 25 per cent.

08 REALISED LOSSES AND WRITE-DOWNS

(FIGURES IN NOK 1 000)	WRITE-DOWNS AT 1.1.05	LOSSES REALISED 2005	REVERSAL WRITE-DOWNS 2005	WRITE-DOWNS CHARGED TO TRUST FUND 2005	ACCUMULATED WRITE-DOWNS AT 31.12.05
Write-downs on project loans	11 374	7 797	939		2 638
Write-downs on equity investments	147 072	28 786	24 430	924	92 932
Total	158 446	36 583	25 368	924	95 571

Write-downs charged to the profit and loss account comprise new write-downs and reversals of earlier write-downs in 2005.

Norfund has hedged about 50 per cent of the value of its portfolio of investments in USD. Exchange rate movements will yield income or expenses from portfolio hedging as a result of changes in the value of the forward contracts. The value of hedging transactions and the investment portfolio will change in opposite directions when exchange rates alter. Portfolio hedging accordingly has a smoothing effect on results. Norfund takes the view that income/expenses from portfolio hedging should accordingly be assessed in relation to write-downs and currency regulation. In accordance with generally-accepted accounting practice, these items have been recorded on different lines in the profit and loss account – write-down of investment projects, other operating expenses and other financial income/expenses respectively. The total of these items, designated below as net write-downs, expresses the actual write-down expense after taking account of currency hedging.

	2005	2004
(Reversal of write-down)/write-down of investment projects (see the Reversal of write/down/write-down of investment projects line in the profit and loss account)	(25 368)	26 929
Currency regulation of project loans (see the currency regulation of project loans line in the profit and loss account)	(16 067)	13 622
Results recorded from portfolio hedging (see the other financial income/expenses lines in the profit and loss account)	21 747	(14 416)
Net (reversal of write-downs)/write-downs	(19 688)	26 135
Effect of exchange rate changes on results	2005	2004
(Reversal of write-downs)/write-downs because of exchange rate changes	(36 330)	17 079
Currency regulation of project loans (see the currency regulation of project loans line in the profit and loss account)	(16 067)	13 622
Results recorded from portfolio hedging (see the other financial income/expenses lines in the profit and loss account)	21 747	(14 416)
Net (reversal of write-downs)/write-downs	(30 650)	16 285

09 INVESTMENTS REALISED

(FIGURES IN NOK 1 000)	TOTAL	
	2005	2004
Sales receipts	7 850	0
Cost price, paid-in capital	(44 433)	0
Net gain/(loss), investments sold	(36 583)	0
Written down earlier	36 761	
Net gain/(loss)	178	
Earlier return recorded as income	397	
Investments realised 2005	PAID-IN CAPITAL	
Sinor	16 577	
Msele	15 900	
Future & Hope	1 450	
Norfish Blagaj	10 506	
Sum	44 433	

The loan made to Micro Kenya was repaid in its entirety in 2005.

10 BANK DEPOSITS, CASH IN HAND AND CASH EQUIVALENTS

NOK 702 856 000 and NOK 1 281 845 000 were committed, approved and sanctioned in principle but unpaid at 31 December 2004 and 31 December 2005 respectively. Uncommitted liquid assets include NOK 1 338 550 in the blocked tax withholding account. In addition, NOK 19 956 000 of the institution's liquid assets are tied up in the trust funds. These assets can only be used in accordance with the terms of the trust funds.

11 CAPITAL MOVEMENTS

(FIGURES IN NOK 1 000)	PRIMARY CAPITAL	CAPITAL IN LEGAL RESERVES	SURPLUS FUND	TOTAL EQUITY
Capital at 1 Jan 05	1 521 250	593 750	113 895	2 228 895
Capital received in 2005	341 250	143 750		485 000
Equity adjustment joint venture recorded directly against equity			8 374	8 374
Net loss			93 916	93 916
Capital at 31 Dec 05	1 862 500	737 500	216 185	2 816 185

Capital in legal reserves can only be used to meet losses which cannot be covered from other reserves, excluding primary capital.

The institution has received NOK 2 600 million in capital from the Norwegian government, including NOK 485 million paid in during 2005. Of the total capital received, NOK 350 million is earmarked for investments in the least-developed countries and NOK 420 million for investments in the energy sector.

12 UNUSED FUNDS (TRUST FUND)

Norfund received NOK 9 million in “trust fund” capital in 2005. The trust fund is intended to cover professional assistance to ensure a good and sustainable development effect from investments financed in Norfund’s business areas. Such support includes measures which strengthen local expertise through advice and management development, and which ensure that projects help fulfil the broader development policy goals. This includes taking account of HIV-Aids, equal opportunities, environmental conditions, development effects and, in particular, priorities within geographical areas or disciplines. The trust fund is treated as a current liability, and outgoing payments are included in Norfund’s liquid assets. When costs are met from the trust fund, debt is reduced by the equivalent amount. A total of NOK 10.4 million in costs was charged to the trust fund in 2005. The outstanding balance in the trust fund (remaining capital) amounts to NOK 20 million, which includes funds earmarked for projects in the Balkans.

13 INFORMATION ABOUT FINANCIAL MARKET RISKS AND THE USE OF FINANCIAL INSTRUMENTS

MARKET AND CURRENCY RISKS

Norfund’s investments are undertaken in developing countries in which the country itself as well as its structures, markets and companies are subject to high risk. Future returns depend on the ability to manage the opportunities and risk faced during the investment period.

Investments by Norfund are largely in USD, but will also be in other currencies on some occasions. Since Norfund’s base currency is the NOK, this means that its future returns will be heavily influenced by the exchange rate between the NOK and the USD or other relevant currency. Norfund’s various investments are also subject to fluctuations between local currencies and the USD.

Norfund introduced a currency hedging strategy in December 2002. Adjusted in 2003, its main purpose is to safeguard the value of the investment portfolio. This is accomplished by hedging about 50 per cent of the future cash flow in USD.

Seven currency forward contracts were entered into during 2005, and five fell due in USD. Norfund had six outstanding forward contracts at 31 December 2005, which were capitalised as other market-based financial instruments.

Outstanding contracts at 31 Dec 05

(FIGURES IN NOK/USD 1 000)

TYPE OF CONTRACT	COUNTER-PARTY	PURCHASE DATE	MATURITY	AMOUNT HEDGED	FORWARD RATE	VALUE 31 DEC (NOK)
Forward sale, sell USD against buy NOK	Nordea	10.01.05	10.01.06	USD 2 500	6.2180	(1 380)
Currency swap, sell USD against buy NOK	Nordea	10.01.05	10.01.06	USD 8 000	6.2175	(4 420)
Currency swap, sell USD against buy NOK	DnBNor	10.01.05	10.01.06	USD 15 000	6.2150	(8 016)
Forward sale, sell USD against buy NOK	DnBNor	13.04.05	10.01.06	USD 2 900	6.2600	(1 419)
Currency swap, sell USD against buy NOK	DnBNor	20.04.05	10.01.06	USD 1 700	6.2325	(879)
Forward sale, sell USD against buy NOK	Nordea	21.12.05	10.01.06	USD 4 800	6.7873	62
Total						(16 052)

Interest rate risk

Norfund’s interest rate risk relates primarily to liquid assets placed in Norwegian banks. Interest on project loans may also be affected by interest rate risk, depending on the rate of interest charged on the various loans. Project loans are usually based on the variable Libor plus a margin. Norfund increased its commitment to loans during 2005.

CREDIT RISK

Project loans are assessed at their estimated actual value. The risks associated with such loans are otherwise partially reflected in the terms applied to each loan. What Norfund defines as its loan portfolio presents no credit risk in accounting terms, since its value in the balance sheet is zero. Generally speaking, the risks associated with loans are regarded as relatively high and are to be considered more as an equity risk than as a traditional loan risk. Credit risk is not considered to be heavily concentrated because Norfund is diversified in terms of both industries and geographical areas.

LIQUIDITY RISK

Norfund has no interest-bearing debt. An attempt has been made to identify its liquidity risk by quantifying committed investments and specific projects in the planning phase in a single item.

14 COMMITMENTS

(FIGURES IN NOK 1 000)

	LEASE DURATION	ANNUAL RENT
Premises at Munkedamsveien 45B	1 Aug 99-31 Jul 09	2 358

Norfund resolved in 2004 to establish a tender guarantee scheme in order to encourage increased financial cooperation and investment in developing countries. This scheme is administered by the Norwegian Guarantee Institute for Export Credit (GIEK). NOK 2.7 million was charged to Norfund's accounts in 2005 in respect of the scheme, which could lead to up to NOK 13 million being charged to Norfund's accounts over a three-year period to 2007.

15 DEBT

The institution has no debts to joint ventures or other related parties.

Current liabilities include a provision for a payment of NOK 80 000 000 from a settlement with Statkraft on non-cash contributions in SN Power Invest AS (see note 4).



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To NORFUND, a company under special law

AUDITOR'S REPORT FOR 2005

Respective Responsibilities of Directors and Auditors

We have audited the annual financial statements of NORFUND as of 31 December 2005, showing a profit of NOK 93 916 000. We have also audited the information in the Board of Directors' report concerning the financial statements, the going concern assumption and the proposal for the allocation of the profit. The annual financial statements comprise the balance sheet, the statements of income and cash flows and the accompanying notes. The rules of the Norwegian accounting act and good accounting practice in Norway have been applied to prepare the financial statements. These financial statements and the Board of Directors' report are the responsibility of the Fund's Board of Directors and Managing Director. Our responsibility is to express an opinion on these financial statements and on the other information according to the requirements of the Norwegian Act on Auditing and Auditors.

Basis of Opinion

We conducted our audit in accordance with the Norwegian Act on Auditing and Auditors and good auditing practice in Norway, including standards on auditing adopted by Den norske Revisorforening. These auditing 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 management, as well as evaluating the overall financial statement presentation. To the extent required by law and good auditing practice an audit also comprises a review of the management of the Fund's financial affairs and its accounting and internal control systems. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion,

- the financial statements are prepared in accordance with the law and regulations and give a true and fair view of the financial position of the Fund as of 31 December 2005, the results of its operations and its cash flows for the year then ended, in accordance with the rules of the Norwegian accounting act and good accounting practice in Norway
- the company's management has fulfilled its duty to produce a proper and clearly set out registration and documentation of accounting information in accordance with the law and good bookkeeping practice in Norway
- the information in the Board of Directors' report concerning the financial statements, the going concern assumption and the proposal for the allocation of the profit is consistent with the financial statements and comply with the law and regulations.

Oslo, 13 March 2006

KPMG AS

Not to be signed

Tom Myhre

State Authorised Public Accountant

Note: This translation from Norwegian has been prepared for information purposes only

Offices in

Oslo	Haugesund	Sandnessjøen
Bodo	Kristiansund	Svingen
Ålesund	Larvik	Stord
Arendal	Lørenskog	Tromsø
Bergen	Molde	Tvedestrand
Elverum	Oslo	Tvedestrand
Fremont	Oslo	Tvedestrand
Geneva	Sandnessjøen	Ålesund

KPMG AS is the Norwegian member firm of KPMG International,
a Swiss entity.

Distributionsadresse: Investerings- og Revisorforening i Den norske Revisorforening

Norfund's management team



PER EMIL LINDØE

Managing director



TONE WILLE

Deputy managing director
Director of strategic investments



SVEIN OVE FAKSVÅG

Director of finance and support



ELIZABETH LEE MARINELLI

Director of investments,
financial institutions



THOR SVEGÅRDEN

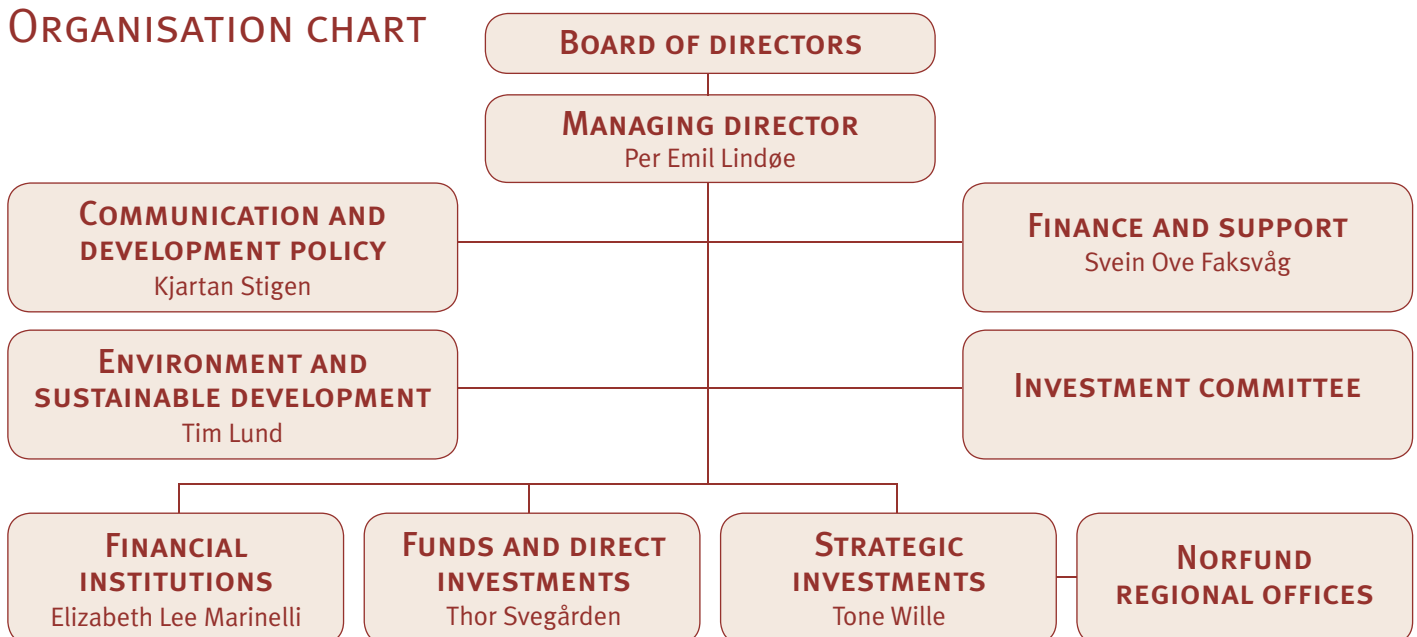
Director of funds and direct
investments



KJARTAN STIGEN

Director of communication
and development policy

ORGANISATION CHART





*Norfund helps to reduce poverty
by investing knowledge
and risk capital in profitable
enterprises in developing countries*

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