Prime Bank

PUTTING YOU FIRST

ANNUAL REPORT & FINANCIAL STATEMENTS **2016**

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:

FINANCIAL STATEMENTS:

CORPORATE INFORMATION
BOARD OF DIRECTORS


CHAIRMAN
Mr. R. C. Kantaria


Director
Mr. T. M. Davidson


Director
Mr. J. N. Mungai


Director
Mr. S. K. Shah


Director
Mr. D. G. M. Hutchison


Director
Mr. J. K. Kibet


Director
Mr. Farid Mohamed


Company Secretary
Mr. Arun Shah


Executive Director
Mr. A. R. Kantaria


Managing Director
Mr. Bharat Jani

BANK INFORMATION
FOR THE YEAR ENDED 31 DECEMBER 2016

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

MAHINDA & MAINA COMPANY ADVOCATES
P.O Box 42508 – 00100
Nairobi

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

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

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2016

"The Bank, this year, celebrates its 25th Anniversary, quite a remarkable achievement. This year, we celebrate our glorious past and look forward to shaping a future filled with innovation and progress."

It gives me great pleasure to present Prime Bank's Annual Report and Financial Statements for the year ended 31st December 2016.

The difficult economic conditions which emanated from the third quarter of 2015 continued into 2016 with the placement of two banks under receivership thereby resulting in unprecedented market turbulence affecting both interest and exchange rates. Not only was the Bank able to weather the turbulence, but also emerged stronger. The year also provided particularly useful experiences for strengthening the Bank's foundation and reinforcing our value pillars.

Given the conditions which prevailed during the year, the Bank recorded a solid performance.

OPERATING ENVIRONMENT

The year was characterized by unbalanced global economic growth. The sluggish start of the year followed by the United Kingdom's exit from the European Union, led to International Monetary Fund (IMF) reducing the world projected growth by 0.1% to 3.1% from an earlier projection of 3.2% at the beginning of the year. However, the projections materialized into the actual global economic expansion of 3.4 % powered by an uneven growth in developed countries and rebalancing of China's economy.

The Sub Saharan Africa, being resource based was adversely affected due to weakness in commodity markets and decreased economic growth to an estimated 3.0% compared to 3.4% in the previous year.

The Kenyan economy is estimated to have grown by about 5.9% in 2016 up from 5.6% in 2015. Macro economic conditions remained challenging for the better part of the year. The steady increase in oil prices and food shortages caused by drought saw inflation rate rise steadily during the year, although it remained below the Central Bank of Kenya's upper limit of 7.5 per cent.

Adverse weather remains a major concern, affecting food and energy prices. The internal security situation improved significantly but re-alignments in the run-up to the 2017 General Election raised political temperatures during the period under review.

BANKING SECTOR AND REGULATORY ENVIRONMENT

The banking sector in Kenya recorded sharp decline in earnings following the interest rate controls which reduced profit margins as well as credit uptake during the year. Upon the enactment of the amendments to the Banking Act, the lending rates were capped at 4% above the Central Bank rate with the interbank rate and 91- day Treasury bill rates touching highs of 8.2 % and 8.5 % respectively.

The cost of deposits rose significantly as banks complied with the interest rate controls, which set a floor on the returns payable on customer savings.

CHAIRMAN'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2016

The sector's averages for liquidity ratio and capital adequacy ratio stood at 41.4 percent and 18.7 percent respectively.

The Treasury offered mixed returns as the CBK sought to keep a lid on the Government's cost of borrowing. The closure of one bank in the year and liquidity imbalances dented customer confidence in the industry. The situation has improved tremendously after takeover of one of the banks by an international lender while CBK's close surveillance boosted customers' confidence. The Monetary Policy Committee raised the Central Bank Rate to 10 per cent by the close of the year.

BANK PERFORMANCE
The Bank weathered an otherwise challenging operating environment in the year to report a net profit of KShs. 1.9 billion reflecting a 5 % decline from KShs. 2 billion reported in the year 2015.

GOVERNANCE AND BOARD CHANGES
Prime Bank upholds high standards of corporate governance and continues to review its corporate governance structures in line with regulatory requirements.

In the course of the year, Mr. Farid Mohamed joined the Bank's Board. A financial advisor to the private sector, Mr. Mohamed has over 25 years experience ranging from structuring and arranging finance for large infrastructure projects in Europe, South East Asia and Latin America, to projects in industrial and energy sectors in East and Southern Africa. I take this opportunity to welcome him to the Board of Prime Bank Ltd.

CORPORATE SOCIAL RESPONSIBILITY
Our success as a bank comes from the partnership and support we have extended to communities in the areas in which we operate.

The Bank has continued to make contributions to communities under our four key pillars on Corporate Social Responsibility of health, education, gender and sports.

The Social Service League launched a state-of-the-art cardiac centre at the MP Shah Hospital which was officially inaugurated in January. The Dr. Rasik Kantaria Cardiac Centre is a boon for the heart patients, as sophisticated treatment for their ailments is now available locally and they no longer need to incur heavy expenses of seeking treatment overseas. The Bank donated KShs. 28 million towards the construction of the centre.

In one of its flagship projects of promoting the girl child education – Freedom for Girls, the Bank donated KShs 1 million, thus ensuring girls do not miss school during their monthly cycle. This year, the Bank's staff also joined in the noble cause by donating KShs. 600,000 thus augmenting the donation from the Bank to KShs. 1.6million. Since its inception, the Bank has donated KShs. 11 million thus ensuring 24,444 girls are guaranteed a full year's supply of sanitary towels and undergarments.

In order to develop talent and make golf courses accessible to the youth, the Bank has, through Prime Visa Golf Card, partnered with Kenya Golf Union, Junior Golf Foundation and Visa. This credit card has a two-fold effect in that it is designed to enable golfers enjoy a wide range of benefits on and off the course and at the same time make funds available for Junior Golf Foundation. In December 2016, the Bank presented a cheque of KShs.894, 000 as proceeds of the partnership.

Towards the year end, the Bank sponsored a colorful Christmas Party for Nyumbani Children's Home, where the staff cooked food for children and presented gifts to them.

The staff interacted and shared special moments with the children through various activities - a true reflection of the Bank's spirit of caring for communities.

2016 AND BEYOND
The Kenyan economy is expected to grow at a rate of 5.4% - 5.7% in 2017, supported by a stable macro-economic environment. However, private sector credit growth is expected to decline and this will impact businesses negatively.

CHAIRMAN'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

Completion of the first phase of the Standard Gauge Railway from Mombasa to Nairobi is expected to boost efficiency by easing movement of people and goods between the country's two biggest cities.

The award of Category One status to Kenya by the US Government is expected to culminate in the launch of direct flights to the US towards the end of the year. The direct connection to the world's biggest economy has the potential to lift Kenya's economic growth.

The general elections are slated for August 2017. We remain optimistic that presidential aspirants will conduct campaigns peacefully and the electoral agency will deliver free and fair results which will in turn set the right tone for economic growth for the next five years.

The Bank, this year, celebrates its 25th Anniversary, quite a remarkable achievement. This year, we celebrate our glorious past and look forward to shaping a future filled with innovation and progress.

As an institution which is an essential part of the nation's economic fabric, the Bank will continue to seek and tap into economic opportunities likely to yield maximum benefits for all our stakeholders.

I see a bright future for the Bank that will usher in an era of strong growth for many years to come. I believe the results reported are good, given the business environment experienced during the financial year.

APPRECIATION

On behalf of the Board of Directors, I take this opportunity to thank our customers for their continued support which is a clear demonstration of their confidence in the Bank. We also acknowledge the contribution of our partners for the growth of the Bank.

The good performance in 2016 is a testimony to the continued dedication by all our staff. I take this opportunity to thank them for their contribution and commitment to the Bank. I thank my fellow Directors for their wise counsel and commitment at both board and committee levels. In conclusion, I want to thank our regulators, the Central Bank of Kenya and the Treasury for their support and for ensuring an enabling business environment.

R. C. Kantaria
Chairman

MANAGING DIRECTOR'S STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2016

2016 marked the third year of the Bank's five-year growth blueprint - Strategic plan 2014-2018, which emphasizes on delivering value to our customers by providing quality products and efficient services. The execution of our strategic plan and our reliance on transparency and openness in all our transactions continued to reward us with strong financial performance as well as customers' confidence.

PERFORMANCE

The enactment of the Banking Amendment Act was undoubtedly the highlight of the year for the banking sector.

Despite the above limitation, coupled with sluggish economic environment which saw non-performing loans in the banking sector shoot up to 9 percent and placement of a bank under statutory management, which in turn affected liquidity across the market and loss of confidence in the sector, we remained focused on ways to boost our income, while reducing avoidable expenditure.

Despite a challenging and volatile operating environment, I am happy to report that we closed the year 2016 with profit after tax of KShs. 1.9Billion, a marginal drop from KShs. 2.03Billion reported in the previous year.

As regards asset quality, a rigorous monitoring and close supervision of our credit portfolio throughout the year ensured that the non-performing loans were well under control at 2.7% compared to the industry's average of 9% which in itself attests to the strong asset quality of the Bank.

The customers' deposits stood at KShs.49.3Billion, while total loans and advances amounted to Kshs.38.6 Billion at the close of the year.

The Shareholders' funds closed the year at KShs. 9.7Billion, well above the minimum capital requirement of KShs. 1 billion. This in turn moved the capital adequacy ratio to a significantly higher level compared to the minimum regulatory requirement of 14.5%.

OPERATIONAL HIGHLIGHTS

EXPANSION

In 2016, the Bank focused on improving service delivery and efficiency across all aspects of the Bank's operations by relying more on technological innovations.

In response to our customers' requirements for a better ambience and more space in the banking halls, we moved some of our existing branches to bigger and spacious premises. We also refurbished and gave a new look to some of our existing branches.

During the year, our ATM deployment program remained on course bringing the total number of ATMs countrywide to 16.

MEDIUM TERM NOTE

During the year, we raised Tier II Capital of KShs.1Billion ($10 million) by way of a private placement of a medium-term note, to further expand and strengthen the Bank's capital base and support future expansion plans. The issue was fully subscribed.

PRODUCT INNOVATION

We continued to commit our energies in placing our clients' needs at the forefront thus conceptualizing and developing products that help our customers optimize their business opportunities.

MANAGING DIRECTOR'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2016

To that effect, the Bank continued to offer its robust e-banking platforms- **PrimeMobi** and **PrimeNet** which allow the customers a very convenient access to the newly enhanced mobile money services and internet banking round the clock.

The i-tax platform, an efficient system with automated reconciliation continued to provide a very easy and convenient tax **payment process for our customers**.

CAPACITY BUILDING

Staff training and hiring of new talent is at the heart of Prime Bank's long term growth plans. European Investment Bank (EIB), our partner in financing of SME sector, is also providing technical training to the Bank's staff.

In 2016, to improve customer grievance handling mechanism, we set up the Quality Assurance Department to monitor and maintain high levels of service standards across all our customer contact points for maximum customer satisfaction.

THE YEAR AHEAD

This year, we are marking our silver jubilee as we celebrate 25 years of excellent service to our customers. We have lined up events and get-togethers to express our gratitude to our customers for their unstinting support.

In the last few years, we have had tremendous growth in our customer base. To cater to this segment, we have embarked on expanding our network, and during the year, we will be opening two more branches and moving some of the existing ones to bigger and spacious premises. This is intended to add banking convenience to you - our customers. We have already opened our 19th branch at the Two Rivers Mall.

In 2016, commercial banks' industry body - Kenya Bankers Association (KBA) -established a full-fledged technological payments service – PesaLink as part of a joint strategic effort to boost the banking sector's interoperability.

PesaLink provides a safe, secure and cost efficient platform for real-time money transfer services, at a low cost, across all banks in Kenya, 24 hours a day, seven days a week. This year, we will be rolling out the Pesa Link system within our **Mobile banking platform**.

The Bank will continue to invest heavily in automation and Internet-based delivery channels to fine tune our service standards.

APPRECIATION

The impressive annual results were as a result of our continued focus on the key strategic pillar - **Putting our customers first.**

We owe our success to our customers' continued support and the resilience of our business model which withstood the various macroeconomic headwinds and regulatory policy interventions during the period under review.

I thank our dear customers, staff and all other stakeholders for their admirable support to the Bank. I also wish to thank, on behalf of the management and staff of Prime Bank, our Board under the leadership of Dr. Rasik Kantaria for their continued support, encouragement and guidance. A special mention goes to our regulator, Central Bank of Kenya, for providing useful guidance throughout the year.

I assure our customers that we will continue to respond to your needs and to serve you even better - always "Putting You First"

Bharat Jani
Managing Director

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2016

The directors submit their report together with the audited financial statements for the year ended 31 December 2016. In accordance with Section 42 of the Sixth Schedule, Transitional and Saving Provisions, of the Kenyan Companies Act, 2015 this report has been prepared in accordance with Section 157 of the repealed Companies Act, as if that repeal had not taken effect.

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 21**.

3. DIVIDEND
The directors paid an interim dividend of KShs 500 million for the year ended 31 December 2016. (2015- KShs 450 million)

4. RESERVES
The reserves of the bank are set out on page **23** and note **24**.

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

Mr. R.C. Kantaria	-	Chairman (Non-Executive)
Mr. A. R. Kantaria	-	Executive
Mr. Bharat Jani	-	Managing
Mr. J.N. Mungai		
Mr. S.K. Shah		
Mr. D.G.M. Hutchison*		
Mr. T.M. Davidson*		
Mr. J.K. Kibet		
Mr. Farid Mohamed	-	Appointed on 29 August 2016

*British

6. AUDITORS
Ernst & Young LLP have expressed their willingness to continue in office in accordance with Kenyan Companies Act, 2015 and subject to Section 24(1) of the Banking Act.

By Order of the Board

A. H. Shah
Secretary

14 March 2017

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2016

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, an executive director and the Managing 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 2016 6

NAME OF DIRECTOR	NUMBER OF MEETINGS ATTENDED
Mr. R. C. Kantaria (Chairman)	6
Mr. A. R. Kantaria (Executive)	6
Mr. Bharat Jani (Managing)	6
Mr. D. G. M. Hutchison	5
Mr. J. N. Mungai	5
Mr. S. K. Shah	6
Mr. T. M. Davidson	6
Mr. J.K. Kibet	5
Mr. F. Mohamed	nil

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

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

ratings were agreed taking into account the individual ratings and comments. Overall, the Board concluded that it was operating in an effective manner.

The Board has appointed nine committees – Credit, Debt Management, Audit, Risk and Compliance, IT, Asset and Liability Management, Operations, Human Resource and Executive. 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 four of them have an additional non-executive director as a member.

CREDIT COMMITTEE

Mr. F. Mohamed, 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, the Assistant General Manager (Credit) are also present in the this 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. J. K. Kibet, a non - executive director. Mr. A. R. Kantaria, Executive Director, Mr. B. Jani, the Managing Director, the Assistant General Manager (Credit) are also present in 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, the Head of internal audit department are also present in 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 and compliance are also present in 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, Mr. B. Jani, the Managing Director and the General Manager and Head of IT are also present in this Committee. 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 Mr. B Jani, Managing Director. A. R. Kantaria, the Executive Director, the General Manager, Deputy General Manager, Assistant General Manager (Credit), Chief Manager (Treasury), Chief Manager (Accounts) and the Head of Risk and Compliance Department are the other members of the Committee.

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016 (Continued)

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 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 of the Deputy General Manager, the Director, Business Development, 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 Mr. B. Jani, the Managing Director and has, A. R. Kantaria, the Executive Director, Deputy General Manager and Senior 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 Managing Director, 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.

The Kenyan Companies Act, 2015 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 profit or loss results for that year. It also requires the directors to ensure the bank maintains proper accounting records that are sufficient to show and explain the transactions of the company and disclose, with reasonable accuracy, the financial position of the bank. They directors are also responsible for safeguarding the assets of the bank and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

STATEMENT OF DIRECTORS' RESPONSIBILITIES ON THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016

The directors accept responsibility for the preparation and presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. They also accept responsibility for:

(i) designing, implementing and maintaining such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;

(ii) selecting suitable accounting policies and applying them consistently; and

(iii) making accounting estimates and judgements that are reasonable in the circumstances.

Having made an assessment of the company's ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the company's ability to continue as a going concern.

The directors acknowledge that the independent audit of the financial statements does not relieve them of their responsibilities.

Approved by the board of directors on 14 March 2017 and signed on its behalf by:

………………………………………….
Director

………………………………………….
Director

………………………………………….
Director

………………………………………….
Director

14 March 2017
………………………………………….
Date

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PRIME BANK LIMITED
FOR THE YEAR ENDED 31 DECEMBER 2016

REPORT ON THE FINANCIAL STATEMENTS

Opinion

We have audited the accompanying financial statements of Prime Bank Limited set out on pages 20 to 85, which comprise the statement of financial position as at 31 December 2016, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Prime Bank Limited as at 31 December 2016, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015*.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code, and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

The directors are responsible for the other information. The other information comprises the Directors' Report as required by the Kenyan Companies Act, 2015. The other information does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PRIME BANK LIMITED (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

RESPONSIBILITIES OF THE DIRECTORS FOR THE FINANCIAL STATEMENTS

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for overseeing the Company's financial reporting processes.

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PRIME BANK LIMITED (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

REPORT ON OTHER LEGAL REQUIREMENTS

As required by the Kenyan Companies Act 2015, 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;

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PRIME BANK LIMITED (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

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 auditor's report was CPA Churchill Atinda Practising Certificate No. P.1425

Ernst & Young

Certified Public Accountants, Nairobi

31 March ……………………………………..2017

**In accordance with Section 42 of the Sixth Schedule, Transitional and Saving Provisions, of the Kenyan Companies Act, 2015, the company's financial statements and this report have been prepared in accordance with Sections 147 to 163 of the repealed Companies Act, as if that repeal had not taken effect.*

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2016

	Note	2016 KShs'000	2015 KShs'000
ASSETS			
Cash and balances with the Central Bank of Kenya	5	3,200,067	4,103,641
Placements and balances with other banks	6	2,713,176	1,591,726
Treasury bills and term notes	7	6,106,650	6,703,031
Held to maturity investments	8	7,688,071	7,243,023
Investment in bonds-available for sale	9	3,698,408	2,912,557
Investment in ordinary shares available for sale	10	981,561	930,275
Loans and advances to customers	11	38,559,603	39,845,100
Other assets	12	479,928	436,582
Investment in associate	13	372,648	329,321
Leasehold land	14	340,000	54,248
Property and equipment	15	970,664	514,981
Intangible assets	16	159,642	163,705
Tax recoverable	22	67,793	18,147
Deferred tax asset	17	-	155,315
TOTAL ASSETS		**65,338,211**	**65,001,652**
LIABILITIES AND EQUITY			
LIABILITIES			
Balances due to banks and financial institutions	18	3,499,822	4,873,763
Medium term note	19	1,024,000	-
Deposits from customers	20	49,322,594	50,880,558
Other liabilities	21	583,772	522,124
Deferred tax liability	17	74,030	-
TOTAL LIABILITIES		**54,504,218**	**56,276,445**
EQUITY			
Share capital	23	5,000,000	5,000,000
Reserves	24	5,833,993	3,725,207
TOTAL EQUITY		**10,833,993**	**8,725,207**
TOTAL LIABILITIES AND EQUITY		**65,338,211**	**65,001,652**

These financial statements were approved by the Board of Directors on 14 March 2017 and signed on its behalf by:

Sushal ………………………………………… Directors

………………………………………… Directors

………………………………………… Directors

………………………………………… Directors

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 KShs'000	2015 KShs'000
Interest income	25	7,578,910	6,981,582
Interest expense	26	(4,027,947)	(3,627,563)
Net interest income		3,550,963	3,354,019
Fees and commission income	27	467,432	446,816
Foreign exchange gains		298,311	442,441
Dividend income		19,779	49,562
Other income	28	141,421	174,707
		4,477,906	4,467,545
Allowance for impairment of loans and advances	29	(209,484)	(152,022)
Other operating expenses	30	(1,998,457)	(1,766,326)
Profit before tax and share of profit of associate	31	2,269,965	2,549,197
Share of profit of associate	13	65,857	43,558
Profit before tax		2,335,822	2,592,755
Income tax expense	22	(431,116)	(569,566)
Profit for the year		1,904,706	2,023,189
Earnings per share (basic and diluted) (KShs)	32	381	405

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 KShs'000	2015 KShs'000
Profit for the year		1,904,706	2,023,189
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Available for sale financial assets:			
Gain/(loss) arising during the year		191,370	(693,007)
Reclassification of available for sale reserve to profit or loss on sale of investments		(29,296)	35,364
		162,074	(657,643)
Other comprehensive income that will not be reclassified to profit or loss in subsequent periods:			
Revaluation of land and buildings		774,295	-
Deferred income tax on revaluation surplus	17	(232,289)	-
		542,006	-
Share of other comprehensive income from associate	13	-	(25,359)
Other comprehensive income for the year, net of tax		704,080	(683,002)
Total comprehensive income for the year, net of tax		2,608,786	1,340,187

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 2016

	Share capital KShs'000	Retained earnings KShs'000	Available for-sale reserve KShs'000	Asset revaluation reserve KShs'000	Total equity
At 1 January 2015	**3,000,000**	**3,934,080**	**800,940**	**-**	**7,735,020**
Reserves capitalized (note 24)	1,900,000	(1,900,000)	-	-	-
Issued and paid up ordinary shares	100,000	-	-	-	100,000
Dividends paid – 2015					
(note 34)	-	(450,000)	-	-	(450,000)
Total comprehensive income					
– profit for the year	-	2,023,189	-	-	2,023,189
- other comprehensive income	-	-	(683,002)	-	(683,002)
At 31 December 2015	**5,000,000**	**3,607,269**	**117,938**	**-**	**8,725,207**

	Share capital KShs'000	Retained earnings KShs'000	Available for-sale reserve KShs'000	Asset revaluation reserve KShs'000	Total equity
At 1 January 2016	**5,000,000**	**3,607,269**	**117,938**	**-**	**8,725,207**
Dividends paid – 2016					
(note 34)	-	(500,000)	-	-	(500,000)
Total comprehensive income		-			
– profit for the year	-	1,904,706	-	-	1,904,706
- other comprehensive income	-	-	162,074	542,006	704,080
At 31 December 2016	**5,000,000**	**5,011,975**	**280,012**	**542,006**	**10,833,993**

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 KShs'000	2015 KShs'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		2,335,822	2,592,755
Adjustment for:			
Gain on disposal of property and equipment		(7,721)	(6,761)
Dividends received		(19,779)	(49,562)
Effect of foreign exchange gain on translation of foreign currency balances held		(298,311)	(454,484)
Provision for staff leave		580	13
Allowances for impairment of loans and advances	29	209,484	152,022
Share of profit of associate	13	(65,857)	(43,558)
Amortisation of leasehold land	14	859	1,361
Depreciation on property and equipment	15	100,276	97,503
Impairment loss	15	2,020	-
Amortisation of intangible assets	16	73,920	64,652
Write-off of intangible assets	16	635	-
Loss on sale of available for sale investments		-	34,916
Gain on sale of available for sale investments		(29,296)	(448)
CASH FLOWS FROM OPERATING ACTIVITIES BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		2,302,632	2,388,409
Decrease/(increase) in cash ratio reserve		39,282	(43,038)
(Increase)/decrease in securities maturing after 91 days		(2,275,648)	1,768,038
Decrease/(increase) in loans and advances to customers		1,076,013	(6,574,646)
Increase in other assets		(43,346)	(133,848)
(Decrease)/increase in deposits from customers		(1,557,964)	5,805,513
Medium term note issued (note 17)		1,024,000	-
Increase in other liabilities		61,648	133,167
Cash flows from operating activities		626,617	3,343,595
Income taxes paid	22	(483,706)	(643,977)
NET CASHFLOWS GENERATED FROM OPERATING ACTIVITIES		142,911	2,699,618
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of property and equipment		48,349	6,761
Dividend income		19,779	49,562
Proceeds from redemption of held to maturity investments	8	1,725,976	2,551,770
Proceeds from redemption of treasury bills and term notes	7	13,697,336	11,321,666
Proceeds from sale of investments in bonds-available for sale	9	1,722,796	1,943,393
Proceeds from sale of ordinary shares- available for sale		-	26,336
Purchase of ordinary shares - available for sale	10	(23,671)	(70,302)
Dividend from associate	13	22,530	18,860
Purchase of held to maturity investments	8	(2,171,024)	(4,201,976)

STATEMENT OF CASH FLOWS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

	Note	2016 KShs'000	2015 KShs'000
Purchase of treasury bills and term notes	7	(13,100,955)	(10,561,228)
Purchase of investments in bonds- available for sale	9	(2,344,949)	(3,168,086)
Purchase of property and equipment¬	15	(110,923)	(117,380)
Purchase of intangible assets	16	(70,492)	(44,357)
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(585,248)	(2,244,981)
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends paid during the year	34	(500,000)	(450,000)
Issue of shares	23	-	100,000
NET CASH FLOWS USED IN FINANCING ACTIVITIES		(500,000)	(350,000)
Net (decrease) / increase in cash and cash equivalents		(942,338)	104,637
Effect of foreign exchange gain on translation of foreign currency balances held		146,457	454,918
Cash and cash equivalents at 1 January		1,919,566	1,360,011
Cash and cash equivalents at 31 December	35	1,123,685	1,919,566

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2016

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, 2015.

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

New and amended standards and interpretations

The bank applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2016. The bank has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The nature and the effect of these changes are disclosed below. Although these new standards and amendments applied for the first time in 2016, they did not have a material impact on the annual financial statements of the bank. The nature and the impact of each new standard or amendment is described below:

IFRS 14 Regulatory Deferral Accounts

IFRS 14 is an optional standard that allows an entity, whose activities are subject to rate-regulation, to continue applying most of its existing accounting policies for regulatory deferral account balances upon its first-time adoption of IFRS. Entities that adopt IFRS 14 must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of profit or loss and OCI. The standard requires disclosure of the nature of, and risks associated with, the entity's rate-regulation and the effects of that rate-regulation on its financial statements.

Since the bank is an existing IFRS preparer and is not involved in any rate-regulated activities, this standard does not apply.

Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests in Joint Operations

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 Business Combinations principles for business combination accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation if joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party. The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are applied prospectively. These amendments do not have any impact on the bank as it does not have any interest in joint operations.

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

The amendments clarify the principle in IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is a 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 applied prospectively and do not have any impact on the bank, given that it has not used a revenue-based method to depreciate its non-current assets.

Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants

The amendments change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of IAS 41 Agriculture. Instead, IAS 16 will apply. After initial recognition, bearer plants will be measured under IAS 16 at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce that grows on bearer plants will remain in the scope of IAS 41 measured at fair value less costs

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants (continued)

to sell. For government grants related to bearer plants, IAS 20 Accounting for Government Grants and Disclosure of Government Assistance will apply. The amendments are applied retrospectively and do not have any impact on the bank as it does not have any bearer plants.

Amendments to IAS 27: Equity Method in Separate Financial Statements

The amendments 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 their separate financial statements have to apply that change retrospectively. These amendments will not have any impact on the bank, as the bank does not prepare separate financial statements.

Annual Improvements 2012-2014 Cycle

These improvements include:

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 the 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. This amendment is applied prospectively.

IFRS 7 Financial Instruments: Disclosures

i) 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 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be made retrospectively. However, the required disclosures need not be provided for any period beginning before the annual period in which the entity first applies the amendments.

ii) Applicability of the amendments to IFRS 7 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. This amendment is 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. This amendment is 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. This amendment is applied retrospectively. These amendments do not have any impact on the bank.

Amendments to IAS 1 Disclosure Initiative

The amendments to IAS 1 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

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

Amendments to IAS 1 Disclosure Initiative (continued)

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 OCI. These amendments do not have any impact on the bank.

Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 Consolidated Financial Statements. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 Investments in Associates and Joint Ventures allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries. These amendments are applied retrospectively and do not have any impact on the bank as the bank does not prepare consolidated financial statements.

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the bank's financial statements are disclosed below. The bank intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

Introduction

In July 2014, the IASB issued IFRS 9 Financial Instruments, the standard that will replace IAS 39 for annual periods on or after 1 January 2018, with early adoption permitted.

Classification and measurement

From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories will be replaced by: fair Value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortised cost. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or fair value through OCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to profit or loss.

The accounting for financial liabilities will largely be the same as the requirements of IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements will be presented in OCI with no subsequent reclassification to profit or loss, unless an accounting mismatch in profit or loss would arise.

Having completed its initial assessment, the Bank has concluded that:

- The majority of loans and advances to banks, loans and advances to customers, cash collateral

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

IFRS 9 Financial Instruments (continued)

Classification and measurement (continued)

for reverse repo agreements and cash settlement balances with clearing houses that are classified as loans and receivables under IAS 39 are expected to be measured at amortised cost under IFRS 9

- Financial assets and liabilities held for trading and financial assets and liabilities designated at FVPL are expected to be continue to be measured at FVPL

- The majority of the debt securities classified as available for sale under IAS 39 are expected to be measured at amortised cost or FVOCI. Some securities, however, will be classified as FVPL, either because of their contractual cash flow characteristics or the business model within which they are held

- Debt securities classified as held to maturity are expected to continue to be measured at amortised cost.

Hedge accounting

IFRS 9 allows entities to continue with the hedge accounting under IAS 39 even when other elements of IFRS become mandatory on 1 January 2018. The Bank does not have any hedging instruments.

Impairment of financial assets

Overview

IFRS 9 will also fundamentally change the loan loss impairment methodology. The standard will replace IAS 39's incurred loss approach with a forward-looking expected loss (ECL) approach. The bank will be required to record an allowance for expected losses for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.

The Bank has established a policy to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

- To calculate ECL, the Bank will estimate the risk of a default occurring on the financial instrument during its expected life. ECLs are estimated based on the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e., the difference between: the contractual cash flows that are due to the Bank under the contract; and,

- The cash flows that the Bank expects to receive, discounted at the effective interest rate of the loan.

In comparison to IAS 39, the Bank expects the impairment charge under IFRS 9 to be more volatile than under IAS 39 and to result in an increase in the total level of current impairment allowances.

Forward looking information

The bank will incorporate forward-looking information in both the assessment of significant increase in credit risk and the measurement of ECLs. The bank considers forward-looking information such as macroeconomic factors (e.g., unemployment, GDP growth, interest rates and house prices) and economic forecasts. To evaluate a range of possible outcomes, the bank intends to formulate three scenarios: a base case, a worse case and a better case. The base case scenario represents the more likely outcome resulting from the bank's normal financial planning and budgeting process, while the better and worse case scenarios represent more optimistic or pessimistic outcomes. For each scenario, the bank will derive an ECL and apply a probability weighted approach to determine the impairment allowance. The bank will use internal information coming from internal economic experts, combined with published external information from government and private economic forecasting services. The Risk, Compliance and Finance management teams will need to approve the forward-looking assumptions

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

IFRS 9 Financial Instruments (continued)

Impairment of financial assets (continued)

before they are applied for different scenarios.

Limitation of estimation techniques

The models that will be applied by the bank may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to need to be made until the base models are updated. Although the bank will use data that is as current as possible, models used to calculate ECLs will be based on data that is one month in arrears and adjustments will be made for significant events occurring prior to the reporting date.

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 Leases).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The bank does not anticipate early adopting IFRS 15 and is currently evaluating its impact.

IFRS 16 Leases

The IASB issued the new standard for accounting for leases - IFRS 16 Leases in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in profit or loss. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach.

The bank does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively.

IFRS 2 Classification and Measurement of Share-based Payment Transactions — Amendments to IFRS 2

The IASB issued amendments to IFRS 2 Share-based Payment that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled. On adoption, entities are required to apply

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

IFRS 2 Classification and Measurement of Share-based Payment Transactions — Amendments to IFRS 2 (continued)

the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted. The amendment has no effect on bank's financial statements.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts - Amendments to IFRS 4

The amendments introduce two options for entities issuing insurance contracts: a temporary exemption from applying IFRS 9 and an overlay approach.

Temporary exemption from IFRS 9

The optional temporary exemption from IFRS 9 is available to entities whose activities are predominantly connected with insurance. The temporary exemption permits such entities to continue to apply IAS 39 Financial Instruments: Recognition and Measurement while they defer the application of IFRS 9 until 1 January 2021 at the latest. Predominance must be initially assessed at the annual reporting date that immediately precedes 1 April 2016 and before IFRS 9 is implemented. Also the evaluation of predominance can only be reassessed in rare cases. Entities applying the temporary exemption will be required to make additional disclosures.

The overlay approach

The overlay approach is an option for entities that adopt IFRS 9 and issue insurance contracts, to adjust profit or loss for eligible financial assets; effectively resulting in IAS 39 accounting for those designated financial assets. The adjustment eliminates accounting volatility that may arise from applying IFRS 9 without the new insurance contracts standard. Under this approach, an entity is permitted to reclassify amounts between profit or loss and other comprehensive income (OCI) for designated financial assets. An entity must present a separate line item for the amount of the overlay adjustment in profit or loss, as well as a separate line item for the corresponding adjustment in OCI.

The temporary exemption is first applied for reporting periods beginning on or after 1 January 2018. An entity may elect the overlay approach when it first applies IFRS 9 and apply that approach retrospectively to financial assets designated on transition to IFRS 9. The entity restates comparative information reflecting the overlay approach if, and only if, the entity restates comparative information when applying IFRS 9. The overlay approach requires an entity to remove from profit or loss additional volatility that may arise if IFRS 9 is applied with IFRS 4. When applying the temporary exemption, entities must still provide extensive disclosure that require the application of some aspects of IFRS 9. The amendment is effective from 1 January 2018. The amendments will not have an impact on the bank as it does not have insurance contracts.

Transfers of Investment Property (Amendments to IAS 40)

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date. Retrospective application in accordance with IAS 8 is only permitted if that is possible without the use of hindsight. Early application of the amendments is permitted and must be disclosed. The amendment is effective from 1 January 2018. The Bank is currently evaluating the impact.

Amendments to IAS 7 Statement of Cash Flows

In January 2016, the IASB issued amendments to IAS 7 Statement of Cash Flows with the intention to improve

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

Amendments to IAS 7 Statement of Cash Flows (continued)

disclosures of financing activities and help users to better understand the reporting entities' liquidity positions. Under the new requirements, entities will need to disclose changes in their financial liabilities as a result of financing activities such as changes from cash flows and non-cash items (e.g., gains and losses due to foreign currency movements). The amendment is effective from 1 January 2017. The bank is currently evaluating the impact.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the nonmonetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration.

The amendments are intended to eliminate diversity in practice, when recognising the related asset, expense or income (or part of it) on the derecognition of a nonmonetary asset or non-monetary liability relating to advance consideration received or paid in foreign currency. Entities may apply the amendments on a fully retrospective basis. Alternatively, an entity may apply the interpretation prospectively to all assets, expenses and income in its scope that are initially recognised on or after:

(i) The beginning of the reporting period in which the entity first applies the interpretation; or,

(ii) The beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

Early application of interpretation is permitted and must be disclosed. This is effective for annual periods beginning on or after 1 January 2018. The bank is currently evaluating the impact

IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognised in the opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact. These amendments are effective for annual periods beginning on or after 1 January 2017 with early application permitted. If an entity applies the amendments for an earlier period, it must disclose that fact. These amendments are not expected to have any impact on the bank.

Annual Improvements 2014-2016 Cycle

These improvements include:

IFRS 1 First-time Adoption of International Financial Reporting Standards

Short-term exemptions in paragraphs E3–E7 of IFRS 1 were deleted because they have now served their intended purpose. The amendment is effective from 1 January 2018.

IAS 28 Investments in Associates and Joint Ventures

The amendments clarifies that:

- An entity that is a venture capital organisation, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

New and amended standards and interpretations (continued)

IAS 28 Investments in Associates and Joint Ventures (continued)

fair value through profit or loss.

- If an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which (a) the investment entity associate or joint venture is initially recognised; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent.

The amendments should be applied retrospectively and are effective from 1 January 2018, with earlier application permitted. If an entity applies those amendments for an earlier period, it must disclose that fact.

IFRS 12 Disclosure of Interests in Other Entities

The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10–B16, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale. The amendments are effective from 1 January 2017 and 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 and land and buildings which have been measured at fair value.

For the Kenyan Companies Act, 2015 reporting purposes, in these financial statements, the balance sheet is represented by the statement of financial position and the profit and loss account is represented by the income statement and the statement of comprehensive income.

(b) Fair value measurement

The bank measures financial instruments and land and buildings at fair value at each reporting 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 principal or the most advantageous market must be accessible by the bank. 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 made in note 42.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Fair value measurement(continued)

The bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities

- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable

- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognised in the financial statements on a recurring basis, the bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

External valuers are involved for valuation of significant assets, such as properties.

(c) Financial assets and liabilities

(i) Recognition

The Bank initially recognises loans and advances, on the date that they are originated. Financial assets and liabilities are initially recognised on the trade date, i.e. the date at which the Bank becomes a party to the contractual provisions of the instrument.

(ii) Initial measurement

All financial instruments are measured initially at their fair value plus transaction costs, except for financial assets and financial liabilities recorded at fair value through profit or loss. The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics.

(iii) Subsequent 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 investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity, and which are not designated at fair value through profit or loss or available-for-sale, or do not meet the definition of loans and receivables.

After initial recognition, held-to-maturity investments are carried at amortised cost using the effective interest method less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. Any sale or reclassification of a significant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available-for-sale.

2) Loans and receivables

These include placements and balances with other banks, loans and advances to customers, cash and balances with Central Bank of Kenya, treasury bills and terms notes. These are non-derivative financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial assets and liabilities (continued)

(iii) Subsequent measurement (continued)

2) **Loans and receivables (continued)** not entered are 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 other banks, loans and advances to customers, treasury bills and terms notes are 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 investments are non-derivative investments that are designated as available for sale or are not classified as (a) loans and receivables, (b) held to maturity or (c) financial assets at fair value through profit and loss. These are those securities 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 equity securities whose fair value cannot be reliably measured are carried at cost. All other available-for-sale investments are carried at fair value, with unrealised gains/ losses recognised as other comprehensive income and credited in the available for sale reserve until the investment is derecognised, at which time, the cumulative gain or loss is recognised in profit or loss, or the investment is determined to be impaired, when the cumulative loss is reclassified from the available-for-sale reserve to profit or loss. Foreign exchange gains or losses on available-for-sale debt security investments are 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.

The bank has not designated any loans or receivables as available for sale.

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.

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash on hand, unrestricted current accounts with Central Bank of Kenya, amounts due from banks, government securities and term notes with an original maturity of three months or less, less balances due to banks and financial institutions.

Financial liabilities

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, plus directly attributable transaction costs.

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial assets and liabilities (continued)

Subsequent measurement

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

4) Cash and cash equivalents (continued)

near term. Gains or losses on liabilities held for trading are recognised in the income statement.

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.

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.

Borrowings are recognised initially at fair value. After initial measurement, borrowings are subsequently measured at amortised cost using the effective interest rate method

(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.

(v) Offsetting of financial instruments

Financial assets

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

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial assets and liabilities (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. 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 whether objective evidence of impairment exists for financial assets that are 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 asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not 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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial assets and liabilities (continued)

(viii) Impairment of financial assets (continued)

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

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 asset'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 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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial assets and liabilities (continued)

(viii) Impairment of financial assets (continued)

3) Available-for-sale financial assets (continued)

financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) 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.

(d) 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.

(ii) Fees and commission income

The bank earns fees 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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Recognition of income and expenses (continued)

(iii) Dividend income

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

(e) Property and equipment

Property and equipment, except for land and buildings, are stated at cost less accumulated depreciation and impairment in value.

Land and buildings are measured at fair value at the dates of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses on buildings. Valuations are performed every three years to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

A revaluation surplus is recorded in other comprehensive income and credited to the asset revaluation reserve in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in profit or loss, the increase is recognised in profit and loss. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation reserve.

An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation is calculated on the straight-line basis at annual rates estimated to write off carrying amounts of the assets 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 depreciated over their shorter of the estimated useful lives 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 assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted prospectively if appropriate, at each financial year-end.

(f) Foreign currency translation

Transactions in foreign currencies 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 translation 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.

(g) 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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Employee benefits (continued)

(i) Defined contribution plans (continued)

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.

(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.

(h) Taxation

1. 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.

2. 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 at the reporting date.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Taxations (continued)

2. Deferred tax (continued)

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 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.

3. Value added tax

Expenses and assets are recognised net of Value added 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.

(i) 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.

(j) 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 in the income statement.

(k) 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 an 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:

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Intangible assets (continued)

- Computer software 5 years
- Visa license 5 years

(l) Dividends

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

(m) 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 expense categories consistent with the function of the impaired asset, except for properties previously revalued with the revaluation surplus taken to OCI. For such properties, the impairment is recognised in OCI up to the amount of any previous revaluation.

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 income statement unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

(n) 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 Other Comprehensive Income OCI of the associate 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 associate.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) Investment in an associate (continued)

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 amount is recognized in the 'share of losses of an associate' in the bank's income statement.

(o) 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. The expense relating to any provision is presented in profit or loss net of any reimbursement.

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 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 11 and discussed further in note 44.

(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. The bank treats 'significant' generally as 20% of cost and 'prolonged' as greater than 1 year. 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 9 and 10.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(o) Provisions (continued)

(ii) 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 42.

4. 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 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 11 and discussed further in note 44.

(ii) Impairment of available-for-sale investments

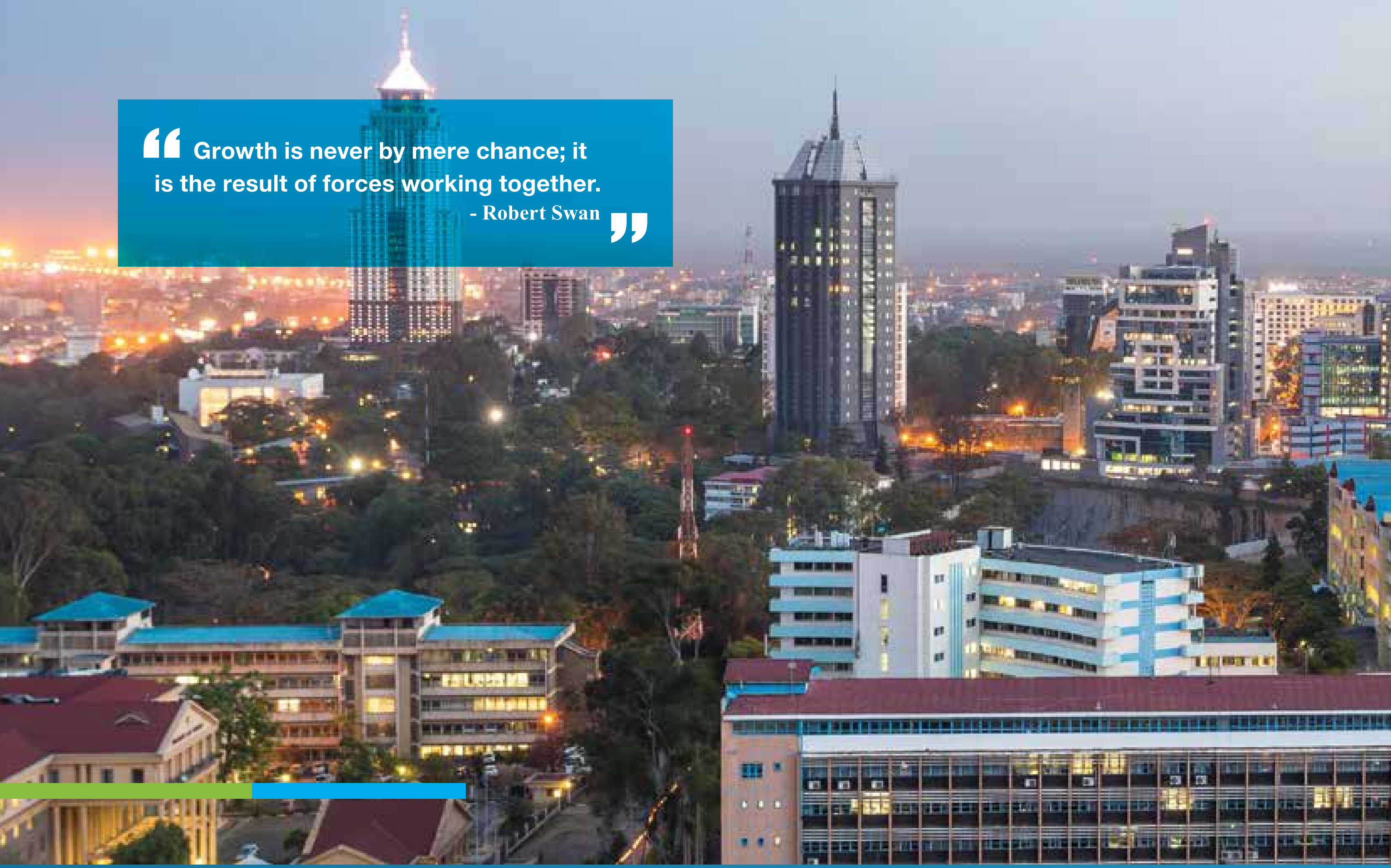
The bank reviews its debt securities classified as available–for–sale investments at each reporting date to assess whether they are impaired. This requires similar judgement as applied to the individual assessment of loans and advances.

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. The bank treats 'significant' generally as 20% of cost and 'prolonged' as greater than 1 year. 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 9 and 10.

(iii) Fair value of financial instruments

Where the fair values of financial assets and financial



> Growth is never by mere chance; it is the result of forces working together.
> - Robert Swan

BANK PROFILE

Introduction

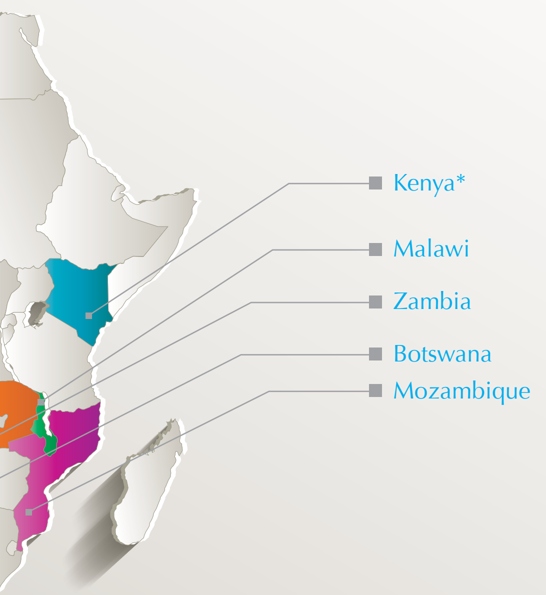
Prime Bank Ltd is one of the leading Private Banks in Kenya and was founded in 1992. With 25 years of experience, Prime Bank has the expertise to deliver flexible, efficient and personalized service, ensuring our customers profit from the best. Prime Bank has regional presence in Malawi, Botswana, Mozambique and Zambia through First Merchant Bank in Malawi.

Bank's Growth

- In 2016, the core capital of the bank grew to Kshs. 9.74 billion, against the statutory requirements of Kshs. 1 billion.
- Customer deposits stood at Kshs. 49.31 billion, while Total Net Advances stood at Kshs. 39.35 billion
- Profit after tax stood at Kshs. 1.90 billion
- The liquidity position and other statutory ratios of the Bank have been much above the requirement of Central Bank of Kenya.

Affiliations & Correspondent Relationships

The Bank has correspondent banking relationships with Citibank N.A, New York, London, Frankfurt, Standard Bank of South Africa Limited, Johannesburg, Standard Chartered Bank Limited, London/Mumbai/Nairobi, ICICI Bank – India/ China/ Hong Kong/ Singapore/ UAE, Development Credit Bank Limited, India, Barclays Bank of Kenya Limited, Nairobi, KBC Bank, Belgium, Mashreq Bank PSC Dubai and New York, Habib Bank AG Zurich-Dubai, UAE, Bank of Commerce and Placements, Geneva, Switzerland, Bank of Beirut UK Limited, London/Germany, China Construction Bank Corporation, Shanghai, Bank of China Limited, China, SBM BankLimited, Port Louis, Mauritius, Danske Bank Limited, Sweden, UniCredit Bank Limited, Austria/Italy, United Bank Limited, Dubai, UAE, Capital Bank Limited, Botswana, First Capital Bank of Zambia Ltd., Zambia, First Capital Bank of Mozambique Ltd., Mozambique, First Merchant Bank, Malawi, Bank Sarasin, Dubai, UAE, Affiliations with DFIs: International Finance Corporation (IFC)- Washington -the private sector development arm of the World Bank Group, who have extended a trade finance guarantee facility to the Bank. This enables the Bank to offer full-fledged trade finance and foreign exchange services. Prime Bank has signed finance contracts with EIB and Proparco for SME financing.



*In Kenya, Prime Bank has a network of 19 branches.
Nairobi (13) Mombasa (2) Kisumu (1)Eldoret (1) Nakuru (1) Thika (1)




NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

4. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

(iii) Fair value of financial instruments (continued)

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 42.

5. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2016 KShs'000	2015 KShs'000
Cash in hand	543,618	408,186
Balances with Central Bank of Kenya:		
-Restricted balances (Cash Reserve Ratio)	1,391,910	1,431,192
-Unrestricted balances	764,362	1,701,037
Cheques and items for clearing	500,177	563,226
	3,200,067	4,103,641

The Cash Reserve Ratio is non-interest earning and is based on the value of deposits as adjusted for the Central Bank of Kenya requirements. At 31 December 2016, the Cash Reserve Ratio requirement was 5.25% (2015 – 5.25%) of all qualifying deposits.

These funds are available for use by the Bank in its day-to-day operations in a limited way provided that on any given day this balance does not fall below the 3.00% requirement and provided that the overall average in the month is at least 5.25%.

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

6. PLACEMENTS AND BALANCES WITH OTHER BANKS

	2016 KShs'000	2015 KShs'000
Lending to other banks and financial institutions	1,943,583	1,185,175
Balances with banks outside Kenya	769,593	406,551
	2,713,176	1,591,726

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

7. TREASURY BILLS AND TERM NOTES

	2016 KShs'000	2015 KShs'000
As at 1 January	6,703,031	7,463,469
Purchase of investment securities	13,100,955	10,561,228
Retirement of investment securities	(13,697,336)	(11,321,666)
As at 31 December	6,106,650	6,703,031
Treasury bills		
Maturing within 91 days of the date of acquisition	-	2,225,650
Maturing after 91 days to 182 days of the date of acquisition	3,922,171	1,500,755
Maturing after 182 days of the date of acquisition	1,675,897	2,083,800
Term notes		
Maturing within 91 days of the date of acquisition	102,174	303,504
Maturing after 91 days to 182 days of the date of acquisition	29,911	167,552
Maturing after 182 days of the date of acquisition	376,497	421,770
	6,106,650	6,703,031

Treasury bills are debt securities issued by the Government of Kenya and are classified as loans and receivables. The weighted average effective interest rate on the treasury bills as at 31 December 2016 was 10.91% (2015: 10.63%). Term notes are debt instruments issued by private and public entities for varied terms and maturity dates.

8. HELD TO MATURITY INVESTMENTS

	2016 KShs'000	2015 KShs'000
As at 1 January	7,243,023	5,592,817
Purchase of investment securities	2,171,024	4,201,976
Retirement of investment securities	(1,725,976)	(2,551,770)
As at 31 December	7,688,071	7,243,023
Treasury bonds		
Maturing after 182 days of the date of acquisition	7,688,071	7,243,023

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

9. 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 bond issued by 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.

	2016 KShs'000	2015 KShs'000
As at 1 January	2,912,557	1,928,885
Purchase of investment securities	2,344,949	3,168,086
Sales of investment securities	(1,722,796)	(1,943,393)
Foreign exchange gain	33,977	12,043
Gain/(loss) on fair valuation	129,721	(253,064)
As at 31 December	3,698,408	2,912,557
The maturity profile is as follows:		
Within one year	-	18,767
After one year but within two years	8,084	402,510
After two years but within five years	440,821	430,385
After five years	3,249,503	2,060,895
	3,698,408	2,912,557

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

a) Investment in listed shares:

	2016 KShs'000	2015 KShs'000
Investment as at 1 January	686,151	1,064,732
Purchase of shares	-	51,886
Sale of shares	-	(25,888)
Gain / (loss) in fair value	32,353	(404,579)
As at 31 December	718,504	686,151

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. The fair value movement relating to First Merchant Bank, Malawi amounts to a gain of KShs 51.6 million (2015: loss of KShs. 396.6 million).The fair value movement relating to locally held shares amounts to a loss of KShs 19.3 million (2015: KShs 8 million).

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

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

b) Investment in privately held shares:

	2016 KShs'000	2015 KShs'000
Capital Bank Limited, Botswana	96,445	96,258
Capital Bank Mozambique	142,080	118,596
Cooperative Bank Plc, United Kingdom	24,532	29,270
As at 31 December	263,057	244,124
The movement in these shares is summarised as below:		
As at 1 January	244,124	201,536
Purchase of shares	23,671	18,416
Foreign exchange (loss)/gain	(4,738)	24,172
As at 31 December	263,057	244,124

Investment in privately held shares comprise investments 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.

	2016 KShs'000	2015 KShs'000
Investment in listed shares (note 10a)	718,504	686,151
Investment in privately held shares (note 10b)	263,057	244,124
Total investment in ordinary shares available for sale	981,561	930,275

11. LOANS AND ADVANCES TO CUSTOMERS

a) Loans and advances to customers

	2016 KShs'000	2015 KShs'000
a) Loans and advances to customers (gross)	39,824,616	40,822,365
Less – Allowances on impairment of loans and advances (note 11 (b))	(1,265,013)	(977,265)
Loans and advances to customers net of allowances	38,559,603	39,845,100

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

11. 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 2016	278,558	290,914	407,793	977,265
Bad debts written off	(13,902)	(43,780)	-	(57,682)
Allowances and suspended interest reversed	(49,564)	(23,428)	-	(72,992)
Suspended interest during the year	-	207,762	-	207,762
Allowance during the year	167,197	-	43,463	210,660
At 31 December 2016	382,289	431,468	451,256	1,265,013
At 1 January 2015	374,552	204,072	338,231	916,855
Bad debts written off	(55,694)	(2,240)	-	(57,934)
Allowances and suspended interest reversed	(109,300)	(16,727)	-	(126,027)
Suspended interest during the year	-	105,809	-	105,809
Allowance during the year	69,000	-	69,562	138,562
At 31 December 2015	278,558	290,914	407,793	977,265

c) Non-performing loans and advances

Non-performing loans and advances on which interest has been suspended amount to KShs 1,231 million (2015: KShs 419.1 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 2,112 million (2015: KShs 410.1 million).

(d) Lending concentration

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

	2016 %	2015 %
Manufacturing	21	21
Wholesale and retail trade	30	30
Transport and communication	6	5
Real estate	18	18
Business services	12	13
Others	13	13
	100	100

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

11. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(e) Maturity analysis

2016	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	1,063,980	349,349	188,583	6,693,310	8,295,222
Trade	1,534,739	627,536	134,665	9,608,649	11,905,589
Transport	130,461	771	-	2,153,689	2,284,921
Real estate	486,015	342,590	46,630	6,278,125	7,153,360
Other	1,229,260	358,690	168,099	8,429,475	10,185,524
Total	4,444,455	1,678,936	537,977	33,163,248	39,824,616
2015					
Manufacturing	855,430	348,335	74,835	7,259,557	8,538,157
Trade	2,020,660	926,400	109,065	15,713,089	18,769,214
Transport	7,262	100,603	1,287	1,909,951	2,019,103
Real estate	480,635	220,913	279	6,478,403	7,180,230
Other	376,921	87,561	14,081	3,837,098	4,315,661
Total	3,740,908	1,683,812	199,547	35,198,098	40,822,365

12. OTHER ASSETS

	2016 KShs'000	2015 KShs'000
Prepayments and deposits	144,037	180,543
Accrued income	51,609	31,664
Others*	284,282	224,375
	479,928	436,582

* Comprises amounts paid in advance for various projects being undertaken by the bank, salary advances, deposits paid for properties to be acquired and withholding tax on interest on fixed deposits paid in advance.

13. INVESTMENT IN ASSOCIATE

The bank owns a 37.55% (2015 – 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:

	2016 KShs'000	2015 KShs'000
As at 1 January	329,321	329,982
Dividends received	(22,530)	(18,860)
Share of profit	65,857	43,558
Share of other comprehensive income*	-	(25,359)
	372,648	329,321
Non-current assets	1,197,661	1,022,264
Current assets	908,342	1,059,050
Non-current liabilities	(1,012,260)	(1,007,000)
Current liabilities	(101,338)	(129,761)
Equity	992,405	944,553
37.55% of equity	372,648	354,680
Other comprehensive income*	-	(25,359)
Bank's carrying amount of the investment	372,648	329,321
Revenue	920,346	877,062
Profit before tax	244,320	177,234
Profit after tax	175,384	116,000
Cash and bank balances	14,473	44,771
Depreciation and amortisation	7,221	8,337
Income tax expense	(68,936)	(61,234)

* In 2014, the bank recognised KShs 23.359 million as its share of other comprehensive income from its associate. However, this amount related to revaluation gain on property and, since the bank carried its property and equipment at cost, the amount was adjusted for in 2015 by reducing the value of the investment in the associate and other comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

14. LEASEHOLD LAND

	2016 KShs'000	2015 KShs'000
COST		
At 1 January and 31 December	71,381	71,381
Revaluation	325,204	-
Eliminated on revaluation	(14,985)	-
Disposal	(41,600)	-
Total	340,000	71,381
AMORTISATION		
At 1 January	17,133	15,772
Charge for the year	859	1,361
Disposal	(3,007)	-
Eliminated on revaluation	(14,985)	-
At 31 December	-	17,133
NET CARRYING AMOUNT		
At 31 December	340,000	54,248

The bank's leasehold land was revalued as at 31 December 2016 by Knight Frank, registered valuers, on the open market value basis. The carrying amount of the leasehold land was adjusted to the revalued amount and the resultant surplus, net of deferred tax, was recognised in other comprehensive income and credited to the asset revaluation reserve in equity. If leasehold land was measured using the cost model, the net carrying amount would have been KShs 14,796,000.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

15. PROPERTY AND EQUIPMENT

a) As at 31 December 2016

	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 OR VALUATION								
At 1 January 2016	15,645	306,330	265,311	107,466	145,654	88,566	235,166	1,164,138
Additions	-	39,993	22,843	3,842	8,215	6,680	29,350	110,923
Revaluation	33,355	415,736	-	-	-	-	-	449,091
Eliminated on revaluation	-	(79,816)	-	-	-	-	-	(79,816)
Impairment loss*	-	(2,020)	-	-	-	-	-	(2,020)
Disposals	-	-	(3,236)	-	(130)	(7,665)	-	(11,031)
At 31 December 2016	49,000	680,223	284,918	111,308	153,739	87,581	264,516	1,631,285
COMPRISING								
Cost	15,645	346,323	284,918	111,308	153,739	87,581	264,516	1,264,030
Valuation adjustment at 31 December 2016	33,355	333,900	-	-	-	-	-	367,255
	49,000	680,223	284,918	111,308	153,739	87,581	264,516	1,631,285
DEPRECIATION								
At 1 January 2016	-	68,700	157,896	79,507	89,979	61,117	191,958	649,157
Charge for the year	-	11,116	24,211	6,570	13,220	14,755	30,404	100,276
Eliminated on revaluation	-	(79,816)	-	-	-	-	-	(79,816)
Disposals	-	-	(2,022)	-	(97)	(6,877)	-	(8,996)
At 31 December 2016	-	-	180,085	86,077	103,102	68,995	222,362	660,621
NET CARRYING AMOUNT								
At 31 December 2016	49,000	680,223	104,833	25,231	50,637	18,586	42,154	970,664

The bank's freehold land and buildings were revalued as at 31 December 2016 by Knight Frank, registered valuers, on the open market value basis. The carrying amount of the freehold land and buildings was adjusted to the revalued amount and the resultant surplus, net of deferred tax, was recognised in other comprehensive income and credited to the asset revaluation reserve in equity. If freehold land and buildings were measured using the cost model, their net carrying amounts would have been KShs 15,645,000 and KShs 226,514,000, respectively.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

*The impairment loss of KShs 2,020,000 represents the write-down of the bank's Westlands building to the fair value. This was recognised in profit or loss in other operating expenses. The recoverable amount of KShs 40,000,000 as at 31 December 2016 was based on the open market valuation basis as disclosed above, and in note 42.

15. PROPERTY AND EQUIPMENT

b) As at 31 December 2015

	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 2015	15,645	306,330	222,338	100,947	131,776	79,880	206,047	1,062,963
Additions	-	-	42,973	6,546	13,878	24,864	29,119	117,380
Disposals	-	-	-	(27)	-	(16,178)	-	(16,205)
At 31 December 2015	15,645	306,330	265,311	107,466	145,654	88,566	235,166	1,164,138
DEPRECIATION								
At 1 January 2015	-	58,383	132,912	73,119	76,781	59,062	167,602	567,859
Charge for the year	-	10,317	24,984	6,415	13,198	18,233	24,356	97,503
Disposals	-	-	-	(27)	-	(16,178)	-	(16,205)
At 31 December 2015	-	68,700	157,896	79,507	89,979	61,117	191,958	649,157
NET CARRYING AMOUNT								
At 31 December 2015	15,645	237,630	107,415	27,959	55,675	27,449	43,208	514,981

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

16. INTANGIBLE ASSETS

	2016 KShs'000	2015 KShs'000
COST		
At 1 January	392,983	348,626
Additions	70,492	44,357
Write off*	(635)	-
At 31 December	462,840	392,983
AMORTISATION		
At 1 January	229,278	164,626
Charge for the year	73,920	64,652
At 31 December	303,198	229,278
NET CARRYING AMOUNT		
At 31 December	159,642	163,705

Intangible assets comprise of computer software and VISA license fees.

*This relates to withholding tax payment erroneously made to the supplier of software in the prior year which was erroneously posted into intangible assets. This has been reversed in the current year.

17. DEFERRED TAX

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

2016	At 1 January KShs '000	Recognised in income statement KShs '000	Recognised in other comprehensive income KShs '000	At 31 December KShs '000
Arising from:				
Property and equipment	29,551	(9,456)	(232,289)	(212,194)
Provision for staff leave	3,425	580	-	4,005
Provision for loans and advances	122,339	11,820	-	134,159
	155,315	2,944	(232,289)	(74,030)
2015				
Arising from:				
Property and equipment	32,755	(3,204)	-	29,551
Provision for staff leave	3,412	13	-	3,425
Provision for loans and advances	101,471	20,868	-	122,339
	137,638	17,677	-	155,315

The deferred tax liability is mainly due to accelerated capital allowances and the tax effect of the revaluation surplus on land and buildings valued in the year as detailed in notes 14 and 15.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

18. BALANCES DUE TO BANKS AND FINANCIAL INSTITUTIONS

	2016 KShs'000	2015 KShs'000
Due to other banks	1,687,552	2,812,994
Due to financial institutions	1,812,270	2,060,769
	3,499,822	4,873,763

19. MEDIUM TERM NOTE

	2016 KShs'000	2015 KShs'000
Medium term note	1,024,000	-

The bank issued a medium term note on 1 February 2016 at a fixed rate of 7 % per annum. The note will be redeemed in full on 26 July 2021.

20. DEPOSITS FROM CUSTOMERS

	2016 KShs'000	2015 KShs'000
Current deposits	12,207,515	11,292,164
Savings deposits	268,789	335,549
Call deposits	102,486	1,777,882
Fixed deposits	36,743,804	37,474,963
	49,322,594	50,880,558

Included in deposits from customers, were deposits of KShs 334 million (2015: KShs 728.7 million) held as collateral for irrevocable commitments. The weighted average effective interest rate on interest bearing customer deposits as at 31 December 2016 was 7.6 % (2015: 7.3%).

21. OTHER LIABILITIES

	2016 KShs'000	2015 KShs'000
Pay orders issued	85,694	99,118
Bills payable	165,127	181,247
Sundry creditors and accruals	332,951	241,759
	583,772	522,124

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 2016

22. INCOME TAX

	2016 KShs'000	2015 KShs'000
STATEMENT OF FINANCIAL POSITION		
Balance brought forward	(18,147)	38,587
Charge for the year	434,060	587,243
Paid during the year	(483,706)	(643,977)
Income tax recoverable	(67,793)	(18,147)
INCOME STATEMENT		
Current income tax at 30% on the taxable profit for the year	434,060	587,243
Deferred tax credit (note 17)	(2,944)	(17,677)
Income tax expense	431,116	569,566
Reconciliation of tax expense to tax based on accounting profit:		
Accounting profit before tax	2,335,822	2,592,754
Tax applicable rate of 30%	700,747	777,827
Tax effect of share of profit of associate	(19,757)	(13,067)
Other expenses not deductible for tax purposes	35,718	18,824
Other income not subject to tax	(285,592)	(214,018)
Tax charge for the year	431,116	569,566

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

23. SHARE CAPITAL

	2016 Ordinary shares of KShs 1,000 each	2016 Ordinary class 'B' shares of KShs 1,000 each	2015 Ordinary shares of KShs 1,000 each	2015 Ordinary class 'B' shares of KShs 1,000 each
Authorised	4,991,000	9,000	4,991,000	9,000
Issued and fully paid:				
At 1 January	4,991,000	9,000	2,991,000	9,000
Reserves capitalized during the year	-	-	1,900,000	-
Issued during the year	-	-	100,000	-
At 31 December	4,991,000	9,000	4,991,000	9,000

	2016 KShs'000	2015 KShs'000
Authorised, issued and fully paid:		
4,991,000 Ordinary shares of KShs 1,000 each (2015: 4,991,000)	4,991,000	4,991,000
9,000 Ordinary class "B" shares of KShs 1,000 each	9,000	9,000
	5,000,000	5,000,000

24. RESERVES

	2016 KShs'000	2015 KShs'000
Retained earnings	5,011,975	3,607,269
Available-for-sale reserve	280,012	117,938
Asset revaluation reserve	542,006	-
Balance carried forward	5,833,993	3,725,207

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

The asset revaluation reserve is not distributable and is used to record increases in the fair value of land and buildings and decreases to the extent that such decrease relates an increase in the same assets previously recognized in equity.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

25. INTEREST INCOME

	2016 KShs'000	2015 KShs'000
Loans and advances to customers	5,350,523	5,091,114
Placements and bank balances	71,395	148,177
Reverse repurchase agreements	3,641	5,102
Treasury bills and term notes	842,602	814,675
Government securities-held-to-maturity	900,867	599,697
Available -for-sale investments	409,882	322,817
	7,578,910	6,981,582

26. INTEREST EXPENSE

	2016 KShs'000	2015 KShs'000
Due to customers	3,788,420	3,489,927
Due to banks and other financial institutions	239,527	137,636
	4,027,947	3,627,563

27. FEES AND COMMISSION INCOME

	2016 KShs'000	2015 KShs'000
Commission income	299,628	238,094
Fees income	167,804	197,577
Other standing charges	-	11,145
	467,432	446,816

28. OTHER INCOME

	2016 KShs'000	2015 KShs'000
Miscellaneous income	83,387	64,214
Write back of provisions	49,564	109,300
Recoveries of loans and advances previously written off	8,470	1,193
	141,421	174,707

29. ALLOWANCES FOR IMPAIRMENT OF LOANS AND ADVANCES

	2016 KShs'000	2015 KShs'000
Specific allowance on loans and advances (note 11 (b))	167,197	69,000
Collective allowance for impairment (note 11 (b))	43,463	69,562
Collective allowance on term notes and bonds	(4,059)	1,438
Write-off during the year	2,883	12,022
	209,484	152,022

30. OTHER OPERATING EXPENSES

	2016 KShs'000	2015 KShs'000
Staff costs (note 33)	977,981	863,327
Depreciation on property and equipment	100,276	97,503
Amortisation of intangible assets	73,920	64,652
Impairment loss	2,020	-
Amortisation of leasehold land	859	1,361
Auditors' remuneration	3,713	3,713
Directors' emoluments	119,145	84,847
Deposit protection fund levy	72,136	65,509
Rent and rates	103,424	91,824
Other general administration expenses	544,983	493,590
	1,998,457	1,766,326

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

31. PROFIT BEFORE TAX

	2016 KShs'000	2015 KShs'000
Profit before tax is stated after charging: -		
Depreciation on property and equipment	100,276	97,503
Amortisation of intangible assets	73,920	64,652
Amortisation of leasehold land	859	1,361
Impairment loss	2,020	-
Directors' emoluments	119,145	84,847
Auditors' remuneration	3,713	3,713
And after crediting: -		
Foreign exchange gains	298,311	442,441
Dividend income	19,779	49,562
Gain on sale of property and equipment	7,721	6,761

32. 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:

	2016 KShs'000	2015 KShs'000
Profit for the year attributable to shareholders	1,904,706	2,023,189
Weighted average number of shares ('000)	5,000	5,000
Basic and diluted earnings per share (KShs)	381	405

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

33. STAFF COSTS

	2016 KShs'000	2015 KShs'000
Salaries and wages	844,680	745,047
Contributions to pension scheme	48,275	41,719
Other staff costs	85,026	76,561
	977,981	863,327

34. DIVIDENDS PAID

	2016 KShs'000	2015 KShs'000
Declared and paid		
Dividend on ordinary shares	500,000	450,000
Total dividend paid	500,000	450,000
Dividend per ordinary share	100	90

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

35. CASH AND CASH EQUIVALENTS

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

	2016 KShs'000	2015 KShs'000
Cash in hand (note 4)	543,618	408,186
Balances with Central Bank of Kenya-unrestricted (note 4)	764,362	1,701,037
Cheques and items for clearing (note 4)	500,177	563,226
Placements and balances with other banks (note 5)	2,713,176	1,591,726
Government securities and term notes maturing within 91 days	102,174	2,529,154
Due to banks and financial institutions (note 18)	(3,499,822)	(4,873,763)
	1,123,685	1,919,566

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

36. CONTINGENT LIABILITIES

	2016 KShs'000	2015 KShs'000
Letters of credit	2,330,507	1,680,891
Local guarantees	2,833,650	3,586,038
Bills for collection	3,056,600	2,709,253
Foreign currency bills for collection	298,837	72,471
Custodial treasury bonds	2,621,158	2,173,044
Spot sales/purchase	513,229	336,604
Swap sales/purchases	5,416,135	10,306,664
Forward contracts	134,195	308,075
	17,204,311	21,173,040

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.

37. CAPITAL COMMITMENTS

	2016 KShs'000	2015 KShs'000
Capital commitments contracted for	220,000	150,000

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

38-39. 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:

	2016 KShs'000	2015 KShs'000
Within 1 year	62,244	62,207
After 1 year but not more than 5 years	127,984	161,157
More than 5 years	243	2,498
	190,471	225,862

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

40. 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.

	2016 KShs'000	2015 KShs'000
a) Due from		
i) Loans and advances to employees	296,034	209,288
ii) Loans and advances to directors and their associates	1,515,631	1,830,067
	1,811,665	2,039,355
Allowance during the year:		
At 1 January	20,292	17,798
Allowance during the year	(2,176)	2,494
At 31 December	18,116	20,292

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

	2016 KShs'000	2015 KShs'000
b) Due to		
i) Deposits from employees	255,735	262,897
ii) Deposits from directors and their associates	1,170,873	699,963
	1,426,608	962,860
c) Key management personnel compensation		
i) Salaries	332,921	270,997
ii) Post employment benefits	24,527	19,267
	357,448	290,264
d) Directors' emoluments		
i) As management	51,977	57,573
ii) As executives	67,168	27,274
	119,145	84,847

e) Transactions with related parties

Included in interest income is KShs 251,386,323 (2015: KShs 210,899,788) being interest on loans and advances to related parties.

Included in interest expense is KShs 82,220,366 (2015: KShs 83,671,704) being interest on deposits from related parties.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

41. 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 2016

	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash and balances with the Central Bank of Kenya	3,200,067	-	3,200,067
Placements and balances with other banks	2,713,176	-	2,713,176
Treasury bills and term notes	5,884,593	222,057	6,106,650
Held to maturity investments	653,196	7,034,875	7,688,071
Investment in bonds-available for sale	-	3,698,408	3,698,408
Investment in ordinary shares available for sale	-	981,561	981,561
Loans and advances to customers	16,302,865	22,256,738	38,559,603
Other assets	454,031	25,897	479,928
Investment in associate	-	372,648	372,648
Intangible assets	-	159,642	159,642
Tax recoverable	67,793	-	67,793
Leasehold land	-	340,000	340,000
Property and equipment	-	970,664	970,664
TOTAL ASSETS	29,275,721	36,062,490	65,338,211
LIABILITIES			
Balances due to banks and financial institutions	3,499,822	-	3,499,822
Medium term note	-	1,024,000	1,024,000
Deposits from customers	49,322,594	-	49,322,594
Other liabilities	583,772	-	583,772
Deferred tax liability	-	74,030	74,030
TOTAL LIABILITIES	53,406,188	1,098,030	54,504,218
NET ASSETS	(24,130,467)	34,964,460	10,833,993

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

41. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

As at 31 December 2015

	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash and balances with the Central Bank of Kenya	4,103,641	-	4,103,641
Placements and balances with other banks	1,591,726	-	1,591,726
Treasury bills and term notes	6,337,498	365,533	6,703,031
Held to maturity investments	1,154,110	6,088,913	7,243,023
Investment in bonds-available for sale	684,206	2,228,351	2,912,557
Investment in ordinary shares available for sale	-	930,275	930,275
Loans and advances to customers	16,974,010	22,871,090	39,845,100
Other assets	120,007	316,575	436,582
Investment in associate	-	329,321	329,321
Intangible assets	-	163,705	163,705
Tax recoverable	18,147	-	18,147
Leasehold land	-	54,248	54,248
Property and equipment	-	514,981	514,981
Deferred tax asset	-	155,315	155,315
TOTAL ASSETS	30,983,345	34,018,307	65,001,652
LIABILITIES			
Balances due to banks and financial institutions	4,873,763	-	4,873,763
Deposits from customers	50,880,558	-	50,880,558
Other liabilities	522,124	-	522,124
TOTAL LIABILITIES	56,276,445	-	56,276,445
NET ASSETS	(25,293,100)	34,018,307	8,725,207

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

42. FAIR VALUE OF MEASUREMENTS

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.

	2016 Carrying amount KShs '000	Fair value KShs '000	2015 Carrying amount KShs '000	Fair value KShs '000	Un-recognised gain/(loss) KShs '000
Cash and Balances with Central Bank of Kenya	3,200,067	3,200,067	4,103,641	4,103,641	-
Placements and balances with other banks	2,713,176	2,713,176	1,591,726	1,591,726	-
Held-to-maturity:					
Treasury bonds	7,688,071	7,450,808	7,243,023	6,905,155	-
Treasury bills	5,598,068	5,598,068	5,810,205	5,810,205	-
Term notes	508,582	508,582	892,826	892,826	-
Bonds-available-for-sale	3,698,408	3,698,408	2,912,557	2,912,557	-
Ordinary shares-available-for-sale	718,504	718,504	686,151	686,151	-
Loans and advances to customers	38,559,603	38,559,603	39,845,100	39,845,100	-
Due to banks and other financial institutions	3,499,822	3,499,822	4,873,763	4,873,763	-
Medium term note	1,024,000	1,024,000	-	-	-
Deposits from customers	49,322,594	49,322,594	50,880,558	50,880,558	
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 2016

42. FAIR VALUE OF MEASUREMENTS (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.

2016	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	8	3,698,408	-	-	3,698,408
Investments in ordinary shares	9	718,504	-	-	718,504
Held to maturity investments		7,450,808	-	-	7,450,808
Property and equipment (Freehold land and buildings)	14	-	-	729,223	729,223
Leasehold land		-	-	340,000	340,000
		11,867,720	-	1,069,223	12,936,943

2015	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	8	2,912,557	-	-	2,912,557
Investments in ordinary shares	9	686,151	-	-	686,151
Held to maturity investments		6,905,155	-	-	6,905,155
		10,503,863	-	-	10,503,863

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

42. FAIR VALUE OF MEASUREMENTS (Continued)

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

Description of valuation techniques used and key inputs to valuation on land and buildings:

	Valuation technique	Significant unobservable inputs	Range (Weighted Average)
Free hold land, leasehold land and buildings	Open market valuation	Estimated rental value per s.q.m. per month	KShs 180 –ground flr space
			KShs 120 –upper flr space
		Rent growth p.a	8%
		Discount rate	8%

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

Reconciliation Of Fair Value Measurement Of The Land And Buildings

	2016 KShs'000	2015 KShs'000
Leasehold land		
As at 1 January	71,381	71,381
Additions	-	-
Disposals	(41,600)	-
Total gains and losses recognised in other comprehensive income	310,219	-
As at 31 December	340,000	71,381
Freehold land		
As at 1 January	15,645	15,645
Additions	-	-
Disposals	-	-
Total gains and losses recognised in other comprehensive income	33,355	-
As at 31 December	49,000	15,645
Buildings		
As at 1 January	306,330	306,330
Additions	39,993	-
Impairment loss	(2,020)	-
Total gains and losses recognised in other comprehensive income	335,920	-
	680,223	306,330
Accumulated depreciation	-	(68,700)
As at 31 December	680,223	237,630

Significant unobservable valuation input	Range
Rental value per square metre per month	KShs 180 –ground floor space
	KShs 120 –upper floor space

Significant increases (decreases) in estimated rental value per square metre in isolation would result in a significantly higher (lower) fair value on a linear basis.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

43. 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:-

	2016 Actual KShs'000	Required KShs'000	2015 Actual KShs'000	Required KShs'000
Tier 1 Capital	10,011,975	1,000,000	8,607,269	1,000,000
Tier 2 Capital	822,019	-	117,938	-
Term subordinated debt	1,024,000	-	-	-
Total regulatory capital	11,857,994	1,000,000	8,725,207	1,000,000
Risk weighted assets	48,575,540	-	48,318,393	-
Capital Ratios				
Total regulatory capital expressed as a percentage of total risk-weighted assets	23%	14.50%	18.05%	14.50%
Total tier 1 capital expressed as a percentage of risk weighted assets	20%	10.50%	17.80%	10.50%

44. 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 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 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk (continued)

Exposure to credit risk

Maximum exposure to credit risk before collateral held

	2016 KShs'000	2015 KShs'000
Cash and balances with the Central Bank of Kenya	2,656,449	3,695,455
Placements and balances with other banks	2,713,176	1,591,726
Treasury bills and term notes	6,106,650	6,703,031
Held to maturity investments	7,688,071	7,243,023
Investment in bonds-available for sale	3,698,408	2,912,557
Loans and advances to customers	39,824,616	40,822,365
Other assets	51,609	31,922
	62,738,979	63,000,079

Loans and advances to customers

The aging analysis of the loans and advances is as follows :

	Collectively impaired		Individually impaired			
	Neither past due nor impaired		Past due and impaired			
	Normal	Watch	Substandard	Doubtful	Loss	
		> 30	91-180	181-360	> 360	
		days	days	days	days	Total
31-Dec-2016	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
Gross	34,391,953	3,400,753	1,009,595	779,198	243,117	39,824,616
Impairment	(343,920)	(107,391)	(97,211)	(472,870)	(243,621)	(1,265,013)
Net carrying amount	34,048,033	3,470,471	725,407	316,196	(504)	38,559,603
31-Dec-2015						
Gross	39,608,893	224,879	659,424	247,801	81,368	40,822,365
Impairment	(401,047)	(6,746)	(377,895)	(143,055)	(48,522)	(977,265)
Net carrying amount	39,207,846	218,133	281,529	104,746	32,846	39,845,100

Past due but not impaired loans

These are loans where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Bank.

Impaired loans and securities

Impaired loans and securities are loans and securities 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/securities agreement(s).

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk (continued)

Exposure to credit risk (continued)

Loans and advances to customer (continued)

	2016 KShs'000	2015 KShs'000
Individually impaired		
Grade 3: Impaired (Substandard)	822,618	659,424
Grade 4: Impaired (Doubtful)	789,066	247,801
Grade 5: Impaired (Loss)	243,117	81,368
Gross amount	1,854,801	988,593
Allowance for impairment	813,702	569,472
Carrying amount	1,041,099	419,121
Collectively impaired		
Grade 1: Normal	34,391,953	39,608,893
Grade 2: Watch list	3,577,862	224,879
Gross amount	37,969,815	39,833,772
Allowance for impairment	451,311	407,793
Carrying amount	37,518,504	39,425,979
Total carrying amount	38,559,603	39,845,100

Loans and advances graded 3, 4 and 5 in the bank's 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 recognised 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.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk (continued)

Exposure to credit risk (continued)

Loans and advances to customer (continued)

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 below:

Loans and advances to customers (gross)

	2016 KShs'000	2015 KShs'000
CONCENTRATION BY SECTOR:		
Agriculture	239,158	340,517
Mining and quarry	1,998	5,384
Manufacturing	8,295,222	8,538,157
Electricity and water	42,939	62,795
Building and construction	996,214	1,006,441
Wholesale and retail	11,905,589	12,164,297
Transport and communication	2,284,921	2,019,103
Finance and insurance	162,932	52,765
Real estate	6,157,146	7,180,231
Business services	5,776,728	5,324,039
Foreign trade	1,378,542	1,802,237
Other enterprises	2,583,227	2,326,399
	39,824,616	40,822,365

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

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:

	2016	2015
At 31 December	40%	37%
Average for the year	39%	38%
Maximum for the year	43%	43%
Minimum for the year	37%	32%
Central Bank of Kenya required minimum	20%	20%

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 financial 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 the undiscounted cash flows of the financial assets and liabilities of the bank based on the remaining period using 31 December 2014 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

b) Liquidity risk (continued)

Management of liquidity risk (continued)

As at 31 December 2016	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 and balances with						
Central Bank of Kenya	3,200,067	-	-	-	-	3,200,067
Placements and balances						
with other banks	2,713,176	-	-	-	-	2,713,176
Treasury bills and term notes	725,466	2,216,240	3,110,350	222,057	-	6,274,113
Held-to-maturity investments	-	-	653,196	1,541,592	12,485,137	14,679,925
Bonds- available-for-sale	-	-	-	448,905	6,985,058	7,433,963
Other assets	-	-	51,609	-	-	51,609
Total assets	6,638,709	2,216,240	3,815,155	2,212,554	19,470,195	34,352,853
FINANCIAL LIABILITIES						
Due to banks and financial institutions	208,277	987,234	520,693	2,884,424	-	4,600,628
Medium term note	-	-	-	-	1,024,000	1,024,000
Deposits from customers	13,074,143	19,709,888	16,403,354	125,013	10,196	49,322,594
Other liabilities	114,029	8,415	14,928	32,557	-	169,930
Total liabilities	13,396,449	20,705,537	16,938,975	3,041,994	1,034,196	55,117,151

As at 31 December 2015	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 and Balances						
with Central Bank						
of Kenya	4,103,641	-	-	-	-	4,103,641
Placements and balances						
with other banks	1,591,726	-	-	-	-	1,591,726
Treasury bills and term notes	1,405,764	2,526,148	2,405,586	365,533	-	6,703,031
Held-to-maturity investments	154,077	-	1,027,178	2,545,841	3,686,285	7,413,381
Bonds- available-for-sale	-	-	799,607	490,307	2,097,133	3,387,047
Other assets	-	-	31,922	-	-	31,922
Total assets	7,255,208	2,526,148	4,264,293	3,401,681	5,783,418	23,230,748
FINANCIAL LIABILITIES						
Due to banks and						
financial institutions	552,456	4,321,307	-	-	-	4,873,763
Deposits from customers	25,314,568	12,889,558	12,676,432	-	-	50,880,558
Other liabilities	8,214	104,092	74,891	-	-	187,198
Total liabilities	25,875,236	17,314,957	12,751,323	-	-	55,941,519

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Classification of financial instruments

The table below sets out the Bank's classification of each class of financial assets and liabilities. The amounts in the table are the carrying amounts of the financial instruments at the reporting date:

As at 31 December 2016	Held to maturity KShs '000	Loans and receivables KShs '000	Available for sale financial assets KShs '000	Other liabilities at amortized cost KShs '000	Carrying amount KShs '000
Assets					
Cash and Balances with Central Bank of Kenya	-	3,200,067	-	-	3,200,067
Placements and balances with other banks	-	2,713,176	-	-	2,713,176
Treasury bills & Term notes	-	6,106,650	-	-	6,106,650
Held to maturity investments	7,688,071	-	-	-	7,688,071
Investment in bonds-available for sale	-	-	3,698,408	-	3,698,408
Investment in ordinary shares available for sale	-	-	981,561	-	981,561
Loans and advances to customers	-	38,559,603	-	-	38,559,603
Other assets	-	51,609	-	-	51,609
Total Assets	7,688,071	50,631,105	4,679,969	-	62,999,145
Liabilities					
Balances due to banks and financial institutions	-	-	-	4,523,822	4,523,822
Medium term note	-	-	-	1,024,000	1,024,000
Deposits from customers	-	-	-	49,322,594	49,322,594
Other liabilities	-	-	-	169,930	169,930
Total liabilities	-	-	-	55,040,346	55,040,346

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Classification of financial instruments (continued)

As at 31 Decemeber 2015	Held to maturity KShs '000	Loans and receivables KShs '000	Available for sale financial assets KShs '000	Other liabilities at amortized cost KShs '000	Carrying ampunt KShs '000
Cash and Balances with					
Central Bank of Kenya	-	4,103,641	-	-	4,103,641
Placements and balances					
with other banks	-	1,591,726	-	-	1,591,726
Treasury bills & Term notes	-	6,703,031	-	-	6,703,031
Held to maturity investments	7,243,023	-	-	-	7,243,023
Investment in bonds-					
available for sale	-	-	2,912,557	-	2,912,557
Investment in ordinary					
shares available for sale	-	-	930,275	-	930,275
Loans and advances					
to customers	-	39,845,100	-	-	39,845,100
Other assets	-	374,814	-	-	374,814
Total assets	7,243,023	52,618,312	3,842,832	-	63,704,167
Liabilities					
Balances due to banks					
and financial institutions	-	-	-	4,873,763	4,873,763
Deposits from customers	-	-	-	50,880,558	50,880,558
Other liabilities	-	-	-	394,255	394,255
Total liabilities	-	-	-	56,148,576	56,148,576

d) 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) Market risk (continued)

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 2015 would have increased equity by KShs 65 million (2014: KShs 88 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 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 on next page 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:

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) Market Risk (continued)

Interest risk exposure (continued)

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
As at 31 December 2016							
Cash and balance							
with Central Bank of Kenya	-	-	-	-	-	3,200,067	3,200,067
Placements and balances							
with other banks	2,504,276	-	-	-	-	208,900	2,713,176
Treasury bills and term notes	725,466	2,216,240	2,942,887	222,057	-	-	6,106,650
Held-to-maturity investments	-	-	653,196	1,541,592	5,493,283	-	7,688,071
Bonds- available for sale	-	-	-	448,905	3,249,503	-	3,698,408
Ordinary shares-Available-for-sale	-	-	-	-	-	981,561	981,561
Loans and advances to customers	3,658,705	2,152,093	10,492,067	9,986,589	12,270,149	-	38,559,603
Other assets	-	-	-	-	-	479,928	479,928
Total assets	6,888,447	4,368,333	14,088,150	12,199,143	21,012,935	4,870,456	63,427,464
LIABILITIES							
Due to banks & financial institutions	-	970,752	2,324,270	-	-	204,800	3,499,822
Medium term note	-	-	-	-	1,024,000	-	1,024,000
Deposits from customers	866,628	19,709,888	16,403,354	135,209	-	12,207,515	49,322,594
Other liabilities	-	-	-	-	-	169,930	169,930
Total liabilities	866,628	20,680,640	18,727,624	135,209	1,024,000	12,582,245	54,016,346
Total interest sensitivity gap	6,021,819	(16,312,307)	(4,639,474)	12,063,934	19,988,935	(7,711,789)	9,411,118

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
As at 31 December 2015							
Total assets	7,400,905	5,284,246	14,614,857	16,201,264	15,349,239	4,915,424	63,765,935
Total liabilities	14,117,661	13,907,819	13,801,423	519,297	1,658,758	12,271,487	56,276,445
Total interest sensitivity gap	(6,716,756)	(8,623,573)	813,434	15,681,967	13,690,481	(7,356,063)	7,489,490

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) 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:

	2016 KShs'000	2015 KShs'000
Effect on profit before tax of a +1% change in interest rates	(46,240)	(20,118)
Effect on profit before tax of a -1% change in interest rates	46,240	20,118
Effect on equity	32,368	14,082

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 2016, if the US dollar had strengthened by 2% 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 590,634 (2015: KShs 3 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 2016, if the Euro had strengthened against the Shilling by 6%, with all other variables held constant, the sensitised effect on profit or loss would have been an increase in profit before tax of KShs 474,748 (2015: KShs 230,416) 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 2016

44. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) Market risk (continued)

Foreign Currency Exchange Risk (continued)

The table below summarises foreign currency exposure to the bank

As at 31 December 2016 in KShs'000	USD	GBP	Euro	ZAR	JPY	Others	Total
Assets							
Cash and cash equivalents	478,145	152,496	110,175	2,666	8,519	17,592	769,593
Investment in ordinary							
shares available for sale	238,524	24,532	-	-	-	646,841	909,897
Offshore bonds	129,493	-	-	-	-	-	129,493
Loans and advances to customers	10,267,123	134,108	1,412,558	-	-	-	11,813,789
Total assets	11,113,285	311,136	1,522,733	2,666	8,519	664,433	13,622,772
Liabilities							
Balances due to banks abroad							
and private enterprises	4,418,475	-	105,347	-	-	-	4,523,822
Deposits	4,871,915	978,310	487,301	4,242	348,200	-	6,689,968
Total liabilities	9,290,390	978,310	592,648	4,242	348,200	-	11,213,790
Net exposure as at 31 December	1,822,895	(667,174)	930,085	(1,576)	(339,681)	664,433	2,408,982

As at 31 December 2015 in KShs'000	USD	GBP	Euro	ZAR	JPY	Others	Total
Assets							
Cash and cash equivalents	217,513	110,818	16,477	12,572	28,802	20,368	406,550
Investment in ordinary							
shares available for sale	214,853	29,271	-	-	-	595,290	839,414
Offshore bonds	209,992	-	-	-	-	-	209,992
Loans and advances to customers	8,620,011	238,614	1,413,739	-	-	-	10,272,364
Total assets	9,262,369	378,703	1,430,216	12,572	28,802	615,658	11,728,320
Liabilities							
Balances due to banks abroad							
and private enterprises	4,598,460	-	127,258	-	-	-	4,725,718
Deposits	5,116,170	832,278	546,899	-	-	-	6,495,347
Total liabilities	9,714,630	832,278	674,157	-	-	-	11,221,065
Net exposure as at 31 December	(452,261)	(453,575)	756,059	12,572	28,802	615,658	507,255

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2016

45. 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

46. EVENTS AFTER THE REPORTING PERIOD

The Board of Directors approved the financial statements on 14 March 2016 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.

47. CURRENCY

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

CORPORATE SOCIAL RESPONSIBILITY

1

2

1. CHAIRMAN INDUCTED INTO ARCH KLUMPH SOCIETY

On 6th April 2016 Prime Bank Chairman Dr. Rasik Kantaria was among 8 Rotarians who were inducted into the Arch Klumph Society in recognition of their service to humanity at the Rotary International headquarters in Evanston, Illinois, USA,

Arch Klumph Society recognizes donors who have given at least $250,000 to The Rotary Foundation in support of Rotary's life-changing work around the world.

2. 2016 JUNIOR GOLF FOUNDATION DONATION

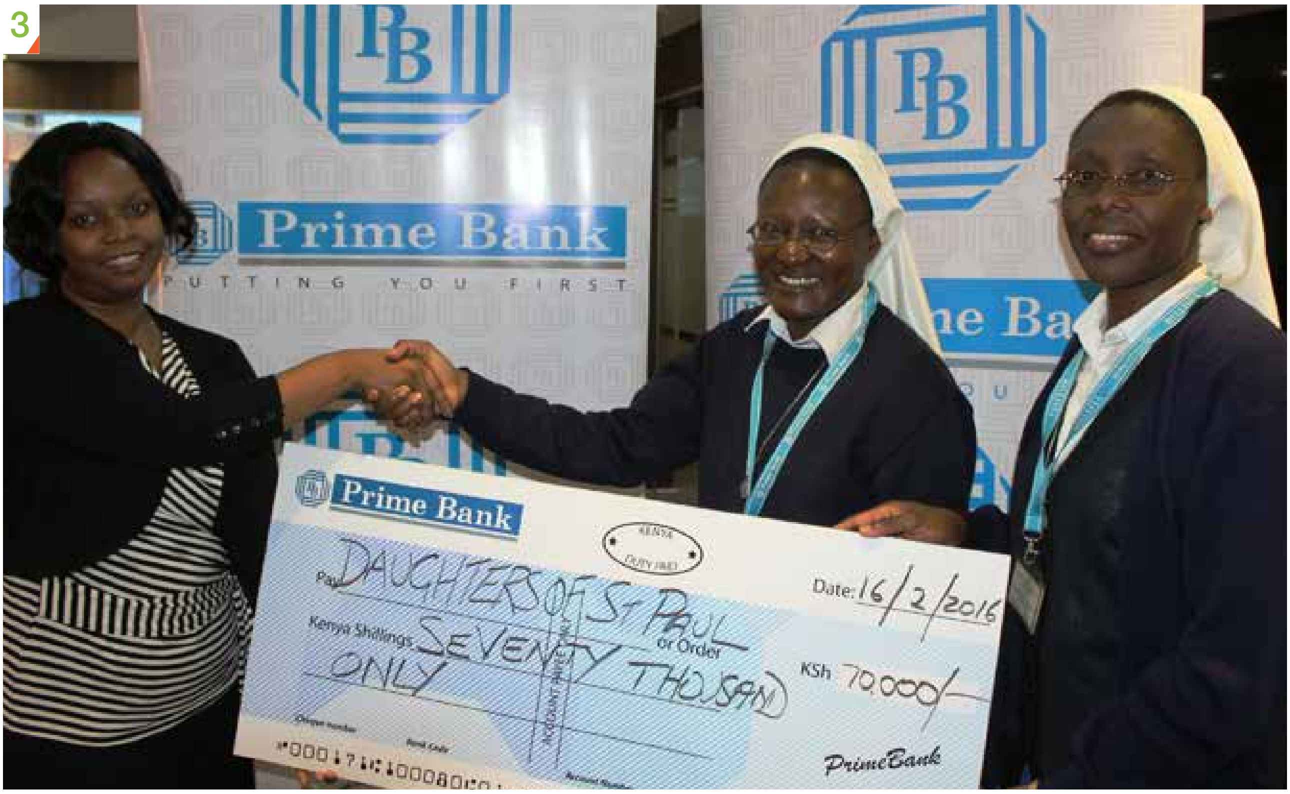
Prime Bank partnered with Kenya Golf Union, Junior Golf Foundation, and Visa to launch the first ever golf card in Kenya – the Prime Visa Golf Card.

This unique concept of a core-branded Visa golf card is geared towards developing talent and making golf courses accessible to the youth.

This golf credit card has a twin effect in that it is specifically designed to enable golfers enjoy a wide range of benefits on and off the course at the same time making funds available for JGF.

CORPORATE SOCIAL RESPONSIBILITY

3



4

For each golfer who signs up for the card, Prime Bank is donating KShs. 2,000 to JGF.

On 14th December 2016, Prime Bank presented a cheque of KShs. 894, 000 as proceeds of the partnership with JGF and KGU through the Prime Visa Golf Card.

3. DAUGHTERS OF ST PAUL DONATION

Paulines Publications Communications opened a new publication wing in Nairobi. To aid in the opening of the centre, Prime Bank through Riverside Drive Branch, donated KShs. 70,000/=

4. RUNNING FOR A CAUSE

The third edition of the First Lady Half Marathon (FLHM) was held on 6th March 2016 at the Nyayo stadium and First Lady Margaret Kenyatta led runners in 21km stretch. Prime Bank staff joined more than 50,000 participants in the 21km and 10km races.

5. PRIME BANK SUPPORTS FREEDOM FOR GIRLS SANITARY TOWELS PROJECT 2016

Prime Bank sponsored 3,333 orphaned and vulnerable girls with a full year's supply of sanitary towels, undergarments and health education.

CORPORATE SOCIAL RESPONSIBILITY

5a

5b

In one of its flagship Corporate Social Responsibility (CSR) projects – Freedom for Girls, the Bank donated KShs. 1 million towards ensuring girls do not miss school during their monthly cycle. This year, the Bank's staff also joined noble cause by donating KShs. 600,000 upping the donation from the Bank to KShs. 1.6million.

Since its inception, Prime Bank has so far donated KShs. 11 million hence ensuring 24,444 girls are guaranteed full year's supply of sanitary towels and undergarments.

In the course of the year, the Bank staff in partnership with Health Education Africa Resource Team (HEART) paid a visit to Leisure Lodge Rondwe Jalaram Girls Secondary school in Kwale County – one of the beneficiaries of the project - and donated a full year's supply of sanitary towels, undergarments and health education to vulnerable girls in the school.

6. PRIME BANK DONATES FOR MP SHAH CARDIAC CENTRE.

The Social Service League launched a state-of-the-art cardiac at the MP Shah Hospital which was officially inaugurated on

CORPORATE SOCIAL RESPONSIBILITY

6

31st January by Prime Bank Chairman Dr. Rasik Kantaria. Since its inception, the Dr. Rasik Kantaria Cardiac Centre has immensely reduced the cost for heart patients who have had to regularly travel abroad to seek treatment on various heart ailments.

Through its philanthropic Chairman Dr. Kantaria, Prime Bank donated KShs. 28 million towards the construction of the centre on 31st January 2016.

7a

7. SHARING CHRISTMAS WITH NYUMBANI CHILDREN'S HOME

Prime Bank staff paid a visit to Nyumbani Children's Home in Nairobi during the festive season.

The staff interacted and shared special moments with the children through various activities including singing and dancing and sharing a meal in a true reflection of the Bank's spirit of caring for the communities in which it operates in.

The staff shared the Christmas cake and served lunch to the children to celebrate the festive season.

7b


POLISHED, SIMPLE & FAST
Our newly upgraded website is now live on the URL - www.primebank.co.ke
Prime Bank Head Office
Nairobi: Riverside Drive
Pilot Line: (020) 420 3000 / 0719 090 000
Direct Line: (020) 420 3216
Fax: (020) 445 1247
Email: customercare@primebank.co.ke
Prime Bank
PUTTING YOU FIRST
customercare@primebank.co.ke | www.primebank.co.ke


More Money, More Time...
Convenience With Internet & Mobile Banking
PrimeNet Banking
PrimeMobi Banking
Prime Bank
PUTTING YOU FIRST
customercare@primebank.co.ke | www.primebank.co.ke


More Money, More Time...
Convenience With Internet & Mobile Banking
PrimeMobi Banking
Prime Bank
PUTTING YOU FIRST
customercare@primebank.co.ke | www.primebank.co.ke

"A team is not a group of people who work together. A team is a group of people who trust each other."

Simon Sinek

Head Office - Nairobi
Riverside Drive
Pilot Line: (020) 420 3000 | Mobile: 0719 090 000
Customer Care: (020) 420 3222 | Email: customercare@primebank.co.ke
Website: www.primebank.co.ke