Prime Bank

PUTTING YOU FIRST

ANNUAL REPORT & FINANCIAL STATEMENTS 2017

OUR VISION

To be the financial service provider of first choice.

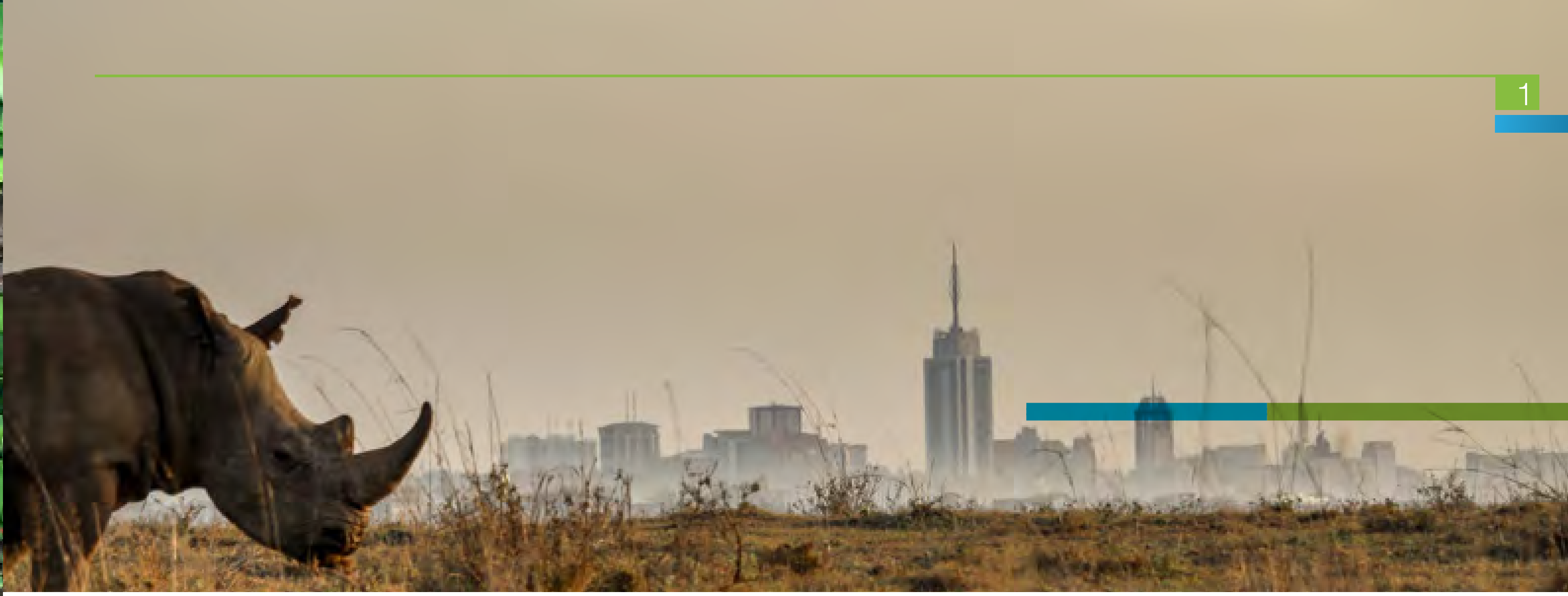
OUR MISSION

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

OUR CORE VALUES

- **Integrity**
- **Quality**
- **Innovativeness**
- **Social Responsibility**
- **Teamwork**

25 YEARS
Prime Bank
PUTTING YOU FIRST
est. 1992



CONTENTS

CORPORATE INFORMATION:

FINANCIAL STATEMENTS:

CORPORATE INFORMATION
BOARD OF DIRECTORS

CHAIRMAN
Dr. R. C. Kantaria

Vice Chairman
Mr. S. K. Shah

Director
Mr. J. N. Mungai

Director
Mr. T. M. Davidson

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

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 2017

" The Bank demonstrated its resilience to the tough operating conditions that persisted during the year. It recorded a net profit of Sh2.1 billion for the group in 2017 compared to Sh1.9 billion in 2016. "

It gives me great pleasure to present the Annual Report and Financial Statements of Prime Bank Group for the year ended December 31 2017.

The Bank weathered the difficult operating environment that prevailed throughout the year, attributed to the impact on the economy of prolonged political activity and protracted disputes over the outcome of the presidential elections. The prospects for banks also remained challenging due to the capping of interest rates that slowed down lending to the private sector, particularly to the small and medium enterprise (SME) segment.

Viewed against this background, the performance of the Bank during the year was encouraging and it reflected its resilience to domestic and external shocks. The Bank stands on solid foundation, built over the past 25 years.

OPERATING ENVIRONMENT

The global economic environment remained particularly challenging. In its December 2017 review, The International Monetary Fund (IMF) described 2017 as a "tumultuous year" that was marked by natural disasters, geopolitical tensions and deep political divisions in many countries.

Escalating trade tensions that included threat of tariffs between China and the United States, the two largest world economies, undermined the stability of global financial markets. However, growth in the global economy continued throughout the year across the world in response to recovery in global investment and growth in trade.

Economic prospects for African economies were generally mixed though economic growth improved in 2017 relative to 2016. The key drivers of growth included better prices of commodities, including fuel, that supported recovery in the three largest economies, Nigeria, South Africa and Angola, according to the World Bank's Africa Pulse released in April 2018. Growth in non-oil producing countries was uneven.

Kenya's economy emerged much stronger than expected, achieving a Gross Domestic Product (GDP) growth rate of 4.8 percent. Although the growth rate was lower than 5.5 percent projected earlier, the performance of the economy was remarkable considering the combined impact of the elections and a drought that caused devastating food shortages, leading to massive Government spending on maize and other food commodity imports.

BANKING SECTOR AND REGULATORY ENVIRONMENT

The performance of the banking sector in Kenya was mixed in 2017. The impact of the interest rate caps imposed by the Government in September 2016 reduced operating margins. The difficult economic environment that persisted during the election year also had a negative effect on business prospects.

The Central Bank of Kenya tightened bank regulation, in response to the failure of three banking institutions in 2016, to maintain the discipline and stability of the financial market.

The CBK's Monetary Policy Committee (MPC) maintained the benchmark Central Bank Rate (CBR) at 10 percent throughout 2017

CHAIRMAN'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

PRIME BANK PERFORMANCE
The Bank demonstrated its resilience to the tough operating conditions that persisted during the year. It recorded a net profit of KShs 2.1Billion for the Group in 2017 compared to KShs 1.9 Billion in 2016. The higher profit includes the profit of Tausi Assurance Company Limited.

The Bank acquired majority shares in Tausi Assurance Company Limited that will enable it to deepen its insurance services to its clients.

CORPORATE GOVERNANCE
As a reputable financial institution, we continue to maintain high standards of corporate governance and regular review of our corporate governance structures in line with regulatory requirements.

CORPORATE SOCIAL RESPONSIBILITY
The Bank has a long history of active engagement with the communities through our corporate social responsibility program. During the year, we deepened our partnerships and extended our support to a diverse range of community activities.

Under the health pillar, the Bank continued its engagement with Jalaram Medical Centre, Social Service League and Lions Sight First Eye Hospital. It is our belief that in supporting these health based organizations, the communities that we operate in will be able to access quality and affordable healthcare.

In our flagship program - Freedom for Girls - the number of school girls who are beneficiaries of Prime Bank's continuous support to the annual supply of sanitary towels hit 16,155 in the year 2017.

In the beginning of the year, when the Government declared the country's drought crisis a national emergency, the Bank's Head Office and Mombasa Branch mobilized tonnes of foodstuffs to reach out to those affected by famine particularly in Turkana County and Kilibasi, Kwale County. During the marking of 25 years of excellent service to our clients, we paid a visit to SCANN - Street Children's Assistance Network of Nakuru – an organization primarily founded with one major objective; to rehabilitate the needy, destitute Street Children in the society. In the spirit of caring and sharing, the Bank made donations to enable SCANN meet part of its obligations.

Towards the year end, the Bank once again joined Nyumbani Children's Home to celebrate Christmas, where staff interacted and shared special moments with the children through various activities - a true reflection of the Bank's spirit of caring for communities.

Throughout the year, we continued to focus on our long standing support for charitable institutions, non-governmental organizations, schools, and trusts, nurturing talent through promotion of sports, among other initiatives.

2018 AND BEYOND
The global financial market has demonstrated resilience to shocks but its real test will be determined by how long it takes for China and the USA to moderate their trade disputes. Africa's growth continues to improve, underpinned by global trade and financial markets, according to the World Bank, but challenges remain including rising public debt.

The domestic economy is showing signs of recovery from last year's drought and the impact of elections. The World Bank projects a Gross Domestic Product (GDP) growth rate of 5.5 percent, though the National Treasury foresees a higher growth rate of 5.8 – 6.0 percent. Stronger growth and implementation of the Government's Big 4 agenda on enhancing food security, manufacturing, affordable housing and universal healthcare, will improve the prospects of banking institutions.

The Kenya Shilling continues to strengthen against international currencies, driven by easing of political tensions since early this year. The MPC reduced the CBR to 9.5 percent in its March 2018 meeting to support economic recovery. The CBK has also issued a guidance note clarifying regulatory requirements on conducting money laundering and terrorism financing risk assessment by banking institutions under the Kenya Anti-Money Laundering and Combating Financing of Terrorism legislation. These developments will contribute to changes in business prospects for banking institutions.

The banking sector looks forward to removal of interest rate caps that is widely expected during the annual Budget statement in June. This would enable banks increase lending to the SME sector and improve their financial performance.

APPRECIATION
The marking of our 25th Anniversary was not so much a festivity, but it provided us an opportunity to pause and look back at the journey, a moment to look ahead at the mountains we must still climb.

CHAIRMAN'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

With humility I pay tribute to our founding partners, directors', and employees who have stood by the Bank since its inception. It goes without saying that all of the accomplishments of the Bank over the last 25 years would not have been possible without their dedication and input in the initial stages.

To our customers whose patronage and loyalty we do not take for granted, we remain true to our clarion call of "Putting you first'. We will always endeavor to exceed your expectations.

I thank my fellow Directors past and present for their zeal, wise counsel – as always - and commitment at both board and committee levels.

To our regulators, in particular, CBK, Capital Markets Authority (CMA), and the Treasury, we look forward to the next 25 years of collaboration and stable environment for the financial industry.

In conclusion, the performance of the Bank during the period under review was impressive notwithstanding the headwinds in the operating environment. On behalf of the Board, I wholeheartedly thank the staff and management team led by the Executive Director Mr. Amar Kantaria and Managing Director Mr. Bharat Jani for their efforts.

With best Wishes,

R.C Kantaria
Chairman

MANAGING DIRECTOR'S STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2017

"What started as a small bank with one branch at Kenindia House... now has more than 400 employees, serving over 35,000 customers in 20 branches across the country."

Prime Bank's performance for the year ended 31st December 2017 exhibited sustained growth despite a challenging and subdued business environment. I am pleased to present the highlights of our financial performance and the outlook for 2018.

The year 2017 marked Prime Bank's Silver Jubilee. What started in 1992 as a small bank with one branch at Kenindia House along Loita Street is now a solid institution with a story of resilience, hard work, exponential growth and flourishing partnerships.

The Bank now has more than 400 employees, serving over 35,000 customers in 20 branches across the country. Over the years, we have built an excellent brand and a reputation that is a source of tremendous pride to all our partners and stakeholders.

OPERATING ENVIRONMENT

Kenya's economy in 2017 was overshadowed by a credit squeeze owing to adverse effects of the interest capping law, ballooning public debt and rising oil prices coupled with election related uncertainties. The hostile weather led to the reduction in corporate earnings for commercial banks. Despite the challenging environment, the Bank remained resilient and focused on growing the business.

The year under review saw the Bank acquire 80.7% shareholding of Tausi Assurance Limited elevating our status to a financial group. The First Merchant Bank, Malawi strengthened its footprints in the South African Development Community (SADC) market by the acquisition of controlling interest in Barclays Bank of Zimbabwe.

PERFORMANCE

During the period under review, we shrugged off a tough and challenging year to record a consistent performance across all key financial indicators thereby making great strides towards achieving our strategic plan.

The Group's Net profit for the year stood at KShs.2.245Billion while the Bank's stood at KShs.1.842Billion representing a slight decline from KShs1.904Billion recorded in the corresponding period of 2016.

The Bank's balance sheet expanded to KShs.76.438Billion from KShs.65.338Billion representing an upward trajectory of 16% while non-performing loans remaining low at 3.4%.

Shareholder Funds went up by 32% from KShs.10.833Billion recorded in 2016 to KShs.14. 337Billion.

Our Net advances stood at KShs.38.25Billion while total deposits grew by KShs.8 Bn to KShs. 57.55Billion.

The Bank's liquidity ratio stood at 48.6%, much above the CBK's statutory minimum requirement of 20%.

During the year, we maintained strong capital adequacy positions closing the year with core capital of KShs. 11.175Billion against CBK's statutory requirement of KShs. 1Billion.

PRODUCT DEVELOPMENT

In 2017, we continued to expand our product offering by launching various products in line with the Bank's focus on innovation.

We expanded our local network to 20 branches across the country with the addition of UAP/Old Mutual Towers Branch in the course of last year. We also broadened our ATM network with new installations bringing the number to 21 countrywide.

MANAGING DIRECTOR'S STATEMENT (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

2017 saw the Bank roll out virtual branches in the form of Smart ATMs - with multi-functional capabilities including cash deposit and withdrawal, cheque deposits at any time, bill payment for utilities, among others. These virtual branches have already been installed at Diamond Plaza Parklands and Pandya Hospital in Mombasa.

We have also installed Cash Deposit Machines in Nairobi at Langata, Westlands, and in Eldoret. This will help customers deposit cash at their convenience any time 24/7 without having to visit the branch.

We stepped up efforts towards revamping our digital platforms with continued investment in technology on our PrimeMobi platform through the incorporation of PesaLink and mVisa systems in conjunction with Kenya Bankers Association and Visa respectively.
The two services provide a safe, secure and cost efficient platform for person-to-person real-time money transfer services.

GOING FORWARD

Going into 2018, challenges in our macroeconomic environment are likely to persist, our focus will be to ensure we continue to grow and become a more successful group in the next 25 years.

BRANCH NETWORK

Our expansion program will remain key to the realization of our strategic plan. In the course of the year, we will be opening one more branch with the sole purpose of taking services closer to our customers. Our Eldoret, Nyali and Parklands branches have already shifted to bigger premises for the comfort and convenience of our customers. I am pleased to inform our customers that Parklands and Nyali branches have moved to premises owned by the Bank.

"Bank on wheels" – a fully functional mobile unit branch is a concept that has already been actualized with the aim of offering banking services to select customers at their convenience, through a specially designed truck. Our customers will be able to deposit cash in the cash deposit machine installed in the mobile unit which will be taken to the customers' premises at a pre agreed time.

The Bank has also launched the Visa Platinum Credit Card, a premium product specifically designed to complement our customers' lifestyles. The card is equipped with a vast array of exclusive services symbolizing our customers' success.

APPRECIATION

The satisfactory performance during the year under review was as a result of focused team work.

On behalf of the management and staff of Prime Bank, I wish to extend our appreciation to Board of Directors under the leadership of Dr. Rasik Kantaria for their continuous support, encouragement and guidance.

I wish to thank our clients for their support, loyalty and cooperation to the Bank throughout the year.

I also thank my colleagues for their commitment, dedication and support. I compliment my team for remaining customer centric.

My appreciation goes to our regulator - Central Bank of Kenya (CBK) for the supervision and the maintenance of an enabling environment for the banking and financial services industry during the period under review.

Finally, while we have achieved much success to date, we are not complacent. We continue to work hard, seek improvements to our business model while maintaining our spirit of *"Putting You First"*

Bharat Jani
Managing Director

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2017

The Directors have pleasure in submitting their report together with the consolidated audited financial statements for the year ended 31 December 2017.

Incorporation
The company is domiciled in Kenya where it is incorporated as a private company limited by shares under the Kenyan Companies Act, 2015. The address of the registered office is set out on page 3.

Directorate
The directors who held office during the year and to the date of this report are set out on page 11. In accordance with Article 91 of the Articles of Association, S.K.Shah and David Hutchison retire by rotation and, being eligible, offer themselves for re-election.

Principal activities
The principal activities of the company are corporate and retail banking services while its subsidiary provides general insurance services with the exception of aviation insurance services.

Recommended dividend
The directors recommended and paid an interim dividend of KShs 400 million. (2016: KShs 500 million).

Statement as to disclosure to the company's auditor

With respect to each director at the time this report was approved:

(a) there is, so far as the person is aware, no relevant audit information of which the company's auditor is unaware; and
(b) the person has taken all the steps that the person ought to have taken as a director so as to be aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Terms of appointment of the auditor
Ernst & Young LLP continues in office in accordance with the company's Articles of Association and Section 719 of the Kenyan Companies Act, 2015. The directors monitor the effectiveness, objectivity and independence of the auditor. The directors also approve the annual audit engagement contract which sets out the terms of the auditor's appointment and the related fees. The agreed auditor's remuneration of KShs 3.9 million has been charged to profit or loss in the year.

Business review
On the background of a challenging economic environment occasioned by the long electioneering period, full year effect of the interest rate capping, the bank recorded a commendable performance during 2017.

Total assets of the bank grew from KShs 65 billion in 2016 to KShs 76 billion in 2017, deposits grew from KShs 49.3 billion to KShs 57.6 billion in 2017, while profit after tax was down by 3% from KShs 1.904 billion to Kshs1.84 billion in 2017. The decrease in profitability was mainly due to the effect of the interest rate capping law that came into effect in September 2016.

Management is aware of the liquidity risks that are inherent in the banking sector and have maintained the bank's liquidity ratio average at 49%, double that required under CBK regulations.

As regards the credit risk, a rigorous monitoring and close supervision of our credit portfolio throughout the year ensured that the non-performing loans were well under control at 3.4% way below the industry.

The bank acquired a majority stake in Tausi Assurance Company Limited during the year and will leverage on this acquisition to cross sell products and services between banking and insurance clients which is expected to boost performance in future.

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

In view of the challenges experienced, and in order to further strengthen the Bank and assist it grow to the next level, there are future plans to issue additional shares to raise approximately KShs 5 billion which will be invested in secure high return investments such as government securities, possibly in the second half of 2018.

Approval of financial statements
The financial statements were approved at a meeting of the Board of Directors held on

20th March 2018.

By order of the board

Anttshe.

....

Company Secretary
Nairobi

STATEMENT OF DIRECTORS' RESPONSIBILITIES
FOR THE YEAR ENDED 31 DECEMBER 2017

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the company as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the company keeps proper accounting records that: (a) show and explain the transactions of the company; (b) disclose, with reasonable accuracy, the financial position of the company; and (c) enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Companies Act, 2015.

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 20th March 2018 and signed on its behalf by:

……………………………… Director

……………………………… Director

……………………………… Director

……………………………… Director

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017

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 2017.......................... 5

Name of Director	Number of meetings attended
Dr. R. C. Kantaria (Chairman)	5
Mr. S. K. Shah (Vice Chairman)	5
Mr. A. R. Kantaria (Executive)	5
Mr. Bharat Jani (Managing)	5
Mr. D. G. M. Hutchison	4
Mr. J. N. Mungai	4
Mr. T. M. Davidson	4
Mr. J.K. Kibet	4
Mr. F. Mohamed	5

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

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

The Board has appointed nine committees – Credit, Debt Management, Audit, Risk and Compliance, IT, Assets and Liability Management, Operations and 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 and Assistant General Manager (Credit) are the other members of the Committee. Fresh credit proposals are placed before the Credit Committee for sanction. The Committee also reviews the credit limits sanctioned, as per the credit policy approved by the Board.

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

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

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

made by the bank supervision department of the Central Bank of Kenya in its inspection reports.

RISK AND COMPLIANCE COMMITTEE

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

IT COMMITTEE

Mr. T.M. Davidson, a non-executive director chairs this Committee and Mr. D.G.M. Hutchison, another non - executive director is a member. The other members are Mr. A. R. Kantaria, Executive Director, Mr. B. Jani, 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 Mr B. Jani Managing Director, Mr A.R. Kantaria the Executive Director, the General Manager, Chief Manager (Treasury), Assistant General Manager (Credit) and Chief Manager (Accounts) and Head of Risk and Compliance are the other members of the Committee. This Committee monitors the liquidity position of the Bank and the compliance with regard to statutory liquidity ratio, cash reserve ratio and foreign exchange exposure as per the prudential guidelines of the 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 Deputy General Manager, Director of 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, Managing Director and has Mr. A.R. Kantaria, 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.

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

FOR THE YEAR ENDED 31 DECEMBER 2017

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the accompanying financial statements of Prime Bank Limited set out on pages 15 to 98, which comprise the statement of financial position as at 31 December 2017, 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 2017, 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 Report of the Directors as required by the Kenyan Companies Act, 2015 and the Statement of Corporate Governance. 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.

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,

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

FOR THE YEAR ENDED 31 DECEMBER 2017

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.

- 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 matters prescribed by the Kenyan Companies Act, 2015

In our opinion the information given in the report of the directors on page 9 is consistent with the financial statements.

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

Nairobi, Kenya

29th March 2018

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017* KShs '000
ASSETS		
Cash and balances with the Central Bank of Kenya	5	5,265,571
Placements and balances with other banks	6	3,090,911
Treasury bills and term notes	7	7,895,066
Held to maturity investments	8	12,803,105
Investment in bonds-available for sale	9	3,750,776
Investment in ordinary shares- available for sale	10(a)	3,046,775
Investment in ordinary shares-at fair value through profit or loss	10(b)	141,222
Loans and advances	11	38,403,672
Other assets	12	858,235
Leasehold land	14	501,911
Property and equipment	15	1,374,058
Intangible assets	16	769,449
Tax recoverable	22	87,158
TOTAL ASSETS		**77,987,909**
LIABILITIES AND EQUITY		
LIABILITIES		
Balances due to banks and financial institutions	18	2,798,287
Medium term note	19	1,033,000
Deposits from customers	20	57,283,242
Other liabilities	21	1,827,185
Deferred tax liability	17	127,450
TOTAL LIABILITIES		**63,069,164**
EQUITY		
Share capital	23	5,000,000
Reserves	24	9,661,956
Equity attributable to equity holders of the parent		14,661,956
Non-controlling interests		256,789
TOTAL EQUITY		**14,918,745**
TOTAL LIABILITIES AND EQUITY		**77,987,909**

**As disclosed in note 13, the bank acquired a majority stake in Tausi Assurance Company Limited in the course of the year, and as such, no comparative figures for the Group have been presented in these financial statements.*

These financial statements were approved by the Board of Directors on 20th March 2018 and signed on its behalf by: -

Director

Director

Director

Director

COMPANY STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 KShs '000	2016 KShs '000
ASSETS			
Cash and balances with the Central Bank of Kenya	5	5,257,076	3,200,067
Placements and balances with other banks	6	2,985,079	2,713,176
Treasury bills and term notes	7	7,895,066	6,106,650
Held to maturity investments	8	11,909,836	7,688,071
Investment in bonds-available for sale	9	3,651,715	3,698,408
Investment in ordinary shares available for sale	10	2,951,142	981,561
Loans and advances	11	38,255,467	38,559,603
Other assets	12	383,457	479,928
Investment in subsidiary	13(b)	1,395,692	-
Investment in associate	13(d)	-	372,648
Leasehold land	14	409,411	340,000
Property and equipment	15	1,145,748	970,664
Intangible assets	16	124,730	159,642
Tax recoverable	22	73,780	67,793
TOTAL ASSETS		76,438,199	65,338,211
LIABILITIES AND EQUITY			
LIABILITIES			
Balances due to banks and financial institutions	18	2,790,922	3,499,822
Medium term note	19	1,033,000	1,024,000
Deposits from customers	20	57,554,722	49,322,594
Other liabilities	21	657,042	583,772
Deferred tax liability	17	64,794	74,030
TOTAL LIABILITIES		62,100,480	54,504,218
EQUITY			
Share capital	23	5,000,000	5,000,000
Reserves	24	9,337,719	5,833,993
TOTAL EQUITY		14,337,719	10,833,993
TOTAL LIABILITIES AND EQUITY		76,438,199	65,338,211

These financial statements were approved by the Board of Directors on 20th March 2018 and signed on its behalf by: -

Director

Director

Director

Director

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017* KShs '000
Interest income	25	7,370,226
Interest expense	26	(3,741,459)
Net interest income		3,628,767
Fees and commission income	27	512,383
Foreign exchange gains		196,974
Dividend income		25,004
Other income	28	750,312
		5,113,440
Allowance for impairment of loans and advances	29	(340,588)
Other operating expenses	30	(2,384,746)
Profit before tax	**31**	**2,388,106**
Income tax expense	22	(142,963)
Profit for the year		**2,245,143**
Attributable to:		
Equity holders of the parent		1,812,953
Non-controlling interests		432,190
		2,245,143
Earnings per share (basic and diluted) (KShs):		
Attributable to:		
Equity holders of the parent (KShs)	32	363

**As disclosed in note 13, the bank acquired a majority stake in Tausi Assurance Company Limited in the course of the year, and as such, no comparative figures for the Group have been presented in these financial statements.*

COMPANY STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 KShs '000	2016 KShs '000
Interest income	25	7,370,226	7,578,910
Interest expense	26	(3,741,459)	(4,027,947)
Net interest income		3,628,767	3,550,963
Fees and commission income	27	512,383	467,432
Foreign exchange gains		196,974	298,311
Dividend income		25,004	19,779
Other income	28	168,298	141,421
		4,531,426	4,477,906
Allowance for impairment of loans and advances	29	(340,588)	(209,484)
Other operating expenses	30	(2,320,374)	(1,998,457)
Profit before tax and share of profit of associate	31	1,870,464	2,269,965
Share of profit of associate	13	106,513	65,857
Profit before tax		1,976,977	2,335,822
Income tax expense	22	(134,968)	(431,116)
Profit for the year		**1,842,009**	**1,904,706**
Earnings per share (basic and diluted) (KShs)	32	368	381

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017* KShs '000
Profit for the year		2,245,143
Other comprehensive income		
Other comprehensive income to be reclassified to profit or loss in subsequent periods:		
Available for sale financial assets:		
Gain arising during the year		2,065,785
Reclassification of available for sale reserve to profit or loss on sale of investments		-
		2,065,785
Other comprehensive income that will not be reclassified to profit or loss in subsequent periods:		
Revaluation of land and buildings		4,866
Deferred income tax on revaluation surplus	17	(1,460)
		3,406
Other comprehensive income for the year, net of tax		2,069,191
Total comprehensive income for the year, net of tax		4,314,334

**As disclosed in note 13, the bank acquired a majority stake in Tausi Assurance Company Limited in the course of the year, and as such, no comparative figures for the Group have been presented in these financial statements.*

COMPANY STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 KShs '000	2016 KShs '000
Profit for the year		1,842,009	1,904,706
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Available for sale financial assets:			
Gains arising during the year		2,061,716	191,370
Reclassification of available for sale reserve to profit or loss on sale of investments		-	(29,296)
		2,061,716	162,074
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 of associate		-	-
Other comprehensive income for the year, net of tax		2,061,716	704,080
Total comprehensive income for the year, net of tax		3,903,725	2,608,786

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017

	Share capital KShs '000	Retained earnings KShs '000	Available-for-sale reserve KShs '000	Asset revaluation reserve KShs '000	Total KShs '000	Non-controlling interests KShs '000	Total equity KShs '000
At 1 January 2017	-	-	-	-	-	-	-
On business combination	5,000,000	5,011,975	280,012	542,006	10,833,993	-	10,833,993
Dividends paid – 2017 (note 34)	-	(400,000)	-	-	(400,000)	-	(400,000)
NCI arising on business combination (note 13)	-	-	-	-	-	364,648	364,648
Acquisition of NCI (note 13d)	-	(75,508)	-	-	(75,508)	(118,723)	(194,231)
Total comprehensive income							
- profit for the year	-	2,236,384	-	-	2,236,384	8,759	2,245,143
- other comprehensive income –available for sale	-	-	2,064,640	-	2,064,640	1,146	2,065,786
- other comprehensive income- asset revaluation reserve	-	-	-	2,447	2,447	959	3,406
At 31 December 2017	5,000,000	6,772,851	2,344,652	544,453	14,661,956	256,789	14,918,745

COMPANY STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER 2017

	Share capital KShs '000	Retained earnings KShs '000	Available-for-sale reserve KShs '000	Asset revaluation reserve KShs '000	Total KShs '000
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
At 1 January 2017	5,000,000	5,011,975	280,012	542,006	10,833,993
Dividends paid – 2017					
(note 34)	-	(400,000)	-	-	(400,000)
Total comprehensive income		-			
– profit for the year	-	1,842,009	-	-	1,842,009
- other comprehensive income	-	-	2,061,716	-	2,061,716
At 31 December 2017	5,000,000	6,453,984	2,341,728	542,006	14,337,718

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017* KShs '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before tax		2,388,116
Adjustments for:		
Gain on disposal of property and equipment		(4,474)
Dividends received		(52,833)
Effect of foreign exchange gain on translation of foreign currency balances held		(196,974)
Fair value gain on previously held shares in associate	28	(372,018)
Fair value gain on available for sale shares	10(b)	(23,300)
Provision for staff leave		1,946
Allowances for impairment of loans and advances	29	340,588
Amortisation of leasehold land	14	9,069
Depreciation on property and equipment	15	134,869
Amortisation of intangible assets	16	80,594
Gain on sale of available for sale investments		-
CASH FLOWS FROM OPERATING ACTIVITIES BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		2,304,968
Increase in cash ratio reserve		(252,754)
Increase in securities maturing after 91 days		(1,857,505)
Decrease in loans and advances to customers		148,205
Increase in other assets		(378,307)
Increase in deposits from customers		7,960,649
Increase in other liabilities		1,243,413
Cash flows from operating activities		9,169,662
Income taxes paid	22	(160,706)
NET CASH FLOWS FROM OPERATING ACTIVITIES		9,008,956
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of property and equipment		5,083
Dividend income		52,833
Proceeds from redemption of held to maturity investments	8	1,677,068
Proceeds from redemption of treasury bills and term notes	7	12,779,350
Proceeds from sale of investments in bonds-available for sale	9	149,554
Purchase of held to maturity investments	8	(6,792,102)
Purchase of treasury bills and term notes	7	(14,567,766)
Purchase of investments in bonds- available for sale	9	(103,620)
Purchase of property and equipment	15	(297,825)
Purchase of intangible assets	16	(47,906)
Acquisition of a subsidiary, net of cash acquired	13(a)	(348,566)

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017* KShs '000
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(7,493,897)
CASH FLOWS FROM FINANCING ACTIVITIES		
Acquisition of non-controlling interests	13(b)	(194,231)
Dividends paid to equity holders of the parent	34	(400,000)
NET CASH FLOWS USED IN FINANCING ACTIVITIES		(594,231)
Net increase in cash and cash equivalents		920,828
Effect of foreign exchange gain on translation of foreign currency balances held		196,974
Cash and cash equivalents at 1 January		2,830,186
Cash and cash equivalents at 31 December	35	3,947,610

COMPANY STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 KShs '000	2016 KShs '000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		1,976,977	2,335,822
Adjustments for:			
Gain on disposal of property and equipment		(4,474)	(7,721)
Dividends received		(25,004)	(19,779)
Effect of foreign exchange gain on translation of foreign currency balances held		(196,974)	(298,311)
Provision for staff leave		1,946	580
Allowances for impairment of loans and advances	29	340,588	209,484
Share of profit of an associate	13	(106,513)	(65,857)
Amortisation of leasehold land	14	7,833	859
Depreciation on property and equipment	15	130,761	100,276
Impairment loss	15	-	2,020
Amortisation of intangible assets	16	80,595	73,920
Write-off of intangible assets	16	-	635
Gain on sale of available for sale investments		-	(29,296)
CASH FLOWS FROM OPERATING ACTIVITIES BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		2,205,734	2,302,632
Increase/(decrease) in cash ratio reserve		(252,754)	39,282
Increase in securities maturing after 91 days		(155,789)	(2,275,648)
Decrease in loans and advances to customers		197,798	1,076,013
Decrease/(increase) in other assets		96,471	(43,346)
Increase/(decrease) in deposits from customers		8,232,128	(1,557,964)
Medium term note issued (note 17)		-	1,024,000
(Decrease)/increase in other liabilities		(73,271)	61,648
Cash flows from operating activities		10,250,318	626,617
Income taxes paid	22	(149,318)	(483,706)
NET CASH FLOWS FROM OPERATING ACTIVITIES		10,101,000	142,911

COMPANY STATEMENT OF CASH FLOWS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 KShs '000	2016 KShs '000
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of property and equipment		5,083	48,349
Dividend income		25,004	19,779
Proceeds from redemption of held to maturity investments	8	1,669,831	1,725,976
Proceeds from redemption of treasury bills and term notes	7	12,779,350	13,697,336
Proceeds from sale of investments in bonds-available for sale	9	144,995	1,722,796
Purchase of ordinary shares - available for sale	10	-	(23,671)
Purchase of shares from associate	13(b)	(23,123)	-
Investments in subsidiary	13(b)	(727,006)	-
Dividend from associate	13(b)	27,829	22,530
Purchase of held to maturity investments	8	(5,891,596)	(2,171,024)
Purchase of treasury bills and term notes	7	(14,567,766)	(13,100,955)
Purchase of investments in bonds- available for sale	9	-	(2,344,949)
Purchase of property and equipment	15	(383,698)	(110,923)
Purchase of intangible assets	16	(45,683)	(70,492)
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(6,986,780)	(585,248)
CASH FLOWS FROM FINANCING ACTIVITIES			
Purchase of shares in subsidiary	13(b)	(194,231)	-
Dividends paid during the year	34	(400,000)	(500,000)
NET CASH FLOWS USED IN FINANCING ACTIVITIES		(594,231)	(500,000)
Net increase/(decrease) in cash and cash equivalents		2,519,989	(942,337)
Effect of foreign exchange gain on translation of foreign currency balances held		196,974	146,457
Cash and cash equivalents at 1 January		1,123,686	1,919,566
Cash and cash equivalents at 31 December	35	3,840,648	1,123,685

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017

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. The consolidated financial statements comprise the Bank and its subsidiaries together referred to as “the Group”. The Group is primarily involved in corporate and retail banking and all classes of general insurance with the exception of aviation insurance services as defined by section 31 of the insurance Act (Cap 487).

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES
New and amended standards and interpretations
The group applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2017. The group 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 2017, they did not have a material impact on the annual financial statements of the group. The nature and the impact of each new standard or amendment is described below.

IAS 7 Disclosure Initiative – Amendments to IAS 7
The amendments to IAS 7 Statement of Cash Flows are part of the IASB’s Disclosure Initiative and help users of financial statements better understand changes in an entity’s debt. The amendments require entities to provide disclosures about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses).

On initial application of the amendment, entities are not required to provide comparative information for preceding periods. The amendment has no impact on the Group.

IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12
Effective for annual periods beginning on or after 1 January 2017.

The IASB issued the amendments to IAS 12 Income Taxes to clarify the accounting for deferred tax assets for unrealised losses on debt instruments measured at fair value. 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 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 did not have any impact on the Group.

IFRS 12 Disclosure of Interests in Other Entities - Clarification of the scope of the disclosure requirements
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. These amendments did not affect the Group’s financial statements as there were no subsidiaries or associates classified as held for sale.

Standards issued but not yet effective
Annual Improvements 2014-2016 Cycle
IFRS 1 First-time Adoption of International Financial Reporting Standards - Deletion of short term exemptions for first-time adopters
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. This amendments are applied retrospectively.

IAS 28 Investments in Associates and Joint Ventures - Clarification that measuring investees at fair value through profit or loss is an investment - by -investment choice
The amendments clarify 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 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

2.CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Standards issued but not yet effective (continued)

IAS 28 Investments in Associates and Joint Ventures - Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice (continued)

(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.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 replaces all existing revenue requirements in IFRS (IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers and SIC 31 Revenue – Barter Transactions Involving Advertising Services) and applies to all revenue arising from contracts with customers, unless the contracts are in the scope of other standards, such as IAS 17 Leases (or IFRS 16 Leases, once applied). Its requirements also provide a model for the recognition and measurement of gains and losses on disposal of certain non-financial assets, including property, plant and equipment and intangible assets. The standard outlines the principles an entity must apply to measure and recognise revenue. The core principle is that an entity will recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer.

In April 2016, the IASB issued amendments to IFRS 15 to address several implementation issues discussed by the Joint Transition Resource Group for Revenue Recognition. The amendments have an effective date of 1 January 2018, which is the effective date of IFRS 15. Entities are required to apply these amendments retrospectively. The amendments are intended to clarify the requirements in IFRS 15, not to change the standard. Entities can choose to apply the standard using either a full retrospective approach or a modified retrospective approach, with some limited relief provided under either approach. Early application is permitted and must be disclosed. The Group does not anticipate early adopting IFRS 15 and is currently evaluating its impact.

IFRS 9 Financial Instruments

On 29 July 2014, the IASB issued the final IFRS 9 Financial Instruments Standard, which brings together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement.

The standard is effective for annual period beginning on or after 1 January 2018 with retrospective application permitted if, and only if, it is possible without the use of hindsight. The Bank will take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement including impairment changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will be recognised in retained earnings and reserves as at 1 January 2018.

The new classification and measurement and impairment requirements will be applied by adjusting our Balance Sheet on 1 January 2018, the date of initial application, with no restatement of comparative period financial information.

Based on current estimates, the adoption of IFRS 9 is not expected to result in a reduction to retained earnings as at 1 January 2018. The estimated IFRS 9 impairments are lower than those calculated under IAS 39 by between 34- to 40%. This is primarily attributable to the fact the Bank's facilities are highly collaterised.

The adoption of IFRS 9 is therefore not expected to change the Bank's Capital Adequacy Ratios. We will continue to monitor and refine certain elements of our impairment process.

Classification and measurement

IFRS 9 introduces a principles-based approach to the classification of financial assets. Debt instruments, including hybrid contracts, are measured at fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI) or amortized cost based on the nature of the cash flows of the assets and an entity's business model. These categories replace the existing IAS 39 classifications of FVTPL, available for sale (AFS), loans and receivables, and held-to-maturity. Equity instruments are measured at FVTPL, unless they are not held for trading purposes, in which case an irrevocable election can be made on initial recognition to measure them at FVOCI with no subsequent reclassification to profit or loss.

For financial liabilities, most of the pre-existing requirements for classification and measurement previously included in IAS 39 were carried forward unchanged into IFRS 9 other than the provisions relating to the recognition of changes in own credit risk for financial liabilities designated at fair value through profit or loss, as permitted by IFRS 9.

The combined application of the contractual cash flow

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

2.CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Standards issued but not yet effective (continued)

Classification and measurement (continued)

characteristics and business model tests as at 1 January 2018 is expected to have no significant impact when compared to the Bank's classification under IAS 39.

Impairment

Overall comparison of the new impairment model and the current model IFRS 9 introduces a new, single impairment model for financial assets that requires the recognition of expected credit losses (ECL) rather than incurred losses as applied under the current standard. Currently, impairment losses are recognized if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after initial recognition of the asset and that loss event has a detrimental impact on the estimated future cash flows of the asset that can be reliably estimated. If there is no objective evidence of impairment for an individual financial asset, that financial asset is included in a group of assets with similar credit risk characteristics and collectively assessed for impairment losses incurred but not yet identified. Under IFRS 9, ECLs will be recognized in profit or loss before a loss event has occurred, which could result in earlier recognition of credit losses compared to the current model.

Under the current standard, incurred losses are measured by incorporating reasonable and supportable information about past events and current conditions. Under IFRS 9, the ECL model, which is forward-looking, in addition requires that forecasts of future events and economic conditions be used when determining significant increases in credit risk and when measuring expected losses. Forward-looking macroeconomic factors such as unemployment rates, inflation rates, interest rates, exchange rates, domestic borrowing, credit to private sector and gross domestic product will be incorporated into the risk parameters. Estimating forward-looking information will require significant judgment and must be consistent with the forward-looking information used by the Bank for other purposes, such as forecasting and budgeting.

Scope

Under IFRS 9, the same impairment model is applied to all financial assets, except for financial assets classified or designated as at FVTPL and equity securities designated as at FVOCI, which are not subject to impairment assessment. The scope of the IFRS 9 expected credit loss impairment model includes amortized cost financial assets, debt securities classified as at FVOCI, and off balance sheet loan commitments and financial guarantees which were previously provided for under IAS 37 Provisions, Contingent Liabilities and Contingent Assets (IAS 37). The above-mentioned reclassifications into or out of these categories under IFRS 9 and items that previously fell under the IAS 37 framework were considered in determining the scope of the Bank's application of the new expected credit loss impairment model.

Measurement of expected credit losses

ECLs are measured as the probability-weighted present value of expected cash shortfalls over the remaining expected life of the financial instrument.

The measurement of ECLs will be based primarily on the product of the instrument's probability of default (PD), loss given default (LGD), and exposure at default (EAD).

The ECL model contains a three-stage approach that is based on the change in the credit quality of assets since initial recognition.

- Stage 1 - If, at the reporting date, the credit risk of non-impaired financial instruments has not increased significantly since initial recognition, these financial instruments are classified in Stage 1, and a loss allowance that is measured, at each reporting date, at an amount equal to 12-month expected credit losses is recorded.
- Stage 2 - When there is a significant increase in credit risk since initial recognition, these non-impaired financial instruments are migrated to Stage 2, and a loss allowance that is measured, at each reporting date, at an amount equal to lifetime expected credit losses is recorded. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, the ECL model requires reverting to recognition of 12-month expected credit losses.
- When one or more events that have a detrimental impact on the estimated future cash flows of a financial asset have occurred, the financial asset is considered credit-impaired and is migrated to Stage 3, and an allowance equal to lifetime expected losses continues to be recorded or the financial asset is written off.

Interest income is calculated on the gross carrying amount of the financial assets in Stages 1 and 2 and on the net carrying amount of the financial assets in Stage 3.

Assessment of significant increase in credit risk

The determination of a significant increase in credit risk takes into account many different factors including a comparison of a financial instrument's credit risk or PD

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

2.CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Standards issued but not yet effective (continued)

Assessment of significant increase in credit risk (continued)

at the reporting date and the credit risk or PD at the date of initial recognition. The Bank has included relative and absolute thresholds in the definition of significant increase in credit risk and a backstop of 30 days past due. All financial instruments that are 30 days past due will be migrated to Stage 2.

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 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. These amendments are not expected to have any impact on the Group.

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

The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing IFRS 17 Insurance Contracts, which replaces 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 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 other comprehensive income.

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.

The Group is considering the impact of these amendments.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

2.CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Standards issued but not yet effective (continued)

Transfers of Investment Property – Amendments to IAS 40 (continued)

These amendments are not expected to have any impact on the Group.

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 non-monetary 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.

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: The beginning of the reporting period in which the entity first applies the interpretation or 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.

First-time adopters of IFRS are also permitted to apply the interpretation prospectively to all assets, expenses and income initially recognised on or after the date of transition to IFRS.

The Group is considering the impact of these amendments.

IFRS 16 Leases

IFRS 16 requires lessees to account for all leases under a single on-balance sheet model in a similar way to finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. Early application is permitted, but not before an entity applies IFRS 15.

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

IFRIC Interpretation 23 Uncertainty over Income Tax Treatments

The interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12. The interpretation does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. An entity has to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed.

The Group is considering the impact of these amendments.

Prepayment Features with Negative Compensation - Amendments to IFRS 9

Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. The amendments must be applied retrospectively; earlier application is permitted.

Long-term interests in associates and joint ventures - Amendments to IAS 28

The amendments clarify that an entity applies IFRS 9 Financial Instruments to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in IFRS 9 applies to such long-term interests.

The Board also clarified that, in applying IFRS 9, an entity does not take account of any losses of the associate or joint

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

2.CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Standards issued but not yet effective (continued)

Long-term interests in associates and joint ventures - Amendments to IAS 28 (continued)

venture, or any impairment losses on the net investment, recognised as adjustments to the net investment in the associate or joint venture that arise from applying IAS 28 Investments in Associates and Joint Ventures.

Entities must apply the amendments retrospectively, with certain exceptions. Early application of the amendments is permitted and must be disclosed.

Annual Improvements 2015-2017 Cycle

IFRS 3 Business Combinations- Previously held Interests in a joint operation

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation. An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2019. Earlier application is permitted.

IFRS 11 Joint Arrangements- Previously held Interests in a joint operation

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured. An entity applies those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after 1 January 2019. Earlier application is permitted.

IAS 12 Income Taxes- Income tax consequences of payments on financial instruments classified as equity

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events. An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period.

IAS 23 Borrowing Costs- Borrowing costs eligible for capitalization

The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete. An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted.

IFRS 17 Insurance Contracts

IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers.

In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach)
- A simplified approach (the premium allocation approach) mainly for short-duration contracts

IFRS 17 is effective for reporting periods starting on or after 1 January 2021, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17.The Board decided on a retrospective approach for estimating the CSM on the transition date. However, if full retrospective application, as defined by IAS 8 for a group of insurance contracts, is impracticable, an entity is required to choose one of the following two alternatives:

Modified retrospective approach - based on reasonable and supportable information available without undue cost and effort to the entity, certain modifications are applied to the extent full retrospective application is not possible, but still with the objective to achieve the closest possible

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

2.CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Standards issued but not yet effective (continued)

IFRS 17 Insurance Contracts (continued)

outcome to retrospective application

Fair value approach - the CSM is determined as the positive difference between the fair value determined in accordance with IFRS 13 Fair Value Measurement and the fulfilment cash flows (any negative difference would be recognised in retained earnings at the transition date)
Both the modified retrospective approach and the fair value approach provide transitional reliefs for determining the grouping of contracts. If an entity cannot obtain reasonable and supportable information necessary to apply the modified retrospective approach, it is required to apply the fair value approach.

The Group is considering the impact of these amendments.

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

The amendments address the conflict between IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures 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 a full gain or loss is recognised when a transfer to an associate or joint venture involves a business as defined in IFRS 3 Business Combinations. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The amendments must be applied prospectively. Early application is permitted and must be disclosed.

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 consolidated 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) and the requirements of the Kenyan Companies Act, 2015. The financial statements are presented in the functional currency, Kenya Shillings, rounded to the nearest thousand (KShs '000),except where otherwise indicated and have been prepared on a historical basis except for available for sale investments, investments at fair value through profit or loss 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 statement of profit and loss and the statement of comprehensive income.

(b) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at 31 December 2017. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Specifically, the Group controls an investee if, and only if, the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee
- The ability to use its power over the investee to affect its returns

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement(s) with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of OCI are attributed to the equity holders of the parent of the Group and to

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value.

(c) Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 Financial Instruments: Recognition and Measurement, is measured at fair value with the changes in fair value recognised in the statement of profit or loss in accordance with IAS 39.Other contingent consideration that is not within the scope of IAS 39 is measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests and any previous interest held over the net identifiable assets acquired and liabilities assumed). If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit (CGU) and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

(d) 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Fair value measurement (continued)

disclosures for financial instruments that are measured at fair value are made in note 41.

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.

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.

(e) 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

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 are not entered into with the intention of immediate or short-term resale and are not classified as 'Financial assets held for trading', designated as 'Financial investments - available-for-sale' or 'Financial

3. SIGNIFICANT ACCOUNTING POLICIES (continued)
(e) Financial assets and liabilities (continued)
(ii) Subsequent measurement (continued)
2) Loans and receivables (continued)

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 statement of profit or loss 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 unrealized gains/losses recognized as other comprehensive income and credited in the available for sale reserve until the investment is derecognized, at which time, the cumulative gain or loss is recognized 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 recognized 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.

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

Financial liabilities designated upon initial

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Financial assets and liabilities (continued)

4) Cash and cash equivalents (continued)

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 amortized cost using the effective interest rate method. Gains and losses are recognized in profit or loss when the liabilities are derecognized as well as through the effective interest rate method (EIR) amortization process.

Borrowings are recognized initially at fair value. After initial measurement, borrowings are subsequently measured at amortized 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.

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 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.

(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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)
(e) Financial assets and liabilities (continued)
4) Cash and cash equivalents (continued)

(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 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Financial assets and liabilities (continued)

(viii) Impairment of financial assets (continued)

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 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.

(f) 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:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Recognition of income and expenses (continued)

(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.

(iii) Dividend income

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

(g) 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%
Office equipment	12.50%
Motor vehicles	25.00%
Computer equipment	25% - 33.33%
Leasehold improvements	12.50%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Property and equipment (continued)

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.

(h) 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.

(i) Employee benefits

(i) Defined contribution plans

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

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

(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.

(j) 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Taxation (continued)

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

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

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

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

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

Deferred tax assets and deferred tax liabilities are 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.

(k) 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.

(l) 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 statement of profit or loss.

(m) 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Intangible assets (continued)

changes in accounting estimates. The amortisation expense on intangible assets is recognised in profit or loss in the expense category consistent with the function of the asset.

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

• Computer software	5 years
• Visa license	5 years

(n) Dividends

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

(o) 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 statement of profit or loss unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

(p) 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 statement of profit or loss 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

3. SIGNIFICANT ACCOUNTING POLICIES (continued)
(p) Investment in an associate (continued)

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

(q) 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.

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 statement of profit or loss. 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 (a).

(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 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.(a).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

5. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Cash in hand	621,726	613,231	543,618
Balances with Central Bank of Kenya:			
- Restricted balances (Cash Reserve Ratio)	1,644,664	1,644,664	1,391,910
- Unrestricted balances	2,501,021	2,501,021	764,362
Cheques and items for clearing	498,160	498,160	500,177
	5,265,571	5,257,076	3,200,067

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 2017, the Cash Reserve Ratio requirement was 5.25% (2016 – 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

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Lending to other banks and financial institutions	984,181	878,349	1,943,583
Lending and balances with banks outside Kenya	2,106,730	2,106,730	769,593
	3,090,911	2,985,079	2,713,176

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

7. TREASURY BILLS AND TERM NOTES

	COMPANY	
	2017 KShs '000	2016 KShs '000
At 1 January	6,106,650	6,703,031
Purchase of investment securities	14,567,766	13,100,955
Retirement of investment securities	(12,779,350)	(13,697,336)
At 31 December	7,895,066	6,106,650
Treasury bills:		3,200,067
Maturing within 91 days of the date of acquisition	-	-
Maturing after 91 days to 182 days of the date of acquisition	3,597,631	3,922,171
Maturing after 182 days of the date of acquisition	3,923,059	1,675,897
Term notes:		
Maturing within 91 days of the date of acquisition	34,079	102,174
Maturing after 91 days to 182 days of the date of acquisition	64,465	29,911
Maturing after 182 days of the date of acquisition	275,832	376,497
	7,895,066	6,106,650

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 2017 was 10.66% (2016: 10.91%).

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

8. HELD TO MATURITY INVESTMENTS

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
At 1 January	7,688,071	7,688,071	7,243,023
Purchase of investment securities	6,792,102	5,891,596	2,171,024
Retirement of investment securities	(1,677,068)	(1,669,831)	(1,725,976)
At 31 December	12,803,105	11,909,836	7,688,071
Treasury and corporate bonds			
Maturing after 182 days of the date of acquisition	12,803,105	11,909,836	7,688,071

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

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.

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
As at 1 January	3,698,408	3,698,408	2,912,557
Purchase of investment securities	103,620	-	2,344,949
Sales of investment securities	(149,554)	(144,995)	(1,722,796)
Foreign exchange gain	1,348	1,348	33,977
Gain on fair valuation	96,954	96,954	129,721
As at 31 December	3,750,776	3,651,715	3,698,408
The maturity profile is as follows:			
Within one year	4,442	4,442	-
After one year but within two years	251,820	227,379	8,084
After two years but within five years	2,007,224	2,007,224	440,821
After five years	1,487,290	1,412,670	3,249,503
	3,750,776	3,651,715	3,698,408

10. INVESTMENT IN ORDINARY SHARES

(a) Available-for-sale

(i)Investment in listed shares:

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Investment as at 1 January	788,933	718,504	686,151
Gain in fair value	1,989,966	1,964,762	32,353
As at 31 December	2,778,899	2,683,266	718,504

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 1.91 billion (2016: gain of KShs 51.6 million).The fair value movement relating to locally held shares amounts to a gain of KShs 55.9 million (2016: loss of KShs 19.3million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

10. INVESTMENT IN ORDINARY SHARES (continued)

(a) Available-for-sale (continued)

(ii) Investment in privately held shares:

	GROUP & COMPANY	
	2017 KShs '000	2016 KShs '000
Capital Bank Limited, Botswana	125,183	96,445
Capital Bank Mozambique	115,438	142,080
Cooperative Bank Plc, United Kingdom	27,255	24,532
As at 31 December	267,876	263,057
The movement in these shares is summarised below:		
As at 1 January	263,057	244,124
Purchase of shares	-	23,671
Foreign exchange gain/(loss)	4,819	(4,738)
As at 31 December	267,876	263,057

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 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 unrealized gains/losses recognized as other comprehensive income in the available for sale reserve until the investment is derecognized or impaired.
Foreign exchange gains or losses on available-for-sale debt security investments are recognized in profit or loss.

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Investment in listed shares - note 10 (a) (i)	2,778,899	2,683,266	718,504
Investment in privately held shares - note 10 (a) (ii)	267,876	267,876	263,057
Total investment in ordinary shares available for sale	3,046,775	2,951,142	981,561

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

10. INVESTMENT IN ORDINARY SHARES (continued)

(b) At fair value through profit and loss

	GROUP & COMPANY	
	2017 KShs '000	2016 KShs '000
At start of the year	117,946	-
Disposals	(24)	-
Fair value loss	23,300	-
	141,222	-

11. LOANS AND ADVANCES

(a) Loans and advances to customers

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Loans and advances to customers (gross)	39,774,741	39,626,536	39,824,616
Less – Allowances on impairment of loans and advances - note 11 (b)	(1,371,069)	(1,371,069)	(1,265,013)
Loans and advances to customers net of provisions allowances	38,403,672	38,255,467	38,559,603

(b) Allowances on impairment of loans and advances - COMPANY

	Specific allowance KShs '000	Suspended interest KShs '000	Collective allowance KShs '000	Total KShs '000
GROUP AND COMPANY				
At 1 January 2017	382,289	431,468	451,256	1,265,013
Bad debts written off	(56,927)	(89,053)	-	(145,979)
Allowances and suspended interest reversed	(96,156)	(169,611)	3,456	(262,311)
Suspended interest during the year	-	183,546	-	183,546
Allowance during the year	359,800	-	(29,000)	330,800
At 31 December 2017	589,006	356,350	425,712	1,371,069

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

11. LOANS AND ADVANCES (continued)
(b) Allowances on impairment of loans and advances - COMPANY

	Specific allowance KShs '000	Suspended interest KShs '000	Collective allowance KShs '000	Total KShs '000
COMPANY				
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

(c) Non-performing loans and advances
Non-performing loans and advances on which interest has been suspended amount to 1,306 million (2016: KShs 1,041 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 2,501 million (2016: KShs 1,371 million).

(d) Lending concentration
Economic sector risk concentrations within the customer loan portfolio were as follows:

	GROUP & COMPANY	
	2017 %	2016 %
Manufacturing	23	21
Wholesale and retail trade	28	30
Transport and communication	5	6
Real estate	17	18
Business services	17	14
Others	10	11
	100%	100%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

11. LOANS AND ADVANCES (continued)
(d) Lending concentration (continued)
Maturity analysis - GROUP

	Within 30 days KShs '000	31-60 days KShs '000	61-90 days KShs '000	More than 90 days KShs '000	Total KShs '000
MATURITY ANAYLSIS - GROUP 2017					
Manufacturing	787,155	765,922	169,555	7,353,800	9,076,432
Trade	1,281,707	1,882,772	248,365	7,886,291	11,299,135
Transport	22,661	291,989	773	1,469,385	1,784,808
Real estate	347,437	865,801	285,822	5,117,869	6,616,929
Other	556,001	567,635	155,172	9,718,629	10,997,437
Total	2,994,961	4,374,119	859,687	31,545,974	39,774,741
MATURITY ANAYLSIS - COMPANY 2017					
Manufacturing	787,155	765,922	169,555	7,353,800	9,076,432
Trade	1,281,707	1,882,772	248,365	7,886,291	11,299,135
Transport	22,661	291,989	773	1,469,385	1,784,808
Real estate	347,437	865,801	285,822	5,117,869	6,616,929
Other	556,001	567,635	155,172	9,570,424	10,849,232
Total	2,994,961	4,374,119	859,687	31,397,769	39,626,536
MATURITY ANAYLSIS - COMPANY 2016					
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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

12. OTHER ASSETS

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Prepayments and deposits	154,253	154,253	144,037
Accrued income	49,777	49,777	51,609
Others*	654,205	179,427	284,282
	858,235	383,457	479,928

*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. It also includes receivables arising out of insurance and reinsurance arrangements and reinsurer's share of contract liabilities.

13. INVESTMENT IN SUBSIDIARY

At 1 January 2017, the bank owned a 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 insurance services. The bank's interest in Tausi Assurance Company Limited was accounted for using the equity method. In February 2017, the bank acquired a further 1.10% in Tausi, bringing its shareholding to 38.65%. The consideration paid to acquire this stake was KShs 23 million.

On 14 November 2017 the bank acquired additional shareholding of 33.20% increasing its ownership to 71.85%. The consideration paid for the acquisition was KShs 727 million. The net assets acquired as at that date was KShs 1,295 million. The existing shares were restated to the current fair value giving rise to fair value gain of KShs 372 million which is recognised in the statement of profit or loss. With a minority interest of KShs 364 million, the goodwill that a rose on acquisition was KShs 642 million. The acquisition date fair values of the assets and liabilities acquired is disclosed in 13(a) below.

The Group has elected to measure the non-controlling interest in the acquire at the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable nets asset.

On 31 December 2017, the Group acquired an additional 8.9% interest in the voting shares of Tausi Assurance Limited, increasing its ownership interest to 80.72%. Cash consideration of KShs 194 million was paid to the non-controlling shareholders. (Refer to 13(c) below).

HISTORY OF PRIME BANK

1992 - 2003 - 2004 - 2005 - 2006 - 2007 - 2008 - 200

Opening of Branches

Kenindia House Branch, Nairobi
September 8, 1992

Biashara Branch, Nairobi
May 13, 1994

Mombasa Branch
December 14, 1994

Westlands Branch, Nairobi
May 06, 1996

Industrial Area Branch, Nairobi
May 13, 1999

Kisumu Branch
January 2, 2000

Parklands Branch, Nairobi
January 21, 2002

Riverside Drive Branch, Nairobi
December 1, 2003

Prime Bank moved to its own Headquarters on Riverside Drive from Kenindia House.

Acquired associate membership of VISA to issue international debit and credit cards.

Secured trade finance guarantee from the International Finance Corporation (IFC) as part of the Global Finance Program.

Introduced VISA Gold and Classic Cards.

Prime Bank brand identity gets a face-lift, from dark blue, Prime Bank absorbs sky blue, symbolising depth and stability combined with loyalty and trust of our customers.

VISA-branded Prime debit and credit cards, accepted at all VISA approved outlets are made available to customers.

Partnered with PesaPoint, Kenya's largest independent ATM network.

Launched Prime Bank website www.primebank.co.ke to keep customers and members of the public updated.

E-statements service launched.

First runners-up of the best bank in customer satisfaction by the Market Intelligence Banking Survey Awards.

Seven-day banking, along with longer banking hours, initiated to fuel and compliment the steady growth of the business.

Hurlingham Branch opened.

Global Credit Rating (GCR) company of South Africa rates Prime Bank high, implying the soundness of liquidity and fundamentals for prudent investments.

Signed an agreement with (IFC) which extended USD 1 billion

Global Trade Finance Program to support the emerging market of Kenya.

Prime Bank's bid for Prime Capital receives the CBK approval.

Prime Bank acquired a license from the Retirement Benefit Authority (RBA) and the Capital Markets Authority (CMA) to offer custodial services.

Capital Centre and Nyali Branches opened.

Capital Bank in Botswana launched through First Merchant Bank.

Prime Bank Ltd. launches an efficie cash-managemen product for handli school fees paymer

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9 - - 2010 - - 2012 - - 2013 - - 2014 - - 2015 - - 2016 - - 2017

Prime Bank is recognized as a 'large bank' by the CBK.

Prime Bank starts offering internet banking services.

Awarded the 2nd runners-up for being the fastest growing bank during the 5th Annual Banking Awards.

Kamukunji & Eldoret Branches opened.

CHIP and PIN cards launched.

Prime Bank builds an eye operation theatre at Lions Eye Hospital.

The new tag line 'Putting You First' introduced, reflecting the bank's focus and commitment to offer the best to its customers.

Prime Chinese Yuan Account launched.

Karen & Nakuru Branches opened.

The bank starts offering accounts in INR, USD, GBP and the Euro.

The core banking system is upgraded from Flexcube to Finacle - a high-end universal banking system.

The SME-lending programme starts in partnership with European Investment Bank.

Gigiri Branch opened.

The 2014 – 2018 strategic plan with the main focus in technological advancement is launched.

Secured USD 15 million credit from PROPARCO, a French DFI to support long-term lending.

Launched the Platinum Banking Centre and internet-based platforms PrimeNet and PrimeMobi.

Thika Branch opened.

Recognition as 1st runner-up – Best Bank in Tier III and 1st runner-up Bank with the Lowest Charges during the 9th Annual Banking Awards.

VISA Golf card launched in partnership with VISA, Kenya Golf Union, and Junior Golf Foundation.

Prime Bank partners with selected insurance companies to provide nsurance products through Prime Merchant Insurance Agency.

Second runner-up award by Think Business Banking Award for the Bank with lowest charges.

Garden City Branch opened.

Achieved KSh. 2 billion net profit mark.

Prime VISA Golf Card feted with the VISA Co-brand Award.

Prime Bank raises USD 10 million through a private placement.

Two Rivers and UAP Tower Branches opened

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

13. INVESTMENT IN SUBSIDIARY (continued)

(a) The fair value of assets and liabilities of Tausi Assurance Limited as at the date of acquisition (14/11/2017) were as follows:

	KShs '000
Assets	
Property and equipment	283,062
Cash and cash equivalents	378,439
Intangible assets	1,290
Mortgage loans	158,466
Government securities	897,862
Deposits with financial institutions	236,807
Others	714,736
	2,670,662
Liabilities	
Deferred tax	(50,681)
Others	(1,324,605)
Total identifiable net assets at fair value	1,295,376
Non-controlling interest	(364,648)
Goodwill arising on acquisition (note 16)	642,752
Fair value of previously-held equity interest in Tausi Assurance Company Limited	846,472
Purchase consideration transferred	727,006

From the date of acquisition, Tausi Assurance Company Limited contributed KShs 134 million of revenue and KShs 39 million to profit before tax from continuing operations of the Group. If the combination had taken place at the beginning of the year, revenue from continuing operations would have been KShs 9,343 million and profit before tax from continuing operations for the Group would have been KShs 2,078 million.

Analysis of cash flows on acquisition:

	KShs '000
Transaction costs of the acquisition (included in cash flows from operating activities)	(727,005)
Net cash acquired with the susbsidiary (included in cash flows from investing activities)	378,439
Net cash flow on acquisition	(348,566)
Purchase consideration Cash	727,006

Transaction costs of KShs 18 million were expensed and are included in other operating expenses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

13. INVESTMENT IN SUBSIDIARY (continued)

(b) The breakdown of the investment in subsidiary as at 31 December 2017 is as follows:

	2017 KShs '000
As at 1 January	372,648
Purchase of additional shares in associate	23,123
Dividends received	(27,829)
Share of profit	106,513
Purchase consideration transferred- on acquisition of subsidiary	727,006
Additional investment in subsidiary (note 13 (c))	194,231
	1,395,692

(c) Acquisition of additional interest in Tausi Assurance Limited

On 31 December 2017, the Group acquired an additional 8.9% interest in the voting shares of Tausi Assurance Limited, increasing its ownership interest to 80.72%. Cash consideration of KShs 194 million was paid to the non-controlling shareholders. The carrying amount of the net assets of Tausi Assurance Limited (excluding goodwill on the original acquisition) was KShs 1,326 million. Following is a schedule of additional interest acquired in Tausi Assurance Limited:

	KShs '000
Cash consideration paid to non-controlling shareholders	194,231
Carrying value of the additional interest in Tausi Assurance Limited	(118,723)
Difference recognised in retained earnings	75,708

(d) The breakdown of the investment in associate as at 31 December 2016 was as follows:

In 2016, the bank owned 37.55% shareholding in Tausi Assurance Company Limited. The bank's investment in Tausi Assurance Company Limited is shown below:

	2016 KShs '000
As at 1 January	329,321
Dividends received	(22,530)
Share of profit	65,857
Share of other comprehensive income*	-
	372,648

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

13. INVESTMENT IN SUBSIDIARY (continued)

(d) The breakdown of the investment in associate as at 31 December 2016 was as follows (continued):

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

	2016 KShs '000
Non-current assets	1,197,661
Current assets	908,342
Non-current liabilities	(1,012,260)
Current liabilities	(101,338)
Equity	992,405
Bank's carrying amount of the investment	372,648
Revenue	920,346
Profit before tax	244,320
Profit after tax	175,384
Cash and bank balances	14,473
Depreciation and amortisation	7,221
Income tax expense	(68,936)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

14. LEASEHOLD LAND

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
COST			
At 1 January	329,000	329,000*	71,381
Acquisition of subsidiary	80,000	-	-
Revaluation	12,500	-	325,204
Eliminated on revaluation	-	-	(14,985)
Additions	88,244	88,244	-
Disposal	-	-	(41,600)
At 31 December	509,744	417,244	340,000
AMORTISATION			
At 1 January	-	-	17,133
On business combination	1,069	-	-
Charge for the year	9,069	7,833	859
Disposal	-	-	(3,007)
Eliminated on revaluation	(2,305)	-	(14,985)
At 31 December	7,833	7,833	-
NET CARRYING AMOUNT			
At 31 December	501,911	409,411	340,000

*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.

The opening balance for 2017 has a difference of KShs 11 million since by end of 2016 the bank did not have a segregation between land and building in one of the properties in Kisumu. Cost of the building is KShs 11 million.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

15. PROPERTY AND EQUIPMENT - GROUP

(a) Year ended 31 December 2017

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

	Freehold land KShs '000	Buildings KShs '000	Leasehold improve-ments KShs '000	Furniture and fittings KShs '000	Office equipment KShs '000	Motor vehicles KShs '000	Computer equipment KShs '000	Total KShs '000
COST /VALUATION								
At 1 January 2017	49,000	636,472	284,918	133,505	153,739	90,356	293,436	1,641,426
Additions	-	92,992	64,629	10,988	23,158	19,000	87,058	297,825
Acquisition of subsidiary	-	269,652	2,455	32,748	-	962	33,300	339,117
Disposals	-	-	-	(261)	(122)	(14,425)	-	(14,808)
At 31 December 2017	49,000	999,116	352,002	176,980	176,775	95,893	413,794	2,263,560
DEPRECIATION								
At 1 January 2017	-	-	180,085	107,564	103,102	71,450	250,575	712,776
Acquisition of subsidiary	-	3,900	2,455	21,486	-	-	28,214	56,055
Charge for the year		18,518	32,096	9,130	15,492	14,111	45,522	134,869
Disposals	-	-	-	(163)	(110)	(13,925)	-	(14,198)
At 31 December 2017	-	22,418	214,636	138,017	118,484	71,636	324,311	889,502
NET CARRYING AMOUNT								
At 31 December 2017	49,000	976,698	137,366	38,963	58,291	24,257	89,483	1,374,058

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 as at 31 December 2017 would have been KShs 15,645,000 and KShs 226,514,000, respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

15. PROPERTY AND EQUIPMENT - COMPANY

(a) Year ended 31 December 2017

	Freehold land KShs '000	Buildings KShs '000	Leasehold improve-ments KShs '000	Furniture and fittings KShs '000	Office equipment KShs '000	Motor vehicles KShs '000	Computer equipment KShs '000	Total KShs '000
COST OR VALUATION								
At 1 January 2017	49,000	691,223	284,918	111,308	153,739	87,581	264,516	1,642,285
Additions	-	92,992	64,629	10,089	23,158	19,000	85,585	295,453
Disposals	-	-	-	(261)	(122)	(14,425)	-	14,808)
At 31 December 2017	49,000	784,215	349,547	121,136	176,775	92,156	350,101	1,922,930
DEPRECIATION								
At 1 January 2017	-	-	180,085	86,077	103,102	68,995	222,362	660,621
Charge for the year	-	18,518	32,096	7,522	15,492	13,791	43,342	130,761
Disposals	-	-	-	(163)	(110)	(13,925)	-	(14,198)
At 31 December 2017	-	18,518	212,181	93,436	118,484	68,861	265,704	777,184
NET CARRYING AMOUNT								
At 31 December 2017	49,000	765,697	137,366	27,700	58,291	23,295	84,397	1,145,748

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 as at 31 December 2017 would have been KShs 15,645,000 and KShs 284,139,019 respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

15. PROPERTY AND EQUIPMENT - COMPANY

(b) Year ended 31 December 2016

	Freehold land KShs '000	Buildings KShs '000	Leasehold improve-ments KShs '000	Furniture and 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 as at 31 December 2016 would have been KShs 15,645,000 and KShs 295,816,271 respectively.

**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.*

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

16. INTANGIBLE ASSETS - GROUP

	Computer software and Visa license fees KShs '000	Good will KShs '000	Total KShs '000
COST			
At 1 January	462,840	-	462,840
Additions	45,682	-	45,682
Acquisition of subsidiary	1,967	642,752	644,719
At 31 December	510,489	642,752	1,153,241
AMORTISATION			
At 1 January	303,198	-	303,198
Charge for the year	80,594	-	80,594
At 31 December	383,792	-	383,792
NET CARRYING AMOUNT			
At 31 December	126,697	642,752	769,449

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. The Group performed its annual impairment test on December 2017. The Group considers the relationship between its probable market capitalisation and its book value, among other factors, when reviewing for indicators of impairment. As at 31 December 2017, the market capitalisation of the Group was above the book value of its equity, indicating that no potential impairment of goodwill. In addition, the banking industry in the country remains stable.

The Group has not identified separate cash generating units (CGUs) and as such goodwill has not been allocated.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

16. INTANGIBLE ASSETS - COMPANY

	COMPANY	
	2017 KShs '000	2016 KShs '000
COST		-
At 1 January	462,840	392,983
Additions	45,683	70,492
Write-off*	-	(635)
	508,522	462,840
AMORTISATION		
At 1 January	303,198	229,278
Charge for the year	80,594	73,920
At 31 December	383,792	303,198
NET CARRYING AMOUNT		
At 31 December	124,730	159,642

Intangible assets comprise computer software and Visa license fees.

**The write-off relates to withholding tax payment erroneously made to the supplier of software in the prior year which was erroneously posted to intangible assets. This was reversed in the previous year.*

Computer software is what the entity paid to acquire the bank's core banking system and other peripheral systems. Visa license fees is paid for the use of the Visa payment system. Most of these assets will be amortised in the next four years. The bank has not pledged its intangible assets as security for liabilities and therefore the bank has no restriction over title of its assets as at 31 December 2016 and 31 December 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

17. DEFERRED TAX

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

	At 1 January KShs '000	Recognised in statement of profit or loss KShs '000	Recognised in other comprehensive income KShs '000	At 31 December KShs '000
2017				
GROUP				
Arising from:				
Property and equipment	(271,928)	6,104	(1,460)	(267,284)
Provision for staff leave	4,005	584	-	4,589
Provision for loans and advances	143,211	(7,966)	-	135,245
	(124,712)	(1,278)	(1,460)	(127,450)
2017				
COMPANY				
Arising from:				
Property and equipment	(212,194)	16,451	-	(195,743)
Provision for staff leave	4,005	584	-	4,589
Provision for loans and advances	134,159	(7,799)	-	126,360
	(74,030)	9,236	-	(64,794)
2016				
COMPANY				
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)

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 CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

18. BALANCES DUE TO BANKS AND FINANCIAL INSTITUTIONS

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Due to other banks	1,350,265	1,342,900	1,687,552
Due to financial institutions	1,448,022	1,448,022	1,812,270
	2,798,287	2,790,922	3,499,822

19. MEDIUM TERM NOTE

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Medium term note	1,033,000	1,033,000	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

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Current deposits	13,808,848	13,822,880	12,207,515
Savings deposits	552,715	552,715	268,789
Call deposits	352,852	352,852	102,486
Fixed deposits	42,568,827	42,826,275	36,743,804
	57,283,242	57,554,722	49,322,594

Included in deposits from customers, were deposits of KShs 385 million (2016: KShs 334 million) held as collateral for irrevocable commitments. The weighted average effective interest rate on interest bearing customer deposits as at 31 December 2017 was 6.7 % (2016: 7.6%).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

21. OTHER LIABILITIES

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Payorder issued	95,186	95,186	85,694
Bills payable	203,084	203,084	165,127
Sundry creditors and accruals	1,528,915	358,772	332,951
	1,827,185	657,042	583,772

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

22. INCOME TAX

	2017 KShs '000	2016 KShs '000
GROUP		
STATEMENT OF FINANCIAL POSITION		
Balance brought forward	(67,264)	-
Charge for the year	141,685	-
Withholding tax recovered	(873)	-
Paid during the year	(160,706)	-
Income tax recoverable	(87,158)	-
COMPANY		
STATEMENT OF FINANCIAL POSITION		
Balance brought forward	(67,793)	(18,147)
Charge for the year	144,204	434,060
Withholding tax recovered	(873)	-
Paid during the year	(149,318)	(483,706)
Income tax recoverable	(73,780)	(67,793)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

22. INCOME TAX (continued)

STATEMENT OF PROFIT AND LOSS	GROUP 2017 KShs '000	COMPANY 2017 KShs '000	COMPANY 2016 KShs '000
Current income tax at 30% on the taxable profit for the year	141,685	144,204	434,060
Deferred tax charge/(credit) (note 17)	1,278	(9,236)	(2,944)
Income tax expense	142,963	134,968	431,116
Reconciliation of tax expense to tax based on accounting profit:			
Accounting profit before tax	2,272,593	1,976,977	2,335,822
Tax applicable rate of 30%	681,778	593,093	700,747
Tax effect of share of profit of associate	-	(31,954)	(19,757)
Other expenses not deductible for tax purposes	24,856	24,653	35,718
Other income not subject to tax	(563,670)	(450,824)	(285,592)
Tax charge for the year	142,964	134,968	431,116

23. SHARE CAPITAL

	2017 KShs '000	2016 KShs '000
Authorised:		
Ordinary shares of KShs 1,000 each	5,000,000	5,000,000
3 million shares of KShs 1,000 each	3,000,000	-
	8,000,000	5,000,000
Issued and fully paid:		
At 1 January and 31 December	5,000,000	5,000,000

On 20 March 2017, the authorised share capital was increased by KShs 3 billion by the creation of 3 million ordinary shares of KShs 1,000 each.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

24. RESERVES

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Retained earnings	6,772,851	6,453,984	5,011,975
Available-for-sale reserve	2,344,652	2,341,729	280,012
Asset revaluation reserve	544,453	542,006	542,006
	9,661,956	9,337,719	5,833,993

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 fair value of the same assets previously recognized in equity.

25. INTEREST INCOME

	2017 KShs '000	2016 KShs '000
Loans and advances to customers	4,794,699	5,350,523
Placements and bank balances	140,910	71,395
Reverse repurchase agreements	25,674	3,641
Treasury bills and term notes	751,262	842,602
Government securities-held-to-maturity	1,218,372	900,867
Available -for-sale investments	439,309	409,882
	7,370,226	7,578,910

26. INTEREST EXPENSE

	2017 KShs '000	2016 KShs '000
Due to customers	3,527,362	3,788,420
Due to banks and other financial institutions	214,097	239,527
	3,741,459	4,027,947

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

27. FEES AND COMMISSION INCOME

	2017 KShs '000	2016 KShs '000
Commission income	303,394	299,628
Fees income	208,989	167,804
Other standing charges	-	-
	512,383	467,432

28. OTHER INCOME

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Miscellaneous income	281,762	71,766	83,387
Write back of provisions	-	-	49,564
Recoveries of loans and advances previously written off	96,532	96,532	8,470
Fair value on previous equity interest in subsidiary	372,018	-	-
	750,312	168,298	141,421

29. ALLOWANCES FOR IMPAIRMENT OF LOANS AND ADVANCES

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Specific allowance on loans and advances - note 11 (b)	359,800	359,800	167,197
Collective allowance for impairment (note 11 (b))	(29,000)	(29,000)	43,463
Collective allowance on term notes and bonds	-	-	(4,059)
Write-off during the year	9,788	9,788	2,883
	340,588	340,588	209,484

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

30. OTHER OPERATING EXPENSES

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Staff costs (note 33)	1,124,299	1,106,960	977,981
Depreciation on property and equipment	134,869	130,761	100,276
Amortisation of intangible assets	80,594	80,594	73,920
Impairment loss	-	-	2,020
Amortisation of leasehold land	9,069	7,833	859
Auditors' remuneration	4,199	3,899	3,713
Directors' emoluments	120,564	119,727	119,145
Deposit protection fund levy	75,697	75,697	72,136
Rent and rates	129,944	129,953	103,424
Other general administration expenses	705,501	664,950	544,983
	2,384,736	2,320,374	1,998,457

31. PROFIT BEFORE TAX

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Profit before tax is stated after charging: -			
Depreciation on property and equipment	134,869	130,761	100,276
Amortisation of intangible assets	80,594	80,594	73,920
Amortisation of leasehold land	9,069	7,833	859
Impairment loss	-	-	2,020
Directors' emoluments	120,564	119,727	119,145
Auditors' remuneration	4,199	3,899	3,713
And after crediting: -			
Foreign exchange gains	196,974	196,974	298,311
Dividend income	25,004	25,004	19,779
Gain on sale of property and equipment	4,474	4,474	7,721

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

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:

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Profit for the year attributable to equity holders of the parent (KShs '000)	1,812,953	1,842,009	1,904,706
Weighted average number of shares (Thousands)	5,000	5,000	5,000
Basic and diluted earnings per share (KShs)	363	368	381

33. STAFF COSTS

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Salaries and wages	958,034	943,248	844,680
Contributions to pension scheme	53,731	52,961	48,275
Other staff costs	112,534	110,751	85,026
	1,124,299	1,106,960	977,981

34. DIVIDENDS PAID

	2017 KShs '000	2016 KShs '000
Dividend declared and paid on ordinary shares	400,000	500,000
Dividend per ordinary share	80	100

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

35. CASH AND CASH EQUIVALENTS

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

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Cash in hand (note 5)	621,726	613,231	543,618
Balances with Central Bank of Kenya-unrestricted (note 5)	2,501,021	2,501,021	764,362
Cheques and items for clearing (note 5)	498,160	498,160	500,177
Placements and balances with other banks	3,090,911	2,985,079	2,713,176
Government securities and term notes maturing within 91 days (note 7)	34,079	34,079	102,174
Due to banks and financial institutions (note 18)	(2,798,287)	(2,790,922)	(3,499,822)
	3,947,610	3,840,648	1,123,685

36. CONTINGENT LIABILITIES

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Letters of credit	1,875,490	1,875,490	2,330,507
Local guarantees	3,628,250	3,628,250	2,833,650
Bills for collection	3,138,106	3,138,106	3,056,600
Foreign currency bills for collection	173,966	173,966	298,837
Custodial treasury bonds	3,036,699	3,036,699	2,621,158
Spot sales/purchase	841,186	841,186	513,229
Swap sales/purchases	5,268,024	5,268,024	5,416,135
Forward contracts	1,983,011	1,983,011	134,195
	19,944,732	19,944,732	17,204,311

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

37. CAPITAL COMMITMENTS

	2017 KShs '000	2016 KShs '000
Capital commitments contracted for	270,000	220,000

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

38. 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:

	2017 KShs '000	2016 KShs '000
Within 1 year	78,704	62,244
After 1 year but not more than 5 years	139,291	127,984
More than 5 years	2,199	243
	220,194	190,471

39. 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.

	2017 KShs '000	2016 KShs '000
a) Due from		
i) Loans and advances to employees	288,194	296,034
ii) Loans and advances to directors and their associates	1,651,510	1,515,631
	1,939,704	1,811,665
Allowance during the year:		
At 1 January	18,116	20,292
Allowance during the year	1,896	(2,176)
At 31 December	20,012	18,116

The loans to related parties are given in the ordinary course of business. The average term of the loans to related parties is 3 years. The loans are secured by titles to property and directors' guarantees.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

39. RELATED PARTY TRANSACTIONS (continued)

	2017 KShs '000	2016 KShs '000
b) Due from		
i) Deposits from employees	321,047	255,735
ii) Deposits from directors and their associates	886,445	1,170,873
	1,207,492	1,426,608
c) Key management personnel compensation		
i) Salaries	380,391	332,921
ii) Post-employment benefits	19,899	24,527
	400,290	357,448

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
d) Directors' emoluments			
i) As management	70,580	70,167	51,977
ii) As executives	49,984	49,560	67,168
	120,564	119,727	119,145

e) Transactions with related parties

Included in interest income is KShs 208,084,729 (2016: KShs 251,386,323) being interest on loans and advances to related parties.

Included in interest expense is KShs 95,156,720 (2016: KShs 82,220,366) being interest on deposits from related parties.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

40. 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 2017 GROUP	Within 12 months KShs '000	After 12 months KShs '000	Total KShs '000
ASSETS			
Cash and balances with the Central Bank of Kenya	5,265,571	-	5,265,571
Placements and balances with other banks	2,755,186	335,725	3,090,911
Treasury bills and term notes	7,619,233	275,833	7,895,066
Held to maturity investments	796,924	11,991,734	12,788,658
Investment in bonds-available for sale	-	3,750,776	3,750,776
Investment in ordinary shares available for sale	-	3,046,775	3,046,775
Loans and advances to customers	16,828,496	21,575,176	38,403,672
Other assets	512,175	346,061	858,236
Intangible assets	-	762,981	762,981
Tax recoverable	87,158	-	87,158
Leasehold land	-	501,911	501,911
Property and equipment	-	1,374,058	1,374,058
Commercial paper	-	14,447	14,447
Quoted shares at fair value through profit and loss	-	141,222	141,222
TOTAL ASSETS	33,864,743	44,116,699	77,981,442
LIABILITIES			
Balances due to banks and financial institutions	2,798,287	-	2,798,287
Medium term note	-	1,033,000	1,033,000
Deposits from customers	57,283,243	-	57,283,243
Other liabilities	1,069,687	757,498	1,827,185
Deferred tax liability	-	127,450	127,450
TOTAL LIABILITIES	61,151,217	1,917,948	63,069,165
NET ASSETS	(27,286,474)	42,198,751	14,912,277

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

40. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

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 2017 COMPANY	Within 12 months KShs '000	After 12 months KShs '000	Total KShs '000
ASSETS			
Cash and balances with the Central Bank of Kenya	5,257,076	-	5,257,076
Placements and balances with other banks	2,649,354	335,725	2,985,079
Treasury bills and term notes	7,619,233	275,832	7,895,066
Held to maturity investments	759,445	11,150,391	11,909,836
Investment in bonds-available for sale	-	3,651,715	3,651,715
Investment in ordinary shares available for sale	-	2,951,142	2,951,142
Loans and advances to customers	16,739,816	21,515,651	38,255,467
Other assets	344,538	38,919	383,457
Investment in associate	-	1,395,692	1,395,692
Intangible assets	-	124,730	124,730
Tax recoverable	73,780	-	73,780
Leasehold land	-	409,411	409,411
Property and equipment	-	1,145,748	1,145,748
TOTAL ASSETS	33,443,242	42,994,956	76,438,199
LIABILITIES			
Balances due to banks and financial institutions	2,790,922	-	2,790,922
Medium term note	-	1,033,000	1,033,000
Deposits from customers	57,554,722	-	57,554,722
Other liabilities	657,043	-	657,043
Deferred tax liability	-	64,794	64,794
TOTAL LIABILITIES	61,002,687	1,097,794	62,100,481
NET ASSETS	(27,559,445)	41,897,162	14,337,718

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

40. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

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 COMPANY	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 CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

41. FAIR VALUE MEASUREMENT

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

	GROUP		COMPANY				
	2017		2017		2016		
	Carrying amount KShs '000	Fair value KShs '000	Carrying amount KShs '000	Fair value KShs '000	Carrying amount KShs '000	Fair value KShs '000	Un-recognised gain/(loss) KShs '000
Cash and balances with Central Bank of Kenya	5,265,571	5,265,571	5,257,076	5,257,076	3,200,067	3,200,067	-
Placements and balances with other banks	3,090,911	3,090,911	2,985,079	2,985,079	2,713,176	2,713,176	-
Treasury bonds	12,803,105	12,944,326	11,909,836	11,989,089	7,688,071	7,450,808	-
Treasury bills	7,520,690	7,520,690	7,520,690	7,520,690	5,598,068	5,598,068	-
Term notes	374,376	374,376	374,376	374,376	508,582	508,582	-
Bonds-available-for-sale	3,750,776	3,750,776	3,651,715	3,651,715	3,698,408	3,698,408	-
Ordinary shares-available-for-sale	3046775	3046775	2,683,266	2,683,266	718,504	718,504	-
Investment in ordinary shares-at fair value through profit or loss	141,222	141,222					
Loans and advances to customers	38,403,672	38,403,672	38,255,467	38,255,467	38,559,603	38,559,603	-
Due to banks and other financial institutions	2,798,287	2,798,287	2,790,922	2,790,922	3,499,822	3,499,822	-
Medium term note	1,033,000	1,033,000	1,033,000	1,033,000	1,024,000	1,024,000	
Deposits from customers	57,389,755	57,389,755	57,554,722	57,554,722	49,322,594	49,322,594	-
Total unrecognised change in unrealised fair value	-	-	-	-	-	-	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

41. FAIR VALUE MEASUREMENT (continued)

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

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.

GROUP 2017	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	9	3,750,776	-	-	3,750,776
Investments in ordinary shares available- for-sale	10 (a)	2,778,899	-	-	2,778,899
Investments in ordinary shares at fair value through profit or loss	10 (b)	144,122	-	-	144,122
Held to maturity investments		12,854,512	-	-	12,854,512
Property and equipment			-	-	
(Freehold land and buildings)	15	-	-	1,374,058	1,374,058
Leasehold land	14	-		501,911	501,911
		19,528,309	-	1,875,969	21,404,278

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

41. FAIR VALUE MEASUREMENT (continued)
b) Determination of fair value and fair value hierarchy

2017 COMPANY	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	9	3,651,715	-	-	3,651,715
Investments in ordinary shares available- for-sale	10 (a)	2,683,266	-	-	2,683,266
Held to maturity investments	8	11,989,089	-	-	11,989,089
Property and equipment					
(Freehold land and buildings)	15	-	-	1,145,748	1,145,748
Leasehold land	14			409,411	409,411
		18,324,070	-	1,555,159	19,879,229

2016 COMPANY	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		3,698,408	-	-	3,698,408
Investments in ordinary shares available- for-sale	8	718,504	-	-	718,504
Held to maturity investments	9	7,450,808	-	-	7,450,808
Property and equipment					
(Freehold land and buildings)	14	-	-	970,664	970,664
Leasehold land				340,000	340,000
		11,867,720	-	1,310,664	13,178,384

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 floor space
			KShs 120 –upper floor space
		Rent growth p.a.	8%
		Discount rate	8%

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

41. FAIR VALUE MEASUREMENT (continued)

b) Determination of fair value and fair value hierarchy
Reconciliation of fair value measurement of the land and buildings

	2017 KShs '000	2016 KShs '000
Leasehold land		
As at 1 January	329,000	71,381
Additions	88,244	-
Disposals	-	(41,600)
Total gains and losses recognised in other comprehensive income	-	310,219
Accumulated depreciation	(7,833)	-
As at 31 December	409,411	340,000
Freehold land		
As at 1 January	49,000	15,645
Total gains and losses recognised in other comprehensive income	-	33,355
As at 31 December	49,000	49,000
Buildings		
As at 1 January	691,223	306,330
Additions	95,012	39,993
Impairment loss	-	(2,020)
Total gains and losses recognised in other comprehensive income	-	335,920
	786,235	680,223
Accumulated depreciation	(20,538)	-
As at 31 December	765,697	680,223

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 CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

42. 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:-

	2017		2016	
	Actual KShs '000	Required KShs '000	Actual KShs '000	Required KShs '000
Tier 1 Capital	11,175,783	1,000,000	10,011,975	1,000,000
Tier 2 Capital	-	-	822,019	-
Term subordinated debt	619,800	-	1,024,000	-
Total regulatory capital	11,795,583	1,000,000	11,857,994	1,000,000
Risk weighted assets	52,554,722	-	48,575,540	-
Capital Ratios				
Total regulatory capital expressed as a percentage of total risk-weighted assets	23%	14.50%	23%	14.50%
Total tier 1 capital expressed as a percentage of risk weighted assets	21%	10.50%	20%	10.50%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. 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 CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Exposure to credit risk

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Cash and balances with the Central Bank of Kenya	4,652,341	4,643,848	2,656,449
Placements and balances with other banks	3,090,911	2,985,079	2,713,176
Treasury bills and term notes	7,895,066	7,895,066	6,106,650
Held to maturity investments	12,803,105	11,909,836	7,688,071
Investment in bonds-available for sale	3,750,776	3,651,715	3,698,408
Loans and advances to customers	38,403,672	38,255,467	38,559,603
Other assets	49,777	49,777	51,609
Off balance sheet items (note 36)	19,944,732	19,944,732	17,204,311
	90,590,380	89,335,520	78,678,277

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

	Collectively impaired		Individually impaired			
	Neither past due nor impaired	Past due but not impaired loans	Past due and Impaired			
	Normal	Watch	Substandard	Doubtful	Loss	
	KShs '000	> 30 days KShs '000	91-180 days KShs '000	181-360 days KShs '000	> 360 days KShs '000	Total KShs '000
31-Dec-2017						
Gross	35,886,140	1,599,697	387,163	1,330,726	422,810	39,626,536
Impairment	(377,721)	(47,991)	(39,568)	(482,830)	(422,959)	(1,371,069)
Net carrying amount	35,508,419	1,551,706	347,595	847,896	(149)	38,255,467
31-Dec-2016						718,504
Gross	34,391,953	3,577,862	822,618	789,066	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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)
a) Credit risk (continued)

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 agreements.

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.

Loans and advances to customers:

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Individually impaired			
Grade 3: Impaired (Substandard)	387,163	387,163	822,618
Grade 4: Impaired (Doubtful)	1,330,726	1,330,726	789,066
Grade 5: Impaired (Loss)	422,810	422,810	243,117
Gross amount	2,140,699	2,140,699	1,854,801
Allowance for impairment	945,357	945,357	813,702
Carrying amount	1,195,342	1,195,342	1,041,099
Collectively impaired			
Grade 1: Normal	35,886,140	35,886,140	34,391,953
Grade 2: Watch list	1,599,697	1,599,697	3,577,862
Gross amount	37,485,837	37,485,837	37,969,815
Allowance for impairment	425,712	425,712	451,311
Carrying amount	37,060,125	37,060,125	37,518,504
Total carrying amount	38,255,467	38,255,467	38,559,603

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)
a) Credit risk (continued)

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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

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)
Concentration by sector

	GROUP	COMPANY	
	2017 KShs '000	2017 KShs '000	2016 KShs '000
Agriculture	187,145	187,145	239,158
Mining and quarry	6,636	6,636	1,998
Manufacturing	9,076,432	9,076,432	8,295,222
Electricity and water	132,184	132,184	42,939
Building and construction	1,160,041	1,160,041	996,214
Wholesale and retail	11,299,135	11,299,135	11,905,589
Transport and communication	1,784,808	1,784,808	2,284,921
Finance and insurance	155,094	155,094	162,932
Real estate	5,456,888	5,456,888	6,157,146
Business services	6,911,220	6,911,220	5,776,728
Foreign trade	1,031,989	1,031,989	1,378,542
Other enterprises	2,573,169	2,424,964	2,583,227
	39,774,741	39,626,536	39,824,616

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

	2017 KShs '000	2016 KShs '000
At 31 December	49%	40%
Average for the year	49%	39%
Maximum for the year	51%	43%
Minimum for the year	42%	37%
Central Bank of Kenya required minimum	20%	20%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Management of liquidity risk

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

Treasury department maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to 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 2017 as a base period to the contractual maturity date. Deposits from customers shown as maturing within 90 days relate to current, savings, call and fixed account balances. Although classified in this band, previous experience has shown these to be stable and of a long term nature.

As at 31 December 2017 GROUP	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months – 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	5,265,571	-	-	-	-	5,265,571
Placements and balances with other banks	3,090,911	-	-	-	-	3,090,911
Treasury bills and term notes	1,143,774	2,317,599	4,268,710	475,897	-	8,205,980
Held-to-maturity investments	160,475	268,940	367,509	4,637,766	9,198,234	14,632,924
Bonds- available-for-sale	-	-	-	326,675	4,607,406	4,934,081
Other assets	-	-	49,777	-	-	49,777
Total assets	9,660,731	2,586,539	4,685,996	5,440,338	13,805,640	36,179,244
FINANCIAL LIABILITIES						
Due to banks and financial institutions	523,865	2,274,422	-	-	-	2,798,287
Medium term note	-	-	-	1,045,000	-	1,045,000
Deposits from customers	16,252,509	21,001,856	20,002,128	32,650	-	57,289,143
Other liabilities	-	1,544,181	-	-	-	1,544,181
Total liabilities	16,776,374	24,820,459	20,002,128	1,077,650	-	62,676,611
Net liquidity gap	(7,115,643)	(22,233,920)	(15,316,132)	4,362,688	13,805,640	(26,497,367)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Management of liquidity risk (continued)

As at 31 December 2017 COMPANY	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months – 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	5,257,076	-	-	-	-	5,257,076
Placements and balances with other banks	2,985,079	-	-	-	-	2,985,079
Treasury bills and term notes	1,143,774	2,317,599	4,268,710	475,897	-	8,205,980
Held-to-maturity investments	160,475	255,541	343,429	4,534,007	9,198,234	14,491,686
Bonds- available-for-sale	-	-	-	302,234	4,532,786	4,835,020
Other assets	-	-	49,777	-	-	49,777
Total assets	9,546,404	2,573,140	4,661,916	5,312,138	13,731,020	35,824,618
FINANCIAL LIABILITIES						
Due to banks and financial institutions	516,500	2,274,422	-	-	-	2,790,922
Medium term note	-	-	-	1,045,000	-	1,045,000
Deposits from customers	16,523,988	21,001,856	20,002,128	32,650	-	57,560,622
Other liabilities	-	374,039	-	-	-	374,039
Total liabilities	17,040,488	23,650,317	20,002,128	1,077,650	-	61,770,583
Net liquidity gap	(7,494,084)	(21,077,177)	(15,340,212)	4,234,488	13,731,020	(25,945,965)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)
(b) Liquidity risk (continued)
Management of liquidity risk (continued)

As at 31 December 2016 COMPANY	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months – 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	3,291,545	-	-	-	3,499,822
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	23,009,848	16,418,282	157,570	1,034,196	54,016,345
Net liquidity gap	(6,757,740)	(20,793,608)	(12,603,127)	2,054,984	18,435,999	(19,663,492)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (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 2017 GROUP	Held to maturity KShs '000	Loans and receivables KShs '000	Available for sale financial assets KShs '000	At fair value through profit or loss KShs '000	Financial liabilities measured at amortized cost KShs '000	Carrying amount KShs '000
ASSETS						
Cash and balances with Central Bank of Kenya	-	5,265,571	-	-	-	5,265,571
Placements and balances with other banks	-	3,090,911	-	-	-	3,090,911
Treasury bills and term notes	-	7,895,066	-	-	-	7,895,066
Held to maturity investments	12,803,105	-	-	-	-	12,803,105
Investment in bonds-available for sale	-	-	3,750,776	-	-	3,750,776
Investment in ordinary shares- available for sale	-	-	3,046,775	-	-	3,046,775
Investment in ordinary shares- at fair value through profit or loss	-	-	-	141,222	-	141,222
Loans and advances to customers	-	38,403,672	-	-	-	38,403,672
Other assets	-	49,777	-	-	-	49,777
Quoted shares at fair value through profit or loss	-	-	136,222	-	-	136,222
Total assets	12,803,105	54,704,997	6,933,773	141,222	-	74,583,097
Liabilities						
Balances due to banks and financial institutions	-	-	-	-	2,798,287	2,798,287
Medium term note	-	-	-	-	1,033,000	1,033,000
Deposits from customers	-	-	-	-	57,389,755	57,389,755
Other liabilities	-	-	-	-	1,544,181	1,544,181
Total liabilities	-	-	-	-	62,765,223	62,765,223

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)
(c) Classification of financial instruments (continued)

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 2017 COMPANY	Held to maturity KShs '000	Loans and receivables KShs '000	Available for sale financial assets KShs '000	Financial liabilities measured at amortized cost KShs '000	Carrying amount KShs '000
ASSETS					
Cash and balances with Central Bank of Kenya	-	5,257,076	-	-	5,257,076
Placements and balances with other banks	-	2,985,079	-	-	2,985,079
Treasury bills and term notes	-	7,895,066	-	-	7,895,066
Held to maturity investments	11,909,836	-	-	-	11,909,836
Investment in bonds-available for sale	-	-	3,651,715	-	3,651,715
Investment in ordinary shares available for sale	-	-	2,951,142	-	2,951,142
Loans and advances to customers	-	38,255,467	-	-	38,255,467
Other assets	-	49,777	-	-	49,777
Total assets	11,909,836	54,442,465	6,602,857	-	72,955,158
Liabilities					
Balances due to banks and financial institutions	-	-	-	2,790,922	2,790,922
Medium term note	-	-	-	1,033,000	1,033,000
Deposits from customers	-	-	-	57,554,722	57,554,722
Other liabilities	-	-	-	374,039	374,039
Total liabilities	-	-	-	61,752,683	61,752,683

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)
(c) Classification of financial instruments (continued)

As at 31 December 2016 COMPANY	Held to maturity KShs '000	Loans and receivables KShs '000	Available for sale financial assets KShs '000	Financial liabilities measured 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 and 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	-	-	-	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	-	-	-	169,930	169,930
Total liabilities	-	-	-	54,016,346	54,016,346

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.

Equity price risk

Equity price risk is the risk that the fair value of equities fluctuates 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 2017 would have increased equity by KShs 72million (2016: KShs 69 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)

d) Market risk (continued)

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

As at 31 December 2017 GROUP	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
ASSETS						
Cash and balances with the Central Bank of Kenya	-	-	-	-	-	
Placements and balances with other banks	1,483,452	300,000	300,000	-	335,725	2,419,177
Treasury bills and term notes	1,143,774	2,317,599	4,268,710	164,983	-	7,895,066
Held-to-maturity investments	160,475	255,541	380,909	3,180,189	8,825,990	12,803,104
Bonds- available for sale	-	-	-	319,618	3,431,158	3,750,776
Loans and advances to customers	2,183,115	5,143,044	9,417,743	10,154,089	11,505,680	38,403,671
Total assets	4,970,816	8,016,184	14,367,362	13,818,879	24,098,553	65,271,794
LIABILITIES						
Due to banks & financial institutions	523,865	2,274,422	-	-	-	2,798,287
Medium term note	-	-	-	1,033,000	-	1,033,000
Deposits from customers	2,429,632	21,001,856	20,028,878	-	-	43,460,366
Total liabilities	2,953,497	23,276,278	20,028,878	1,033,000	-	47,291,653
Total interest sensitivity gap	2,017,319	(15,260,094)	(5,661,516)	12,785,879	24,098,553	17,980,141
As at 31 December 2016						
Total assets	6,888,447	4,368,333	14,088,150	12,199,143	21,012,935	58,557,008
Total liabilities	866,628	20,680,640	18,727,624	135,209	1,024,000	41,434,101
Total interest sensitivity gap	6,021,819	(16,312,307)	(4,639,474)	12,063,934	19,988,935	17,122,907

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)
d) Market risk (continued)
Interest risk exposure (continued)

As at 31 December 2017 COMPANY	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
ASSETS						
Placements and balances with other banks	1,377,620	300,000	300,000	-	335,725	2,313,345
Treasury bills and term notes	1,143,774	2,317,599	4,268,710	164,983	-	7,895,066
Held-to-maturity investments	160,475	255,541	343,429	3,061,984	8,088,407	11,909,836
Bonds- available for sale	-	-	-	295,176	3,356,539	3,651,715
Loans and advances to customers	2,182,523	5,142,258	9,415,035	10,113,363	11,402,288	38,255,467
Total assets	4,864,392	8,015,398	14,327,174	13,635,506	23,182,959	64,025,429
LIABILITIES						
Due to banks & financial institutions	516,500	516,500	309,900	1,448,022	-	2,790,922
Medium term note	-	-	-	1,033,000	-	1,033,000
Deposits from customers	2,701,112	21,001,856	20,028,878	26,750	-	43,758,586
Total liabilities	3,217,612	21,518,356	20,338,778	2,481,022	-	47,555,768
Total interest sensitivity gap	1,646,780	(13,502,958)	(6,011,604)	11,154,484	23,182,959	16,469,661

As at 31 December 2016 COMPANY	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
Total assets	6,888,447	4,368,333	14,088,150	12,199,143	21,012,935	58,557,008
Total liabilities	866,628	20,680,640	18,727,624	135,209	1,024,000	41,434,101
Total interest sensitivity gap	6,021,819	(16,312,307)	(4,639,474)	12,063,934	19,988,935	17,122,907

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (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:

	2017 KShs '000	2016 KShs '000
Effect on profit before tax of a +1% change in interest rates	(90,675)	(46,240)
Effect on profit before tax of a -1% change in interest rates	90,675	46,240
Effect on equity	674,680	32,368

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 2017, 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 86,063 (2016: KShs 590,634) and a decrease in equity of KShs 60,244 (2016: KShs 413,444) 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 2017, 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 54,633 (2016: KShs 474,748) and an increase in equity of KShs 38,243 (2016: KShs 332,324) 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 CONSOLIDATED FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)

d) Market risk (continued)

The table below summarises foreign currency exposure to the group and bank:

As at 31 December 2017 *in Kshs' 000*	USD	GBP	Euro	ZAR	JPY	Others	Total
Assets							
Cash and cash equivalents (Group and Bank)	1,693,355	98,929	87,871	38,020	10,133	(3,358)	1,924,950
Investment in ordinary shares available for sale	240,620	27,255	-	-	-	2,555,673	2,823,548
Offshore bonds	136,152	-	-	-	-	-	136,152
Loans and advances	9,782,174	151,010	1,625,435	-	-	-	11,558,619
Total assets	11,852,301	277,194	1,713,306	38,020	10,133	2,552,315	16,443,269
Liabilities							
Balances due to banks and financial institutions	2,742,840	-	101,602	-	-	-	2,844,442
Deposits	7,007,727	1,491,515	627,581	35,125	5,617	2,811	9,170,376
Total liabilities	9,750,567	1,491,515	729,183	35,125	5,617	2,811	12,014,818
Net exposure as at 31 December	2,101,734	(1,214,321)	984,123	2,895	4,516	2,549,504	4,428,451

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

43. FINANCIAL RISK MANAGEMENT (continued)
d) Market risk (continued)
The table below summarises foreign currency exposure to the group and 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	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 and financial institutions	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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED 31 DECEMBER 2017

44. 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.

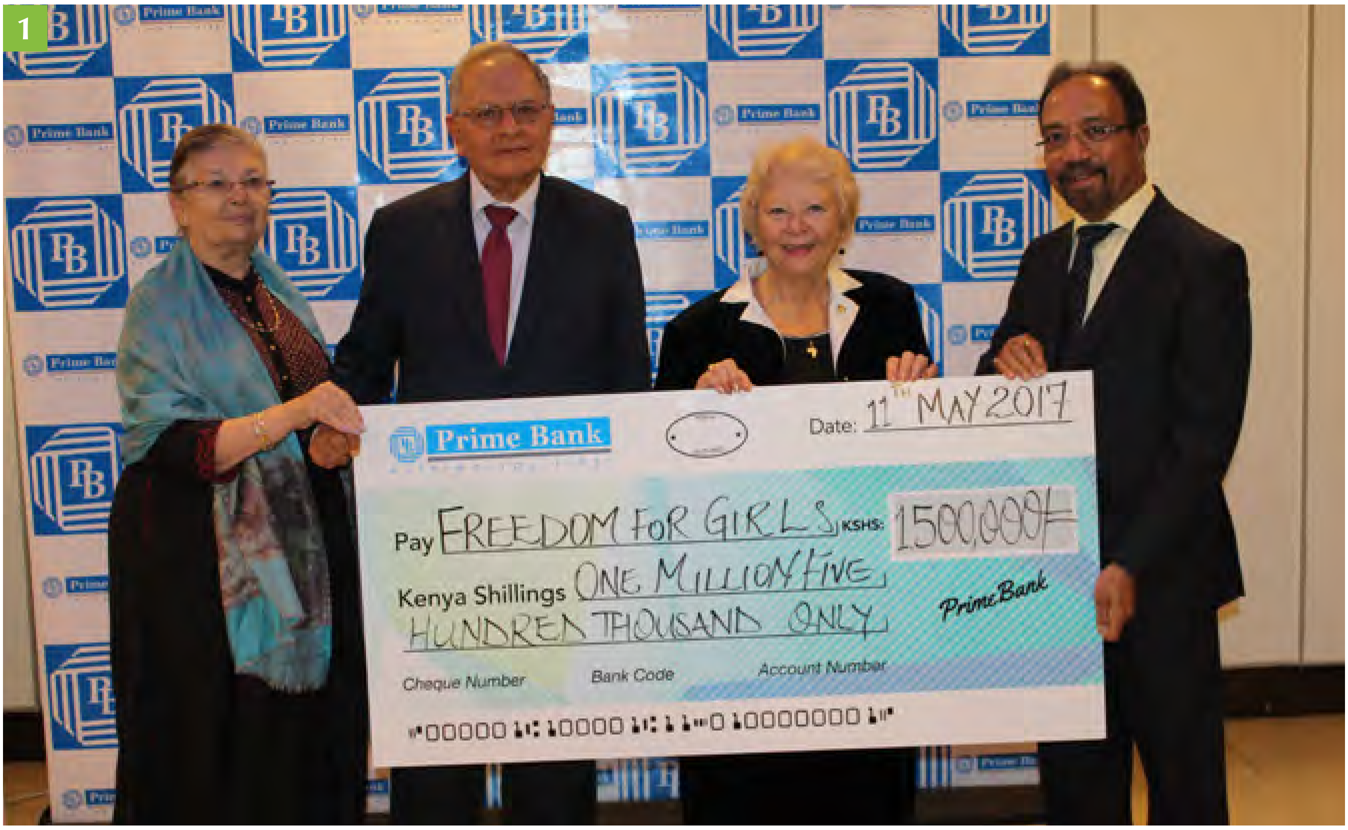
The bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

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

45. EVENTS AFTER THE REPORTING PERIOD
The Board of Directors approved the financial statements on 20th March 2018 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 group and bank and results of its operations as laid out in these financial statements.

CORPORATE SOCIAL RESPONSIBILITY
FOR THE YEAR ENDED 31 DECEMBER 2017



1. FREEDOM FOR GIRLS REACHES 16,000 SCHOOL GIRLS

The number of school girls who have benefitted from Prime Bank's donation to the annual supply of sanitary pads hit 16,155 in the year 2017.

The Bank, on 11th May, donated sanitary pads worth KShs1.5 million for distribution to various primary schools across the country.

Prime Bank has sponsored Freedom for Girls Project for the last 7 years, an initiative of Health Education Africa Resource Team (HEART) in partnership with Rotary District 9212 and Lions Multiple District 411A.

2. FAMINE RELIEF ACTIVITY

Prime Bank donated 10 tonnes of foodstuff - 2,000 packets of maize meal, 5 kg each expected to help 4 members in a family - to reach 8,000 people who were affected by the drought in Turkana at the beginning of the year 2017.

The Bank's Mombasa Branch staff also embarked on feeding program in Kilibasi, Kwale County where they distributed foodstuffs worth KShs. 800,000. The team also visited an orphanage on Makinnon road where they donated foodstuffs to feed more than 65 children.

CORPORATE SOCIAL RESPONSIBILITY
FOR THE YEAR ENDED 31 DECEMBER 2017

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3. PRIME BANK AT THE STAWISHA MAISHA EXHIBITION

The Asian Foundation organized an exhibition on philanthropy, first of its kind in East Africa, showcasing the various philanthropic activities by individuals, family, business, Trusts and Foundations.

Held from 12th to 14th May 2017 at the Oshwal Centre, Stawisha Maisha brought together more than 50 corporate and charitable organizations from the Asian community with the aim of recognizing, acknowledging and showcasing each organization's philanthropic endeavors within communities in which they operate. Prime Bank took part in the 3 day event.

4. CBK MT. KILIMANJARO FUNDRAISING EXPEDITION

The Central Bank of Kenya organized a fundraising initiative in aid of St. Kizito School for the Deaf in Kericho.

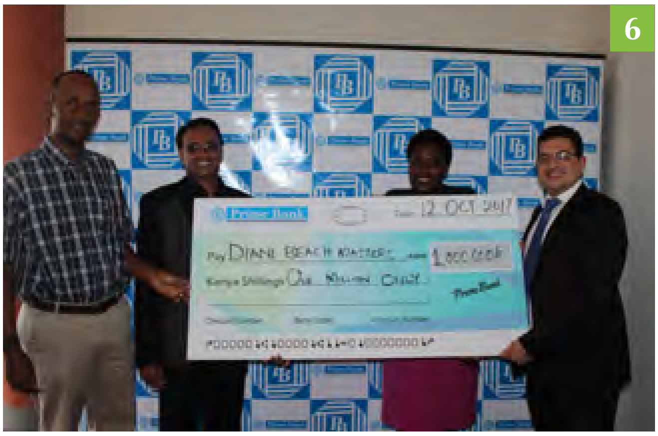
The initiative involved an expedition to climb Mt. Kilimanjaro to raise funds to enable the school meet various basic necessities such as water harvesting structures, rehabilitation of sanitary facilities as well the purchase and installation of a generator and solar panels. Prime Bank donated of KShs 1.1 million towards the fundraising.

CORPORATE SOCIAL RESPONSIBILITY
FOR THE YEAR ENDED 31 DECEMBER 2017

5. A VISIT TO SCANN

SCANN - Street Children's Assistance Network of Nakuru - is a charitable organization primarily founded with one major objective; to rehabilitate the needy, destitute Street Children in the society.

During the marking of 25 years of excellent service to its clients, Prime Bank paid a visit to the home in the spirit of caring and sharing the achievement with the needy and donated KShs 500,000 to enable SCANN meet part of its obligations.



6. ANNUAL DIANI BEACH MASTERS GOLF CHAMPIONSHIP

For the last 16 years, Leisure Lodge Beach & Golf Resort has hosted the Diani Beach Masters, one of Kenya's most celebrated and prestigious golf championships events in the country that brings together golfers from around the East African region.

During the 2017 edition of the golf tourney, the Bank donated KShs.1 million towards the success of the event.

7. 2017 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.

CORPORATE SOCIAL RESPONSIBILITY
FOR THE YEAR ENDED 31 DECEMBER 2017

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. For each golfer who signs up for the card, Prime Bank is donating KShs. 2,000 to JGF. In December 2017, Prime Bank presented a cheque of KShs.950, 000 as proceeds of the partnership with JGF and KGU through the Prime Visa Golf Card.

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8. 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 and donated foodstuffs to celebrate the festive season.

NOTES

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25
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