2012

FIRST MERCHANT BANK LTD.
ANNUAL REPORT

contents

Financial Statements:

Board of Directors

1 Rasik C. Kantaria (Chairman)

Mr Kantaria has a BSc in Economics and is Chairman of Prime Bank Ltd., Kenya and Managing Director of Prime Capital and Credit Ltd., Kenya and also holds directorates in a number of other sectors of the Kenya economy, principally property and tourism.

3 John M. O'Neill (Executive Director)

Mr O'Neill has a BSc in Mathematics and Management Sciences and is a qualified chartered accountant with membership of the relevant institutes in Ireland and Malawi. Mr O'Neill's previous experience includes a career of 17 years with the international accountancy firm Deloitte, in the UK and Malawi, including 6 years as a partner in its Malawi practice.

2 Hitesh Anadkat (Vice Chairman)

Mr Anadkat holds an MBA from Cornell University and a B.Sc Economics (Hons) from the University of London and prior to returning to Malawi to establish First Merchant Bank he worked in a corporate finance house in USA specializing in mergers, acquisitions and valuations. He also holds directorates in a number of other sectors of the Malawi economy, principally telecommunication, manufacturing and property development.

4 N. G. Anadkat (Director)

Mr Anadkat is a well respected and long established business man in Malawi where he has been in business for over 40 years.

5 Modecai Msisha SC (Director)

Mr. Msisha SC is a legal practitioner and Commissioner of Oaths. He is qualified with Bachelor of Laws and Master of Laws (Toronto) and has practised and lectured law since 1975. He has been a partner in Nyirenda and Msisha Law Offices since 1990 and was appointed as Senior Counsel in 1997. He has served in various prominent roles in special legal assignments and commissions of national importance.

6 Bharat Jani (Director)

Mr Jani was appointed as the CEO of Prime Bank on 25th October 2008 after having served in the position of General Manager for a period of five years. Mr Jani is a qualified, experienced and result oriented banker holding a post graduate degree in Commerce with specialization in Accountancy & Economics. In addition Mr Jani holds a professional qualification in Banking & Financial Management and has vast experience of over 30 years in international banking.

7 Stewart Malata (Director)

Mr Malata holds Master's Degree in Accounting and Finance and has held senior positions in MDC Ltd., Admarc Investment Holding Company Ltd., and Smallholder Farmers Fertilizer Revolving Fund. He serves on the boards of numerous companies in Malawi including the listed companies, Illovo Sugar Malawi Ltd., and Malawi Property Investment Company Ltd.

Management Team

1 **Lucas Kondowe**
General Manager

2 **Dheeraj Dikshit**
Managing Director

3 **Thomas Kadantot**
General Manager

Ravindra Bajaj
Chief Commercial Officer

Mani Verma
Chief Operations Officer

Agnes Jazza
Chief Risk Officer

Prescott Nkhata
Head of Human Resources

Devendar Kuragayala
Head of I.T.

Sylvia Mataka
Head of Marketing

Siza Makwakwa
Head of Operations

Lee Mulele
Head of Internal Audit

Daniel Mangwela
Legal Counsel

Chairman's Report

The group financial performance in 2012 was again very satisfactory, especially considering the many challenges posed as a result of the major microeconomic policy reforms implemented by Government during the year.

In a very competitive market, strong balance sheet growth was achieved and overall net interest margins maintained without compromising compliance with prudential liquidity and capital adequacy requirements.

Non funded income growth was broad based with the main driver being increased foreign exchange trading volumes. Although inflationary pressures led to higher levels of operating expenditure, a much higher level of growth in total operating income saw our cost to income ratio reduced from 55% to 46%. After provisions for impairment and taxation, group profit for the year was 70% higher than the previous year and earnings per share attributable to ordinary shareholders increased by 82.5% from 80 tambala to 146 tambala.

Following a dilution of our holding from 53.70% to 38.60% the status of our investment in Capital Bank Limited changed from subsidiary to associated company and, accordingly, its assets and liabilities are not included in the 2013 consolidated statements of financial position.

Economic Overview

By the beginning of 2012, Malawi was facing serious economic problems. Burgeoning fiscal deficits, peaking at 7.3% of gross domestic products for the 2011/2012 fiscal year, were being financed primarily by domestic borrowing fuelling growth in money supply well in excess of 30% per annum.

The adherence of the previous government to fixed exchange rate policy while allowing the monetary base to grow dramatically greatly exacerbated the historic foreign exchange demand/supply imbalance leading to widening current account deficit, severe foreign exchange shortages and build up of an enormous backlog of unpaid foreign liabilities.

The country's Extended Credit Facility programme with the IMF had already been suspended in 2011 and as a result of this and a number of other disagreements with development partners, most bilateral and multilateral aid inflows were discontinued. This also had a significant impact on the negative fiscal outturn, the increased level of Government borrowing and the acute foreign exchange crisis.

Following a change of government in the second quarter of 2012 there was a radical shift in government macroeconomic policy with major reforms including liberalisation of the foreign exchange market, removal of price controls/ subsidies on fuel and utilities and the adoption of an austerity budget under which Government undertook not to resort to increased domestic borrowing in the 2012 /2013 fiscal year.

The IMF responded positively to the policy reforms and, in July 2012, approved a new US$156 Million Extended Credit Facility Arrangement for Malawi. The country's historic bilateral and multilateral development partners also pledged and commenced disbursement of significant amounts of assistance to the economy. However, progress towards macroeconomic stability has been somewhat slower than anticipated as the extent of the economic contraction and structural imbalances arising from previous policies became more apparent.

The Kwacha depreciated sharply upon liberalisation and then continued to lose value over the remainder of the year. Inflows in the form of donor support, though significant, were insufficient to compensate for the reduced export earnings from one of the worst tobacco crops on record. Between flotation of the currency and year end the Kwacha value declined from US Cents 0.60 to US Cents 0.27 equivalent.

The inflation rate, which had remained artificially subdued for a number of years, soured to beyond 30% year on year due to a number of factors including introduction of market determined exchange rates for imports, removal of subsidies and a contraction in national maize production leading to increased prices for the staple food.

The monetary authorities sought to control money supply growth in order to dampen inflationary pressures and reduced demand for foreign currency. Over the course of the year there were three successive increases (from 13% to 16% then 18% and another 25%) in the benchmark bank accommodation rate and money market yields and commercial bank lending rates spiraled upwards in response.

Financial sector liquidity came under severe pressure as a result of settlement of significant arrears of foreign liabilities built up over the period of the implicit currency peg. To counter possible systemic risk to the banking sector Reserve Bank of Malawi availed an unsecured accommodation window to those institutions otherwise unable to meet prudential reserve requirements. Unfortunately this accommodation negated to an extent the impact of other measures to contract money supply growth.

After several downgrades over the course of the year, the latest official estimates of 2012 real economic growth is 1.9% but it would not be surprising to see a further downward. A 3% contraction in the key agricultural sector of the economy is the main reason for the disappointing economic growth.

2012 maize production, initially estimated to be 7% lower than the prior year may actually have been even lower than this given the extent of food shortages emerging over the post harvest lean season. Production of the major export crop, tobacco, plummeted to below 90,000 tonnes from 237,000 tonnes produced in 2011. 2012 was the lowest tobacco crop in more than two decades.

The manufacturing sector contracted by significant 6.4% in 2012 as it was severely hampered by fuel and foreign exchange shortages in the earlier part of the year and then lower levels of agro-processing activities due to the reduced agricultural output, manufacturing now contributes little more than 10% of national gross domestic product.

Performance of other economic sectors was mixed. Growth in wholesale and retail trade and accommodation and food services was, as expected, marginal while the construction and information and communication sectors enjoyed double digit growth attributable respectively to a greenfield rail project and a significant increase in telephone penetration and usage of data services. Mining, with a compound annual growth rate less than 4% over 2011 and 2012 remains a relatively insignificant contributor of less than 3% of national output.

Group Performance

Key highlights of the 2012 group performance were:

- 32% growth in total Malawi assets from K41 billion to K54 billion.
- 80% growth in profit attributable to shareholders from K1.9 billion to K3.46 billion.
- 41% growth in shareholders equity from K8.6 billion to K12.1 billion.

Despite the highly competitive market, the customer base of FMB grew by over 60% with current and savings accounts and foreign currency accounts being the main growth drivers. Our subsidiary Leasing and Finance Company of Malawi Limited which, because of the nature of its business, is highly dependent on the more volatile wholesale deposit market saw a sharp fall in the level of its liabilities to customers.

Following liberalisation of foreign exchange market, there was noticeable increase in the level of utilisation of approved credit lines but an overall credit to deposit ratio was contained at a prudent level of 70%. The worsening general economic conditions led to higher than normal proportion of nonperforming assets within our advances portfolio. We have deemed it prudent to create a substantial impairment provision of K447 million against accounts where recovery in the normal course of business may be doubtful.

The group remains highly liquid with investments in low risk money market instruments, bank and cash totaling K18.8 billion at year end representing coverage of more than 50% of our liabilities to customers.
Although lending rates increased significantly over the second half of the year, our decision to maintain a large proportion of our assets in lower risk, lower yielding instruments has meant that net interest margin overall has remained broadly in line with prior years.

Growth in non interest income from K2.3 billion to K4.6 billion was broad based with the main driver being increased foreign exchange trading volumes. Our equity investment portfolio also performed well yielding a return of K0.56 billion, equivalent to just over 20% after tax profit for the year.

Inflationary pressures led to a significant increase in operating expenditure, in particular staff and training costs which increased by 58% as opposed to a 35% year on year increase in other components of operating expenditure. However the increase in the level of operating income was relatively greater than the overall cost increases with the results that overall group cost to income ratio has fallen from 54% to 46%.

Profits for the year attributable to shareholders were K3.42billion of which K0.75 billion was distributed by way of dividend to shareholders with the balance retained to grow our capital base. The Group's equity was further augmented by a net surplus of approximately K1 billion arising from a revaluation of the group property portfolio.

Corporate Social Responsibility

In recognition of its responsibility as a corporate citizen, FMB remains committed to social investment through the advancement of health, education, sports and environmental issues. Particular encouragement is given to branch and agency initiatives in the communities served by the bank.

On the health front, in 2012 FMB made major contributions to Malawi Blood Transfusion Services (MBTS) towards blood bags needed during blood drive initiatives and to Operation Smile through the Rotary Club of Lilongwe for reconstructive cleft lip surgery for over 150 beneficiaries.

Sponsorship of different sporting activities still remains a priority and to underscore its commitment, FMB substantially increased the sponsorship of the Under-20 Youth Football League to ensure participation of more districts at grass root level. Minority sports such as rugby, cricket and hockey were also sponsored in the course of the year.

Over 70 students identified by their respective educational institutions by virtue of both need and ability to excel in their studies continue to benefit from scholarships awarded for both high school and tertiary education.

In compliance with the requirements stipulated by the Malawi Stock Exchange a separate statement is included in this report with regard to corporate governance.

Human Resources

During the year, we successfully and fully implemented the revised performance management system that led to alignment of individual and company objectives and goals as enshrined in the group's performance management policy. Our pay for performance remuneration philosophy was also fully operationalised at both employee and management levels.

We continued to invest in our people by channelling considerable financial resources towards incentivizing staff in business roles in order to enhance their performance and achievement of organizational goals.

In line with our agenda on people management, we continued to foster harmonious work relationships with our people by entering into a formal union agreement with staff. This has established a strong foundation for cordial and positive employee and employer relationship which is key to achievement of organisation objectives.

We also focused our energies on staff training and development and encouraged personal growth of our people and supported them in mapping their career in the group.

In the year 2013, we look forward to consolidating the groups' pay for performance culture across the bank through staff reward and recognition programs aimed at recognizing and rewarding exceptional individual contribution to group success.

We also anticipate implementation of comprehensive leadership development programs that prepare our key people for higher responsibilities within the group.

Outlook

It is expected that economic output will recover in 2013 and relatively high overall growth rate shall be achievable. Sectoral performance will however be mixed with the key growth driver being a reversal of the downturn in agricultural output in 2012.

A generally satisfactory rainfall pattern was experienced over most areas of the country and overall maize production in excess of national consumption requirements is anticipated. Although reduced area has been planted with cotton, it is likely that this is mainly attributable to non planting by more marginal, less productive farmers and the overall cotton crop should be close to last year's all time record seed cotton production of just short of 10,000 tonnes. The outturn from cotton should also benefit from a slight firming in world cotton prices.

The 2013 burley tobacco crop is officially estimated to come in around 135,000 tonnes, more than double the 2012 production and some industry players anticipate a crop as high as 130,000 tonnes. Tobacco farmers have responded positively to the better dollar prices achieved last year and also to a much more favourable Kwacha / US Dollar exchange rate. Prices should remain firm with leaf of a higher nicotine content being in particular demand. Production of other tobacco types principally Virginia will not be significantly different from prior years at around 20,000 tonnes and good prices are also expected for these tobacco varieties.

The manufacturing sector is also expected to return to positive growth territory, partly due to availability of fuel and forex and marginally improved utility services but mainly due to a much higher level of agro-processing activity. Transport and storage will also benefit from increased crop volumes.

Construction and mining and quarrying sector growth should remain robust throughout the period of construction of Malawi section of Tete to Nacala rail line. On the downside the erosion of consumer purchasing power due prevailing high inflation rates will have negative implications for the rate of growth of these sectors more dependent on discretionary spending such as wholesale and retail trade, information and communication and real estate.

Inflationary pressures are likely to persist in 2013 but may moderate somewhat as food prices decline following a satisfactory maize harvest. However a recent public sector pay award is likely to have some inflationary impact. The average year on year inflation for 2013 is now officially forecast in the region of 20% per annum.

It will be an enormous challenge for government to maintain its commitment to not resort to domestic borrowing to finance budgetary operations though into the 2013/2014 fiscal year. Payment arrears inherited from its predecessor government have not yet been fully addressed, the extent of the public sector pay award was not budgeted for and from June 2011, government will be required to contribute to the National Pension Fund for all its employees. In addition to this, the next national elections are scheduled to take place in May 2014 and will, unless funded to significant extent by donors, place a further strain on the resource envelope.

Demand for foreign exchange continues to exceed available supply and foreign exchange reserves have dwindled to below one month of import cover. The Kwacha has continued to depreciate in value over the early part of 2013 though some price elasticity of demand is now emerging. With realisation from tobacco crop expected to recover to historic levels, there should be increased availability of foreign exchange in the market in the second and third quarters of 2013 but the currency may come under increased pressure once again towards the end of the year.

Against this background, the monetary authorities will likely maintain policies aimed at curbing money supply growth. Expectations are that banking sector liquidity will remain tight, current high interest rates will endure for some time and financial institutions will be obliged to continue to compete aggressively for customer deposits.

We expect nevertheless continued balance sheet growth in 2013. Although demand for credit will remain due to the illiquidity of the market, we are cognisant of the enhanced credit risks in the current economic environment and will manage our growth conservatively. The long term interest of all our stakeholders takes precedence over short term margin opportunities. Growth and diversifications of both our funded and non funded income bases and cost containment in an inflationary environment are the critical elements of our forward plan to grow shareholders value.

Acknowledgements

Our customers are the foundation on which the group's success is built and I wish, firstly to thank them all for their valued support. My thanks go also to our colleagues in the industry, both domestic, financial institutions and overseas correspondents, for their continued co-operation. I also wish to record my appreciation of the support and guidance received from Reserve Bank of Malawi and Bank of Botswana.

In conclusion, I express my gratitude to my fellow directors, management and staff for their hard work and dedication throughout the year.

R.C. Kantaria
Chairman

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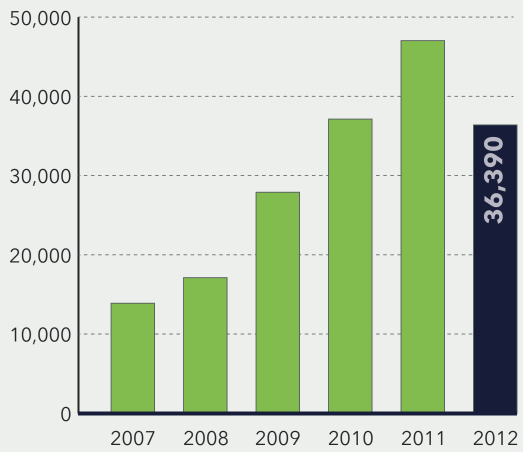
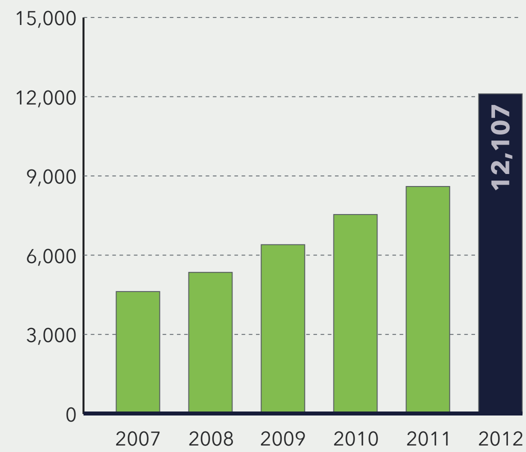
Financial Performance Highlights

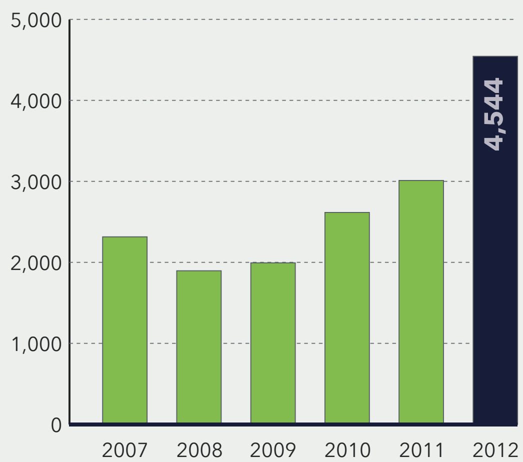
Deposits (MK million)



Shareholders' funds (MK million)

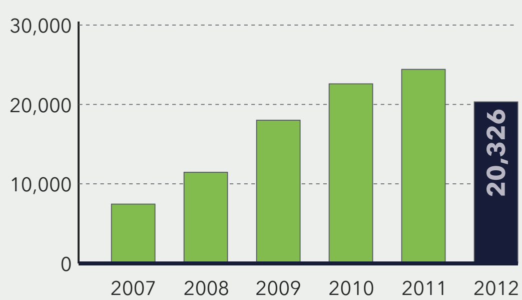


Profit before tax (MK million)



Profit after tax (MK million)

Loans and advances (MK million)



successful business partnerships

HELPING MALAWIAN BUSINESSES GROW

Our good credit quality and strong capital and liquidity levels, not only safeguard us, but also position us to take advantage of the future while helping businesses grow. **This is done by our team of Business Drivers.**

BUSINESS DRIVERS

Ewen Hiwa
Head Retail Sales

Kenneth Musonzo
Regional Commercial Manager
Lilongwe Cluster

Emily Banda
Regional Commercial Manager
Blantyre Cluster

Henry Kamowa
Regional Commercial Manager
Limbe Cluster

Joyce Nyirenda
Regional Commercial Manager
Capital City Cluster

Leman Chisi
Regional Commercial Manager
Mzuzu Cluster

Nelson Njikho
Programme Manager -
Makwacha

Lexah Msowoya
Regional Corporate Manager -
South

Joseph Chavula
Regional Corporate Manager -
Central & North

Tasokwa Mchawe
Head Corporate Sales &
Wholesale Deposits

Business Partnerships


Universal Industries

Over the years FMB has helped many Malawian businesses grow through affordable financial products.


The new Zokoma Plant


Mota Engil

generating positive growth and success


Work in progress at the Nacala Railway corridor


Maxi Eggs


Enhancing food production

Lujeri Tea Estate

Forging ahead in the export industry

supporting businesses of national importance

Bakhresa

Another success story in export products

Leasing & Finance Company (LFC)

LFC's product range fulfills our customers' needs across many industry sectors in Malawi. We adopt a flexible approach and seek to design and tailor our products and services to meet the requirements of our customers.

Bessie Sambo
Deputy General Manager

Alex Chigwale
General Manager

Jolly Longwe
Head of Finance

Ron Nkomba
Director

Although the company provides a wide range of products, asset finance remains its core business.

Rashy Motors is one of the success stories in the LFC business partnerships.

connecting **economies**

Capital Bank, Botswana

Mogoditshane Branch of the bank

Senior Management team of the bank

Sitting from left to right: S. Ramamoorthy, Keone Kehatlhilwe, Kgomotso Tshimologo, Sharad Agarwal

Standing left to right: Goitseone Moshabela, Taka Nyahunzvi. Anil Bholla, Ebson Mushininga, Vilipo Munthali, Sriram Gade

Capital Bank commenced commercial operations in Botswana on 7th July 2008. Currently, the bank has four branches at Gaborone, Francistown, Broadhurst and Mogoditshane. The Bank offers all types of commercial banking products like deposits, loans, overdrafts, guarantees, and foreign exchange remittances among others.

With a team that's technologically savvy, Capital Bank offers services like Internet Banking, VISA Electron debit cards, E-statements, SMS/Email Alerts, Corporate Payroll, sweep-in sweep-out between current and call accounts.

The bank is a direct member of Electronic Clearing House (ECH) and Real Time Gross Settlement (RTGS) system. It has also correspondent relationships with leading international banks.

The Bank strives to achieve highest standards of customer service and corporate governance.

www.capitalbank.co.bw

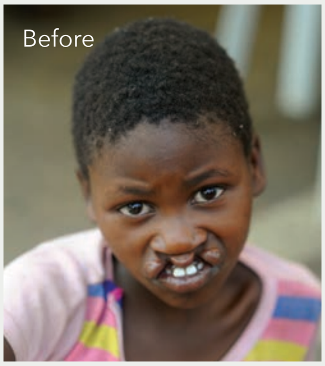
corporate social responsibility

SUPPORTING THE COMMUNITIES WE SERVE

Ball boys at FMB U20 Youth football league championships

In Malawi there is a reported rate for cleft lip of

7 per 1,000 live births



Before

FMB Social Football Team - taking time to play

After

A timely donation of blood bags to Malawi Blood Transfusion Services (MBTS) - *(November 2012)*

Over 150 beneficiaries benefited from FMB's donation to Operation Smile for cleft lip reconstructive surgery.

Supporting emerging minority sports - Leslie Sevens Rugby Tournament Winners (*May 2012*)

FMB Ball Pool Golf Competition - FMB team getting ready to tee off.

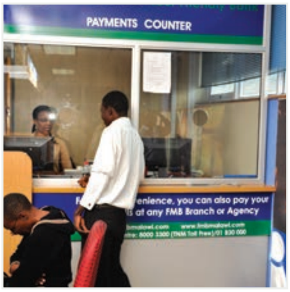
Siphetheni Sigauke, lady winner of the FMB ball pool golf competition

Supporting tertiary education - Scholarships Mzuzu University

Donation of computers to Healing Hope Missions International – *(April 2012)*

Beneficiaries of the computers

Director's Report



The Directors have pleasure in submitting their report together with the audited Consolidated and Separate Financial Statements of First Merchant Bank Limited for the year ended 31 December 2012.

Nature of Business, Incorporation and Registered Office

First Merchant Bank Limited is a public limited liability company incorporated in Malawi under the Malawi Companies Act, 1984. It is listed on the Malawi Stock Exchange and is registered as a commercial bank under the Banking Act 1989. It has three wholly owned subsidiaries incorporated in Malawi, The Leasing and Finance Company of Malawi Limited, a licensed Financial Institution engaged in deposit taking and asset finance, FMB Pensions Limited, a company administering pension funds and FMB Forex Bureau Limited, a licensed foreign exchange bureau. First Merchant Bank Limited also holds a 38.60% (2011: 53.76%) shareholding in Capital Bank Limited, a licensed commercial bank incorporated in Botswana.

The physical address of the holding company's registered office is:-

Livingstone Towers, Private Bag 122,
Glyn Jones Road, Blantyre, Malawi.

Financial Performance

The results and state of affairs of the Group and Company are set out in the accompanying statements of financial position, statements of comprehensive income, statements of changes in equity, statements of cash flows and associated accounting policies and notes.

Dividends

Last year's second interim dividend of **MK116.813 million** (5 tambala per share) and final dividend of **MK46.725 million** (2 tambala per share) were paid during the year. An interim dividend for the year 2012 of **MK817.688 million** (35 tambala per share) was paid during the year and a second interim dividend of **MK233.625 million** (10 tambala per share) was declared and will be paid in April 2013. The Directors also propose a final dividend of **K116.813 million** (5 tambala per share) for approval at the Forthcoming Annual General Meeting.

Directorate and Secretary

The following Directors and Secretary served during the year:

Mr. R.C. Kantaria	Chairman – Non Executive	Throughout the year
Mr. H.N. Anadkat	Vice Chairman – Non Executive	Throughout the year
Mr. D. Dikshit	Managing Director	From 5th October 2012
Mr. J.M. O'Neill	Executive Director	Throughout the year
Mr. N.G. Anadkat	Director – Non Executive	Throughout the year
Mr. B. Jani	Director – Non Executive	Throughout the year
Mr. M. Msisha	Director – Non Executive	Throughout the year
Mr. S.G. Malata	Director – Non Executive	Throughout the year
Mr. C. Chuka	Director – Non Executive	To 24th April 2012
Mr. L. Kondowe	Acting Company Secretary	From 5th October 2012

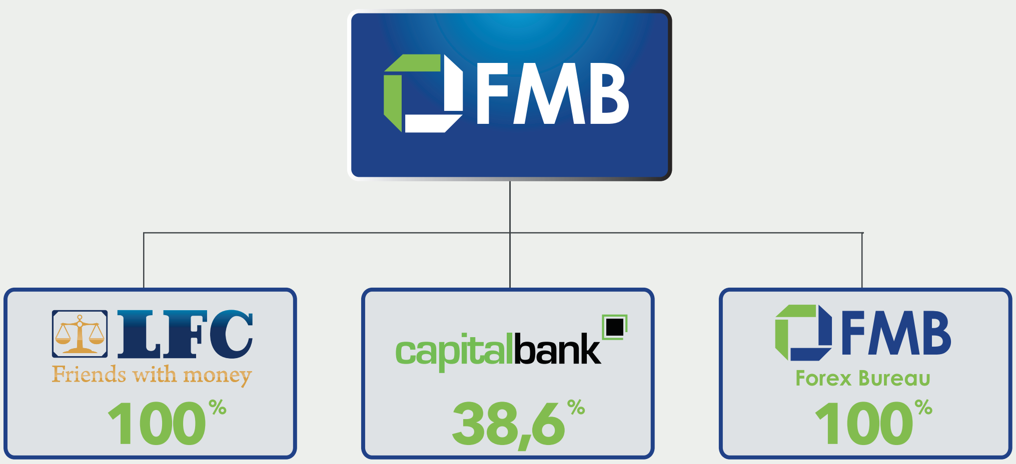
In accordance with the Company's Articles of Association, Messrs J.M O'Neill and B. Jani retired by rotation at the last Annual General Meeting on 15 June 2012 and were reappointed. Messrs M. Msisha and N.G Anadkat retire at the forthcoming Annual General Meeting but being eligible for re-appointment they offer themselves for re-election.

Members are also being requested to confirm the appointment of Mr. Dheeraj Dikshit who was appointed as Managing Director from 5 October 2012.

Shareholding Analysis

Name	2012	2011
	(%)	(%)
Zambezi Investments Limited	**44.94**	44.94
Simsbury Holdings Limited	**22.69**	22.69
Prime Capital and Credit Limited	**11.24**	11.24
Prime Bank Limited	**11.24**	11.24
General Public	**9.89**	9.89
	100.00	100.00

FMB GROUP STRUCTURE



AUDITORS

A resolution will be proposed at the forthcoming Annual General Meeting to re-appoint Messrs. KPMG, Certified Public Accountants and Business Advisors (Malawi) as auditors in respect of the Company's 31 December 2013 financial statements.

…………………………………	…………………………………
Mr. Dheeraj Dikshit	**M. Msisha**
MANAGING DIRECTOR	**DIRECTOR**

22 March 2013

FMB Head Office, Blantyre.

Statement on Corporate Governance

THE BOARD

The Bank has a unitary Board of Directors comprising a Non-Executive Chairman, 7 Non-Executive Directors and 2 Executive Directors. The Board has adopted without modification the major principles of modern corporate governance as contained in the reports of Cadbury and King II, and the Basel Committee on Banking Supervision.

The Board meets 4 times a year. There are adequate and efficient communication and monitoring systems in place to ensure that the Directors receive all relevant, accurate information to guide them in making necessary strategic decisions, and providing effective leadership, control and strategic direction over the Bank's operations, and in ensuring that the company fully complies with relevant legal, ethical and regulatory requirements.

Board meetings - Meeting Attendance

Member	21 Mar- 2012	13 Apr-2012	5 Oct- 2012	13 Dec- 2012
Mr. R.C. Kantaria - Chairman	√	√	√	x
Mr. H.N. Anadkat - Vice Chairman	√	√	√	√
Mr. D. Dikshit – Managing Director	N/A	N/A	√	√
Mr. J.M. O'Neill	√	√	√	√
Mr. N.G. Anadkat	√	√	√	√
Mr. M. Msisha	√	√	√	√
Mr. S.G. Malata	√	x	x	√
Mr. B. Jani	x	√	√	x
Mr. C. Chuka	√	√	N/A	N/A

Key
√ = Attendance
x = Apology
N/A= Not Applicable

Mr. D. Dikshit was appointed as Managing Director effective 5 October 2012.
Mr. C. Chuka resigned from the board on 24 April 2012 after his appointment as Governor of Reserve Bank of Malawi.

Board and Management Committees

There is one permanent management committee namely, the Asset and Liability Management Committee ("ALCO"), four permanent board committees, the Audit Committee, Credit Committee, the Appointments and Remuneration Committee and a Risk Committee comprising both Directors and senior management. Additionally, there is an informal Business Promotion Committee which comprises branch managers, senior management, 2 Non-Executive Directors and 1 Executive Director. This Committee meets regularly, usually once a month, and reviews the Bank's market position relative to its peers and sets operational strategy to maintain and grow market share.

Asset and Liability Management Committee (ALCO)

The primary objective of the ALCO is to ensure a proper balance in terms of maturity profile, cost and yield, risk exposure etc. between funds mobilized and funds deployed. The ALCO seeks to manage risks in order to minimize the volatility of net interest income and protect the long term economic value of the Bank. The committee also monitors the capital adequacy of the Bank.

Key functions of the ALCO include setting pricing guidelines for assets and liabilities, setting limits and managing liquidity risk and interest rate risk and ensuring that contingency funding plans are in place to avert funding crises. The ALCO is composed of Managing Director and 6 members of management and meets regularly, usually once a month. The members of the ALCO are:

Mr. L. Kondowe	General Manager
Mr. D Dikshit	Managing Director
Mr. T. Kadantot	General Manager
Miss. A. Jazza	Chief Risk Officer
Mr. M. Kadumbo	Manager, Financial Control
Ms. M. Nyasulu	Manager, Treasury
Ms. C. Chirwa	Manager, Risk and Compliance

Audit Committee

The Audit Committee assists the Board in discharging its duties in relation to financial reporting, asset management, risk management, internal control systems, processes and procedures and monitors the quality of both the external and internal audit functions. The Bank's External Auditors and Internal Auditors report to the committee in their independent, private meetings to discuss risk exposure areas. Where the committee's monitoring and review activities reveal causes for concern or scope for improvement, it makes recommendations to the Board on required remedial actions.

The Audit Committee comprises 3 non-executive Directors, 1 of whom acts as Chairman. The committee meets at least twice a year. The members of the Audit Committee are:

Mr M. Msisha	Non-Executive Director (Chairman)
Mr B. Jani	Non-Executive Director
Mr S.G. Malata	Non-Executive Director

Members	21 March 2012	9 October 2012
Mr. M. Msisha - Chairman	√	√
Mr. S.G. Malata	√	√
Mr B.Jani	x	x

Key
√ = Attendance
x = Apology
N/A= Not Applicable

Credit Committee

The Credit Committee comprises 3 local Directors with a good knowledge of the Malawi economy and business environment. Its overall responsibility is to ensure the soundness of the Bank's credit portfolio (including advances, guarantees and other facilities). Specific responsibilities include:

- Ratification of terms and conditions of all credit facilities granted by management under its discretionary powers;
- Approval of all credit facilities above the discretionary limits set for management save for those facilities requiring full board approval in accordance with Reserve Bank of Malawi directives; and
- Review of non-performing assets and recovery procedures initiated in respect thereof and establishment of appropriate levels of provisioning where required.

The Managing Director, Chief Risk Officer and Branch Managers attend all Credit Committee meetings in a non-voting capacity. The Credit Committee meets regularly, usually twice a quarter and comprises the following members:

Members	25 April 2012	17 May 2012	27 June 2012
Mr. H. N. Anadkat - Chairman	√	√	√
Mr. J.M O'Neill	√	√	√
Mr. N.G. Anadkat	X	√	x

Members	19 July 2012	23 August 2012	22 September 2012
Mr. H. N. Anadkat - Chairman	√	x	√
Mr. J.M O'Neill	√	√	√
Mr. N.G. Anadkat	X	√	√

Members	24 October 2012	23 November 2012
Mr. H. N. Anadkat - Chairman	√	√
Mr. J.M O'Neill	X	√
Mr. N.G. Anadkat	√	√

Key:
√=Attendance
x=Apology

Appointments and Remuneration Committee

The Appointments and Remuneration Committee nominates persons to be appointed Directors (subject to shareholders' approval) and recommends to the Board, Executive and Non-Executive Directors and senior management remuneration.

The Committee also approves overall human resource and remuneration policies and strategies. The Appointments and Remuneration Committee meets twice a year and comprises the following members:-

Member	11 April 2012	9 October 2012
Mr H. N. Anadkat -Chairman	√	√
Mr M. Msisha	√	√

Key:
√=Attendance
x=Apology

Risk Committee

The Risk Committee assists the board in relation to assessing, controlling and mitigating business risks. The committee identifies risks facing the bank and recommends controls to the Board.

The Risk Committee comprise of one non-executive director, who is chairman of the committee and one non-executive director and the Managing Director, General Manager, Risk and Compliance Manager. The members of committee are:-

Mr. S. Malata	Non-Executive Director (Chairman)
Mr B. Jani	Non-Executive Director
Mr. J.M O'Neill	Executive Director

Risk Committee

Member	12 April 2012	5 October 2012
Mr. S. Malata - Chairman	√	√
Mr. B Jani	√	√
Mr. J.M. O'Neill	√	√

Key:
√=Attendance
x=Apology

Ethical Standards

The Board is fully committed to ensuring the Group's affairs are conducted with integrity and that the highest ethical standards are maintained. All employees of the Group are required to abide by a code of conduct containing detailed guidelines governing ethics and integrity in the workplace.

FMB Head Office, Board Room.

Director's Responsibility Statement

The Directors are responsible for the preparation and fair presentation of the annual financial statements of First Merchant Bank Limited and its subsidiaries, comprising the statements of financial position, the statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and the notes to the financial statements, which include a summary of significant accounting policies and other explanatory notes, and the directors' report, in accordance with International Financial Reporting Standards, and in the manner required by the Malawi Companies Act, 1984.

The Act also requires the directors to ensure that the Company keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and ensure the financial statements comply with the Malawi Companies Act, 1984.

In preparing the financial statements, the directors accept responsibility for the following:-

- Maintenance of proper accounting records;
- Selection of suitable accounting policies and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Compliance with applicable accounting standards, when preparing financial statements, subject to any material departures being disclosed and explained in the financial statements; and
- Preparation of financial statements on a going concern basis unless it is inappropriate to presume the company will continue in business.

The directors are also responsible for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error and for maintaining adequate accounting records and an effective system of risk management.

The Directors' responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of these financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

The Directors have made an assessment of the Bank's ability to continue as a going concern and have a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

The auditor is responsible for reporting on whether the annual financial statements are fairly presented in accordance with applicable financial reporting framework.

Approval of financial statements

The financial statements of the Bank, as indicated above, were approved by the Board of Directors on **21 February 2013** and are signed on its behalf by.

By order of the Board

Mr. Dheeraj Dikshit Managing Director

Mr M. Msisha Director

Independent Auditors' Report to the Shareholders of First Merchant Bank Limited

Report on the financial statements

We have audited the accompanying consolidated and separate financial statements of First Merchant Bank Limited and its subsidiaries, which comprise the statements of financial position as at 31 December 2012, the statements of comprehensive income, the statements of changes in equity and statements of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 41 to 123.

Directors' responsibility for the financial statements

The company's directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in a manner required by the Malawi Companies Act 1984 and for such controls as the directors determine are necessary to enable the preparation of financial statements that are free from material misstatements 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 the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control systems relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control systems. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the company as at 31 December 2012, and of its consolidated financial performance and its consolidated cashflows for the year then ended in accordance with International Financial Reporting Standards and the provisions of the Malawi Companies Act 1984, so far as concerns members of the company.

KPMG
cutting through complexity™
Certified Public Accountants and Business Advisors
Blantyre

KPMG.

21 February 2013

Consolidated and Separate Financial Statements

For the year ended 31 December 2012

STATEMENTS OF FINANCIAL POSITION

In thousands of Malawi Kwacha

	Note	Group 2012	Group 2011	Company 2012	Company 2011
ASSETS					
Cash and cash equivalents	7	15,962,215	13,938,583	15,593,573	6,453,389
Money market investments	8	2,878,008	10,291,645	2,674,726	2,349,453
Loans and advances to customers	9	20,325,685	24,421,580	20,567,475	15,407,652
Finance lease receivables	10	5,354,608	5,308,046	-	-
Other assets	11	634,591	533,833	621,602	531,141
Amounts due from subsidiaries and associate company	12	-	-	194,650	82,342
Investments in listed companies	13	2,488,253	2,128,795	2,488,253	2,128,795
Investment in subsidiaries	14	-	-	75,911	785,968
Investment in associate	15	1,067,956	-	903,854	-
Property and equipment	16	4,312,255	3,297,374	4,149,262	2,609,967
Total assets		**53,023,571**	**59,919,856**	**47,269,306**	**30,348,707**
LIABILITIES AND EQUITY					
Liabilities					
Customer deposits	18	36,390,079	47,027,658	32,387,874	19,954,221
Balances due to other banks	19	1,975,643	1,466,070	1,975,643	1,466,070
Income tax payable		467,371	180,943	426,361	45,208
Other liabilities	20	1,573,785	1,605,797	1,499,437	1,329,040
Employee benefits liabilities	21	28,041	59,149	28,041	59,149
Deferred tax liabilities	17	482,064	240,909	451,141	217,872
Total liabilities		**40,916,983**	**50,580,526**	**36,768,497**	**23,071,560**
Equity					
Issued capital	22	116,813	116,813	116,813	116,813
Share premium	22	1,565,347	1,565,347	1,565,347	1,565,347
Property revaluation reserve	23	1,614,204	523,198	1,519,018	485,599
Investment revaluation reserve	24	1,827,528	1,381,407	1,688,085	1,381,407
Loan loss reserve	25	240,464	114,638	205,675	16,898
Non distributable reserves	26	350,000	350,000	-	-
Translation reserve		-	(44,187)	-	-
Retained earnings		6,392,232	4,593,039	5,405,871	3,711,083
Total equity attributable to equity holders of the Company		**12,106,588**	**8,600,255**	**10,500,809**	**7,277,147**
Non Controlling Interest		-	739,075	-	-
Total equity		12,106,588	9,339,330	10,500,809	7,277,147
Total equity and liabilities		**53,023,571**	**59,919,856**	**47,269,306**	**30,348,707**

The financial statements of the Group and Company were approved for issue by the Bank's Board of Directors on **21 February 2013** and were signed on its behalf by:

....................................Managing Director
D. Dikshit

....Director
M. Msisha

The financial statements are to be read in conjunction with the notes from pages 48 to 123.
The independent auditor's report is on page 37.

STATEMENTS OF COMPREHENSIVE INCOME

In thousands of Malawi Kwacha

	Note	Group		Company	
		2012	2011	2012	2011
Interest income	27	5,800,254	6,068,358	4,423,208	3,264,171
Interest expense on deposits and other accounts		(1,498,217)	(1,799,469)	(867,937)	(400,420)
Net interest income		**4,302,037**	**4,268,889**	**3,555,271**	**2,863,751**
Fees and commissions		2,248,814	1,245,391	2,259,912	1,041,784
Income from investments	28	546,656	354,609	803,301	479,609
Gain on foreign exchange transactions		1,872,418	752,859	1,872,418	661,719
Net trading income		**8,969,925**	**6,621,748**	**8,490,902**	**5,046,863**
Other operating income	29	28,273	83,923	264	12,584
Total operating income		**8,998,198**	**6,705,671**	**8,491,166**	**5,059,447**
Staff and training costs	30	2,130,817	1,586,407	2,021,966	1,273,043
Premises and equipment costs		543,794	535,613	543,794	479,808
Depreciation expense	16	396,434	400,689	383,178	318,042
Other expenses	31	1,099,669	1,083,487	1,004,991	827,235
Impairment loss on financial assets		447,077	88,823	303,286	26,044
Total expenses		**4,617,791**	**3,695,019**	**4,257,215**	**2,924,172**
Operating profit		**4,380,407**	**3,010,652**	**4,233,951**	**2,135,275**
Share of profit from associate	15	164,102	-	-	-
Profit before income tax expense		**4,544,509**	**3,010,652**	**4,233,951**	**2,135,275**
Income tax expense	32	(1,127,841)	(995,620)	(1,062,483)	(636,999)
PROFIT FOR THE YEAR		**3,416,668**	**2,015,032**	**3,171,468**	**1,498,276**
Other comprehensive income					
Revaluation surplus on property		1,361,727	-	1,280,400	-
Tax on other comprehensive income		(270,721)	5,986	(246,981)	7,056
Transfer to profit and loss on reclassification		(20,116)	-	-	-
Translation difference for foreign operations		-	(102,241)	-	-
Total other comprehensive income for the year		**1,070,890**	**(96,255)**	**1,033,419**	**7,056**
Total comprehensive income for the year		**4,487,558**	**1,918,777**	**4,204,887**	**1,505,332**
Profit attributable to:					
Owners of the parent		3,416,668	1,858,453	3,171,468	1,498,276
Non controlling interest		-	156,579	-	-
Profit for the year		**3,416,668**	**2,015,032**	**3,171,468**	**1,498,276**
Total comprehensive income attributable to:					
Owners of the parent		4,487,558	1,809,474	4,204,887	1,505,332
Non controlling interest		-	109,303	-	-
Total comprehensive income for the year		**4,487,558**	**1,918,777**	**4,204,887**	**1,505,332**
Basic and diluted earnings per share (tambala)	33	**146**	**80**		

The financial statements are to be read in conjunction with the notes from pages 48 to 123.
The independent auditor's report is on page 37.

sTATEMENTS OF CHANGES IN EQUITY
In thousands of Malawi Kwacha

GROUP	Share Capital	Share premium	Translation reserve	Property revaluation Reserve	Investment revaluation Reserve	Loan loss reserve	Non distributable reserve	Retained Earnings	Attributable to owners of the parent	Non controlling Interest	Total Equity
Balance at 1 January 2011	116,813	1,565,347	10,778	540,731	1,124,130	40,032	350,000	3,790,550	7,538,381	629,772	8,168,153
Total comprehensive income for the year											
Profit for the year	-	-	-	-	-	-	-	1,858,453	1,858,453	156,579	2,015,032
Other Comprehensive income											
Transfer from deferred tax	-	-	-	(1,070)	-	-	-	-	(1,070)	-	(1,070)
Arising on consolidation of subsidiary	-	-	(54,965)	-	-	-	-	-	(54,965)	(47,276)	(102,241)
Transfer from/to investment revaluation reserve	-	-	-	-	257,277	-	-	(257,277)	-	-	-
Depreciation on re-valued assets	-	-	-	(23,519)	-	-	-	23,519	-	-	-
Deferred tax on excess depreciation on revaluation	-	-	-	7,056	-	-	-	-	7,056	-	7,056
Movement in loan loss reserve	-	-	-	-	-	74,606		(74,606)	-	-	-
Total other comprehensive income	**-**	**-**	**(54,965)**	**(17,533)**	**257,277**	**74,606**	**-**	**(308,364)**	**(48,979)**	**(47,276)**	**(96,255)**
Total comprehensive income for the year	**-**	**-**	**(54,965)**	**(17,533)**	**257,277**	**74,606**	**-**	**1,550,089**	**1,809,474**	**109,303**	**1,918,777**
Transactions with owners, recorded directly in equity											
Contributions by and distributions to owners											
Dividends to owners of the parent	-	-	-	-	-	-	-	(747,600)	(747,600)	-	(747,600)
	-	-	-	-	-	-	-	(747,600)	(747,600)	-	(747,600)
Balance at 31 December 2011	**116,813**	**1,565,347**	**(44,187)**	**523,198**	**1,381,407**	**114,638**	**350,000**	**4,593,039**	**8,600,255**	**739,075**	**9,339,330**

The financial statements are to be read in conjunction with the notes from pages 48 to 123.
The independent auditor's report is on page 37.

STATEMENTS OF CHANGES IN EQUITY

In thousands of Malawi Kwacha

GROUP	Share Capital	Share premium	Translation reserve	Property revaluation Reserve	Investment revaluation Reserve	Loan loss reserve	Non distributable reserve	Retained Earnings	Attributable to owners of the parent	Non controlling Interest	Total Equity
Balance at 1 January 2012	116,813	1,565,347	(44,187)	523,198	1,381,407	114,638	350,000	4,593,039	8,600,255	739,075	9,339,330
Total comprehensive income for the year											
Profit for the year	-	-	-	-	-	-	-	3,416,668	3,416,668	-	3,416,668
Other Comprehensive income											
Deferred tax on property revaluation	-	-	-	(270,721)	-	-	-	-	(270,721)	-	(270,721)
Property revaluation	-	-	-	1,361,727	-	-	-	-	1,361,727	-	1,361,727
Transfer to investment revaluation	-	-	-		306,676	-	-	(306,676)	-	-	-
Transfer to loan loss reserve	-	-	-	-	-	190,129	-	(190,129)	-	-	-
Transfer to profit and loss on reclassification	-	-	44,187	-	-	(64,303)	-	-	(20,116)	-	(20,116)
Total other comprehensive income	-	-	44,187	1,091,006	306,676	125,826	-	(496,805)	1,070,890	-	1,070,890
Total comprehensive income for the year	-	-	44,187	1,091,006	306,676	125,826	-	2,919,863	4,487,558	-	4,487,558
Transactions with owners, recorded directly in equity											
Contributions by and distributions to owners											
Arising on loss of control in subsidiary	-	-	-	-	139,445	-	-	(139,445)	-	(739,075)	(739,075)
Dividends to owners of the parent	-	-	-	-	-	-	-	(981,225)	(981,225)	-	(981,225)
Total transaction with owners	-	-	-	-	139,445	-	-	(1,120,670)	(981,225)	(739,075)	(1,720,300)
Balance at 31 December 2012	116,813	1,565,347	-	1,614,204	1,827,528	240,464	350,000	6,392,232	12,106,588	-	12,106,588

The financial statements are to be read in conjunction with the notes from pages 48 to 123.
The independent auditor's report is on page 37.

STATEMENTS OF CHANGES IN EQUITY

In thousands of Malawi Kwacha

COMPANY	Share capital	Share premium	Property revaluation reserve	Investment revaluation reserve	Loan loss reserve	Retained Earnings	Total
Balance at 1 January 2011	116,813	1,565,347	502,062	1,124,130	16,898	3,194,165	6,519,415
Total comprehensive income for the year							
Profit for the year	-	-	-	-	-	1,498,276	1,498,276
Other comprehensive income							
Investment revaluation reserve	-	-	-	257,277	-	(257,277)	-
Depreciation on re valued asset	-	-	(23,519)	-		23,519	-
Deferred tax on property revaluation	-	-	7,056	-	-	-	7,056
Transfer from / to revaluation reserve	-	-	-	-	-	-	-
Total other comprehensive income	-	**-**	**(16,463)**	**257,277**	**-**	**(233,758)**	**7,056**
Total comprehensive income for the year	-	**-**	**(16,463)**	**257,277**	**-**	**1,264,518**	**1,505,332**
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Dividends paid	-	-	-	-	-	(747,600)	(747,600)
Balance at 31 December 2011	**116,813**	**1,565,347**	**485,599**	**1,381,407**	**16,898**	**3,711,083**	**7,277,147**

The financial statements are to be read in conjunction with the notes from pages 48 to 123.
The independent auditor's report is on page 37.

STATEMENTS OF CHANGES IN EQUITY

In thousands of Malawi Kwacha

COMPANY	Share capital	Share premium	Property revaluation reserve	Investment revaluation reserve	Loan loss reserve	Retained Earnings	Total
Balance at 1 January 2012	116,813	1,565,347	485,599	1,381,407	16,898	3,711,083	7,277,147
Total comprehensive income for the year							
Profit for the year	-	-	-	-	-	3,171,468	3,171,468
Other comprehensive income							
Deferred tax on property revaluation	-	-	(246,981)	-	-	-	(246,981)
Property revaluation	-	-	1,280,400	-	-	-	1,280,400
Transfer to profit and loss	-	-	-	-	188,777	(188,777)	-
Transfer to investment revaluation reserve	-	-	-	306,678	-	(306,678)	-
Total other comprehensive income	**-**	**-**	**1,033,419**	**306,678**	**188,777**	**(495,455)**	**1,033,419**
Total comprehensive income for the year	**-**	**-**	**1,033,419**	**306,678**	**188,777**	**2,676,031**	**4,204,887**
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Dividends paid	-	-	-	-	-	(981,225)	(981,225)
Balance at 31 December 2012	**116,813**	**1,565,347**	**1,519,018**	**1,688,085**	**205,675**	**5,405,871**	**10,500,809**

The financial statements are to be read in conjunction with the notes from pages 48 to 123.
The independent auditor's report is on page 37.

STATEMENTS OF CASH FLOWS

In thousands of Malawi Kwacha

	Note	GROUP 2012	GROUP 2011	COMPANY 2012	COMPANY 2011
CASH FLOWS FROM OPERATING ACTIVITIES					
Interest and fees received		9,905,986	8,150,531	8,510,179	4,975,290
Interest paid		(1,463,412)	(1,778,713)	(832,979)	(379,664)
Cash paid to suppliers and employees		(3,617,186)	(3,467,543)	(3,494,453)	(2,927,510)
		4,825,388	2,905,275	4,182,747	1,668,116
Net (decrease)/increase in customer balances		(971,630)	5,846,534	7,438,195	3,804873
Cash generated from operations		3,853,758	8,751,809	11,620,942	5,472,989
Income taxes paid		(883,093)	(1,144,216)	(695,042)	(755,766)
Net cash from operating activities		**2,970,665**	**7,607,593**	**10,925,900**	**4,717,223**
CASH FLOWS FROM/(USED IN) INVESTING ACTIVITIES					
Maturities/(Purchases) of money market investments		667,056	3,087,682	(325,273)	1,082,753
Proceeds from sale of shares and other investments	13	17,292	17,560	17,292	17,560
Purchase of shares in associate company	15	(7,869)	-	(7,869)	-
Proceeds from sale of equipment		264	2,423	264	385
Acquisition of property and equipment	16	(645,719)	(867,926)	(642,073)	(833,594)
Net dividend received from listed and subsidiary companies		70,345	97,896	220,345	222,896
Purchase of listed equity investments	13	(67,177)	(580,111)	(67,177)	(580,111)
Net cash from/ (used in) investing activities		**34,192**	**1,757,524**	**(804,491)**	**(90,111)**
CASH FLOWS TO FINANCING ACTIVITIES					
Dividend paid		(981,225)	(747,600)	(981,225)	(747,600)
Net cash used in financing activities		**(981,225)**	**(747,600)**	**(981,225)**	**(747,600)**
Net increase in cash and cash equivalents		2,023,632	8,617,517	9,140,184	3,879,512
Cash and cash equivalents at beginning of the year		13,938,583	5,321,066	6,453,389	2,573,877
Cash and cash equivalents at end of the year	**7**	**15,962,215**	**13,938,583**	**15,593,573**	**6,453,389**
ADDITIONAL STATUTORY DISCLOSURE					
Net movement in working capital		**2,630,119**	**1,514,892**	**3,250,624**	**744,864**

The financial statements are to be read in conjunction with the notes from pages 48 to 123.
The independent auditor's report is on page 37.

The net movement in the Group cash and cash equivalents for the year includes a net reduction of K3.605 billion in cash and cash equivalents arising as a result of the deconsolidation of Capital Bank Limited (Botswana) which from 1 January 2012 became an associated company

Notes to the Consolidated and Separate Financial Statements

1. Reporting Entity

First Merchant Bank Limited, the Bank, is a public limited liability company incorporated in Malawi under the Malawi Companies Act, 1984. It is listed on the Malawi Stock Exchange and is registered as a commercial bank under the Banking Act 2010. It has three wholly owned subsidiaries incorporated in Malawi, The Leasing and Finance Company of Malawi Limited, a licensed Financial Institution engaged in deposit taking and asset finance, FMB Pensions Limited, a company administering pension funds and FMB Forex Bureau Limited, a licensed foreign exchange bureau. First Merchant Bank Limited also holds a **38.60%** (2011:53.76%) shareholding in Capital Bank Limited, a licensed commercial bank incorporated in Botswana.

2. Basis of preparation

Where reference is made in the basis of preparation to Group it should be interpreted as being applied to the consolidated and separate financial statements as the context requires.

(i) Statement of compliance

The consolidated and separate financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and the provisions of the Malawi Companies Act, 1984, Banking Act 2010 and Financial Services Act 2010.

(ii) Basis of measurement

The consolidated and separate financial statements are prepared on the historical cost basis except for the following:

- land and buildings which are revalued;
- financial instruments at fair value through profit or loss are measured at fair value;
- available-for-sale financial assets are measured at fair value.

(iii) Functional and presentation currency

These consolidated and separate financial statements are presented in Malawi Kwacha, which is the Bank's functional and presentation currency. Except as indicated, financial information presented in Malawi Kwacha has been rounded to the nearest thousand.

2. Basis of preparation (continued)

(iv) Use of estimates and judgements

The preparation of financial statements in conformity with IFRSs require management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in the following notes.

- Note 9 - Loans and advances to customers - Impairment
- Note 10 - Finance leases - Impairment
- Note 16 - Depreciation of property and equipment
- Notes 8,12 - Fair value measurement

3. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2012, and have not been applied in preparing these financial statements:

- ***IFRS 7 Financial Instruments Disclosures*;** Amendments enhancing disclosures about transfers of financial assets. The amendments will allow users of financial statements to improve their understanding of transfer transactions of financial assets (for example, securitisations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period. The effective date is annual periods beginning on or after 1 July 2013.

3. New standards and interpretations not yet adopted (continued)

- ***IFRS 9 Financial Instruments;*** This standard forms part of the IASB's project to replace the existing standard on the recognition and measurement of financial instruments. The standard defines two measurement categories for financial assets: amortised cost and fair value. A financial asset may only be measured at amortised cost if it has basic loan features and is managed on a contractual yield basis. The standard also differs from existing requirements for accounting for financial assets in various other areas, such as embedded derivatives and the recognition of fair value adjustments in other comprehensive income. The standard will be applied retrospectively (subject to the standard's transitional provisions). The impact on the financial statements will require reclassification of financial assets. The effective date is annual periods beginning on or after 1 January 2015.

- ***IFRS 10 Consolidated Financial Statements;*** This standard requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements, it defines the principle of control, and establishes control as the basis for consolidation, it set out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee and it sets out the accounting requirements for the preparation of consolidated financial statements. The effective date is annual periods beginning on or after 1 January 2013.

- ***IFRS 11 Joint Arrangements;*** The core principle of IFRS 11 is that a party to a joint arrangement determines the type of joint arrangement in which it is involved by assessing its rights and obligations and accounts for those rights and obligations in accordance with that type of joint arrangement. The effective date is annual periods beginning on or after 1 January 2013.

- ***IFRS 12 Disclosure of Interest in other Entities;*** The objective of IFRS 12 is to require the disclosure of information that enables users of financial statements to evaluate, the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The effective date is annual periods beginning on or after 1 January 2013.

3. New standards and interpretations not yet adopted (continued)

- ***IFRS 13 Fair Value Measurement;*** 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). The effective date is annual periods beginning on or after 1 January 2013.

- ***IAS 1 Presentation of Financial Statements;*** Amendments to revise the way other comprehensive income is presented. The amendments to IAS 1 retain the 'one or two statement' approach at the option of the entity and only revise the way other comprehensive income is presented: requiring separate subtotals for those elements which may be 'recycled' (e.g. cash-flow hedging, foreign currency translation), and those elements that will not (e.g. fair value through OCI items under IFRS 9). The effective date is annual periods beginning on or after 1 July 2012.

- ***IAS 19 Employee Benefits*;** Amended Standard resulting from the Post-Employment Benefits and Termination Benefits projects, requires recognition of changes in the net defined benefit liability (asset) including immediate recognition of defined benefit cost, disaggregation of defined benefit cost into components, recognition of remeasurements in other comprehensive income, plan amendments, curtailments and settlements. It introduces enhanced disclosures about defined benefit plans, modifies accounting for termination benefits, including distinguishing benefits provided in exchange for service and benefits provided in exchange for the termination of employment and affect the recognition and measurement of termination benefits, clarifies miscellaneous issues, including the classification of employee benefits, current estimates of mortality rates, tax and administration costs and risk-sharing and conditional indexation features. The effective date is annual periods beginning on or after 1 January 2013.

3. New standards and interpretations not yet adopted (continued)

- ***IAS 27 Consolidated and Separate Financial Statements;*** Reissued as IAS 27 *Separate Financial Statements* (as amended in 2011), Consolidation requirements previously forming part of IAS 27 (2008) have been revised and are now contained in IFRS 10 *Consolidated Financial Statements*. The effective date is annual periods beginning on or after 1 January 2013.

- ***IAS 28 Investments in Associates;*** Reissued as IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011), the objective of IAS 28 (as amended in 2011) is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 applies to all entities that are investors with joint control of, or significant influence over, an investee (associate or joint venture). The effective date is annual periods beginning on or after 1 January 2013.

4. Significant accounting policies

The accounting policies have been consistently applied by the group and are consistent with those used in the previous year.

(a) Basis of consolidation

The Consolidated and Separate Financial Statements incorporate the financial statements of the Bank and its subsidiaries and associates, the Leasing and Finance Company of Malawi Limited, FMB Forex Bureau Limited, FMB Pensions Limited and Capital Bank Limited (together referred to as 'the Group').

(i) **Subsidiaries**

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are presently exercisable are taken into account. The financial statements of subsidiaries are included in the Consolidated and Separate Financial Statements from the date that control commences until the date that control ceases. Uniform accounting policies have been applied throughout the Group.

4. Significant accounting policies (continued)

(ii) **Funds management**

The Group manages and administers assets held in investment vehicles on behalf of investors. The financial statements of these entities are not included in these Consolidated and Separate Financial Statements except when the Group controls the entity.

(iii) **Transactions eliminated on consolidation**

Intra-group balances and transactions and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the Consolidated and Separate Financial Statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(iv) **Associates**

An associate arises when the group has significant influence in the financial and operating policies of an entity.

(v) **Loss of control**

On the loss of control,the Group derecognises the assets and liabilities of the subsidiary, any non controlling interest and the other components of the equity related to the subsidiary. Any surplus or deficit on the loss of control is recognised in profit or loss. If the group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently that interest is accounted for as an equity-accounted investee or as an available for sale financial asset depending on the level of influence retained.

4. Significant accounting policies (continued)

(b) Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated to Malawi Kwacha at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to Malawi Kwacha at the foreign exchange rate (mid-rate) ruling at that date. Foreign exchange differences arising on translation are recognised in the profit /loss. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Malawi Kwacha at foreign exchange rates ruling at the dates the fair values were determined.

Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to Malawi Kwacha at exchange rates (mid-rate) ruling at the reporting date. The income and expenses of foreign operations are translated to Malawi Kwacha at average exchange rates during the year.

Exchange difference arising on the translation of the assets and liabilities of foreign operations are recognised directly in other comprehensive income. When a foreign operation is disposed of in part or in full, the relevant amount in the foreign currency translation reserve is transferred to profit or loss.

Foreign exchange gains or losses arising from monetary items receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future and which in substance is considered to from a part of the net investment in foreign operation, are recognised directly in the foreign currency translation reserve.

4. Significant accounting policies (continued)

(c) Financial assets and liabilities

(i) ***Recognition and measurement***

The group initially recognising loans debt securities issued and subordinate receivables. All other financial asset or financial liabilities are recognised in the statement of financial position when and only when, the entity becomes a party to the contractual provisions of the instrument. A financial assets or financial liabilities are recognised in the statement of financial position. A financial asset or liability is initially measured at fair value plus (for an item not classified at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

(ii) ***Derecognition***

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire. The difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred) and the consideration received including any new accounts obtained less any new liability assumed) is recognised in profit or loss.

The Group also derecognises certain assets when they are deemed to be uncollectible.

4. Significant accounting policies (continued)

(c) Financial assets and liabilities (continued)

(iii) ***Offsetting***

Financial assets and liabilities are set off and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by accounting standards, or for gains and losses arising from a group of similar transactions within the Group's trading activity.

(iv) ***Fair value measurement***

The determination of fair values of financial assets and financial liabilities is based on quoted market prices for financial instruments traded in active markets where these are available. Where quoted market prices are not available fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, the discounted cash flow method, comparison to similar instruments for which market observable prices exist and valuation models.

The value produced by a model or other valuation technique is adjusted to take into account a number of factors as appropriate because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to take into account model risks, bid-ask spreads, liquidity risks as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments measured at fair value on the statement of financial position.

When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

4. Significant accounting policies (continued)

(v) ***Identification and measurement of impairment***

At each reporting date the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the financial asset and that the loss event has an impact on the future cash flows from the asset that can be estimated reliably.

The Group considers evidence of impairment at both a specific financial asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortised cost) with similar risk characteristics.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, 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.

In assessing collective impairment (if applicable) the Group uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

4. Significant accounting policies (continued)

(c) Financial assets and liabilities (continued)

Impairment losses on financial assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted the financial assets' original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss. Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised out of other comprehensive income to profit or loss. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale security is recognised directly in other comprehensive income. Any changes in impairment provisions attributable to time value are reflected as a component of interest income.

(viii) ***Designation at fair value through profit or loss***

The Group has designated financial assets and liabilities at fair value through profit or loss when either:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise.

Investments in listed companies ***(see note 13)*** have been designated at fair value through profits or loss.

(d) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value. Cash and cash equivalents are measured at amortised cost in the statement of financial position.

4. Significant accounting policies (continued)

(e) Other assets

Other financial assets are subsequently measured at amortised cost using the effective interest method less impairment losses. Other assets comprise interbranch accounts, interest receivables and staff advances.

(f) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term.

When the Group purchases a financial asset and simultaneously enters into an agreement to resell 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 to the other party, and the underlying asset is not recognised in the Group's financial statements.

Loans and advances are initially measured at fair value, and subsequently measured at their amortised cost using the effective interest method.

(g) Investments

Investment securities are initially measured at fair value plus incremental direct transaction costs, for investments not at fair value through profit and loss. Subsequent to initial recognition investment securities are accounted for depending on their classification as either held-to-maturity, fair value through profit or loss, or available-for-sale.

(i) ***Held-to-maturity***

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity, and which are not designated at fair value through profit or loss or available-for-sale.

Held-to-maturity investments are measured at amortised cost using the effective interest method. Any sale or reclassification of a significant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available- for-sale, and prevent the Group from classifying investment securities as held-to-maturity for the current and the following two financial years.

4. Significant accounting policies (continued)
(g) Investments (continued)

(ii) ***Fair value through profit or loss***

The Group recognises some investment securities at fair value, with fair value changes recognised immediately in profit or loss as described in accounting policy **(c).**

(iii) ***Available for sale***

Available-for-sale investments are non-derivative investments that are designed available for sale or are not classified as another category of financial assets. Unquoted available for sale securities whose fair value cannot be reliably measured, are measured at cost. All other available-for-sale investments are measured at fair value.

Interest income is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the group becomes entitled to the dividend. Foreign exchange gains or losses on available for sale debt security investments are recognised in profit or loss.

Fair value changes are recognised directly in other comprehensive income until the investment is sold or impaired where upon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to profit or loss as a reclassification adjustment and the balance is recognised in profit or loss.

(h) Investment in subsidiaries

Investments in subsidiaries are recognised at cost in the company financial statements less any impairment losses.

4. Significant accounting policies (continued)

(i) Property and equipment

(i) ***Owned assets***

Items of property and equipment are stated at cost except for freehold property and leasehold improvements which are stated at latest valuation less accumulated depreciation and impairment losses as described in accounting policy **(k).**

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, qualifying borrowing costs, the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

When revalued assets are sold, the amounts included in the revaluation reserve are transferred to retained earnings.

All properties are subject to revaluation every three years and when ever economic conditions have significantly changed, with surpluses on revaluation being transferred to a non-distributable property revaluation reserve.

(ii) ***Subsequent expenditure***

Expenditure incurred to replace a component of an item of property and equipment that is accounted for separately, including major inspection and overhaul expenditure is capitalised. Other subsequent expenditure is capitalised only when it is probable that the future economic benefits embodied within the part will flow to the entity and its costs can be measured reliably. All other expenditure is recognised in the profit and loss as an expense as incurred.

4. Significant accounting policies (continued)

(i) Property and equipment (continued)

(iii) ***Depreciation***

Property and equipment are depreciated on a straight-line basis at rates that would reduce carrying amounts to their residual values, estimated at the date of purchase, over the initially anticipated useful lives of the assets. The group re-assesses the useful lives, the depreciation method and the residual values of the assets at each reporting date. Any changes in the useful lives, depreciation method or estimated residual values are accounted for prospectively as a change in accounting estimate in accordance with IAS 8: *Accounting policies changes in accounting estimates and errors*.

Depreciation is recognised in profit or loss.

The depreciation rates for the current and comparative period are:

- lease hold improvements 2.5% (or period of lease if shorter)
- freehold properties 2.5%
- motor vehicles 25%
- furniture, fixtures and fittings, computers, office equipment 20%

Freehold land is not depreciated. At each reporting date, residual values, and useful lives of each item of property and equipment are reassessed.

(j) Capital work in progress

Capital work in progress represent gross amount spent to date in carrying out work of a capital nature. It is measured at cost recognised to date.

Capital work in progress is presented as part of property and equipment in the statement of financial position. If the project is completed the expenditure is capitalised to the relevant items of plant and equipment. Capital work in progress is not depreciated.

4. Significant accounting policies (continued)

(k) Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups of assets. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the units on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

An impairment loss is recognised in profit or loss unless it concerns property carried at revalued amount in which case it is treated as a revaluation decrease. If the impairment loss exceeds the revaluation reserve in respect of the impaired asset, the excess is recognised in profit or loss.

A reversal of an impairment loss is recognised in profit or loss, unless it relates to property carried at revalued amounts, in which case the excess of the reversal over the amount recognised in profit or loss is treated as a revaluation increase.

4. Significant accounting policies (continued)

(l) Liabilities to customers and other banks

When the Group sells a financial asset and simultaneously enters into a "repo" or "stock lending" agreement to repurchase the asset (or a similar asset) at a fixed price on a future date, the arrangement is accounted for as a deposit, and the underlying asset continues to be recognised in the Group's financial statements.

Deposits are initially measured at fair value plus directly attributable transaction costs, and subsequently measured at their amortised cost using the effective interest method, except where the Group chooses to account for the financial liabilities at fair value through profit or loss.

(m) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

(n) Other liabilities

Other liabilities are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest method.

4. Significant accounting policies (continued)

(o) Share capital

Share issue costs

Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

(p) Employee benefits

(i) ***Short-term employee benefits***

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) ***Share-based payment transactions***

The grant-date fair value of share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

The fair value of the amount payable to employees in respect of share appreciation rights, which are settled in cash, is recognised as an expense with a corresponding increase in liabilities, over the period that the employees become unconditionally entitled to payment. The liability is remeasured at each reporting date and at settlement date based on the fair value of the share appreciation rights. Any changes in the liability are recognised as employee benefit expenses in profit or loss.

4. Significant accounting policies (continued)

(p) Employee benefits (continued)

(iii) ***Defined contribution plan***

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution plans are recognised as an employee benefit expense in profit or loss in the periods during which related services are rendered by employees. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available. Contributions to a defined contribution plan that are due more than 12 months after the end of the period in which the employees render the service are discounted to their present value.

(iv) ***Defined benefit plans***

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net obligation in respect of defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value. Any unrecognised past service costs and the fair value of any plan assets are deducted. The discount rate is the yield at the reporting date on corporate bonds, that have a credit rating of at least AA from rating agency (y), that have maturity dates approximating the terms of the Group's obligations and that are denominated in the currency in which the benefits are expected to be paid.

(q) Net interest income

Interest income and expense are recognised in profit or loss 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 asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability.

When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses.

4. Significant accounting policies (continued)

(q) Net interest income (continued)

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 asset or liability.

Interest income and expense presented in the profit or loss include:

- interest on financial assets and liabilities at amortised cost on an effective interest rate basis
- interest on available-for-sale investment securities on an effective interest rate basis.

Interest income is accrued and included impairment losses when the collection of the loans becomes doubtful.

Income from leasing is included in net interest income as further described in accounting policy (r).

(r) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

(i) ***The group as a lessor***

Amounts due from lessees under finance leases are recorded as receivables at the amount of the group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

(ii) ***The group as a lessee***

Rentals payable under operating leases are recognised in profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

4. Significant accounting policies (continued)

(s) Fees and commissions income

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, account service fees, investment management fees, sales commission, placement fees and syndication fees are recognised as the related services are performed.

(t) Income from investments

Income from investments includes dividend income and increase in fair value of investments.

Dividend income is recognised when the right to receive income is established. Usually this is the ex-dividend date for available for sale securities.

Increase in fair value of investments designated at fair value through profit or loss includes all realised and unrealised fair value changes.

(u) Other income

Other income includes rentals receivable and net gains on the sale of assets and is recognised on the accruals basis.

4. Significant accounting policies (continued)

(v) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the profit or loss except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet liability method, providing 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 recognised for all temporary differences. 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. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current assets, and they relate to income taxes levied in the same tax authority on the same taxable entity, or on different entities but they intend to settle current liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously. 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.

Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries, associates and jointly controlled entities to the extent that the Group is able to control the timing of the reversal of the temporary differences and it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

4. Significant accounting policies (continued)

(w) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Group 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 after adjusting for the effects of all dilutive potential ordinary shares.

(x) Financial guarantees

Financial guarantee contracts require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

These financial guarantee contracts are classified as insurance contracts as defined in IFRS 4 *Insurance Contracts*. A liability is recognised when it is probable that an outflow of resources embodying economic benefits will be required to settle the contract and a reliable estimate can be made of the amount of the obligation. The amount recognised is the best estimate of the expenditure required to settle the contract at the statement of financial position date. Where the effect of discounting is material, the liability is discounted. The discount rate used is a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(y) Determination of fair values

- The fair values of investments in the listed equities are derived from price ruling at reporting date.
- The fair values of properties are estimated by a qualified valuer on an open market value basis.

5. Financial risk management

The board of directors of the Bank has ultimate responsibility for the level of risk taken by the bank and accordingly they have approved the overall business strategies and significant policies of the bank, including those related to managing and taking risk. Senior management in the bank is responsible for implementing strategies in a manner that limits risks associated with each strategy and that ensures compliance with applicable rules and regulation, both on a long term and day to day basis. The bank has a risk management department, which is independent of those who accept risks in the bank. The risk management department is tasked to:-

- identify current and emerging risks
- develop risk assessment and measurement systems
- establish policies, practices and other control mechanisms to manage risks
- develop risk tolerance limits for senior management and board approval
- monitor positions against approved risk tolerance limits
- report results of risk monitoring to senior management and the board.

To ensure that risk management is properly explained to and understood by all business lines the board has established the following risk management policies:-

- Credit Risk Management Policy
- Liquidity Risk Management Policy
- Operational Risk Management Policy
- Capital Risk Management Policy
- Market Risk Policy

5(a) Credit risk

Credit risk is the risk of financial loss to the Group if a counterparty to a financial instrument fails to meet their contractual obligations, and arises principally from the Group's loans and advances to customers and other banks and its investment in securities. For risk management reporting purposes, the group considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

5. Financial risk management (continued)

5(a) Credit risk (continued)

Management of credit risk

The Board of Directors of the Group have delegated responsibility for the management of credit risk to their Credit Committee to whom separate Credit departments report. The Credit Committees are responsible for oversight of credit risk, including:-

- *Formulating credit policies*, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- *Establishing the authorisation structure* for the approval and renewal of credit facilities. All credit facilities are authorized by Head Office management. Larger facilities require approval by The Credit Committee or the Board of Directors as appropriate.
- *Reviewing and assessing credit risk*. The Credit Department assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the branches concerned. Renewals and reviews of facilities are subject to the same review process.
- *Limiting concentrations of exposure* to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).
- *Reviewing compliance* of business units with agreed exposure limits.

5. Financial risk management (continued)

5(a) Credit risk (continued)

Exposure to credit risk

The Group's exposure to credit risk principally comprises loans and advances to customers and finance lease receivable analysed as follows:

	Group		Company	
	2012	2011	2012	2011
Standard (fully performing)	24,665,173	27,554,096	19,977,896	14,935,694
Past due but not impaired	1,760,281	1,651,083	1,187,655	635,067
Impaired (Note 9 & 10)	1,044,746	1,433,794	646,282	425,652
	27,470,200	**30,638,973**	**21,811,833**	**15,996,413**

Past due but not impaired loans and advances comprise:

30-60 days	762,719	542,620	744,302	205,263
61-90 days	672,457	772,977	281,338	94,318
>90 days	325,105	335,486	162,015	335,486
	1,760,281	**1,651,083**	**1,187,655**	**635,067**

An estimate of the fair value of collateral held against loans and advances to customers is shown below:

Against individually impaired				
Property	78,082	1,161,307	57,356	277,407
Motor vehicles	80,632	212,921	52,722	148,245
	158,714	**1,374,228**	**110,078**	**425,652**
Against past due but not impaired				
Property	881,324	1,939,560	591,904	998,550
Motor vehicles	1,498,369	1,363,578	595,751	649,592
	2,379,693	**3,303,138**	**1,187,655**	**1,648,142**
Against neither past due nor impaired				
Property	14,185,771	24,586,434	12,219,651	10,342,123
Motor vehicles	10,961,680	22,814,639	6,748,810	15,296,311
	25,147,451	**47,401,073**	**18,968,461**	**25,638,434**

The Group's policy is to pursue the timely realisation of the collateral in an orderly manner. The Group generally does not use the non-cash collateral for its own operations.

5. Financial risk management (continued)

5(a) Credit risk (continued)

Impaired loans and securities

Impaired loans and securities are loans and securities for which the Bank determines that it is probable that it will be unable to collect all principal and/or interest due according to the contractual terms of the loan / securities agreements.

Past due but not impaired loans

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

Allowances for impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures.

Impairment policy

The Bank writes off a loan / security balance (and any related allowances for impairment losses) when the Credit committee determines that the loans / securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

5. Financial risk management (continued)

5(a) Credit risk (continued)

The Bank monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown below:

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

	Group		Company	
	2012	**2011**	**2012**	**2011**
Agriculture	3,912,215	2,557,209	3,772,375	2,457,535
Mining	16,999	28,191	16,999	28,191
Finance and Insurance	1,845,292	6,074,964	1,838,213	65,995
Construction	3,335,629	4,171,995	3,182,135	3,001,985
Manufacturing	3,785,664	3,609,636	3,626,499	2,476,577
Wholesale and retail	4,286,612	4,455,213	3,335,918	3,934,983
Tourism and leisure	959,864	832,404	561,506	448,083
Transport	6,305,739	5,363,314	3,135,764	1,919,711
Others	3,022,186	3,546,047	2,342,424	1,663,353
	27,470,200	**30,638,973**	**21,811,833**	**15,996,413**

The risk that counterparties to trading instruments might default on their obligations is monitored on an on-going basis. In monitoring credit risk exposure, consideration is given to trading instruments with a positive fair value and the volatility of the fair value of trading instruments.

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5(a) Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank. The table below shows the credit quality by class of financial asset for credit risk related items.

GROUP	Performing Loans		Non - Performing Loans					
2012 Credit quality	Standard	Special Mention	Sub-Standard	Doubtful	Loss	Total	Security against impaired loans	Net impaired loans
Loans, advances and leases to customers:								
Personal and Business Banking								
- Mortgage Lending								
- Instalment sales and finance leases								
- Other loans and advances	2,863,379	9,102	11,401	261,389	66,101	3,211,372	59,643	324,033
Corporate and Investment Banking								
- Corporate lending	19,951,117	2,149,068	661,273	1,276,763	220,607	24,258,828	1,461,146	42,134
Total recognised financial instruments	**22,814,496**	**2,158,170**	**672,674**	**1,538,152**	**286,708**	**27,470,200**	**1,520,789**	**366,167**

COMPANY	Performing Loans		Non - Performing Loans					
2012 Credit quality	Standard	Special Mention	Sub-Standard	Doubtful	Loss	Total	Security against impaired loans	Net impaired loans
Loans, advances and leases to customers:								
Personal and Business Banking								
- Mortgage Lending								
- Instalment sales and finance leases								
- Other loans and advances	2,863,379	9,102	11,401	261,389	66,101	3,211,372	59,643	324,033
Corporate and Investment Banking								
- Corporate lending	16,105,082	735,200	431,952	1,141,441	186,786	18,600,461	220,472	42,134
Total recognised financial instruments	**18,968,461**	**744,302**	**443,353**	**1,402,830**	**252,887**	**21,811,833**	**280,115**	**366,167**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5(a) Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank. The table below shows the credit quality by class of financial asset for credit risk related items.

GROUP	Performing Loans		Non - Performing Loans				Security against impaired loans	Net impaired loans
2011 Credit quality	Standard	Special Mention	Sub-Standard	Doubtful	Loss	Total		
Loans, advances and leases to customers:								
Personal and Business Banking								
- Mortgage Lending								
- Instalment sales and finance leases								
- Other loans and advances	2,319,298	41,304	44,340	91,851	71,944	2,568,737	201,143	28,202
Corporate and Investment Banking								
- Corporate lending	25,403,798	465,135	1,407,682	243,635	549,986	28,070,236	998,377	738,915
Total recognised financial instruments	**27,723,096**	**506,439**	**1,452,022**	**335,486**	**621,930**	**30,638,973**	**1,199,520**	**767,117**

COMPANY	Performing Loans		Non - Performing Loans				Security against impaired loans	Net impaired loans
2011 Credit quality	Standard	Special Mention	Sub-Standard	Doubtful	Loss	Total		
Loans, advances and leases to customers:								
Personal and Business Banking								
- Other loans and advances	1,973,790	21,210	42,365	91,851	71,944	2,201,160	201,143	26,228
Corporate and Investment Banking								
- Corporate lending	12,961,904	184,053	51,952	243,635	353,708	13,795,252	94,433	738,915
Total recognised financial instruments	**14,935,694**	**205,263**	**94,317**	**335,486**	**425,652**	**15,996,412**	**295,576**	**765,143**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5(a) Credit risk (continued)

Maximum exposure to credit risk without taking into account any collateral

The table below shows the maximum exposure to credit risk by class of financial instrument. Financial instruments include financial instruments defined and recognised under IAS 39 *Financial Instruments: Recognition and measurement* as well as other financial instruments not recognised. The maximum exposure is presented gross, before the effect of mitigation through the use of master netting and collateral agreements.

GROUP	Note	Gross maximum exposure	
Gross maximum exposure		2012	2011
Balances with central banks	7	3,641,949	2,544,670
Balances with other banks	7	2,544,161	6,611,295
Balance with foreign banks	7	6,810,887	2,835,199
Money market investments	8	2,878,008	10,291,645
Personal and Business Banking			
- Mortgage lending		-	1,980,977
- Instalment sales and finance leases	9,10	5,243,762	3,519,398
- Other loans and advances	9,10	3,338,269	2,568,737
Corporate and Investment Banking			
- Corporate lending	9,10	17,098,262	22,569,861
Total recognised financial instruments		**41,555,298**	**52,921,782**
Letters of credit	36	3,772,293	199,747
Financial guarantees	36	8,343,516	8,205,328
Total unrecognised financial instruments		**12,115,809**	**8,405,075**
Total credit risk exposure		**53,671,107**	**61,326,857**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5(a) Credit risk (continued)

Maximum exposure to credit risk without taking into account any collateral or other credit enhancements

GROUP	Note	Gross maximum exposure	
Gross maximum exposure		2012	2011
Balances with central bank	7	3,641,949	1,059,160
Balances with other banks	7	2,201,726	1,318,227
Balance with foreign banks	7	6,810,887	2,343,976
Money market investments	8	2,674,726	2,349,453
Personal and Business Banking			
- Other loans and advances	9	2,868,852	2,201,161
Corporate and Investment Banking			
- Corporate lending	9	18,942,981	13,795,252
Total recognised financial instruments		**37,141,121**	**23,067,229**
Letters of credit	36	3,772,293	160,294
Financial guarantees	36	8,343,516	5,030,825
Total unrecognised financial instruments		**12,115,809**	**5,191,119**
Total credit risk exposure		**49,256,930**	**28,258,348**

Net exposure to credit risk without taking into account any collateral or other credit enhancements

In respect of certain financial assets, the Bank has legally enforceable rights to offset them with financial liabilities. However, in normal circumstances, there would be no intention of settling net, or of realising the financial assets and settling the financial liabilities simultaneously. Consequently, the financial assets are not offset against the respective financial liabilities for financial reporting purposes. However, the exposure to credit risk relating to the respective financial assets is mitigated as follows:

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5(a) Credit risk (continued)

GROUP		At 31 December 2012	
	Note	Carrying amount	Net exposure to credit risk
Cash and balances with banks	7	6,430,386	6,430,386
Loans and advances to banks	7	6,955,048	6,955,048
Loans and advances to customers and finance leases	9,10	27,437,189	27,437,189
		40,822,623	**40,822,623**

GROUP		At 31 December 2011	
	Note	Carrying amount	Net exposure to credit risk
Cash and balances with banks	7	6,715,272	6,715,272
Loans and advances to banks	7	5,275,893	5,275,893
Loans and advances to customers and finance leases	9, 10	30,638,973	30,638,973
		42,630,138	**42,630,138**

COMPANY		At 31 December 2012	
	Note	Carrying amount	Net exposure to credit risk
Cash and balances with banks	7	6,404,179	6,404,179
Loans and advances to banks	7	6,812,613	6,812,613
Loans and advances to customers and finance leases	9, 10	21,811,833	21,811,833
		35,028,625	**35,028,625**

COMPANY		At 31 December 2011	
	Note	Carrying amount	Net exposure to credit risk
Cash and balances with banks	7	2,602,319	2,602,319
Loans and advances to banks	7	3,753,202	3,753,202
Loans and advances to customers and finance leases	9, 10	15,996,413	15,996,413
		22,351,934	**22,351,934**


50 KWACHA
RESERVE BANK OF MALAWI
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5. Financial risk management (continued)

5 (b) Liquidity risk

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

Management of liquidity risk

The group's approach to managing liquidity is to ensure as far as possible that it will always have sufficient liquidity to meet its liabilities when due, both under stressed and normal conditions, without causing damage to the group's reputation.

The daily liquidity position is monitored. It is assumed that under normal circumstances customer demand deposits will remain stable or increase in value and unrecognised loan/overdraft commitments are not expected to be immediately drawn down in their entirety. Regular stress testing is done under normal and severe, market conditions and the results are discussed with ALCO and the Risk Committee.

All liquidity policies and procedures are subject to review and approval by the Asset Liability Committees (ALCO). These are management committees which meet once a month or more often if necessary. The daily monitoring of liquidity is the responsibility of an integrated treasury department which monitors the level of mismatches in the maturity positions of assets and liabilities. The maturity gap analyses as at 31 December 2012 and 31 December 2011 are given below:-

Asset and Liability Management Committee (ALCO)

The primary objective of the ALCO is to ensure a proper balance in terms of maturity profile, cost and yield, risk exposure etc. between funds mobilized and funds deployed. The ALCO seeks to manage risks in order to minimize the volatility of net interest income and protect the long term economic value of the Bank. The committee also monitors the capital adequacy of the Bank.

Key functions of the ALCO include setting pricing guidelines for assets and liabilities, setting limits and managing liquidity risk and interest rate risk and ensuring that contingency funding plans are in place to avert funding crises.

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (b) Liquidity risk (continued)

GROUP 2012	Note	Carrying amount	Gross Nominal inflow/ (outflow)	Up to 1 month	1-3 months	3-6 months	6-12 months	1-3 years	Over 5 years
ASSETS									
Cash and cash equivalents	7	15,962,215	15,962,215	15,962,215	-	-	-	-	-
Money market investments	8	2,878,008	2,878,008	-	1,819,832	-	-	45,000	1,013,176
Gross loans, advances and leases	9,10	25,680,293	27,437,189	7,481,107	4,849,747	2,108,188	7,918,037	2,929,132	2,150,978
Investment in listed companies	12	2,488,253	2,488,253	-	-	-	-	-	2,488,253
Other assets	11	634,590	634,590	634,590	-	-	-	-	-
Total assets		**47,643,359**	**49,400,255**	**24,077,912**	**6,669,579**	**2,108,188**	**7,918,037**	**2,974,132**	**5,652,407**
LIABILITIES									
Current and savings account	18	(19,297,203)	(19,297,203)	(3,859,441)	-	(15,437,762)	-	-	-
Foreign currency accounts	18	(7,818,808)	(7,818,808)	(1,563,762)	(6,255,046)	-	-	-	-
Term deposit accounts	18	(9,274,068)	(9,274,068)	(146,878)	(8,936,836)	-	(190,354)	-	-
Total liabilities to customers		**(36,390,079)**	**(36,390,079)**	**(5,570,081)**	**(15,191,882)**	**(15,437,762)**	**(190,354)**	**-**	**-**
Deposits due to other banks	19	(1,975,643)	(1,975,643)	(200,000)	(149,108)	(40,444)	(189,553)	(1,086,841)	(309,697)
Total liabilities		**(38,365,722)**	**(38,365,722)**	**(5,770,081)**	**(15,340,990)**	**(15,478,206)**	**(379,907)**	**(1,086,841)**	**(309,697)**
Net Liquidity Gap		**9,277,637**	**11,034,533**	**18,307,831**	**(8,671,411)**	**(13,370,018)**	**7,538,130**	**1,887,291**	**5,342,710**
Cumulative Liquidity Gap		**9,277,637**	**11,034,533**	**18,307,831**	**9,636,420**	**(3,733,598)**	**3,804,532**	**5,691,823**	**11,034,533**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (b) Liquidity risk (continued)

COMPANY 2012	Note	Carrying amount	Gross Nominal inflow/ (outflow)	Up to 1 month	1-3 months	3-6 months	6-12 months	1-3 years	Over 5 years
ASSETS									
Cash and cash equivalents	7	15,593,573	15,593,573	15,593,573	-	-	-	-	-
Money market investments	8	2,674,726	2,674,726	-	1,616,550	-	-	45,000	1,013,176
Gross loans, advances and leases	9,10	20,567,475	21,811,833	5,946,631	3,855,420	1,675,953	6,294,628	2,328,582	1,710,619
Investment in listed companies	12	2,128,795	2,128,795	-	-	-	-	-	2,128,795
Other assets	11	816,250	816,250	816,250	-	-	-	-	-
Total assets		**41,780,819**	**43,025,177**	**22,356,454**	**5,471,970**	**1,675,953**	**6,294,628**	**2,373,582**	**4,852,590**
LIABILITIES									
Current and savings account	18	(19,376,907)	(19,376,907)	(3,875,381)	-	(15,501,526)	-	-	-
Foreign currency accounts	18	(7,818,808)	(7,818,808)	(1,563,762)	(6,255,046)	-	-	-	-
Term deposit accounts	18	(5,192,158)	(5,192,158)	(146,878)	(4,854,926)	-	(190,354)	-	-
Total liabilities to customers		**(32,387,873)**	**(32,387,873)**	**(5,586,021)**	**(11,109,972)**	**(15,501,526)**	**(190,354)**	**-**	**-**
Deposits due to other banks		(1,975,643)	(1,975,643)	(200,000)	(149,108)	(40,444)	(189,553)	(1,086,641)	(309,697)
Total liabilities		**(34,363,516)**	**(34,363,516)**	**(5,786,021)**	**(11,259,080)**	**(15,541,970)**	**(379,907)**	**(1,086,641)**	**(309,697)**
Net Liquidity Gap		**7,417,303**	**8,661,661**	**16,570,433**	**(5,737,110)**	**(13,866,017)**	**5,914,721**	**1,286,941**	**4,542,893**
Cumulative Liquidity Gap		**7,417,303**	**8,661,661**	**16,570,433**	**10,783,323**	**(3,082,694)**	**2,832,027**	**4,118,968**	**8,661,861**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (b) Liquidity risk (continued)

GROUP 2011	Note	Carrying amount	Gross Nominal inflow/ (outflow)	Up to 1 month	1-3 months	3-6 months	6-12 months	1-3 years	Over 5 years
ASSETS									
Cash and cash equivalents	7	13,938,583	13,938,583	13,348,583	590,000	-	-	-	-
Money market investments	8	10,291,645	10,291,645	6,834,946	2,809,019	647,680	-	-	-
Gross loans, advances and leases	9,10	30,638,973	30,638,973	12,247,374	2,021,582	6,421,104	-	7,147,274	2,801,639
Investment in listed companies	8	2,128,795	2,128,795	-	-	-	-	-	2,128,795
Other assets	11	128,602	128,602	128,602	-	-	-	-	-
Total assets		**57,126,598**	**57,126,598**	**32,559,505**	**5,420,601**	**7,068,784**	**-**	**7,147,274**	**4,930,434**
LIABILITIES									
Current and savings account	18	(18,010,968)	(18,010,968)	(5,680,890)	(1,014,097)	(11,315,981)	-	-	-
Foreign currency accounts	18	(4,203,453)	(4,203,453)	(2,051,443)	(2,152,010)	-	-	-	-
Term deposit accounts	18	(24,813,237)	(24,813,237)	(15,600,833)	(5,461,334)	(3,751,070)	-	-	-
Total liabilities to customers		**(47,027,658)**	**(47,027,658)**	**(23,333,166)**	**(8,627,441)**	**(15,067,051)**	**-**		**-**
Balances due to other banks	19	(1,466,070)	(1,466,070)	(1,466,070)	-	-	-	-	-
Total liabilities		**(48,493,728)**	**(48,493,728)**	**(24,799,236)**	**(8,627,441)**	**(15,067,057)**	**-**	**-**	**-**
Net Liquidity Gap		**8,632,870**	**8,632,870**	**7,760,269**	**(3,206,840)**	**(7,998,267)**	**-**	**7,147,274**	**4,930,432**
Cumulative Liquidity Gap		**8,632,870**	**8,632,870**	**7,760,269**	**4,4553,429**	**(3,444,838)**	**(3,444,838)**	**3,702,438**	**8,632,870**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (b) Liquidity risk (continued)

COMPANY 2011	Note	Carrying amount	Gross Nominal inflow/ (outflow)	Up to 1 month	1-3 months	3-6 months	6-12 months	1-3 years	Over 5 years
ASSETS									
Cash and cash equivalents	7	6,453,389	6,453,389	6,453,389	-	-	-	-	-
Money market investments	8	2,349,453	2,349,453	-	2,304,453	-	45,000	-	-
Gross loans, advances and leases	9,10	15,996,413	15,996,413	6,088,718	1,856,986	-	5,454,415	1,807,012	789,282
Investment in listed companies	8	2,128,795	2,128,795	-	-	-	-	2,128,795	-
Other assets	11	128,602	128,602	128,602	-	-	-	-	-
Total assets		**27,056,652**	**27,056,652**	**12,670,709**	**4,161,439**	**-**	**5,499,415**	**3,935,807**	**789,282**
LIABILITIES									
Current and savings account	18	(13,868,495)	(13,868,495)	(2,773,699)	-	(11,094,797)	-	-	-
Foreign currency accounts	18	(2,690,013)	(2,690,013)	(538,003)	(2,152,010)	-	-	-	-
Term deposit accounts	14	(3,395,713)	(3,395,713)	-	(3,269,188)	-	(126,525)	-	-
Other liabilities	18	(1,221,557)	(1,221,557)	(1,221,557)	-	-	-	-	-
Total liabilities to customers		**(21,175,778)**	**(21,175,779)**	**(4,533,259)**	**(5,421,198)**	**(11,094,797)**	**(126,525)**	**3,935,807**	**789,282**
Deposits due to other banks	19	(1,466,070)	(1,466,070)	(1,466,070)	-	-	-	-	-
Total liabilities		**(22,641,848)**	**(22,641,848)**	**(5,999,329)**	**(5,421,198)**	**(11,094,797)**	**(126,525)**	**3,935,807**	**789,282**
Net Liquidity Gap		**5,507,759**	**4,414,803**	**6,671,380**	**(1,259,759)**	**(11,094,797)**	**5,372,890**	**3,935,807**	**789,282**
Cumulative Liquidity Gap		**8,414,804**	**4,414,803**	**6,671,380**	**5,411,621**	**(5,683,176)**	**(310,286)**	**3,625,521**	**4,414,803**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (b) Liquidity risk (continued)

The previous table shows the undiscounted cash flows on the group's financial assets and liabilities on the basis of their expected maturities as opposed to their earliest possible contractual maturity. Out of these, 20% are demand deposits and overdrafts, and are classified in the up to one month category with the balance in the over 5 years category as the Group's expected cash flows on these instruments varies significantly from their contractual maturity profile.

The Reserve Bank of Malawi has issued the following guidelines on the management of liquidity:

- Liquidity Ratio 1: Net liquidity (total liquid assets less suspense accounts in foreign currency) divided by total deposits must be at least 30 percent.
- Liquidity Ratio 2: Net liquidity (total liquid assets less suspense account in foreign currency and cheques in the course of collection) divided by total deposits must be at least 20 percent.

Liquidity Ratios 1 and 2 were as specified below:-

First Merchant Bank Limited

	31 December	
	2012	2011
Liquidity Ratio I	**53.50%**	37.94%
Liquidity Ratio II	**52.98%**	37.38%
The Leasing and Finance Company of Malawi Limited*		
Liquidity Ratio I	**11.00%**	55.00%
Liquidity Ratio II	**11.00%**	55.00%

*The liquidity ratio for Leasing and Finance Company of Malawi Limited has tremendously decreased during the period. The availability of forex after devaluation in May 2012 resulted in depletion of deposits from corporate clients who were purchasing forex to pay off their foreign creditors, hence the sharp drop in deposits which resulted to drop in treasury bills and interbank investments.

5 (c) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the group's processes, personnel, technology and infrastructure and from external factors other than credit, liquidity, interest rate and market risks such as those arising from legal and regulatory requirements and the requirement to observe generally accepted standards of corporate behaviour. Operational risks arise from all of the Group's operations.

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

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each branch. The responsibility is supported by the development of overall standards in the group for the management of operational risks in the following areas:-

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action.
- development of contingency plans
- training and professional development
- ethical and business standards
- implementation of anonymous hotline for reporting fraud and other inappropriate conduct as per fraud risk policy

Compliance with group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Group Audit Committee.

Risk management function also assesses operational risks and discusses the results with senior management and the risk committee.

in thousands of Malawi Kwacha

5 (d) Capital management

Reserve Bank of Malawi sets and monitors the capital requirements for the group and requires the bank to maintain a minimum of 6 percent and 10 percent for core and total capital respectively. These requirements have remained consistent from prior year. The group's regulatory capital is analysed in two parts:-

- Tier I capital, which includes paid-up share capital, share premium, retained earnings, and other reserves less investment in subsidiaries
- Tier II capital, which includes investment revaluation reserve, property revaluation reserve and loan loss reserve.

The calculation of both the above ratios is given below:-

	Group		Company	
	2012	**2011**	**2012**	**2011**
Tier 1 Capital (Core Capital/Capital Base)				
Share Capital	**116,813**	116,813	**116,813**	116,813
Share Premium	**1,565,347**	1,565,347	**1,565,347**	1,565,347
Retained Earnings	**6,392,232**	4,593,039	**5,405,871**	3,711,085
Investments in unconsolidated Subsidiaries	**-**	-	**(75,911)**	(785,968)
Investments in equities of Financial Institutions	**(1,067,955)**	(280,746)	**(903,854)**	-
Subtotal	**7,006,437**	**5,994,453**	**6,108,266**	**4,607,277**
Tier 2 Capital				
General Reserves	4,032,196	2,325,056	3,412,778	1,883,903
Total Regulatory Capital	**11,038,633**	**8,319,509**	**9,521,044**	**6,491,180**
Risk Weighted Assets	**46,200,864**	**44,215,839**	**41,114,136**	**23,475,548**
Capital Ratios				
Tier 1 Capital expressed as a percentage of total risk weighted assets	**15.17**	13.56	**14.86**	19.63
Total Capital expressed as a percentage of total risk weighted assets	**23.89**	18.82	**23.16**	27.65

5. Financial risk management (continued)

5 (e) Market risk management policy

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates and other available for sale financial assets prices will affect the group income or the value of its holding of financial instruments. The objective of the group's market risk management policy is to manage and control market risk exposures within acceptable parameters while optimizing the return on risk.

Investments in shares

The Board of Directors sets and regularly reviews exposure limits for investment in equity instruments. The performance of the equity market in general and the group's equity investments in particular are closely monitored and appropriate risk mitigation measures are implemented where necessary.

The group measures its investment in equities at fair value, with fair value changes recognized immediately in accordance with accounting policy **(g).**

Foreign Exchange Risk

Foreign exchange risk is the exposure of group's financial condition to adverse movements in foreign exchange rates. It arises from change in value of local currency against foreign currencies.

Foreign currency transactions and positions are monitored by senior management and ALCO.

Foreign Exchange Rate Risk Management

The responsibilities of the Integrated Treasury Department include monitoring of foreign exchange risk. Foreign exchange rate risk is the potential impact of adverse currency rates movements on earnings and economic value. This involves the risks of the group incurring financial loss on settlement of foreign exchange positions taken in both the trading and banking books. The foreign exchange positions arise from the following activities:-

5. Financial risk management (continued)

5 (e) Market risk management policy (continued)

- Trading in foreign currencies through spot, forward and option transactions as a market maker or position taker, including the unhedged position arising from customer driven foreign exchange transactions.
- holding foreign currency position in the bank books (e.g. in the form of loans, deposits, cross border investments, etc)
- Engaging in derivative transactions that are denominated in foreign currency for trading or hedging purposes.

The treasury department is responsible for:-

- Setting the foreign exchange risk management strategy and tolerance levels.
- Ensuring that effective risk management systems and internal controls are in place.
- Monitoring significant foreign exchange exposure.
- Ensuring that foreign exchange operations are supported by adequate management information systems which complement the risk management strategy
- Reviewing the policies, procedures and currency limits regularly in line with changes in the economic environment.

The ALCO regularly monitors the controls put in place by the treasury department, which are approved and reviewed by the board from time to time.

5. Financial risk management (Continued)

5 (e) Market risk management policy

The group does not perform a sensitivity analysis on its foreign exchange exposure but manages its foreign exchange risk mainly by hedging assets in foreign exchange with liabilities in foreign exchange. The group's foreign exchange exposures at the reporting date were as follows:

	2012			2011		
GROUP	**Assets**	**Liabilities**	**Net**	**Assets**	**Liabilities**	**Net**
USD	11,390,664	7,754,716	3,636,248	13,355,855	1,233,901	12,121,954
GBP	401,379	306,188	95,191	558,960	626,535	(67,575)
EUR	1,041,664	807,350	234,314	1,419,757	626,535	793,222
ZAR	142,378	57,816	84,162	154,357	5,338	149,019
INR	35,499	-	35,499	41	-	41
JPY	11,642	-	11,642	-	6	(6)
BWP	46	-	46	-	-	-
COMPANY	**Assets**	**Liabilities**	**Net**	**Assets**	**Liabilities**	**Net**
USD	11,390,664	7,754,716	3,635,948	3,145,412	2,273,423	871,989
GBP	401,379	306,188	95,191	-	90,780	(90,780)
EUR	1,041,664	807,350	234,314	377,130	1,607,357	(1,230,227)
ZAR	142,378	57,816	84,562	-	25,641	(25,641)
INR	35,499	-	35,499	-	-	-
JPY	11,642	-	11,642	-	-	-
BWP	46		46	-	-	-

Interest Rate Risk

Interest Rate risk is the exposure of group's financial condition to adverse movements in interest rates. It basically arises from timing differences in the maturity of re-pricing of the group's assets and liabilities. Changes in interest rates can have adverse effects on the group's earnings and its economic value. The relevant Asset and Liability Committee (ALCO) monitors interest rate risk in the group. Interest rate sensitivity analyses as on the reporting date are set out below:-

Stress testing on the three elements of market risk is done by an independent risk function. The results are discussed with ALCO and the Risk Committee and appropriate risk mitigation measures and contingency plans are implemented.

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (e) Market risk management policy (continued)

GROUP 2012	Zero rate	Floating rate	Fixed Rate Instruments 0-3 months	3-6 months	6-9 months	9-12 months	Over 12 months	Total
Total assets	24,468,101	6,367,783	10,953,944	1,561,292	4,051,911	1,811,550	3,808,990	53,023,571
Total liabilities and shareholders funds	16,633,493	27,116,011	262,345	8,671,714	340,008	-	-	53,023,571
Interest sensitivity gap	**7,834,608**	**(20,748,228)**	**10,691,599**	**(7,110,422)**	**3,711,903**	**1,811,550**	**3,808,990**	**-**
Impact on profit of increase of interest rate 1%	**-**	**(207,482)**	**106,916**	**(71,104)**	**37,119**	**18,115**	**38,090**	**-**
Impact on profit of decrease of interest rate 1%	**-**	**207,482**	**(106,916)**	**71,104**	**(37,119)**	**(18,115)**	**(38,090)**	**-**

GROUP 2011	Zero rate	Floating rate	Fixed Rate Instruments 0-3 months	3-6 months	6-9 months	9-12 months	Over 12 months	Total
Total assets	11,116,867	34,677,861	13,621,959	602,680	-	45,000	-	60,063,887
Total liabilities and shareholders funds	12,463,432	29,382,728	17,793,714	208,644	215,369	-	-	60,063,887
Interest sensitivity gap	**(1,346,565)**	**5,294,653**	**(4,171,755)**	**394,036**	**(215,369)**	**45,000**	**-**	**-**
Impact on profit and equity of increase of interest rate 1%	**-**	**52,974**	**(41,718)**	**3,940**	**(2,154)**	**450**	**-**	**-**
Impact on profit and equity of decrease of interest rate 1%	**-**	**(52,974)**	**41,718**	**(3,940)**	**2,154**	**(450)**	**-**	**-**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (e) Market risk management policy (continued)

	Fixed Rate Instruments							
COMPANY 2012	Zero rate	Floating rate	0-3 months	3-6 months	6-9 months	9-12 months	Over 12 months	Total
Total assets	24,194,068	1,013,176	10,859,319	1,579,865	4,100,112	1,833,100	3,853,766	47,433,406
Total liabilities and shareholders funds	15,045,533	27,195,715	146,876	4,854,926	190,356	-	-	47,433,406
Interest sensitivity gap	**9,148,535**	**(26,182,539)**	**10,712,443**	**(3,275,061)**	**3,909,756**	**1,833,100**	**3,853,766**	**-**
Impact on profit and equity of increase of interest rate 1%	**-**	**(261,825)**	**107,124**	**(35,751)**	**39,098**	**18,331**	**38,538**	**-**
Impact on profit and equity of decrease of interest rate 1%	**-**	**261,825**	**(107,124)**	**35,751**	**(39,098)**	**(18,331)**	**(38,538)**	**-**

	Fixed Rate Instruments							
COMPANY 2011	Zero rate	Floating rate	0-3 months	3-6 months	6-9 months	9-12 months	Over 12 months	Total
Total assets	12,498,758	15,407,652	1,701,773	602,680	-	45,000	-	30,255,863
Total liabilities and shareholders funds	10,301,641	16,558,509	2,971,700	208,644	215,369	-	-	30,255,863
Interest sensitivity gap	**2,197,117**	**(1,150,857)**	**(1,269,927)**	**394,036**	**(215,369)**	**45,000**	**-**	**-**
Impact on profit and equity of increase of interest rate 1%	**-**	**(11,509)**	**(12,699)**	**3,940**	**(2,154)**	**450**	**-**	**-**
Impact on profit and equity of decrease of interest rate 1%	**-**	**11,509**	**12,699**	**(3,940)**	**2,154**	**(450)**	**-**	**-**

in thousands of Malawi Kwacha

5. Financial risk management (continued)

5 (e) Market risk management policy (continued)

Effective interest rates of financial assets and liabilities

The effective interest rates for the principal financial assets and liabilities at 31 December 2012 and 2011 were in the following ranges:-

	2012	2011
	%	%
Assets:		
Government securities	**7-26**	6.00 – 8.00
Deposits with banking institutions	**9-25**	2.50 – 13.0
Loans and advances to customers (base rate)	**17.75-35**	17.75
Liabilities:		
Customer deposits	**0.5-21**	0.50-8.00

5 (f) Compliance risk

The office of Compliance Officer is an independent risk management activity, which also has unrestricted access to the managing director and the chairman of the Risk Committee. The Group is subject to extensive supervisory and regulatory regimes, and the executive management remains responsible for overseeing the management of the bank's compliance risk.

Money laundering controls are managed within the compliance function. The Group has adopted anti-money laundering policies including Know Your Customer policies and procedures and adheres to the country's anti-money laundering legislation and Reserve Bank of Malawi regulations.

The management of compliance risk has become a distinct discipline within the Group's overall risk management framework. Ultimate responsibility for this risk lies with the Board of Directors. A combination of key activities are undertaken to manage the risk such as identifying the regulatory universe and developing compliance management plans, training staff and other stakeholders on relevant regulatory requirements, and monitoring compliance. Compliance with the Know-Your-Customer and Anti-money Laundering procedures and legislation became an area of major focus for the Group. The Group has a Compliance Officer who consults the country's Financial Intelligence Unit on money laundering and anti-terrorist financing matters.

6. Financial assets and liabilities

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements.

Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.

Level 2: Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

in thousands of Malawi Kwacha

6. Financial assets and liabilities (continued)

GROUP
31 December 2012

Financial assets	Note	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	7	**15,962,215**	**-**	**-**	**15,962,215**
Money market investments	8	**-**	**2,878,009**	**-**	**2,878,009**
Loans and advances to customers	9	**-**	**-**	**20,325,685**	**20,325,685**
Finance lease receivables	10	**-**	**-**	**5,354,608**	**5,354,608**
Investments in listed companies	13	**2,488,253**	**-**	**-**	**2,488,253**
		18,450,468	**2,878,009**	**25,680,293**	**47,008,770**
Financial liabilities					
Deposits from customers	18	**-**	**-**	**36,390,079**	**36,390,079**
Deposits from banks	19	**1,975,643**	**-**	**-**	**1,975,643**
		1,975,643	**-**	**36,390,079**	**38,365,722**

31 December 2011

Financial assets	Note	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	7	13,938,583	-	-	13,938,583
Money market investments	8	-	10,219,645	-	10,219,645
Loans and advances to customers	9	-		24,421,580	24,421,580
Finance lease receivables	10	-	-	5,305,046	5,305,046
Investments in listed companies	13	2,128,795	-	-	2,128,795
		16,067,378	**10,219,645**	**29,726,626**	**56,013,649**
Financial liabilities					
Deposits from customers	18	-	-	47,027,658	47,027,658
Deposits from banks	19	1,466,070	-	-	1,466,070
		1,466,070	**-**	**47,027,658**	**48,493,728**

in thousands of Malawi Kwacha

6. Financial assets and liabilities (continued)

COMPANY
31 December 2012

Financial assets	Note	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	7	**15,593,573**	**-**	**-**	**15,593,573**
Money market investments	8	**-**	**2,674,726**	**-**	**2,674,726**
Loans and advances to customers	9	**-**	**-**	**20,567,475**	**20,567,475**
Finance lease receivables	13	**2,488,253**	**-**	**-**	**2,488,253**
Investments in listed companies		**18,081,826**	**2,674,726**	**20,567,475**	**41,324,027**
		18,450,468	**2,878,009**	**25,680,293**	**47,008,770**
Financial liabilities					
Deposits from customers	18	**-**	**-**	**32,387,874**	**32,387,874**
Deposits from banks	19	**1,975,643**	**-**	**-**	**1,975,643**
		1,975,643	**-**	**32,387,874**	**34,363,517**

31 December 2011

Financial assets					
Cash and cash equivalents	7	6,453,389	-	-	6,453,389
Money market investments	8	-	2,349,453	-	2,349,453
Loans and advances to customers	9	-		15,407,652	15,407,652
Finance lease receivables		-	-	-	-
Investments in listed companies	13	2,128,795	-	-	2,128,795
		8,582,184	**2,349,453**	**15,407,652**	**26,339,289**
Financial liabilities					
Deposits from customers	18	-	-	19,954,221	19,954,221
Deposits from banks	19	1,466,070	-	-	1,466,070
		1,466,070	**-**	**19,954,221**	**21,420,291**

in thousands of Malawi Kwacha

	Group		Company	
7. Cash and cash equivalents	**2012**	**2011**	**2012**	**2011**
Liquidity Reserve Deposits:				
- Central Banks	3,641,949	2,544,670	3,641,949	1,059,160
Placements with other banks	2,400,000	5,275,893	2,200,000	-
Balances with banks abroad	6,810,887	2,835,199	6,810,887	2,434,975
Balances with local banks	144,161	1,335,403	1,726	1,318,227
Cheques in course of clearing	176,781	97,321	176,781	97,321
Cash balances	2,788,437	1,850,097	2,762,23	1,543,706
	15,962,215	13,938,583	**15,593,573**	6,453,389

8. Money market investments				
Bank of Botswana Certificates	-	6,746,580	-	-
Malawi Government Treasury Bills	1,819,832	3,450,065	1,616,550	2,254,453
Local Registered Government Stocks	45,000	95,000	45,000	95,000
Malawi Government Promissory Notes	1,013,176	-	1,013,176	-
	2,878,008	10,291,645	**2,674,726**	2,349,453

The interest rate on Local Registered Government Stocks approximates the market interest rate and hence the carrying amount approximates the fair value. All money market investments mature between 2 and 12 months except for Local Registered Government Stocks and Malawi Government Promissory Notes which mature after 12 months.

in thousands of Malawi Kwacha

9. Loans and advances to customers

	Group		Company	
	2012	**2011**	**2012**	**2011**
Loans and advances are receivable as follows:				
Maturing within 3 months	10,157,899	13,105,264	10,157,899	7,945,704
Maturing between 3 and 12 months	8,136,024	6,076,908	7,734,414	5,454,415
Maturing after 12 months	3,285,724	5,956,426	3,919,520	2,596,294
	21,579,647	25,138,598	**21,811,833**	15,996,413
Segmental analysis by industry:				
Agriculture	3,772,375	2,457,534	3,772,375	2,457,535
Mining	16,999	28,191	16,999	28,191
Finance and insurance	1,838,213	6,057,478	1,838,213	65,995
Construction	3,182,135	3,871,767	3,182,135	3,001,985
Manufacturing	3,626,499	3,553,426	3,626,499	2,476,577
Wholesale and retail	3,335,918	3,934,983	3,335,918	3,934,983
Tourism and leisure	561,506	448,083	561,506	448,083
Transport	3,135,764	2,176,049	3,135,764	1,919,711
Others	2,110,238	2,611,087	2,342,424	1,663,353
	21,579,647	25,138,598	**21,811,833**	15,996,413
Specific allowances for impairment:				
Balance at 1 January	(332,001)	(266,781)	(251,638)	(227,103)
Adjustment for reclassification of Capital Bank	83,990	-	-	-
Charge for the year	(458,511)	(212,158)	(451,571)	(171,473)
Customer Debit Balances offset against non interest income	(177,393)	-	(177,393)	-
Write offs	86,035	1,509	86,035	1,509
Recoveries	148,285	145,429	148,285	145,429
Balance at 31 December	**(649,595)**	(332,001)	**(646,282)**	(251,638)
Interest in suspense:				
Balance at 1st January	(385,017)	(400,607)	(337,123)	(356,662)
Adjustment for reclassification of Capital Bank	47,894	-	-	-
Charge for the year	(267,244)	15,590	(260,953)	19,539
Balance at 31 December	(604,367)	(385,017)	(598,076)	(337,123)
Net loans and advances	**20,325,685**	24,421,580	**20,567,475**	15,407,652

The directors consider that the carrying amount of loans and advances approximates to their fair value. Impairment of loans and advances has been calculated as disclosed in note 5a.

in thousands of Malawi Kwacha

10. Finance lease receivables

	Group		Company	
	2012	**2011**	**2012**	**2011**
Investment in finance leases, receivable:				
Less than one year	2,506,220	1,757,572	-	-
Between one and five years	2,973,705	3,529,085	-	-
More than five years	377,617	213,718	-	-
Balance at 31 December	**5,857,542**	5,500,375	**-**	-
Specific allowances for impairment:				
Balance at 1 January	(79,638)	(60,063)	-	-
Charge for the year	(165,807)	(34,558)	-	-
Write-offs	119	2,519	-	-
Recoveries	28,956	12,464	-	-
Balance at 31 December	**(216,370)**	**(79,638)**	**-**	**-**
Interest in suspense:				
Balance at 1 January	(112,691)	(81,678)		-
Charge for the year	(173,873)	(31,013)	-	-
Balance at 31 December	(286,564)	(112,691)	-	-
Net finance lease receivables	**5,354,608**	5,308,046	**-**	-

The directors consider that the carrying amount of lease receivables approximates to their fair value.

11. Other assets

Cheques in course of collection	134,812	116,050	134,812	116,050
Interest receivable	58,026	55,009	58,026	55,009
Prepayments	96,001	40,357	90,386	29,004
Dividend receivable from listed companies	105,262	17,244	105,262	17,244
Stock of consumable stationery	81,858	79,219	81,858	77,630
Stock of computer spares	19,596	8,970	19,596	8,970
Due from Thomas Cook	-	115,936	-	115,936
Other receivables	139,036	101,048	131,662	111,298
	634,591	533,833	**621,602**	531,141

12. Amounts due from subsidiaries and associate company

FMB Forex Bureau Limited	-	-	161,521	82,342
FMB Pensions Limited	-	-	25,324	-
Capital Bank Limited	-	-	7,628	-
Leasing and Finance Company of Malawi Limited	-	-	177	-
	-	-	**194,650**	82,342

Balances due from subsidiaries represent current accounts which carry interest at the bank's lending rate and are repayable on demand.

in thousands of Malawi Kwacha

13. Investments in listed companies

	Group and Company			
	2012		2011	
	Valuation	**Cost**	Valuation	Cost
Balance at 1 January	2,128,795	747,388	1,308,968	184,837
Additions during the year	67,177	67,177	580,111	580,111
Change in fair value of listed companies during the year	309,573	-	257,277	-
Disposals during the year	(17,292)	(17,292)	(17,561)	(17,561)
Balance at 31 December	**2,488,253**	**797,273**	2,128,795	747,387

All investments in quoted companies are held for trading. The increase in fair value is taken to profit or loss. The investments have been designated at fair value through profit and loss upon initial recognition.

14 . Investment in subsidiaries

	Shareholding		Company	
At cost	**2012**	2011	**2012**	2011
The Leasing and Finance Company of Malawi Ltd.	100%	100%	65,911	65,911
FMB Pension Fund Limited	100%	100%	-	-
FMB Forex Bureau Limited	100%	100%	10,000	10,000
Capital Bank Limited (Botswana)	-	53.8%	-	710,057
Total investment in subsidiaries			**75,911**	785,968

Movement during the year:

Balance at 1 January	785,968	785,968
Loss of control in Capital Bank Limited (Botswana)	(710,057)	-
Balance at 31 December	**75,911**	785,968

During the year the Bank's shareholding in Capital Bank Limited (Botswana) was reduced from 53.8% to 38.6%. The Bank was constrained from participating in a rights offer undertaken in Botswana. Consequently Capital Bank Limited (Botswana) has been reclassified as an associate company.

in thousands of Malawi Kwacha

15. Investment in Associate

	Group		Company	
	2012	2011	**2012**	2011
At cost	**1,067,956**	-	**903,854**	-
Movement during the year:				
	710,057	-	710,057	
	185,928	-	185,928	-
	7,869	-	7,869	-
	164,102	-	-	-
	1,067,956	-	**903,854**	-
Share of profit in associate:				
Profit before tax	520,286	-	-	-
Taxation	(95,150)	-	-	-
Profit after tax	425,136	-	-	-
Share of profits after tax (38.6%)	**164,102**	-	**-**	-

in thousands of Malawi Kwacha

16. Property and equipment

GROUP	Freehold property	Leasehold improvements	Motor vehicles	Equipment fixture & fittings	Capital work in progress	Total
Cost or valuation						
Balance at 1 January 2012	1,100,245	582,475	212,476	2,424,493	553,725	4,873,414
Adjustment for reclassification of Capital Bank	(431,604)	-	(15,131)	(347,379)	(42,987)	(837,101)
Revaluation surplus during the year	793,257	506,643	-	-	-	1,299,900
Additions during the year	3,099	185	31,907	360,774	249,754	645,719
Disposals	-	-	-	(45)	-	(45)
Balance at 31 December 2012	**1,464,997**	**1,089,303**	**229,252**	**2,437,843**	**760,492**	**5,981,887**
Accumulated depreciation and impairment losses						
Balance at 1 January 2012	37,130	20,911	127,498	1,390,501	-	1,576,040
Adjustment for reclassification of Capital Bank	(11,733)	296	(10,659)	(218,109)	-	(240,205)
Charge for the year	13,446	11,827	36,924	334,237	-	396,434
Released on revaluation and disposal	(36,815)	(25,012)	-	-	-	(61,827)
Released on disposal	-	-	-	(810)	-	(810)
Balance at 31 December 2012	**2,028**	**8,022**	**153,763**	**1,505,819**	**-**	**1,669,632**
Carrying amount						
At 31 December 2012	**1,462,969**	**1,081,281**	**75,489**	**932,024**	**760,492**	**4,312,255**
Cost or valuation						
Balance at 1 January 2011	1,075,495	535,922	190,749	1,985,224	250,116	4,037,506
Additions	24,750	54,969	26,546	458,052	303,609	867,926
Disposals	-	-	(4,819)	-	-	(4,819)
Write off	-	(8,416)	-	(18,783)	-	(27,199)
Balance at 31 December 2011	**1,100,245**	**582,475**	**212,476**	**2,424,493**	**553,725**	**4,873,414**
Accumulated depreciation and impairment losses						
Balance at 1 January 2011	12,840	10,323	95,606	1,049,796	-	1,168,565
Charge for the year	23,666	10,774	36,282	329,967	-	400,689
Translation loss	624	-	753	15,330	-	16,707
Released on revaluation and disposals	-	(186)	(5,143)	(4,592)	-	(9,921)
Balance at 31 December 2011	**37,130**	**20,911**	**127,498**	**1,390,501**	**-**	**1,576,040**
Carrying amount						
At 31 December 2011	**1,063,115**	**561,564**	**84,978**	**1,033,992**	**553,725**	**3,297,374**

in thousands of Malawi Kwacha

16. Property and equipment (continued)

COMPANY	Freehold property	Leasehold improvements	Motor vehicles	Equipment fixture & fittings	Capital work in progress	Total
Cost or valuation						
Balance at 1 January 2012	609,188	582,475	182,652	2,030,248	510,738	3,915,301
Revaluation surplus during the year	714,909	506,643	-	-	-	1,221,552
Additions during the year	900	185	31,907	359,327	249,754	642,073
Balance at 31 December 2012	**1,324,997**	**1,089,303**	**214,559**	**2,389,575**	**760,492**	**5,778,926**
Accumulated depreciation and impairment						
Balance at 1 January 2011	23,507	21,207	112,133	1,148,487	-	1,305,334
Charge for the year	12,357	11,963	34,172	324,686	-	383,178
Released on revaluation	(33,836)	(25,012)	-	-	-	(58,848)
Balance at 31 December 2012	**2,028**	**8,158**	**146,305**	**1,473,173**	**-**	**1,629,664**
Carrying amount						
At 31 December 2012	**1,322,969**	**1,081,145**	**68,254**	**916,402**	**760,492**	**4,149,262**
Cost or valuation						
Balance at 1st January 2011	591,088	535,922	167,431	1,564,568	250,116	3,109,125
Additions during the year	18,100	54,969	15,440	484,463	260,622	833,594
Disposals/write off	-	(8,416)	(219)	(18,783)	-	(27,418)
Balance at 31 December 2011	**609,188**	**582,475**	**182,652**	**2,030,248**	**510,738**	**3,915,301**
Accumulated depreciation and impairment						
Balance at 1 January 2011	11,058	10,323	80,432	891,108	-	992,921
Charge for the year	12,449	11,076	31,920	262,597	-	318,042
Released on disposal/write offs	-	(192)	(219)	(5,218)	-	(5,629)
Balance at 31 December 2011	**23,507**	**21,207**	**112,133**	**1,148,487**	**-**	**1,305,334**
Carrying amount						
At 31 December 2011	**585,681**	**561,268**	**70,519**	**881,761**	**510,738**	**2,609,967**

Registers of land and buildings giving details as required under the Companies Act 1984, Schedule 3, Section 16 are maintained at the registered office of the company and are open for inspection by members or their duly authorised agents.

The freehold properties and leasehold improvements were last revalued on 31 December 2012 by Don Whayo BSc; MRICS; MSIM of Knight Frank Malawi Limited, independent valuers, not connected with the group, on an open market value basis. The resultant surplus were credited to revaluation reserve in 2012. This is not available for distribution until realised.

Capital work in progress represents development costs on the bank's various branches and Auto teller machines in the course of installation.

in thousands of Malawi Kwacha

17. Deferred tax (assets)/liabilities

		Assets		Liabilities		Net	
		2012	2011	2012	2011	2012	2011
(i)	**GROUP**						
	Property and equipment	-	-	102,499	201,591	102,499	201,591
	Accrued income	-	-	17,799	3,780	17,799	3,780
	Revaluation of property	-	-	388,169	123,432	388,169	123,432
	Tax losses	-	(118,774)	-	-		(118,774)
	Operating leases - accrual	-	(480)	-	-	-	(480)
	Gratuity and severance pay liabilities	(25,224)	(24,777)	-	-	(25,224)	(24,777)
	Accrued interest	-	-	220	34,091	220	34,091
	Translation reserve	-	-	-	29,047	-	29,047
	Investment revaluation	-	-	2,898	77,183	2,898	77,183
	Property impairment	(4,297)	-	-	-	(4,297)	-
	Tax (assets)/liabilities	**(29,521)**	(144,031)	**511,585**	469,124	**482,064**	325,093
(ii)	**COMPANY**						
	Property and equipment	-	-	102,290	50,991	102,290	50,991
	Accrued income	-	-	17,799	3,780	17,799	3,780
	Revaluation of property	-	-	357,676	110,695	357,676	110,695
	Gratuity and severance pay liabilities	(25,224)	(24,777)	-	-	(25,224)	(24,777)
	Property impairment	(4,298)	-	-	-	(4,298)	-
	Investment revaluation	-	-	2,898	77,183	2,898	77,183
	Tax (assets)/liabilities	**(29,522)**	(24,777)	**480,663**	242,649	**451,141**	217,872

in thousands of Malawi Kwacha

17. Deferred tax (assets)/liabilities (continued)

Movements in temporary differences during the year

GROUP	Opening balance	Adjustment for Capital Bank reclassification	Recognised in profit or loss	Recognised in other comprehensive income	Closing balance
2012					
Property and equipment	201,591	(149,958)	50,866	-	102,499
Accrued income	3,780	-	14,019	-	17,799
Revaluation of property	123,432	(5,986)	-	270,723	388,169
Tax losses	(118,774)	118,774	-	-	-
Operating lease	(480)	480	-	-	-
Gratuity and severance pay provisions	(24,777)	-	(447)	-	(25,224)
Accrued interest	34,091	(5,975)	(27,896)	-	220
Translation reserve	29,047	(29,047)	-	-	-
Investment revaluation	77,183	-	(74,285)	-	2,898
Property impairment	-	-	(4,297)	-	(4,297)
	325,093	**(71,712)**	**(42,040)**	**270,723**	**482,064**
2011					
Property and equipment	163,585	-	38,006	-	201,591
Accrued income	50,042	-	(46,262)	-	3,780
Revaluation of property	109,320	-	1,070	13,042	123,432
Tax losses	(118,774)	-	-	-	(118,774)
Operating lease	(480)	-	-	-	(480)
Gratuity and severance pay provisions	(54,787)	-	30,010	-	(24,777)
Accrued interest	4,803	-	29,288	-	34,091
Translation reserve	6,733	-	27,049	(4,735)	29,047
Investment Revaluation	-	-	77,183	-	77,183
	160,442	-	156,344	8,307	325,093

in thousands of Malawi Kwacha

17. Deferred tax liabilities (Continued)

COMPANY	Opening balance	Recognised in profit or loss	Recognised in equity	Closing balance
2012				
Property and Equipment	50,991	51,299	-	102,290
Accrued income	3,780	14,019	-	17,799
Revaluation of investment	77,183	(74,285)	-	2,898
Revaluation of Property	110,695	-	246,982	357,677
Gratuity and severance pay provisions	(24,777)	(448)	-	(25,225)
Property impairment	-	(4,297)	-	(4,297)
Tax (assets)/liabilities	**217,872**	**(13,712)**	**246,982**	**451,142**
2011				
Property and Equipment	31,270	19,721	-	50,991
Accrued income	50,042	(46,262)	-	3,780
Revaluation of investment	-	77,183	-	77,183
Revaluation of Property	103,639	-	7,056	110,695
Gratuity and severance pay provisions	(54,787)	30,010	-	(24,777)
Tax (assets)/liabilities	**130,164**	**80,652**	**7,056**	**217,872**

18. Customer deposits

	Group		Company	
	2012	**2011**	**2012**	**2011**
Current and savings accounts	19,297,203	18,010,968	19,376,908	13,868,496
Foreign currency accounts	7,818,808	4,203,453	7,818,808	2,690,013
Term deposit accounts	9,274,068	24,813,237	5,192,158	3,395,712
	36,390,079	47,027,658	32,387,874	19,954,221
Payable as follows:				
Maturing within 3 months	28,380,917	42,424,692	24,378,712	17,137,684
Maturing after 3 months and above	8,009,162	4,602,966	8,009,162	2,816,537
	36,390,079	**47,027,658**	**32,387,874**	**19,954,221**

For information about interest rates refer to note 5.

19. Balances due to other banks

	Group 2012	Group 2011	Company 2012	Company 2011
Local banks	200,000	-	200,000	-
European Investment Bank loan	1,172,534	1,055,165	1,172,534	1,055,165
Loans due to foreign banks	603,109	410,371	603,109	410,371
Other foreign banks	-	534	-	534
	1,975,643	**1,466,070**	**1,975,643**	**1,466,070**

Balances due to local banks represent overnight borrowing by the group.

in thousands of Malawi Kwacha

First Merchant Bank has two credit line facilities with European Investment Bank (EIB) and NORSAD Agency which are used to disburse as loans to customers in qualifying sectors.

The EIB line of credit is for a total of US$8m at an average fixed rate of 5.6% per annum as part Malawi Global Loan III. The facility was signed on 6 April 2008. The repayments are made biannually and the loan will be fully paid on 15 March 2019.

The NORSAD Agency on behalf of the NORSAD Fund granted a credit line of US$3m at a fixed interest rate of 7% per annum. The Line of Credit Agreement was signed on 13 June 2008. The repayments are made 4 times a year and the loan will be fully paid on 31 December 2015.

There are several covenants governing the determination of qualified recipients, the on-going monitoring process of the ultimate recipients and the repayment process. In all cases the Bank assumes all credit risk related to the ultimate borrower and must check compliance with all covenants.

The bank has not had any defaults of principal or interest during the period on its borrowed funds. At 31 December 2012, management believes that the Bank is in compliance with all significant covenants.

20. Other liabilities

	Group		Company	
	2012	**2011**	**2012**	**2011**
Interest payable	65,001	30,042	65,001	30,042
Bankers cheques issued and uncleared	168,655	265,465	132,976	224,724
Margins on letters of credit and forward And other instruments	155,720	213,964	155,722	-
Bills payable	125,756	91,517	119,922	91,517
Trade payables	489,786	863,694	487,698	875,274
Accrued expenses	568,867	141,115	538,118	107,483
	1,573,785	1,605,797	**1,499,437**	1,329,040

21. Employee benefits liabilities

	Group 2012	Group 2011	Company 2012	Company 2011
Severance pay provision				
Balance at 1 January	59,149	190,108	59,149	170,556
Transfers to profit or loss	-	(109,552)	-	(90,000)
Payment made during the year	(31,108)	(21,407)	(31,108)	(21,407)
Balance at 31 December	**28,041**	59,149	**28,041**	59,149

22 (a). Share capital

	Group and Company	
	2012	2011
Authorised, issued and fully paid 2,336,250,000 ordinary shares of 5 tambala each	**116,813**	116,813

(b). Share premium

Authorised, issued fully paid at 1 January and 31 December	**1,565,347**	1,565,347

Share premium represents the excess amount received over the face value of the bank's issued share capital.

in thousands of Malawi Kwacha

23. Property revaluation reserve

	Group		Company	
	2012	**2011**	**2012**	**2011**
Property revaluation	**1,614,204**	523,198	**1,519,018**	485,599

This represents the surplus arising on revaluation of property and equipment net of the related deferred taxation provision and is not available for distribution to the owners.

24. Investment revaluation reserve

	Group		Company	
	2012	**2011**	**2012**	**2011**
Investment revaluation	**1,827,528**	1,381,407	**1,688,085**	1,381,047

This represents the unrealized increase in fair value of investments at fair value through profit or loss net of the related deferred taxation provision transferred from retained earnings and is not available for distribution to the owners.

25. Loan loss reserve

	Group		Company	
	2012	**2011**	**2012**	**2011**
Loan loss reserve	**240,464**	114,638	**205,675**	16,898

Arising from the changes to IAS 39: Financial Instruments: Recognition and Measurement, the 1% general provision against risk assets as required by the Reserve Bank of Malawi may no longer be offset against the gross value of the assets. The loan loss reserve is additional impairment made in excess of what IAS 39 requires and is made in order to comply with the Reserve Bank of Malawi's requirements.

26. Non Distributable Reserves

	Group		Company	
	2012	**2011**	**2012**	**2011**
Non Distributable Reserves	**350,000**	350,000	**-**	-

This represents the capitalisation of retained earnings in Leasing and Finance Company of Malawi Limited in 2009 to meet the minimum capital requirement stipulated by the regulator.

in thousands of Malawi Kwacha

27. Interest income

	Group		Company	
	2012	2011	2012	2011
Loans and advances	3,974,636	4,098,761	3,989,886	2,970,459
Lease finance	1,277,013	927,321	-	-
Treasury bills	176,637	308,876	122,540	240,781
Bank of Botswana certificates	-	463,899	-	-
Local registered stocks	8,734	18,371	8,734	18,371
Promissory note (Malawi Government)	44,968	-	44,968	-
Placements with other banks	318,266	251,130	257,080	34,560
Total interest income	**5,800,254**	6,068,358	**4,423,208**	3,264,171

28. Income from investments

	Group		Company	
	2012	2011	2012	2011
Dividend income	158,364	97,896	308,363	222,896
Movement in fair value of investments	388,292	256,713	494,938	256,713
	546,656	354,609	**803,301**	479,609

29. Other operating income

	Group		Company	
	2012	2011	2012	2011
Profit on disposal of motor vehicles and equipment	264	2,182	264	385
Cash transaction income	-	42,630	-	-
Fees for excesses	-	26,912	-	-
Other	28,009	12,199	-	12,199
	28,273	83,923	**264**	12,584

30. Staff and training costs

	Group		Company	
	2012	2011	2012	2011
Salaries and wages	968,138	1,035,365	930,790	715,983
Training and other staff costs	1,090,165	595,331	1,022,854	594,912
Provision for severance pay	-	(109,552)	-	(90,000)
Contributions to defined contribution plans	72,514	65,263	68,322	52,148
	2,130,817	1,586,407	**2,021,966**	1,273,043

31. Other expenses

	Group		Company	
	2012	2011	2012	2011
Other costs include:				
Auditor's remuneration				
- Current audit fees	34,080	33,808	25,280	18,755
- Under provision in previous year	-	153	-	-
Directors' remuneration 67,210	114,046	67,120	113,966	
Others	998,379	935,480	912,591	694,514
Total other costs	**1,099,669**	1,083,487	**1,004,991**	827,235

in thousands of Malawi Kwacha

32. Income tax expense

Recognised in the statement of comprehensive income

	Group		Company	
	2012	**2011**	**2012**	**2011**
Current tax expense				
Current year at 30% (2011: 30%) based on profits	1,169,881	897,338	1,076,195	536,156
Dividend tax expense	-	20,191	-	20,191
Origination and reversal of temporary differences (Note 17)	(42,040)	78,091	(13,712)	80,652
Total income tax expense in statement of Comprehensive income	**1,127,841**	995,620	**1,062,483**	636,999

Reconciliation of effective tax rate

Operating Profit	**4,380,407**	3,010,651	**4,233,951**	2,135,275
Income tax using the domestic corporation tax rate 30% (2011: 30%)	1,314,122	903,196	1,270,186	640,583
Non-deductible expenses	33,848	139,110	31,815	43,102
Tax exempt income	(218,873)	(66,877)	(238,262)	(66,877)
Tax incentives on training costs	(1,256)	-	(1,256)	-
Dividend tax expense	-	20,191	-	20,191
Total income tax expense in statement of comprehensive income	**1,127,841**	995,620	**1,062,483**	636,999

33. Basic and diluted earnings per share

	Group	
	2012	**2011**
Profit attributable to ordinary shareholders	**3,416,668**	1,858,453
Weighted average number of ordinary shares in issue (thousands)	**2,336,250**	2,336,250
Basic and diluted earnings per share (tambala)	**146**	80

There are no potential dilutive ordinary shares.

34. Dividends

Last year's second interim dividend of **MK116.813 million** (2011: MK116.813 million), final dividend of **MK46.725 million** (2011: MK46.725 million) and an interim dividend for the year of **MK817.688 million** (2011: MK584.063 million) were declared and paid during the year.

in thousands of Malawi Kwacha

35. Related party transactions

The Group transacts part of its business with related parties including directors and parties related to or under the control of the directors. Details of related party transactions of the Group are set out below:

	31 December 2012	31 December 2011
Corporate bodies directly or indirectly Related to Directors*		
Balance at the beginning of the year	1,116,183	1,284,051
Loans granted during the year	1,315,986	29,107
Repayments	(413,395)	(196,975)
Balance at the end of the year	**2,018,774**	**1,116,183**
Subsidiary companies:		
Balance at the beginning of the year	39,682	-
Loans granted during the year	960,318	100,000
Repayments	(1,000,000)	(60,318)
Balance at the end of the year	**-**	**39,682**
Senior management:		
Balance at the beginning of the year	162,301	119,259
Loans granted during the year	173,645	98,141
Repayments	(109,331)	(55,099)
Balance at the end of the year	**226,615**	**162,301**

*There were no loans to Directors in their individual capacities. All loans to bodies directly or indirectly linked to Directors were made on arm's length commercial terms.

Advances to directors and parties related thereto are in the normal course of business and considered to be adequately secured.

Advances to employees include **MK2,947,000** (2011: MK4,947,000) of interest free advances and **MK449,885,000** (2011: MK267,499,000) of advances which carry interest at one quarter of the prevailing prime lending rate of the Bank. All other transactions with related parties are carried out on an arms length basis on normal commercial terms.

Transactions with related parties are conducted at arm's length basis.

in thousands of Malawi Kwacha

35. Related party transactions (continued)

Details of related party transactions between the Bank and its wholly owned subsidiaries and its associate Capital Bank Limited, The Leasing and Finance Company of Malawi Limited (LFC), FMB Forex Bureau Limited and FMB Pension Fund which have been eliminated on consolidation are as follows:

	2012	2011
Deposits by LFC Limited with FMB Limited	(56,685)	10,308
Loan syndications	647,791	188
Short term deposits	-	1,319,983
Fees and commissions received	31,647	4,162
Interest received	-	11,343
Interest paid	113,586	5,090
Management fees (Capital Bank Limited)	8,100	6,134

Key management personnel compensation:

	Executive Directors		Non-Executive Directors	
	2012	2011	2012	2011
Salaries	42,000	45,133	-	-
Bonuses	44,000	34,000	-	-
Fees	-	-	67,020	34,913
	86,000	79,133	**67,020**	34,913

In addition to their salaries, the Group also provides non-cash benefits to executive directors. The estimated value of total non-cash benefits to directors amounts to **MK3.1 million** (2011: MK2.7 million).

Directors' interests

As at 31 December 2012, the total direct and indirect interests of the directors and parties related thereto in the issued share capital of the company were as follows:

	Ordinary Shares	
	2012	2011
R. C. Kantaria	**1,050,000,000**	1,050,000,000
H. N. and N. G. Anadkat	**1,050,000,000**	1,050,000,000
J. M. O'Neill	**5,309,391**	4,649,391
M. Msisha	**1,050,000**	1,050,000
S.G. Malata	**47,250**	47,250

in thousands of Malawi Kwacha

36. Capital commitments and contingent liabilities

In common with other banks, the Bank conducts business involving acceptances, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties.

The contractual amounts of the Bank's off balance sheet financial instruments that commit it to extend credit to customers are as follows:

	Group		Company	
	2012	**2011**	**2012**	**2011**
Contingent liabilities				
Acceptances and letters of credit	3,772,293	199,747	3,772,293	160,294
Financial guarantees	8,343,516	8,205,328	8,343,516	5,030,825
	12,115,809	8,405,075	**12,115,809**	5,191,119

Contingencies in respect of letters of credit will only crystallise into an asset or a liability when bills are presented in accordance with the terms and conditions of payment of the individual letters of credit.

Contingencies in respect of guarantees and performance bonds issued will only crystallise into an asset and a liability in the event of default by the relevant counterparty.

Contingencies in respect of civil litigation and labour matters will crystallise into a liability only in the unlikely event of an unfavourable judgement.

Capital commitments

Company

Capital expenditure	**2012**	2011
Authorised but not contracted	**967,000**	281,740

in thousands of Malawi Kwacha

37. Statutory requirements

In accordance with Section 27 of the Banking Act 1989, the Reserve Bank of Malawi has established the following requirements as at the financial reporting date:

(i) Liquidity Reserve Requirement

The Bank is required to maintain a liquidity reserve as defined by the Reserve Bank of Malawi, calculated on a fortnight average basis, of not less than **15.5%** (2011: 15.5%) of the preceding weeks total deposit liabilities. In the last two weeks of December 2012, the liquidity reserve was **16.28%** (2011: 21.50%) of total customer deposits.

(ii) Capital Adequacy Requirement

The Bank's available capital is required to be a minimum of 10% of its risk bearing assets and contingent liabilities. At 31 December 2012, the Bank's available capital was **14.07%** (2011: 18.08%) of its risk bearing assets and contingent liabilities.

38. Exchange rates and inflation

The average of the year-end buying and selling rates of the major foreign currencies most affecting the performance of the group are stated below, together with the increase in the National Consumer Price Index, which represent an official measure of inflation.

Exchange rates	**2012**	2011	2010
	MK	MK	MK
Kwacha/GBP	541.6	255.0	235.6
Kwacha/Rand	39.6	22.2	23.8
Kwacha/US Dollar	335.0	165.4	150.8
Kwacha/Euro	442.0	214.4	202.9
Kwacha/Pula	42.5	21.7	22.7
Inflation rate %	34.6%	9.8%	7.4%

At the time of signing these financial statements the exchange rates moved as follows:

Kwacha/GBP	554.0
Kwacha/Rand	41.0
Kwacha/US Dollar	365.2
Kwacha/Euro	483.9
Kwacha/Pula	45.3

in thousands of Malawi Kwacha

39. Effective interest rates of financial assets and liabilities

The effective interest rates for the principal financial assets and liabilities at 31 December were in the following ranges:

	2012	2011
Assets		
Government securities	7.25-26.4%	6.00-8.00%
Deposits with banking institutions	6.50-32.0%	2.50-13.00%
Loans and advances to customers	7.75-45%	4.44-31.75%
Liabilities		
Customer deposits	0.75-31.0%	0.5-8.0%

40. Segmental Reporting

Separate financial information is presented to the Group's chief operating decision makers in respect of the individual legal entities comprised in the Group, namely:

- First Merchant Bank Limited – corporate and retail banking in Malawi
- The Leasing and Finance Company of Malawi Limited - deposit taking and asset finance in Malawi
- FMB Forex Bureau Limited – operation of foreign exchange bureaux in Malawi
- Capital Bank Limited – corporate and retail banking in Botswana *
- FMB Pensions Limited – Administration of Pension Funds

* An associate of the bank

In the case of First Merchant Bank Limited information on income and expenditure, assets and liabilities is further disaggregated between its various individual branches and agencies and its head office operations. Head office income includes group treasury income from dealing in foreign currency and trading in financial instruments and income from funds management, corporate advisory and transfer secretarial services. Head office expenditure includes all head office staff, premises and overhead costs including the costs of group treasury and capital market operations which are not separately identified in internal reports.

Branches and agencies of First Merchant Bank are all engaged in corporate and retail banking, offer similar products and services to similar classes of customer and are governed by the same regulatory environment. Given their common economic characteristics, these individual segments are aggregated and presented in a single segment, Malawi corporate and retail banking, in these financial statements.

40. Segmental Reporting (continued)

FMB Pension Fund Limited does not meet any of the quantitative thresholds set out in IFRS 8 Segment Reporting for separate disclosure and reporting and this segment has been aggregated into the Malawi corporate and retail banking segment information presented below.

Income tax expense, assets and liabilities are not disaggregated but allocated in full to head office.

Included in external interest income is income from placements with banks abroad of K4.5 million (2011: K5.02 million). All other revenues are attributable to the country in which the respective operating segment is domiciled.

During the year the Group earned K185.4 million (2011: K791.1 million) interest on Government of Malawi treasury bills and local registered stock; K45 million (2011: Knil) interest on Malawi Government Promissory Note; K167 million (2011: K184.6 million) interest on loans and advances to enterprises controlled by Government of Malawi.

in thousands of Malawi Kwacha

40. Segmental Reporting (Continued)

31 December 2012

	Malawi Corporate and Retail banking	FMB Forex Bureau	Malawi asset finance	Total Malawi	Botswana Corporate and Retail Banking	Total before adjustments	Consolidation adjustments	Total
Interest Income - External	4,423,208	-	1,490,781	5,913,989	-	5,913,989	(113,735)	5,800,254
Total Interest Income	**4,423,208**	**-**	**1,490,781**	**5,913,989**	**-**	**5,913,989**	**(113,735)**	**5,800,254**
Interest Expense - External	(867,937)	-	(776,349)	(1,644,286)	-	(1,644,286)	(146,069)	(1,498,217)
Total Interest Expense	**(867,937)**	**-**	**(776,349)**	**(1,644,286)**	**-**	**(1,644,286)**	**(146,069)**	**(1,498,217)**
NET INTEREST INCOME	**3,555,271**	**-**	**714,432**	**4,269,703**	**-**	**4,269,703**	**-**	**4,302,037**
Fees and Commissions	2,259,912	-	20,366	2,280,278	-	2,280,278	31,464	2,248,814
Total Fees and Commission	**2,259,912**	**-**	**20,366**	**2,280,278**	**-**	**2,280,278**	**31,464**	**2,248,814**
Income from Investments	696,655	-	-	696,656	-	696,656	150,000	546,656
Gain on foreign exchange transactions	1,872,418	-	-	1,872,418	-	1,872,418	-	1,872,418
Other Operating Income	2,202	26,942	-	29,144	-	29,144	871	28,273
Total Operating income	**8,386,458**	**26,942**	**734,797**	**9,148,198**	**-**	**9,148,198**	**-**	**8,998,198**

in thousands of Malawi Kwacha

40. Segmental Reporting (Continued)

	Malawi Corporate and Retail banking	FMB Forex Bureau	Malawi Asset finance	Total Malawi	Botswana Corporate and Retail Banking	Total before adjustments	Consolidation adjustments	Total
Staff and Training costs	(2,027,342)	(12,538)	(90,937)	(2,130,317)	-	(2,130,817)	-	(2,130,817)
Premises and Equipment	(543,794)	-	-	(543,794)	-	(543,794)	-	(543,794)
Depreciation	(389,074)	(2,041)	(5,318)	(396,434)	-	(396,434)	-	(396,434)
Other expense	(1,007,504)	(7,515)	(84,650)	(1,099,669)	-	(1,099,669)	-	(1,099,669)
Impairment of financial assets	(303,286)	-	(143,791)	(447,077)	-	(447,077)	-	(447,077)
Total Expenditure	**(4,271,000)**	**(22,094)**	**(324,696)**	**(4,617,791)**	**-**	**(4,617,791)**	**-**	**(4,617,791)**
Profit before income tax expense	4,146,730	4,848	410,099	4,561,677	164,102	4,561,678	150,000	4,565,621
Income tax expense	(1,062,484)	(1,419)	(125,062)	(1,188,966)	-	(1,188,966)	(61,125)	(1,127,841)
Profit for the year	**3,052,975**	**3,429**	**285,037**	**3,341,441**	**164,102**	**3,341,441**	**88,875**	**3,416,668**
Other Comprehensive Income								
Tax on other comprehensive income	(246,981)	-	(23,740)	(270,711)	-	(270,711)	-	(270,711)
Property revaluation	1,280,400	-	81,327	1,361,727	-	1,361,727	-	1,361,727
Other movements	(20,116)	-	-	(20,116)	-	(20,116)	-	(20,116)
Total other Comprehensive Income for the year	**1,033,419**	**-**	**57,587**	**1,070,890**	**-**	**1,070,890**	**-**	**1,070,890**
Total comprehensive income for the year	**4,368,989**	**-**	**118,569**	**4,487,558**	**-**	**4,487,558**	**-**	**4,487,558**
Total Segment assets	**47,468,035**	**198,959**	**6,376,466**	**54,043,461**	**-**	**54,043,461**	**(990,368)**	**53,053,093**
Total Segment Liabilities	**36,824,023**	**164,716**	**4,873,096**	**41,861,835**	**-**	**41,861,835**	**(915,331)**	**40,946,505**

in thousands of Malawi Kwacha

40. Segmental Reporting (Continued)

31 December 2011

	Malawi Corporate and Retail banking	FMB Forex Bureau	Malawi Asset Finance	Total Malawi	Botswana Corporate and Retail Banking	Total before adjustments	Consolidated adjustments	Total
Interest Income - External	3,264,171	157	1,227,366	4,491,694	1,593,256	6,084,950	16,592	6,068,358
Total Interest Income	**3,264,171**	**157**	**1,227,366**	**4,491,694**	**1,593,256**	**6,084,950**	**16,592**	**6,068,358**
Interest Expense - External	(400,420)	(806)	(546,170)	(947,396)	(868,665)	(1,816,061	(16,592)	(1,799,469)
Total Interest Expense	**(400,420)**	**(806)**	**(546,170)**	**(947,396)**	**(868,665)**	**(1,816,061)**	**(16,592)**	**(1,799,469)**
NET INTEREST INCOME	**2,863,751**	**(649)**	**681,196**	**3,544,298**	**724,591**	**4,268,889**	**-**	**4,268,889**
Fees and Commissions	109,195	281	11,644	121,120	192,100	313,220	(417)	312,803
Other external Fees and Commissions	932,588	-	-	932,588	-	932,588	-	932,588
Total Fees and Commission	**1,041,783**	**281**	**11,644**	**1,053,708**	**192,100**	**1,245,808**	**(417)**	**1,245,391**
Income from Investments	479,609		-	479,609		479,609	(125,000)	354,609
Gain on foreign exchange transactions	661,719	43,692	-	705,411	47,448	752,859	-	752,859
Other Operating Income	122,136	-	3,235	125,371	77,583	202,954	(9,479)	83,923
Total Operating income	**5,168,998**	**43,324**	**696,075**	**5,908,397**	**1,041,722**	**6,950,119**	**(134,896)**	**6,705,671**

in thousands of Malawi Kwacha

40. Segmental Reporting (Continued)

	Malawi Corporate and Retail banking	FMB Forex Bureau	Malawi Asset Finance	Total Malawi	Botswana Corporate and Retail Banking	Total before adjustments	Consolidation adjustments	Total
Staff and Training costs	(1,388,517)	(11,850)	(54,358)	(1,454,725)	(241,234)	(1,695,959)	-	(1,695,959)
Premises and equipment	(480,093)	(3,180)	-	(483,273)	(52,340)	(535,613)	-	(535,613)
Depreciation	(320,341)	(1,656)	(4,732)	(326,729)	(73,960)	(400,689)	-	(400,689)
Other expense	(848,200)	(5,392)	(53,488)	(907,080)	(186,303)	(1,093,383)	9,896	(1,083,487)
Impairment of financial assets	(26,044)	-	(22,759)	(48,803)	(40,020)	(88,823)	-	(88,823)
Total Expenditure	**(3,063,195)**	**(22,078)**	**(135,337)**	**(3,220,610)**	**(593,857)**	**(3,814,467)**	**9,896**	**(3,804,571)**
Profit before income tax expense	**2,105,803**	**21,246**	**560,738**	**2,687,787**	**447,865**	**3,135,652**	**(125,000)**	**3,010,652**
Income tax expense	(636,999)	(6,271)	(170,006)	(813,276)	(89,664)	(902,940)	(92,680)	(995,620)
Profit for the year	**1,468,804**	**14,975**	**390,732**	**1,874,511**	**358,201**	**2,232,712**	**(217,680)**	**2,015,032**
Other Comprehensive Income								
Tax on other Comprehensive income	7,056	-	(1,070)	5,986	-	5,986	-	5,986
Translation difference foe foreign operations	-	-	-	-	(102,241)	(102,241)	-	(102,241)
Total other Comprehensive income for the period	**7,056**	**-**	**(1,070)**	**5,986**	**(102,241)**	**(96,255)**	**-**	**(96,255)**
Total comprehensive income for the period	**1,475,860**	**14,975**	**389,662**	**1,880,497**	**255,960**	**2,136,457**	**(217,680)**	**1,918,777**
Total Segment assets	**30,255,863**	**120,675**	**10,846,970**	**41,223,508**	**19,592,835**	**60,816,343**	**(747,412)**	**60,068,931**
Total Segment Liabilities	**23,096,337**	**89,860**	**9,536,411**	**32,722,608**	**18,017,003**	**50,739,611**	**(15,054)**	**50,724,557**

41. Subsequent events

Subsequent to the reporting date, no significant events have occurred necessitating adjustments or disclosures in these consolidated and separate financial statements.

Shareholder Statistics

INDUSTRY	Holders	Holder %	Total Shares	Shares %
LOCAL COMPANIES	70	3.67%	1,610,081,609	68.92%
FOREIGN COMPANIES	7	0.37%	534,438,245	22.88%
CITIZEN RESIDENT INDIVIDUALS	1,569	82.24%	104,443,741	4.47%
PENSION FUNDS	38	1.99%	45,220,805	1.94%
INVESTMENT COMPANIES & TRUSTS	22	1.15%	9,714,949	0.42%
INSURANCE COMPANIES	7	0.37%	8,820,608	0.38%
BANKS	5	0.26%	7,314,790	0.31%
NOMINEES LOCAL	35	1.78%	4,236,299	0.18%
NON RESIDENTS	25	1.31%	4,052,739	0.17%
EMPLOYEES	108	5.66%	3,605,300	0.15%
OTHER ORGANISATIONS	7	0.37%	2,206,850	0.09%
PERMANENT RESIDENT	1	0.05%	984,152	0.04%
NON RESIDENT CITIZENS	4	0.21%	506,113	0.02%
LEASING AND FINANCE	9	0.47%	499,600	0.02%
FINANCIALS	1	0.05%	120,000	0.01%
DECEASED ESTATES	1	0.05%	4,200	0.00%
Grand Total	**1,909**	**100.00%**	**2,336,250,000**	**100.00%**

COUNTRY	Holders	Holder %	Total Shares	Shares %
BOTSWANA	1	0.00%	10,500	0.00%
CAYMAN ISLANDS	1	0.00%	990	0.00%
KENYA	3	0.10%	525,002,750	22.47%
MALAWI	1,854	97.59%	1,805,608,400	77.29%
PORTUGAL	8	0.37%	2,335,200	0.10%
SOUTH AFRICA	3	0.10%	298,515	0.01%
UNITED KINGDOM	3	0.10%	955,896	0.04%
USA	5	0.21%	659,268	0.03%
WARRANT NOT PRESENTABLE	29	1.47%	1,145,972	0.05%
ZIMBABWE	2	0.05%	232,509	0.01%
Grand Total	**1,909**	**100.00%**	**2,336,250,000**	**100.00%**

RANGE	Holders	Holder %	Total Shares	Shares %
1-5000	473	24.78%	1,196,078	0.05%
5001-10000	267	13.99%	1,803,738	0.08%
10001-25000	445	23.31%	7,004,216	0.30%
25001-50000	184	9.64%	6,940,478	0.30%
50001-100001	133	6.97%	9,006,438	0.39%
100001-200000	152	7.96%	18,487,877	0.79%
200001-500000	178	9.32%	52,548,060	2.25%
500001-1000000	41	2.15%	28,642,198	1.23%
1000001and Above	36	1.89%	2,210,620,917	94.62%
Grand Total	**1,909**	**100.00%**	**2,336,250,000**	**100.00%**

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RUMPHI	Thom Mtika	01 372 577 / 534	01 372 538
SALIMA	Mary Likoya	01 262 899 / 882	01 262 900
ZOMBA	Mackson Chibwe	01 527 268 / 253	01 527 288

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