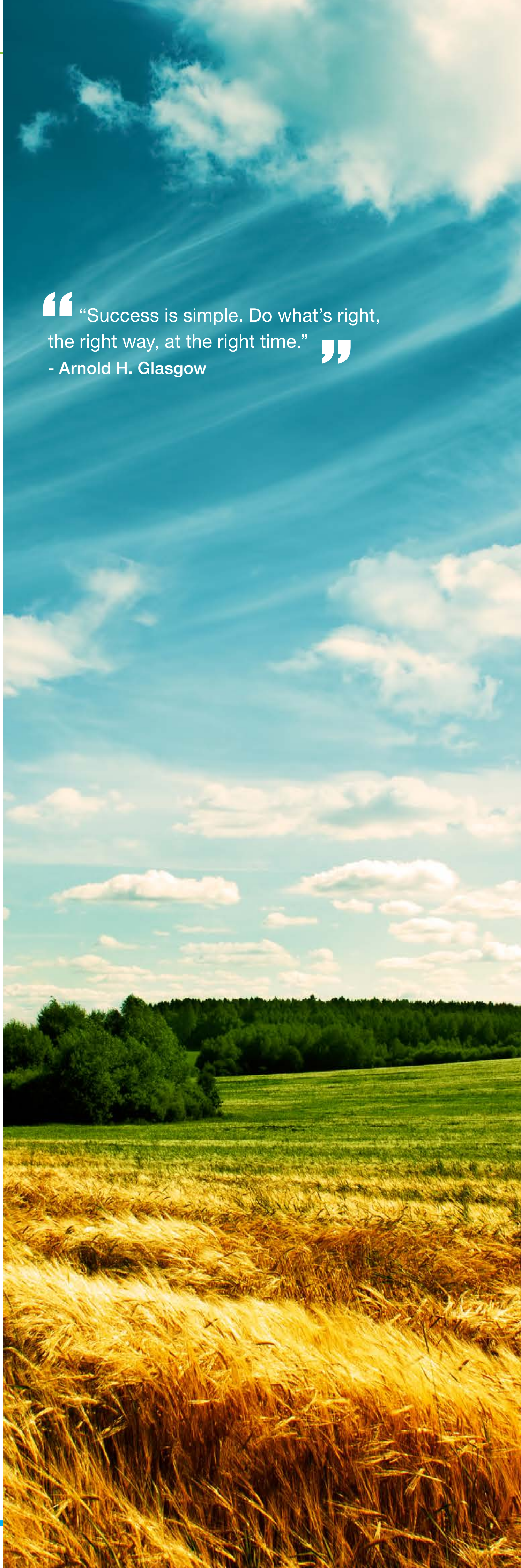
Prime Bank

PUTTING YOU FIRST

ANNUAL REPORT

2014



OUR VISION

To be the financial service provider of first choice.

OUR MISSION

To provide quality and acceptable personalized financial services to our customers while observing compliance, growth and shareholder value.

CORE VALUES

Integrity

Quality

Innovativeness

Social Responsibility

Teamwork

CONTENTS

CORPORATE INFORMATION
BOARD OF DIRECTORS

CHAIRMAN
Mr. R. C. Kantaria

Director
Mr. V. N. Ponda

Director
Mr. J. N. Mungai

Director
Mr. S. K. Shah

Director
Mr. D. G. M. Hutchison

Director
Mr. T. M. Davidson

Executive Director
Mr. A. R. Kantaria

Managing Director
Mr. Bharat Jani

Director
Mr. J. K. Kibet

Company Secretary
Mr. Arun Shah

BANK INFORMATION
FOR THE YEAR ENDED 31 DECEMBER 2014

PRINCIPAL PLACE OF BUSINESS
L.R. 209/8571
Prime Bank Building
Riverside Drive
P.O. Box 43825 - 00100
Nairobi

REGISTERED OFFICE
L.R. 209/8890
Kenindia House
Loita Street
P.O. Box 43825 - 00100
Nairobi

LAWYERS
KIRUTI & COMPANY ADVOCATES
P.O. Box 13160 - 00100
Nairobi

MACHARIA MWANGI & NJERU ADVOCATES
P.O. Box 10627-00100
Nairobi

A B PATEL & PATEL ADVOCATES
P.O Box 80274-80100
Mombasa

MANDLA & SEHMI ADVOCATES
P.O Box 48642 – 00100
Nairobi

SECRETARY
A. H. Shah
Company Secretary
P.O. Box 46559 - 00100
Nairobi.

AUDITORS
Ernst & Young
Kenya - Re Towers, Upperhill
Off Ragati Road
P.O. Box 44286 - 00100
Nairobi

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2014

"Prime Bank is keen to take advantage of the expected positive growth of the economy to expand its network in locations where it considers its presence to be strategic for business growth."

It gives me great pleasure to present the annual report and financial statements of Prime Bank Ltd for the financial year 2014.

I am pleased to report that 2014 was a year of great progress. Against uncertain global economic recovery and stiff competition in the banking industry, we continued to focus on our strategic objectives.

During the year, our strong performance once again was a testament of our ability to deliver admirable results and substantial growth.

ENVIRONMENT

We began the year with a fluctuating exchange rate, drop in foreign exchange inflows, and a reduction in Gross Domestic Product (GDP) growth. However, the economy remained resilient and grew by 5.4 % during the year.

Kenya crossed the threshold to become a lower middle income country following the rebasing of its National Accounts during the year, including Gross Domestic Product and Gross National Income.

The commencement of the construction of the Standard Gauge Railway (SGR) is a major step forward for Kenya and for the region. It will boost integration across East Africa by reducing transport costs significantly, bringing down the cost of doing business and improving standards of living for the population.

The depreciation of the Kenyan shilling during the year mostly reflected developments in international currency markets, and foreign exchange reserves averaged 4.9 months of import cover, boosted by proceeds from the highly successful sovereign bond issuance in June 2014. Investment in power generation and in particular in geothermal energy, is already translating into lower electricity costs for industry as well as households.

However, difficult security conditions had a dampening effect on the tourism sector.

Despite the challenging environment, Kenya's economy continues to grow and the most recent economic update points to an optimistic outlook for higher growth.

BANK'S PERFORMANCE

The Bank posted a 20 per cent growth in profit after tax for the year ended December 2014 powered by strategic partnerships and innovations coupled with improved operational efficiency and growth in customer deposits and the loan book.

The Bank's net profit for the year stood at KSh.1.74 billion compared to KSh.1.44 billion for the previous year. Our core capital grew to KSh 6.7 billion against the statutory requirement of KSh. 1 billion while loans and advances to customers rose steadily by 31 per cent from KSh. 25.5 billion to KSh. 33.5 billion. Customer

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2014

deposits increased by 11 per cent from KSh.40.5 billion to KSh.45 billion.

BANK DEVELOPMENTS

The Bank has in place Strategic Plan 2014-2018 duly approved by the Board of Directors. Our main focus in the next 5 years would be to leverage on technological advancement and use IT as a business driver so as to encourage the customers to carry out their banking transactions from their homes or offices. In line with this strategy, we launched two new products - 'Prime Mobi' and 'PrimeNet' during the year. These products enable our customers to access our Mobile Banking and Internet Banking services 24/7 throughout the year.

To create more opportunities for our SME customers, we partnered with PROPARCO, the French Development Finance Institution, and availed a credit facility of USD 15m (KSh 1.33 billion) to support long term funding requirements of our customers.

In view of the unfolding economic opportunities in the country and in line with the Bank's expansion strategy, we opened a Branch at Thika which increases our network to 17 branches.

The highly successful year just passed, leads me to say with confidence that we have the strategy, people and resources to continue to deliver sustainable growth in the years ahead.

BOARD

In the course of the year, Mr. Jinaro Kibet joined the Bank's Board. He is a practicing lawyer with a wealth of experience in commercial and civil law. I take this opportunity to welcome him to the Board.

CSR

Our Corporate Social Responsibility approach is to create a positive impact in the lives of the less fortunate members of our community. Each year we continue our tradition of investing in our communities.

Freedom For Girls (FFG) Project is one of the flagship CSR projects of Prime Bank. For the last seven years, the Bank has continued to donate a full year's supply of sanitary towels and undergarments and facilitated health education every year to more than 2000 girls of meager means. In 2014, the Bank donated KShs. One million towards this noble cause.

As part of the Bank's support for development of sports in Kenya, this year a partnership was forged between the Bank, Kenya Golf Union, Junior Golf Foundation and Visa with the launch of the Prime Visa Gold Golf Card. This unique concept of a gold golf card is geared towards developing talent amongst the youth. Towards this end, the Bank will donate the annual subscription fees for the gold golf cards to Junior Golf Foundation. The Bank also contributed KSh. 500,000 towards the St. Mary's Mission Hospital's initiative to restore eye sight to patients suffering from blindness caused by cataracts.

THE YEAR AHEAD

Early projections indicate that the economy is likely to pick up and attain a growth rate of about 6.2 per cent in 2015 aided by the recent discoveries of crude oil, and natural gas, and the successful Eurobond issue – factors which are likely to attract more foreign direct investment.

The year 2015 will possibly be characterized by the relative stability of the economy and markets. Inflation is likely to remain manageable, perhaps between 6-7.5 % for most of the year.

Prime Bank is keen to take advantage of the expected positive growth of the economy by expanding its network in locations where it considers its presence will benefit all stakeholders.

The Bank continues to enhance its service delivery by leveraging on the increased branch network.

APPRECIATION

Our customers are and will always remain the corner stone of our success. I thank them for their continued

CHAIRMAN’S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

patronage and support. I assure them of even better service and support in the ensuing years to enable them fulfill their financial needs.

The excellent performance of the Bank could not have been possible without the extraordinary zeal and dedication to duty demonstrated by the management and all members of staff throughout the year. I take this opportunity, on behalf of all the directors and the shareholders, to express my appreciation and urge them to redouble their efforts so that the Bank can progress from strength to strength in the years to come.

I wish to place on record my sincere appreciation to the government of Kenya, particularly the Treasury and the Central Bank of Kenya for their continued guidance and support.

Finally, I take this opportunity to thank my colleagues on the Board for their very valuable counsel.

R. C. Kantaria
Chairman

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2014

The directors submit their report and the audited financial statements for the year ended 31 December 2014 which show the state of the bank's affairs.

1. PRINCIPAL ACTIVITY
The bank continues to offer corporate and retail banking services.

2. RESULTS
The results for the year are set out on page 17.

3. DIVIDEND
The directors have not paid any dividend for the year ended 31 December 2014 (2013 – KShs 150 million).

4. RESERVES
The reserves of the bank are set out on page 19 and note 21.

5. DIRECTORS
The directors who served during the year and to the date of this report were:-

Mr. R.C. Kantaria	- Chairman
Mr. A. R. Kantaria	- Executive
Mr. Bharat Jani	- Managing (Appointed 19 December 2014)
Mr. J.N. Mungai	
Mr. V.N. Ponda	
Mr. S.K. Shah	
Mr. D.G.M. Hutchison*	
Mr. T.M. Davidson*	
Mr. J.K. Kibet	- Appointed 2 April 2014

*British

6. AUDITORS
Ernst & Young have expressed their willingness to continue in office in accordance with Section 159 (2) of the Kenyan Companies Act and subject to Section 24(1) of the Banking Act.

By Order of the Board

A. H. Shah
Secretary

10 March 2015

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2014

INTRODUCTION
Prime Bank Limited recognises the need to conduct its business with integrity and in line with the generally accepted corporate practice. The bank will strive to maintain the highest standards of corporate governance.

SHAREHOLDERS' RESPONSIBILITIES
The shareholders' role is to appoint the Board of Directors and independent auditors. The role of the shareholders is to ensure that the Board is accountable for effective and efficient governance.

BOARD OF DIRECTORS
The Board of Directors is responsible for the governance of the bank and to ensure that the bank complies with the law and the highest standards of corporate governance and business ethics. The Board is responsible for the long term growth and profitability of the bank.

The Directors guide the management and maintain full and effective control over financial, strategic, operational and compliance issues of the bank. The Board is chaired by a non-executive director and has six other non-executive directors and an executive director. The Board meets regularly and holds special meetings as and when the situation demands.

ATTENDANCE OF DIRECTORS AT BOARD MEETINGS
Number of Board Meetings held in 2014 6

NAME OF DIRECTOR	NUMBER OF MEETINGS ATTENDED
Mr. R. C. Kantaria (Chairman)	6
Mr. V. N. Ponda	4
Mr. D. G. M. Hutchison	6
Mr. J. N. Mungai	5
Mr. S. K. Shah	6
Mr. T. M. Davidson	6
Mr. A. R. Kantaria (Executive)	6
Mr. J.K. Kibet	1

BOARD PERFORMANCE EVALUATION
As per the Prudential Guidelines of the Central Bank of Kenya, the Board is responsible for ensuring that an evaluation of its performance as well as that of the individual directors and various committees is done. The results of such an evaluation are to be provided to the Central Bank of Kenya.

The Board conducted its evaluation and that of the members, the Chairman and the Board Committees. The aim was to assess their capacity and effectiveness relative to their mandates, and identify challenges that need to be addressed in the coming year. Each Board member was provided with the questionnaire before the Board meeting convened to discuss the evaluation. At the Board meeting, the ratings given by each member of the Board and its committees were discussed by all members under the direction of the Chairman of the Board. Overall ratings were agreed taking into account the individual ratings and comments. Overall, the Board concluded that it was operating in an effective manner.

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

The Board has appointed five committees – Credit, Debt Management, Audit, Risk and Compliance and IT. These committees have been given terms of reference and they meet regularly. These committees make recommendations to the Board on matters which fall under their mandates. The committees are chaired by non-executive directors and three of them have an additional non-executive director as a member.

CREDIT COMMITTEE

Mr. V. N. Ponda, a non-executive director chairs the Credit Committee. Mr. J. N. Mungai, a non-executive director, Mr. A.R. Kantaria, Executive Director, Mr. B. Jani, Managing Director and Assistant General Manager (Credit) are the other members of the Committee. Fresh credit proposals are placed before the Credit Committee for sanction. The Committee also reviews the credit limits sanctioned, as per the credit policy approved by the Board.

DEBT MANAGEMENT COMMITTEE

This Committee is chaired by Mr. V. N. Ponda who is a non - executive director. Mr. A. R. Kantaria, Executive Director, the Managing Director and Assistant General Manager (Credit) are the other members of this Committee. The Committee monitors the progress made in the recovery of advances which have been classified as non-performing assets.

AUDIT COMMITTEE

The Audit Committee is headed by Mr. S. K. Shah who is a non-executive director. Mr. T. M. Davidson, non - executive director, Mr. J.K. Kibet, non-executive director and the Head of internal audit department are the other members of this Committee. The Committee reviews the audit reports presented to it by the internal and external auditors and based on these reports also reviews various operational areas of the bank. The Committee also reviews the observations made by the bank supervision department of the Central Bank of Kenya in its inspection reports.

RISK AND COMPLIANCE COMMITTEE

The Risk and Compliance Committee is headed by Mr. S. K. Shah who is a non-executive director. Mr. T. M. Davidson, non-executive director, Head of risk department and Head of compliance are the other members of this Committee. The Committee reviews the risk and compliance reports presented to it by the respective departments. The Committee also reviews the observations given in the report and recommends remedial measures wherever necessary.

IT COMMITTEE

Mr. T. M. Davidson, a non-executive director chairs this Committee and Mr. D. G. M. Hutchison another non-executive director is a member. The other members are Mr. A. R. Kantaria, Executive Director, the Managing Director and the General Manager. The responsibilities of the IT Committee are; approval of IT policy, identification of operational areas where automation is necessary, undertaking new automation projects, procurement of hardware and software and monitoring project implementation, providing directions to the IT and operations department on implementation issues and review of systems audit reports.

ASSETS AND LIABILITY MANAGEMENT COMMITTEE (ALCO)

This Committee is chaired by the Managing Director. The Executive Director, the General Manager, Chief Manager (Treasury), Assistant General Manager (Credit) and Chief Manager (Accounts) are the other members of the Committee. This Committee monitors the liquidity position of the bank and the compliance with regard to statutory liquidity ratio, cash reserve ratio and foreign exchange exposure as per the prudential guidelines of the

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (Continued)

Central Bank of Kenya. The Committee decides on investments in various securities to maximise the returns. It also analyses the interest rate risk and fixes the interest rates in line with the market trends.

OPERATIONS COMMITTEE

The operations Committee is chaired by the General Manager and comprises the Risk Manager, Head of audit, Chief Manager (Accounts), Chief Manager (IT) and two Branch Managers. The Committee reviews various operational procedures of the bank and decides on changes to be effected to improve operational efficiency, improve service delivery and minimise manual procedures.

HUMAN RESOURCES COMMITTEE

The HR Committee is headed by the Managing Director and has the Executive Director, General Manager and Manager (HR) as the members. The Committee decides on recruitment of staff members, their placements, promotions, transfers and benefits to the employees. The Committee also monitors the training imparted to staff members.

EXECUTIVE COMMITTEE

The Executive Committee is chaired by Executive Director and has the Chief Executive, General Manager and Deputy General Manager as members. The Committee reviews implementation of various projects and approves policies with regard to the operational areas. The Committee also ensures adherence to the strategic plan approved by the Board.

EMPLOYEES

The bank adheres to the banking code of ethics which requires all employees to conduct business with high integrity. The staff members sign a declaration of fidelity and secrecy.

PUBLICATION OF ACCOUNTS

The bank publishes its results every quarter in the newspapers as per the Prudential Guidelines of Central Bank of Kenya. Financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and the requirements of all relevant statutes, rules and regulations.

STATEMENT OF DIRECTORS' RESPONSIBILITIES ON THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2014

The Kenyan Companies Act requires the directors to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the bank as at the end of the financial year and of its operating results for that year. It also requires the directors to ensure the bank keeps proper accounting records, which disclose with reasonable accuracy, the financial position of the bank. They are also responsible for safeguarding the assets of the bank.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and the requirements of the Kenyan Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the bank and of its operating results. The directors further accept responsibility for the maintenance of accounting records, which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

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

………………………………………..
Director

………………………………………..
Director

………………………………………..
Director

………………………………………..

Date

10 March 2015
………………………………………..

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PRIME BANK LIMITED

FOR THE YEAR ENDED 31 DECEMBER 2014

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Prime Bank Limited, which comprise the statement of financial position as at 31 December 2014, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes, as set out on pages 16 to 71.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, and for such internal controls as the directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an independent opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the financial statements present fairly, in all material respects, the financial position of Prime Bank Limited as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PRIME BANK LIMITED (continued)
FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

REPORT ON OTHER LEGAL REQUIREMENTS

As required by the Kenyan Companies Act, we report to you, based on our audit, that:

i) we have obtained all the information and explanations which, to the best of our knowledge and belief, were considered necessary for the purposes of our audit;

ii) in our opinion, proper books of account have been kept by the Bank, so far as appears from our examination of those books; and,

iii) the Bank's statement of financial position, income statement and statement of comprehensive income are in agreement with the books of account.

The engagement partner responsible for the audit resulting in this independent auditors' report is CPA Avani S Gilani-P/No.787

Ernst & Young

Certified Public Accountants, Nairobi

17 March ……………………………………..2015

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2014

	Note	2014 KShs'000	2013 KShs'000
ASSETS			
Cash in hand		434,470	346,135
Balances with the Central Bank of Kenya	4	2,364,013	2,592,844
Placements and balances with other banks	5	940,209	2,060,779
Held to maturity investments	6	13,056,286	13,935,390
Investment in bonds-available for sale	7	1,928,885	2,404,434
Investment in ordinary shares available for sale	8	1,266,268	1,017,425
Loans and advances to customers	9	33,422,476	25,530,436
Other assets	10	302,734	522,176
Investment in associate	11	329,982	270,396
Leasehold land	12	55,609	56,970
Property and equipment	13	495,104	497,920
Intangible assets	14	184,000	98,052
Deferred tax asset	15	137,638	127,932
TOTAL ASSETS		54,917,674	49,460,889
LIABILITIES AND EQUITY			
LIABILITIES			
Balances due to banks and financial institutions	16	1,680,066	2,447,685
Deposits from customers	17	45,075,045	40,562,029
Other liabilities	18	388,956	433,029
Tax payable	19	38,587	202,299
TOTAL LIABILITIES		47,182,654	43,645,042
EQUITY			
Share capital	20	3,000,000	3,000,000
Reserves	21	4,735,020	2,815,847
TOTAL EQUITY		7,735,020	5,815,847
TOTAL LIABILITIES AND EQUITY		54,917,674	49,460,889

These financial statements were approved by the Board of Directors on 10 March 2015 and signed on its behalf by:

…………………………………………… Directors

…………………………………………… Directors

…………………………………………… Directors

…………………………………………… Directors

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2014

	Note	2014 KShs'000	2013 KShs'000
Interest income	22	5,837,392	5,022,621
Interest expense	23	(2,848,182)	(2,502,676)
Net interest income		2,989,210	2,519,945
Fees and commission income		376,461	335,393
Foreign exchange gains		338,209	311,027
Dividend income		49,378	28,673
Other income	24	139,023	128,581
		3,892,281	3,323,619
Allowance for impairment of loans and advances	25	(100,783)	(138,740)
Other operating expenses	26	(1,546,905)	(1,370,605)
Profit before tax and share of profit Associate	27	2,244,593	1,814,274
Share of profit of associate	11	53,086	78,603
Profit before tax		2,297,679	1,892,877
Income tax expense	19	(561,660)	(452,107)
Profit for the year		1,736,019	1,440,770
Earnings per share (basic and diluted) (KShs)	28	578.67	480.26

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2014

	Note	2014 KShs'000	2013 KShs'000
Profit for the year		1,736,019	1,440,770
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Available for sale financial assets:			
Gain arising during the year		157,795	347,972
Share of other comprehensive income from associate		25,359	1,907
Net Profit		183,154	349,879
Income tax effect		-	-
Other comprehensive income for the year, net of tax		183,154	349,879
Total comprehensive income for the year, net of tax		1,919,173	1,790,649

All of the profit for the year and total comprehensive income are attributable to equity holders of the Bank.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2014

	Share capital KShs'000	Retained earnings KShs'000	Available for-sale reserve KShs'000	Total equity KShs'000
At 1 January 2013	2,500,000	1,407,291	267,907	4,175,198
Reserves capitalized	500,000	(500,000)	-	-
Total comprehensive income				
- profit for the year	-	1,440,770	-	1,440,770
- other comprehensive income	-	-	349,879	349,879
Dividend paid – 2013 (note 30)	-	(150,000)	-	(150,000)
At 31 December 2013	3,000,000	2,198,061	617,786	5,815,847

	Share capital KShs'000	Retained earnings KShs'000	Available for-sale reserve KShs'000	Total equity KShs'000
At 1 January 2014	3,000,000	2,198,061	617,786	5,815,847
Total comprehensive income				
- profit for the year	-	1,736,019	-	1,736,019
- other comprehensive income	-	-	183,154	183,154
At 31 December 2014	3,000,000	3,934,080	800,940	7,735,020

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2014

	Note	2014 KShs'000	2013 KShs'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		2,297,679	1,892,877
Adjustment for:			
Gain on disposal of property and equipment		(2,681)	(2,136)
Dividends received		(49,378)	(28,673)
Foreign exchange loss on translation of off shore investment	7	10,146	3,000
Effect of foreign exchange gain on translation of foreign currency balances held		(338,209)	(311,028)
Share of profit of associate	11	(53,086)	(78,603)
Amortisation of leasehold land	12	1,361	1,360
Depreciation on property and equipment	13	86,504	81,505
Amortisation of intangible assets	14	56,387	28,406
CASH FLOWS FROM OPERATING ACTIVITIES BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		2,008,723	1,586,708
(Increase)/decrease in securities maturing after 91 days		(5,587,680)	2,878,870
Increase in loans and advances to customers		(7,892,040)	(5,637,200)
Decrease/(increase) in other assets		219,442	(87,720)
Increase in deposits from customers		4,513,016	3,890,449
Decrease in other liabilities		(44,073)	(97,444)
Cash flows (used in) / from operating activities		(6,782,612)	2,533,663
Income taxes paid	19	(735,078)	(257,204)
NET CASHFLOWS (USED IN) / FROM OPERATING ACTIVITIES		(7,517,690)	2,276,459
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of property and equipment		2,965	3,717
Dividends income		49,378	28,673
Proceeds from redemption of held to maturity investments	6	20,978,411	13,513,091
Proceeds from sale of investments in bonds-available for sale	7	1,286,795	1,479,574
Purchase of ordinary shares - available for sale	8	(120,397)	-
Dividend from associate	11	18,859	35,237
Purchase of held to maturity investments	6	(20,099,307)	(13,830,397)
Purchase of investments in bonds- available for sale	7	(792,043)	(1,348,903)
Purchase of shares in associate	11	-	(1,184)
Purchase of intangible assets	14	(142,335)	(100,108)
Purchase of property and equipment	13	(83,972)	(115,567)
NET CASHFLOWS FROM / (USED IN) INVESTING ACTIVITIES		1,098,354	(335,867)

STATEMENT OF CASH FLOWS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

	Note	2014 KShs'000	2013 KShs'000
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends paid during the year	30	-	(150,000)
NET CASH FLOWS USED IN FINANCING ACTIVITIES		-	(150,000)
Net (decrease)/ increase in cash and cash equivalents		(6,419,336)	1,790,592
Effect of foreign exchange gain on translation of foreign currency balances held		338,209	311,028
Cash and cash equivalents at 1 January		8,829,292	6,727,672
Cash and cash equivalents at 31 December	31	2,748,165	8,829,292

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2014

1. GENERAL INFORMATION

Prime Bank Limited is a financial institution licensed under the Kenyan Banking Act, Cap 488 that provides corporate and retail banking services in various parts of the country.

The bank is incorporated and domiciled in Kenya under the Kenyan Companies Act.

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

New and amended standards and interpretations

The following standards and amended interpretation have been adopted by the bank for the first time for the financial year beginning on or after 1 January 2014:

- Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)
- Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32
- Recoverable Amount Disclosures for Non-Financial Assets –Amendments to IAS 36
- Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39
- IFRIC 21 Levies
- Annual Improvements 2010-2012 Cycle
- Annual Improvements 2011-2013 Cycle

These revised standards and interpretations did not have any material effect on the financial performance or position of the bank. They did, however, give rise to additional disclosures in some occasions.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)

These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10 Consolidated Financial Statements and must be applied retrospectively, subject to certain transition relief. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. These amendments have no impact on the bank, since the entity does not have any subsidiaries.

Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32

These amendments clarify the meaning of 'currently has a legally enforceable right to set-off' and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting and is applied retrospectively. These amendments have no impact on the bank since it does not have any offsetting arrangements.

Recoverable Amount Disclosures for Non-Financial Assets –Amendments to IAS 36

The amendments to IAS 36 Impairment of Assets clarify the disclosure requirements in respect of fair value less costs of disposal. The amendments remove the requirement to disclose the recoverable amount for each cash-generating unit for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant. The amendment has no impact on the bank.

Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria and retrospective application is required. These amendments have no impact on the bank as the bank does not deal in derivatives.

IFRIC 21 Levies

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. Retrospective application is required for IFRIC 21. This interpretation has no material impact on the bank as it does not have significant levy liabilities.

Annual Improvements 2010-2012 Cycle

In the 2010-2012 annual improvements cycle, the IASB issued seven amendments to six standards, which included an amendment to IFRS 13 Fair Value Measurement. The amendment to IFRS 13 is

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

Annual Improvements 2010-2012 Cycle (Continued)

effective immediately and, thus, for periods beginning at 1 January 2014, and it clarifies in the Basis for Conclusions that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This amendment to IFRS 13 has no impact on the bank as it has been measuring the short-term receivables and payables at invoice amounts.

Annual Improvements 2011-2013 Cycle

In the 2011-2013 annual improvements cycle, the IASB issued four amendments to four standards, which included an amendment to IFRS 1 First-time Adoption of International Financial Reporting Standards. The amendment to IFRS 1 is effective immediately and, thus, for periods beginning at 1 January 2014, and clarifies in the Basis for Conclusions that an entity may choose to apply either a current standard or a new standard that is not yet mandatory, but permits early application, provided either standard is applied consistently throughout the periods presented in the entity's first IFRS financial statements. This amendment to IFRS 1 has no impact on the bank, since the company is an existing IFRS preparer.

Standards issued but not effective

The following standards have been issued or revised and are not yet effective:

IAS 1 Disclosure Initiative – Amendments to IAS 1

The amendments to IAS 1 Presentation of Financial Statements clarify, rather than significantly change, existing IAS 1 requirements.

The amendments clarify

- The materiality requirements in IAS 1
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated
- That entities have flexibility as to the order in which they present the notes to financial statements
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and other comprehensive income.

The standard is effective for annual periods beginning on or after 1 January 2016.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the bank's financial assets, and the bank is in the process of determining the impact of the change on the classification and measurement of the bank's financial liabilities.

Amendments to IAS 19 Defined Benefit Plans: Employee Contributions

IAS 19 requires an entity to consider contributions from employees or third parties when accounting for defined benefit plans. Where the contributions are linked to service, they should be attributed to periods of service as a negative benefit. These amendments clarify that, if the amount of the contributions is independent of the number of years of service, an

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2014

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

Standards issued but not effective (continued)

entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to the periods of service. This amendment is effective for annual periods beginning on or after 1 July 2014. It is not expected that this amendment would be relevant to the bank, since it does not have a defined benefit plan.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The bank is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation

The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets.

The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the bank given that the bank has not used a revenue-based method to depreciate its non-current assets.

Amendments to IAS 27: Equity Method in Separate Financial Statements

The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively.

For first-time adopters of IFRS electing to use the equity method in its separate financial statements, they will be required to apply this method from the date of transition to IFRS. The amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments will not have any impact on the bank as the bank does not prepare separate financial statements.

Annual improvements 2010-2012 Cycle

These improvements are effective from 1 July 2014 and are not expected to have a material impact on the bank. They include:

IFRS 2 Share-based Payment

This improvement is applied prospectively and clarifies various issues relating to the definitions of performance and service conditions which are vesting conditions, including:

- A performance condition must contain a service condition
- A performance target must be met while the counterparty is rendering service
- A performance target may relate to the operations or activities of an entity, or to those of another entity in the same group
- A performance condition may be a market or non-market condition

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

Standards issued but not effective (continued)

IFRS 2 Share-based Payment (continued)

If the counterparty, regardless of the reason, ceases to provide service during the vesting period, the service condition is not satisfied.

IFRS 3 Business Combinations

The amendment is applied prospectively and clarifies that all contingent consideration arrangements classified as liabilities (or assets) arising from a business combination should be subsequently measured at fair value through profit or loss whether or not they fall within the scope of IFRS 9 (or IAS 39, as applicable).

IFRS 8 Operating Segments

The amendments are applied retrospectively and clarifies that:

- An entity must disclose the judgements made by management in applying the aggregation criteria in paragraph 12 of IFRS 8, including a brief description of operating segments that have been aggregated and the economic characteristics (e.g., sales and gross margins) used to assess whether the segments are 'similar'
- The reconciliation of segment assets to total assets is only required to be disclosed if the reconciliation is reported to the chief operating decision maker, similar to the required disclosure for segment liabilities.

IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets

The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data on either the gross or the net carrying amount. In addition, the accumulated depreciation or amortisation is the difference between the gross and carrying amounts of the asset.

IAS 24 Related Party Disclosures

The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services.

Annual improvements 2011-2013 Cycle

These improvements are effective from 1 July 2014 and are not expected to have a material impact on the bank. They include:

IFRS 3 Business Combinations

The amendment is applied prospectively and clarifies for the scope exceptions within IFRS 3 that:

- Joint arrangements, not just joint ventures, are outside the scope of IFRS 3
- This scope exception applies only to the accounting in the financial statements of the joint arrangement itself.

IFRS 13 Fair Value Measurement

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable).

IAS 40 Investment Property

The description of ancillary services in IAS 40 differentiates between investment property and owner-occupied property (i.e., property, plant and equipment). The amendment is applied prospectively and clarifies that IFRS 3, and not the description of ancillary services in IAS 40, is used to determine if the transaction is the purchase of an asset or business combination.

Annual Improvements 2012-2014 Cycle

In the 2012-2014 annual improvements cycle, the IASB issued five amendments to four standards, summaries of which are provided below. The changes are effective 1 January 2016. Earlier application is permitted and must be disclosed. They include:

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2014

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

Standards issued but not effective (continued)

Annual Improvements 2012-2014 Cycle (continued)

IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations

Assets (or disposal groups) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. The amendment must be applied prospectively.

IFRS 7 Financial Instruments: Disclosures

Servicing contracts

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7.B30 and IFRS 7.42C in order to assess whether the disclosures are required.

The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

Applicability of the offsetting disclosures to condensed interim financial statements

The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. The amendment must be applied retrospectively.

IAS 19 Employee Benefits

The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. The amendment must be applied prospectively.

IAS 34 Interim Financial Reporting

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report).

The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. The amendment must be applied retrospectively.

3. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied, unless otherwise stated.

(a) Basis of preparation

The financial statements of the bank have been prepared in accordance with International Financial Reporting Standards (IFRS), which comprise standards and interpretations, as issued by the International Accounting Standard Board (IASB). The financial statements are presented in the functional currency, Kenya Shillings, rounded to the nearest thousand (KShs '000), and have been prepared on a historical basis except for available for sale investments, which have been measured at fair value.

(b) Significant accounting judgements, estimates and assumptions

The preparation of the bank's financial statements requires management to make judgments, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Significant accounting judgements, estimates and assumptions (continued)

of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are described below. The bank based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances beyond the control of the bank. Such changes are reflected in the assumptions when they occur.

(i) Impairment losses on loans and advances

The bank reviews its individually significant loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the income statement. In particular, management's judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowances against individually significant loans and advances, the bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default, obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

The impairment loss on loans and advances is disclosed in Note 9 and further described in Note 39.

(ii) Impairment of available-for-sale investments

The bank reviews its debt securities classified as available–for–sale investments at each reporting date to assess whether they are impaired. This requires similar judgement as applied to the individual assessment of loans and advances.

The bank also records impairment charges on available–for–sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the bank evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost. No impairment losses were recognized in the current or previous year. Further disclosures on this class of assets are done in notes 7 and 8.

(iii) Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The valuation of financial instruments is described in more detail in note 37.

(iv) Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2014

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Significant accounting judgements, estimates and assumptions

(iv) Deferred tax assets (continued)

that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies (see note 15).

(c) Fair value measurement

The bank measures financial instruments at fair value at each balance sheet date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. Fair value related disclosures for financial instruments that are measured at fair value are done in note 37

(d) Financial instruments – initial recognition and subsequent measurement

(i) Date of recognition

All financial assets and financial liabilities are initially recognised at the trade date, i.e. the date that the bank becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the timeframe generally established by regulation or convention in the market place.

(ii) Initial measurement

The classification of financial instruments at initial recognition depends on their purpose and characteristics and the management's intention in acquiring them. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

(iii) Classification and measurement

Financial assets

The bank classifies its financial assets in the following categories: investments held-to-maturity, loans and receivables and available-for-sale investments. The bank determines the classification of its investments at initial recognition.

1) Held-to-maturity financial investments

Held-to-maturity financial investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and which the bank has the positive intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are subsequently measured at amortised cost using the effective interest rate method less allowance for impairment.

2) Placements and balances with other banks and loans and advances to customers (classified as loans and receivables).

Placements and balances with other banks and loans and advances to customers include non-derivative financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as 'Financial assets held for trading', designated as 'Financial investments - available-for-sale' or 'Financial assets designated as at fair value through profit or loss'. After initial measurement, placements and balances with banks and loans and advances to customers are

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Financial instruments – initial recognition and subsequent measurement (continued)

(iii) Classification and measurement (continued)

subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. The losses arising from impairment are recognised in the income statement in allowance for impairment of loans and advances.

3) Available-for-sale financial assets

Available-for-sale financial assets are those which are designated as such or do not qualify to be classified as designated at fair value through profit or loss, held-to-maturity or loans and advances. They include equity instruments, investments in the money market and other debt instruments.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value. Unrealised gains and losses are recognised directly in other comprehensive income. When the security is disposed of, the cumulative gain or loss previously recognised in equity is recognised in profit or loss. Where the bank holds more than one investment in the same security they are deemed to be disposed of on a first-in-first-out basis. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the effective interest rate.

Dividends earned whilst holding available-for-sale financial investments are recognised in profit or loss when the right of the payment has been established. The losses arising from impairment of such investments are recognised in profit or loss and removed from available-for-sale reserve.

4) Cash and cash equivalents

The bank considers all highly liquid investments with maturities of 90 days or less at purchase to be cash equivalents. The cost of cash equivalents approximates their fair values due to the short-term nature thereof.

Cash and cash equivalents as referred to in the statement of cash flows comprise cash on hand, non-restricted current accounts with Central Bank of Kenya, and amounts due from banks and government securities on demand or with an original maturity of three months or less, less balances due to banks and financial institutions.

Financial assets

Initial recognition and measurement

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, or other financial liabilities, as appropriate.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs.

The bank's financial liabilities include balances due to banks and financial institutions, deposits from customers, and other liabilities.

Subsequent measurement

The measurement of financial liabilities depends on their classification, as described below:

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Financial liabilities are classified as held for trading if they are incurred for the purpose of repurchasing in the near term. Gains or losses on liabilities held for trading are recognised in the statement of profit or loss.

Financial liabilities designated upon initial recognition at fair value through profit or loss are designated at the initial date of recognition, and only if the criteria in IAS 39 are satisfied. The bank has not designated any financial liability as at fair value through profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Financial instruments – initial recognition and subsequent measurement (continued)

After initial recognition, other financial liabilities are subsequently measured at amortised cost using the effective interest rate method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the effective interest rate method (EIR) amortisation process.

(iv) Derecognition of financial assets and financial liabilities

Financial assets

A financial asset (or, where applicable a part of financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- The bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either,

(a) The bank has transferred substantially all the risks and rewards of the asset, or

(b) The bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the bank's continuing involvement in the asset. In that case, the bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the bank could be required to repay.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

Securities lending and borrowing

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of the securities to counterparties is only reflected on the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

Securities borrowed are not recognised on the statement of financial position, unless they are sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value with any gains or losses included in profit or loss.

(v) Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if;

- there is a currently enforceable legal right to offset the recognised amounts and
- there is an intention to settle on a net basis, to realize the assets and settle the liabilities simultaneously.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Financial instruments – initial recognition and subsequent measurement (continued)

(vi) Determination of fair value

Investments in equity and debt securities

The fair value of available-for-sale financial assets is determined by reference to their quoted closing bid price at the reporting date.

Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. In respect of the liability component of convertible notes, the market rate of interest is determined by reference to similar liabilities that do not have conversion option.

Non-performance risk of financial liabilities includes, but may not be limited to, the company's own credit risk. Non-performance risk is assumed to be the same before and after the transfer of the liability. The fair value of a liability reflects the effect of non-performance risk on the basis of its unit of account.

(vii) Determination of amortised cost

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in 'interest income' in profit or loss. The losses arising from impairment are recognised in profit or loss in 'allowance for impairment of loans and advances'.

(viii) Impairment of financial assets

The bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as change in arrears or economic conditions that correlate with defaults.

1) Placements and balances with other banks and loans and advances to customers

For placements and balances with other banks and loans and advances to customers carried at amortised cost, the bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognised, are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Financial instruments – initial recognition and subsequent measurement (continued)

(viii) Impairment of financial assets (continued)

yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset.

Loans, together with the associated allowance, are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered the recovery is credited to 'other income'.

The present value of the estimated future cash flows is discounted at the financial asset's original interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of collective evaluation of impairment, financial assets are grouped on the basis of the bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

2) Held-to-maturity investments

For held-to maturity investments, the bank assesses individually whether there is objective evidence of impairment by evaluating factors such as unwarranted default in interest payments and delay in settling the bond liability upon maturity.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Financial instruments – initial recognition and subsequent measurement (continued)

(viii) Impairment of financial assets (continued)

impairment was recognised, any amounts formerly charged are credited to profit or loss.

3) Available-for-sale financial assets

For available-for-sale financial assets, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of debt instruments classified as available-for-sale, the Bank assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in profit or loss. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in profit or loss is removed from available-for-sale reserve and recognised in profit or loss. Impairment losses on equity investments are not reversed through profit or loss; increases in their fair value after impairment are recognised directly in other comprehensive income.

(e) Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

(i) Interest income and expense

For all financial instruments measured at amortised cost and interest bearing financial instruments classified as available-for-sale financial investments, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments through the expected life of the financial instrument or a shorter period where appropriate, to the net carrying amount of the financial asset or liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the bank revises its payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest rate used to discount the future cash flows for the purpose of measuring the impairment loss.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Recognition of income and expenses (continued)

(ii) Fee and commission income

The bank earns fee and commission income from a diverse range of services it provides to its customers. Fees earned for the provision of services over a period of time are accrued over that period.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

(iii) Dividend income

Dividend income is recognised when the bank's right to receive payment is established.

(f) Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment in value.

Depreciation is calculated on the straight-line basis at annual rates estimated to write off carrying amounts of the property and equipment over their expected useful lives.

The annual depreciation rates in use are: -

Furniture and fittings	**12.50% p.a.**
Office equipment	**12.50% p.a.**
Motor vehicles	**25.00% p.a.**
Computer equipment	**25% - 33.33% p.a.**
Leasehold improvements	**12.50% p.a.**

Buildings are amortised over the shorter of the estimated useful life and the lease term.

Freehold land is not depreciated as it is deemed to have an indefinite life.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in 'other income' or 'other expenses' in profit or loss in the year the asset is derecognised.

The asset's residual value, useful lives and methods of depreciation are reviewed, and adjusted prospectively if appropriate, at each financial year-end. Changes in the expected useful lives are accounted for by changing the depreciation period or method, as appropriate, and are treated as changes in accounting estimates.

(g) Foreign currency

Transactions during the year are converted into Kenya shillings at rates ruling at the transaction dates. Monetary assets and liabilities at the reporting date which are expressed in foreign currencies are translated into Kenya shillings at rates ruling at that date. The resulting differences from conversion and translations are dealt with in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(h) Employee benefits

(i) Defined contribution plans

The bank contributes to a statutory defined contribution provident scheme, the National Social Security Fund (NSSF). Contributions are determined by local statute and are currently limited to KShs 200 per employee per month. The bank also operates a defined contribution provident fund scheme for all its employees. The assets of the scheme are held in a separate trustee administered fund that is funded by both the bank and employees.

The bank's contributions in respect of retirement benefit costs are charged to profit or loss in the year to which they relate.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Employee benefits (continued)

(ii) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

The liability for employees' accrued annual leave entitlement at the reporting date is recognised as an expense accrual.

(i) Taxation

(i) Current tax

Current income tax is provided for on the basis of the results for the year as shown in the financial statements, adjusted in accordance with tax legislation. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

(ii) Deferred tax

Deferred taxation is provided using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences except:-

- Where the deferred tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and,

- In respect of temporary differences associated with investments in subsidiaries and associates, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilized except;

- Where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and,

- In respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at reporting date and reduced to the extent that it is no-longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it is probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Current tax and deferred tax relating to items recognised directly in other comprehensive income or equity are also recognised in other comprehensive income or equity and not in profit or loss.

Deferred tax assets and deferred tax liabilities are

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Taxation (continued)

offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

(iii) Value added tax

Expenses and assets are recognised net of the amount of sales tax, except:

- When the value added tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the value added tax is recognised as part of the cost of acquisition of the asset or as part of the expense item, as applicable, and
- When receivables and payables are stated with the amount of value added tax included.

The net amount of value added tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position.

(j) Guarantees, acceptances and letters of credit

Guarantees, acceptances and letters of credit are not accounted for in the statement of financial position but are disclosed as contingent liabilities.

(k) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date and requires an assessment whether fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset, even if that right is not explicitly specified in an arrangement.

Leases of leasehold land are classified as operating leases. Operating leases are leases which do not transfer to the bank substantially all the risks and benefits incidental to ownership of the leased items. The costs incurred to acquire the lease are included in the financial statements as long term prepayments and rentals payable are accounted for on a straight-line basis over the lease term and included in other operating expenses expenses in the income statement.

(l) Intangible assets

The bank's intangible assets include the value of computer software (swift software, finacle software and other associated costs) and Visa License fees. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment loss.

The useful lives of intangible assets are assessed to be finite. Intangible assets are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset are reviewed at least each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period and method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets is recognised in profit or loss in the expense category consistent with the function of the asset.

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over the estimated useful lives as follows:

- Computer software 5 years
- Visa license 4 years

(m) Dividends

Dividends are charged to equity in the year in which they are declared.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) Impairment of non - financial assets

The bank assesses at each reporting date, or more frequently if events or changes in circumstances indicate that an asset may be impaired, whether there is an indication that a non-financial asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the bank makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less costs of disposal and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs of disposal, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount.

Impairment losses are recognised in the profit or loss in other operating expenses.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised.

The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of profit or loss.

Such reversal is recognised in the income statement.

(o) Investment in an associate

An associate is an entity over which the bank has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies. The bank accounts for investment in its associate using the equity method. Under the equity method, the investment in the associate is carried in the statement of financial position at cost plus post acquisition changes in the bank's share of net assets of the associate since the acquisition date.

The income statement reflects the share of the results of operations of the associate. Any change in OCI of those investees is presented as part of the bank's OCI. In addition, when there has been a change recognized directly in the equity of the associate, the bank recognizes its share of any changes and discloses this, when applicable, in the statement of changes in equity.

The financial statements of the associate are prepared for the same period as the bank. When necessary, appropriate adjustments are made to the associate's financial statements to ensure conformity with the bank's accounting policies.

Upon loss of significant influence over an associate, the bank measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss.

After application of the equity method, the bank determines whether it is necessary to recognize an impairment loss on the bank's investment in its

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(o) Investment in an associate continued

associate. The bank determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case the difference between the recoverable amount of the associate and its carrying value is recognized in the 'share of losses of an associate' in the bank's income statement.

(p) Provisions

Provisions are recognised when The bank has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

4. BALANCES WITH CENTRAL BANK OF KENYA

	2014 KShs'000	2013 KShs'000
Cash ratio reserve	1,894,934	2,135,807
Cheques and items for clearing	469,079	457,037
	2,364,013	2,592,844

The cash ratio reserve balance is non-interest bearing and is based on the value of customer deposits as adjusted in accordance with Central Bank of Kenya requirements. As at 31 December 2014, the cash ratio requirement was 5.25% (2013: 5.25%) of eligible customer deposits.

Cheques and items for clearing represent values of outward clearing instruments, which are awaiting clearance.

5. PLACEMENTS AND BALANCES WITH OTHER BANKS

	2014 KShs'000	2013 KShs'000
Lending to other banks and financial institutions	29,334	1,858,902
Balances with banks outside Kenya	910,875	201,877
	940,209	2,060,779

These are non-interest bearing accounts that are due on demand.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

6. HELD-TO-MATURITY INVESTMENTS

	2014 KShs'000	2013 KShs'000
As at 1 January	13,935,390	13,618,084
Purchase of investment securities	20,099,307	13,830,397
Retirement of investment securities	(20,978,411)	(13,513,091)
As at 31 December	13,056,286	13,935,390
Treasury bills and bonds		
Maturing within 91 days of the date of acquisition	499,539	5,917,398
Maturing after 91 days to 182 days of the date of Acquisition	1,939,920	1,687,299
Maturing after 182 days of the date of acquisition	9,966,474	5,920,284
Term notes	650,353	410,409
	13,056,286	13,935,390

Treasury bills and bonds are debt securities issued by the Government of Kenya and are classified as held-to-maturity. The weighted average effective interest rate on the treasury bills as at 31 December 2014 was 9.06% (2013: 8.8%).

Term notes are debt instruments issued by private and public entities for varied terms and maturity dates.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

7. INVESTMENT IN BONDS-AVAILABLE-FOR-SALE

The bonds are debt securities and include treasury bonds issued by the Government of Kenya, offshore bonds and corporate bonds issued by Safaricom Limited and Kengen Limited and are classified as available-for-sale. The fair value of the bonds is determined by reference to published price quotations in an active market.

	2014 KShs'000	2013 KShs'000
As at 1 January	2,404,434	2,457,454
Purchase of investment securities	792,043	1,348,903
Sales of investment securities	(1,286,795)	(1,479,574)
Foreign exchange loss	(10,146)	(3,000)
Gain on fair valuation	29,349	80,651
As at 31 December	1,928,885	2,404,434
The maturity profile is as follows:		
Within one year	18,767	1,110,778
After one year but within two years	402,510	96,222
After two years but within five years	430,385	8,559
After five years	1,077,223	1,188,875
	1,928,885	2,404,434

8. INVESTMENT IN ORDINARY SHARES-AVAILABLE-FOR-SALE

a) Investment in listed shares:

	2014 KShs'000	2013 KShs'000
Investment as at 1 January	936,286	668,965
Fair value movement	128,446	267,321
As at 31 December	1,064,732	936,286

The fair value of the listed shares is determined by reference to published price quotations in an active market. Available-for-sale investments in ordinary shares have no fixed maturity date or coupon rate.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

8. INVESTMENT IN ORDINARY SHARES-AVAILABLE-FOR-SALE (continued)

b) Investment in privately held shares:

	2014 KShs'000	2013 KShs'000
Capital Bank Limited, Botswana	81,139	81,139
Purchase of Capital Bank Mozambique	93,110	-
Cooperative Bank Plc, United Kingdom	27,287	-
As at 31 December	201,536	81,139

Investment in privately held shares comprise of an investment in shares of Capital Bank Limited, Botswana ,Capital Bank Limited, Mozambique and Cooperative Bank Plc, United Kingdom, which are unquoted companies. These shares are those that are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions. Unquoted shares are carried at cost, since the fair value cannot be reliably measured.

All other available-for-sale investments are carried at fair value, with unrealised gains/losses recognised as other comprehensive income in the available for sale reserve until the investment is derecognised or impaired.

Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss.

	2014 KShs'000	2013 KShs'000
Investment in listed shares (note 8a)	1,064,732	936,286
Investment in privately held shares (note 8b)	201,536	81,139
Total investment in ordinary shares available for sale	1,266,268	1,017,425

9. LOANS AND ADVANCES TO CUSTOMERS

b) Loans and advances to customers

	2014 KShs'000	2013 KShs'000
a)Loans and advances to customers (gross)	34,339,331	26,470,460
Less – Allowances on impairment of loans and advances (note 9 (b))	(916,855)	(940,024)
Loans and advances to customers net of allowances	33,422,476	25,530,436

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

9. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

b) Allowances on impairment of loans and advances

	Specific Allowance KShs'000	Suspended Interest KShs'000	Collective Allowance KShs'000	Total KShs'000
At 1 January 2014	450,596	204,917	284,511	940,024
Bad debts written off	(13,537)	(5,182)	-	(18,719)
Suspended interest reversed	-	(81,493)	-	(81,493)
Bad debts recovered	(51,625)	-	-	(51,625)
Suspended interest during the year	-	28,541	-	28,541
Allowance during the year	45,100	-	55,027	100,127
At 31 December 2014	430,534	146,783	339,538	916,855
At 1 January 2013	472,943	186,255	218,652	877,850
Bad debts written off	(1,868)	(3,012)	-	(4,880)
Suspended interest reversed	-	(23,549)	-	(23,549)
Bad debts recovered	(89,571)	-	-	(89,571)
Suspended interest during the year	-	42,882	-	42,882
Allowance during the year	71,433	-	65,859	137,292
At 31 December 2013	452,937	202,576	284,511	940,024

c) Non-performing loans and advances

Non-performing loans and advances on which interest has been suspended amount to KShs 87.04 million (2013: KShs 47.53 million), net of specific allowance. Interest on these accounts is not being recognised as these advances are classified as non-performing in accordance with the Central Bank of Kenya guidelines. In the opinion of the directors, securities held in respect of these loans and advances are valued at KShs 328.4 million (2013: KShs 304.75 million).

(d) Lending concentration

Economic sector risk concentrations within the customer loan portfolio were as follows:

	2014 %	2013 %
Manufacturing	22	25
Wholesale and retail trade	29	25
Transport and communication	4	4
Real estate	19	20
Business services	14	12
Others	12	14
	100	100

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

9. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(e) Maturity analysis

2014	Within 30 days KShs'000	31-60 days KShs'000	61-90 days KShs'000	More than 90 days KShs'000	Total KShs'000
Manufacturing	1,007,436	635,333	50,255	5,898,401	7,591,425
Trade	1,916,253	521,355	196,343	13,073,795	15,707,746
Transport	43,832	204,643	1,294	1,127,590	1,377,359
Real estate	439,711	188,154	41,939	5,725,838	6,395,642
Other	512,741	96,717	75,416	2,582,285	3,267,159
Total	3,919,973	1,646,202	365,247	28,407,909	34,339,331
2013					
Manufacturing	2,141,234	539,429	21,740	3,883,257	6,585,660
Trade	3,399,190	1,326,631	14,860	6,350,265	11,090,946
Transport	25,450	226,858	3,000	832,506	1,087,814
Real estate	551,245	649,375	20,353	4,656,984	5,877,957
Other	314,489	101,487	343	1,411,764	1,828,083
Total	6,431,608	2,843,780	60,296	17,134,776	26,470,460

10. OTHER ASSETS

	2014 KShs'000	2013 KShs'000
Prepayments and deposits	114,503	252,124
Accrued income	91,642	97,150
Others	96,589	172,902
	302,734	522,176

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

11. INVESTMENT IN ASSOCIATE

The bank owns a 37.55% (2013 – 37.55%) shareholding in Tausi Assurance Company Limited, a company incorporated in Kenya, with its principal place of business being Tausi Road off Muthithi Road Westlands, Nairobi. The principal activity of the company is provision of general insurance services with the exception of aviation. The bank's interest in Tausi Assurance Company Limited is accounted for using the equity method. The bank's investment in Tausi Assurance Company Limited is shown below:

	2014 KShs'000	2013 KShs'000
As at 1 January	270,396	223,939
Purchase of ordinary shares	-	1,184
Dividends received	(18,859)	(35,237)
Share of profit	53,086	78,603
Share of available for sale reserve	25,359	1,907
	329,982	270,396

The associate assets, liabilities, revenue and profit are as shown below;

	2014 KShs'000	2013 KShs'000
Assets	1,956,517	1,999,915
Liabilities	1,068,910	1,304,445
Revenue	847,068	783,598
Profit before tax	201,964	259,443
Profit after tax	141,345	209,329
Other comprehensive income	67,534	5,085
Cash and cash equivalents	44,795	50,307
Depreciation and amortisation	8,337	8,947
Income tax expense	60,589	71,380

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

12. LEASEHOLD LAND

	2014 KShs'000	2013 KShs'000
COST		
At 1 January and 31 December	71,381	71,381
AMORTISATION		
At 1 January	14,411	13,051
Charge for the year	1,361	1,360
At 31 December	15,772	14,411
NET CARRYING AMOUNT		
At 31 December	55,609	56,970

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

13. PROPERTY AND EQUIPMENT

a) As at 31 December 2014

2014	Freehold land KShs'000	Leasehold buildings KShs'000	Leasehold improvements KShs'000	Furniture & fittings KShs'000	Office equipment KShs'000	Motor vehicles KShs'000	Computer equipment KShs'000	Total KShs'000
COST								
At 1 January 2014	15,645	306,330	193,499	92,365	116,245	80,428	183,679	988,191
Additions	-	-	28,839	8,582	17,513	6,670	22,368	83,972
Disposals	-	-	-	-	(1,982)	(7,218)	-	(9,200)
At 31 December 2014	15,645	306,330	222,338	100,947	131,776	79,880	206,047	1,062,963
DEPRECIATION								
At 1 January 2014	-	48,066	110,796	66,933	66,335	51,510	146,631	490,271
Charge for the year	-	10,317	22,116	6,186	12,428	14,486	20,971	86,504
Disposals	-	-	-	-	(1,982)	(6,934)	-	(8,916)
At 31 December 2014	-	58,383	132,912	73,119	76,781	59,062	167,602	567,859
NET CARRYING AMOUNT								
At 31 December 2014	15,645	247,947	89,426	27,828	54,995	20,818	38,445	495,104

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

13. PROPERTY AND EQUIPMENT

b) As at 31 December 2013

2013	Freehold land KShs'000	Leasehold buildings KShs'000	Leasehold improvements KShs'000	Furniture & fittings KShs'000	Office equipment KShs'000	Motor vehicles KShs'000	Computer equipment KShs'000	Total KShs'000
COST								
At 1 January 2013	15,645	294,629	174,971	83,018	95,482	68,068	150,458	882,271
Additions	-	11,701	18,528	9,499	20,763	21,855	33,221	115,567
Disposals	-	-	-	(152)	-	(9,495)	-	(9,647)
At 31 December 2013	15,645	306,330	193,499	92,365	116,245	80,428	183,679	988,191
DEPRECIATION								
At 1 January 2013	-	37,749	91,465	61,385	55,693	41,716	128,824	416,832
Charge for the year	-	10,317	19,331	5,700	10,642	17,708	17,807	81,505
Disposals	-	-	-	(152)	-	(7,914)	-	(8,066)
At 31 December 2013	-	48,066	110,796	66,933	66,335	51,510	146,631	490,271
NET CARRYING AMOUNT								
At 31 December 2013	15,645	258,264	82,703	25,432	49,910	28,918	37,048	497,920

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

14. INTANGIBLE ASSETS

	2014 KShs'000	2013 KShs'000
COST		
At 1 January	206,291	106,183
Additions	142,335	100,108
At 31 December	348,626	206,291
AMORTISATION		
At 1 January	108,239	79,833
Charge for the year	56,387	28,406
At 31 December	164,626	108,239
NET CARRYING AMOUNT		
At 31 December	184,000	98,052

Intangible assets comprise of computer software and VISA license fees.

15. DEFERRED TAX

Movement of the deferred tax asset during the year is as follows:

2014	At 1 January KShs'000	Recognised in income statement KShs'000	At 31 December KShs'000
Arising from:			
Property and equipment	36,441	(3,686)	32,755
Provision for staff leave	2,864	548	3,412
Provision for loans and advances	88,627	12,844	101,471
	127,932	9,706	137,638
2013			
Arising from:			
Property and equipment	38,525	(2,084)	36,441
Provision for staff leave	2,490	374	2,864
Provision for loans and advances	66,509	22,118	88,627
	107,524	20,408	127,932

The deferred asset has been fully recognised in the financial statements and is mainly due to accelerated depreciation expense and general allowances on impairment of loans and advances.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

16. BALANCES DUE TO BANKS AND FINANCIAL INSTITUTIONS

	2014 KShs'000	2013 KShs'000
Due to other banks	1,680,066	2,447,685

These are non-interest bearing accounts that are due on demand.

17. DEPOSITS FROM CUSTOMERS

	2014 KShs'000	2013 KShs'000
Current deposits	12,204,844	9,803,753
Savings deposits	349,017	364,669
Call deposits	293,978	595,614
Fixed deposits	32,227,206	29,797,993
	45,075,045	40,562,029

Included in deposits from customers, were deposits of KShs 202.7 million (2013: KShs 322.6 million) held as collateral for irrevocable commitments. The weighted average effective interest rate on interest bearing customer deposits as at 31 December 2014 was 6.5 % (2013: 7.2%).

18. OTHER LIABILITIES

	2014 KShs'000	2013 KShs'000
Pay orders issued	98,638	93,935
Bills payable	109,677	175,836
Sundry creditors and accruals	180,641	163,258
	388,956	433,029

Pay orders issued, bills payable and sundry creditors and accruals are payable on demand and are non-interest bearing.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

19. INCOME TAX

	2014 KShs'000	2013 KShs'000
STATEMENT OF FINANCIAL POSITION		
Balance brought forward	202,299	(13,012)
Charge for the year	571,366	472,515
Paid during the year	(735,078)	(257,204)
Income tax payable	38,587	202,299
INCOME STATEMENT		
Current income tax at 30% on the taxable profit for the year	571,366	472,515
Deferred tax credit (note 15)	(9,706)	(20,408)
Income tax expense	561,660	452,107
Reconciliation of tax expense to tax based on accounting profit:		
Accounting profit before tax	2,297,679	1,892,877
Tax applicable rate of 30%	689,304	567,863
Tax effect on items not eligible for tax	(127,644)	(115,756)
Tax charge for the year	561,660	452,107

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

20. SHARE CAPITAL

	2014 Ordinary shares of KShs 1,000 each	2014 Ordinary class 'B' shares of KShs 1,000 each	2013 Ordinary shares of KShs 1,000 each	2013 Ordinary class 'B' shares of KShs 1,000 each
Authorised	2,991,000	9,000	2,991,000	9,000
Issued and fully paid:				
At 1 January	2,991,000	9,000	2,491,000	9,000
Issued during the year	-	-	500,000	-
At 31 December	2,991,000	9,000	2,991,000	9,000

	2014 KShs'000	2013 KShs'000
Authorised, issued and fully paid:		
2,991,000 Ordinary shares of KShs 1,000 each	2,991,000	2,991,000
9,000 Ordinary class "B" shares of KShs 1,000 each	9,000	9,000
	3,000,000	3,000,000

Class 'B' shares have equal rights as other ordinary shares and participate in dividends and voting.

21. RESERVES

	2014 KShs'000	2013 KShs'000
Retained earnings	3,934,080	2,198,061
Available-for-sale reserve	800,940	617,786
Balance carried forward	4,735,020	2,815,847

Available-for-sale reserve comprises changes in fair value of available-for-sale investments

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

22. INTEREST INCOME

	2014 KShs'000	2013 KShs'000
Loans and advances to customers	4,100,697	3,253,254
Placements and bank balances	51,777	110,543
Reverse repurchase agreements	64,030	34,985
Government securities-held-to-maturity	1,344,112	1,353,400
Available -for-sale investments	276,776	270,439
	5,837,392	5,022,621

23. INTEREST EXPENSE

	2014 KShs'000	2013 KShs'000
Due to customers	2,815,880	2,488,380
Due to banks and other financial institutions	32,302	14,296
	2,848,182	2,502,676

24. OTHER INCOME

	2014 KShs'000	2013 KShs'000
Miscellaneous income	87,398	39,010
Recoveries of loans and advances previously written off	51,625	89,571
	139,023	128,581

25. ALLOWANCES FOR IMPAIRMENT OF LOANS AND ADVANCES

	2014 KShs'000	2013 KShs'000
Specific allowance on loans and advances (note 9 (b))	45,100	71,433
Collective allowance for impairment (note 9 (b))	55,027	65,859
Write-off during the year	656	1,448
	100,783	138,740

26. OTHER OPERATING EXPENSES

	2014 KShs'000	2013 KShs'000
Staff costs (note 29)	793,370	723,219
Depreciation on property and equipment	86,504	81,505
Amortisation of intangible assets	56,387	28,406
Amortisation of leasehold land	1,361	1,360
Auditors' remuneration	3,536	3,214
Directors' emoluments	71,613	64,468
Deposit protection fund levy	58,070	50,128
Rent and rates	75,924	64,524
Other general administration expenses	400,140	353,781
	1,546,905	1,370,605

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

27. PROFIT BEFORE TAX

	2014 KShs'000	2013 KShs'000
Profit before tax is stated after charging: -		
Depreciation on property and equipment	86,504	81,505
Amortisation of intangible assets	56,387	28,406
Amortisation of leasehold land	1,361	1,360
Director's fees	24,252	17,363
Directors' emoluments	47,361	47,105
Auditors' remuneration	3,536	3,214
And after crediting: -		
Foreign exchange gains	338,209	311,027
Dividend income	49,378	28,673
Gain on sale of property and equipment	2,681	2,136

28. EARNINGS PER SHARE

a) Basic earnings per share is calculated on the profit for the year and on the weighted average number of shares outstanding during year.

b) Diluted earnings per share is calculated on the profit for the year and on the weighted average number of shares outstanding during the year plus the weighted average number of shares that would be issued on conversion of all the dilutive potential shares into shares. There are no such dilutive shares.

The following reflects the profit for the year and share data used in calculating the basic and diluted earnings per share.

	2014 KShs'000	2013 KShs'000
Profit for the year attributable to shareholders	1,736,019	1,440,770
Weighted average number of shares ('000)	3,000	3,000
Basic and diluted earnings per share (KShs)	578.67	480.26

29. STAFF COSTS

Salaries and wages	692,325	625,336
Contribution to pension scheme	33,487	27,601
Other staff costs	67,558	70,282
	793,370	723,219

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

30. DIVIDENDS PAID

	2014 KShs'000	2013 KShs'000
Declared and paid		
Dividend on ordinary shares	-	150,000
Total dividend paid	-	150,000
Dividend per ordinary share	-	50

Dividend per share is calculated based on the amount of the dividends and on the number of shares issue at the respective reporting dates.

31. CASH AND CASH EQUIVALENTS

For the purpose of the statement of cash flows, cash and cash equivalents comprise the following:

	2014 KShs'000	2013 KShs'000
Cash in hand	434,470	346,135
Cash ratio reserve (note 4)	1,894,934	2,135,807
Cheques and items for clearing (note 4)	469,078	457,037
Placements and balances with other banks (note 5)	940,209	2,060,779
Government securities and term notes maturing within 91 days	689,540	6,277,219
Due to banks and financial institutions (note 16)	(1,680,066)	(2,447,685)
	2,748,165	8,829,292

32. CONTINGENT LIABILITIES

	2014 KShs'000	2013 KShs'000
Letters of credit	1,152,662	607,909
Local guarantees	2,446,105	2,504,478
Bills for collection	2,054,655	1,234,130
Foreign currency bills for collection	145,919	118,746
Custodial treasury bonds	2,066,263	1,222,134
Spot sales/purchase	754,744	-
Swap sales/purchases	13,154,193	-
Forward contracts	1,084,975	397,278
	22,859,516	6,084,675

The contingent liabilities represent transactions entered into in the normal course of business and are represented by counter indemnities or cash securities from customers for the same amount. Letters of credit, guarantee and acceptance commit the bank to make payments on behalf of the customers in the event of a specific act, generally relating to the import and export of goods.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

33. CAPITAL COMMITMENTS

	2014 KShs'000	2013 KShs'000
Capital commitments contracted for	100,000	50,000

Capital commitments relate to expected capital expenditure to be incurred in leasehold improvements, furniture and fittings and other assets.

34. OPERATING LEASE COMMITMENTS

As a lessee, the bank leases a number of branch and office premises under operating leases. The leases typically run for a year up to ten years, with an option to renew the lease after that date. Lease payments are increased accordingly to reflect market lease rentals.

The total future minimum lease payments due to third parties under non-cancellable operating leases are as follows:

	2014 KShs'000	2013 KShs'000
Within 1 year	48,453	41,576
After 1 year but not more than 5 years	138,361	96,572
More than 5 years	3,695	6,492
	190,509	144,640

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

35. RELATED PARTY TRANSACTIONS

The bank enters into transactions, arrangements and agreements involving directors, senior management and their related concerns in the ordinary course of business at commercial interest and commission rates.

	2014 KShs'000	2013 KShs'000
a) Due from		
i) Loans and advances to employees	189,758	232,958
ii) Loans and advances to directors and their associates	1,440,072	1,167,978
	1,629,830	1,400,936
Allowance during the year:		
At 1 January	14,009	10,372
Allowance during the year	3,789	3,637
At 31 December	17,798	14,009

The loans to related parties are given in the ordinary course of business at commercial interest rates. The average term of the loans to related parties is 4 years. The loans are secured by titles to property and directors guarantees.

	2014 KShs'000	2013 KShs'000
b) Due to		
i) Deposits from employees	202,609	167,045
ii) Deposits from directors and their associates	131,350	382,943
	333,959	549,988
c) Key management personnel compensation		
i) Salaries	322,961	233,974
ii) Post employment benefits	15,809	16,062
	338,770	250,036
d) Directors' emoluments		
i) As management	24,252	17,363
ii) As executives	47,361	47,105
	71,613	64,468

e) Interest income and interest expense

Included in interest income is KShs 168,319,221 (2013: KShs 92,102,592) being interest on loans and advances to related parties. Included in interest expense is KShs 45,442,597 (2013: KShs 5,678,461) being interest on deposits from related parties.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

36. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled.

As at 31 December 2014

2014	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash in hand	434,470	-	434,470
Balances with the Central Bank of Kenya	2,364,013	-	2,364,013
Placements and balances with other banks	940,209	-	940,209
Held to maturity investments	9,933,029	3,123,257	13,056,286
Investment in bonds-available for sale	18,767	1,910,118	1,928,885
Investment in ordinary shares available for sale	-	1,266,268	1,266,268
Loans and advances to customers	14,523,906	18,898,570	33,422,476
Other assets	158,245	144,489	302,734
Investment in associate	-	329,982	329,982
Intangible assets	-	184,000	184,000
Leasehold land	-	55,609	55,609
Property and equipment	-	495,104	495,104
Deferred tax asset	-	137,638	137,638
TOTAL ASSETS	28,372,639	26,545,035	54,917,674
LIABILITIES			
Balances due to banks and financial institutions	1,680,066	-	1,680,066
Deposits from customers	45,075,045	-	45,075,045
Tax payable	38,587	-	38,587
Other liabilities	388,956	-	388,956
TOTAL LIABILITIES	47,182,654	-	47,182,654
NET ASSETS	(18,810,015)	26,545,035	7,735,020

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

36. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

As at 31 December 2013

2013	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash in hand	346,135	-	346,135
Balances with the Central Bank of Kenya	2,592,844	-	2,592,844
Placements and balances with other banks	2,060,779	-	2,060,779
Held to maturity investments	9,825,809	4,109,581	13,935,390
Investment in bonds-available for sale	1,031,991	1,372,443	2,404,434
Investment in ordinary shares available for sale	-	1,017,425	1,017,425
Loans and advances to customers	-	25,530,436	25,530,436
Other assets	95,146	427,030	522,176
Investment in associate	-	270,396	270,396
Intangible assets	-	98,052	98,052
Leasehold land	-	56,970	56,970
Property and equipment	-	497,920	497,920
Deferred tax asset	-	127,932	127,932
TOTAL ASSETS	15,952,704	33,508,185	49,460,889
LIABILITIES			
Balances due to banks and financial institutions	2,447,685	-	2,447,685
Deposits from customers	40,562,029	-	40,562,029
Tax payable	202,299	-	202,299
Other liabilities	-	433,029	433,029
TOTAL LIABILITIES	43,212,013	433,029	43,645,042
NET ASSETS	(27,259,309)	33,075,156	5,815,847

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

37. FAIR VALUE OF FINANCIAL INSTRUMENTS

a) Comparison of the carrying amounts and fair values of the financial instruments

Set out below is a comparison by class of the carrying amounts and fair values of the bank's financial instruments that are carried in the financial statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

	2014 Carrying amount KShs '000	Fair value KShs '000	2013 Carrying amount KShs '000	Fair value KShs '000	Un-recognised gain/(loss) KShs '000
Cash in hand	434,470	434,470	346,135	346,135	-
Balances with Central Bank of Kenya	2,364,013	2,364,013	2,592,844	2,592,844	-
Placements and balances with other banks	940,209	940,209	2,060,779	2,060,779	-
Held-to-maturity:					
Treasury bonds	5,592,816	6,953,326	4,695,333	5,820,913	
Treasury bills	6,813,117	6,813,117	8,829,648	8,829,648	
Term notes	650,353	650,353	410,409	410,409	
Bonds-available-for-sale	1,928,885	1,928,978	2,404,434	2,404,434	-
Ordinary shares-available-for-sale	1,064,732	1,064,732	936,286	936,286	-
Loans and advances to customers	33,422,476	33,422,476	25,530,436	25,530,436	-
Due to banks and other financial institutions	1,680,066	1,680,066	2,447,685	2,447,685	-
Deposits from customers	45,075,045	45,075,045	40,562,029	40,562,029	-
Total unrecognised change in unrealised fair value	-	-	-	-	-

b) Determination of fair value and fair value hierarchy

The bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1:
Included in level 1 category are financial assets that are measured in whole or in part by reference to unadjusted, quoted prices in an active market for identical assets and liabilities. Quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The assets are traded in an active market and quoted prices are available

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

37. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

b) Determination of fair value and fair value hierarchy (continued)

Level 2:

Included in level 2 category are financial assets measured using inputs other than quoted prices included within level 1 that are observable for the asset, either directly (i.e. as prices) or indirectly (i.e. derived from prices). For example, instruments measured using a valuation technique such as discounted cash flows, based on assumptions that are supported by prices from observable current market transactions are categorized as level 2. The bank did not have any financial assets designated as level 2 within the fair value hierarchy.

Level 3:

Financial assets measured using inputs that are not based on observable market data are categorised as level 3. Non market observable inputs means that fair values are determined in whole or in part using a valuation technique (model) based on assumptions that are neither supported by prices from observable current market transactions in the same instrument nor are they based on available market data. Valuation techniques are used to the extent that observable inputs are not available, thereby allowing for situations for which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of the bank. Therefore, unobservable inputs reflect the bank's own assumptions about the assumptions that market participants would use in pricing the asset (including assumptions about risk). These inputs are developed based on the best information available, which might include the bank's own data. However, significant portion of the unquoted shares have been valued at cost and variation in inputs would not have significant fair value change.

2014	Note	Level 1 KShs'000	Level 2 KShs'000	Level 3 KShs'000	Total KShs'000
Financial investments available- for-sale:					
Investment in bonds available- for-sale	7	1,928,885	-	-	1,928,885
Investments in ordinary shares	8	1,064,732	-	-	1,064,732
Investment in government securities		6,953,326	-	-	6,953,326
		9,946,943	-	-	9,946,943

2013	Note	Level 1 KShs'000	Level 2 KShs'000	Level 3 KShs'000	Total KShs'000
Financial investments available- for-sale:					
Investment in bonds available- for-sale	7	2,404,434	-	-	2,404,434
Investments in ordinary shares	8	936,286	-	-	936,286
Investment in government securities		5,820,913	-	-	5,820,913
		9,161,633	-	-	9,161,633

There were no transfers between levels 1, 2 and 3 in the year.

38. CAPITAL MANAGEMENT

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the banking industry as a whole. It has set among other measures, the rules and ratios to monitor adequacy of a bank's capital.

In implementing current capital requirements, the Central Bank of Kenya requires the bank to maintain a prescribed ratio of total capital to total risk-weighted assets.

The bank's regulatory capital is analysed in two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of fair value reserve relating to unrealised gains on equity instruments classified as available for sale.

Various limits are applied to elements of the capital base; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There are also restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital.

The bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised in addition to recognising the need to maintain a balance between the higher returns and that may be possible with greater gearing and the advantages and security afforded by sound capital position.

The bank has complied with capital requirements.

The bank's regulatory capital position at 31 December was as follows:-

	2014 Actual KShs'000	Required KShs'000	2013 Actual KShs'000	Required KShs'000
Tier 1 Capital	6,934,080	1,000,000	5,198,063	1,000,000
Tier 2 Capital	800,940	-	617,784	-
Total regulatory capital	7,735,020	1,000,000	5,815,847	1,000,000
Risk weighted assets	40,099,746	-	30,901,688	-
Capital Ratios				
Total regulatory capital expressed as a percentage of total risk-weighted assets	19.28%	14.5%	18.82%	14.5%
Total tier 1 capital expressed as a percentage of risk weighted assets	17.28%	14.5%	16.82%	14.5%

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT

Risk management framework

The Bank's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risks. The bank's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risks. The bank's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the bank's financial performance.

The Board of Directors (the Board) has overall responsibility for the establishment and oversight of the bank's risk management framework. The Board has established various committees, which are responsible for developing and monitoring the bank's risk management policies in their specified areas. All committees report regularly to the Board on their activities.

The bank's risk management policies are established to identify and analyse the risks faced by the bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

a) Credit risk

Credit risk is the risk of financial loss to the bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the bank's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the bank considers and consolidates all elements of credit risk exposure.

Management of credit risk

The Board has delegated the responsibility for the management of credit risk to the Credit Committee chaired by a Non-Executive Director. The Credit Department, headed by the Assistant General Manager, oversees the operation under the guidance of top management responsible for overseeing of the bank's credit risk including:

1. Formulating credit policies, covering collateral requirements, credit assessment, risk grading, documentary and legal procedures, and compliance with regulatory and statutory requirements.
2. Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to various officers at different levels. Larger facilities require approval by Credit Committee or the Board as appropriate.
3. Reviewing and assessing credit risk. Credit Department assesses all credit exposures prior to facilities being committed to customers concerned. Renewals and reviews of facilities are subject to the same review process.
4. Limiting concentrations of exposure. The Board approved delegated authority restricts exposure for any sector.
5. Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to Credit Committee/Board in respect of large borrowers.
6. Providing advice, guidance and specialist skills to business units to promote best practice in the management of credit risk.

Regular audits of Credit Department processes are undertaken by Internal Audit Department.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk (continued)

Exposure to credit risk

Maximum exposure to credit risk before collateral held

	2014 KShs'000	2013 KShs'000
Cash in hand	434,470	346,135
Balances with the Central Bank of Kenya	2,364,013	2,592,844
Placements and balances with other banks	940,209	2,060,779
Held to maturity investments	13,056,286	13,935,390
Investment in bonds-available for sale	1,928,885	2,404,434
Loans and advances to customers	33,422,476	25,530,436
	52,146,339	46,870,018
LOANS AND ADVANCES TO CUSTOMERS		
Individually impaired		
Grade 3: Impaired (Substandard)	198,910	164,318
Grade 4: Impaired (Doubtful)	358,979	396,405
Grade 5: Impaired (Loss)	107,783	143,627
Gross amount	665,672	704,350
Allowance for impairment	577,317	655,513
Carrying amount	88,355	48,837
Collectively impaired		
Grade 1: Normal	33,511,351	24,910,290
Grade 2: Watch list	162,308	855,820
Gross amount	33,673,659	25,766,110
Allowance for impairment	339,538	284,511
Carrying amount	33,334,121	25,481,599
Total carrying amount	33,422,476	25,530,436

Loans and advances graded 3, 4 and 5 in the banks' internal credit risk grading system are impaired. These are advances for which the bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan agreements. Specific impairment losses are made on these grades.

Loans and advances graded 1 and 2 are not impaired. According to the Central Bank of Kenya guidelines, a minimum collective impairment provision of 1% and 3% on gross advances on grade 1 and grade 2, respectively, should be held to cater for any unidentified credit risk.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk (continued)

Exposure to credit risk (continued)

Loans and advances to customers (continued)

The internal rating scale assists management in determining whether objective evidence of impairment exists under IAS 39, based on the following criteria set out by the bank:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral.

The bank's policy requires the review of individual financial assets regularly when individual circumstances require. Impairment allowances on individually assessed accounts are determined by an evaluation of the impairment at the reporting date on a case-by-case basis, and are applied to all individual significant accounts. The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.

Write-off policy

The bank has set up a Debt Management Committee which is headed by a Non-executive Director. The Committee has been mandated to review all the non- performing assets and give direction /guidance to the Credit Department. The bank writes off loans as and when Debt Management Committee determines that the loans are irrecoverable. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation or that proceeds from collateral will not be sufficient to pay back the entire exposure.

Collateral on loans and advances.

The bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing and generally are not updated except when a loan is individually assessed as impaired.

The bank monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown on next page.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk (continued)

Exposure to credit risk (continued)

Loans and advances to customer (continued)

Loan advances to customers (Gross)

	2014 KShs'000	2013 KShs'000
CONCENTRATION BY SECTOR:		
Agriculture	387,844	29,671
Mining and quarry	6,781	-
Manufacturing	7,591,425	6,585,660
Electricity and water	10,582	37,868
Building and construction	740,113	637,408
Wholesale and retail	9,807,768	6,683,540
Transport and communication	1,377,359	1,087,815
Finance and insurance	283	51,164
Real estate	6,395,643	5,240,549
Business services	4,731,723	3,120,915
Foreign trade	1,157,673	1,157,766
Other enterprises	2,132,137	1,838,104
	34,339,331	26,470,460

b) Liquidity risk

Liquidity risk is the risk that the bank will encounter difficulty in meeting obligations from its financial liabilities.

Exposure to liquidity risk

The key measure used by the bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers.

Details of the reported bank ratio of net liquid assets to deposits from customers at the reporting date and during the year were as follows:

	2014	2013
At 31 December	38%	42%
Average for the year	41%	45%
Maximum for the year	45%	50%
Minimum for the year	37%	41%
Central Bank of Kenya required minimum	20%	20%

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

b) Liquidity Risk (continued)

Management of liquidity risk

The bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Institution's reputation.

Treasury department maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to institutions and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the institution as a whole. All liquidity policies and procedures are subject to review and approval by an Assets and Liabilities Committee.

The bank manages the liquidity structure of assets, liabilities and commitments so that cash flows are appropriately matched to ensure that all funding obligations are met when due. Banking operations are such that mismatch of assets and liabilities according to their maturity profiles cannot be avoided. However, management ensures that the mismatch is controlled in line with allowable risk levels. The table below analyses maturity profiles of assets and liabilities of the bank based on the remaining period using 31 December 2013 as a base period to the contractual maturity date. Deposits from customers shown as maturing within 90 days relate to current, savings, call and fixed account balances. Although classified in this band, previous experience has shown these to be stable and of a long term nature.

As at 31 December 2014

	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months to 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Cash in hand	434,470	-	-	-	-	434,470
Balances with Central Bank of Kenya	2,364,013	-	-	-	-	2,364,013
Placements and balances with other banks	940,209	-	-	-	-	940,209
Held-to-maturity investments	860,118	3,248,428	6,348,197	1,966,936	1,320,992	13,744,671
Bonds- available-for-sale	-	-	19,166	861,258	1,089,502	1,969,926
Other assets	2,061	153,990	2,194	144,489	-	302,734
Total assets	4,600,871	3,402,418	6,369,557	2,972,683	2,410,494	19,756,023
FINANCIAL LIABILITIES						
Due to banks and financial institutions	1,680,066	-	-	-	-	1,680,066
Deposits from customers	21,035,531	11,109,277	12,930,237	-	-	45,075,045
Other liabilities	132,358	151,887	104,708	-	-	388,953
Total liabilities	22,847,955	11,261,164	13,034,945	-	-	47,144,064

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

b) Liquidity risk (continued)

Management of liquidity risk (continued)

As at 31 December 2013

	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months to 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Cash in hand	346,135	-	-	-	-	346,135
Balances with Central						
Bank of Kenya	2,592,844	-	-	-	-	2,592,844
Placements and balances						
with other banks	126,124	1,934,655	-	-	-	2,060,779
Held-to-maturity investments	437,781	6,046,843	3,661,689	3,417,622	826,008	14,389,943
Bonds- available-for-sale	-	-	1,035,769	16,358	1,399,222	2,451,349
Other assets	-	-	95,146	394,647	32,383	522,176
Total assets	3,502,884	7,981,498	4,792,604	3,828,627	2,257,613	22,363,226
FINANCIAL LIABILITIES						
Due to banks and						
Financial institutions	192,703	666,050	1,588,932	-	-	2,447,685
Deposits from customers	20,131,293	10,373,462	10,057,274	-	-	40,562,029
Other liabilities	195,663	225,148	12,218	-	-	433,029
Tax Payable	-	202,299	-	-	-	202,299
Total liabilities	20,519,659	11,466,959	11,658,424	-	-	43,645,042

c) Market risk

Market risk is the risk that fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices.

The objective of market risk management is to manage and control market risk exposure within acceptable levels, while optimising on return on the risk.

Equity price risk

Equity price risk is the risk that the fair value of equities decreases as a result of changes in the value of equity indices and individual stocks. A 10% increase in the value of The bank's available-for-sale equities as at 31 December 2014 would have increased equity by KShs 80 million (2013: KShs 94 million). An equivalent decrease would have resulted in an equivalent but opposite impact and would cause a potential impairment which would reduce profit before tax.

Interest risk exposure

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Market Risk (continued)

Interest risk exposure (continued)

increase as a result of changes in the prevailing levels of market rates but may also decrease or create losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest repricing that may be undertaken. Consequently, the interest sensitivity effect on profit or loss would not be significant given the repricing frequency.

The table below summarises the exposure to interest rates risks. Included in the table are the bank's assets and liabilities at carrying amounts categorised by the earlier of contractual repricing or maturity dates:

ASSETS	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months to 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Non-interest bearing KShs '000	Total KShs '000
Cash in hand	-	-	-	-	-	434,470	434,470
Balances with Central Bank of Kenya	-	-	-	-	-	2,364,013	2,364,013
Placements and balances							
with other banks	-	-	-	-	-	940,209	940,209
Held-to-maturity investments	817,040	3,085,734	6,030,255	1,868,425	1,254,832	-	13,056,286
Bonds- available for sale	-	-	18,767	843,315	1,066,803	-	1,928,885
Ordinary shares-Available-for-sale	-	-	-	-	-	1,266,268	1,266,268
Loans and advances to customers	3,945,728	1,867,410	8,950,473	10,811,552	7,847,313	-	33,422,476
Other assets	-	-	-	-	-	302,734	302,734
Total assets	4,762,768	4,953,144	14,999,495	13,523,292	10,168,948	5,307,694	53,715,341
LIABILITIES							
Due to banks &							
Financial institutions	1,680,066	-	-	-	-	-	1,680,066
Deposits from customers	13,304,418	11,109,277	12,930,237	-	-	7,731,113	45,075,045
Other liabilities	-	-	-	-	-	388,956	388,956
Tax payable	-	-	38,587	-	-	-	38,587
Total liabilities	14,984,484	11,109,277	12,968,824	-	-	8,120,069	47,182,654
Total interest sensitivity gap	(10,221,716)	(6,156,133)	2,030,671	13,523,292	10,168,948	(2,812,375)	6,532,687
As at 31 December 2013							
Total assets	6,899,680	8,963,917	10,733,818	11,390,268	5,924,356	4,497,580	48,409,619
Total liabilities	16,480,015	11,039,512	11,782,128	66,377	-	4,277,010	43,645,042
Total interest							
Sensitivity gap	(9,580,335)	(2,075,595)	(1,048,310)	11,323,891	5,924,356	220,570	4,764,577

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Market risk (continued)

Interest risk exposure (continued)

The sensitivity computations assume that loan and advances and deposits maintain a constant rate of return from one year to the next. The effect on profit due to reasonable possible changes in interest rates, with all other variables held constant, is as follows:

	2014 KShs'000	2013 KShs'000
Effect on profit before tax of a +1% change in interest rates	(16,666)	16,364
Effect on profit before tax of a -1% change in interest rates	16,666	(16,364)
Effect on equity	11,666	11,455

Foreign Currency Exchange Risk

The bank records transactions in foreign currencies at the rates in effect at the date of the transaction. The bank retranslates monetary assets and liabilities denominated in foreign currencies at the rates of exchange in effect at the reporting date. The bank holds foreign currency denominated balances for cash and bank balances and placements, loans and advances and customer deposits. All the gains or losses arising from the changes in the currency exchange rates are accounted for in profit or loss.

The bank's functional currency, the Shilling, has generally, over the recent past shown a weakening tendency against the US dollar and strengthening against the Euro, the two major currencies in which the bank has significant foreign transactions.

The US dollar

At 31 December 2014, if the US dollar had strengthened by 5% against the Shilling, with all other variables held constant, the sensitised effect on profit or loss would have been a decrease in profit before tax of KShs 2 million (2013: KShs 1 million decrease), mainly as a result of the Dollar denominated net monetary liabilities. The reverse would also occur if the Kenya Shilling weakened with all other variables held constant.

The Euro

At 31 December 2014, if the Euro had strengthened against the Shilling by 8%, with all other variables held constant, the sensitised effect on profit or loss would have been an increase in profit before tax of KShs 378,742 (2013: KShs 25.4 million) mainly as a result of the Euro denominated net monetary assets. The reverse would also occur if the Kenya Shilling weakened with all other variables held constant.

In computing the percentage change in exchange rates, management has taken into consideration the direction of the published rates movement in the functional currency against the major foreign transactional currencies over the last two years.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Market risk (continued)

Foreign Currency Exchange Risk (continued)

The table below summarises foreign currency exposure to the bank

	2014 KShs'000	2013 KShs'000
Foreign Currency Assets:		
Cash and balances with banks abroad	1,467,523	490,561
Offshore bonds	239,032	186,662
Loan and advances	10,498,902	8,240,028
Total foreign currency assets	12,205,457	8,917,251
Foreign Currency Liabilities:		
Balances due to banks abroad	1,867,006	2,448,915
Deposits	5,769,678	5,369,681
Total foreign currency liabilities	7,636,684	7,818,596
Net exposure at 31 December	4,568,773	1,098,655

40. OPERATIONAL RISK

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the bank's processes, personnel, technology and infrastructure and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the bank's operations and are faced by all business units.

The bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall bank standards for the management of operational risk in the following areas:

- Requirements for appropriate segregation of duties, including the independent authorisation of transactions
- Requirement for the reconciliation and monitoring of transactions
- Compliance with regulatory and other legal requirements
- Documentation of controls and procedures
- Requirements for the yearly assessment of operational risk faced, and the requirements of controls and procedures to address the risk identified
- Requirements for the reporting of operational losses and proposed remedial action
- Development of contingency plans
- Training and professional development
- Ethical and business standards
- Risk mitigation, including insurance where this is effective

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2014 (continued)

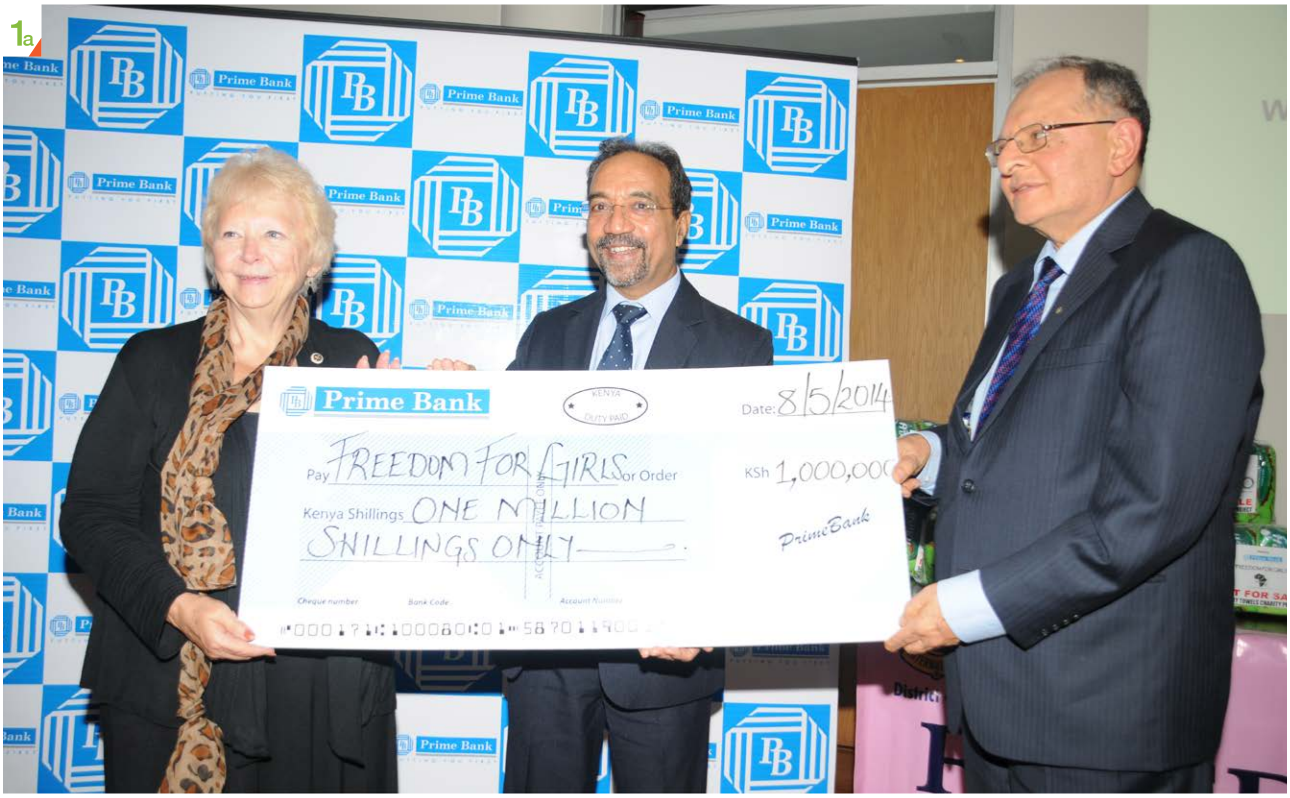
41. EVENTS AFTER THE REPORTING PERIOD

The Board of Directors approved the financial statements on 19 March 2013 and authorised that the financial statements be issued. On this date, the Directors were not aware of any matter or circumstances arising since the end of the financial year, not otherwise dealt with in the financial statements, which would significantly affect the financial position of the bank and results of its operation as laid out in these financial statements.

42. CURRENCY

These financial statements are presented in Kenya Shillings (KShs) and rounded to the nearest thousand (KShs'000).

CORPORATE SOCIAL RESPONSIBILITY



1. FREEDOM FOR GIRLS 2014

Freedom for Girls Project (FFG) is one of the flagship Corporate Social Responsibility projects Prime Bank Ltd has spon¬sored since 2009. In 2014, the Bank sponsored 2000 orphaned and vulnerable girls with a full year's supply of sanitary towels, under¬garments and health education. FFG is undertaken in conjunction with Rotary Club 9212, Lions International and Health Education Africa Resource Team (HEART) Foundation as the implementing partner.

The project has the twin effect of sup¬porting the education of the girl child through minimized absenteeism and eradication of early marriages. Prime Bank donated KSh 1million towards this noble cause. The Bank also supported the FFG Project separately in Kisumu. The girls are from various schools in different regions across the country.

Prime Bank sponsored Freedom for Girls Project in 2008 (2400 girls), 2010 (2000 girls) and 2013 (2000 girls) with a year's supply of sanitary towel and has once again stepped up to champion this cause with this year's donation.

The 2,000 girls that will be assisted this year include girls from Nyakach, Kisumu County, Loresho Primary School, Nyumbani Children's Home, Rondwe Jalaram Secondary Girls School, Kwale-Mombasa, Rohi Orphanage, Nakuru, Kitengela Academy and Desai Memorial School.

2. ST. MARY'S MISSION HOSPITAL

For yet another year, we supported St. Mary's Mission Hospital in their noble endeavor to restore sight to patients suffering from

CORPORATE SOCIAL RESPONSIBILITY

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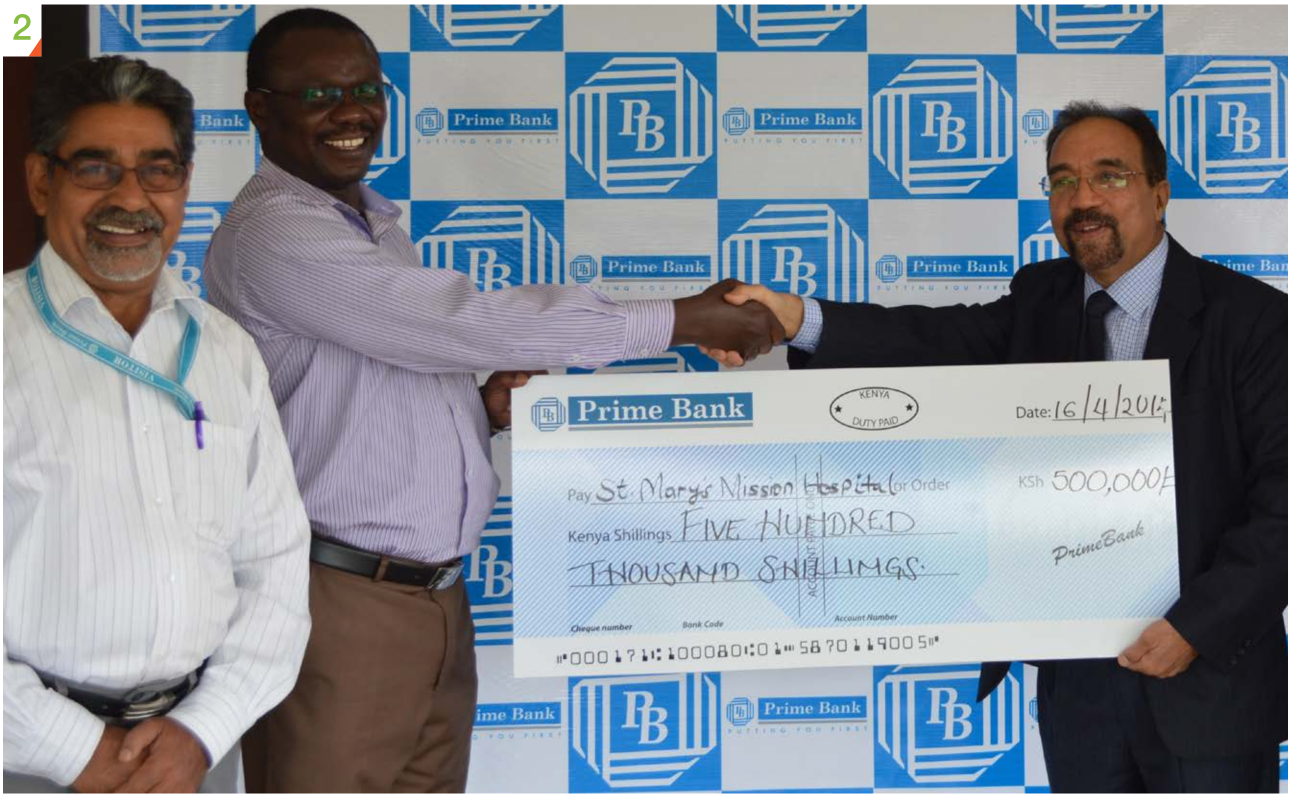

blindness caused by cataracts. The KSh 500,000 donation assisted over 100 patients undergo successful cataract operations. St. Mary's Mission Hospital conducts many eye outreach programs into remote rural areas and offer to less fortunate members of the society free eye cataract surgery.

3. MAKINI COLLEGE YOUWIN YOUTH ENTERPRISE DINNER

Makini Training and Consultancy launched an initiative dubbed YouWin Awards (Youth With Initiative Awards) in May 2013 – an initiative aimed at challenging the youth in our country to change their mindset from that of "job-seekers" to that of "job-creators".

Prime Bank sponsored the awards held in March 2014. The YouWin Awards will be held annually and will identify and re-ward youth entrepreneurs (18-35years) who are making great strides in business and enterprise.

4. ST. BARNADOS CHILDREN HOME VISIT

Prime Bank prides itself with reaching out to the less fortunate and vulnerable¬able groups in the society. Through the Corporate Social Responsibility initiative, Mr. Vicky Jotangia, the Branch Manager Westlands led staff in donating food stuff, clothing and writing material to St. Barnados Childrens home in Westlands.

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CORPORATE SOCIAL RESPONSIBILITY

5. STEREHE GIRLS' CENTRE 9TH ANNUAL FUNDRAISING

On 15th November, 2014, Starehe Girls' Centre held their 10th Anniversary Celebrations and the annual Fundraising dinner. Prime Bank donated KSh 100,000 which will go towards the sponsorship of students in the school. Prime Bank's Managing Director Mr. Bharat Jani presented the cheque to Ms. Elizabeth Kimkung on behalf of the school.

6. IN SUPPORT OF JUNIOR GOLF FOUNDATION

In 2014 the bank partnered Kenya Golf Union and Junior Golf Foundation and Visa to unveil Prime Visa Gold Golf Card. This unique concept of a gold golf card is geared towards developing talent amongst the youth through supporting JGF. Prime Bank will donate the annual subscription fees for the co-branded cards to Junior Golf Foundation (JGF).Prime Bank's Head of Card centre Ms. Jackline Oyuga presented a cheque of KSh. 50,000 to the Chairman of Junior Golf Foundation Mr. Ashwin Gidoomal.

Growth is never by mere chance; it is the result of forces working together.

- James Cash Penney

Prime Bank

PUTTING YOU FIRST