ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

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CORPORATE INFORMATION

<table>
<tr><td>DIRECTORS

J P M Ndegwa - Chairman
F M Mbiru - Vice Chairman
J W Macharia - Group Managing Director
A Dodd*
G A Maina
F N Mwanzia
A S M Ndegwa
I Ochola-Wilson
M L Somen
P V Shah

*British</td><td>AUDIT COMMITTEE

F N Mwanzia - Chairman
F M Mbiru
I Ochola-Wilson

NOMINATIONS COMMITTEE

J P M Ndegwa - Chairman
G A Maina
M L Somen
I Ochola-Wilson</td></tr>
<tr><td>CREDIT RISK COMMITTEE

F M Mbiru - Chairman
F N Mwanzia
A S M Ndegwa
M L Somen
P V Shah</td><td>HUMAN RESOURCES AND COMPENSATION COMMITTEE

I Ochola-Wilson - Chairman
F M Mbiru
A S M Ndegwa</td></tr>
<tr><td>EXECUTIVE COMMITTEE

A S M Ndegwa - Chairman
G A Maina
M L Somen
P V Shah</td><td>REGISTERED OFFICE

NIC House
Masaba Road
P O Box 44599
Nairobi - GPO 00100</td></tr>
<tr><td>RISK MANAGEMENT COMMITTEE

G A Maina - Chairman
F M Mbiru
I Ochola-Wilson</td><td>REGISTRARS AND TRANSFERS OFFICE

Custody & Registrars Services Limited
6th Floor, Bruce House,
Standard Street
P.O Box 8484
Nairobi - GPO 00100</td></tr>
<tr><td>GROUP COMPANY SECRETARY

L Murage
Certified Public Secretary (Kenya)
NIC House, Masaba Road
P O Box 44599
Nairobi - GPO 00100</td><td>AUDITORS

Deloitte & Touche
Certified Public Accountants (Kenya)
Deloitte Place
Waiyaki Way, Muthangari
P O Box 40092
Nairobi - GPO 00100</td></tr>
</table>

REPORT OF THE DIRECTORS

The Board of Directors has pleasure in submitting the annual report together with the audited financial statements for the year ended 31 December 2012 in accordance with Section 22 of the Banking Act and Section 157 of the Kenyan Companies Act which discloses the state of affairs of the Group and the Bank.

1. ACTIVITIES

The principal activities of the Group are the provision of retail and corporate banking, stock brokerage, bancassurance and investment banking services.

2. RESULTS FOR THE YEAR

The Group profit for the year of Shs 3,036,794,000 (2011: Shs 2,707,137,000) has been added to revenue reserves.

3. DIVIDENDS

The Board has resolved to recommend to the shareholders at the forthcoming Annual General Meeting, scheduled for 8 May 2013, the payment of a first and final dividend for the year of Shs 1 (2011 – Shs 0.25 interim dividend and Shs 0.25 final dividend) for every ordinary share of Shs 5. The dividends will be payable to the shareholders registered on the company's register at the close of business on 27th March 2013 and will be paid on or after 8 May 2013. The register will remain closed for one day on 28th March 2013.

4. CAPITAL

The authorized share capital of the Bank was increased from shillings two billion to shillings four billion following the approval by shareholders in the last annual general meeting held on 2 May 2012. During the year, the Group undertook a successful Rights Issue of one share for every four shares held amounting to 98,724,391 shares at Shs 21, resulting in increase of capital of Shs 493,622,000 and share premium of Shs 1,579,590,000. The shareholders approved a bonus issue where shareholders received one ordinary shares for every ten shares held.

5. NC UGANDA

In line with its regional expansion strategy, the Bank received approval from the shareholders and Bank of Uganda to conduct banking business in Uganda through its wholly owned subsidiary, NC Bank Uganda. The investment is supported by a capital investment of Shs 1,137m (Uganda Shillings 30 billion).

6. NIC TANZANIA

The Board of Directors of NIC Bank Tanzania Limited, where NIC Bank owns 51% shareholding, as at 31st December 2012, has approved the raising of additional capital of TZShs 8.5 billion through a Rights Issue. The Board of Directors of NIC Bank Limited has approved full participation in the Rights Issue which will involve an additional investment of TZShs 4,335 million (KShs 234 million) in NIC Tanzania. In addition, the Board of Directors approved the acquisition of additional shares from existing shareholders, and the take-up of Rights that are not exercised by existing shareholders. This will involve an investment of TZShs 6,925 million (KShs 374 million). This brings the total additional investment in NIC Tanzania to TZShs 11,261 million (KShs 608 million). The rights issue is expected to be concluded by 30 June 2013.

7. DIRECTORS

The directors who held office during the year and to date are shown on page 2. In accordance with articles 108, 109 and 110 of the Articles of Association, J P M Ndegwa, G A Maina and F M Mbiru retire by rotation and, being eligible, offer themselves for re-election.

REPORT OF THE DIRECTORS (Continued)

8. AUDITORS

The auditors, Deloitte & Touche retire from office at the conclusion of the next Annual General Meeting.

PricewaterhouseCoopers be appointed Auditors of the Company in place of the retiring auditors, Deloitte & Touche, to hold office until the conclusion of the next general meeting at which accounts are laid before the Company, subject to Sections 142 and 160(1) of the Companies Act (Cap 486) and Central Bank of Kenya approval in accordance with section 24(1) of the Banking Act (Cap 488).

9. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 20 February 2013.

BY ORDER OF THE BOARD

L. Murage
Group Company Secretary

Nairobi

20 February 2013

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

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

Nothing has come to the attention of the directors to indicate that the Bank and its subsidiaries will not remain going concerns for at least the next twelve months from the date of this statement.

J P M NDEGWA
(Chairman)

J W MACHARIA
(Group Managing Director)

20 February 2013

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF NIC BANK LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of NIC Bank Limited and its subsidiaries, set out on pages 8 to 86, which comprise the consolidated and bank statements of financial position as at 31 December 2012, and the consolidated and bank statements of comprehensive income, consolidated and bank statements of changes in equity and consolidated and bank statements of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the accompanying financial statements give a true and fair view of the state of financial affairs of the bank and its subsidiaries as at 31 December 2012, and of their profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF NIC BANK LIMITED (Continued)

Report on Other Legal Requirements

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

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

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

iii) the bank's statement of financial position (balance sheet) and statement of comprehensive income (profit and loss account) are in agreement with the books of account.

Deloittee & Touche

Certified Public Accountants (Kenya)

20 February 2013

Nairobi

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

Bank				Group	
2012	**2011**			**2012**	**2011**
Shs'000	**Shs'000**		**Note**	**Shs'000**	**Shs'000**
10,446,405	6,285,410	Interest income	7	11,467,574	6,831,580
(5,526,845)	(2,337,059)	Interest expense	8	(5,983,706)	(2,552,092)
4,919,560	**3,948,351**	**NET INTEREST INCOME**		**5,483,868**	**4,279,488**
939,747	883,737	Fee and commission income	9	1,053,113	1,016,583
(57,918)	(51,257)	Fee and commission expense	9	(64,273)	(58,400)
881,829	**832,480**	**NET FEE AND COMMISSION INCOME**		**988,840**	**958,183**
1,291,926	930,949	Net trading income	10	1,323,271	1,011,720
263,044	164,792	Other operating income	11	520,146	353,343
7,356,359	**5,876,572**	**OPERATING INCOME**		**8,316,125**	**6,602,734**
(265,264)	(249,166)	Impairment on loans and advances	12 (c)	(297,485)	(258,151)
(1,592,554)	(1,326,585)	Employee expenses	13	(1,978,651)	(1,598,250)
(270,943)	(178,831)	Depreciation and amortisation	14(a)	(317,932)	(198,788)
(916,649)	(761,388)	Other operating expenses	14(b)	(1,204,090)	(942,597)
(3,045,410)	**(2,515,970)**	**OPERATING EXPENSES**		**(3,798,158)**	**(2,997,786)**
4,310,949	**3,360,602**	**PROFIT BEFORE TAX**		**4,517,967**	**3,604,948**
(1,403,087)	(827,554)	Income tax expense	15(a)	(1,481,173)	(897,811)
2,907,862	**2,533,048**	**PROFIT FOR THE YEAR**		**3,036,794**	**2,707,137**
		OTHER COMPREHENSIVE INCOME:			
406,377	(340,569)	Fair value gain / (loss) on available for sale investments net of deferred tax	36(c)	406,377	(340,569)
-	-	Exchange differences on translation of foreign operations	36(d)	(335,010)	(8,371)
406,377	**(340,569)**	**OTHER COMPREHENSIVE INCOME FOR THE YEAR NET OF TAX**		**71,367**	**(348,940)**
3,314,239	**2,192,479**	**TOTAL COMPREHENSIVE INCOME FOR THE YEAR**		**3,108,161**	**2,358,197**
		Profit attributable to:			
2,907,862	2,533,048	Equity holders of the Bank		2,984,406	2,652,458
-	-	Non-controlling interests		52,388	54,679
2,907,862	**2,533,048**			**3,036,794**	**2,707,137**

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 December 2012 (Continued)

Bank				Group	
2012	**2011**			**2012**	**2011**
Shs'000	**Shs'000**		**Note**	**Shs'000**	**Shs'000**
		Total comprehensive income attributable to:			
3,314,239	2,192,479	Equity holders of the Bank		3,055,773	2,303,518
-	-	Non-controlling interests		52,388	54,679
3,314,239	**2,192,479**			**3,108,161**	**2,358,197**
		EARNINGS PER SHARE			
Shs 5.87	**Shs 5.29**	**- BASIC**	16	**Shs 6.03**	**Shs 5.54**
Shs 5.87	**Shs 5.29**	**- DILUTED**	16	**Shs 6.03**	**Shs 5.54**

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2012

Bank				Group	
2012	**2011**			**2012**	**2011**
Shs'000	**Shs'000**		**Note**	**Shs'000**	**Shs'000**
		ASSETS			
5,963,269	4,764,626	Cash and balances with Central Banks	17	7,050,962	5,638,916
375,240	250,024	Items in the course of collection	18	429,545	281,796
6,569,964	4,486,475	Due from banking institutions	19	8,188,716	5,692,655
16,222,431	7,216,755	Government securities	20	17,478,232	7,500,288
78,724	474,068	Derivative assets held for risk management	21	83,123	474,068
66,381,215	52,025,475	Loans and advances to customers	22	71,540,092	56,624,621
615,156	246,508	Other assets	23	913,742	335,487
-	-	Current income tax recoverable	15(c)	17,860	8,690
1,603,250	1,360,846	Due from group companies	24	-	-
2,285,324	1,147,786	Investments	25	243,931	52,932
241,808	348,946	Deferred tax asset	26	257,632	361,842
785,612	851,768	Property and equipment	27	1,009,891	967,988
642,337	400,544	Intangible assets	28	1,127,492	1,037,222
7,375	7,500	Operating lease prepayments	29	7,375	7,500
101,771,705	**73,581,321**	**Total assets**		**108,348,593**	**78,984,005**
		LIABILITIES			
77,466,042	62,008,953	Customer deposits	30	83,379,576	66,293,053
3,044,959	206,149	Due to banking institutions	31	3,571,280	788,647
3,655,414	190,280	Lines of credit	32	3,655,414	190,280
610,360	322,115	Due to group companies	33	-	-
382,138	223,321	Current income tax payable	15(c)	383,325	229,538
1,494,231	674,738	Other liabilities	34	1,823,422	903,629
53,954	55,905	Unclaimed dividends	35	53,954	55,905
86,707,098	**63,681,461**	**Total liabilities**		**92,866,971**	**68,461,052**
		EQUITY			
		Capital and reserves attributable to equity holders of the Bank			
2,714,921	1,974,488	Share capital	36(a)	2,714,921	1,974,488
1,208,799	-	Share premium	36(a)	1,208,799	-
155,083	159,864	Revaluation surplus on property	36(b)	155,083	159,864
(30,787)	(437,164)	Investments revaluation reserve	36(c)	(30,787)	(437,164)
-	-	Foreign currency translation reserve	36(d)	(414,094)	(79,084)
637,174	507,519	Statutory credit risk reserves	36(e)	687,543	533,581
10,379,417	7,695,153	Revenue reserves	36(f)	10,638,623	7,902,122
15,064,607	**9,899,860**	**Total capital and reserves attributable to equity holders of the Bank**		**14,960,088**	**10,053,807**
-	-	Non-controlling interests	37	521,534	469,146
15,064,607	**9,899,860**	**Total equity**		**15,481,622**	**10,522,953**
101,771,705	**73,581,321**	**Total liabilities and equity**		**108,348,593**	**78,984,005**

The financial statements on pages 8 to 86 were approved and authorised for issue by the Board of Directors on 20 February 2013 and were signed on its behalf by:

J P M NDEGWA
(Chairman)

J W MACHARIA
(Group Managing Director)

F N MWANZIA
(Director)

L MURAGE
(Group Company Secretary)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2012

← Non-distributable → Distributable

	Note	Share capital Shs'000	Share premium Shs'000	Revaluation surplus on property Shs'000	Investments revaluation reserve Shs'000	Foreign currency translation reserve Shs'000	Statutory credit risk reserves Shs'000	Revenue reserves Shs'000	Capital and reserves attributable to equity holders of the Bank Shs'000	Non-controlling interests Shs'000	Total Equity Shs'000
At 1 January 2011		**1,794,989**	**28,848**	**164,645**	**(96,595)**	**(70,713)**	**369,372**	**5,748,216**	**7,938,762**	**414,467**	**8,353,229**
Profit for the year		-	-	-	-	-	-	2,652,458	**2,652,458**	54,679	**2,707,137**
Other comprehensive income for the year:											
Prior year deferred tax adjustment on available-for-sale financial assets net of deferred tax	26	-	-	-	(28,979)	-	-	-	**(28,979)**	-	**(28,979)**
Fair value loss on available-for- sale financial assets net of deferred tax	36(c)	-	-	-	(311,590)	-	-	-	**(311,590)**	-	**(311,590)**
Exchange differences on translation of foreign operation	36(d)	-	-	-	-	(8,371)	-	-	**(8,371)**	-	**(8,371)**
Transfer of excess depreciation		-	-	(6,830)	-	-	-	6,830	**-**	-	**-**
Deferred tax on excess depreciation		-	-	2,049	-	-	-	(2,049)	**-**	-	**-**
Transfer to statutory reserve	36(e)	-	-	-	-	-	164,209	(164,209)	**-**	-	**-**
Total comprehensive income for the year		**-**	**-**	**(4,781)**	**(340,569)**	**(8,371)**	**164,209**	**2,493,030**	**2,303,518**	**54,679**	**2,358,197**
Transactions with owners, recorded directly through equity											
Bonus issue of shares	36(a)	179,499	(28,848)	-	-	-	-	(150,651)	**-**	-	**-**
Dividends paid:											
- Final for 2010	35	-	-	-	-	-	-	(89,749)	**(89,749)**	-	**(89,749)**
- Interim 2011	35	-	-	-	-	-	-	(98,724)	**(98,724)**	-	**(98,724)**
At 31 December 2011		**1,974,488**	**-**	**159,864**	**(437,164)**	**(79,084)**	**533,581**	**7,902,122**	**10,053,807**	**469,146**	**10,522,953**
At 1 January 2012		**1,974,488**	**-**	**159,864**	**(437,164)**	**(79,084)**	**533,581**	**7,902,122**	**10,053,807**	**469,146**	**10,522,953**
Profit for the year		-	-	-	-	-	-	2,984,406	**2,984,406**	52,388	**3,036,794**
Other comprehensive income for the year:											
Fair value gain on available-for- sale financial assets net of deferred tax	36(c)	-	-	-	406,377	-	-	-	**406,377**	-	**406,377**
Exchange differences on translation of foreign operations	36(d)	-	-	-	-	(335,010)	-	-	**(335,010)**	-	**(335,010)**
Transfer of excess depreciation		-	-	(6,830)	-	-	-	6,830	**-**	-	**-**
Deferred tax on excess depreciation		-	-	2,049	-	-	-	(2,049)	**-**	-	**-**
Transfer to statutory reserve	36(e)	-	-	-	-	-	153,962	(153,962)	**-**	-	**-**
Total comprehensive income for the year		**-**	**-**	**(4,781)**	**406,377**	**(335,010)**	**153,962**	**2,835,225**	**3,055,773**	**52,388**	**3,108,161**
Transactions with owners, recorded directly through equity											
Bonus issue of shares	36(a)	246,811	(246,811)	-	-	-	-	-	**-**	-	**-**
Rights issue of shares	36(a)	493,622	1,579,590	-	-	-	-	-	**2,073,212**	-	**2,073,212**
Bonus and rights issue expenses paid	36(a)		(123,980)	-	-	-	-	-	**(123,980)**	-	**(123,980)**
Dividends paid:											
- Final for 2011	35	-	-	-	-	-	-	(98,724)	**(98,724)**	-	**(98,724)**
At 31 December 2012		**2,714,921**	**1,208,799**	**155,083**	**(30,787)**	**(414,094)**	**687,543**	**10,638,623**	**14,960,088**	**521,534**	**15,481,622**

BANK STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2012

		←		Non-distributable	→		Distributable	
	Note	Share capital Shs'000	Share premium Shs'000	Revaluation surplus on property Shs'000	Investments revaluation reserve Shs'000	Statutory credit risk reserve Shs'000	Revenue reserves Shs'000	Total Equity Shs'000
At 1 January 2011		**1,794,989**	**28,848**	**164,645**	**(96,595)**	**366,056**	**5,637,911**	**7,895,854**
Profit for the year		-	-	-	-	-	2,533,048	**2,533,048**
Prior year deferred tax adjustment on available-for- sale financial assets net of deferred tax	26	-	-	-	(28,979)	-	-	(28,979)
Fair value loss on available-for- sale financial assets net of deferred tax	36(c)	-	-	-	(311,590)	-	-	(311,590)
Transfer of excess depreciation		-	-	(6,830)	-	-	6,830	**-**
Deferred tax on excess depreciation		-	-	2,049	-	-	(2,049)	**-**
Transfer to statutory reserve	36(e)	-	-	-	-	141,463	(141,463)	**-**
Total comprehensive income for the year		**-**	**-**	**(4,781)**	**(340,569)**	**141,463**	**2,396,366**	**2,192,479**
Transactions with owners, recorded directly through equity								
Bonus issue of shares	36(a)	179,499	(28,848)	-	-	-	(150,651)	**-**
Bonus share issue expenses	36(a)							
Dividends paid:		-	-	-	-	-	-	-
- Final for 2010	35	-	-	-	-	-	(89,749)	**(89,749)**
- Interim 2011	35	-	-	-	-	-	(98,724)	**(98,724)**
At 31 December 2011		**1,974,488**	**-**	**159,864**	**(437,164)**	**507,519**	**7,695,153**	**9,899,860**
At 1 January 2012		**1,974,488**	**-**	**159,864**	**(437,164)**	**507,519**	**7,695,153**	**9,899,860**
Profit for the year		-	-	-	-	-	2,907,862	**2,907,862**
Fair value gain on available-for- sale financial assets net of deferred tax	36(c)	-	-	-	406,377	-	-	**406,377**
Transfer of excess depreciation		-	-	(6,830)	-	-	6,830	**-**
Deferred tax on excess depreciation		-	-	2,049	-	-	(2,049)	**-**
Transfer to statutory reserve		-	-	-	-	129,655	(129,655)	**-**
Total comprehensive income for the year		**-**	**-**	**(4,781)**	**406,377**	**129,655**	**2,782,988**	**3,314,239**
Transactions with owners, recorded directly through equity								
Rights issue	36(a)	493,622	1,579,590	-	-	-	-	**2,073,212**
Bonus and rights issue expenses paid	36(a)	-	(123,980)	-	-	-	-	**(123,980)**
Bonus issue of shares	36(a)	246,811	(246,811)	-	-	-	-	-
Dividends paid:								
- Final for 2011	35	-	-	-	-	-	(98,724)	**(98,724)**
At 31 December 2012		**2,714,921**	**1,208,799**	**155,083**	**(30,787)**	**637,174**	**10,379,417**	**15,064,607**

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2012

Bank				Group	
2012	2011			2012	2011
Shs'000	Shs'000		Note	Shs'000	Shs'000
		CASH FLOWS FROM OPERATING ACTIVITIES			
4,863,667	1,061,287	Cash generated from operations	39 (a)	5,343,733	692,663
(1,311,294)	(950,051)	Income tax paid	15 (c)	(1,406,507)	(1,020,833)
3,552,373	**111,236**	**Net cash generated from / (used in) operating activities**		**3,937,226**	**(328,170)**
		CASH FLOWS FROM INVESTING ACTIVITIES			
(1,137,538)	-	Investment in NC Uganda	25 (a)	-	-
(107,554)	(307,052)	Purchase of equipment	27	(258,698)	(375,026)
(339,005)	(306,759)	Purchase of intangible assets	28 (a)	(455,620)	(311,238)
290	990	Proceeds from sale of motor vehicle and equipment	39 (c)	688	1,012
(1,583,807)	**(612,821)**	**Net cash used in investing activities**		**(713,630)**	**(685,252)**
		CASH FLOWS FROM FINANCING ACTIVITIES			
(100,675)	(182,749)	Dividends paid	35	(100,675)	(182,749)
2,073,212	-	Rights issue of shares	36 (a)	2,073,212	-
(123,980)	-	Bonus and rights issue expenses paid	36 (a)	(123,980)	-
1,848,557	**(182,749)**	**Net cash generated from / (used in) financing activities**		**1,848,557**	**(182,749)**
3,817,123	**(684,334)**	**NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS**		**5,072,153**	**(1,196,171)**
6,179,353	**6,863,687**	**CASH AND CASH EQUIVALENTS AT 1 JANUARY**		**7,055,642**	**8,254,584**
-	-	Effect of foreign exchange rate changes		(17,646)	(2,771)
9,996,476	**6,179,353**	**CASH AND CASH EQUIVALENTS AT 31 DECEMBER**	39 (b)	**12,110,149**	**7,055,642**

NOTES TO THE FINANCIAL STATEMENTS

1) Reporting Entity

NIC Bank Limited (The "Bank/Parent") and its subsidiaries (together, the Group) provide retail, corporate banking, brokerage, bancassurance and investment banking services. NIC Bank Limited is incorporated in Kenya under the Companies Act as a public limited liability company and is domiciled in Kenya. The Bank's shares are listed on the Nairobi Securities Exchange (NSE). NIC Bank Limited and its subsidiaries operate in Kenya, Tanzania and in Uganda through its subsidiary NIC Bank Tanzania Limited and NC Uganda Limited.

The address of its registered office is as follows:
LR Plot No.8182
NIC House, Masaba Road
P O Box 44599
Nairobi-GPO 00100

2) Standards and interpretations affecting the reported result or financial position

Adoption of new and revised International Financial Reporting Standards (IFRSs)

(i) *New standards and amendments to published standards effective for the year ended 31 December 2012*

The following new and revised IFRSs were effective in the current year and had no material impact on the amounts reported in these financial statements.

Amendments to IFRS 7 Disclosures – Transfers of Financial Assets	The amendments to IFRS 7 increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures of transactions where a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The application of the amendment had no effect on the Group's financial statements as the Group did not transfer any such financial assets during the year.
Amendments to IAS 12 Deferred Tax: Recovery of Underlying Assets	The amendments to IAS 12 provide an exception to the general principle set out in IAS 12 Income Taxes that the measurement of deferred tax should reflect the manner in which an entity expects to recover the carrying amount of an asset. Specifically, the amendments establish a rebuttable presumption that the carrying amount of an investment property measured using the fair value model in IAS 40 Investment Property will be recovered entirely through sale. The amendments were issued in response to concerns that application of IAS 12's general approach can be difficult or subjective for investment property measured at fair value because it may be that the entity intends to hold the asset for an indefinite or indeterminate period of time, during which it anticipates both rental income and capital appreciation. The application of the amendments had no effect on the Group's financial statements as the Group had no investment property in its statement of financial position.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

2) Standards and interpretations affecting the reported result or financial position

Adoption of new and revised International Financial Reporting Standards (IFRSs)

(i) New standards and amendments to published standards effective for the year ended 31 December 2012 (Continued)

Amendments to IFRS 1 Severe Hyperinflation	The amendments regarding severe hyperinflation provide guidance for entities emerging from severe hyperinflation either to resume presenting IFRS financial statements or to present IFRS financial statements for the first time The amendments had not effect on the Group's financial statements as the Group did not trade in such hyperinflation environment.

(ii) New and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2012

	Effective for annual periods beginning on or after
IFRS 7, Amendments-Disclosure: offsetting financial assets and financial liabilities	1 January 2013
IFRS 9 Financial Instruments (as revised in 2010)	1 January 2015
IFRS 10 Consolidated Financial Statements	1 January 2013
IFRS 11, Joint Arrangements	1 January 2013
IFRS 12, Disclosure of Interests in Other Entities	1 January 2013
IFRS 13, Fair Value Measurement	1 January 2013
IAS 19, Employee Benefits (2011) - Revised requirements for pensions and other post retirement benefits, termination benefits and other changes.	1 January 2013
IAS 27, Separate Financial Statements (as revised in 2011)	1 January 2013
IAS 28, Investments in Associates and Joint Ventures	1 January 2013
IAS 32, Financial Instruments: Presentation – Amendments to application guidance on the offsetting of financial assets and financial liabilities	1 January 2014
IFRIC 20, Stripping costs in the production phase of a surface mine	1 January 2013

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2012 and future annual periods

- **IFRS 9, Financial Instruments**

  IFRS 9 *Financial Instruments* issued in November 2010 and amended in October 2010 and December 2011 introduces new requirements for the classification and measurement of financial assets.

  IFRS 9 requires all recognised financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods.

NOTES TO THE FINANCIALS STATEMENTS (CONTINUED)

2) Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2012 and future annual periods (Continued)

- **IFRS 9, Financial Instruments (Continued)**

The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was recognised in profit or loss.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015, with earlier application permitted.

The directors anticipate that IFRS 9 will be adopted in the company's financial statements for the annual period beginning 1 January 2015 and that the application of IFRS 9 may have a significant impact on amounts reported in respect of the Group's financial assets and financial liabilities (e.g the Group will classify financial assets as subsequently measured at either amortised cost or fair value). However, it is not practicable to provide a reasonable estimate of that effect until a detailed review is done.

- **IFRS 10: Consolidated Financial Statements**

IFRS 10 requires a parent to present consolidated financial statements as those of a single economic entity, replacing the requirements previously contained in IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation - Special Purpose Entities'.

The standard identifies the principles of control, determines how to identify whether an investor controls an investee and therefore must consolidate the investee, and sets out the principles for the preparation of consolidated financial statements. The Standard introduces a single consolidation model for all entities based on control, irrespective of the nature of the investee (i.e. whether an entity is controlled through voting rights of investors or through other contractual arrangements as is common in 'special purpose entities'). Under IFRS 10, control is based on whether an investor has:

- power over the investee
- exposure, or rights, to variable returns from its involvement with the investee, and
- the ability to use its power over the investee to affect the amount of the returns.

The standard is effective for annual periods beginning on or after 1 January 2013. The Group will apply this amendment prospectively.

- **IFRS 11: Joint Arrangements**

IFRS 11 replaces IAS 31 'Interests in Joint Ventures'. It requires a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and then account for those rights and obligations in accordance with that type of joint arrangement.

NOTES TO THE FINANCIALS STATEMENTS (CONTINUED)

2) Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2012 and future annual periods (Continued)

- **IFRS 11: Joint Arrangements (Continued)**

Joint arrangements are either joint operations or joint ventures:

- A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint operators recognise their assets, liabilities, revenue and expenses in relation to its interest in a joint operation (including their share of any such items arising jointly)
- A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (joint venturers) have rights to the net assets of the arrangement. A joint venturer applies the equity method of accounting for its investment in a joint venture in accordance with IAS 28 'Investments in Associates and Joint Ventures (2012)'. Unlike IAS 31, the use of 'proportionate consolidation' to account for joint ventures is not permitted.

The standard is effective for annual periods beginning on or after 1 January 2013. The Group will apply this amendment prospectively. The directors anticipate no material impact to the Group's financial statements currently. However, the Group would have to apply this standard to any such arrangements entered in the course of its expansion strategy.

- **IFRS 12 Disclosure of Interests in Other Entities**

IFRS 12 requires the extensive disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.

In high-level terms, the required disclosures are grouped into the following broad categories:

- Significant judgements and assumptions - such as how control, joint control, significant influence has been determined
- Interests in subsidiaries - including details of the structure of the group, risks associated with structured entities, changes in control, and so on
- Interests in joint arrangements and associates - the nature, extent and financial effects of interests in joint arrangements and associates (including names, details and summarised financial information)
- Interests in unconsolidated structured entities - information to allow an understanding of the nature and extent of interests in unconsolidated structured entities and to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities

IFRS 12 lists specific examples and additional disclosures which further expand upon each of these disclosure objectives, and includes other guidance on the extensive disclosures required.

The adoption of IFRS 12 in the Group's financial statements for the annual period beginning 1 January 2013 and that the application of the new standard would result in more extensive disclosures in the financial statements.

NOTES TO THE FINANCIALS STATEMENTS (CONTINUED)

2) Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 30 December 2012 and future annual periods (Continued)

- **IFRS 13 Fair Value Measurements**

IFRS 13 replaces the guidance on fair value measurement in existing IFRS accounting literature with a single standard. The IFRS is the result of joint efforts by the IASB and FASB to develop a converged fair value framework. The IFRS defines fair value, provides guidance on how to determine fair value and requires disclosures about fair value measurements. However, IFRS 13 does not change the requirements regarding which items should be measured or disclosed at fair value.

IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements).

With some exceptions, the standard requires entities to classify these measurements into a 'fair value hierarchy' based on the nature of the inputs:

- Level 1 - quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 - inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly;
- Level 3 - unobservable inputs for the asset or liability.

The scope of IFRS 13 is broad; it applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except in specified circumstances. In general, the disclosure requirements in IFRS 13 are more extensive than those required in the current standards. For example, quantitative and qualitative disclosures based on the three-level fair value hierarchy currently required for financial instruments only under IFRS 7 Financial Instruments: Disclosures will be extended by IFRS 13 to cover all assets and liabilities within its scope.

The directors anticipate that the application of the new Standard may affect the amounts reported in the financial statements and result in more extensive disclosures in the financial statements, however, the Group is yet to assess IFRS 13’s full impact and intends to adopt the standard no later than the accounting period beginning on or after 1 January 2013.

- **Disclosures — Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)**

Amends the disclosure requirements in IFRS 7 *Financial Instruments*: Disclosure to require information about all recognised financial instruments that are set off in accordance with paragraph 42 of IAS 32 Financial Instruments: Presentation.

The amendments also require disclosure of information about recognised financial instruments subject to enforceable master netting arrangements and similar agreements even if they are not set off under IAS 32. The IASB believes that these disclosures will allow financial statement users to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position.

The amendments to IFRS 7 are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The director’s anticipate that the application of these amendments to IFRS 7 may result in more disclosures being made with regard to offsetting financial assets and financial liabilities in the future.

NOTES TO THE FINANCIALS STATEMENTS (CONTINUED)

2) Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 30 December 2012 and future annual periods (Continued)

- **Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)**

These amend IAS 1, Presentation of Financial Statements, to revise the way other comprehensive income is presented.

The amendments:

- Preserve the amendments made to IAS 1 in 2007 to require profit or loss and Other comprehensive Income (OCI) to be presented together, i.e. either as a single 'statement of profit or loss and comprehensive income', or a separate 'statement of profit or loss' and a 'statement of comprehensive income' – rather than requiring a single continuous statement.
- Require entities to group items presented in OCI based on whether they are potentially reclassifiable to profit or loss subsequently. i.e. those that might be reclassified and those that will not be reclassified.
- Require tax associated with items presented before tax to be shown separately for each of the two groups of OCI items (without changing the option to present items of OCI either before tax or net of tax).

The above amendments are generally effective for annual periods beginning on or after 1 July 2012. The company will apply the amendments prospectively. Other than presentation, the directors anticipate no material impact to the company's financial statements.

- **Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)**

Amends IAS 32 Financial Instruments: Presentation to clarify certain aspects because of diversity in application of the requirements on offsetting, focused on four main areas:

- the meaning of 'currently has a legally enforceable right of set-off'
- the application of simultaneous realisation and settlement
- the offsetting of collateral amounts
- the unit of account for applying the offsetting requirements.

The amendments to IAS 32 are not effective until annual periods beginning on or after 1 January 2014, with retrospective application required. The directors anticipate that the application of this amendment may result in more disclosures being made with regard to offsetting of financial assets and financial liabilities in the future. The Group will apply the amendments prospectively.

- **IAS 19 (as revised in 2012)- Employee Benefits**

The amendments to IAS 19 change the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets. The amendments require the recognition of changes in defined benefit obligations and in fair value of plan assets when they occur, and hence eliminate the 'corridor approach' permitted under the previous version of IAS 19 and accelerate the recognition of past service costs. The amendments require all actuarial gains and losses to be recognised immediately through other comprehensive income in order for the net pension asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus.

NOTES TO THE FINANCIALS STATEMENTS (CONTINUED)

2) Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 30 December 2012 and future annual periods (Continued)

- **IAS 19 (as revised in 2012)- Employee Benefits (Continued)**

  The amendments to IAS 19 are effective for annual periods beginning on or after 1 January 2013 and require retrospective application with certain exceptions. The directors anticipate that the amendments to IAS 19 will be adopted in the Group's financial statements for the annual period beginning 1 January 2013 and that the application of the amendments to IAS 19 will not have an impact on the financial statements.

- **IAS 27 Separate Financial Statements (2012)**

  Amended version of IAS 27 which now only deals with the requirements for separate financial statements, which have been carried over largely unamended from IAS 27 Consolidated and Separate Financial Statements. Requirements for consolidated financial statements are now contained in IFRS 10 Consolidated Financial Statements.

  The Standard requires that when an entity prepares separate financial statements, investments in subsidiaries, associates, and jointly controlled entities are accounted for either at cost, or in accordance with IFRS 9 Financial Instruments.

  The Standard also deals with the recognition of dividends, certain group reorganisations and includes a number of disclosure requirements.

  The standard is effective for annual periods beginning on or after 1 January 2013. The Group will apply this amendment prospectively. The directors anticipate no material impact to the Group's financial statements.

- **IAS 28 Investments in Associates and Joint Ventures (2012)**

  This Standard supersedes IAS 28 Investments in Associates and prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

  The Standard defines 'significant influence' and provides guidance on how the equity method of accounting is to be applied (including exemptions from applying the equity method in some cases). It also prescribes how investments in associates and joint ventures should be tested for impairment.

  The standard is effective for annual periods beginning on or after 1 January 2013. The Group will apply this amendment prospectively. The directors, however, anticipate no material impact to the Group's financial statements.

(iv) Early adoption of standards

The Group did not early-adopt new or amended standards in 2012.

NOTES TO THE FINANCIALS STATEMENTS (CONTINUED)

3) Summary of significant accounting policies

a) Statement of compliance

The Group's consolidated financial statements for the year 2012 have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board [IASB]. Additional information required by the regulatory bodies is included where appropriate.

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

b) Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis of accounting except for property that is measured at revalued amounts and the following financial instruments, measured at fair value:

- Derivative financial instruments
- Financial instruments at fair value through profit or loss
- Available for sale financial instruments
- Certain investments in equity instruments at fair value through profit or loss.

c) Presentation of financial statements

The consolidated financial statements comprise the consolidated and Bank statements of comprehensive income, consolidated and Bank statements of financial position, the consolidated and Bank statements of changes in equity, the consolidated and Bank statements of cash flows and the notes to the financial statements.

The Group classifies its expenses by the nature of expense methodology.

The disclosures on risks from financial instruments are presented in the financial risk management report contained in note 4.

The consolidated and Bank statements of cash flows shows the changes in cash and cash equivalents arising during the period from operating, investing and financing activities.

d) Foreign currencies

i) Functional and presentation currency

The financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Kenya Shillings, which is the Bank's functional and presentational currency.

Except as indicated, financial information presented in Kenya Shillings has been rounded to the nearest thousand.

ii) Transactions and balances

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the respective functional currencies of the operations using the exchange rates prevailing at the dates of the transactions.

At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.

Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when fair value was determined. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 Summary of significant accounting policies (Continued)

d) Foreign currencies (Continued)

ii) Transactions and balances (Continued)

Foreign currency exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised through profit or loss.

iii) Group companies

The results and financial position of Group entities that have a functional currency different from the presentation currency are retranslated into the presentation currency as follows:

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in Kenyan shillings using exchange rates prevailing at the reporting date. Income and expense items of foreign operations are retranslated at average exchange rates for the period.

Foreign currency exchange differences are reported as 'exchange differences on translations of foreign operations' and are recognised in other comprehensive income and presented in the foreign currency translation reserve in equity.

e) Use of estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates. The preparation of financial statements also requires management to exercise its judgement in the process of applying the Group's accounting policies. Actual results in future may differ from estimates upon which financial information is prepared.

Significant assumptions and estimates to the financial statements and areas involving a higher degree of judgement or complexity are disclosed in note 5.

f) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and all its subsidiaries for the year ended 31 December, 2012. A list of the Bank's subsidiaries is set out in note 25(b).

Subsidiaries are those companies in which the Bank has power to exercise control over the operations of the entities. Subsidiaries are included in the consolidated financial statements from the date group gains effective control. Entities controlled by the group are consolidated until the date that control ceases.

The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

Intra-group balances and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

The acquisition method of accounting is used when subsidiaries are acquired by the group. The cost of an acquisition in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the consideration transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

f) Basis of consolidation (Continued)

At the acquisition date, the acquired identifiable assets and the liabilities assumed are generally measured and recognized at their fair value.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the Group's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

In the event that the amounts of net assets acquired is in excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of Group’s previously held equity interest, the difference is recognised immediately in the profit or loss as a bargain purchase.

In a business combination achieved in stages, the previously held equity interest is re-measured at the acquisition-date fair value with the resulting gain or loss recognised in the profit or loss. Changes in the group’s ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity holders and are reported in equity.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS.

g) Income recognition

I. Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised in the statement of comprehensive income on accrual basis using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate is established on initial recognition of the financial instrument.

The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest that was used to discount the future cash flows for purposes of measuring the allowance for impairment.

Interest income and expense on all trading assets and liabilities are considered to be incidental to the Group’s trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

II. Fee and commission income and expenses

In the normal course of business, the Group earns fees and commission income from a diverse range of services to its customers. Fees and commission income and expenses that are integral to the effective interest rate on a financial instrument are included in the measurement of the effective interest rate.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

g) Income recognition (Continued)

II. Fee and commission income and expenses (Continued)

Other fees and commission income, including account servicing fees, investment management fees, placement fees, brokerage fees, bancassurance fees, and syndication fees, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period.

Other fees and commission expense relates mainly to transaction and service fees, which are incurred as the services are received.

III.Net trading income

Net trading income arises from the margins which are achieved through market-making and customer business and from changes in market value caused by movements in interest and exchange rates, equity prices and other market variables. It comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

h) Financial instruments

I. Recognition

The Group initially recognises loans and receivables, deposits and debt securities issued on the date that they are originated. All other financial instruments are initially recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

II. Classification

1. Financial assets

The Group classifies its financial assets into the following categories:

- At fair value through profit or loss
- Loans, advances and receivables
- Held-to-maturity investments
- Available for sale investments

Management determines the appropriate classification of its investments at initial recognition

Financial assets at fair value through profit or loss

This category has two sub-categories: Financial assets classified as held for trading and those designated at fair value through profit or loss at inception.

A financial asset is classified as held for trading if acquired principally for the purpose of selling in the short term. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. Financial instruments included in this category are recognised initially at fair value, transactions costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

h) Financial instruments (Continued)

II. Classification (Continued)

1. Financial assets (Continued)

Financial assets at fair value through profit or loss (Continued)

The group designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting measurement mismatch or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis.

Financial assets for which the fair value option is applied are recognised in the statement of financial position as 'Financial assets designated at fair value'. Fair value changes relating to financial assets designated at fair value through profit or loss are recognised in 'Net gains on financial instruments designated at fair value through profit or loss'.

Loans and receivables

Loans and advances to customers and trade receivables are non-derivative financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market and which the Group does not intend to sell immediately or in the near term. Loans and advances to customers are recognised when cash is advanced to borrowers.

Held-to-maturity investments

These are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intention and ability to hold to maturity. Where a sale occurs, other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and classified as available for sale.

Available-for-sale investments

Available-for-sale financial assets are assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as (a) financial assets at fair value through profit or loss, (b) loans and receivables, or (c) financial assets held to maturity.

Available for sale financial assets are initially recognised at fair value and measured subsequently at fair value with gains and losses being recognised in other comprehensive income and accumulated in the investments revaluation reserve with the exception of;

- impairment losses
- interest calculated using the effective interest rate method
- foreign exchange gains and losses on monetary assets which are recognised in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

h) Financial instruments (Continued)

II. Classification (Continued)

2. Financial liabilities

Financial liabilities are recognised when the Group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities is at amortised cost using effective interest rate method. Financial liabilities will include deposits from banks or customers, trade payables in the brokerage and lines of credit for which the fair value option is not applied.

II. Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or substantially all the risks and rewards of ownership incidental to the financial asset are transferred. A financial liability is derecognised when its contractual obligations are redeemed or otherwise extinguished.

III. Measurement

Financial instruments are initially recognised at fair value plus transaction costs.

Financial assets at 'fair value through profit or loss' are subsequently carried at fair value. Gains and losses arising from changes in the fair value in those assets are recognised in profit or loss.

Gains and losses arising from changes in the fair value of 'available-for-sale financial assets' are recognised in other comprehensive income in the period in which they arise and accumulated in the investment revaluation reserves.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments previously recognised in the investment revaluation reserves are reclassified to profit or loss.

Dividends on available-for-sale equity instruments are recognised in profit or loss as part of other income when the Group's right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unquoted securities), the Group establishes fair value by using valuation techniques that include the use of various valuation methodology. The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of those that sourced them.

Loans and receivables and held to maturity investments are carried at amortised cost using the effective interest rate method.

Financial liabilities are subsequently measured at amortised cost.

IV. Impairment of financial assets

(i) Amounts carried at amortised costs

The Group reviews regularly, on a case-by–case basis, whether any objective evidence exists of impairment, individually for financial assets that are significant and individually or collectively for financial assets that are not individually significant. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

h) Financial instruments (Continued)

I. Impairment of financial assets (Continued)

(ii) Amounts carried at amortised costs (Continued)

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the profit or loss as 'impairment loss on loans and receivables'. When a loan or receivable is uncollectible, it is written off against the related allowance account. Subsequent recoveries of amounts previously written off are credited through profit or loss.

Objective evidence that loans and receivables are impaired can include significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue), the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the Group are considered indicators that the loans or receivable is impaired.

In assessing impairment losses, the Group considers the following factors, in each category:

i) Individually assessed loans

- The aggregate exposure to the Group.
- The viability of the customer's business model and its capacity to trade successfully out of financial difficulties and generate sufficient cash flows to meet its debt obligations.
- The realisable value of the security (or other mitigants) and likelihood of successful repossession net of any costs involved in recovery of amounts.
- The amount and timing of expected receipts and, in cases of liquidation or bankruptcy, dividend available.
- The extent and complexity of other creditors commitment ranking pari passu with the Group and the likelihood of other creditors continuing to support the customer.

ii) Collectively assessed

- For loans not subject to individual assessment, to cover losses which have been incurred but have not yet been identified.
- For homogeneous groups of loans that are not considered individually significant, where there is objective evidence of impairment.

Homogeneous groups of loans

For homogeneous groups of loans that are not considered individually significant, or in other cases, when the portfolio size is small or when information is insufficient or not reliable enough, the Group adopts a formulaic approach which allocates progressively higher percentage loss rates in line with the period of time for which a customer's loan is overdue. Loss rates are calculated from the discounted expected future cash flows from a portfolio. These rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

h) Financial instruments (Continued)

v. Impairment of financial assets (continued)

ii) Collectively assessed (Continued)

Loan write – offs

An uncollectible loan is written off against the relevant provision for impairment, either partially or in full, when there is no realistic prospect of recovery and the proceeds from realising the security have been substantially or fully recovered.

Restructured loans

Restructured loans, whose terms have been renegotiated are no longer considered to be past due but are treated as new loans after the minimum required number of payments under the new arrangement have been received.

iii) Amounts classified as available for sale

In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from other comprehensive income and recognised in profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

vi) Impairment of non financial assets

At the end of each reporting period, the Group reviews the carrying amount of its tangible and intangible assets to determine whether there is any indication that these assets have suffered an impairment loss.

If objective evidence on impairment losses exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit or loss. In cases where the asset is carried at revalued amount, the impairment loss is treated as a revaluation decrease.

In determining the recoverable amount, the Group considers the higher of the fair value of the asset less costs to sell, and value in use. In estimating value in use, the Group is cognisant of the estimated future cash flows discounted to the present value using a pre-tax discount rate that is reflective of the current market assessment of time value of money and the risks specific to the asset itself.

Intangible assets with indefinite useful life are tested for impairment annually, and when there is indication that the asset may be impaired.

Where impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised, unless such asset is carried at revalued amount, in which case the reversal of the impairment loss is treated as revaluation income.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

i) Offsetting

Financial instruments are offset and the net amount reported in the statement of financial position when, and only when, there is a legal right to set off the amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

j) Employee expenses

I. Retirement benefit obligations

The Group operates a defined contribution plan under which the Group pays fixed contributions into a separate entity. The Group has no obligation, legal or constructive, to pay further contributions if the scheme does not have sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The assets of the scheme are held in a separate trustee administered fund, which is funded by contributions from both the Group and the employees.

In addition, the Group also contributes to the National Social Security Fund in Kenya, Parastatal Pension Fund in Tanzania and National Social Security Fund in Uganda, which are defined contribution scheme registered under respective Acts of Parliament in the respective countries.

The Group's contributions to the defined contribution schemes are charged to the profit or loss in the year in which they relate.

Contract staff are entitled to gratuity payment at the completion of the contract. Provision is made for gratuity in line with the contracts.

II. Short-term benefits

Short-term employee benefit obligations (e.g medical reimbursements and insurance) are measured on an undiscounted basis and are expensed as the employee renders service.

The monetary benefits for employee accrued leave entitlement at the reporting date are recognised as an expense accrual.

k) Leasehold land

Payments to acquire leasehold interest in land are treated as prepaid operating lease rentals and amortised on straight line basis over the period of the lease. When a lease includes land and buildings elements, the bank assesses the classification of each element as either a finance lease or an operating lease. In determining classification of the land element, an important consideration is that land normally has an indefinite economic life. Therefore the finance lease or operating lease classification of the land is considered a critical area of judgment. See note 5 to these financial statements.

l) Income tax expense

Income tax expense comprises current and deferred tax. Current tax is the expected tax payable on the taxable profit for the year using currently enacted tax rates, and any adjustment to tax payable in respect of previous years.

The current income tax charge is calculated on the basis of tax laws enacted or substantively enacted at the reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

Management establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax is provided using the liability method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Currently enacted tax rates are used to determine deferred tax.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

l) Income tax expense (Continued)

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The tax effects of carry-forwards of unused losses or unused tax credits are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

m) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares in the financial statements. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding adjusted for the effects of all potentially dilutive ordinary shares.

n) Dividends on ordinary shares

Dividends are charged to equity in the period in which they are declared. Proposed dividends are not accrued until they have been ratified at the Annual General Meeting.

o) Cash and cash equivalents

Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. These includes notes and coins on hand, unrestricted balances held with Central Banks, items in the course of collection from other banks, deposits held at call with banks, net of deposits and balances due to banking institutions and treasury bills with original maturities of less than three months. Such assets are generally subject to insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

p) Leases

When the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is classified as a finance lease within loans and receivables. All other lessees are classified as operating leases.

Minimum lease payments made under finance leases are apportioned between the finance income and the reduction of the outstanding principal. The finance income is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the asset.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Rentals payable under operating leases are charged to profit or loss over the terms of the relevant lease.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

q) Repurchase agreements

When the Group purchases a financial asset and simultaneously enters into an agreement to re-sell the asset (or a substantially similar asset) at a fixed price on a future date ("reverse repo or stock borrowing"), the arrangement is accounted for as a loan or receivable, and the underlying asset is not recognised in the Group's financial statements.

r) Property and equipment

I. Recognition and measurement

Items of fixtures and equipment are stated at historical cost less accumulated depreciation. Buildings comprising mainly of the head office are stated in the statement of financial position at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour and any other costs directly attributable to bringing the asset to a working condition for its intended use. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property or equipment have different useful lives, they are accounted for as separate items of property and equipment.

The gain or loss arising on the disposal or retirement of an item of property or equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit or loss for the year.

II. Subsequent costs

The cost of replacing part of an item of property or equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are charged to profit or loss for the year as incurred.

In relation to buildings, revaluations are performed with sufficient regularity such that the carrying amounts do not differ materially from those that would be determined using fair value at the reporting date. Any increase arising on the revaluation is recognised in other comprehensive income and accumulated in the revaluation surplus on property. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and charged against the revaluation surplus on property; all other decreases are charged to the profit or loss for the year.

III. Depreciation

Depreciation which is recognised in Profit or Loss is calculated on a straight-line basis to allocate the costs or revalued amounts over their estimated useful lives as follows:

Building	2.5%
Furniture, fittings and equipment	20.0%
Motor vehicles	20.0%
Computers	33.3%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Excess depreciation, representing the additional depreciation based on revalued amounts over depreciation based on historical costs, is transferred annually from revaluation surplus on property to revenue reserves, net of deferred tax.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

s) Intangible assets

I. Goodwill

Goodwill arises on business combinations through acquisition of subsidiaries when the cost of acquisition exceeds the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired. If the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business is greater than the cost to acquire, the excess is recognised immediately in profit or loss.

Goodwill is allocated to cash-generating units for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the present value of the expected future cash flows from a business with the carrying value of its net assets, including attributable goodwill. Goodwill is stated at cost less accumulated impairment losses which are charged to profit or loss.

II. Computer software

Acquired computer software and related licences are stated at cost less accumulated amortisation. Subsequent expenditure on software products is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred. Where software is not an integral part of the related hardware it is recognised as an intangible asset.

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The estimate useful life of software is three to five years.

III. License

Separately acquired licences in business combination are initially recognised at their fair value at the acquisition date (which is regarded as cost). Licences with an indefinite useful life are not amortised and are reviewed at each reporting date to determine whether events and circumstances continue to support an indefinite useful life assessment of the asset. Where the Group re-assesses the useful life of an intangible asset as finite rather than indefinite, the asset may be considered to be impaired. The Group tests the asset for impairment annually and whenever there is an indication that the intangible asset may be impaired by comparing it's recoverable amount, with the carrying amount and recognising any excess of the carrying amount over the recoverable amount as an impairment.

t) Legal and other claims

Provisions for legal claims are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3) Summary of significant accounting policies (Continued)

u) Share capital and share premium

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

v) Statutory credit risk reserves

IAS 39 requires the Group to recognise an impairment loss when there is objective evidence that loans and receivables are impaired. However, prudential guidelines issued by banking regulators require the Group to set aside amounts for impairment losses on loans and receivables based on their guidelines. Extra losses over and above those already recognised under IAS 39 are accumulated under statutory reserves through appropriations of revenue reserves.

w) Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds, which are credit-related instruments, are generally given by the Group to support performance by a customer to third parties. Nominal principal amounts represent amounts at risk should the Group be required to meet these obligations in the event the customer defaults. These obligations are accounted for as off balance sheet transactions and disclosed as contingent liabilities.

x) Fiduciary activities

The Group provides custody, trustee, corporate administration, investment management and advisory services to third parties, which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these financial statements.

y) Derivative financial instruments

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices. Derivatives are intended to acquire, increase, reduce or alter exposure to market risks. The group uses derivatives for its customers and on its own account to manage exposure to market risks. Derivative assets and liabilities on different transactions are only set off if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis.

z) Segmental reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker (Group management). The management then allocates resources to each operating segment of the Group and assesses their performance. The operating segments are based on the Group's management and internal reporting structure. In accordance with IFRS 8, Operating Segments, the Group has the following business segments; corporate and institutional banking, treasury dealing and brokerage, retail banking, asset finance and investment banking and others (see note 6).

aa) Comparatives

Except otherwise required, all amounts are reported or disclosed with comparative information.
Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives

Group risk management framework and governance structures

A) Risk management overview

In the financial services sector, sustainable growth in profitability involves selectively taking and managing risks. The Group's goal is to earn, on behalf of the stakeholders, an optimal, stable and sustainable rate of return for every shilling of risk we take, while continually investing in our business to meet our future growth objectives. The risk management resources and processes are designed to identify, understand, measure and report risks that the Group's businesses are exposed to, and develop governance, controls, and risk management frameworks necessary to mitigate these risks as appropriate. These resources and processes are strengthened by the Group's culture which emphasises transparency and accountability for managing risk.

The Group defines risk as an event or events of uncertainty which can be caused by internal or external factors resulting in the possibility of losses (downside risk). However, the Group appreciates that some risk events may result into opportunities (upside risk) and should therefore be actively sought and exploited.

The Group operates in an environment of numerous risks as shown below that may cause financial and non-financial results to differ significantly from expected outcomes. The Group has an enterprise-wide approach to the identification, measurement, monitoring and management of risks faced across the organisation. These risks are classified as follows:

Financial risks:

- Credit & counterparty risk
- Liquidity & funding risk
- Market risk that fall within:
    - Interest rate risk
    - Foreign exchange risk
    - Price risk

Non-financial risks are discussed on pages 86 to 90.

How we manage risk

Risk management in the Group is integrated with the strategic agenda and closely tied to the capitalisation levels of Group. This is intended to align risks incurred in pursuit of strategic objectives to shareholder expectations and acceptable international best practices. Through an integrated risk management framework, the Group has embedded a strong risk management culture and ensures its alignment with enterprise – wide strategic goals.

The Group is governed by the following complementary risk principles:

i. Enterprise-wide in scope – Risk management spans all areas of the Group activities, including strategic alliances, and all boundaries, both geographic and regulatory.

ii. Enhanced accountability – Risks are explicitly owned, understood and actively managed by the business units' management and all employees, individually and collectively.

iii. Independent oversight – Risk policies, procedures, and reporting will be established independently and objectively.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

A) Risk management overview (Continued)

iv. Integrated risk and control culture – Risk management disciplines will be integrated into the daily routines, decision-making and strategy of the Group.

v. Attainment of strategic balance – Risk will be managed to an acceptable level of exposure, recognising the need to enhance shareholder value whilst protecting shareholder equity and other stakeholders at all times.

vi. Transparent and effective communication – Matters related to risk will be communicated and escalated in a timely, accurate and forthright manner.

The Group's risk management approach is comprehensive, proactive and continuous. It combines the experience and specialised knowledge of individual business units, risk professionals, and the corporate oversight functions. In managing risk, the Group:

a) Defines acceptable risk appetite within a comprehensive framework, through the determination and maintenance of appropriate risk management policies, limits, guidelines and practices. Adherence to this framework is primarily managed by individual business units [risk owners] and assessed or monitored through independent oversight arms of management i.e Risk Management and Internal Audit Departments. Key risk management objectives form a substantial input in performance appraisal across the Group.

b) Actively monitor internal and external risk events to determine and implement effective internal controls to withstand risk shocks. Each business unit and oversight functions periodically identifies and assesses its own key risks and internal controls through structured risk models.

c) Allocates capital by thoroughly interrogating the risks faced by the Group and the potential impact on capital adequacy. This is done through the use of appropriate and validated risk measurement methodologies developed internally or/and from existing regulatory framework.

d) Communicates quantitative and qualitative elements of the risk profile to Senior Management, the Board of Directors and other relevant stakeholders through an integrated risk management information system.

e) Periodically employs stress testing approaches to access/understand applicability and continued relevance of risk mitigants on potential vulnerabilities.

NIC Bank Group's risk management framework

The framework has five main components which are continually reviewed and updated to ensure that they are consistent and appropriate to risk taking activities, and that they remain relevant to the Group's business and strategies. The framework consists of the following:

Policies & limits

These define the Group's overall risk appetite, and are developed based on the requirements of regulatory authorities and input from the Board of Directors and Senior Management. The policies also provide guidance to the business units by setting boundaries on the types and levels of risks the Group is prepared to assume.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

A) Risk management overview (Continued)

Guidelines

These are directives provided to implement policies and limits as set out above. They describe the facility types, aggregate facility exposures and conditions under which the Group is prepared to do business. Risk taking outside these guidelines has to be approved by Senior Management of the Group, or by the Board of Directors, depending on set approval limits.

Processes & standards

These are activities associated with identifying, evaluating, documenting, reporting and controlling risk. They define the breadth and quality of information required to make decisions and the expectation in terms of quality of analysis and presentation. At the operating level these are the activities that must be achieved before risk decisions are taken.

Measurement, monitoring & reporting

Measurement and reporting tools quantify risks across products, activities and business units and are used among other things, to determine risk exposures. The Risk Management Department is responsible for developing and maintaining an appropriate suite of such tools to support the operations of the various business units. Measurement information is compared against approved policies, limits and guidelines and presented to Senior Management and the Board of Directors to enable them to understand the Group's risk profile. A comprehensive summary of the Group's risk profile and performance against defined tolerance goals is presented to Senior Management and the Board Risk Management Committee and the Board of Directors for their review, action and guidance.

Independent review

The Internal audit department and the external auditors independently monitor the effectiveness of the risk management programs and internal controls through periodic testing of the design and operations of processes related to identification, measurement or assessment, monitoring, controlling and reporting of risks. Additionally, the Group's internal audit programs are derived from a risk based assessment so as to focus its audit assessment attention to risk areas of the business units deemed high on probability or impact.

The notes below provide high-level information on each of the key risk classes we face in line with the Group's objectives, policies and programs for identifying, measuring or assessing, monitoring, controlling and reporting / communicating those risks to stakeholders. It also elucidates the Group's management of its capital taking into account the approved risk appetite and profile.

a) Credit and counterparty risk

Credit risk is the potential for loss due to the Group's customers' or counterparties' failure or unwillingness to meet their contractual credit obligations. It is the single largest financial risk that the Group faces.

It arises principally from, but is not limited to, commercial and retail loans and advances, commitments from forward foreign exchange contracts , financial guarantees, letters of credit and acceptances, investments in debt securities and other exposures arising from trading and settlement activities with market counterparties.

The amounts presented in these financial statements are net of impairment allowances based on prudent assessment of customers' or counterparties' abilities to meet their contractual obligations.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

a) Credit and counterparty risk (Continued)

The Group's lending principles are laid out in an elaborate series of corporate strategies, policies, standards, guidelines, directives and procedures, all of which are developed, approved and reviewed regularly by the Board Credit Risk Committee and respective Risk Management Committees. This is to ensure policies are current and consistent with the Group's risk appetite. The structure, limits, collateral requirements, ongoing management, monitoring and reporting of credit exposures are all governed by these principles.

Who manages credit & counterparty risk

The Board of Directors and Senior Management pay special attention to credit risk exposure at all times. The Board retains responsibility for the under-writing and independent review of the credit risk exposures through specifically constituted Board sub-committees: the Board Credit Risk Committee and the Board Risk Management Committee respectively. To facilitate the day to day management of credit risk i.e. under-writing functions, monitoring and control, there is a specialised, independent and centralized credit review/approval team headed by the Head of Credit who reports to the Group Managing Director. The Board of Directors retains the authority to approve credit facilities that are significant in size or complexity.

Effective credit risk management begins with experienced and professional lending officers who have been mandated to authorise credit exposures for the Group. These individuals are subjected to a rigorous lender qualification process and operate within a disciplined environment with clear delegation of management discretionary limits at both the individual and joint levels depending on the size and complexity of credit decisions they make.

To facilitate quick credit decisions, the Board Credit Risk Committee has granted discretionary limits to several Senior Managers (at individual and committee levels), in line with their skills, experience and ability to make sound credit decisions.

To separate the sales and credit under-writing functions from credit operations, a credit administration unit that reports directly to the Head of Technology and Operations, handles post-approval credit administration as well as the daily monitoring of credit exposures against approved limits. This together with the complete segregation of sales activities from the underwriting process, maintains an adequate governance structure that eliminates conflicts of interest that may occur in the course of business.

Credit risk management key performance indicators, including the quality of our credit portfolios, portfolio concentrations, amongst others, are independently reviewed by the Head of Risk Management & Compliance with oversight from the Board Risk Management Committee.

Regular independent audits of the approval process and adherence to credit risk management programs are carried out by the Internal Audit Department. Adverse findings are submitted to Senior Management and the Board Audit Committee for information and corrective action. Furthermore, audit programs are carried out using a risk based approach to concentrate activities where high probability and high impact risk events are envisaged.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

a) Credit and counterparty risk (continued)

How credit and counterparty risk is managed

Credit and counterparty risk measurement & assessment

The estimation of credit exposures at the individual and portfolio levels is complex and requires the use of special models, as the value of products or portfolios varies with changes in market variables, expected cash-flows and the passage of time. The assessment of a portfolio of assets' credit exposures entails further estimation of the likelihood of defaults occurring, of associated losses, and of default correlations between borrowers or counterparties, the facilities granted, and their industries. This is achieved using a credit rating model developed internally for use in the business.

Credit & counterparty risk limit control and mitigation policies

The Board Credit Risk Committee regularly sets, reviews and approves exposure limits for the larger counterparties as well as tolerance limits on a portfolio basis. In turn, the Group manages the limits and controls concentrations of credit risk exposures against internal and regulatory requirements with respect to individual counterparties or related groups of counterparties, industry sectors, amongst others.

Exposures to any one borrower (including bank counterparties) are further restricted by sub-allocating limits covering separate on and off – balance sheet exposures, as well as daily delivery exposures in relation to trading items e.g. forward foreign contracts.

Lending limits are reviewed regularly in view of changing business/financial risks of the borrowers, in addition to industry and general economic conditions in which they operate. To enable prudent and consistent credit assessments at the individual level, the Group has robust approval processes and models covering different business segments. This process basically captures the borrower's financial viability, industry / economic performance, geopolitical risks and its managements' ability to steer the organisation. These models are suited to counterparties who are homogeneous in nature for ease of their use.

Limits for commercial and corporate clients are reviewed at least once annually. The credit review process ensures that an appropriate facility structure, including covenant monitoring, is in place for each client. The frequency of reviews is increased in accordance with the likelihood and size/complexity of potential credit losses, with deteriorating higher-risk situations referred to independent debt recovery units for closer attention where appropriate.

The risks in industry sectors are managed through limits and lending criteria / guidelines relevant to each particular industry. Borrower limits are set within the context of established guidelines for individual borrowers and particular industries to ensure the Group does not have excessive concentration in any related group of borrowers or industry. Through this portfolio management process, loans may be syndicated to reduce overall exposure to a single name.

Exposures against tolerance limits in relation to credit risk categories are measured and monitored periodically on an aggregated basis. Actual exposures against limits are monitored daily through the management information systems in place.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

a) Credit and counterparty risk (continued)

Other specific control and mitigation measures are outlined below:

Although the Group only lends to counterparties that primarily demonstrate adequate capacity to repay loans, it also employs a range of policies, guidelines and models to mitigate credit risk as follows:

i) Collateral

This is only considered in those cases where the Group would want to take a credit risk mitigant. The Group has developed specific policies and guidelines for the acceptance of different classes of collateral.

Estimates of the collateral's fair values are based on the value of collateral independently and professionally assessed at the time of borrowing, and re-valued with a frequency commensurate with nature and type of the collateral and credit advanced. Collateral structures and covenants are subjected to regular review to ensure they continue to fulfil the intended purpose.

Collateral is generally not held in respect of deposits and balances due from banking institutions, items in the course of collection, and Government securities, except when securities are held for reverse purchase and securities borrowing activity.

ii) Credit rating

The Group uses an internal scoring and rating system for its borrowing clients. The system sets maximum exposure limits for individuals or groups of clients using a scoring rating attained by the borrowers. The system rating will also inform the basis of determining the value and classes of collateral acceptable for the borrower(s).

iii) Settlement risk

This is the risk of loss due to the failure by counterparty to honour its obligations to deliver cash, securities or other assets as contractually agreed. It arises in situations where a payment in cash is made in anticipation of corresponding receipt of cash securities or other assets. Daily settlement limits are approved by the relevant authority levels and established for each counterparty to cover the aggregate of all settlement risks arising from the counterparty's market transactions on a single day. Acceptance of the counterparty's settlement risk is determined on the basis of financial strengths and other non-financial considerations subject to Board Credit Risk Committee approval.

Impairment policies

Across all its loan portfolios, the Group employs a disciplined approach to impairment allowances evaluation, with prompt identification of problem loans being a key risk management objective. The Group maintains both collective and specific impairment allowances for credit losses, the sum of which is sufficient to reduce the book value of credit assets to their estimated realisable value. Specific impairment allowances reduce the aggregate carrying value of credit assets where there is specific evidence of deterioration in credit quality. In line with regulatory guidelines, a collective allowance is maintained to cover potential impairment in the existing portfolio that cannot be associated with specific credit. These allowances are reviewed and updated on a regularly basis.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

a) Credit and counterparty risk (continued)

Write-off policy

The Group writes off loans and advances net of any related allowances for impairment losses when it determines that the loans are uncollectable and securities unrealisable. This determination is reached after accessing objective evidence or occurrence of significant changes in the borrower or issuer's financial position such that they are no longer able to repay the obligation, or that proceeds from the sale of collateral will not be sufficient to pay back the entire exposure. This is done after exhausting all other means including litigation. For Retail and Asset Finance loans, charge off decisions are generally based on product specific days past due status and the size of balances owed per borrower.

I. Maximum exposure to credit risk before collateral held

	2012		2011	
	Shs'000	%	Shs'000	%
Credit exposures				
On – balance sheet items				
Items in the course of collection	429,545	-	281,796	-
Due from banking institutions	8,188,716	7	5,692,655	7
Loans and advances to customers	71,540,092	64	56,624,621	68
Government securities	17,478,232	16	7,500,288	9
Other assets – trade receivables	71,206	-	59,826	-
	97,707,791	**87**	**70,159,186**	**84**
Off-balance sheet items				
Letters of credit	4,451,256	4	5,301,250	6
Guarantees and performance bonds	9,660,754	9	8,175,203	10
	14,112,010	**13**	**13,476,453**	**16**
	111,819,801	**100**	**83,635,639**	**100**

The above represents the worst case scenario of credit exposure for both years, without taking into account collateral held or other credit enhancements/mitigants.

Loans and advances to customers and other trade related items (off-balance sheet items) comprise of 77% (2011: 84%) of the total credit exposure. While collateral is an important mitigant to credit risk, the Group's underwriting policy ensures that loans are strictly granted on a going concern basis with adequate demonstration of repayment capacity. Other than exposures amounting to Shs 1,774,801,000 (2011 - Shs 1,413,257,000) that are unsecured, all other facilities are secured by collateral in the form of charges over cash, land and buildings, marketable securities, plant and machinery, amongst others. The fair value of collateral held for impaired loans and advances is Shs 679,715,000 (2011 - Shs 270,751,000). The Group is confident that its credit policies and programs provide sufficient safeguards against the credit risk exposure shown in the table below:

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

a) Credit and counterparty risk (Continued)

II. Classification of loans & advances to customers

GROUP
2012

At 31 December 2012	Kenya Shs `000	Tanzania Shs `000	Uganda Shs `000	Total Shs `000
Gross loans and advances				
Neither past due nor impaired	63,686,832	4,479,687	314,372	68,480,891
Past due but not impaired	2,326,120	160,874	-	2,486,994
Impaired	2,050,874	281,827	-	2,332,701
Total gross loans advanced	**68,063,826**	**4,922,388**	**314,372**	**73,300,586**
Impairment Allowances				
Neither past due nor impaired	-	-	-	-
Past due but not impaired	(99,464)	(8,044)	-	(107,508)
Impaired	(1,583,147)	(69,829)	-	(1,652,986)
Impairment allowances	**(1,682,611)**	**(77,883)**	**-**	**(1,760,494)**
Net loans and advances	**66,381,215**	**4,844,505**	**314,372**	**71,540,092**
	%	**%**	**%**	**%**
Impairment allowance as a percentage of total loans advanced	**2.47**	**1.58**	**-**	**2.40**

At 31 December 2011	Kenya Shs `000	Tanzania Shs `000	Uganda Shs `000	Total Shs `000
Gross loans and advances				
Neither past due nor impaired	50,751921	4,350,303	-	55,102,224
Past due but not impaired	1,243,078	48,121	-	1,291,199
Impaired	1,656,672	304,605	-	1,961,277
Total gross loans advanced	**53,651,671**	**4,703,029**	**-**	**58,354,700**
Impairment allowances				
Neither past due nor impaired	-	-	-	-
Past due but not impaired	(39,034)	(519)	-	(39,553)
Impaired	(1,587,162)	(103,364)	-	(1,690,526)
Impairment allowances	**(1,626,196)**	**(103,883)**	**-**	**(1,730,079)**
Net loans and advances	**52,025,475**	**4,599,146**	**-**	**56,624,621**
	%	**%**	**%**	**%**
Impairment allowance as a percentage of total loans advanced	**3.03**	**2.21**	**-**	**2.96**

The Kenya figures relates to the Bank

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

a) Credit and counterparty risk (Continued)

Loans and advances that are neither past due nor impaired

The Group classifies loans and advances under this category if they are up to date and in line with their contractual agreements (0-30 days). Such loans would have demonstrated the meeting of their financial and non-financial conditions and the borrowers would have proven capacity to repay the loans. These exposures will normally be maintained largely within approved facility programs and with no depiction of impairment or distress signs. These exposures are categorised as normal accounts (category 1) in line with internal guidelines and those issued by regulators where applicable. A collective provision on the total outstanding balances is made and appropriated from revenue reserves to statutory credit risk reserves.

Past due but not impaired

This category includes exposures that are between 31 – 90 days past due, where losses have been incurred but have not been identified. These exposures are graded as category 2 in line with our internal guidelines and those issued by banking regulators. A collective impairment allowance is made to cover losses which have been incurred but have not yet been identified.

Impaired loans and advances

Impaired loans and advances are those which the Group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan securities agreement(s). These loans are graded between categories 3 (91-180 days), 4(181 -360 days) and 5 (over 360 days) using the Group's internal credit rating system. These clients, under guidelines issued by the Central Banks in the regions we operate in, are termed as non-performing loans. The Group establishes a specific allowance for impairment losses that represents the estimate of losses that will be incurred in its loan portfolio.

Concentrations of risk

The Group monitors concentration of risk exposures in its lending and other portfolios by individuals or groups of related borrowers and industry sector concentrations in line with Board of Directors' approved limits. These limits are reviewed regularly using economic risk indicators identified in particular industrial sectors. An analysis of concentrations within the loans and advances to customers and off balance sheet items are as follows:

Loans and advances to customers

Bank			Group	
2012	2011		2012	2011
%	%		%	%
10	12	Wholesale and retail	11	11
3	4	Real estate	3	4
6	8	Agriculture	6	8
19	13	Social community and personal services	19	15
25	21	Manufacturing	23	22
13	15	Transport and communication	13	16
24	26	Other	25	24
100	**100**		**100**	**100**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

a) Credit and counterparty risk (Continued)

Contingent liabilities

Bank			Group	
2012	**2011**		**2012**	**2011**
%	**%**		**%**	**%**
1	2	Agriculture	1	2
1	2	Business services	1	2
7	9	Wholesale and retail	7	9
-	-	Real estate and construction	1	-
25	9	Transport and communication	24	9
16	38	Manufacturing	16	38
50	40	Other	50	40
100	**100**		**100**	**100**

b) Liquidity and funding risk

Liquidity risk is the potential for loss to an institution arising from either its inability to meet its obligations when they fall due or to fund increases in asset without incurring unacceptable costs or losses. Effective liquidity risk management is essential in order to maintain the confidence of depositors and counterparties, and to enable our core business to continue operating even under adverse liquidity circumstances.

Who manages liquidity and funding risk

The Assets and Liabilities Committee (ALCO), a management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when they fall due, and that the Group will not encounter difficulties in meeting its obligations or financial liabilities as they fall due.

ALCO relies substantially on the Group's Treasury Department to coordinate and ensure discipline across the Group and business units, certify sufficient liquidity under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Board Executive Committee has oversight over ALCOs activities through regular review of its minutes and significant reports outlining current exposures against approved risk limits. These reports are also reviewed by the Board Risk Management Committee on a quarterly basis.

Liquidity policies / guidelines and limits are reviewed periodically, or as the need arises.

How liquidity and funding risk is managed

I Liquidity and funding management

The Group's liquidity and funding policies require that it:

- Enters into lending contracts subject to availability of funds.
- Projects cash flows by major currencies and consider the level of liquid assets necessary in relation thereto.
- Monitors liquidity ratios against internal and regulatory requirements and guidelines.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

b) Liquidity and funding risk (continued)

How liquidity and funding risk is managed (Continued)

I Liquidity and funding management (Continued)

- Maintains an array of a diverse range of funding sources as back–up facilities.
- Monitors depositor concentration to avoid undue reliance on large individual depositors and ensure a satisfactory funding mix.
- Invests in short term liquid instruments, which can easily be sold in the market when the need arises.
- Ensure investments in large cash outlay projects e.g property and equipment purchases are budgeted for and carried out only when the Group has sufficient cash flows.
- Maintains liquidity and funding contingency plans. These plans and key risk indicators clearly identify early stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crisis while minimising adverse long-term implications.

II Sources of funding

The Group's major source of funding is customer deposits. To this end, the Group maintains a diversified and stable funding base comprising of the core retail and corporate customers and wholesale banking clientele. The Group places considerable importance on the stability of these deposits, which is achieved through the Group's corporate, institutional and retail banking activities and by maintaining depositor confidence in the Group's business strategies and financial strength. An analysis of concentrations within the customer deposits is as follows:

Customer deposits

Bank			Group	
2012	**2011**		**2012**	**2011**
%	**%**		**%**	**%**
-	1	Co-operative societies	-	1
8	11	Insurance companies	7	11
5	7	Non profit institutions and individuals	7	9
87	81	Private enterprises	86	79
100	**100**		**100**	**100**

The Group also borrows from the inter bank and wholesale markets such as pension funds and insurance companies to meet its short term liquidity and other investment objectives.

The Group does not maintain cash reserves to meet all its obligations as experience over time has shown that a minimum level of reinvestment of maturing customer funds can be predicted with a high level of certainty. Although the contractual repayments of many customer accounts are on demand or short notice, in practice short-term deposit balances remain stable as inflows and outflows broadly match.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

b) Liquidity and funding risk (Continued)

III Exposure to liquidity risk

The key measures used by the Group for managing liquidity risk are;

- The ratio of net liquid assets to deposits from customers (liquidity ratio). For this purpose, net liquid assets include cash and cash equivalents and investments in securities for which there is an active and liquid market less any deposits from banks, as well as other borrowings and commitments maturing within the next month. The banking regulators require that the Group maintains a cash reserve ratio computed as percentage of eligible customer deposits.

  The banking regulations require that the Group maintains a minimum liquidity ratio of 20%. The Group complied with the liquidity requirements during the year.

  The average liquidity ratio for the year was 32% (2011 – 30%).

- The maturity analysis of assets and liabilities report (note 44 (a)). The Group uses the maturity mismatch ladders to compare cash inflows and outflows each month and over a series of time-bands. The maturity mismatch ladder shows the net cash flows of the Group in various time bands. The Group net funding requirements are determined by analysing present and future cash flows of the entire statement of financial position at selected maturity dates, based on assumptions of the behaviour of assets, liabilities and off-balance sheet items. Calculations will include the cumulative net excess or shortfall over the time frame of the liquidity assessment.

  The Group also monitors its liquidity exposures through an array of internally developed risk indicators such as advances to deposit ratios, proportion of largest depositors to total deposits, liquidity gap analysis ratios, inter-bank borrowings as a proportion of total deposits, amongst others. This enables the group to arrest any early warning signs and take timely corrective action.

  As part of the ALCO function, Treasury receives information from business units regarding the liquidity profile of their financial assets and liabilities plus details of other projected cash flows arising from projected future business. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment grade securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole. The liquidity requirements of business units and subsidiaries are met through various funding options to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements.

  The table in note 44 (b) presents cash flows payable by the Group under financial liabilities by remaining contractual maturities at the reporting date and the cash flows receivable from financial assets by expected maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows, whereas the Group manages the liquidity risk based on a different basis (note 44 (a)), not resulting in a significantly different analysis.

c) Market risk

Market risk is the risk that the values of assets and liabilities or revenues will be adversely affected by changes in market conditions or market movements. Market risks in the Group arise from movements in market prices particularly changes in interest rates, foreign currency exchange rates, fixed rate securities and equity prices which we are exposed to. It is often propagated by other forms of financial risks such as credit and market liquidity risk events. The objective of market risk management programs is to manage and control market risk exposures in order to optimise return on risk taken while maintaining a good market profile as a provider of financial products and services.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

c) Market risk (Continued)

Who manages market risk?

The Board Risk Management Committee reviews and approves market risk policies and limits periodically or as need arises. The Treasury Department in consultation with the Risk Management Department are responsible for the development of detailed market risk management policies, subject to review and support by ALCO and approval by the Board Risk Management Committee.

The Board receives quarterly reports of market risk exposures or activities through relevant ALCO minutes, and Treasury reports outlining current risk exposures against risk limits.

How market risk is managed

The Group's Asset & Liability Committee (ALCO) oversees the application of the framework set by the Board of Directors and monitors the Group's market risk exposures as well as activities that give rise to these exposures. Overall responsibility for the management of market risks rests with ALCO which reviews market risk activity reports monthly. Treasury is responsible for the day to day implementation of those policies or programs and limits.

In view of the fact that our market risk operations are not very complex, we basically use interest rates variance analysis models (against budget and prior month), interest rate gap analysis, proportion of interest sensitive deposits to total deposits, amongst other models and key performance indicators, appropriate for our operations. The management of market risk is supplemented by the monitoring of key market risk and economic performance variables.

The distinct market risk exposures faced by the Group are:

- Interest rate risk.
- Foreign exchange risk.
- Price risk.

I. Interest rate risk

Interest rate risk represents exposures to instruments whose values vary with the level or volatility of interest rates. These instruments include, but are not limited to loans, debt securities, certain traded assets and liabilities, deposits, borrowings and derivative instruments. Generally, hedging instruments used by banks to mitigate such risks include related derivatives such as options and swaps.

The Group is exposed to the risk that the value of a financial instrument will fluctuate due to changes in market interest rates, as funds are sourced and invested at both fixed and floating rates. The maturities of assets and liabilities, plus the ability to replace interest bearing liabilities at an acceptable cost as they mature, are important factors in assessing the Group's exposure to changes in interest rates.

In addition to maintaining an appropriate mix between fixed and floating rates deposit base, interest rates on advances to customers and other risk assets are mainly pegged to the Group's base lending rate (floating rates). The base lending rate is adjusted from time to time to reflect prevailing market costs of deposits.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

c) Market Risk (Continued)

I. Interest rate risk (Continued)

Interest rates on customer deposits are negotiated between the Group and its customers, with the Group retaining the discretion to re-negotiate the rates at maturity in line with changes in market trends. The interest rates given or charged to clients therefore fluctuate depending on the movements in the market interest rates. The Group also invests in fixed interest rate instruments issued by the Government of Kenya, Tanzania and Uganda through the Central Banks. The interest rate risk assessment table is found under note 44.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group's interest rate risk. It is unusual for a bank ever to completely be matched due to the nature of business terms and types of products offered.

Interest rate risk – stress tests

The Group monitors the impact of risks associated with the effects of fluctuations in prevailing interest rates. At 31st December 2012, the following table summarises the estimated impact of an immediate hypothetical increase or decrease in interest rates of 125 basis points on consolidated profit before income tax expense, and current interest rate risk profile.

2012 Shs'000	2011 Shs'000		2012 Shs'000	2011 Shs'000
249,384	**158,505**	125 basis points increases in interest rates	**304,628**	**175,981**
(280,401)	**(196,814)**	125 basis points decrease in interest rates	**(370,626)**	**(231,602)**

The model does not take into account any corrective action in response to interest rate movements, particularly in adverse situations.

II. Foreign exchange risk

Foreign currency exchange risk refers to the potential changes in current and future earnings or capital arising from movements in foreign exchange market rates. The Group, through stringent intra-day and overnight exposure limits, ensures that the potential risk of loss arising from foreign exchange fluctuations to the Group's earnings and capital is within prudential guidelines and internal policies. Any material overnight position is covered by stop loss orders with our international counter-parties.

The Group is exposed to the risk that the value of foreign financial instruments it holds will fluctuate due to changes in market foreign exchange rates. The Board of Directors periodically approves policies and limits on the maximum level of exposures by currency and in total for both overnight and intra-day positions. Foreign currency risk is addressed through the following measures:

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

c) Market Risk (Continued)

II. Foreign exchange risk (Continued)

- On a daily basis, the overall foreign exchange risk exposure is measured using spot mid-rates and does not exceed 10% of the Group's core capital.
- Any single currency exposure, irrespective of short or long positions does not exceed the limit of 10% of core capital.
- Intra-day and overnight foreign exchange positions are limited within strictly defined exposure and stop loss limits approved periodically by the Board Risk Management Committee.

The table under note 45 summarises the Group's exposure to foreign currency exchange rate risks.

Foreign exchange risk – stress test

At 31st December 2012, if the functional currencies in the economic environment in which the Group operates in i.e the Kenya Shilling, Tanzania Shilling and the Uganda Shilling had weakened or strengthened by 10% against the world's major currencies, with all other variables held constant, consolidated profit before income tax expense would have been higher or lower as depicted in below table:

BANK			GROUP	
2012 Shs'000	2011 Shs'000		2012 Shs'000	2011 Shs'000
4,284	**7,655**	10% depreciation/appreciation	**55,245**	**11,875**

III. Price risk

Shares quoted in the Nairobi Securities Exchange i.e "listed shares" and Treasury bonds held for trading are stated at their fair value on the last day of business in the year. These values are subject to frequent variations due to changes in their market prices.

At 31st December 2012, if the prices at the Nairobi Securities Exchange had appreciated/depreciated by 5% with all other variables held constant, the impact on the shareholders equity would have been Shs 1,095,021 (2011 – Shs 1,200,585) higher/lower.

For the Treasury bonds, an increase/reduction in interest rates by 1% with all other variables held constant, will have an decrease / increase in shareholders' equity of Shs 69,060,500 (2011 Shs 77,112,758).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

d) Capital management

The Group's objectives when managing capital are:

- To safeguard the Group's ability to continue as a going concern in order to provide acceptable returns to the shareholders and benefits for other stakeholders while maintaining an optimal capital structure.

- To comply with capital requirements set by our regulators within the markets that the Group operates in.

- To maintain a strong capital base to support continued business development.

- To create an acceptable buffer catering for unexpected losses that the Group may incur in adverse market scenarios during the course of its business.

- To manage its capital structure and make adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The Group's objectives when managing capital are broadly covered as follows:

I Banking

In line with our industry, the broader concept of capital and its adequacy is based on guidelines developed by the Basel Committee's Accords and implemented for supervisory purposes by the Central Banks.

Central Bank of Kenya (CBK), Bank of Tanzania (BOT) and Bank of Uganda (BOU) largely segregate the total regulatory capital into two tiers;

- Tier 1 Capital (Core Capital), which includes ordinary share capital, share premium and retained earnings. The investment in subsidiaries or other financial institutions is deducted in arriving at tier 1 capital.
- Tier 2 Capital (Supplementary Capital) includes among others, 25% of property revaluation reserves (subject to regulatory approval) and collective impairment allowances.

The risk weighted assets are measured by means of a hierarchy of four risk weights classified according to the nature of, and reflecting an estimate of, the credit risk associated with each asset and counterparty. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

During the year, the bank had complied in full with all its externally imposed capital requirements (2011: the same).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

5) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

d) Capital management (Continued)

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
12,569,308	9,073,356	Tier 1 capital	14,091,433	9,633,972
13,246,448	9,623,232	Tier 1 + Tier 2 capital	14,817,999	10,209,174
		Risk–weighted assets		
70,906,334	55,939,531	On-balance sheet	76,700,845	60,678,777
9,658,895	4,267,022	Off-balance sheet	9,926,665	4,577,812
80,565,229	**60,206,553**	**Total risk-weighted assets**	**86,627,511**	**65,256,589**

		Regulatory ratios	**(Minimum requirements %)**
15.60%	14.98%	Core capital/risk assets	8%
16.29%	14.68%	Core capital/deposits	8%
16.44%	15.89%	Total capital/risk assets	12%

I Investment banking and stock brokerage businesses

The Capital Markets Authority, which regulates the Group's Investment Banking and Stock Brokerage businesses i.e NIC Capital Limited and NIC Securities Limited respectively, prescribes minimum capitalisation requirements and a working capital of not below 20% of the prescribed minimum shareholders funds or three times the average monthly operating costs whichever is higher. The subsidiaries maintained their capital together with the other requirements well above the minimum requirements as outlined below;

	NIC Capital Shs'000	**NIC Securities Shs 000**
Minimum capital	**250,000**	**50,000**
Capital held as at;		
31 December 2012	**437,105**	**341,958**
31 December 2011	**373,646**	**381,064**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4) Financial risk management objectives (Continued)

Group risk management framework and governance structures (Continued)

e) Fair value of financial assets and liabilities

IFRS 7 specifies a hierarchy of valuation techniques based on whether inputs used in the valuation techniques of financial instruments are observable or unobservable. Financial instruments are grouped into 3 levels based on the degree to which fair value data / input is observable.

i) Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed debt and equity instruments traded mainly on the Nairobi Securities Exchange.

ii) Level 2 fair value measurements are those derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. as a price) or indirectly (i.e. derived from prices). Input data for this category is sourced mainly from Reuters and the Nairobi Securities Exchange.

iii) Level 3 fair value measurements are those derived from valuation techniques that include inputs that are not based on observable market data (unobservable inputs).

The table below shows an analysis of financial instruments at fair value by level of the fair value hierarchy.

Bank				Group	
2012 Shs'000	**2011 Shs'000**		**Note**	**2012 Shs'000**	**2011 Shs'000**
		Level 1			
-	-	Treasury bonds - fair value through profit and loss.	20	**138,509**	**267,464**
7,027,460	**4,139,032**	Treasury bonds – available for sale	20	**7,027,460**	**4,139,032**
-	-	Investment in quoted shares at fair value.	25	**28,932**	**25,151**
		Level 2			
35,705	**474,068**	Derivative assets held for risk management.	21	**35,705**	**474,068**
		Level 3			
-	-	Shares in NSE	25	**191,000**	-

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

5) Critical accounting estimates and judgments in applying the Group's accounting policies

I Impairment losses on loans and advances

The Group reviews its loan portfolios to assess impairment regularly. In determining whether an impairment loss should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a Group, or national or local economic conditions that correlate with defaults on assets in the Group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

II Held -to-maturity investments

The Group follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value and not amortised cost.

III Goodwill impairment

The Group's accounting policy for goodwill is described in Note 3(s). Goodwill is allocated to cash-generating units ('CGU') for the purpose of impairment testing. When the process of identifying and evaluating goodwill impairment demonstrates that the expected cash flows of a CGU have declined and/or that its cost of capital has increased, the effect is to reduce the CGU's estimated fair value. If this results in an estimated recoverable amount that is lower than the carrying amount of the CGU, a charge for impairment of goodwill will be recorded, thereby reducing by a corresponding amount the Group's profit for the year. Goodwill is stated at cost less accumulated impairment losses. Significant management judgement is involved in determining the cost of capital assigned to an individual CGU and in estimating its future cash flows.

IV Property and equipment

Critical estimates are made by the directors in determining depreciation rates for property and equipment.

V Fair value of trade receivables and payables

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

VI Taxes

The Group is subjected to numerous taxes and levies by various government and quasi- government regulatory bodies. As a rule of thumb, the Group recognises liabilities for the anticipated tax/levies payable with utmost care and diligence. However, significant judgment is usually required in the interpretation and applicability of those taxes/levies. Should it come to the attention of management, in one way or the other, that the initially recorded liability was erroneous, such differences will impact on the income and liabilities in the period in which such differences are determined.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

5) Critical accounting estimates and judgments in applying the Group's accounting policies (Continued)

VII Impairment of available-for-sale equity investments

The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the volatility in share price. In addition, objective evidence of impairment may be deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

VIII Valuation of financial instruments

The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of those that sourced them. The directors believe that the chosen valuation techniques and assumptions used in the valuation of its investments in NSE shares are appropriate in determining the fair value of financial instruments.

IX Classification of leases of land and buildings as finance or operating leases

At the inception of each lease of land or building, the Group considers the substance rather than the form of the lease contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- The lease transfers ownership of the asset to the lessee by the end of the lease term;
- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- The leased assets are of such a specialised nature that only the lessee can use them without major modifications.

The Group also considers indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease. Examples of such indicators include:

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

6) Operating segments

a) Geographical segments

The Group operations are within three geographical segments, Kenya, Tanzania and Uganda. The table below contains segmental information provided to the Chief Operating Decision Maker (the Group Executive Committee of management) for the year ended 31 December 2012.

2012

	Kenya Shs `000	Tanzania Shs `000	Uganda Shs `000	Total Shs `000
Net interest income	5,008,522	355,152	120,194	5,483,868
Net fee and commission income	2,554,679	258,262	19,316	2,832,257
Operating income	**7,563,201**	**613,414**	**139,510**	**8,316,125**
Operating expenses	(2,906,115)	(430,717)	(163,841)	(3,500,673)
Impairment on loans and advances	(265,264)	(32,221)	-	(297,485)
Profit/(loss) before tax	**4,391,822**	**150,476**	**(24,331)**	**4,517,967**
Profit/(loss)after tax	**2,957,922**	**103,203**	**(24,331)**	**3,036,794**
Loans and advances to customers	**66,381,215**	**4,844,505**	**314,372**	**71,540,092**
Customer deposits	**77,466,042**	**5,834,066**	**79,468**	**83,379,576**

2011

	Kenya Shs `000	Tanzania Shs `000	Uganda Shs `000	Total Shs `000
Net interest income	3,610,609	293,441	-	3,904,050
Net fee and commission income	2,448,824	249,860	-	2,698,684
Operating income	**6,059,433**	**543,301**	**-**	**6,602,734**
Operating expenses	(2,362,770)	(376,865)	-	(2,739,635)
Impairment on loans and advances	(249,166)	(8,985)	-	(258,151)
Profit before tax	**3,447,497**	**157,451**	**-**	**3,604,948**
Profit after tax	**2,597,567**	**109,570**	**-**	**2,707,137**
Loans and advances to customers	**52,025,475**	**4,599,146**	**-**	**56,624,621**
Customer deposits	**62,008,953**	**4,284,100**	**-**	**66,293,053**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

6) Operating segments (Continued)

b) Business segments

The Group maintains the following business segments for allocation of resources and assessment of performance.

I. Corporate and Institutional Banking

Targets medium to large corporate clientele and institutions, with a focus on liability mobilization and asset growth.

II. Treasury dealing and brokerage

Treasury dealing targets corporate clientele and institutions, with a focus on those with a foreign exchange component in their business, whereas the stock brokerage focuses on the execution of transactions at the Nairobi Securities Exchange on behalf of high net worth and institutional clients.

III. Retail banking

Targets the mass affluent to high net worth and business banking clientele, with a focus on becoming the customers' core deposit, transactional banker and financier.

IV. Asset finance

Targets both the retail and corporate end of the market as the preferred financier in the motor vehicles, machinery and equipment segments in addition to Insurance Premium Financing (IPF) segment.

V. Investment banking

Targets large and medium sized companies for research, advisory and capital restructuring requirements.

The segment information provided to the Executive Committee of management for the reported segments is contained under note 46. There were no changes in the reportable segments during the year.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

7) Interest income

Bank			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**		**Shs'000**	**Shs'000**
290,551	**113,675**	**Due from banking institutions**	**412,324**	**137,689**
		Government securities		
396,382	281,549	- Held to maturity	415,849	284,756
-	21,108	- At fair value through profit or loss	60,231	46,569
685,037	328,869	- Available for sale	685,037	328,869
1,081,419	**631,526**		**1,161,117**	**660,194**
		To customers		
3,022,674	1,791,229	- Finance leases	3,022,749	1,791,229
6,051,761	3,748,980	- Loans and advances	6,871,384	4,242,468
9,074,435	**5,540,209**		**9,894,133**	**6,033,697**
10,446,405	**6,285,410**		**11,467,574**	**6,831,580**
27,792	**7,499**	Interest income earned on impaired financial assets	**27,792**	**7,499**

Interest income earned on impaired financial assets represents the unwinding of discounting in accordance with IAS 39.

8) Interest expense

Bank			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**		**Shs'000**	**Shs'000**
5,342,007	2,261,284	Customer deposits	5,735,877	2,417,373
124,874	62,211	Due to banking institutions	187,865	121,155
59,964	13,564	Line of credit	59,964	13,564
5,526,845	**2,337,059**		**5,983,706**	**2,552,092**

9) Net fee and commission income

Fee and commission income

Bank			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**		**Shs'000**	**Shs'000**
251,825	248,288	Credit related fees and commissions	265,517	260,616
686,922	635,449	Service / transaction fees	787,596	755,967
939,747	**883,737**		**1,053,113**	**1,016,583**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

9) Net fee and commission income
Fee and commission income (Continued)

Fee and commission expense

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
57,918	51,257	Fees & commissions expense	64,273	58,400
57,918	**51,257**		**64,273**	**58,400**

10) Net trading income

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
1,074,248	851,587	Foreign exchange income	1,164,312	946,410
217,678	79,362	Bond trading income	217,678	79,362
-	-	Fair value gain/(loss) on investment in quoted shares (note 25 (a))	1,281	(14,052)
-	-	Loss on revaluation of investment NSE shares	(60,000)	-
1,291,926	**930,949**		**1,323,271**	**1,011,720**

11) Other operating income

The following items are included in other operating income

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
4,114	7,145	Rental income	2,526	3,581
186	574	Gain on disposal of motor vehicle & equipment (note 39 (c))	888	595
2,482	9,643	Bad debt recoveries	12,782	39,849
68,788	55,520	Trust and other fiduciary fees	68,788	55,520

12) Impairment on loans and advances

a) **Specific allowance for impairment**

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
1,587,161	1,321,616	At 1 January	1,690,526	1,420,444
-	-	Exchange difference on translation	(23,691)	(3,929)
204,834	274,805	Charge for the year	229,530	283,271
(208,848)	(9,260)	Write-offs	(243,379)	(9,260)
1,583,147	**1,587,161**	**At 31 December**	**1,652,986**	**1,690,526**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

12) Impairment on loans and advances (Continued)

b) Collective allowance for impairment

Bank			Group	
2012 Shs'000	2011 Shs'000		2012 Shs'000	2011 Shs'000
39,034	64,673	At 1 January	39,553	64,673
60,430	(25,639)	Charge/(release) for the year	67,955	(25,120)
99,464	**39,034**	**At 31 December**	**107,508**	**39,553**

c) Total allowance for impairment

Bank			Group	
2012 Shs'000	2011 Shs'000		2012 Shs'000	2011 Shs'000
1,626,195	1,386,289	At 1 January	1,730,079	1,485,117
-	-	Exchange difference on translation	(23,691)	(3,929)
265,264	249,166	Charge for the year	297,485	258,151
(208,848)	(9,260)	Release for the year	(243,379)	(9,260)
1,682,611	**1,626,195**	**At 31 December**	**1,760,494**	**1,730,079**

13) Employee expenses

The following items are included under employee costs:

Bank			Group	
2012 Shs'000	2011 Shs'000		2012 Shs'000	2011 Shs'000
1,384,561	1,147,465	Salaries and wages	1,695,590	1,381,847
520	1,046	Gratuity provision	520	1,046
11,370	6,890	Directors' emoluments – fees	15,181	8,809
98,766	90,280	– other	148,701	108,773
1,467	1,324	Pension costs - statutory contributions	19,428	13,082
95,870	79,580	Pension costs – defined contribution	99,231	84,693
1,592,554	**1,326,585**		**1,978,651**	**1,598,250**

The total number of employees as at 31 December 2012 for the Group was 783 (2011 – 712)

14) Operating expenses

(a) Depreciation and amortisation

Bank			Group	
2012 Shs'000	2011 Shs'000		2012 Shs'000	2011 Shs'000
173,605	143,134	Depreciation (note 27)	204,346	157,151
97,213	35,572	Amortisation of computer software (note 28)	113,461	41,512
125	125	Amortisation of operating lease (note 29)	125	125
270,943	**178,831**	**At 31 December**	**317,932**	**198,788**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

14) Operating expenses

(b) Other operating expenses

The following items are included under this category:

Bank			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**		**Shs'000**	**Shs'000**
4,950	4,002	Auditors' remuneration	10,859	6,918
101,037	95,846	Rental charges	169,317	137,530
19,599	25,052	Share registrations costs	19,599	25,052

15) Income tax

a) Income tax expense

Bank			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**	**Current tax**	**Shs'000**	**Shs'000**
1,470,111	987,367	Income tax based on taxable profit for the year at 30%	1,550,816	1,058,727
-	11,790	Prior year under provision - current tax	1,295	11,790
1,470,111	**999,157**		**1,552,111**	**1,070,517**
		Deferred tax (note 26)		
(67,024)	(128,022)	- Current year	(70,938)	(129,125)
-	(43,581)	- Prior year over provision	**-**	(43,581)
1,403,087	**827,554**		**1,481,173**	**897,811**

b) Reconciliation of tax expense to expected tax base based on accounting profit

The tax on the Group's profit before tax differs from the tax charge that would apply if all profit had been taxed using the statutory income tax rate:

Bank			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**		**Shs'000**	**Shs'000**
4,310,949	**3,360,602**	Profit before tax	**4,517,967**	**3,604,948**
1,293,285	1,008,181	Income tax - at the statutory rate of 30 %	1,355,390	1,081,484
183,482	162,304	Tax effect of expenses not deductible for tax	342,492	168,966
(73,680)	(311,140)	Tax effect of revenues that are not taxable	(218,004)	(320,848)
-	11,790	Prior year under provision - current tax	1,295	11,790
-	(43,581)	Deferred tax – prior year	-	(43,581)
1,403,087	**827,554**		**1,481,173**	**897,811**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

15) Income tax

c) Current income tax payable/(recoverable) movement

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
223,321	174,215	**At 1 January**	220,848	171,164
-	-	Exchange difference on translation	(2,282)	-
1,470,111	987,367	Tax charge (note 15 (a))- current year	1,552,111	1,058,727
-	11,790	Tax charge (note 15 (a))- prior year	1,295	11,790
(1,311,295)	(950,051)	Income taxation paid	(1,406,507)	(1,020,833)
382,138	**223,321**	**At 31 December**	**365,465**	**220,848**
		Comprising;		
-	-	Current income tax recoverable	(17,860)	(8,690)
382,138	223,321	Current income tax payable	383,325	229,538
382,138	**223,321**	**At 31 December**	**365,465**	**220,848**

16) Earnings per share

Earnings per share is calculated by dividing the profit attributable to equity holders of the parent company by the weighted average number of ordinary shares outstanding during the year.

Bank			Group	
2012	**2011**		**2012**	**2011**
2,907,862	**2,533,048**	Profit attributable to equity holders of the Bank (Shs'000)	**2,984,406**	**2,652,458**
		Weighted average number of shares for purposes of basic and diluted earnings per share:		
394,897,562	394,897,562	Issued ordinary shares at 1 January	394,897,562	394,897,562
50,733,367	34,736,362	Effects of rights issue exercised	50,733,367	34,736,362
49,362,195	49,362,195	Effects of bonus shares issued	49,362,195	49,362,195
494,993,127	**478,996,119**	**At 31 December**	**494,993,127**	**478,996,119**
5.87	**5.29**	Earnings Per Share (Shs)	**6.03**	**5.54**

The calculation of basic and diluted earnings per share is based on continuing operations attributable to the ordinary equity holders of the parent company. There were no discontinued operations during the year.

During the year, the company issued bonus shares in the ratio of one bonus share for every ten shares held (2011: 1 for every 10 shares held). The bonus issue was approved by way of ordinary resolution at the last Annual General Meeting. Because the bonus issue was without consideration, it is treated as if it had occurred before the beginning of 2011, the earliest period presented.

There were no potentially dilutive ordinary shares outstanding as at 31 December 2012 and 31 December 2011. Diluted earnings per share is therefore same as basic earnings per share.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

17) Cash and balances with Central Banks

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
830,855	562,869	Cash on hand	1,081,132	718,687
		Balances with Central Banks:		
998,928	-	- Reverse purchase agreement	998,928	-
221,306	907,767	- Other (available for use by the Group)	472,081	956,716
2,051,089	**1,470,636**	**Included in cash and cash equivalents [note 39 (b)]**	**2,552,141**	**1,675,403**
3,912,180	3,293,990	Mandatory reserve deposits	4,498,821	3,963,513
5,963,269	**4,764,626**		**7,050,962**	**5,638,916**

The mandatory reserve deposits mainly represents regulatory cash ratio requirements based on the customer deposits with the Group. As at 31 December 2012 the cash ratio requirement in Kenya was 5.25% (2011 – 5.25%), in Tanzania 10.0% (2011 – 10.0%) and Uganda 8.5% of eligible deposits. These funds are not available for the day to day operations of the Group and are non interest earning.

18) Items in the course of collection

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
375,240	**250,024**	Clearing account balances	**429,545**	**281,796**

19) Due from banking institutions

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
395,976	428,214	Deposits due from banking institutions	807,078	598,221
6,173,988	4,058,261	Balances due from banking institutions	7,381,638	5,094,434
6,569,964	**4,486,475**		**8,188,716**	**5,692,655**
3.44%	**1.92%**	Weighted average effective interest	**3.27%**	**2.17%**

20) Government securities

Securities held to maturity are stated at amortised cost while those classified as "Fair value through profit or loss" and "Available for Sale" are stated at fair value.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

20) Government securities (Continued)

a) Government securities are categorised as follows:

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
9,194,971	**3,077,723**	Investment securities - Held to maturity	**10,312,263**	**3,093,792**
		Held for dealing purposes		
-	-	Fair value through profit or loss	138,509	267,464
7,027,460	4,139,032	Available for sale	7,027,460	4,139,032
7,027,460	**4,139,032**		**7,165,969**	**4,406,496**
16,222,431	**7,216,755**		**17,478,232**	**7,500,288**

The table below summarises the weighted average effective interest rate for Government securities.

Bank 2012 %	Bank 2011 %		Group 2012 %	Group 2011 %
9.43	10.80	Held to maturity	9.40	11.50
-	-	Fair value through profit or loss	15.70	9.28
10.86	9.16	Available for sale	10.86	9.16

b) The maturity profile of Government securities is a follows:

Maturity	Held to maturity Shs `000	Designated at fair value through profit or loss Shs `000	Available for sale Shs `000	Total Shs `000
Group				
2012				
Included in cash and cash equivalent	**4,511,027**	**-**	**-**	**4,511,027**
Less than 1 year	4,512,444	3,725	2,018,456	6,534,625
1-5 years	985,235	112,695	3,393,385	4,491,315
Over 5 years	303,557	22,089	1,615,619	1,941,265
	10,312,263	**138,509**	**7,027,460**	**17,478,232**
2011				
Included in cash and cash equivalent	**16,069**	**-**	**178,366**	**194,435**
Less than 1 year	845,034	267,464	1,146,003	2,258,501
1-5 years	-	-	-	-
Over 5 years	2,232,689	-	2,814,663	5,047,352
	3,093,792	**267,464**	**4,139,032**	**7,500,288**

20) Government securities (Continued)

b) The maturity profile of Government securities is a follows: (Continued)

Bank

2012				
Included in cash and cash equivalent	**4,045,142**	**-**	**-**	**4,045,142**
Less than 1 year	3,861,037	**-**	2,018,456	5,879,493
1-5 years	985,235	-	3,393,385	4,378,620
Over 5 years	303,557	-	1,615,619	1,919,176
	9,194,971	**-**	**7,027,460**	**16,222,431**
2011				
Included in cash and cash equivalent	**-**	**-**	**178,366**	**178,366**
Less than 1 year	845,034	-	1,146,003	1,991,037
1-5 years	-	-	-	-
Over 5 years	2,232,689	-	2,814,663	5,047,352
	3,077,723	**-**	**4,139,032**	**7,216,755**

21) Derivative assets held for risk management

The amount represents the fair value of forward foreign exchange contracts. These derivative assets and liabilities are measured at fair value through the profit or loss. Notional principal amounts are the amounts underlying the contract at the reporting date.

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
78,724	**474,068**	Fair value of forward contracts	**83,123**	**474,068**
10,366,805	**4,375,431**	Notional value of forward contracts	**10,904,232**	**4,375,431**

22) Loans and advances to customers

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
20,269,271	16,327,451	Finance lease receivables	20,292,251	16,327,451
46,826,281	26,769,675	Commercial loans	52,040,061	42,003,364
968,274	23,885	Bills discounted	968,274	23,885
68,063,826	**53,651,671**	**Gross loans and advances to customers**	**73,300,586**	**58,354,700**
		Provisions for impairment		
1,583,147	1,587,162	Specific allowance	1,652,986	1,690,526
99,464	39,034	Collective allowance	107,508	39,553
1,682,611	**1,626,196**	**Total impairment**	**1,760,494**	**1,730,079**
66,381,215	**52,025,475**	**Net loans and advances to customers**	**71,540,092**	**56,624,621**
467,727	**69,510**	**Net non performing loans and advances to customers**	**679,715**	**270,751**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

22) Loans and advances to customers (Continued)

Finance lease receivables, may be analysed as follows:

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
1,528,575	2,538,997	Not later than 1 year	1,551,555	2,538,997
18,776,274	13,838,598	Later than 1 year and not later than 5 years	18,780,053	13,838,598
20,304,849	**16,377,595**		**20,331,608**	**16,377,595**
(35,578)	(50,144)	Unearned future finance income on finance leases	(39,357)	(50,144)
20,269,271	**16,327,451**	**Present value of minimum lease payments receivable**	**20,292,251**	**16,327,451**

The Group and Bank enter into finance leasing arrangements for certain plant, equipment, motor vehicles and aircraft. The average term of finance leases entered into is 3 years. Unguaranteed residual values of assets leased under finance leases are estimated at nil (2011: nil).

The weighted average effective interest rates on loans and advances to customers at year end were as follows:

Bank			Group	
2012 %	**2011 %**		**2012 %**	**2011 %**
17.79	22.18	Finance lease receivables	17.79	22.18
16.00	20.16	Commercial loans	16.19	20.28
20.09	11.89	Bills discounted	20.09	11.89

23) Other assets

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
98,350	134,983	Prepayments	148,514	147,690
516,806	111,525	Other receivables	694,022	127,970
-	-	Trade receivables	71,206	59,827
615,156	**246,508**		**913,742**	**335,487**

24) Due from Group companies

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
4,616	3,054	NIC Capital	-	-
5,390	3,412	NIC Securities	-	-
1,171,950	1,354,380	NIC Bank Tanzania	-	-
421,294	-	NC Bank Uganda	-	-
1,603,250	**1,360,846**		**-**	**-**

25) Investments

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
2,285,324	1,147,786	Investment in subsidiaries	-	-
-	-	Quoted shares at fair value	28,932	25,151
-	-	Unquoted equity security at cost	23,999	27,781
-	-	Unquoted equity investment in NSE at fair value	191,000	-
2,285,324	**1,147,786**		**243,931**	**52,932**

a) The movement in investments is as follows:

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
1,147,786	1,147,786	At start of year	52,932	51,703
		Exchange differences on translation	(3,782)	-
-	-	Additions at cost - investment in quoted shares	6,133	22,973
-	-	Unquoted equity security at cost	-	26,781
-	-	Unquoted equity investment in NSE at fair value	191,000	-
1,137,538	-	Investment in NC Uganda	-	-
-	-	Changes in fair value – investment in quoted shares	1,281	(14,052)
-	-	Disposal – quoted shares	(3,633)	(34,473)
2,285,324	**1,147,786**	**At end of year**	**243,931**	**52,932**

All available-for-sale financial assets are denominated in Kenya Shillings. None of the financial assets are impaired.

b) Investment in subsidiaries (at cost)

BANK

Name	**Principal activity**	**Holding %**	**2012 Shs `000**	**2011 Shs `000**
NC Bank Uganda	Banking	100	1,137,538	-
NIC Bank Tanzania	Banking	51	596,285	596,285
NIC Capital	Financial advisory	100	500,000	500,000
NIC Insurance Agents	Insurance agency	100	1,000	1,000
National Industrial Credit Trustees	Dormant	100	500	500
Mercantile Finance Company	Dormant	100	50,000	50,000
The African Mercantile Banking Company	Dormant	100	1	1
			2,285,324	**1,147,786**

NIC Capital Limited has a subsidiary, NIC Securities Limited whose results have been incorporated in these financial statements. Details of NIC Securities Limited at cost are as follows:

Name	**Principal activity**	**Holding %**	**2012 Shs `000**	**2011 Shs `000**
NIC Securities Limited	Brokerage services	91.3%	438,370	438,370

NOTES TO THE FINANCIAL STATEMENTS (Continued)

25) Investments (Continued)

b) Investment in subsidiaries (at cost) (Continued)

All the subsidiary companies have their financial year ending 31 December and are incorporated as limited liability companies. Except for NIC Bank Tanzania Limited and NC Bank Uganda Limited which are incorporated and domiciled in Tanzania and Uganda respectively, all other subsidiaries are incorporated and domiciled in Kenya.

NC Bank Uganda Limited was established in 2012 to offer banking services for our customers in Uganda. In it's first year of operations, the audited financial statements for the year ended 31 December 2012 show that the company made a loss equivalent to Shs 24,330,000.

NIC Bank Limited acquired 51% of Savings & Finance Commercial Bank Limited now renamed NIC Bank Tanzania Ltd with effective control being passed on 1 May 2009. The audited financial statements for the year ended 31 December 2012 show that the company made a profit equivalent to Shs 103,203,000 (2011 - Shs 109,570,000).

NIC Capital Limited was established in 2005 to offer investment banking services. The audited financial statements for the year ended 31 December 2012 show that the company made a profit of Shs 63,459,000 (2011 – Shs 41,733,000).

NIC Capital Limited (NICCL) acquired NIC Securities Ltd (NICSL) with effective control being passed on 1 January 2008. Subsequently, substantially through rights issues, the shareholding of NICCL in NICSL has increased to 91.3%. NICSL offers brokerage services and is a registered broker with the Nairobi Securities Exchange. The audited financial statements for the year ended 31 December 2012 show that the company made a profit of Shs 20,894,000 (2011 – Shs 11,381,000). The results of NIC Securities Limited are consolidated in these financial statements.

NIC Insurance Agents Limited was a 68% subsidiary of Mercantile Finance Company Limited (MFC). In 2010, NIC Bank Limited acquired the non-controlling interest and now directly owns 100% of the company. The company offers Bancassurance services. The audited financial statements for the year ended 31 December 2012 show that the company made a profit of Shs 12,906,000 (2011 – Shs 11,427,000).

National Industrial Credit Trustees Limited functions in a trustee capacity. The audited financial statements show that the company made no profit or loss for the year (2011 - Shs nil).

Mercantile Finance Company Limited did not trade during the year ended 31 December 2012. Its activities are limited to the recovery of its non performing debts. The audited financial statements show that the company made no profit or loss for the year (2011 - Shs nil).

The African Mercantile Banking Company Limited did not trade during the year ended 31 December 2012. The audited financial statements show that the company made no profit or loss for the year (2011 - Shs nil).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

26) Deferred tax asset

The net deferred tax computed at the enacted rate of 30%, is attributable to the following items:

Bank			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**		**Shs'000**	**Shs'000**
		Assets:		
(9,688)	(6,957)	Leave pay provision	(9,854)	(7,283)
(281,661)	(104,703)	Excess depreciation over capital allowances	(272,756)	(105,131)
(184,040)	(111,396)	Collective allowance for impairment	(187,490)	(111,397)
-	-	Available for sale financial assets		-
-	(158,378)	- current year	-	(158,378)
-	(28,979)	- prior year	-	(28,979)
-	-	Other provisions	(214)	(8,075)
-	-	Tax losses	(22,603)	(4,066)
(475,389)	**(410,414)**		**(492,917)**	**(423,310)**
		Liabilities:		
174,161	-	Available for sale financial assets	175,866	-
59,419	61,468	Revaluation surplus	59,419	61,468
(241,808)	**(348,946)**		**(257,632)**	**(361,842)**

Comprising:

			Group	
2012	**2011**		**2012**	**2011**
Shs'000	**Shs'000**		**Shs'000**	**Shs'000**
		Movement in net deferred tax is as follows:		
(348,946)	10,014	As at 1 January	(361,842)	(1,825)
-	-	Exchange differences on translation	707	47
		Fair value re-measurement of available-for-sale financial assets:		
174,161	(158,378)	- current year	174,441	(158,378)
-	(28,979)	- prior year	-	(28,979)
		Charge to profit or loss (note 15 (a))		
(67,024)	(128,022)	- current year	(70,938)	(129,125)
-	(43,581)	- prior year	-	(43,581)
(241,808)	**(348,946)**	**At 31 December**	**(257,632)**	**(361,842)**
(241,808)	(348,946)	Deferred tax asset	(257,632)	(361,842)
(241,808)	**(348,946)**	**At 31 December**	**(257,632)**	**(361,842)**

As at 31 December 2012, the Group had accumulated tax losses available for future relief of Shs 75,342,429 – relating to NC Uganda Ltd (2011: Shs 13,555,000 – relating to NIC Securities Ltd)

Under the Kenyan legislation, with effect from 1 January 2011, tax losses can only be carried forward to a maximum of four years. In Uganda, however, the tax losses can be carried forward for an indefinite period.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

27) Property and equipment

GROUP

	Buildings Shs `000	Furniture, fittings and equipment Shs `000	Motor vehicles Shs `000	Work in progress Shs `000	Total Shs `000
COST OR VALUATION					
At 1 January 2011	**370,000**	**1,017,058**	**18,814**	**30,233**	**1,436,105**
Additions	-	177,986	8,412	188,628	375,026
Transfers	-	39,486	-	(39,486)	-
Disposals	-	(3,490)	-	-	(3,490)
At 31 December 2011	**370,000**	**1,231,040**	**27,226**	**179,375**	**1,807,641**
At 1 January 2012	**370,000**	**1,231,040**	**27,226**	**179,375**	**1,807,641**
Additions	-	157,111	36,690	64,896	258,698
Transfers - WIP	-	158,688	-	(158,688)	-
Disposals	-	(19,992)	(2,071)	-	(22,063)
Translation adjustments	-	(6,323)	(1,197)	(5,127)	(12,648)
At 31 December 2012	**370,000**	**1,520,524**	**60,648**	**80,456**	**2,031,628**
Comprising:					
Cost	144,617	1,520,524	60,648	80,456	1,806,245
Valuation – 2008	225,383	-	-	-	225,383
	370,000	**1,520,524**	**60,648**	**80,456**	**2,031,628**
DEPRECIATION					
At 1 January 2011	**22,424**	**651,780**	**11,371**	**-**	**685,575**
Charge for the year	11,212	140,854	5,085	-	157,151
Eliminated on disposals	-	(3,073)	-	-	(3,073)
At 31 December 2011	**33,636**	**789,561**	**16,456**	**-**	**839,653**
At 1 January 2012	**33,636**	**789,561**	**16,456**	**-**	**839,653**
Charge for the year	11,212	184,299	8,835		204,346
Eliminated on disposals	-	(19,888)	(2,375)		(22,263)
At 31 December 2012	**44,848**	**953,972**	**22,917**		**1,021,737**
NET BOOK VALUE					
At 31 December 2012	**325,152**	**566,552**	**37,731**	**80,456**	**1,009,891**
At 31 December 2011	**336,364**	**441,480**	**10,770**	**179,375**	**967,988**

Buildings were revalued at Shs 370 million as at 31 December 2008 by registered professional valuers, Knight Frank Limited on an open market value basis by reference to market evidence of recent transactions for similar properties. Buildings are revalued every 3-5 years. At 31 December 2012, the net book value of buildings based on original cost was Shs 127,088,000 (2011 – Shs 131,470,000). There were no capitalised borrowing costs related to the acquisition of property and equipment during the year 2012 (2011 – Shs nil).

Included in motor vehicles and furniture, fittings and equipment are assets with a cost of Shs 538,099,158 (2011 – Shs 473,718,790) which were fully depreciated. The notional depreciation charge on these assets would have been Shs 120,399,602 (2011 – Shs 105,159,025). Computer equipment are included under furniture, fittings and equipment. Work in progress mainly related to the acquisition of banking software and related hardware in 2011 and the branch expansion programme in Tanzania and Kenya in 2012.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

27) Property and equipment (Continued)

BANK

	Buildings Shs `000	Furniture, fittings and equipment Shs `000	Motor vehicles Shs `000	Work In progress Shs `000	Total Shs `000
COST OR VALUATION					
At 1 January 2011	**370,000**	**958,078**	**14,789**	**-**	**1,342,867**
Additions	-	153,092	4,467	149,493	307,052
Disposals	-	(3,469)	-	-	(3,469)
At 31 December 2011	**370,000**	**1,107,701**	**19,256**	**149,493**	**1,646,450**
At 1 January 2012	370,000	1,107,701	19,256	149,493	1,646,450
Additions	-	71,711	18,878	16,965	107,554
Transfers	-	158,688	-	(158,688)	-
Disposals	-	(19,968)	(268)	-	(20,236)
At 31 December 2012	**370,000**	**1,318,132**	**37,866**	**7,770**	**1,733,768**
Comprising:					
Cost	144,617	1,318,132	37,866	7,770	1,421,067
Valuation – 2008	225,383	-	-	-	225,383
	370,000	**1,318,132**	**37,866**	**7,770**	**1,646,450**
DEPRECIATION					
At 1 January 2011	**22,424**	**625,287**	**6,890**	-	**654,601**
Charge for the year	11,212	128,889	3,033	-	143,134
Eliminated on disposals	-	(3,053)	-	-	(3,053)
At 31 December 2011	**33,636**	**751,123**	**9,923**	-	**794,682**
At 1 January 2012	**33,636**	**751,123**	**9,923**	-	**794,682**
Charge for the year	11,212	158,150	4,243	-	173,605
Eliminated on disposals	-	(19,864)	(269)	-	(20,132)
At 31 December 2012	**44,848**	**889,409**	**13,897**	-	**948,156**
NET BOOK VALUE					
At 31 December 2012	**325,152**	**428,723**	**23,967**	**7,770**	**785,612**
At 31 December 2011	**336,364**	**356,578**	**9,333**	**149,493**	**851,768**

Buildings were revalued at Shs 370 million as at 31 December 2008 by registered, professional valuers, Knight Frank Limited on an open market value basis by reference to market evidence of recent transactions for similar properties. At 31 December 2012, the net book value of buildings based on original cost was Shs 127,088,000 (2011 – Shs 131,470,000).

Included in motor vehicles and furniture, fittings and equipment are assets with a cost of Shs 522,846,292 (2011 – Shs 456,796,033) which were fully depreciated. The notional depreciation charge on these assets would have been Shs 116,797,128 (2011 – Shs 91,359,213). Computers are included under furniture, fittings and equipment. Work in progress mainly relates to the acquisition of banking software related hardware; and the branch expansion programme.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28) Intangible assets

Bank				Group	
2012 Shs'000	**2011 Shs'000**		**Note**	**2012 Shs'000**	**2011 Shs'000**
642,337	400,544	Computer software	28(a)	752,066	410,796
-	-	Goodwill	28(b)	375,426	375,426
-	-	NSE Licence	28(c)	-	251,000
642,337	**400,544**	**At 31 December**		**1,127,492**	**1,037,222**

Details of the intangible assets are as follows:

a) Computer software

Bank				Group		
Capitalised Shs `000	**Work-in Progress* Shs `000**	**Total Shs `000**		**Capitalised Shs `000**	**Work-in Progress* Shs `000**	**Total Shs`000**
			COST			
266,703	**45,876**	**312,579**	**At 1 January 2011**	**281,442**	**45,876**	**327,318**
45,819	260,940	306,759	Additions	49,067	262,171	311,238
45,876	(45,876)	-	Transfers	45,876	(45,876)	-
358,398	**260,940**	**619,338**	**At 31 December 2011**	**376,385**	**262,171**	**638,556**
358,398	260,940	619,338	**At 1 January 2012**	376,385	262,171	638,556
-	-	-	Translation adjustment	(886)	(1,272)	(2,158)
84,607	254,398	339,005	Additions	84,609	371,011	455,620
515,338	(515,338)	-	Transfers	629,007	(629,007)	-
958,343	**-**	**958,343**	**At 31 December 2012**	**1,089,115**	**2,903**	**1,092,018**
			AMORTISATION			
183,222	**-**	**183,222**	**At 1 January 2011**	**186,248**	-	**186,248**
35,572	**-**	35,572	Charge for the year	41,512	-	41,512
218,794	**-**	**218,794**	**At 31 December 2011**	**227,760**	**-**	**227,760**
218,794	-	218,794	**At 1 January 2012**	227,760	-	227,760
-	**-**	-	Translation adjustments	(1,268)	-	(1,268)
97,213	**-**	97,213	Charge for the year	113,461	-	113,461
316,007	**-**	**316,007**	**At 31 December 2012**	**339,953**	**-**	**339,953**
			Net Book Value			
642,336	**-**	**642,336**	**2012**	**749,162**	**2,903**	**752,065**
139,604	**260,940**	**400,544**	**2011**	**148,625**	**262,171**	**410,796**

Assets of the Group with a gross value of Shs 210,660,661 (2011 – Shs 150,198,967) are fully amortised but still in use. The notional amortisation charge on the assets would have been Shs 42,132,132 (2011 – Shs 30,039,793).

*Work in progress relates to the purchase of the new banking software.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28) Intangible assets (Continued)

b) Goodwill

The goodwill consists of equity interest held by the Group in;

	2012		2011	
	Ownership %	**Amount Shs'000**	**Ownership %**	**Amount Shs'000**
NIC Bank Tanzania	51.0	251,996	51.0	251,996
NIC Securities	91.3	123,430	91.3	123,430
At 31 December		**375,426**		**375,426**

Goodwill is reviewed annually for impairment or more frequently when there are indications that impairment may have occurred. There was no impairment identified in 2012 (2011: Shs nil).

c) NSE Licence

This licence refers to the seat at the Nairobi Securities Exchange (NSE) held by the Group through NIC Securities Limited. The seat had been revalued at Shs 251 million, based on an arm's length transaction of a similar seat. These seat was converted to ordinary equity shares in NSE in 2012 and has been reclassified under investments (note 25) valued at Shs 191m.

29) Operating lease prepayments – Leasehold land

	GROUP AND BANK	
	2012 Shs `000	**2011 Shs `000**
Cost		
At 31 December	**10,000**	**10,000**
Amortisation		
At 1 January	2,500	2,375
Charge for the year	125	125
At 31 December	**2,675**	**2,500**
Net book value	**7,375**	**7,500**

30) Customer deposits

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
29,541,017	21,085,185	Current	31,448,785	22,228,140
987,637	1,509,284	Savings	1,395,680	2,027,182
46,629,310	39,198,516	Term	50,005,226	41,821,752
308,078	215,968	Other	529,885	215,979
77,466,042	**62,008,953**	**At 31 December**	**83,379,576**	**66,293,053**
5.17%	**7.49%**	Weighted average effective interest	**5.31%**	**7.37%**

Customer deposits include financial instruments classified as liabilities at amortised cost. Included in term deposits are deposits which are at fixed interest rates whereas all other deposits are at variable rates.

Other deposits are those held as collateral for irrevocable commitments mainly under import letters of credit and performance bonds. Their fair value approximates the carrying amount.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31) Due to banking institutions

Bank			Group	
2012 Shs'000	2011 Shs'000		2012 Shs'000	2011 Shs'000
		Maturing within 90 days:		
3,044,959	**206,149**	Due to banking institutions	**3,571,280**	**788,647**
8.36%	**21.9%**	Weighted average effective interest	**7.92%**	**21.5%**

Deposits due to banking institutions include financial instruments classified as liabilities at amortised cost.

32) Lines of credit

GROUP AND BANK

The Bank has an unsecured revolving medium term lines of credit for onward lending with;

a. Agence Francaise De Development (PROPARCO). As at 31 December 2012, the amount outstanding was US$ 22,413,574 (2011 – US$ 2,241,231) equivalent to Shs 1,927,567,000 (2011 – Shs 190,280,499).

b. The Dutch Development Finance Institution, FMO. The amount outstanding was US$ 20,091,244 (2011 –Nil) equivalent to Shs 1,727,847,000 (2011 – Nil).

	2012 Shs `000	2011 Shs `000
Maturity		
Payable within one year	51,583	117,842
Payable after one year and within three years	1,402,041	72,438
Payable after three years	2,201,790	-
	3,655,414	**190,280**
Weighted average effective interest	**3.32%**	**5.23%**

Lines of credit are financial instruments classified as a liability at amortised cost.

33) Due to group companies

BANK

		2012 Shs `000	2011 Shs `000
Deposits held	- NIC Capital	142,105	85,456
	- Mercantile Finance Company	5,210	5,210
	- NIC Securities	198,145	177,282
	- NIC Insurance Agents	16,951	11,339
Other payables	- Mercantile Finance Company	42,020	42,020
	- NIC Bank Tanzania	17,859	808
	- NC Bank Uganda	188,070	-
		610,360	**322,115**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

34) Other liabilities

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
253,378	257,521	Bills payable	270,269	298,089
1,205,930	391,850	Other payables and accruals	1,383,178	479,880
-	-	Preference shares	29,899	34,815
2,630	2,176	Legal and other claims	15,050	13,332
-	-	Trade payables	92,179	53,236
32,293	23,191	Leave pay provision	32,847	24,277
1,494,231	**674,738**	**At 31 December**	**1,823,422**	**903,629**

Legal and other claims relate substantially to a provision for charges brought against the Group by customers of the stock brokerage subsidiary, NIC Securities Limited. In the directors' opinion, after taking appropriate legal advice, the outcome of these legal claims will not give rise to any significant loss beyond the amounts provided at 31 December 2012.

The preference shares relate to East African Development Bank (EADB) which invested TShs 650 million in 8% non-redeemable and non-cumulative preference shares issued by the Bank in November 2004. The preference shareholders have the discretion to transfer to the existing shareholders or may convert their shares into ordinary shares upon attainment of certain covenants. Dividends on the preference shares are payable when there are sufficient cash resources at the date of declaration, subject to the business and industry requirements of the company, making of prudent reserves and provisions in general and complying with all applicable legislation.

35) Dividends

At the Annual General Meeting scheduled for 8 May 2013, a first and final dividend in respect of 2012 of Shs 1.0 per share (2011 – Shs 0.25 interim dividend and Shs 0.25 final dividend per share) amounting to a total of Shs 542,984,000 (2011 – Shs 197,448,000) is to be proposed by the directors.

The total estimated dividend for the year to be paid is therefore Shs 1 per share (2011 - Shs 0.50 per share) amounting to a total of Shs 542,984,000 (2011 - Shs 197,448,000). The final proposed dividend for the year is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

GROUP AND BANK

The movement in unclaimed dividends is as follows:

	2012 Shs`000	**2011 Shs`000**
At 1 January	55,905	50,181
Final dividend declared	98,724	89,749
Interim dividend declared	-	98,724
Dividends paid	(100,675)	(182,749)
At 31 December	**53,954**	**55,905**

Payment of dividends to members with shareholding of up to 12.5% is subject to withholding tax at the rate of 5.0% for residents and 10.0% for non-residents.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

36) Share capital and reserves

(a) Share capital and share premium

GROUP AND BANK	Number of shares	Share capital Shs `000	Share premium Shs `000
Balance at 1 January 2011	358,997,784	1,794,989	28,848
Bonus issue	35,899,778	179,499	(28,848)
Balance at 31 December 2011	**394,897,562**	**1,974,488**	**-**
Balance at 1 January 2012	394,897,562	1,974,488	-
Rights issue	98,724,391	493,622	1,579,590
Bonus issue	49,362,195	246,811	(246,811)
Bonus and Rights issue expenses	-	-	(123,980)
Balance at 31 December 2012	**542,984,148**	**2,714,921**	**1,208,799**

As at 31 December 2012 the authorised share capital of the Bank comprised of 800,000,000 (2012 - 400,000,000) ordinary shares with a par value of Shs 5. The issued shares as at 31 December 2012 are 542,984,148 (2011: 394,897,562) and are fully paid. Issued and fully paid ordinary shares, which have a par value of Shs 5, carry one vote per share and carry a right to dividend.

During the year, the company capitalized the sum of Sh 246,811,000 from the credit of the share premium account and appropriated the amount to ordinary shareholders by way of a 1 for 10 bonus issue. The bonus issue was approved by way of ordinary resolution at the Annual General Meeting held on 2 May 2012. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at General Meetings of the Bank.

During the year, the Bank undertook a successful Rights Issue of one share for every four shares held amounting to 98,724,391 shares at Shs 21, resulting in an increase of capital of Shs 493,622,000 and share premium of Shs 1,579,590,000.

Premiums from the issue of shares are reported as share premiums. During the year, a portion of this was utilised to cater for the Rights Issue and related Rights Issue expenses.

(b) Revaluation surplus on property

Revaluation reserve is made up of the periodic adjustment arising from the valuation of buildings, net of the related deferred taxation. The reserve is not available for distribution to the shareholders.

(c) Investments revaluation reserves

This represents the unrealized increase or decrease in the fair value of available-for-sale investments after deduction of deferred income taxes, excluding impairment losses. The reserve is not available for distribution to the shareholders.

(d) Foreign currency translation reserve

The reserves represent exchange differences arising from translation of the net assets of the Group's foreign operations which are NIC Bank Tanzania Limited and NC Bank Uganda Limited from their functional currency (Tanzania Shillings and Uganda Shillings respectively), to the Group's presentation currency (Kenya Shillings). These differences are recognised directly through other comprehensive income and accumulated in the foreign currency translation reserve in equity. The reserve is not available for distribution to the shareholders.

(e) Statutory credit risk reserves

Where impairment losses required by prudential guidelines issued by the banking regulators exceed those computed under the International Financial Reporting Standards (IFRS), the excess is recognised as a statutory reserve and accounted for as an appropriation from revenue reserves. The reserve is not available for distribution to the shareholders.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

36) Share capital and reserves (Continued)

(f) Revenue reserves

This represents undistributed profits from current and previous years.

37) Non-controlling interests

The total non controlling interest consists of equity interest in subsidiaries;

	2012		2011	
	Ownership %	Amount Shs'000	Ownership %	Amount Shs'000
NIC Bank Tanzania	49.0	486,558	49.0	435,988
NIC Securities	8.7	34,976	8.7	33,158
At 31 December		**521,534**		**469,146**

a) NIC Bank Tanzania

On 1 May 2009, the Group acquired a 51% stake in one of Tanzania's mid-sized commercial bank, Savings & Finance Commercial Bank Ltd, later renamed NIC Bank Tanzania Limited. NIC Bank Tanzania Ltd was founded as a non-bank financial institution in 1994, converted to a fully fledged commercial bank in 2005 and has branches in Dar es Salaam (2), Mwanza (1), Arusha (1) and Kahama (1).

	2012 Shs'000	2011 Shs'000
Movement in non-controlling interests		
At 1 January	435,988	382,299
Share of profit	50,570	53,689
At 31 December	**486,558**	**435,988**

b) NIC Securities

On 31 December 2007, the Bank acquired 57.7% of NIC Securities Limited (formerly Solid Investment Securities Limited) through its wholly owned subsidiary NIC Capital Limited. Through combinations of direct buy-outs and additional rights issues, the Group increased its shareholding in the subsidiary to 91.3% in 2009.

Movement in non-controlling interest

	2012 Shs'000	2011 Shs'000
At 1 January	33,158	32,168
Share of profit	1,818	990
At 31 December	**34,976**	**33,158**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

38) Off balance sheet financial instruments, contingent liabilities and commitments

a) Contingent liabilities

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
4,404,221	5,289,500	Letters of credit	4,451,256	5,301,250
9,410,641	7,896,163	Letters of guarantee & performance bonds	9,660,753	8,175,203
13,814,862	**13,185,663**	**At 31 December**	**14,112,010**	**13,476,453**

In the ordinary course of business, the Group conducts business involving acceptances, letters of credit, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties. In addition, there are other off-balance sheet financial instruments including forward contracts for purchase and sale of foreign currencies, the nominal amounts of which are not reflected in the statement of financial position.

Letters of credit are commitments by the Group to make payments to third parties, on production of documents, on behalf of customers and are reimbursed by customers. Letters of guarantee and performance bonds are issued by the Group, on behalf of customers, to guarantee performance by customers to third parties. The Group will only be required to meet these obligations in the event of default by the customers.

(b) Operating lease prepayments

i) The group as a lessor

At the end of the reporting period, the Group had contracted with tenants for the following future lease receivables:

Group and Bank

	2012 Shs'000	2011 Shs'000
Within one year	2,244	2,580
In the second to fifth year inclusive	-	2,244
At 31 December	**2,224**	**4,824**

Leases are negotiated for an average term of 6 years and rentals are reviewed every two years. The leases are cancellable with a penalty when the tenants do not give three months notice to vacate the premises.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

38) Off balance sheet financial instruments, contingent liabilities and commitments (Continued)

b) Operating lease prepayments (Continued)

ii) The group as a lessee

At the end of the reporting period, the Group had non-cancellable operating leases which fall due as follows:

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
		Premises		
112,693	106,145	Within one year	154,669	132,303
348,230	325,294	In the second to fifth year inclusive	676,519	413,484
460,923	**431,439**	**At 31 December**	**831,188**	**545,787**
		Office equipment		
2,854	1,348	Within one year	2,854	1,348
149	-	In the second to fifth year inclusive	149	-
3,003	**1,348**	**At 31 December**	**3,003**	**1,348**

Operating lease payments represent rentals payable by the Group for its business premises and office equipment. Premises leases are negotiated for an average term of 6 years, while office equipment is for an average term of 3 years. For these contingent liabilities, no reimbursement is expected.

c) Capital commitments

Bank			Group	
2012 Shs'000	**2011 Shs'000**		**2012 Shs'000**	**2011 Shs'000**
51,012	852,668	Authorised and contracted for	85,051	930,120
399,950	223,360	Authorised but not contracted for	469,867	252,092
450,962	**1,076,028**	**At 31 December**	**554,918**	**1,182,212**

The capital commitments largely relate to branch expansion activities and software acquisition. The Group's management is confident that future net revenues and funding will be sufficient to cover this commitment.

d) Legal proceedings

Besides of the provision made (see note 34), various claims against the Group are considered without merit, and the Bank is defending them vigorously. It is not possible to estimate the Bank's possible loss in relation to these matters, nor the effect that they might have upon operating results in any particular financial period. No contingent liability associated with legal actions has been disclosed as professional advice indicates that it is unlikely that any significant loss will arise.

e) Other credit commitments

Commitments to lend are agreements to lend to customers in future subject to certain conditions. Such commitments are normally made for fixed periods. The Group may withdraw from its contractual obligations to extend credit by giving reasonable notice to the customers.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

39) Notes to the consolidated statement of cashflows

a) Cash generated from operations

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
		Reconciliation of profit before tax to cash generated from operations		
4,310,949	3,360,602	Profit before tax	4,517,967	3,604,948
		Adjustments for:		
173,605	143,134	Depreciation	204,346	157,151
125	125	Amortisation of operating lease prepayments	125	125
-	-	Loss on revaluation of investment in NSE seat	60,000	
97,213	35,572	Amortisation of intangible assets	113,461	41,512
-	-	(Gain) / loss on revaluation of fair value through profit and loss investments	(1,281)	14,052
(186)	(574)	Gain on sale of equipment	(888)	(595)
4,581,706	**3,538,859**	**Profit before working capital changes**	**4,893,730**	**3,817,193**
(618,190)	(1,296,906)	Increase in balances with Central Banks – Mandatory reserve deposits	(535,536)	(1,582,227)
(14,355,740)	(13,684,596)	Increase in loans and advances to customers	(14,915,471)	(15,869,642)
-	-	Proceeds on disposal of quoted shares – held for trading	3,633	34,473
-	-	Outflows on purchase of quoted shares - held for trading	(6,133)	(22,973)
-	-	Investment in unquoted shares - available for sale		(26,781)
(4,558,361)	(2,719,906)	Increase in Government securities maturing after 90 days	(5,080,814)	(2,759,747)
395,344	(470,745)	Net movement in derivatives held for risk management	390,945	(470,745)
(368,648)	(77,682)	Increase in other assets	(578,255)	(120,593)
45,841	(821,837)	Due to / (from) group companies	-	-
15,457,089	16,691,292	Increase in customer deposits	17,086,523	17,800,829
819,492	15,812	Increase in other liabilities	619,977	5,880
3,465,134	(113,004)	Increase / (decrease) in line of credit	3,465,134	(113,004)
4,863,667	**1,061,287**	**Cash generated from operations**	**5,343,733**	**692,663**

b) Cash and cash equivalents

Analysis of balances of cash and cash equivalents as shown in the consolidated statement of financial position and notes

Bank 2012 Shs'000	Bank 2011 Shs'000		Note	Group 2012 Shs'000	Group 2011 Shs'000
2,051,089	1,470,636	Cash and balances with central banks	17	2,552,141	1,675,403
375,240	250,024	Items in course of collection	18	429,542	281,796
6,569,964	4,486,475	Due from banking institutions	19	8,188,716	5,692,655
4,045,142	178,366	Government securities	20	4,511,027	194,435
(3,044,959)	(206,149)	Due to banking institutions	31	(3,571,280)	(788,647)
9,996,476	**6,179,353**	**At 31 December**		**12,110,146**	**7,055,642**

39) Notes to the consolidated cash flow statement (Continued)

c) Proceeds from sale of motor vehicle and equipment

Bank 2012 Shs'000	Bank 2011 Shs'000		Note	Group 2012 Shs'000	Group 2011 Shs'000
20,236	3,469	Disposal at cost	27	22,063	3,490
(20,132)	(3,053)	Depreciation eliminated on disposal	27	(22,263)	(3,073)
186	574	Gain on disposal of motor vehicle and equipment	11	888	595
290	**990**	**Proceeds from sale of motor vehicle and equipment**		**688**	**1,012**

40) Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

In the normal course of business, a number of banking transactions are entered into with related parties i.e. staff, directors, their associates and companies associated with directors. These include loans, deposits and foreign currency transactions. Loans and advances to customers at 31 December include loans and advances to staff and to companies associated with directors. Contingent liabilities at 31 December include guarantees and letters of credit for companies associated with directors.

Loans and advances to customers:

Companies associated with directors

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
1,179,687	1,018,418	At 1 January	1,186,810	1,040,829
(206,451)	161,269	Net movement during the year	(197,446)	145,981
973,236	**1,179,687**	**At 31 December**	**989,364**	**1,186,810**
81,250	**90,295**	**Interest earned**	**83,475**	**91,683**
328,653	**356,282**	**Guarantees and letters of credit to companies associated with directors**	**337,658**	**356,282**

The above outstanding balances arose from the ordinary course of business and are substantially on the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

Employees/Staff

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
		Loans and advances to customers:		
611,700	467,649	At 1 January	624,343	479,096
32,459	144,051	Net movement during the year	40,557	145,247
644,159	**611,700**	**At 31 December**	**664,900**	**624,343**
46,513	**30,768**	**Interest earned**	**50,017**	**33,420**

These loans and advances are performing and are adequately secured.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

40) Related party transactions (Continued)

Customer deposits

Companies associated with directors

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
4,696,934	4,980,085	At 1 January	4,744,307	5,007,296
(1,447,431)	(283,151)	Net movement during the year	(1,343,817)	(262,989)
3,249,503	**4,696,934**	**At 31 December**	**3,400,490**	**4,744,307**
325,127	**288,345**	**Interest paid**	**326,770**	**288,623**

Employees/staff

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
		Customer deposits		
97,173	58,225	At 1 January	99,056	78,998
21,808	38,948	Net movement during the year	33,982	20,058
118,981	**97,173**	**At 31 December**	**139,038**	**99,056**
6,535	**2,439**	**Interest paid**	**50,017**	**2,495**

Other amounts outstanding at the end of the reporting period are disclosed in notes 23 and 32.

Key management compensation

The remuneration of directors and other members of key management during the year was as follows:

Bank 2012 Shs'000	Bank 2011 Shs'000		Group 2012 Shs'000	Group 2011 Shs'000
243,994	**212,675**	Salaries and other benefits	**329,683**	**242,781**
		Directors' remuneration		
11,370	6,890	Fees for services as directors	15,181	8,809
98,766	90,280	Other emoluments (included in key management compensation above)	148,701	108,773
109,886	**97,170**		**163,882**	**117,582**

In line with policy, the above compensation is a consolidated salary package encompassing all employment benefits and pension.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

41) Assets pledged as security

As at 31 December 2012, there were no assets pledged by the Group to secure liabilities and there were no secured Group liabilities (2011: Sh nil).

42) Fiduciary activities

The Group holds asset security documents on behalf of customers with a value of Shs 39,120,242,383 (2011 - Shs 30,037,235,373). These securities are held by the custody services department and comprise deposits with financial institutions, government securities and quoted and unquoted securities, among others.

43) Events after the balance sheet date

The Board of Directors of NIC Bank Tanzania Limited where NIC Bank owns 51% shareholding as at 31st December 2012, has approved the raising of additional capital of TZShs 8.5 billion through a Rights Issue. The Board of Directors of NIC Bank Limited has approved full participation in the Rights Issue which will involve an additional investment of TZShs 4,335 million (KShs 234 million) in NIC Tanzania. In addition, the Board of Directors approved the acquisition of additional shares from existing shareholders, and the take-up of Rights that are not exercised by existing shareholders. This will involve an investment of TZShs 6,925 million (KShs 374 million). This brings the total additional investment in NIC Tanzania to TZShs 11,261 million (KShs 608 million). The rights issue is expected to be concluded by 30 June 2013.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

44) (a) MATURITY ANALYSIS OF FINANCIAL LIABILITIES AND ASSETS

	Upto 1 Month Shs'000	1 to 3 Months Shs'000	4 to 12 Months Shs'000	1 to 3 Years Shs'000	4 to 5 Years Shs'000	Over 5 Years Shs'000	Total Shs'000
FINANCIAL LIABILITIES							
Customer deposits	51,456,116	26,828,480	4,962,908	132,072	-	-	83,379,576
Due to banking institutions	3,396,893	346,953	-	-	-	-	3,743,846
Line of credit	12,605	-	38,978	1,402,041	2,201,790	-	3,655,414
Unclaimed dividends	53,954	-	-	-	-	-	53,954
Other liabilities	362,448	-	-	-	-	-	362,448
Total financial liabilities	**55,282,016**	**27,175,433**	**5,001,886**	**1,543,113**	**2,201,790**	**-**	**91,195,238**
FINANCIAL ASSETS							
Cash and balances with Central Banks	4,283,082	1,960,953	208,350	598,577	-	-	7,050,962
Items in the course of collection	429,545	-	-	-	-	-	429,545
Due from banking institutions	6,617,379	1,571,337	-	-	-	-	8,188,716
Government securities	1,120,248	4,374,917	5,290,023	2,420,950	2,352,916	1,919,177	17,478,231
Derivative assets held for risk management	83,123	-	-	-	-	-	83,123
Loans and advances to customers	11,051,916	8,614,929	16,102,807	15,753,461	15,774,966	4,242,013	71,540,092
Other assets	160,813	-	-	-	-	-	160,813
Total financial assets	**23,746,106**	**16,522,136**	**22,601,180**	**18,772,988**	**18,127,882**	**6,161,190**	**104,931,482**
Net liquidity gap	**31,535,910**	**10,653,297**	**(16,599,294)**	**(17,238,875)**	**(15,926,092)**	**(6,161,190)**	**(13,736,244)**
At 31 December 2011							
Total financial liabilities	33,770,119	25,335,477	8,154,251	971,667	-	-	68,231,514
Total financial assets	15,976,919	13,658,436	13,077,714	14,619,883	19,214,879	-	76,547,831
Net liquidity gap	**17,793,200**	**11,677,041**	**(4,923,463)**	**(13,648,216)**	**(19,214,879)**	**-**	**(8,316,317)**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

44) (b) LIQUIDITY RISK (Undiscounted)

	Upto 1 Month Shs'000	1 to 3 Months Shs'000	4 to 12 Months Shs'000	1 to 3 Years Shs'000	Over 3 Years Shs'000	Total Shs'000
FINANCIAL LIABILITIES						
Customer deposits	57,662,814	23,167,076	5,341,141	129,058	-	86,300,089
Due to banking institutions	-	-	-	-	-	-
Line of credit	12,605	-	38,978	1,402,041	2,582,794	4,036,418
Total financial liabilities	**57,675,419**	**23,167,076**	**5,380,119**	**1,531,099**	**2,582,794**	**90,336,507**
FINANCIAL ASSETS						
Cash and balances with Central Banks	4,181,918	2,062,118	208,350	598,577	-	7,050,962
Items in the course of collection	429,545	-	-	-	-	429,545
Due from banking institutions	8,148,275	-	-	-	-	8,148,275
Government securities	1,403,385	4,255,344	6,089,208	3,170,098	3,233,988	18,152,023
Derivative assets held for risk management	83,123	-	-	-	-	83,123
Loans and advances to customers	11,349,615	8,793,583	17,728,567	21,635,038	27,649,509	87,156,312
Total financial assets	**25,595,861**	**15,111,045**	**24,026,125**	**25,403,713**	**30,883,497**	**120,020,240**
Net liquidity gap	**32,079,558**	**8,056,031**	**(18,646,006)**	**(23,872,614)**	**(28,300,703)**	**(30,683,733)**
At 31 December 2011						
Total financial liabilities	34,706,321	26,047,533	8,254,870	1,296,273	-	**70,304,997**
Total financial assets	15,726,936	14,016,953	14,472,776	20,659,885	27,117,328	**91,993,878**
Net liquidity gap	**18,979,385**	**12,030,580**	**(6,217,906)**	**(19,363,612)**	**(27,117,328)**	**(21,688,881)**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

44) (c) INTEREST RATE RISK

	Effective Rates %	Up to 1 Month Shs'000	1 to 3 Months Shs'000	4 to 12 Months Shs'000	1 to 3 Years Shs'000	Over 3 Year Shs'000	Non – interest Bearing Shs'000	Total Shs'000
FINANCIAL ASSETS								
Cash and balances with Central Banks	-	998,929	-	-	-	-	6,052,033	7,050,962
Items in the course of collection	-	-	-	-	-	-	429,545	429,545
Due from banking institutions	2.17	7,888,374	-	-	-	-	300,342	8,188,716
Government securities	8.60	5,402,390	4,143,924	1,499,949	2,420,950	4,011,019	-	17,478,232
Derivative assets held for risk management	-	-	-	-	-	-	35,705	35,705
Loans and advances to customers	12.62	66,393,992	529,086	2,060,101	2,504,913	-	-	71,488,092
Total financial assets		**80,683,685**	**4,673,010**	**3,560,050**	**4,925,863**	**4,011,019**	**6,817,625**	**104,671,252**
FINANCIAL LIABILITES								
Customer deposits	7.37	20,811,162	22,471,216	4,981,969	109,906	-	35,005,323	83,379,576
Due to banking institutions	21.5	3,584,626	159,220	-	-	-	-	3,743,846
Line of credit	5.23	12,552	-	37,656	1,268,471	2,336,735	-	3,655,414
Total financial liabilities		**24,408,340**	**22,630,436**	**5,019,625**	**1,378,377**	**2,336,735**	**35,005,323**	**90,778,836**
Interest rate sensitivity gap		**56,275,345**	**(17,957,426)**	**(1,459,575)**	**3,547,486**	**1,674,284**	**(28,187,698)**	**13,892,416**
At 31 December 2011								
Total financial assets		59,666,806	1,150,795	2,214,403	4,086,638	2,698,922	6,394,780	76,212,344
Total financial liabilities		11,463,225	25,207,290	7,509,616	971,667	-	22,120,182	67,271,980
Interest rate sensitivity gap		**48,203,581**	**(24,056,495)**	**(5,295,213)**	**3,114,971**	**2,698,922**	**(15,725,402)**	**8,940,364**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

45) FOREIGN EXCHANGE (CURRENCY) RISK

	USD	GBP	EURO	Others	TOTAL
2012	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
FINANCIAL ASSETS					
Cash and balances with Central Banks	651,994	86,276	140,406	247	878,923
Due from banking institutions	6,458,638	658,709	1,217,353	259,154	8,593,855
Loans and advances to customers	26,092,406	454,094	1,246,209	33,900	27,826,608
Other assets	1,208,946	27,821	5,534	15,038	1,257,340
Total financial assets	**34,411,984**	**1,226,901**	**2,609,502**	**308,339**	**38,556,726**
FINANCIAL LIABILITES					
Customer deposits	22,107,334	2,152,925	3,403,956	47,935	27,712,150
Due to banking institutions	818,101	79,973	-,	63,222	961,295
Other liabilities	694,585	35,409	689	7,079	737,763
Line of credit	3,655,414	-	-	-	3,655,414
Total financial liabilities	**27,275,434**	**2,268,307**	**3,404,645**	**118,236**	**33,066,622**
Net balance sheet position	**7,135,551**	**(1,041,407)**	**(795,143)**	**190,102**	**5,490,101**
OFF BALANCE SHEET POSITION	**(6,452,705)**	**1,129,998**	**786,441**	**(107,640)**	**(4,643,906)**
2011					
Total financial assets	18,009,128	2,027,165	1,915,163	96,545	22,048,001
Total financial liabilities	15,094,574	2,014,630	1,909,499	44,281	19,062,984
Net balance sheet position	**2,914,554**	**12,535**	**5,664**	**52,264**	**2,985,017**
OFF BALANCE SHEET POSITION	**(2,770,052)**	**-**	**-**	**(45,763)**	**(2,815,815)**

NOTES TO THE FINANCIAL STATEMENTS (Continued)

46) Segmental reporting – by business segments

2012	**Corporate & Institutional Banking Shs '000**	**Treasury Dealing and Brokerage Shs '000**	**Retail Banking Shs '000**	**Asset Finance Shs '000**	**Investment Banking and Others Shs '000**	**Total Shs '000**
Total operating income	2,547,616	1,365,102	1,137,027	840,003	2,426,377	8,316,125
Profit before tax and impairment allowances impairment allowances	2,004,252	951,474	650,217	970,270	239,239	4,815,452
Customer loans and advances	45,404,645	-	6,955,826	14,020,714	5,158,877	71,540,092
Customer deposits	52,835,422	-	24,441,729	188,891	5,913,534	83,379,576
2011						
Total operating income	2,707,633	1,075,901	1,227,312	900,720	691,168	6,602,734
Profit before tax and impairment allowances	1,636,598	827,234	478,500	645,316	275,451	3,863,099
Customer loans and advances	35,958,147	-	3,792,914	12,274,414	4,559,146	56,624,621
Customer deposits	41,946,169	-	20,062,784		4,284,100	66,293,053

Liabilities and all other assets, other than advances to customers, are not directly attributable and neither can they be allocated to a particular segment. Consequently, these have not been included in segment information.

There were no revenues deriving from transactions with a single external customer that amounted to 10% or more of the Group's revenues.

Non-Financial Risk Management disclosures:

a) Strategic risk

Strategic risk is the potential for loss arising from ineffective business strategies, improper implementation of strategies, sudden unexpected changes in the Group's environment, or from lack of adequate responsiveness to changes in the business environment.

The Group faces several strategic risks from its environment which include:

- Macro-economic changes.
- Competition from the financial industry and organisations providing similar services.
- Technological changes.
- Key legislative and regulatory changes.
- Major political events.
- Human capital or social/demographic trends and changes.

Who manages strategic risk

The Board of Directors is responsible for the overall generation and implementation of the Group's strategy for purposes of enhancing shareholders' value. It has however delegated the implementation aspects to the Group Managing Director and the Senior Management team who execute strategy.

Additionally, the Board of Directors, with support from the Group Managing Director and Senior Management, develops and implements a new strategic cycle every 3 years to cater for the next growth phase of the Group.

How we manage strategic risk

The Group Managing Director supported by Senior Management executes the approved strategic objectives on a day to day basis and actively monitors business performance against these objectives through periodic reviews. The business carries out business performance reviews periodically but at a minimum on a monthly basis against pre-determined milestones and key performance indicators. The reviews are reported to the Board of Directors for information and advice, or action where significant deviations occur. These reports include identifying the key risks faced by the Group and how they are being managed.

The Group Managing Director co-ordinates an annual strategic planning process for Senior Management intended to align individual business strategies to overall enterprise level strategies as approved by the Board of Directors. They include a comprehensive review and evaluation of the business strategies, competitive positioning, financial performance, initiatives of strategic executions, and key business risks. The frequency of strategic business reviews depends on the risk profile and size of the business / function.

Each business head unit is responsible for directing strategies in their respective units and ensure such strategies are aligned to the overall strategy of the Group. They are also responsible for monitoring, managing and reporting on the effectiveness and risks of their business' strategic objectives, and the progress they have made towards achieving these. They oversee the direction and trends of significant current and emerging risks related to their business units and that mitigating actions are taken where appropriate.

The Group's financial and non-financial performance, including its key risks, are reported to the Board of Directors on a quarterly basis for review and action, where necessary.

Non-Financial Risk Management disclosures (Continued)

b) Operational risk

Operational risk is the potential for loss arising from inadequate or failed processes, systems, people or external events. Operational risk is embedded in all business activities including the practices for managing other risks e.g. credit, market and liquidity risks and arises in the normal course of business. The impact of these risks can result in significant financial loss, reputational harm or regulatory censure and penalties.

The major operational risks faced by the Group include:

- People and related issues such as staff retention, frauds, amongst others.
- Systems and processes changes related to the drive to meet our clients' needs.

Who manages operational risk

The Management committee [Manco] is tasked with the responsibility designing and maintaining a formal Group-wide operational risk framework that emphasises a strong risk management and internal control culture throughout the Group. The committee meets monthly with a key deliverable of assessing the continued applicability of policies and programs in place to identify, assess, report, monitor, control or mitigate operational risks.

The Group structure is designed with operational risk in mind. As an example, the group maintains specialised functions that manage business continuity, human resources, compliance, administration and procurement, security services and organisational change management.

Senior Management in turn reports to the risk Management Committee on all the key risks detailing corrective action initiatives to address the risks.

How we manage operational risk

Our operational risk management framework is designed to ensure key risk exposures are proactively managed within acceptable levels. It incorporates best practice and meets regulatory guidelines through:

i) Governance and Policy: Management as well as Committee reporting and organisational structures emphasise accountability, ownership and effective oversight of each business unit's operational risk exposures. Furthermore, the Board Risk Management Committee and Senior Management's expectations are set out via enterprise-wide policies.

ii) Risk and Control Self Assessment: Through quarterly comprehensive assessments of our key operational risk exposures and internal control environments, Senior Management is able to evaluate its effectiveness and implement appropriate additional corrective actions where needed, to offset or reduce unacceptable risks.

iii) Operational Risk Event Monitoring: Our policies require that internal and industry-wide operational risk events are identified, tracked, and reported to the right levels to ensure they are analysed appropriately and corrective action taken in a timely manner.

iv) Risk Reporting: Significant operational risk issues together with measures to address them are tracked, assessed and reported to Senior Management and the Board of Directors to ensure accountability is maintained over current and emerging risks.

Non-Financial Risk Management disclosures (Continued)

b) Operational risk (Continued)

How we manage operational risk (Continued)

i) Insurance: A comprehensive portfolio of insurance and other risk mitigating arrangements are maintained with the type and level of insurance coverage continually assessed to ensure both risk tolerance and statutory requirements are met. This includes identifying opportunities for transferring our risks to third parties where appropriate.

ii) Technology and Information: The key risks here revolve around our reliance on technology and information and their impact on operational availability, integrity and security of our information data and systems / infrastructure. Our risk framework and programs use best practice and include robust threat and vulnerability assessments, as well as security and change management practices.

iii) Business Continuity Management: Business Continuity Management supports the ability of Senior Management to continue to operate their businesses, and provide customer access to products and services in times of disruptions. This program includes formal crisis management protocols and continuity strategies. All key functions of the Group are regularly tested to confirm their contingency plan designs are able to respond to a broad range of potentially disruptive scenarios.

iv) Outsourcing Management: While the benefits of outsourcing arrangements are immense (ie. access to leading technology, specialised expertise, economies of scale, operational efficiencies, etc.), we note the need to manage the associated risks. This is done through programs that guide outsourcing activities and ensure the level of risk management and Senior Management oversight is appropriate to the size and complexity of the outsourcing arrangements.

v) Project Management: We have a disciplined project management program to ensure projects are implemented successfully in a planned and systematic manner and are monitored by Senior Management. The Organisational Development Department maintains standards that meet best practice to identify and guide change.

vi) Financial Crime: Safeguarding our customers, employees, assets, information, and preventing plus detecting fraud as well as other forms of financial crime is done through extensive security systems, protocols and practices. This is led by our Security Services unit that carries out regular employee training to ensure compliance with crime prevention policies and practices.

c) Compliance (policy/legal/regulatory) risk:

Compliance risk refers to the potential of loss arising from non-compliance with laws, rules, regulations, obligatory practices / standards, contractual agreements, or other legal requirements including the effectiveness of preventing and handling litigation. It is not actively or deliberately pursued in the expectation of a return but occurs in the normal course of our business operations.

The Group meets high standards of compliance with policy, legal and regulatory requirements in all business dealings and transactions. As a result of high financial business regulation we are exposed to regulatory and legal risks in virtually all our activities including those from our three main regulators (Central Bank of Kenya/Bank of Tanzania and Capital Markets Authority). Failure to comply with regulation not only poses a risk of censure and litigation but may lead to serious reputational risks. Financial penalties and costs related to litigation may also substantially erode the Group's earnings.

Non-Financial Risk Management disclosures (Continued)

c) Compliance (policy/legal/regulatory) risk (Continued)

Who manages regulatory and legal risk

Business unit heads have the responsibility and accountability of managing regulatory and legal risks relating to their units on a day to day basis with assistance / advice and oversight from Legal and Compliance Departments. The Compliance Department identifies and monitors the key risks and is responsible for ensuring that the day to day business controls comply with applicable legislation and are in line with best practice. Internal and external legal counsel work closely with business units to identify areas of existing and potential regulatory/legal risks and actively manage them to reduce the Group's exposures.

Senior Management and the Board Risk Management Committee receive the Risk Management Department's opinions / reports on the strength of the Group's Compliance Risk Framework to enable them to determine whether it is under control and where not, tracks significant corrective actions to finality. Additionally, significant exposures under "for or against" litigation are reviewed periodically.

How we manage regulatory and legal risks

The Board of Directors and Senior Management through the Group's Code of Conduct sets the "tone at the top" for a culture of integrity beginning with concern for what is right (including compliance to policy and the law) in all our business considerations, decisions and actions. All employees are required to attest to this Code when they join the Group and thereafter periodically, indicating that they have understood it and that they have complied with its provisions.

Business unit heads manage day-to-day regulatory and legal risk primarily by implementing appropriate policies, procedures and controls already in place. The Legal & Compliance departments assist them by:

i) Communicating and advising on regulatory and legal requirements, and emerging compliance obligations to each business unit as required.

ii) Implementing or assisting with reviews of policies, procedures and training. They do this by independently monitoring and testing for adherence to certain regulatory and legal requirements, as well as the effectiveness of associated key internal controls.

iii) Tracking, escalating and reporting significant issues and findings to Senior Management and the Board of Directors.

iv) Liaising with regulators, as appropriate, regarding new or revised legislation, regulatory guidelines or regulatory examinations.

We have developed robust policies, programs and systems designed to manage the Know Your Customer (KYC) and Anti-Money Laundering (AML) risks as envisaged in the Proceeds of Crime & Anti-Money Laundering Act and Regulation (CBK/BOT / CMA). We have upgraded account opening requirements and customer transaction screening procedures to meet the stringent requirements stipulated therein. Reporting of suspicious and other transactions is done as required by the law and policy standards. We carry out appropriate periodic due diligence on correspondent banking counterparties, and meet KYC / AML obligations to them continuously. All staff are trained when they join the Group and periodically certified as such in line with the law.

Non-Financial Risk Management disclosures (Continued)

d) Reputational risk

Reputational risk is the potential that negative stakeholder impressions or perceptions, whether true or not, regarding the Group's business practices, actions or inactions, will or may cause a decline in its value, brand, liquidity or customer base. It is a resultant effect of all other risks highlighted in this report and therefore cannot be managed in isolation. Therefore, when all the other risks are managed well, this risk is substantially minimised.

The Group's reputation is an invaluable business asset essential for optimising shareholder value, hence it is constantly under threat. Our services and activities, including new ones, ensure the Group's good reputation is always maintained or enhanced.

Who manages reputational risk

Ultimate responsibility for this risk rests with the Board of Directors and Senior Management who examine the Group's reputational risk as part of their regular mandate. They are assisted in this aspect by the Corporate Communications Department. Their purpose is to ensure that all products, services, and activities meet the Group's reputational risk objectives in line with the Board of Director's approved appetite. Nonetheless, every employee and representative of the Group has a responsibility to contribute positively to our reputation.

Senior Management and the Board of Directors receive periodic reports on the assessment of the Group's reputational risk exposures that arise from its business (including sales and service) activities so as to form a view on associated risks and implement corrective actions.

How we manage reputational risk

Every employee and representative of the Group has a responsibility to contribute in a positive way towards our reputation. This is through ensuring ethical practices are always adhered to, interactions with all stakeholders are positive, and we comply with applicable policies, legislation, and regulations. Reputational risk is most effectively managed when every individual works continuously to protect and enhance our reputation.