FMB

FIRST MERCHANT BANK LIMITED

# 21st ANNUAL GENERAL MEETING 2017

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# NOTICE OF ANNUAL GENERAL MEETING

FMB

FIRST MERCHANT BANK LIMITED

**Notice is hereby given that the 21st Annual General Meeting of the Company will be held at the FMB Training Centre on 6 June 2017 at 15:30 to transact the following business:**

1. **Approval of minutes of the last Annual General Meeting**

   To approve the minutes of the 20th Annual General Meeting held on Friday, 18 May 2016.

2. **Audited financial statements**

   To receive and adopt the audited financial statements for the year ended 31 December 2016 together with the reports of the auditors and directors thereon.

3. **Dividend**

   To approve a final dividend of MK1,168.125 million (50 tambala per share) be paid in respect of the financial year ended 31 December 2016.

4. **Directors**

   **4.1** To re-elect as director Mr Hitesh Anadkat who retires by rotation but being eligible offers himself for re-election.

   **4.2** To re-elect as director Mr Bharat Jani who retires by rotation but being eligible offers himself for re-election.

   **4.3** To re-elect as director Mr Rasik Kantaria to serve until the next Annual General Meeting in compliance with the Companies Act, 2013 which requires annual election of persons above the age of 70.

   **4.4** To elect Ms Abena Lewis as a non-executive director.

   Ms Abena Lewis graduated from King's College London with an LLB Law (Hons) in 2004 and was admitted to membership of the New York Bar in 2009. Prior to returning to Malawi, Ms Foster worked with leading legal firms and financial institutions in London specialising in the area of regulatory compliance and corporate governance. She currently works with Foster Lewis Consulting LLP, a financial services and business advisory firm which she co-founded.

   **4.5** To elect Ms Constance Musopole as a non-executive director.

   Ms Constance Musopole graduated from the University of Malawi, The Polytechnic in 1996 with a Bachelor of Accountancy degree and is a Chartered Accountant with membership of ACCA and ICAM. She is currently the Chief Finance Officer of Lafarge Cement Malawi. Ms Musopole has worked with Lafarge in various finance roles in Zambia and Malawi since joining the group in 1997.

   **4.6** To confirm the remuneration of the directors including executive directors for the year ended 31 December 2016 and to authorise the non-executive directors to determine the remuneration of the executive directors for the forthcoming year.

   **4.7** To fix fees and sitting allowances for the Chairman and other non-executives for the year ending 31 December 2017.

   4.7.1 **Directors' fees**
   - i. Chairman from MK4,200,000.00 to MK5,040,000.00.
   - ii. Other non-executive directors from MK3,675,000.00 to MK4,410,000.00.

   4.7.2 **Sitting allowances**
   - iii. Chairman from MK262,500.00 to MK315,000.00.
   - iv. Other non-executive directors from MK210,000.00 to MK252,000.00.

5. **Auditors**

   **5.1** To approve the payment of audit fees of MK69,318,100.00 to Deloitte in respect of the audit of the financial statements for the year ended 31 December 2016.

   **5.2** To approve the re-appointment of Deloitte as auditors for the year ending 31 December 2017.

6. **Other business**

   To transact such other business as may be transacted at an annual general meeting of members.

**Oswald Chifundo Mtokale**
*Company Secretary*

# MINUTES OF THE 20TH ANNUAL GENERAL MEETING

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**Minutes of Annual General Meeting of First Merchant Bank Limited held on 18 May 2016 at the FMB Training Centre, Blantyre.**

**Directors present**

| | |
|---|---|
| Mr H N Anadkat | Chairman |
| Mr R C Kantaria | Director |
| Mr D Dikshit | Group Managing Director |
| Mr J M O'Neill | Director |
| Mr B Jani | Director |
| Mr K M Carpenter | Director |
| Dr E Ngalande | Director |
| Mr O Mtokale | Company Secretary |
| *Apologies* | |
| Mr M Msisha | Director |

| **Members present by proxy** | **Proxy holder** |
|---|---|
| FMB Pension Fund | Michael Kadumbo |
| First Merchant Bank Pension Fund | Michael Kadumbo |
| Manhill Limited | J M O'Neill |
| Livingstone Exports Limited | M Bamford |
| Livingstone Holdings Limited | M Bamford |
| N.G Anadkat Limited | M Bamford |
| Luvinda General Dealers | F Harawa |
| D. Makadia | M Mkandawire |
| Old Mutual Life Assurance Company Limited | Bernard Sanje |
| Escom Pension Fund | Bernard Sanje |
| TNM Pension Fund | Bernard Sanje |
| Standard Bank ITF Old Mutual Unit Trust | Bernard Sanje |
| Aviation Pension Fund | Bernard Sanje |
| Queen Gondwe | Geoffrey Gondwe |
| Magni Holdings Limited | Hitesh Anadkat |
| Prime Capital Holdings Limited | Mr B N Jani |
| Prime Bank Limited | Mr B N Jani |
| First Names Trust Company (Isle of Man) Limited – The Kalamata Trust | Hitesh Anadkat |
| First Names Trust Company (Isle of Man) Limited – The Raus Declaration Trust | Hitesh Anadkat |
| First Names Trust Company (Isle of Man) Limited – The Picconia Trust | Hitesh Anadkat |
| Roycan Trust Company SA – The North Star Trust | Hitesh Anadkat |
| First Names Trust Company (Isle of Man) Limited – The Lotus Trust | Hitesh Anadkat |
| First Names Trust Company (Isle of Man) Limited – Pisage Trust | Hitesh Anadkat |
| First Names Trust Company (Isle of Man) Limited – The Jasmine Trust | Hitesh Anadkat |
| Illovo Sugar Malawi Pension Fund | Edson Kachitsa |
| Illovo Sugar Malawi Pension Fund | Edson Kachitsa |
| Limbe Leaf Malawi Pension Fund | Edson Kachitsa |
| Limbe Leaf Pension Fund | Edson Kachitsa |
| Limbe Leaf Pension Fund | Edson Kachitsa |
| Limbe Leaf Pension Fund | Edson Kachitsa |
| National Investment Trust Limited | Edson Kachitsa |
| National Investment Trust Limited | Edson Kachitsa |
| NICO General Insurance Co | Edson Kachitsa |

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| Members present by proxy | Proxy holder |
|---|---|
| NICO Life Pension Fund | Edson Kachitsa |
| NICO Life Insurance Company | Edson Kachitsa |
| Press Corporation Limited Pension Fund | Edson Kachitsa |
| Puma (BP) Pension Fund | Edson Kachitsa |
| Standard Bank Pension Fund | Edson Kachitsa |
| Sucoma Group Pension Fund | Edson Kachitsa |
| Sucoma Group Pension Fund | Edson Kachitsa |
| Toyota Malawi Pension Fund | Edson Kachitsa |
| Toyota Malawi Pension Fund | Edson Kachitsa |

| Shareholders present | |
|---|---|
| R R Kaunda | E S Kanyenya |
| R W Kaima | Wesley Mankhomwa |
| Ligwia Kaima | Victor Banda |
| E Chinunda | Andrew Mkandawire |
| H Anadkat | Maclan Kankhomba |
| J P Kalulu | Leonard B C Kasuma |
| Fletcher N Nyirenda | Wilson Kuyokwa |
| D G Mwamira | Tamanda Kamoto |

### Quorum

The Company Secretary reported that a quorum of members was present and the Chairman called the meeting to order at 15:30. It was agreed that the notice of the meeting, which was properly given, be taken as read.

### Scrutineer

The Chairman informed the meeting that he had appointed Deloitte as independent scrutineer of the voting at the meeting.

1. **Approval of minutes of the last Annual General Meeting**

   The minutes of the 19th Annual General Meeting circulated to members were approved as a true record of the meeting. (Motion was carried by a favourable show of hands)

2. **Audited financial statements**

   The audited financial statements for the year ended 31 December 2015 together with the reports of the auditors and directors thereon were approved and adopted. (Motion was carried by a favourable show of hands)

3. **Dividend**

   As recommended by directors, a final dividend of K467.25 million (20 tambala per share) be paid in respect of the financial year ended 31 December 2015. (Motion was carried by a favourable show of hands)

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## 4. Directors

4.1 Mr Modecai Msisha and Mr Dheeraj Dikshit who retired by rotation but being eligible offered themselves for re-election were re-elected. (Motion was carried by a favourable show of hands)

4.2 The appointment of Mr Kevin Carpenter who was co-opted since the last Annual General Meeting was confirmed. (Motion was carried by a favourable show of hands)

4.3 The remuneration of the executive directors for the year ended 2015 was confirmed and the non-executive directors were authorised to determine the remuneration of the executive directors for the forthcoming year, 2016. (Motion was carried by a favourable show of hands)

4.4 The fees and sitting allowances for the Chairman and other non-executive directors for the year ending 31 December 2016 be raised and fixed as follows:

4.4.1 **Directors' fees**

i. Chairman from MK3,360,000.00 to MK4,200,000.00

ii. Other non-executive directors from K2,294,000.00 to MK3,675,000.00

4.4.2 **Sitting allowances**

i. Chairman from MK210,000.00 to MK262,500.00

ii. Other non-executive directors from MK168,000.00 to MK210,000.00

4.5 The special remuneration paid to the non-executive directors in accordance with the provisions of the articles of association of the company during the period ended 31 December 2015 was approved. (Motion was carried by a favourable show of hands)

## 5. Auditors

5.1 The payment of audit fees of K54,255,063.00 to KPMG in respect of the audit of the financial statements for the year ended 31 December 2015 was approved. (Motion was carried by a favourable show of hands)

5.2 Deloitte, a firm of auditors, was appointed as auditors for the year ending 31 December 2016. (Motion was carried by a favourable show of hands)

## 6. Other business

There being no other business of which due notice had been given the meeting was closed.

**Mr H N Anadkat**
*Chairman*

# DIRECTORS' REPORT

For the year ended 31 December 2016

The Directors have pleasure in submitting their report together with the audited consolidated and separate financial statements of First Merchant Bank Limited and its subsidiaries for the year ended 31 December 2016.

## NATURE OF BUSINESS, SUBSIDIARIES AND REGISTERED OFFICE

First Merchant Bank Limited is a public limited liability company incorporated in Malawi under the Malawi Companies Act. It is listed on the Malawi Stock Exchange and is registered as a commercial bank under the Banking Act 2010. It has five wholly owned subsidiaries incorporated in Malawi as follows:

- The Leasing and Finance Company of Malawi Limited – involved in deposit-taking and asset financing
- FMB Capital Markets Limited – involved in asset management
- FMB Forex Bureau Limited – dormant
- FMB Pensions Limited – dormant
- International Commercial Bank Limited – dormant

The Group has the following subsidiaries operating outside Malawi:

- Capital Bank Limited, Mozambique – involved in corporate and retail banking (70.0% shareholding)
- First Capital Bank Zambia Limited – involved in corporate and retail banking (49.0% shareholding)
- Capital Bank Limited, Botswana – involved in corporate and retail banking (38.6% shareholding)

The physical address of First Merchant Bank Limited'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 consolidated and separate statements of financial position, statements of profit or loss and other comprehensive income, statements of changes in equity, statements of cash flows and associated accounting policies and notes.

## DIVIDENDS

Last year's final dividend of K467.25 million (20 tambala per share) was paid during the year. There was no interim dividend for the year 2016. The Directors propose a final dividend of K1,168.125 million (50 tambala per share) for approval at the forthcoming Annual General Meeting.

## DIRECTORATE AND SECRETARY

The following Directors and Company Secretary served during the year:

| | | |
|---|---|---|
| Mr H N Anadkat | Chairman | Non-executive |
| Mr D Dikshit | Group Managing Director | Executive |
| Mr J M O'Neill | Director | Non-executive (Group Finance Director up to March 2016) |
| Mr R C Kantaria | Director | Non-executive |
| Mr B Jani | Director | Non-executive |
| Mr M Msisha | Director | Non-executive |
| Dr E Ngalande | Director | Non-executive |
| Mr K M Carpenter | Director | Non-executive |
| Mr O Mtokale | Company Secretary | |

## SHAREHOLDING ANALYSIS

| Name | 2016 % | 2015 % |
|---|---|---|
| Magni Holdings Limited | **32.80** | 32.80 |
| Prime Capital and Credit Limited | **11.24** | 11.24 |
| Prime Bank Limited | **11.24** | 11.24 |
| N G Anadkat Limited | **7.15** | 7.15 |
| H N Anadkat | **4.56** | 4.99 |
| General Public | **33.01** | 32.58 |
| **Total** | **100.00** | 100.00 |

Subsequent to the year-end, the board of directors were advised by three principal shareholders, collectively representing 55% of the issued capital of FMB that they intend to transfer their shares in FMB to FMB Capital Holdings Plc ("FMBCH"), a company incorporated in Mauritius, in exchange for shares in FMBCH. Subsequently, FMBCH will make an offer on the same terms to acquire the remaining 45% of the issued shares of FMB by way of an offer document complying with the MSE Listings Requirements and the Companies (Panel on Takeovers and Mergers) Rules 2016. On conclusion of the offer period, an application will be made to the Malawi Stock Exchange to list the shares of FMBCH and delist the shares of FMB.

**Mr D Dikshit**
*Group Managing Director*

**Mr H N Anadkat**
*Chairman*

# STATEMENT ON CORPORATE GOVERNANCE

For the year ended 31 December 2016

## THE BOARD

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

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

| | Board meetings attendance 2016 | | | |
|---|---|---|---|---|
| **Member** | **23 Mar 2016** | **18 May 2016** | **16 Aug 2016** | **22 Nov 2016** |
| Mr H N Anadkat – Chairman | √ | √ | √ | √ |
| Mr D Dikshit | √ | √ | √ | √ |
| Mr J M O'Neill | √ | √ | √ | √ |
| Mr M Msisha | √ | x | √ | √ |
| Mr B Jani | √ | √ | √ | x |
| Dr E Ngalande | √ | √ | √ | √ |
| Mr K M Carpenter | √ | √ | √ | √ |
| Mr R C Kantaria | √ | √ | √ | √ |

**Key**
√ = Attended
X = Apology

## BOARD AND MANAGEMENT COMMITTEES

There are three permanent management committees: the Asset and Liability Management Committee, the Management Risk Committee, and the Management Credit Committee, which meet monthly. There are four permanent board committees (comprising of Directors): the Audit Committee, Credit Committee, Appointments and Remuneration Committee, and Risk Committee. Additionally, there is an informal Business Management Committee which comprises of the Group General Manager – Corporate and Commercial Banking, Head of Corporate, Head of Retail/Chief Commercial Officer, Head of Government and International Organisations and Head of Marketing. 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 mobilised and funds deployed. The ALCO seeks to manage risks in order to minimise 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 comprises of the Group General Manager – Treasury and International Banking (Chairman) and nine members of management and meets regularly, usually once a month. The members of the ALCO are:

Group Managing Director

Group General Manager, Credit and Operations

Group General Manager, Treasury and International Banking

Group General Manager, Corporate and Commercial Banking

Head of Corporate Banking

Group Chief Operating Officer

Chief Finance Officer

Manager, Treasury

Risk and Compliance Manager

Management Accountant

## Management Risk Committee (MRC)

MRC is chaired by the Group Managing Director and meets monthly to review management of strategic risk, operational risk, compliance risk, reputation risk and any other risks in the Bank. This forum facilitates coordination and communication among various risk owners and risk management functions to resolve risk related issues in the Bank expeditiously and promote efficient management of relative risks. The members of the MRC are:

Group Managing Director

Group General Manager – Credit and Operations

Group General Manager – Treasury and International Banking

Group General Manager – Corporate and Commercial Banking

Group Head of Information Technology

Risk and Compliance Manager

Group Chief Operations Officer

Chief Operating Officer

Chief Commercial Officer

Head of Corporate Banking

Head of Government and International Organisations

Head of Internal Audit

Head of Human Resources

Head of Alternate Channels

Company Secretary and Legal Counsel

## Management Credit Committee (MCC)

MCC is chaired by the Group Managing Director and meets monthly to review management of credit risk in the Bank. The members of the MCC are:

Group Managing Director

Group General Manager – Credit and Operations

Group General Manager – Corporate and Commercial Banking

Head of Corporate Banking

Risk and Compliance Manager

Company Secretary and Legal Counsel

## 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 the status of the Bank's internal controls and exposures to risks. 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 three non-executive Directors, one of whom acts as Chairman. The Committee meets at least twice a year. During the year, the following served as members of the Audit Committee:

| | |
|---|---|
| Mr K Carpenter | Non-executive Director (Chairman) |
| Mr E Ngalande | Non-executive Director |
| Mr V Kantaria | Alternate to R C Kantaria |

| | Audit Committee meetings attendance 2016 | | | |
|---|---|---|---|---|
| **Members** | **15 Mar 2016** | **17 May 2016** | **15 Aug 2016** | **21 Nov 2016** |
| Mr K Carpenter – Chairman | √ | √ | √ | √ |
| Dr E Ngalande | √ | √ | √ | √ |
| Mr V Kantaria | x | x | x | x |

**Key**
√ = Attended
X = Apology

## Credit Committee

The Credit Committee comprises of three 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:

| | Credit Committee attendance 2016 | | | |
|---|---|---|---|---|
| **Members** | **22 Mar 2016** | **17 May 2016** | **16 Aug 2016** | **22 Nov 2016** |
| Mr J M O'Neill – Chairman | √ | √ | √ | √ |
| Mr B Jani | x | √ | √ | x |
| Mr M Msisha | √ | x | √ | x |

**Key**
√ = Attended
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 comprises the following members:

Mr H N Anadkat – Chairman

Mr M Msisha

Mr B Jani

## 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, and comprises of three Directors, with at least one non-executive director. The chairman of the Committee is a non-executive director. The Group General Manager – Credit and Operations, Group General Manager – Treasury and International Banking, Group General Manager – Corporate and Commercial Banking, Group Chief Operations Officer, Chief Financial Officer and Risk and Compliance Manager attend all meetings. The members of the Committee are:

| | |
|---|---|
| Mr B Jani | Non-executive Director (Chairman) |
| Mr D Dikshit | Group Managing Director |
| Mr J M O'Neill | Director (up to 30 April 2016) |

| Member | Risk Committee meetings attendance 2016<br>23 Mar 2016 | 17 May 2016 | 16 Aug 2016 | 24 Nov 2016 |
|---|---|---|---|---|
| Mr B Jani – Chairman | √ | √ | √ | x |
| Mr D Dikshit | √ | √ | √ | x |
| Mr J M O'Neill | √ | N/A | N/A | N/A |

**Key**
√ = Attended
X = Apology
N/A = Not applicable

## DIRECTORS' QUALIFICATIONS

| | |
|---|---|
| H N Anadkat, BSc (Econ), MBA | Chairman |
| D Dikshit, BComm, MBA | Group Managing Director |
| J M O'Neill, BSc (Maths and Mgt Sc) FCA, CA (Mw) | Director |
| R C Kantaria, BSc (Econ) | Director |
| M Msisha, SC LLM (Toronto), LLB (Hons) Mw | Director |
| B Jani, Post Grad. (Commerce), BSc (Banking and Fin. Mgt) | Director |
| E Ngalande, Phd, BSoc, MA | Director |
| K M Carpenter, FCA, CA (Mw) | Director |

## ETHICAL STANDARDS

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

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

For the year ended 31 December 2016

The Directors are responsible for the preparation and fair presentation of the consolidated and separate annual financial statements of First Merchant Bank Limited, comprising the consolidated and separate statements of financial position at 31 December 2016 and the statements of profit or loss and other comprehensive income, changes in equity and 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, in accordance with International Financial Reporting Standards, and in the manner required by the Malawi Companies Act and the Banking Act 2010. In addition, the Directors are responsible for preparing the Directors' Report.

The Malawi Companies Act also requires the Directors to ensure that the Group and Company maintain proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and Company and ensure the financial statements comply with the Malawi Companies Act.

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 have made an assessment of the Company and its subsidiaries respective abilities to continue as going concerns and have no reason to believe that these businesses will not be going concerns in the year ahead except for those entities described as dormant on page 4.

The external auditor is responsible for reporting on whether the consolidated and separate financial statements are fairly presented in accordance with International Financial Reporting Standards and in a manner required by the Malawi Companies Act.

## Approval of financial statements

The consolidated and separate financial statements of First Merchant Bank Limited as identified in the first paragraph, were approved by the Board of Directors on 29 March 2017 and are signed on its behalf by:

By order of the Board

**Mr D Dikshit**
*Group Managing Director*

**Mr H N Anadkat**
*Chairman*

# INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF FIRST MERCHANT BANK LIMITED

## OPINION

We have audited the consolidated and separate financial statements of First Merchant Bank Limited, set out on pages 16 to 85, which comprise the statements of financial position as at 31 December 2016, and the statements of profit or loss and other comprehensive income, the statements of changes in equity and the statements of cash flows for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated and separate financial statements give a true and fair view of the financial position of First Merchant Bank Limited as at 31 December 2016, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) and in the manner required by the Malawi Companies Act.

## BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the consolidated and separate financial statements section of our report. We are independent of First Merchant Bank Limited in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of consolidated and separate financial statements in Malawi. We have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated and separate financial statements of the current period. These matters were addressed in the context of our audit of the consolidated and separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. The key audit matters noted below relate to the financial statements.

| Key audit matter | How the matter was addressed in the audit |
|---|---|
| **Impairment of loans and advances (Consolidated)** | |
| Significant judgement is required by the Directors in assessing the impairment against loans and advances.<br><br>As disclosed in note 9, impairment against loans and advances amounting to K3 170 million (2015: K3 180 million) against gross loans and advances of K129 695 million (2015: K107 339 million), represents the shortfall between the present value of future expected cash flows, discounted at the original effective interest rates, and the carrying value of the advances in respect of loans and advances that exhibit indicators of impairment.<br><br>The judgements applied in determining the impairment include:<br>• the expected realisable value of the collateral securing the advance; and<br>• the probability that an advance will result in loss.<br><br>As a result of the above noted significant judgements made by the Directors, impairment against loans and advances is considered a key audit matter. | In evaluating the impairment against loans and advances, we assessed the judgements applied by the Directors and our procedures included the following:<br>• Examining on a sample basis the appraised fair value of the collateral securing impaired advances;<br>• Considering the qualitative factors that indicate impairment including the amount in arrears, period in arrears and the financial strength of the borrower;<br>• Assessing the adequacy of the impairment raised based on the realisable value of collateral and the qualitative factors described above; and<br>• Considering managements' credit control processes to identify impaired advances and testing of relevant key controls in the process.<br><br>We found that the judgements applied in determining impairment against loans and advances were appropriate and that the amount raised was reasonable. |
| **Consolidation of Capital Bank Botswana and First Capital Bank of Zambia (Consolidated)** | |
| As disclosed in note 4(a), the consolidated financial statements incorporate the financial statements of First Merchant Bank Limited (FMB) and its subsidiaries. In prior years, FMB consolidated all investments where > 50% shares were held. | Our procedures focused on evaluating FMB's ability to exercise effective (*de facto*) control over the two entities that could qualify for full consolidation. The procedures included:<br>• Discussions with management;<br>• Review of inter-company management agreements; and<br>• Scrutiny of the minority shareholdings in the two entities. |

| Key audit matter | How the matter was addressed in the audit |
|---|---|
| **Consolidation of Capital Bank Botswana and First Capital Bank of Zambia (Consolidated) (continued)** | |
| Investments in First Capital Bank Limited of Zambia (49.0% equity ownership) and Capital Bank Limited of Botswana (38.6% equity ownership) were accounted for using the equity method of accounting under IAS 28 *Investments in Associates* on the grounds that FMB did not have effective control over the two entities.<br><br>In determining whether control exists, IFRS 10 *Consolidated Financial Statements* requires entities to take into account all facts and circumstances, including the size of the investor's holding of voting rights relative to the size and dispersion of other vote holders and voting patterns of the other vote holders at previous shareholders' meetings.<br><br>After reconsideration, the Directors have decided to consolidate the above-noted investments, as they believe that FMB has effective control over the two entities including the power to determine the appointment of key management personnel and to dictate major operating and capital decisions in the two entities. These powers signify the exercise of control as described by IFRS 10 *Consolidated Financial Statements* as "*de facto*" control (i.e. where an investor with less than 50% of the voting rights of an investee has control of the investee for reasons other than contractual arrangements and potential voting rights). Additionally, management believes that FMB held effective control in recent years and, consequently, have restated the comparative balances in the current year group financial statements in line with the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.<br><br>As a result of the above decision and the related impact on the financial statements the consolidation of the two entities was considered a key audit matter. | In addition, we assessed whether FMB had control over the two entities in prior years. This involved review of any changes in the quality of involvement of FMB in the governance and operations of the two entities.<br><br>The results of our procedures led us to concur with management's decision to consolidate the two entities as FMB has had the power to direct the relevant activities of the Botswana and Zambian investments over recent years. |

## OTHER INFORMATION

The Directors are responsible for the other information. The other information comprises the Directors' Report, as required by the Companies Act which we obtained prior to the date of this auditor's report and the Annual Report, which is expected to be made available to us after that date. The other information does not include the consolidated and separate financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## RESPONSIBILITIES OF THE DIRECTORS FOR THE CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

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

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

## AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

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

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

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors;
- conclude on the appropriateness of the Directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated and separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation; and
- obtain sufficient appropriate audit evidence regarding the financial information of the Group or business activities within the Group to express an opinion on the financial statements.

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

We also provide the Directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Directors, we determine those matters that were of most significance in the audit of the consolidated and separate financial statements of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Deloitte.

*Chartered Accountants*

**John Melrose**
*Partner*

30 March 2017

# STATEMENTS OF FINANCIAL POSITION

31 December 2016

| | | CONSOLIDATED | | | SEPARATE | | |
|---|---|---|---|---|---|---|---|
| | | | Restated | Restated | | Restated | |
| | Notes | **2016 K'000** | 2015 K'000 | 2014 K'000 | **2016 K'000** | 2015 K'000 | 2014 K'000 |
| **ASSETS** | | | | | | | |
| Cash and cash equivalents | 7 | **84 616 608** | 73 221 496 | 54 426 309 | **23 326 706** | 28 565 161 | 24 978 112 |
| Money market investments | 8 | **69 016 614** | 52 258 589 | 18 343 566 | **48 548 466** | 26 991 153 | 6 599 188 |
| Loans and advances to customers | 9 | **126 523 651** | 104 158 389 | 78 572 880 | **42 067 041** | 40 285 729 | 29 486 492 |
| Finance lease receivables | 10 | **4 783 100** | 3 524 013 | 4 556 258 | **–** | – | – |
| Amounts due from related parties | 12 | **–** | – | – | **248 533** | 377 072 | 202 907 |
| Derivative asset | 37 | **19 288 094** | 5 980 005 | – | **19 288 094** | 5 980 005 | – |
| Current tax assets | 29(c) | **1 083 165** | 922 527 | 259 690 | **483 886** | 331 530 | – |
| Investments in listed companies | 13 | **3 174 501** | 4 617 771 | 5 025 873 | **3 174 501** | 4 617 771 | 5 025 873 |
| Investment in subsidiaries | 14 | **–** | – | – | **9 348 047** | 7 866 938 | 7 075 393 |
| Investment property | 15(c) | **878 175** | – | – | **–** | – | – |
| Intangible assets | 15(a) | **4 759 657** | 4 043 692 | 1 264 312 | **3 204 457** | 2 224 273 | 156 960 |
| Property and equipment | 15(b) | **11 096 818** | 10 329 774 | 10 858 815 | **7 091 819** | 5 902 424 | 6 912 930 |
| Other assets | 11 | **2 193 330** | 3 345 708 | 4 188 389 | **1 345 806** | 1 016 450 | 1 579 398 |
| **Total assets** | | **327 413 713** | 262 401 964 | 177 496 092 | **158 127 356** | 124 158 506 | 82 017 253 |
| **LIABILITIES AND EQUITY** | | | | | | | |
| **Liabilities** | | | | | | | |
| Balances due to other banks | 17 | **29 553 483** | 23 560 642 | 11 017 773 | **29 181 384** | 14 817 952 | 6 222 275 |
| Customer deposits | 18 | **225 238 235** | 191 224 074 | 121 034 339 | **78 516 090** | 78 334 359 | 46 143 472 |
| Current tax liabilities | | **–** | – | 409 599 | **–** | – | 367 144 |
| Other payables | 19 | **18 008 566** | 3 924 668 | 7 072 848 | **14 586 999** | 2 240 167 | 4 537 449 |
| Subordinated debt | 36 | **9 031 122** | 8 380 285 | 6 092 280 | **7 000 000** | 6 644 451 | 4 644 276 |
| Deferred tax | 16 | **1 761 994** | 1 097 134 | 459 403 | **1 868 827** | 652 801 | 210 624 |
| **Total liabilities** | | **283 593 400** | 228 186 803 | 146 086 242 | **131 153 300** | 102 689 730 | 62 125 240 |
| **Equity** | | | | | | | |
| Share capital | 20(a) | **116 813** | 116 813 | 116 813 | **116 813** | 116 813 | 116 813 |
| Share premium | 20(b) | **1 565 347** | 1 565 347 | 1 565 347 | **1 565 347** | 1 565 347 | 1 565 347 |
| Property revaluation reserve | 21 | **3 447 824** | 2 634 331 | 2 705 248 | **3 339 180** | 2 550 356 | 2 550 356 |
| Loan loss reserve | 22 | **1 260 194** | 1 796 397 | 1 056 223 | **776 191** | 1 345 670 | 445 009 |
| Non-distributable reserves | 23 | **350 000** | 350 000 | 350 000 | **–** | – | – |
| Translation reserve | 24 | **1 893 679** | 1 508 298 | 1 363 367 | **–** | – | – |
| Retained earnings | | **23 129 420** | 16 673 167 | 15 590 809 | **21 176 525** | 15 890 590 | 15 214 488 |
| **Total equity attributable to equity holders of the Company** | | **31 763 277** | 24 644 353 | 22 747 807 | **26 974 056** | 21 468 776 | 19 892 013 |
| Non-controlling interest | 31(b) | **12 057 036** | 9 570 808 | 8 662 043 | **–** | – | – |
| **Total equity** | | **43 820 313** | 34 215 161 | 31 409 850 | **26 974 056** | 21 468 776 | 19 892 013 |
| **Total equity and liabilities** | | **327 413 713** | 262 401 964 | 177 496 092 | **158 127 356** | 124 158 506 | 82 017 253 |

The consolidated and separate financial statements were approved for issue by the Bank's Board of Directors on 29 March 2017 and were signed on its behalf by:

**Mr H N Anadkat**
*Chairman*

**Mr D Dikshit**
*Group Managing Director*

# STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2016

| | | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|---|
| | Notes | 2016<br>K'000 | Restated<br>2015<br>K'000 | 2016<br>K'000 | 2015<br>K'000 |
| Interest income | 25 | **34 001 870** | 23 556 521 | **19 041 104** | 12 728 531 |
| Interest expense on deposits and other accounts | | **(12 955 304)** | (7 467 066) | **(6 872 063)** | (2 960 979) |
| **Net interest income** | | **21 046 566** | 16 089 455 | **12 169 041** | 9 767 552 |
| Fees and commission income | | **9 390 583** | 5 796 072 | **6 149 151** | 2 759 419 |
| (Loss)/income from investments | 26 | **(1 373 565)** | (352 563) | **(962 732)** | 147 437 |
| Gain on foreign exchange transactions | | **5 235 732** | 2 893 215 | **2 256 583** | 2 350 452 |
| **Total operating income** | | **34 299 316** | 24 426 179 | **19 612 043** | 15 024 860 |
| Staff and training costs | 27 | **11 297 517** | 9 013 529 | **5 943 962** | 5 024 206 |
| Premises and equipment costs | | **3 611 027** | 1 788 833 | **1 750 921** | 1 346 199 |
| Depreciation and amortisation | 15 | **2 144 204** | 1 503 014 | **1 117 758** | 744 304 |
| Other expenses | 28 | **5 363 363** | 4 940 252 | **2 793 770** | 2 135 019 |
| Impairment loss on financial assets | 38 | **496 963** | 986 778 | **9 032** | 164 735 |
| **Total expenses** | | **22 913 074** | 18 232 406 | **11 615 443** | 9 414 463 |
| **Profit before income tax expense** | | **11 386 242** | 6 193 773 | **7 996 600** | 5 610 397 |
| Income tax expense | 29 | **(3 725 226)** | (1 930 566) | **(2 812 894)** | (1 697 384) |
| **Profit for the year** | | **7 661 016** | 4 263 207 | **5 183 706** | 3 913 013 |
| **Other comprehensive income** | | | | | |
| **Items that will never be classified to profit or loss** | | | | | |
| Revaluation surplus on property | | **904 317** | – | **878 244** | – |
| Deferred tax on revalued property | | **(91 131)** | 14 369 | **(89 727)** | – |
| Deferred tax released on disposal of revalued property | | **307** | – | **307** | – |
| | | **813 493** | 14 369 | **788 824** | – |
| **Items that are or may be classified to profit or loss** | | | | | |
| Translation difference for foreign operations | | **1 616 629** | 524 752 | **–** | – |
| **Total other comprehensive income for the year** | | **2 430 122** | 539 121 | **788 824** | – |
| **Total comprehensive income for the year** | | **10 091 138** | 4 802 328 | **5 972 530** | 3 913 013 |
| **Profit or loss attributable to:** | | | | | |
| Owners of the parent | | **6 387 300** | 4 073 496 | **5 183 706** | 3 913 013 |
| Non-controlling interest | 31(b) | **1 273 716** | 189 711 | **–** | – |
| **Profit for the year** | | **7 661 016** | 4 263 207 | **5 183 706** | 3 913 013 |
| **Total comprehensive income attributable to:** | | | | | |
| Owners of the parent | | **7 586 174** | 4 232 796 | **5 972 530** | 3 913 013 |
| Non-controlling interest | | **2 504 964** | 569 532 | **–** | – |
| **Total comprehensive income for the year** | | **10 091 138** | 4 802 328 | **5 972 530** | 3 913 013 |
| **Basic and diluted earnings per share** | 30 | **273** | 174 | **–** | – |

# STATEMENTS OF CHANGES IN EQUITY
For the year ended 31 December 2016

CONSOLIDATED

| | Share capital K'000 | Share premium K'000 | Translation reserve K'000 | Property revaluation K'000 |
|---|---|---|---|---|
| **2016** | | | | |
| As at 1 January 2016 (as restated) | **116 813** | **1 565 347** | **1 508 298** | **2 634 331** |
| Profit for the year | – | – | – | – |
| **Other comprehensive income** | | | | |
| Property revaluation | – | – | – | 904 317 |
| Deferred tax on revalued assets | – | – | – | (91 131) |
| Deferred tax released on disposal of revalued property | – | – | – | 307 |
| Arising on consolidation of subsidiaries | – | – | 385 381 | – |
| **Total other comprehensive income** | – | – | 385 381 | 813 493 |
| **Total comprehensive income for the year** | – | – | 385 381 | 813 493 |
| **Transfers within reserves** | | | | |
| Transfer from loan loss reserve | – | – | – | – |
| **Total transfers within reserves** | – | – | – | – |
| **Transactions with owners, recorded directly in equity** | | | | |
| **Contribution by and distribution to owners** | | | | |
| Additional capital subscription | – | – | – | – |
| Dividends paid to non-controlling interests | – | – | – | – |
| Dividends paid to owners of the parent | – | – | – | – |
| **Total transactions with owners** | – | – | – | – |
| **As at 31 December 2016** | **116 813** | **1 565 347** | **1 893 679** | **3 447 824** |
| **2015 (restated)** | | | | |
| As at 1 January 2015 (restated) | 116 813 | 1 565 347 | 1 363 367 | 2 705 248 |
| Profit for the year | – | – | – | – |
| **Other comprehensive income** | | | | |
| Property revaluation | – | – | – | – |
| Deferred tax on revalued assets | – | – | – | 14 369 |
| Arising on consolidation of subsidiaries | – | – | 144 931 | – |
| **Total other comprehensive income** | – | – | 144 931 | 14 369 |
| **Total comprehensive income for the year** | – | – | 144 931 | 14 369 |
| **Transfers within reserves** | | | | |
| Transfer of reserve on sale of property | – | – | – | (85 286) |
| Transfer to loan loss reserve | – | – | – | – |
| **Total transfers within reserves** | – | – | – | (85 286) |
| **Transactions with owners, recorded directly in equity** | | | | |
| **Contribution by and distribution to owners** | | | | |
| Additional capital subscription | – | – | – | – |
| Dividends paid | – | – | – | – |
| **Total transactions with owners** | – | – | – | – |
| **As at 31 December 2015 (restated)** | 116 813 | 1 565 347 | 1 508 298 | 2 634 331 |

| | Loan loss reserve K'000 | Non-distributable reserve K'000 | Retained earnings K'000 | Equity attributable to owners K'000 | Non- controlling interest K'000 | Total equity K'000 |
|---|---|---|---|---|---|---|
| | **1 796 397** | **350 000** | **16 673 167** | **24 644 353** | **9 570 808** | **34 215 161** |
| | **–** | **–** | **6 387 300** | **6 387 300** | **1 273 716** | **7 661 016** |
| | **–** | **–** | | **904 317** | **–** | **904 317** |
| | **–** | **–** | | **(91 131)** | **–** | **(91 131)** |
| | **–** | **–** | | **307** | **–** | **307** |
| | **–** | **–** | **–** | **385 381** | **1 231 248** | **1 616 629** |
| | **–** | **–** | | **1 198 874** | **1 231 248** | **2 430 122** |
| | **–** | **–** | **6 387 300** | **7 586 174** | **2 504 964** | **10 091 138** |
| | **(536 203)** | **–** | **536 203** | **–** | **–** | **–** |
| | **(536 203)** | **–** | **536 203** | **–** | **–** | **–** |
| | **–** | **–** | | **–** | **634 761** | **634 761** |
| | **–** | **–** | | **–** | **(653 497)** | **(653 497)** |
| | **–** | **–** | **(467 250)** | **(467 250)** | **–** | **(467 250)** |
| | **–** | **–** | **(467 250)** | **(467 250)** | **(18 736)** | **(485 986)** |
| | **1 260 194** | **350 000** | **23 129 420** | **31 763 277** | **12 057 036** | **43 820 313** |
| | 1 056 223 | 350 000 | 15 590 809 | 22 747 807 | 8 662 043 | 31 409 850 |
| | – | – | 4 073 496 | 4 073 496 | 189 711 | 4 263 207 |
| | – | – | – | – | – | – |
| | – | – | – | 14 369 | – | 14 369 |
| | – | – | – | 144 931 | 379 821 | 524 752 |
| | – | – | – | 159 300 | 379 821 | 539 121 |
| | – | – | 4 073 496 | 4 232 796 | 569 532 | 4 802 328 |
| | – | – | 85 286 | – | – | – |
| | 740 174 | – | (740 174) | – | – | – |
| | 740 174 | – | (654 888) | – | – | – |
| | – | – | – | – | 339 233 | 339 233 |
| | – | – | (2 336 250) | (2 336 250) | – | (2 336 250) |
| | – | – | (2 336 250) | (2 336 250) | 339 233 | (1 997 017) |
| | 1 796 397 | 350 000 | 16 673 167 | 24 644 353 | 9 570 808 | 34 215 161 |

# STATEMENTS OF CHANGES IN EQUITY (continued)

For the year ended 31 December 2016

SEPARATE

| | Share capital K'000 | Share premium K'000 | Property revaluation K'000 | Loan loss reserve K'000 | Retained earnings K'000 | Total equity K'000 |
|---|---|---|---|---|---|---|
| **2016** | | | | | | |
| As at beginning of the year | 116 813 | 1 565 347 | 2 550 356 | 1 345 670 | 15 890 590 | 21 468 776 |
| Profit for the year | – | – | – | – | 5 183 706 | 5 183 706 |
| **Other comprehensive income** | | | | | | |
| Property revaluation | – | – | 878 244 | – | – | 878 244 |
| Deferred tax released on disposal of revalued property | – | – | 307 | – | – | 307 |
| Deferred tax on revalued assets | – | – | (89 727) | – | – | (89 727) |
| **Total comprehensive income for the year** | – | – | 788 824 | – | 5 183 706 | 5 972 530 |
| **Transfers between reserves** | | | | | | |
| Transfer from loan loss reserve | – | – | – | (569 479) | 569 479 | – |
| **Total transfers between reserves** | – | – | – | (569 479) | 569 479 | – |
| **Transactions with owners, recorded directly in equity** | | | | | | |
| Contribution by and distribution to owners | | | | | | |
| Dividends paid | – | – | – | – | (467 250) | (467 250) |
| **As at 31 December 2016** | 116 813 | 1 565 347 | 3 339 180 | 776 191 | 21 176 525 | 26 974 056 |
| **2015** | | | | | | |
| As at beginning of the year | 116 813 | 1 565 347 | 2 550 356 | 445 009 | 15 214 488 | 19 892 013 |
| Profit for the year | – | – | – | – | 3 913 013 | 3 913 013 |
| **Total comprehensive income for the year** | – | – | – | – | 3 913 013 | 3 913 013 |
| **Transfers between reserves** | | | | | | |
| Transfer to loan loss reserve | – | – | – | 900 661 | (900 661) | – |
| **Transactions with owners, recorded directly in equity** | | | | | | |
| Contribution by and distribution to owners | | | | | | |
| Dividends paid | – | – | – | – | (2 336 250) | (2 336 250) |
| **As at 31 December 2015** | 116 813 | 1 565 347 | 2 550 356 | 1 345 670 | 15 890 590 | 21 468 776 |

## Restatement of current year consolidated comparatives – consolidation of subsidiaries

In prior years, FMB consolidated all investments where > 50% shares were held. Investments in First Capital Bank Limited of Zambia (49.0% equity ownership) and Capital Bank Limited of Botswana (38.6% equity ownership) were accounted for using the equity method of accounting under IAS 28 *Investments in Associates* on the grounds that FMB did not have effective control over the two entities.

After reconsideration, management have decided to consolidate the above-noted investments, as they believe they have effective control over the two entities including the power to determine the appointment of key management personnel and to dictate major operating and capital decisions in the two entities. These powers signify the exercise of control as described by IFRS 10 *Consolidated Financial Statements* as *"de facto"* control (i.e. where an investor with less than 50% of the voting rights of an investee has control of the investee for reasons other than contractual arrangements and potential voting rights). Management also believes that FMB had effective control in recent years and, consequently, have restated the comparative balances in the current year consolidated financial statements in line with the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

## Restatement of current year consolidated and separate financial statement comparatives – currency swaps

During 2015, FMB entered into currency swap deals whereby FMB sold Dollars (USD) for Malawi Kwacha (MWK) at a predetermined spot rate. FMB then bought back the USD at predetermined future rates assumed from the interest rates and tenors of the individual transactions.

FMB retained substantially all the risks and rewards of ownership of the USD amounts sold and, accordingly, should have continued to recognise the USD amount as an asset in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. A liability should also have been recognised for the consideration received in accordance with the principles of IAS 39. However, the deal was valued as a derivative instrument contrary to the nature of the transaction. Therefore, the prior year balances have been restated to recognise these balances on the statement of financial position to comply with the requirements of IAS 39.

## Impact of restatement of comparatives

| | CONSOLIDATED<br>2015<br>K'000 | SEPARATE<br>2015<br>K'000 |
|---|---|---|
| Profit for the year per the 2015 financial statements | 3 860 814 | 3 913 013 |
| **Restatement adjustments** | | |
| Interest income | 6 443 993 | – |
| Interest expense on deposits and other accounts | (2 387 677) | – |
| Fees and commission income | 1 364 123 | – |
| Gain on foreign exchange transactions | 519 389 | – |
| Staff and training costs | (2 464 396) | – |
| Premises and equipment costs | (442 249) | – |
| Depreciation expense | (521 649) | – |
| Other expenses | (1 634 893) | – |
| Share of profit from associate | (236 550) | – |
| Impairment loss on financial assets | (311 847) | – |
| Income tax expense | 74 149 | – |
| **Restated profit for the year** | 4 263 207 | 3 913 013 |
| Total comprehensive income per prior year financial statements | 4 092 277 | 3 913 013 |
| Net adjustment to 2015 profit | 402 393 | – |
| Adjustment to translation difference for foreign operations | 307 658 | – |
| **Restated total comprehensive income for the year** | 4 802 328 | 3 913 013 |

# STATEMENTS OF CHANGES IN EQUITY (continued)

For the year ended 31 December 2016

| | CONSOLIDATED | | SEPARATE |
|---|---|---|---|
| | 2015<br>K'000 | 2014<br>K'000 | 2015<br>K'000 |
| **Assets** | | | |
| Cash and cash equivalents | 37 454 933 | 21 996 878 | – |
| Money market investments | 18 028 099 | 7 692 564 | – |
| Loans and advances to customers | 51 624 606 | 42 922 263 | – |
| Finance lease receivables | 227 516 | – | – |
| Amounts due from related parties | (263 197) | (2 218 403) | – |
| Derivative asset | 5 436 632 | – | 5 436 632 |
| Current tax assets | 350 028 | 259 690 | – |
| Investment property | – | (4 817 483) | – |
| Investment in associated companies | (5 054 032) | – | – |
| Property and equipment | 2 757 169 | 10 858 815 | – |
| Intangible assets | 1 196 948 | 428 561 | – |
| Other assets | 1 594 229 | (3 989 640) | – |
| **Total adjustment to assets** | 113 352 931 | 73 133 245 | 5 436 632 |
| **Liabilities and equity** | | | |
| Balances due to other banks | 11 826 936 | (53 475 554) | 5 436 632 |
| Customer deposits | 88 064 957 | 113 693 139 | – |
| Other payables | 1 443 903 | 1 963 857 | – |
| Subordinated debt | 7 458 073 | 5 740 348 | – |
| Deferred tax liabilities | (5 547 317) | (4 184 873) | – |
| Loan loss reserve | 208 314 | 567 628 | – |
| Translation reserve | 1 411 630 | 1 418 664 | – |
| Retained earnings | (208 312) | (567 629) | – |
| Non-controlling interest | 8 694 747 | 7 977 665 | – |
| **Total adjustment to liabilities and equity** | 113 352 931 | 73 133 245 | 5 436 632 |

# STATEMENTS OF CASH FLOWS

For the year ended 31 December 2016

| | | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|---|
| | | | Restated | | |
| | | 2016 | 2015 | 2016 | 2015 |
| | Notes | K'000 | K'000 | K'000 | K'000 |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | |
| Interest and fees received | | **49 411 884** | 35 042 681 | **28 120 022** | 17 958 310 |
| Interest paid | | **(12 854 287)** | (7 120 417) | **(6 817 301)** | (3 147 335) |
| Cash paid to suppliers and employees | | **(16 323 393)** | (18 507 711) | **(9 584 137)** | (10 232 443) |
| | | **20 234 204** | 9 414 553 | **11 719 484** | 4 578 532 |
| Net increase in net customer balances | | **14 462 311** | 50 620 440 | **11 331 432** | 21 226 915 |
| **Cash generated from operations** | | **34 696 515** | 60 034 993 | **23 050 916** | 25 805 447 |
| Dividend received from listed and subsidiary companies | | **69 705** | 161 272 | **480 538** | 661 272 |
| Income taxes paid | 29c | **(3 091 690)** | (2 276 860) | **(1 838 951)** | (1 953 881) |
| **Cash flows from operating activities** | | **31 674 530** | 57 919 405 | **21 692 503** | 24 512 838 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | |
| Purchases of money market investments | 8 | **(16 758 025)** | (33 915 023) | **(21 557 313)** | (20 391 965) |
| Subscription of shares in subsidiary companies | 14 | **–** | – | **(1 481 109)** | (791 545) |
| Proceeds from sale of equipment | | **13 230** | 7 212 | **13 230** | 7 212 |
| Acquisition of property and equipment | 15 | **(3 741 849)** | (4 336 263) | **(2 574 825)** | (1 901 967) |
| **Net cash flow from investing activities** | | **(20 486 644)** | (38 244 074) | **(25 600 017)** | (23 078 265) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | | |
| Dividends paid to the owners of the parent | 32 | **(467 250)** | (2 336 250) | **(467 250)** | (2 336 250) |
| Capital subscription by non-controlling interests | 14 | **634 761** | 339 233 | **–** | – |
| Dividends paid to non-controlling interests | | **(653 497)** | – | **–** | – |
| Repayment of long-term borrowings | | **(7 923 416)** | (603 880) | **(7 923 417)** | (764 393) |
| Proceeds from long-term borrowings | | **7 000 000** | 1 196 001 | **7 000 000** | 1 196 001 |
| **Net cash flow from financing activities** | | **(1 409 402)** | (1 404 896) | **(1 390 667)** | (1 904 642) |
| Net increase in cash and cash equivalents | | **9 778 483** | 18 270 435 | **(5 298 181)** | (470 069) |
| Cash and cash equivalents at 1 January | | **73 221 496** | 54 426 309 | **28 565 161** | 24 978 112 |
| Effect of changes in exchange rates | | **1 616 629** | 524 752 | **59 726** | 4 057 118 |
| **Cash and cash equivalents at 31 December** | 7 | **84 616 608** | 73 221 496 | **23 326 706** | 28 565 161 |

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2016

## 1. REPORTING ENTITY

First Merchant Bank Limited (the Bank) is a public limited liability company domiciled in Malawi. It is listed on the Malawi Stock Exchange and is registered as a commercial bank under the Banking Act, 2010. These consolidated financial statements comprise the Bank and its subsidiaries ("collectively the Group"). The Group is primarily involved in corporate and retail banking, deposit-taking and asset finance. The Bank's registered office is Livingstone Towers, Private Bag 122, Glyn Jones Road, Blantyre.

## 2. BASIS OF PREPARATION

***(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 in a manner as required by the Companies Act, 2013, and the Banking Act, 2010.

***(ii) Basis of measurement***

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

- properties which are revalued to fair value; and
- financial instruments at fair value through profit or loss.

***(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.

***(iv) Use of estimates and judgements***

The preparation of financial statements in conformity with IFRSs requires 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.

- Notes 4(c)(v), 9 and 38 – Loans and advances to customers – Impairment
- Notes 4(c)(v), 10 and 38 – Finance leases receivables – Impairment
- Notes 6 and 13 – Fair value measurement

***(v) Going concern basis of accounting***

The consolidated financial statements have been prepared on a going concern basis, which assumes that the Group will be able to meet the mandatory repayments terms of the banking facilities as disclosed in note 17, customer deposits as disclosed in note 18, other payables as disclosed in note 19 and subordinated debt as disclosed under note 36.

***(vi) Comparatives***

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

## 3. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

### 3.1 Standards and interpretations affecting amounts reported and/or disclosed in the financial statements

In the current year, the Group has adopted those new and revised standards and interpretations issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee of the International Accounting Standards Board that are relevant to its operations and are effective for annual reporting periods beginning on 1 January 2016.

The adoption of these new and revised standards and interpretations did not have a significant impact on these financial statements.

## 3.2 Standards and interpretations in issue, not yet effective

At the date of authorisation of these financial statements, the following relevant standards and interpretations were in issue but not yet effective:

| Effective date | Standard, amendment or interpretation |
|---|---|
| Annual periods beginning on or after 1 January 2018 | IFRS 9 *Financial Instruments*<br><br>IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013 to include the new requirements for general hedge accounting. Another revised version of IFRS 9 was issued in July 2014 mainly to include impairment requirements for financial assets and limited amendments to the classification and measurement requirements by introducing a "fair value through other comprehensive income" (FVTOCI) measurement category for certain simple debt instruments. |
| Annual periods beginning on or after 1 January 2018 | IFRS 15 *Revenue from Contracts with Customers*<br><br>IFRS 15 specifies how and when an entity will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles-based five-step model to be applied to all contracts with customers. The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. |
| Annual periods beginning on or after 1 January 2019 | IFRS 16 *Leases*<br><br>IFRS 16 specifies how an entity will recognise, measure, present and disclose leases. The standard requires lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying assets has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. |
| Annual periods beginning on or after 1 January 2017 | Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)<br><br>Amends IAS 12 *Income Taxes* to clarify the following aspects:<br>• Unrealised losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use;<br>• The carrying amount of an asset does not limit the estimation of probable future taxable profits;<br>• Estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences; and<br>• An entity assesses a deferred tax asset in combination with other deferred tax assets. Where tax law restricts the utilisation of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type. |
| Annual periods beginning on or after 1 January 2017 | Disclosure Initiative (Amendments to IAS 7)<br><br>Amends IAS 7 *Statement of Cash Flows* to clarify that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. |

## 3. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

### 3.2 Standards and interpretations in issue, not yet effective (continued)

| Effective date | Standard, amendment or interpretation |
|---|---|
| Effective for annual periods beginning on or after 1 January 2018 | Transfers of Investment Property (Amendments to IAS 40)<br><br>The amendments to IAS 40 *Investment Property*:<br>• Amends paragraph 57 to state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use; and<br>• The list of examples of evidence in paragraph 57(a) – (d) is now presented as a non-exhaustive list of examples instead of the previous exhaustive list. |
| The amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after 1 January 2018, the amendment to IFRS 12 for annual periods beginning on or after 1 January 2017 | Annual Improvements to IFRS Standards 2014 – 2016 Cycle<br>Makes amendments to the following standards:<br>• IFRS 1 – Deletes the short-term exemptions in paragraphs E3 – E7 of IFRS 1, because they have now served their intended purpose;<br>• IFRS 12 – Clarifies the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10 – B16, apply to an entity's interests listed in paragraph 5 that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*; and<br>• IAS 28 – Clarifies that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organisation, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition. |
| Annual reporting periods beginning on or after 1 January 2018 | IFRIC 22 *Foreign Currency Transactions and Advance Consideration*<br><br>The interpretation addresses foreign currency transactions or parts of transactions where:<br>• there is consideration that is denominated or priced in a foreign currency;<br>• the entity recognises a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and<br>• the prepayment asset or deferred income liability is non-monetary.<br><br>The Interpretations Committee came to the following conclusion:<br>• The date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability; and<br>• If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. |

The Directors anticipate that other than IFRS 9, 15 and 16, these Standards and Interpretations in future periods will have no significant impact on the financial statements of the Group. IFRS 9 will impact the measurement of financial instruments while IFRS 15 will affect recognition of revenue and IFRS 16 will impact recognition, measurement, presentation and disclosure of leases.

## 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 financial statements incorporate the financial statements of the Bank, its subsidiaries, namely The Leasing and Finance Company of Malawi Limited, FMB Pensions Limited, FMB Forex Bureau Limited, FMB Capital Markets Limited, Capital Bank Limited (Mozambique), International Commercial Bank Limited (Malawi), First Capital Bank Zambia Limited and Capital Bank Limited (Botswana), (together referred to as "the Group").

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date control is transferred to the Group.

#### *(i) Subsidiaries*

Subsidiaries are entities controlled by the Group. The Group controls an investee if it is exposed to, or, has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Uniform accounting policies have been applied throughout the Group.

#### *(ii) Loss of control*

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related non-controlling interest and other components of equity. Any resulting gain or loss, is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

#### *(iii) 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 the consolidated financial statements except when the Group controls the entity.

#### *(iv) 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 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.

#### *(v) Interest in equity-accounted investees*

The Group's interests in equity-accounted investees are interests in associates. Associates are those entities in which the Group has significant influence, but not control over the financial and operating policies.

Interest in associates are accounted for using the equity method. They are recognised initially at fair value. Subsequent to initial recognition, the consolidated financial statements include the Group's share of profits or loss and other comprehensive income of equity investees, until the date on which significant influence ceases.

### (b) Foreign currency

#### *Foreign currency transactions*

Transactions in foreign currencies are translated to Malawi Kwacha at the exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into Malawi Kwacha at the exchange rate (middle rate) at the date on which the fair value is determined.

Non-monetary items that are measured based on historical cost in a foreign currency are translated using the exchange rate (middle rate) at the date of the transaction.

Monetary items denominated in foreign currencies at the reporting date are translated into Malawi Kwacha using the exchange rate at that date. Foreign currency differences arising on translation are generally recognised in profit or loss.

## 4. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (b) Foreign currency (continued)

#### *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 differences arising on the translation of the assets and liabilities of foreign operations are recognised directly in other comprehensive income and accumulated in equity in the translation reserve. When a foreign operation is disposed of in part or in full, the relevant amount in the 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 form a part of the net investment in foreign operation, are recognised directly in the foreign currency translation reserve.

### (c) Financial assets and liabilities

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

The Group initially recognises loans, debt securities issued and subordinate receivables on the date on which they are originated. All other financial assets or financial liabilities are recognised on the trade date which is the date on which the Group becomes a party to the contractual provisions of the instrument. 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.

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.

#### *(ii) Classification*

*Financial assets*

The Group classifies its financial assets into one of the following categories:

- loans and receivables;
- held to maturity;
- available-for-sale; and
- at fair value through profit or loss, and within this category as:
  - held for trading; or
  - designated at fair value through profit or loss.

#### *(iii) 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, cancelled or expire.

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

#### *(iv) 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.

*(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 or a group of 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 incurred but not yet identified. Financial assets that are not individually significant are 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.

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 using the financial assets' original effective interest rate.

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised. If the cash flows of the renegotiated asset are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and the new financial asset is recognised at fair value. The impairment loss before an expected restructuring is measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective interest rate of the existing financial asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and receivables or held-to-maturity investment securities. Interest on the impaired assets continues to be recognised through the unwinding of the discount. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss. The Group writes off a loan or an investment debt security, either partially or in full, and any related allowance for impairment losses, when Group Credit determines that there is no realistic prospect of recovery.

*(vi) 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; and
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise.

Investments in listed companies (see note 13) have been accounted for at fair value through profit or loss.

## 4. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (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.

### (e) Other assets

Other financial assets are measured at amortised cost using the effective interest method less impairment losses. Other non-financial assets are measured at cost less impairment losses, if any. Other assets comprise prepayments, cheques in the course of collection, dividends receivable, stocks of consumable stationery and computer spares and other receivables.

### (f) Loans and advances to customers

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.

The Group classifies its loans and advances to customers as loans and receivables. 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 subsequently measured at their amortised cost using the effective interest method.

### (g) Investment securities

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 or fair value through profit or loss.

#### *(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.

Held-to-maturity investments comprise Treasury Bills, Local Registered Government Stocks and Malawi Government Promissory Notes and are included in money market investments.

#### *(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).

The Group designates its investments in listed companies at fair value through profit or loss.

### (h) Investments in subsidiaries

Investments in subsidiaries are recognised at cost in the separate financial statements less any impairment losses. The investments are fully eliminated on consolidation.

### (i) Investments in associates

Investments in associates are recognised at fair value in the separate financial statements.

## (j) Intangible assets

Intangible assets acquired separately are measured at cost less accumulated amortisation and accumulated impairment losses. Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset it relates to. All other expenditure is expensed as incurred. Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives from the date that the asset is available for use. The effects of any changes in estimates are accounted for on a prospective basis. Intangible assets are amortised over five years. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate. The effects of any changes in estimates are accounted for on a prospective basis.

## (k) Property and equipment

### *(i) Recognition and measurement*

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses except for freehold property and leasehold improvements which are measured at revalued amount less accumulated depreciation and impairment losses as described in accounting policy 4(l).

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 and qualifying borrowing costs. Purchased software that is integral to the functionality of 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.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment, and are recognised net within other operating income in profit or loss. When revalued assets are sold, the amounts included in the revaluation reserve are transferred to retained earnings.

### *(ii) Revaluation*

Freehold properties and leasehold improvements are subject to revaluation with sufficient regularity to ensure that the carrying amount does not differ materially from the fair value. Revaluation surpluses are recognised in other comprehensive income and accumulated in equity in a non-distributable property revaluation reserve. A revaluation surplus will be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

The revaluation surplus included in equity in respect of property, plant and equipment is transferred directly to retained earnings when the asset is sold or disposed.

### *(iii) Subsequent costs*

Subsequent expenditure is capitalised only when it is probable that future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

### *(iv) 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:

| | |
|---|---|
| Leasehold properties | 2.5% (or period of lease if shorter) |
| Freehold properties | 2.5% |
| Motor vehicles | 25% |
| Equipment, fixture and fittings | 20% |

## 4. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (k) Property and equipment (continued)

#### *(v) 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 property and equipment. Capital work in progress is not depreciated.

### (l) 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.

Goodwill is tested annually for impairment. An impairment loss in respect of goodwill is not reversed.

### (m) Customer deposits and balances due to 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.

### (n) Other liabilities and subordinated debt

Other payables and subordinated liabilities are initially measured at fair value minus incremental direct transaction costs and subsequently measured at their amortised cost using the effective interest method, except where the Group designates liabilities at fair value through profit or loss.

### (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) 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.

## (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. The calculation of the effective interest rate includes all fees and rewards 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; and
- interest on held to maturity investments.

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

## (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) Finance lease – 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) Operating leases – 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.

## (s) Fees and commission 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.

# 4. SIGNIFICANT ACCOUNTING POLICIES (continued)

## (t) Income from investments

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

Dividend income is recognised when the right to receive income is established. Usually this is the ex dividend date for held for trading securities.

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

## (u) Income tax

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

### *(i) Current tax*

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.

### *(ii) Deferred tax*

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

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.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. 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.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities. For this purpose, the carrying amount of investment property measured at fair value is presumed to be recovered through sale, and the Group has not rebutted this presumption.

Additional taxes that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised. These amounts are generally recognised in profit or loss because they generally relate to income arising from transactions that were originally recognised in profit or loss.

## (v) 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.

### (w) Provision

A provision is recognised in the statement of financial position when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefit will be required to settle the obligation. If the effect is material, 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.

### (x) Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Group on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

The analysis of fair value hierarchy for financial assets and liabilities is disclosed in Note 6 to these consolidated and separate financial statements.

### (y) Derivative financial instruments

A derivative is a financial instrument whose value changes in response to an underlying variable, requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and is settled at a future date. Derivatives are initially recognised at fair value on the date on which the derivatives are entered into and subsequently remeasured at fair value as described under the fair value policy. Derivatives are always categorised as held-for-trading.

All derivative instruments are carried as assets when the fair value is positive and as liabilities when the fair value is negative, subject to offsetting principles as described under note 4 (c) (iv).

## 4. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (y) Derivative financial instruments (continued)

Embedded derivatives included in hybrid instruments are treated and disclosed as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract, the terms of the embedded derivative are the same as those of a stand-alone derivative and the combined contract is not measured at fair value through profit or loss. The financial host contracts are accounted for and measured applying the rules of the relevant financial instrument category.

The method of recognising fair value gains and losses depends on whether the derivatives are designated as hedging instruments, and if so, the nature of the hedge relationship, or if they are classified as held-for-trading.

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in profit or loss as trading revenue.

### (z) Financial guarantees, acceptances and letters of credit

Financial guarantees, acceptances and letters of credit are accounted for as off-statement of finance position transactions and disclosed as contingent liabilities, unless it is probable that the Group will be required to make payments under these instruments, in which case they are recognised as provisions.

### (aa) Amounts due from related parties

These assets are initially recognised at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, they are measured at amortised cost using the effective interest method.

## 5. RISK MANAGEMENT

The Group is faced with a variety of risks including credit, liquidity, interest rate, foreign exchange, price, operational, compliance/regulatory, reputation, strategic risks and others. The Group is committed to effectively managing these risks with a view to achieving a balance between acceptable exposure and reward.

The Board and senior management actively oversee the risk management process and implement adequate policies, procedures, comprehensive internal controls and limits that are set to mitigate risks. The Group has a risk management framework which covers risk identification, risk measurement, risk monitoring and risk control in respect of the significant risks.

The Board has a risk committee which meets regularly and gets reports from the Risk and Compliance function on risk assessment and levels of risks that the Bank is facing. Stress testing is done quarterly and the results are discussed with the Risk Committee.

### (a) Risk management policies and control

The Group's approach to risk management is based on well-established governance processes, diversification and reliance on both individual responsibility and collective oversight, supported by comprehensive reporting. The Bank has an independent risk management and compliance function and various committees which allow executive management and the Board to evaluate the risks faced by the Bank, as well as its effectiveness for the management of these risks. These committees are integral to the Bank's risk management structure.

### (b) Risk management structure

Responsibility for risk management resides at all levels within the Group, starting at Board level, filtering down to each business unit and ultimately each employee.

The Board is responsible for annually approving the risk appetite which is defined as the level of risk the Group is willing to accept in fulfilling its business objectives. The Group's risk appetite framework is embedded in key decision-making processes and supports the implementation of the Group strategy. The risk appetite has been translated into risk limits. Adherence to these limits is monitored and reported to produce a risk-reward profile for the Group. The Board meets four times a year. Adequate and efficient communication and monitoring systems have been put in place to ensure that the directors receive all relevant, accurate information to guide them in decision-making and in ensuring that the Group fully complies with relevant legal, ethical and regulatory requirements.

## (c) Board subcommittees

### *(i) The Risk Committee*

The Risk Committee assists the Board in assessing, mitigating and controlling risks. The Committee reviews the risk, identifies causes of concern and outlines the scope of improvement where there are concerns. The Committee comprises two non-executive directors and one executive director.

The Group Managing Director, General Manager – Corporate and International Banking, Group General Manager – Credit and Operations, Chief Finance Officer and Risk and Compliance Manager attend the meetings.

### *(ii) The Credit Committee*

The Credit Committee comprises three local directors with a good knowledge of the Malawi economy and business environment. Its overall responsibility is to ensure the soundness of the Group's credit portfolio. 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 requiring full Board approval in accordance with Reserve Bank of Malawi (RBM) directives;
- Review of non-performing assets and recovery procedures initiated in respect thereof and establishment of appropriate levels of provisioning when required; and
- The Group Managing Director, General Manager – Corporate and International Banking, Company Secretary and Legal Counsel, Group General Manager – Credit and Operations, Credit Operations Manager, Risk and Compliance Manager, and Credit Control Manager attend the meetings.

The Group General Manager – Credit and Operations is responsible for credit risk management and underwriting including the assessment of credit facility applications and making recommendations thereon to the Group Managing Director and Credit Committee.

### *(iii) The Audit Committee*

The Committee comprises of three non-executive directors.

The Audit Committee assists the Board in discharging its duties in relation to financial reporting, asset management, internal control systems and processes. It also monitors the quality of both the external and internal audit functions. The Group's external and internal auditors have unlimited access to the Audit Committee and report to it in their independent, private meetings to discuss risk exposure areas. Where the committee identifies causes for concern or scope for improvement, it makes recommendations to the Board and presents remedial actions.

It is Board policy to maintain an independent internal audit function to undertake internal audit work throughout the Group. Internal Audit provides reliable, valued, insightful and timely assurance to the Board and executive management on the effectiveness of governance, risk management and controls over current and evolving risks in the context of the current and expected business environment.

## (d) Management

### *(i) The Group Managing Director*

The Group Managing Director is appointed by the Board to manage the Group's business within an acceptable risk profile, while delivering the approved strategy that leads to the achievement of long-term objectives.

The Group Managing Director appoints the Risk and Compliance Manager, who heads an independent Risk and Compliance function and has overall day-to-day accountability for risk management.

### *(ii) The Risk and Compliance Manager*

The Risk and Compliance Manager is responsible for ensuring that an integrated and effective risk management framework is maintained throughout the Bank. The Risk and Compliance Manager has direct and unfettered access to the Chairman of the Risk Committee.

## 5. RISK MANAGEMENT (continued)

### (d) Management (continued)

#### *(iii) Asset and Liability Management Committee (ALCO)*

The Asset and Liability Management Committee (ALCO) is responsible for capital management and management of liquidity risk, credit risk, interest rate risk, foreign exchange rate risk and price risk in the Bank. ALCO is a management committee and it meets monthly at a minimum. The committee comprises:

- Group General Manager – Treasury and International Banking (Chairman);
- Group Managing Director;
- Group General Manager – Credit and Operations;
- Group General Manager – Corporate and Commercial Banking;
- Group Chief Operating Officer;
- Risk and Compliance Manager;
- Treasury Manager;
- Chief Finance Officer;
- Management Accountant; and
- Head of Corporate Banking.

#### *(iv) Management Risk Committee (MRC)*

The Management Risk Committee (MRC) comprises:

- Group Managing Director;
- Group General Manager – Credit and Operations;
- Group General Manager – Treasury and International Banking;
- Group General Manager – Corporate and Commercial Banking;
- Group Head of Information Technology;
- Risk and Compliance Manager;
- Group Chief Operations Officer;
- Chief Operating Officer;
- Chief Commercial Officer;
- Head of Corporate Banking;
- Head of Government and International Organisations;
- Head of Internal Audit;
- Head of Human Resources;
- Head of Alternate Channels; and
- Company Secretary and Legal Counsel.

It is chaired by the Group Managing Director and meets monthly to review management of strategic risk, operational risk, compliance risk, reputation risk and any other risks in the bank. This forum facilitates co-ordination and communication among various risk owners and risk management functions to resolve risk related issues in the bank expeditiously and promote efficient management of relative risks.

#### *(v) Management Credit Committee (MCC)*

The Management Credit Committee (MCC) comprises:

- Group Managing Director (Chairman);
- Group General Manager – Credit and Operations;
- Group General Manager – Treasury and International Banking;
- Group General Manager – Corporate and Commercial Banking;
- Head of Corporate Banking;
- Risk and Compliance Manager; and
- Company Secretary and Legal Counsel.

It is chaired by the Group Managing Director and meets monthly to review management of credit risk in the bank.

## (e) Risk management philosophy

The Group believes that risk management trickles down from the Board level to every employee; therefore, everyone within the Group is responsible. The Group has a three line of defence approach as outlined in the diagram below:

**3 Lines of Defence Concept**

| Board of Directors | | |
|---|---|---|
| 1st Line of Defence | 2nd Line of Defence | 3rd Line of Defence |
| ***Risk Talking Unit*** | ***Risk Control Unit*** | ***Independent Assurance*** |
| **Business Unit Officers/ Managers** | **Risk and Compliance Department** | **Internal Audit** |
| | **Credit Risk Management and Underwriting** | |

| 1st Line of Defence: | 2nd Line of Defence: | 3rd Line of Defence: |
|---|---|---|
| Comprises of business units and Head Office departments.<br><br>The business units manage risk using laid down policies and procedures. | Comprises of Risk Management and Compliance function and Credit Risk Management and Underwriting function in Head office.<br><br>Responsibilities of Risk Management and Compliance function include:<br>• Formulating risk management framework and policies; developing tools and methodologies for risk identification and measurement; and<br>• Performing independent risk monitoring and reporting to the Risk Committee of the Board.<br><br>Responsibilities of Credit Risk Management and Underwriting function include:<br>• Formulating credit policies; assessing credit facility applications/proposals and recommending approvals to Credit Committee; and<br>• Monitoring credit facilities and reporting to the Credit Committee of the Board. | Comprises of Internal Audit function<br><br>Provides independent assessments of risk management processes and infrastructure, as well as the adequacy and effectiveness of risk policies and internal controls. |

## (f) Risk appetite

Risk appetite is the level of risk that the bank is willing to accept in achieving its strategic objectives. The Group's risk appetite framework is the cornerstone of its risk management architecture. It helps management to better understand and manage risks by translating risk metrics and methods into strategic decisions, reporting, and day-to-day business decisions.

From its long-term strategic goals, the Group has identified key strategic objectives (KSOs) that it will need to pursue in the short to medium term, some of which will be measured quantitatively while others will be measured qualitatively. The Group has set measurable thresholds for the KSOs with levels of tolerance for all risk categories. A monitoring dashboard has been created for the KSOs. These are monitored on an ongoing basis with a three colour coded scale: green, amber and red. Red indicates that the Group has reached the minimum limit. Amber serves as a warning that the Group is approaching minimum limits. Green indicates that the Group is operating with buffer and is far from reaching the minimum levels. When the Group is operating within the buffer, the dashboard indicates amber to warn management against reaching minimum levels and breaching limits.

The Board ensures that management strikes an appropriate balance between promoting short-term profitability and growth and delivering long-term sustainable performance. The Board is fully committed to ensuring that the Group's affairs are conducted with integrity and high ethical standards.

## 5. RISK MANAGEMENT (continued)

### (g) Market disclosures

As a listed company and a bank, the Bank is obliged to make certain disclosures to the public by regulators and other authorities. This is required under the Financial Services Act 2010, the Companies Act, the Listing Requirements of The Malawi Stock Exchange, Reserve Bank of Malawi (RBM) directives and the Market Disclosures guidelines.

RBM requires all banks in Malawi to provide comprehensive disclosures for risk management practices.

The Group has a Market Disclosure policy and a risk management report is published twice a year.

### (h) Stress testing

The Group carries out stress tests to estimate the potential impact of low probability but extreme events on the Group's earnings and capital. The Group has a stress testing framework that defines scenarios to be used for different types of risk exposures. The stress testing scenarios are to be plausible. The stress scenarios that are used cover all the major types of risks including market, credit and liquidity risks. The stress test results are discussed at ALCO and Board Risk Committee and a summary of the results is sent to the Board of Directors.

### (i) Significant risks

From the Bank's risk assessment process, the following have been identified as significant risks that the bank faces:

1. Credit risk
2. Market risk
   - Foreign exchange rate risk
   - Interest rate risk
   - Equity risk
3. Liquidity risk
4. Operational risk
5. Compliance risk
6. Reputational risk
7. Strategic risk

### (j) Capital management

#### *(i) Overview*

The Group operates a centralised capital management model. The capital management objectives as detailed in the Capital Management Framework are to meet the capital ratios required by The Reserve Bank of Malawi (RBM) and the capital target ranges set by the Board and to generate sufficient capital to support asset growth.

Capital is managed according to the Capital Management Framework and through ALCO's, regular reports on the capital positions. Capital risks are presented to the Risk Committee and Board. ALCO meets monthly to review, approve and make recommendations relating to the capital risk profile. This includes risk appetite, policies, limits and utilisation.

#### *(ii) Internal Capital Adequacy Assessment Process (ICAAP)*

In accordance with RBM's Internal Capital Adequacy Assessment Process (ICAAP) guidelines, the Group has a capital management planning process. Every year, the Group prepares an ICAAP document which is submitted to RBM. The ICAAP is based on the Group's five-year business plan. The ICAAP is prepared by Risk and Finance departments in consultation with the Group Managing Director and other members of senior management. The ICAAP is validated by internal auditors before it is presented to the Board of Directors for approval. ICAAP is a continuous process and is revised and updated whenever there are significant changes in the business/strategic plan. The objective of ICAAP is to ensure that the Group is adequately capitalised and that, where there are potential capital shortages, the Board and senior management ensure that the gaps are met. The Group promotes efficient use of capital by aligning business strategy, risk appetite and expected returns with capital requirements.

*(iii)* ***Capital adequacy ratios***

The following minimum capital adequacy ratios have been determined by The Reserve Bank of Malawi:

- Tier 1 Capital/Core Capital: 10%
- Total Capital (Tier 1 and 2): 15%

*(iv)* ***Capital position as at 31 December 2016***

The following is the capital position of the Group and the Bank:

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Share capital | **116 813** | 116 813 | **116 813** | 116 813 |
| Share premium | **1 565 347** | 1 565 347 | **1 565 347** | 1 565 347 |
| Non-distributable reserves | **350 000** | 350 000 | **–** | – |
| Retained earnings | **23 129 420** | 16 673 167 | **21 176 525** | 15 890 590 |
| Investments in unconsolidated entities | **–** | – | **(4 674 024)** | (3 933 469) |
| Deferred tax asset | **(758 720)** | (710 631) | **(305 374)** | (701 561) |
| Non-controlling interest | **8 893 895** | 7 518 395 | | – |
| **Total Tier 1 Capital** | **33 296 755** | **25 513 091** | **17 879 288** | **12 937 720** |
| **Tier 2 Capital** | | | | |
| Translation reserve | **1 893 679** | 1 508 298 | **–** | – |
| Property revaluation reserve | **3 447 824** | 2 634 331 | **3 339 180** | 2 550 356 |
| Loan loss reserve | **1 260 194** | 1 796 397 | **776 191** | 1 345 670 |
| Investments in unconsolidated entities | **–** | – | **(4 674 024)** | (3 933 469) |
| Non-controlling interest | **1 555 728** | 1 273 275 | **–** | – |
| Eligible subordinated debt | **9 031 122** | 8 380 285 | **7 000 000** | 6 644 451 |
| **Tier 2 Capital** | **17 188 547** | **15 592 586** | **6 441 347** | **6 607 008** |
| **Total qualifying capital** | **50 485 302** | **41 105 677** | **24 320 635** | **19 544 728** |
| **Total risk weighted assets** | **238 513 263** | **203 258 180** | **104 326 972** | **101 877 047** |
| Tier 1 risk based capital ratio (minimum 10%) | **14.0%** | 12.6% | **17.1%** | 12.7% |
| Total risk-weighted capital ratio (minimum 15%) | **21.2%** | 20.2% | **23.3%** | 19.2% |

## (k) Credit risk

*(i)* ***Credit risk management***

Credit risk is the risk of financial loss as a result of failure of a counterparty to discharge its contractual obligation. This can be failure or delay in paying interest or the principal amount borrowed.

Management of credit risk is the responsibility of the Board and senior management. The Bank has a Credit Committee consisting of three directors, two of whom are non-executive. Credit department has three sections; Credit Risk Management and Underwriting function, Credit Operations function and Credit Control function. All credit proposals are referred to the Group General Manager – Credit and Operations who reviews the proposal before sending their recommendations to the Group Managing Director.

The board has established authorisation thresholds for the Group Managing Director and Credit Committee of the Board. Credit proposals above certain limits have to be taken to the full board for approval. Credit proposals for related parties have to be taken to the Board irrespective of the authorisation threshold. In approving credit facilities, the Bank's primary consideration is the borrower's ability to repay irrespective of collateral offered.

## 5. RISK MANAGEMENT (continued)

### (k) Credit risk (continued)

#### *(ii) Role of Risk and Compliance function*

The Risk and Compliance function is independent from the credit department.

Apart from the capital charge calculations in accordance with RBM guidelines, the Group has other techniques which are used to measure level of credit risk at the end of each quarter. A Risk Management Report prepared by Risk and Compliance function is presented to ALCO and the Board Risk Committee.

For quantitative assessment, ratios are used to measure risk levels in terms of low, moderate and high. For qualitative assessment, several parameters are used to categorise the quality of credit risk management. Qualitative and quantitative risk levels are combined to arrive at the composite rating of credit risk.

On a monthly basis, the Risk and Compliance function assesses and reports to ALCO on adherence to set limits. ALCO discusses the compliance report and sets preventive measures to avoid breaching limits.

#### *(iii) Credit policies*

The Group has credit policies which cover the types of credit that can be offered, procedures for granting of local currency loans, overdrafts, foreign currency loans, guarantees and letters of credit; approval limits to be exercised by different authority levels for various types of exposures; credit approval processes at the branch and Head Office; applicable charges and margins above the base lending rate for different credit facilities; acceptable security and security loan ratios; record keeping; impairments and provisions; prudential limits on lending concentration; insider lending; and sector limits.

The Group uses the Estimated Recoverable Amount Method (ERAM) for provisioning of bad debts as stipulated in the guidelines issued by RBM.

The Group has a risk management framework which covers credit risk management outlining risk identification, measurement, monitoring and control procedures.

A stress testing framework covers credit risk stress testing procedures.

#### *(iv) Stress testing*

Stress testing is carried out to measure levels of credit risk, among other things. Three different shocks with at least four scenarios for each are used to show impact of the behavioural pattern of the credit portfolio on Capital Adequacy Ratio (CAR).

The outcome is included in the quarterly stress testing report which is presented to ALCO and the Board Risk Committee.

### *(v) Assessment of credit risk exposures*

The Group's credit risk arises from its exposure to a portfolio consisting of foreign currency loans, local currency loans and overdrafts, leases to customers, staff loans, lending to local banks, guarantees and letters of credit and is managed as follows:

#### a. Loans and overdraft in local currency

The Bank has centralised approval of loans and overdrafts. Branches refer all new proposals and renewal of existing facilities to Head Office for approval. Head Office also grants credit in excess of agreed overdraft limits and marks the limits in the system. Depending on the set thresholds and type of customer, some credit facilities have to be approved by the Credit Committee and/or the full Board.

#### b. Leases

The Leasing and Finance Company of Malawi Limited (LFC) offers leases to its customers. Proposals are referred to its Credit Committee for approval. The Board issued a credit policy with procedures and limits that must be adhered to. Acceptable lease assets are land, buildings, motor vehicles and equipment. Financing is for working capital, real estate and residential mortgages and other capital expenditure. All credit facilities must be secured.

#### c. Foreign currency loans

The Bank offers foreign currency loans to its customers. The Bank may lend up to 65% of the monthly average of its daily foreign currency deposits and in addition, the Bank has several off-shore credit lines for lending to its customers. All foreign currency loans are registered with RBM as required. The loan approval process followed is stipulated in the credit policy of the Bank. To hedge the Bank from foreign exchange risk borrowers of foreign currency must be foreign exchange earners.

#### d. Lending to local banks

The Group lends to local banks through the interbank market. Such lending is short-term, overnight in most cases. Investment policy and the policy for domestic money market has limits on how much can be lent unsecured and secured to individual banks in the country.

#### e. Guarantees

The Bank issues financial and non-financial guarantees to third parties on behalf of its customers. The Bank often insists on cash cover in form of a fixed deposit for guarantees. There are other cases where property is accepted as security and in very exceptional cases, guarantees are issued on a clean basis. All guarantees are approved by the Credit Committee.

#### f. Letters of credit

The Bank issues letters of credit for its customers. Letters of credit are issued if the security requirement as stipulated in the Bank's credit policy is met.

## 5. RISK MANAGEMENT (continued)

### (l) IFRS disclosures on credit risk

The Group and Bank's exposure to credit risk principally comprises of loans and advances to customers and finance lease receivable. As at 31 December 2016, these were as follows:

| CONSOLIDATED | | LOANS AND ADVANCES TO CUSTOMERS | | FINANCE LEASE RECEIVABLES | | MONEY MARKET INVESTMENTS | |
|---|---|---|---|---|---|---|---|
| | Notes | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | Restated 2015 K'000 |
| **Carrying amount** | 8,9,10 | **126 523 651** | 104 158 389 | **4 783 100** | 3 524 013 | **69 016 614** | 52 258 589 |
| Standard (fully performing) | | **113 176 667** | 89 402 217 | **3 994 240** | 2 510 797 | **69 016 614** | 52 258 589 |
| Past due but not impaired | | **8 460 123** | 8 424 676 | **446 439** | 229 435 | **–** | – |
| Impaired | | **8 057 730** | 9 170 108 | **833 457** | 1 780 244 | **–** | – |
| **Gross Receivable** | | **129 694 520** | **106 997 001** | **5 274 136** | **4 520 476** | **69 016 614** | **52 258 589** |
| **Past due but not impaired assets** | | | | | | | |
| 30 – 60 days | | **6 936 674** | 6 792 536 | **248 753** | 221 610 | **–** | – |
| 61 – 90 days | | **1 523 449** | 1 632 140 | **197 686** | 7 825 | **–** | – |
| | | **8 460 123** | 8 424 676 | **446 439** | 229 435 | **–** | – |
| **An estimate of the fair value of collateral held** | | | | | | | |
| **Against individually impaired** | | | | | | | |
| Property | | **62 337 897** | 50 005 920 | **1 209 600** | 1 661 100 | **–** | – |
| Others | | **14 561 841** | 696 703 | **434 466** | 438 254 | **–** | – |
| | | **76 899 738** | 50 702 623 | **1 644 066** | 2 099 354 | **–** | – |
| **Against past due but not impaired** | | | | | | | |
| Property | | **8 567 399** | 5 761 949 | **460 700** | 526 500 | **–** | – |
| Others | | **2 941 039** | 915 073 | **102 800** | 39 700 | **–** | – |
| | | **11 508 438** | 6 677 022 | **563 500** | 566 200 | **–** | – |

| SEPARATE | | LOANS AND ADVANCES TO CUSTOMERS | | FINANCE LEASE RECEIVABLES | | MONEY MARKET INVESTMENTS | |
|---|---|---|---|---|---|---|---|
| | Notes | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| **Carrying amount** | 8,9,10 | **42 067 041** | 40 285 729 | **–** | – | **48 548 466** | 26 991 153 |
| Standard (fully performing) | | **38 741 687** | 32 788 620 | **–** | – | **48 548 466** | 26 991 153 |
| Past due but not impaired | | **2 660 332** | 5 889 141 | **–** | – | **–** | – |
| Impaired | | **1 983 934** | 3 405 399 | **–** | – | **–** | – |
| **Gross Receivable** | | **43 385 953** | 42 083 160 | **–** | – | **48 548 466** | 26 991 153 |
| **Past due but not impaired assets** | | | | | | | |
| 30 – 60 days | | **2 383 502** | 5 613 921 | **–** | – | **–** | – |
| 61 – 90 days | | **276 830** | 275 220 | **–** | – | **–** | – |
| | | **2 660 332** | 5 889 141 | **–** | – | **–** | – |
| **An estimate of the fair value of collateral held** | | | | | | | |
| **Against individually impaired** | | | | | | | |
| Property | | **2 660 791** | 6 155 062 | **–** | – | **–** | – |
| Others | | **333 934** | 195 076 | **–** | – | **–** | – |
| | | **2 994 725** | 6 350 138 | **–** | – | **–** | – |
| **Against past due but not impaired** | | | | | | | |
| Property | | **7 797 320** | 3 480 231 | **–** | – | **–** | – |
| Others | | **1 362 484** | 820 335 | **–** | – | **–** | – |
| | | **9 159 804** | 4 300 566 | **–** | – | **–** | – |

Other collateral held includes moveable assets, receivables and share certificates pledged.

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

***(i) Impaired loans and securities***

These are loans and securities for which the Group has determined that there is probability that it will be unable to collect all principal and/or interest due according to the contractual terms of the loan/securities agreements.

***(ii) Past due but not impaired loans***

These are loans and securities where contractual interest or principal payments are past due but the Group 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 Group.

***(iii) Allowances for impairment***

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

## 5. RISK MANAGEMENT (continued)

### (l) IFRS disclosures on credit risk (continued)

#### *(iv) Impairment policy*

The Group 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, and the proceeds from collateral will not be sufficient to pay back the entire exposure.

#### *(v) Distribution of credit exposure by sector*

The Group monitors concentrations of credit risk by sector. Economic sector risk concentrations within the customer loan and finance lease portfolio at 31 December 2016 were as follows:

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | **2016 K'000** | Restated 2015 K'000 | **2016 K'000** | 2015 K'000 |
| Agriculture | **15 788 570** | 12 555 826 | **14 676 182** | 12 114 668 |
| Mining | **32 834** | 26 208 | **32 834** | 26 208 |
| Financial services | **2 424 671** | 1 897 601 | **2 420 448** | 1 840 058 |
| Construction | **4 796 450** | 4 271 703 | **1 139 133** | 1 582 604 |
| Energy/electricity/gas/water | **501 015** | 41 155 | **471 967** | 12 071 |
| Manufacturing | **13 824 207** | 17 089 435 | **7 790 820** | 9 231 803 |
| Wholesale and retail | **65 626 002** | 50 244 651 | **11 355 275** | 11 298 168 |
| Individual/households | **7 731 272** | 5 873 159 | **393 797** | 1 468 033 |
| Real estate | **74 257** | 99 327 | **74 257** | 99 327 |
| Tourism and leisure | **775 921** | 615 942 | **679 846** | 465 651 |
| Transport and communication | **5 143 732** | 5 084 754 | **2 634 753** | 2 906 503 |
| Others | **18 249 725** | 14 059 418 | **1 716 641** | 1 038 066 |
| | **134 968 656** | 111 859 179 | **43 385 953** | 42 083 160 |
| **Split into:** | | | | |
| Loans and advances (note 9) | **129 694 520** | 106 338 703 | **43 385 953** | 42 083 160 |
| Finance leases (note 10) | **5 274 136** | 4 520 476 | **-** | - |
| | **134 968 656** | 111 859 179 | **43 385 953** | 42 083 160 |

## (m) Credit quality per class of financial assets

The table below shows maximum exposure to credit risk without taking into account any collateral. The maximum exposure is presented gross, before effect of mitigation through the use of master netting and collateral agreements.

| | | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|---|
| | Notes | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| **Gross maximum exposure** | | | | | |
| Balances with central banks | 7 | **18 803 266** | 14 617 507 | **5 849 519** | 7 601 018 |
| Balances with other banks | 7 | **55 450 617** | 52 321 431 | **12 156 377** | 17 021 669 |
| Money market investments | 8 | **69 016 614** | 52 258 589 | **48 548 466** | 26 991 153 |
| Cheques in the course of clearing | 7 | **688 273** | 158 963 | **231 058** | 84 070 |
| Derivative asset | 37 | **19 288 094** | 5 980 005 | **19 288 094** | 5 980 005 |
| Investment in finance leases | 10 | **5 274 136** | 4 520 476 | **–** | – |
| Loans and advances | 9 | **129 694 520** | 107 338 703 | **43 385 953** | 42 083 160 |
| **Total recognised financial assets** | | **298 215 520** | 237 195 674 | **129 459 467** | 99 761 075 |
| Letters of credit | 34 | **16 982 273** | 27 315 858 | **15 511 819** | 26 117 340 |
| Financial guarantees | 34 | **29 141 027** | 26 862 656 | **16 273 796** | 13 209 783 |
| **Total unrecognised financial assets** | | **46 123 300** | 54 178 514 | **31 785 615** | 39 327 123 |
| **Total credit risk exposure** | | **344 338 820** | 291 374 188 | **161 245 082** | 139 088 198 |

## (n) Market risk

### Market risk management

This is the risk that the Group's earnings, capital or its ability to meet its business objectives will be adversely affected by changes in market prices and conditions, such as interest rates, foreign exchange rates, equity prices and commodity prices.

Senior management and ALCO are mandated to manage market risk. Apart from the requirement to set aside capital for market risk under Basel II – Pillar I, the Group has internal procedures for identifying, measuring, monitoring and controlling market risk. The Group is exposed to foreign exchange risk, interest rate risk and equity risk. All these risks are properly managed as follows:

### Foreign exchange risk

The Bank has a foreign exchange business policy and a foreign exchange risk management policy. The policies have exposure limits, limits for investments, trading limits and levels of authorisation of foreign currency transactions. Forex exposure positions are regularly monitored by Treasury department and senior management.

The Group is exposed to foreign exchange risk in the trading book and the banking book. The policy for trading book exposure is that the position should be almost square. In the banking book, assets and liabilities mismatch is minimised. Most of the foreign currency borrowings by the Group are hedged by foreign currency loans to customers, to minimise risk exposure.

### Interest rate risk

The Group does not usually offer fixed rate loans and advances to its customers. This minimises interest rate risk because the Group is able to adjust base lending rates of its entities whenever there is a significant change in the market. Lending to other banks at a fixed rate is usually on short-term tenors, so interest rate risk exposure on these assets is minimal.

The Group is exposed to interest rate risk on its liabilities, especially term deposits and subordinated debt. However, the risk exposure is minimised through limiting the proportion of fixed rate term deposit in its overall liabilities to customers.

Overall, the Group usually has more rate sensitive assets than liabilities. Its net interest margin is also wide enough to cover possible losses.

## 5. RISK MANAGEMENT (continued)

### (n) Market risk (continued)

**Equity risk**

The performance of the equity market and the Group's equity investments are closely monitored and appropriate risk mitigation measures are implemented where necessary. Investments in equities are at fair value and marked to market with any revaluation gains or losses immediately recognised in the profit or loss.

### (o) Policies

The Group has several policies which cover:

- Foreign exchange business limits for individual currencies, forex exposures and trading limits for the Bank and dealers;
- Domestic money market limits for counterparties and dealers;
- Types of instruments that the Group can invest in and maximum amounts that it can invest;
- Market risk management and stress testing; and
- Categorisation of assets into trading book and banking book.

### (p) Assessment of market risk

Apart from the capital charge calculations in accordance with RBM guidelines, the Group conducts internal risk assessments on foreign exchange risk, interest rate risk and equity risk at the end of each quarter. A risk management report is prepared by the Risk and Compliance function. This is presented to management and the Board Risk Committee.

For quantitative assessment, ratios are used to measure risk levels in terms of low, moderate and high. For qualitative assessment, several parameters are used to categorise the quality of market risk management in terms of strong, acceptable or weak. Qualitative and quantitative risk levels are used to arrive at the composite rating of each of the three components of market risk.

ALCO meets every month and discusses market risk exposure. ALCO ensures that the Group operates within regulatory and internal limits and approved policies and procedures.

In 2016, market risk was properly managed and the Group operated within limits.

### (q) Stress Testing/scenario analysis

Stress testing is done by an independent Risk and Compliance function every quarter to ascertain impact on the Bank's capital adequacy of changes in interest rates, exchange rates and share prices. Based on the result, management takes corrective steps acting on the advice of ALCO and the Board.

The following are the assumptions used:

1. Increase/(decrease) in interest rate by 1%, 2%, 3%, 5%, 7.5% and 10%. The same is used to measure the level of Interest Rate Risk in the Banking Book.
2. Foreign exchange rate devaluation/appreciation by 5%, 10%, 25% and 50%.
3. Fall in share prices by 10%, 20%, 40% and 50%.

## (r) Exposure to market risk

Foreign exchange exposures were as follows:

CONSOLIDATED

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| Currency | Assets (K'm) | Liabilities (K'm) | Net (K'm) | Sensitivity | Assets (K'm) | Liabilities (K'm) | Net (K'm) | Sensitivity |
| USD | 65 622 | 66 307 | (685) | (6.85) | 41 225 | 37 721 | 3 504 | 35.04 |
| GBP | 6 527 | 6 507 | 20 | 0.20 | 6 956 | 6 895 | 61 | 0.61 |
| EUR | 3 314 | 3 610 | (296) | (2.96) | 5 255 | 4 918 | 337 | 3.37 |
| ZAR | 1 147 | 1 104 | 43 | 0.43 | 1 346 | 565 | 781 | 7.81 |
| INR | 52 | – | 52 | 0.52 | 29 | – | 29 | 0.29 |
| JPY | 30 | – | 30 | 0.30 | 37 | – | 37 | 0.37 |
| BWP | 104 657 | 93 327 | 11 330 | 113.30 | 71 570 | 62 706 | 8 864 | 88.64 |
| MT | 134 024 | 102 209 | 31 815 | 318.15 | 25 612 | 25 568 | 44 | 0.44 |
| ZMK | 4 | 4 | – | 0.00 | 22 622 | 21 934 | 688 | 6.88 |

SEPARATE

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| Currency | Assets (K'm) | Liabilities (K'm) | Net (K'm) | Sensitivity | Assets (K'm) | Liabilities (K'm) | Net (K'm) | Sensitivity |
| USD | 42 894 | 42 527 | 367 | 3.67 | 31 817 | 29 445 | 2 372 | 23.72 |
| GBP | 5 926 | 5 894 | 32 | 0.32 | 6 351 | 6 287 | 64 | 0.64 |
| EUR | 2 488 | 2 432 | 56 | 0.56 | 4 693 | 4 447 | 246 | 2.46 |
| ZAR | 372 | 195 | 177 | 1.77 | 196 | 53 | 143 | 1.43 |
| INR | 49 | – | 49 | 0.49 | 27 | – | 27 | 0.27 |
| JPY | 14 | – | 14 | 0.14 | 22 | – | 22 | 0.22 |

A 1% strengthening of the Malawi Kwacha against the foreign currencies above at the reporting date will increase/(decrease) profit or loss by the amounts shown in the sensitivity column above. The analysis assumes that all other variables in particular, interest rates, remain constant.

A 1% weakening of the Malawi Kwacha against the currencies above at the reporting date would have the equal but opposite effect.

## 5. RISK MANAGEMENT (continued)

### (r) Exposure to market risk (continued)

**Interest rate gap analysis**

The tables below summarises the exposure to interest rate risk. Included in the tables are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates. The Group does not bear an interest rate risk on unrecognised financial instruments.

CONSOLIDATED

| 2016 | | | FIXED RATE | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Zero rate | Floating rate | 0 - 3 months | 3 - 6 months | 6 - 9 months | 9 - 12 months | Over 12 months | Total |
| Total assets | **53 469 860** | **42 454 867** | **124 347 949** | **16 446 628** | **13 912 000** | **22 053 024** | **54 729 385** | **327 413 713** |
| Total liabilities and equity | **63 590 873** | **135 088 514** | **72 012 753** | **34 576 176** | **14 785 492** | **–** | **7 359 905** | **327 413 713** |
| Interest sensitivity gap | **(10 121 013)** | **(92 633 647)** | **52 335 196** | **(18 129 548)** | **(873 492)** | **22 053 024** | **47 369 480** | **–** |
| **2015** | | | | | | | | |
| Total assets | 44 301 824 | 65 160 631 | 91 706 669 | 11 689 438 | 15 890 532 | 9 135 874 | 24 516 996 | 262 401 964 |
| Total liabilities and equity | 39 236 963 | 116 838 685 | 48 165 365 | 22 055 822 | 15 985 608 | 7 515 625 | 12 603 896 | 262 401 964 |
| Interest sensitivity gap | 5 064 861 | (51 678 054) | 43 541 304 | (10 366 384) | (95 076) | 1 620 249 | 11 913 100 | – |

SEPARATE

| 2016 | | | FIXED RATE | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Zero rate | Floating rate | 0 - 3 months | 3 - 6 months | 6 - 9 months | 9 - 12 months | Over 12 months | Total |
| Total assets | **36 104 357** | **38 885 133** | **37 618 772** | **12 757 428** | **8 964 898** | **16 387 893** | **7 408 875** | **158 127 356** |
| Total liabilities and equity | **43 429 882** | **72 108 179** | **18 111 072** | **16 960 631** | **1 127 445** | **–** | **6 390 147** | **158 127 356** |
| Interest sensitivity gap | **(7 325 525)** | **(33 223 046)** | **19 507 700** | **(4 203 203)** | **7 837 453** | **16 387 893** | **1 018 728** | **–** |
| **2015** | | | | | | | | |
| Total assets | 33 896 353 | 23 407 515 | 28 816 772 | 6 642 151 | 8 756 045 | 8 460 285 | 14 179 385 | 124 158 506 |
| Total liabilities and equity | 24 361 744 | 63 920 436 | 22 009 412 | 4 645 754 | 1 279 686 | 5 381 426 | 2 560 048 | 124 158 506 |
| Interest sensitivity gap | 9 534 609 | (40 512 921) | 6 807 360 | 1 996 397 | 7 476 359 | 3 078 859 | 11 619 337 | – |

The effective interest rates for the principal financial assets and liabilities of the Bank at 31 December were:

| | 2016<br>% | 2015<br>% |
|---|---|---|
| **Assets** | | |
| Government securities | **26 – 29** | 27 |
| Deposits with banking institutions | **25 – 26** | 20 |
| Loans and advances to customers (base rate) | **33** | 35 |
| **Liabilities** | | |
| Customer deposits | **0.15 – 10** | 0.15 – 25 |

### Equity Risk

The value of investments in listed companies as at 31 December 2016 and 2015 were as follows:

| | 2016<br>K'000 | 2015<br>K'000 |
|---|---|---|
| Cost of investments in listed companies | **739 679** | 739 679 |
| Fair value of investments in listed companies | **3 174 501** | 4 617 771 |
| Net decrease in fair value of investments in listed companies | **(1 443 270)** | (408 102) |
| Impact on profit and equity of: | | |
| • increase of share price by 10% | **317 450** | 461 777 |
| • decrease of share price by 10% | **(317 450)** | (461 777) |

### Liquidity risk

Liquidity risk is the potential for loss to an institution arising from its inability to meet its obligations as they fall due and/or fund its asset book and operations due to insufficient cash flow.

Liquidity risk is often triggered by consequences of other financial risks such as credit risk, market risk and operational risk. For instance, increasing credit risk through asset concentration may increase liquidity risk and a large loan default or changes in interest rate can adversely impact the liquidity position. If management misjudges the impact on liquidity of entering into a new business or product line, the Group's liquidity risk would increase. Large off-balance sheet exposures, high concentrations in deposits and rapid growth in assets may pose relatively high levels of liquidity risk to the Group.

### Policies

The Bank has an asset liability management policy which outlines policies and procedures in liquidity management including a contingency funding plan. All liquidity policies and procedures are subject to Board approval.

### Liquidity risk management

At FMB, the Board and senior management are responsible for liquidity risk management. The responsibility for managing the overall liquidity of the Group is delegated to ALCO. ALCO is responsible for the implementation of sound policies and procedures keeping in view the strategic direction and risk appetite specified by the Board. ALCO meets every month. The committee interacts regularly with line managers and Board members to enable it to monitor and control liquidity risk arising from new products and future business activities.

ALCO measures the Group's liquidity position using liquidity ratios 1 and 2, liquidity analysis also known as maturity gap analysis, its ability to keep the liquidity reserve requirements, cash flow projections, credit/deposit ratio and other ratios. The Group has an asset liability management policy, liquidity risk management policy and compliance policy. Credit and investments policies and limits are set with liquidity risk management in mind. All these policies are subject to Board approval. Apart from internal policies, the Group is also guided by the Policy Statement on Prudential Aspects of Bank Liquidity issued by the RBM.

## 5. RISK MANAGEMENT (continued)

### (r) Exposure to market risk (continued)

#### Assessment of liquidity risk

Liquidity risk is assessed and monitored on a daily basis. A daily dashboard is circulated to executive management every morning and a Liquidity Position Report is produced by Treasury back office before end of day. This report is used for making decisions on whether to invest surplus funds or borrow funds from the interbank market in order to cover liquidity gaps. Weekly and fortnightly Liquidity Reports are also produced.

An independent Risk and Compliance function prepares reports for ALCO, on a monthly basis, and reports for the Risk Committee on a quarterly basis.

For quantitative assessment, gap analysis and ratios are used to measure risk levels. For qualitative assessment, several parameters are used to determine the quality of liquidity risk management.

#### Stress testing

Stress testing is done by Risk and Compliance function every quarter to ascertain the impact of sudden changes in short-term liabilities and liquid assets on the Bank's liquidity position. The results are discussed with ALCO and the Risk Committee.

#### Liquidity risk

The maturity gap analysis as at 31 December 2016 is given below:

CONSOLIDATED

| | Carrying amount K'000 | Gross nominal amount K'000 | Up to 1 month K'000 | 1 – 3 months K'000 | 3 – 6 months K'000 | 6 – 12 months K'000 | 1 – 3 years K'000 | Over 3 years K'000 |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 84 616 608 | 84 616 608 | 84 616 608 | – | – | – | – | – |
| Money market investments | 69 016 614 | 69 016 614 | 7 573 091 | 20 589 290 | 12 167 617 | 28 637 460 | 49 156 | – |
| Loans, advances and leases | 131 306 751 | 134 968 656 | 29 361 422 | 14 875 941 | 13 568 372 | 12 729 891 | 36 170 963 | 28 262 067 |
| Investments in listed companies | 3 174 501 | 3 174 501 | 634 900 | 634 900 | 634 900 | 634 900 | 634 901 | – |
| Other financial assets | 21 448 638 | 21 448 638 | 2 160 544 | 19 288 094 | – | – | – | – |
| **Total assets** | 309 563 112 | 313 225 017 | 124 346 565 | 55 388 225 | 26 370 889 | 42 002 251 | 36 855 020 | 28 262 067 |
| **Liabilities** | | | | | | | | |
| Liabilities to customers | 225 238 235 | 225 238 235 | 140 571 884 | 52 141 122 | 17 897 468 | 13 658 023 | 969 738 | – |
| Due to other banks | 29 553 483 | 29 553 483 | 890 248 | 4 352 115 | 16 793 526 | 1 127 445 | 4 090 369 | 2 299 780 |
| Subordinated debt | 9 031 122 | 9 031 122 | – | – | – | – | – | 9 031 122 |
| Other liabilities | 16 016 569 | 16 016 569 | 16 016 569 | – | – | – | – | – |
| **Total liabilities** | 279 839 409 | 279 839 409 | 157 478 701 | 56 493 237 | 34 690 994 | 14 785 468 | 5 060 107 | 11 330 902 |
| **Net liquidity gap** | 29 723 703 | 33 385 608 | (33 132 136) | (1 105 012) | (8 320 105) | 27 216 783 | 31 794 913 | 16 931 165 |
| **Cumulative liquidity gap** | 29 723 703 | 33 385 608 | (33 132 136) | (34 237 148) | (42 557 253) | (15 340 470) | 16 454 443 | 33 385 608 |

The maturity gap analysis as at 31 December 2015 is given below:

CONSOLIDATED (RESTATED)

| | Carrying amount K'000 | Gross nominal amount K'000 | Up to 1 month K'000 | 1 – 3 months K'000 | 3 – 6 months K'000 | 6 – 12 months K'000 | 1 – 3 years K'000 | Over 3 years K'000 |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 73 221 496 | 73 221 496 | 73 221 496 | – | – | – | – | – |
| Money market investments | 52 258 589 | 52 258 589 | 10 466 600 | 10 657 578 | 10 292 059 | 16 779 033 | 4 063 319 | – |
| Loans, advances and leases | 107 682 402 | 111 859 180 | 31 006 888 | 18 608 490 | 4 505 099 | 9 181 564 | 28 135 651 | 20 421 486 |
| Investments in listed companies | 4 617 771 | 4 617 771 | 923 554 | 923 554 | 923 554 | 923 554 | 923 555 | – |
| Other financial assets | 8 543 925 | 8 543 925 | 2 563 920 | – | – | – | 5 980 005 | – |
| **Total assets** | **246 324 183** | **250 500 961** | **118 182 458** | **30 189 622** | **15 720 712** | **26 884 151** | **39 102 530** | **20 421 486** |
| **Liabilities** | | | | | | | | |
| Liabilities to customers | 191 224 074 | 191 224 074 | 122 570 248 | 38 435 329 | 17 296 186 | 9 519 939 | 3 402 372 | – |
| Due to other banks | 23 560 642 | 23 560 642 | 38 316 | 2 684 609 | 108 727 | 12 787 516 | 5 381 426 | 2 560 048 |
| Subordinated debt | 8 380 285 | 8 380 285 | – | – | – | – | – | 8 380 285 |
| Other liabilities | 2 349 912 | 2 349 912 | 2 349 912 | – | – | – | – | – |
| **Total liabilities** | **225 514 913** | **225 514 913** | **124 958 476** | **41 119 938** | **17 404 913** | **22 307 455** | **8 783 798** | **10 940 333** |
| **Net liquidity gap** | **20 809 270** | **24 986 048** | **(6 776 018)** | **(10 930 316)** | **(1 684 201)** | **4 576 696** | **30 318 732** | **9 481 153** |
| **Cumulative liquidity gap** | **20 809 270** | **24 986 048** | **(6 776 018)** | **(17 706 334)** | **(19 390 535)** | **(14 813 839)** | **15 504 893** | **24 986 048** |

## 5. RISK MANAGEMENT (continued)

### (r) Exposure to market risk (continued)

**Liquidity risk**

The maturity gap analysis as at 31 December 2016 is given below:

SEPARATE

| | Carrying amount K'000 | Gross nominal amount K'000 | Up to 1 month K'000 | 1 - 3 months K'000 | 3 - 6 months K'000 | 6 - 12 months K'000 | 1 - 3 years K'000 | Over 3 years K'000 |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 23 326 706 | 23 326 706 | 23 326 706 | – | – | – | – | – |
| Money market investments | 48 548 466 | 48 548 466 | 3 654 232 | 11 618 984 | 11 029 809 | 22 245 441 | – | – |
| Loans, advances and leases | 42 067 041 | 43 385 953 | 7 317 725 | 1 885 903 | 12 961 096 | 7 982 707 | 11 225 771 | 2 012 751 |
| Investments in listed companies | 3 174 501 | 3 174 501 | 634 900 | 634 900 | 634 900 | 634 900 | 634 901 | – |
| Other financial assets | 20 302 658 | 20 302 658 | 1 014 564 | 19 288 094 | – | – | – | – |
| **Total assets** | 137 419 372 | 138 738 284 | 35 948 127 | 33 427 881 | 24 625 805 | 30 863 048 | 11 860 672 | 2 012 751 |
| **Liabilities** | | | | | | | | |
| Liabilities to customers | 78 516 090 | 78 516 090 | 72 342 624 | 6 006 361 | 167 105 | – | – | – |
| Due to other banks | 29 181 384 | 29 181 384 | 518 149 | 4 352 115 | 16 793 526 | 1 127 445 | 4 090 369 | 2 299 780 |
| Subordinated debt | 7 000 000 | 7 000 000 | – | – | – | – | – | 7 000 000 |
| Other liabilities | 13 457 493 | 13 457 493 | 13 457 493 | – | – | – | – | – |
| **Total liabilities** | 128 154 967 | 128 154 967 | 86 318 266 | 10 358 476 | 16 960 631 | 1 127 445 | 4 090 369 | 9 299 780 |
| **Net liquidity gap** | 9 264 405 | 10 583 317 | (50 370 139) | 23 069 405 | 7 665 174 | 29 735 603 | 7 770 303 | (7 287 029) |
| **Cumulative liquidity gap** | 9 264 405 | 10 583 317 | (50 370 139) | (27 300 734) | (19 635 560) | 10 100 043 | 17 870 346 | 10 583 317 |

## Liquidity risk

The maturity gap analysis as at 31 December 2015 is given below:

SEPARATE (RESTATED)

| | Carrying amount K'000 | Gross nominal amount K'000 | Up to 1 month K'000 | 1 – 3 months K'000 | 3 – 6 months K'000 | 6 – 12 months K'000 | 1 – 3 years K'000 | Over 3 years K'000 |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 28 565 161 | 28 565 161 | 28 565 161 | – | – | – | – | – |
| Money market investments | 26 991 153 | 26 991 153 | 493 820 | 5 761 809 | 8 645 083 | 8 460 285 | 3 630 156 | – |
| Loans, advances and leases | 40 285 729 | 42 083 160 | 14 311 844 | 8 132 957 | 2 305 281 | 2 625 042 | 8 332 068 | 6 375 968 |
| Investments in listed companies | 4 617 771 | 4 617 771 | 923 554 | 923 554 | 923 554 | 923 554 | 923 555 | – |
| Other financial assets | 6 748 095 | 6 748 095 | 768 090 | 5 980 005 | – | – | – | – |
| **Total assets** | 107 207 909 | 109 005 340 | 45 062 469 | 20 798 325 | 11 873 918 | 12 008 881 | 12 885 779 | 6 375 968 |
| **Liabilities** | | | | | | | | |
| Liabilities to customers | 78 334 359 | 78 334 359 | 70 409 261 | 7 599 491 | 6 501 | 319 106 | – | – |
| Due to other banks | 14 817 952 | 14 817 952 | 38 316 | 5 768 857 | 108 727 | 960 580 | 5 381 426 | 2 560 046 |
| Subordinated debt | 6 644 451 | 6 644 451 | – | – | – | – | – | 6 644 451 |
| Other liabilities | 1 182 803 | 1 182 803 | 1 182 803 | – | – | – | – | – |
| **Total liabilities** | 100 979 565 | 100 979 565 | 71 630 380 | 13 368 348 | 115 228 | 1 279 686 | 5 381 426 | 9 204 497 |
| **Net liquidity gap** | 6 228 344 | 8 025 775 | (26 567 911) | 7 429 977 | 11 758 690 | 10 729 195 | 7 504 353 | (2 828 529) |
| **Cumulative liquidity gap** | 6 228 344 | 8 025 775 | (26 567 911) | (19 137 934) | (7 379 244) | 3 349 951 | 10 854 304 | 8 025 775 |

## Operational risk

Operational risk is a risk of loss or reputational damage resulting from inadequate or failed internal processes, people and systems/technology or from external events. Losses due to damage to physical assets, natural disasters, law suits, frauds, staff injuries, robberies and theft are all part of operational risk.

## 5. RISK MANAGEMENT (continued)

### (r) Exposure to market risk (continued)

#### Operational risk management

The Board and senior management have created a culture that places high priority on effective operational risk management and adherence to sound operating controls. This culture emphasises high standards of ethical behaviour, honesty and integrity at all levels of the Group. The Bank has an organisational structure with clear reporting lines, efficient lay-out of premises conducive to close supervision, sound work systems and procedures and strong internal controls.

The Group has operations manuals, IT policies and manuals, a system of vetting employees, employee- friendly personnel policies, an employee training centre, systems of regular reconciliations of suspense accounts, an array of periodic Management Information Systems (MIS) reports, security and internal audit functions for effective management of operational risk in the Group. Disaster recovery and business continuity plans are in place to manage business disruptions. New products are thoroughly examined by a senior management committee and the risk management function before the Board accords approval for adoption. Insurance policies are in place for premises, various assets and employee fidelity and professional indemnity.

The policies, plans and manuals are regularly reviewed and updated, to ensure that they continue to be relevant to the environment within which the Group operates.

#### Processes

The Group has policies, operational manuals, guidelines and structures to manage its processes.

At bank level, the Bank has a Chief Operating Officer who heads the Operations department and oversees Administration, IT, Central Clearing, Card Centre, Regional Processing Centres, Quality Control department, Branch Supervision and Head Office Operations department. All these departments have departmental heads at senior or middle management levels.

All customer service back office processes are centralised. The centralised processes are handled at the central processing centre (CPC). This was done with the aim of minimising operational risk and improving efficiency. The CPC manager reports to the Chief Operating Officer. Work done by CPC is reviewed every day by an independent Quality Control department in Head Office to ensure that procedures are adhered to and any errors are detected at the earliest.

Branch and agency managers' report to Regional managers who report to the Chief Commercial Officer and the General Manager – Corporate and International Banking.

Other specialised departments like Credit, Treasury, Risk, Compliance, Legal, Finance, Human Resources, Internal Audit report directly to the General Manager or the Group Managing Director. Credit, Risk and Compliance and Internal Audit also have direct reporting to the Board sub-committees.

#### Fraud

The Group has systems and controls to mitigate fraud risk. The Group has a fraud policy which outlines what is to be done in cases of frauds. The Group encourages staff and the public to report actual or suspected fraud through the tip-offs anonymous service, line management or the Compliance Officer. Internal Audit department investigates all fraud cases.

#### IT risk

The risk that the Group can suffer losses or business disruptions due to technological system failure is very high. To manage and mitigate this risk, the Group has the following in place:

1. Policies
2. Modern data centre
3. IT disaster recovery site
4. Offsite backup centre
5. Trained personnel in hardware and software systems
6. Maintenance agreements with system providers

### People risk

The Group realises that its human capital is one of its most important resources. The Group has policies and guidelines on operations to ensure that employees are motivated and perform their duties at high standards at all times. The Group has a Learning and Development Centre (L&D) under Human Resources Department. All new staff go through induction training. L&D organises training throughout the year for staff at all levels. Timely communication is made to staff on the Group's plans, new products and other developments. The Group recruits qualified staff and police clearance is sought for all new staff.

### Assessment of operational risk

An independent Risk and Compliance function conducts ad-hoc risk assessments on premises, products and processes and reports the findings to business units or respective departments and the Managing Director. It conducts operational risk assessments as part of the bank-wide risk assessments and reports to the Managing Director and the Risk Committee on a quarterly basis.

Each entity in the Group has a risk management framework which gives guidelines on how to identify, assess, monitor and control/mitigate operational risk. In addition, there are policies and procedures on operational risk management that are aligned to the overall business strategy and support continuous improvement of overall risk management in the Group.

The bank has an Operational Risk Management System (ORMS) for recording all operational risk incidents and losses.

### Stress testing

Stress testing is done using operational risk scenarios.

### Other risks

### Compliance risk

This is the risk of legal or regulatory sanctions, material financial loss or damage to reputation that the

Group may suffer as a result of failure to comply with laws, regulations, internal policies or code of conduct applicable to the Group's activities.

The Group's Board of Directors has set in place systems for identifying, measuring, monitoring and controlling all the potential lapse areas to ensure continued compliance with all the sections of the Banking Act 2010, Reserve Bank of Malawi Act 1989, Financial Services Act 2011, Money Laundering, Proceeds of Serious Crimes and Terrorist Financing Act, 2006 and RBM directives/prudential guidelines and all other relevant laws in Malawi and other territories in which it conducts operations.

#### *Compliance risk management*

To achieve proper management of compliance risk, the Board has set limits and guidelines through policies on liquidity, credit, money laundering, etc. to ensure that management operates within limits and conditions set in the laws, regulations and directives issued by the government and the regulator. Senior management is responsible for effective management of compliance risk by implementing and instituting a risk management framework to identify, assess, monitor and control the compliance risk in the Group as well as to report to the Board on management of risk and compliance failures, if any, from time to time. Senior management reviews the compliance management framework, operational manuals and employee guidelines periodically for appropriateness and soundness.

Each entity in the Group has a Compliance Officer who is responsible for monitoring and ensuring that regulations and policies are followed. Any breach of limits or regulations are made known to the Compliance Officer and these are reported to the Managing Director and the Board Risk Committee and the Board

Every functional head and line manager in the Group is responsible for ensuring that the Group complies with regulations and policies. Assets and Liability Committee (ALCO) is very instrumental in identifying the potential violation areas and minutes of ALCO meetings are tabled in Board meetings, to ensure that the Board is kept informed of all compliance risk management concerns.

Internal audit function conducts periodical audits and provides reasonable assurance that all activities and aspects of compliance risk are being properly managed. Internal auditors also inform management and the audit committee of any breaches or violations.

## 5. RISK MANAGEMENT (continued)

### (r) Exposure to market risk (continued)

**Reputational risk**

Reputational risk is the potential that negative publicity, whether true or not, will cause a decline in the customer base, costly litigations or revenue reductions. This risk can be a result of the Group's failure to effectively manage any or all of the risk types and it can emerge at all business levels.

***Reputational risk management***

At FMB, it is every employee's responsibility to ensure that the Group's reputation is guarded at all times. From product development stage, we ensure that all products have been vetted to ensure that they don't tarnish the Group's image. All employees and senior management are encouraged to report any negative publicity in newspapers, social media and the grapevine to ensure that any incorrect perceptions are corrected. FMB has a Marketing department and has suggestion boxes at its service centres, a call centre and tip-off anonymous service to enhance customer service but also as a means of getting feedback and information from customers and the public.

The Group has the following Board approved policies which have been formulated to manage reputation risk:

1. Reputation risk management policy, which contain guidance for management of reputation risk.
2. Disclosure policy which defines what information can be disclosed by whom to the public.
3. Market disclosure policy which defines when and what can be disclosed in the risk management report under Basel II – Pillar III.

The Board and the Managing Director have the ultimate responsibility of managing reputation risk.

Risk and Compliance function independently assesses and reports level of reputational risk to the Risk committee.

The Group's Internal Audit function checks that reputation risk is being managed effectively in the Group during their scheduled audits and reports findings to the Board Audit Committee.

**Strategic risk management**

**Strategic risk**

This is the risk of adverse impact on earnings, capital, and reputation arising from changes in the environment and from adverse strategic decisions, improper implementation of decisions or lack of responsiveness to industry, economic or technical changes.

The Group is guided in its strategic decision-making by a strategic plan also known as a business plan covering five years. The plan is developed by the Board of Directors in collaboration with senior management and it is reviewed regularly. The plan is updated whenever there are significant changes or new developments in the market, changes in government policies and shifts in customer behaviour. Within the ambit of the operative business plan, annual budgets are prepared and implemented by management after approval by the Board.

Board and senior management are responsible for strategic risk management. This is achieved by among other things formulating strategy and policies, setting the Group's and individual entities' risk appetites as well as careful assessment before introduction of new products and exiting from certain products. It is the duty of the Board to establish adequate systems and controls to ensure that overall risk remains within acceptable levels. The Board has a duty to assess expansion of business arenas, monitor market changes and emergence of new financial products.

All decisions and actions that have or may have an impact on the Group's strategy have prior approval of the Board. All actions or decisions touching on strategy involve functional managers' first-hand assessments of the competitive and practical considerations underlying such decisions or actions. Strategic decisions are clearly communicated throughout the organisation in a timely manner to ensure that appropriate employees are aware and engaged and act in a manner consistent with such decisions.

The Risk and Compliance function conducts periodic strategic risk assessments and reports the results to the Risk Committee.

## 6. FINANCIAL ASSETS AND LIABILITIES

**Classification of financial assets and financial liabilities**

The table below provides reconciliation between line items in the statement of financial position and categories of financial instruments.

CONSOLIDATED

| 31 December 2016 | Notes | Held for trading K'000 | Designated at fair value K'000 | Held to maturity K'000 | Loans and receivables K'000 | Other amortised cost K'000 | Carrying value K'000 |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | 7 | – | – | – | 84 616 608 | – | 84 616 608 |
| Money market investments | 8 | – | – | 69 016 614 | – | – | 69 016 614 |
| Loans and advances to customers | 9 | – | – | – | 126 523 651 | – | 126 523 651 |
| Finance lease receivables | 10 | – | – | – | 4 783 100 | – | 4 783 100 |
| Derivative asset | 37 | 19 288 094 | – | – | – | – | 19 288 094 |
| Investments in listed companies | 13 | – | 3 174 501 | – | – | – | 3 174 501 |
| | | 19 288 094 | 3 174 501 | 69 016 614 | 215 923 359 | – | 307 402 568 |
| **Financial liabilities** | | | | | | | |
| Balances due to other banks | 17 | – | – | – | – | 29 553 483 | 29 553 483 |
| Customer deposits | 18 | – | – | – | – | 225 238 235 | 225 238 235 |
| Subordinated debt | 36 | – | – | – | – | 9 031 122 | 9 031 122 |
| | | – | – | – | – | 263 822 840 | 263 822 840 |
| **31 December 2015 (restated)** | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | 7 | – | – | – | 73 221 496 | – | 73 221 496 |
| Money market investments | 8 | – | – | 52 258 589 | – | – | 52 258 589 |
| Loans and advances to customers | 9 | – | – | – | 104 158 389 | – | 104 158 389 |
| Finance lease receivables | 10 | – | – | – | 3 524 013 | – | 3 524 013 |
| Derivative asset | 37 | 5 980 005 | – | – | – | – | 5 980 005 |
| Investments in listed companies | 13 | – | 4 617 771 | – | – | – | 4 617 771 |
| | | 5 980 005 | 4 617 771 | 52 258 589 | 180 903 898 | – | 243 760 263 |
| **Financial liabilities** | | | | | | | |
| Balances due to other banks | 17 | – | – | – | – | 23 560 642 | 23 560 642 |
| Customer deposits | 18 | – | – | – | – | 191 224 074 | 191 224 074 |
| Subordinated debt | 36 | – | – | – | – | 8 380 285 | 8 380 285 |
| | | – | – | – | – | 223 165 001 | 223 165 001 |

## 6. FINANCIAL ASSETS AND LIABILITIES (continued)

**Classification of financial assets and financial liabilities** (continued)

SEPARATE

| 31 December 2016 | Notes | Held for trading K'000 | Designated at fair value K'000 | Held to maturity K'000 | Loans and receivables K'000 | Other amortised cost K'000 | Carrying value K'000 |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | 7 | – | – | – | 23 326 706 | – | 23 326 706 |
| Money market investments | 8 | – | – | 48 548 466 | – | – | 48 548 466 |
| Loans and advances to customers | 9 | – | – | – | 42 067 041 | – | 42 067 041 |
| Amounts due from related parties | 12 | – | – | – | 248 533 | – | 248 533 |
| Derivative asset | 37 | 19 288 094 | – | – | – | – | 19 288 094 |
| Investments in listed companies | 13 | – | 3 174 501 | – | – | – | 3 174 501 |
| Investment in subsidiaries | 14 | – | – | – | – | 9 348 047 | 9 348 047 |
| | | 19 288 094 | 3 174 501 | 48 548 466 | 65 642 280 | 9 348 047 | 146 001 388 |
| **Financial liabilities** | | | | | | | |
| Balances due to other banks | 17 | – | – | – | – | 29 181 384 | 29 181 384 |
| Customer deposits | 18 | – | – | – | – | 78 516 090 | 78 516 090 |
| Subordinated debt | 36 | – | – | – | – | 7 000 000 | 7 000 000 |
| | | – | – | – | – | 114 697 474 | 114 697 474 |
| **31 December 2015 (restated)** | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | 7 | – | – | – | 28 565 161 | – | 28 565 161 |
| Money market investments | 8 | – | – | 26 991 153 | – | – | 26 991 153 |
| Loans and advances to customers | 9 | – | – | – | 40 285 729 | – | 40 285 729 |
| Amounts due from related parties | 12 | – | – | – | 377 072 | – | 377 072 |
| Derivative asset | 37 | 5 980 005 | – | – | – | – | 5 980 005 |
| Investments in listed companies | 13 | – | 4 617 771 | – | – | – | 4 617 771 |
| Investment in subsidiaries | 14 | – | – | – | – | 7 866 938 | 7 866 938 |
| | | 5 980 005 | 4 617 771 | 26 991 153 | 69 227 962 | 7 866 938 | 114 683 829 |
| **Financial liabilities** | | | | | | | |
| Balances due to other banks | 17 | – | – | – | – | 14 817 952 | 14 817 952 |
| Customer deposits | 18 | – | – | – | – | 78 334 359 | 78 334 359 |
| Subordinated debt | 37 | – | – | – | – | 6 644 451 | 6 644 451 |
| | | – | – | – | – | 99 796 762 | 99 796 762 |

## Fair values of financial instruments

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:** Inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

**Level 2:** Inputs other than quoted prices included within Level 1 that are observable 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 in which all significant inputs are directly or indirectly observable from market data.

**Level 3:** Inputs that are unobservable. This category includes all instruments for which 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 for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist, and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates and credit spreads used in estimating discount rates, bond and equity prices, and foreign currency exchange rates.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Group uses widely recognised valuation models for determining the fair value of common and simple financial instruments, such as interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices or model inputs are usually available in the market for listed debt and equity securities, and exchange-traded derivatives. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

The following table analyses financial instruments measured at fair value at the reporting date, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position.

The Group does not provide fair value disclosure for financial instruments not measured at fair value, when the carrying amount is a reasonable approximation of fair value and for an investment in equity instruments that do not have a quoted price in an active market for an identical instrument.

### Financial instruments measured at fair value – Fair value hierarchy

| | | 2016 (K'000) | | | 2015 (K'000) | | |
|---|---|---|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 | Level 1 | Level 2 | Level 3 |
| **Consolidated** | | | | | | | |
| Money market investments | 8 | – | 69 016 614 | – | – | 52 258 589 | – |
| Loans and advances to customers | 9 | – | 126 523 651 | – | – | 104 158 389 | – |
| Finance lease receivables | 10 | – | 4 783 100 | – | – | 3 524 013 | – |
| Investments in listed companies | 13 | 3 174 501 | – | – | 4 617 771 | – | – |
| | | 3 174 501 | 200 323 365 | – | 4 617 771 | 159 940 991 | – |
| **Separate** | | | | | | | |
| Money market investments | 8 | – | 48 548 466 | – | – | 26 991 153 | – |
| Loans and advances to customers | 9 | – | 42 067 041 | – | – | 40 285 729 | – |
| Investments in listed companies | 13 | 3 174 501 | – | – | 4 617 771 | – | – |
| | | 3 174 501 | 90 615 507 | – | 4 617 771 | 67 276 882 | – |

## 7. CASH AND CASH EQUIVALENTS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Liquidity reserve deposits: Central Banks | **18 803 266** | 14 617 507 | **5 849 519** | 7 601 018 |
| Placements with other banks | **55 450 617** | 52 321 431 | **12 156 377** | 17 021 669 |
| Cheques in course of clearing | **688 273** | 158 963 | **231 058** | 84 070 |
| Cash balances | **9 674 452** | 6 123 595 | **5 089 752** | 3 858 404 |
| Total cash and cash equivalents | **84 616 608** | 73 221 496 | **23 326 706** | 28 565 161 |

Amounts deposited with Central Banks for liquidity reserve requirement are not available for the Group's operating activities and do not attract interest. Other cash and cash equivalents with other banks earn interest of 8 – 29% (2015: 4 – 25%).

## 8. MONEY MARKET INVESTMENTS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Promissory notes | **9 861 748** | 16 348 538 | **6 273 605** | 11 936 398 |
| Treasury bills | **59 112 954** | 35 546 458 | **42 274 861** | 15 054 755 |
| Corporate bonds | **41 912** | – | **–** | – |
| Local registered government stocks | **–** | 363 593 | **–** | – |
| Total money market investments | **69 016 614** | 52 258 589 | **48 548 466** | 26 991 153 |
| **Movement during the year as follows:** | | | | |
| As at 1 January | **52 258 589** | 18 343 566 | **26 991 153** | 6 599 188 |
| Net movement | **16 758 025** | 33 915 023 | **21 557 313** | 20 391 965 |
| As at 31 December | **69 016 614** | 52 258 589 | **48 548 466** | 26 991 153 |

The interest rate on money market investments approximates the market interest rate and hence the carrying amount reasonably approximates the fair value. All money market investments mature within 12 months.

# 9. LOANS AND ADVANCES TO CUSTOMERS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016<br>K'000 | Restated<br>2015<br>K'000 | 2016<br>K'000 | 2015<br>K'000 |
| **Loans and advances at amortised cost are receivable as follows:** | | | | |
| Maturing within three months | **42 881 207** | 48 190 055 | **9 203 628** | 22 444 801 |
| Maturing between three and 12 months | **25 581 716** | 12 955 647 | **20 943 803** | 4 930 323 |
| Maturing after 12 months | **61 231 597** | 46 193 001 | **13 238 522** | 14 708 036 |
| | **129 694 520** | 107 338 703 | **43 385 953** | 42 083 160 |
| **Specific impairment allowances** | | | | |
| Balance at 1 January | **(1 333 904)** | (2 829 981) | **(521 943)** | (1 383 174) |
| (Charge)/recoveries for the year (note 38) | **(329 796)** | (794 567) | **944** | (116 213) |
| Provision increase offset against fees and commission income | **(268 027)** | (813 722) | **(268 027)** | (813 722) |
| Write-offs | **684 942** | 3 104 366 | **443 813** | 1 791 166 |
| **Balance at 31 December** | **(1 246 785)** | (1 333 904) | **(345 213)** | (521 943) |
| **Collective impairment allowance** | | | | |
| Balance at 1 January | **(390 224)** | (306 341) | **(48 522)** | – |
| Charge for the year (note 38) | **(135 001)** | (83 883) | **(9 976)** | (48 522) |
| **Balance at 31 December** | **(525 225)** | (390 224) | **(58 498)** | (48 522) |
| **Interest in suspense** | | | | |
| Balance at 1 January | **(1 456 186)** | (1 811 182) | **(1 226 966)** | (1 540 266) |
| Interest suspended for the year | **57 327** | 354 996 | **311 765** | 313 300 |
| **Balance at 31 December** | **(1 398 859)** | (1 456 186) | **(915 201)** | (1 226 966) |
| **Net loans and advances to customers** | **126 523 651** | 104 158 389 | **42 067 041** | 40 285 729 |

The directors consider that the carrying amounts of loans and advances are a reasonable approximation of their fair value.

The Group manages these loans and advances in accordance with its investment strategy. Internal reporting and performance measurement of these loans and advances are at amortised cost.

Impairment of loans and advances has been calculated as disclosed in notes 5k (iii) and 38.

Loans and advances as per industry/sector have been disclosed in note 5(l)(v).

Effective base interest rates for loans and advances have been disclosed in note 40.

## 10. FINANCE LEASE RECEIVABLES

| | CONSOLIDATED | |
|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 |
| *Investment in leases at amortised cost are receivable as follows:* | | |
| Less than one year | **2 730 273** | 2 161 072 |
| Maturing between one and five years | **2 385 958** | 2 232 351 |
| Maturing after more than five years | **157 905** | 127 053 |
| | **5 274 136** | 4 520 476 |
| *Specific impairment allowances* | | |
| Balance at 1 January | **(257 452)** | (671 787) |
| Charge for the year (note 38) | **(7 152)** | (76 940) |
| Transfer | **137 720** | – |
| Write-offs | **94 424** | 491 275 |
| Balance at 31 December | **(32 460)** | (257 452) |
| *Collective impairment allowance* | | |
| Balance at 1 January | **(31 388)** | – |
| Charge for the year (note 38) | **(25 014)** | (31 388) |
| Balance at 31 December | **(56 402)** | (31 388) |
| *Interest in suspense:* | | |
| Balance at 1 January | **(707 623)** | (1 391 299) |
| Interest suspended for the year | **443 169** | 683 676 |
| Transfer | **(137 720)** | – |
| Balance at 31 December | **(402 174)** | (707 623) |
| Net finance lease receivables | **4 783 100** | 3 524 013 |

## 11. OTHER ASSETS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Cheques in course of collection | **–** | 1 228 | **–** | 1 228 |
| Prepayments | **923 285** | 1 388 570 | **613 613** | 334 701 |
| Dividend receivable | **3 450** | 3 450 | **3 450** | 3 450 |
| Stock of stationery | **100 449** | 127 767 | **100 449** | 116 556 |
| Stock of computer spares and other items | **112 261** | 128 633 | **101 066** | 128 633 |
| Assets held for sale | **7 045** | 59 345 | **–** | – |
| Available-for-sale financial assets | **27 089** | – | **–** | – |
| Other receivables | **1 019 751** | 1 636 715 | **527 228** | 431 882 |
| Total other assets | **2 193 330** | 3 345 708 | **1 345 806** | 1 016 450 |

All other assets are recoverable/realisable within 12 months and no interest is charged on overdue balances.

Prepayments consists of expenses paid in advance including rentals paid for retail outlets, annual maintenance contracts and software licence fees for several items of software and hardware used in the day-to-day operations of the bank

The group grants loans to its employees at interest rates lower than market rates. Included in Other receivables is K354 million (2015: K302 million) representing the difference between the amount advanced and fair value of these loans using market rates. The difference has been recognised as an employee benefit in compliance with IAS 19 *Employee Benefits*.

## 12. AMOUNTS DUE FROM RELATED PARTIES

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| FMB Pensions Limited | – | – | – | 34 282 |
| Capital Bank Limited Mozambique | – | – | – | 62 811 |
| The Leasing and Finance Company of Malawi Limited | – | – | – | 16 782 |
| FMB Capital Markets Limited | – | – | 271 | – |
| Capital Bank Limited Botswana | – | – | 193 971 | 152 003 |
| First Capital Bank Limited Zambia | – | – | 54 291 | 111 194 |
| Total amounts due to related parties | – | – | 248 533 | 377 072 |

Balances due from related parties have no fixed repayment terms, are unsecured and are interest free.

## 13. INVESTMENTS IN LISTED COMPANIES

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| **Change in fair value** | | | | |
| Balance at 1 January | 4 617 771 | 5 025 873 | 4 617 771 | 5 025 873 |
| Movement in fair value (note 26) | (1 443 270) | (408 102) | (1 443 270) | (408 102) |
| **Balance at 31 December** | 3 174 501 | 4 617 771 | 3 174 501 | 4 617 771 |

All investments in listed companies are designated at fair value through profit or loss upon initial recognition. The movement in fair value is taken to profit or loss.

At year-end, the Group's portfolio of investments in listed companies comprised:

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| **Shares held** | | | | |
| Illovo Sugar (Malawi) Limited | 12 915 541 | 12 915 541 | 12 915 541 | 12 915 541 |
| National Investment Trust Limited | 25 766 628 | 25 766 628 | 25 766 628 | 25 766 628 |
| Telekom Networks Malawi Limited | 38 338 700 | 38 338 700 | 38 338 700 | 38 338 700 |
| **Share price (Kwacha)** | | | | |
| Illovo Sugar (Malawi) Limited | 160.00 | 230.00 | 160.00 | 230.00 |
| National Investment Trust Limited | 34.00 | 55.00 | 34.00 | 55.00 |
| Telekom Networks Malawi Limited | 6.05 | 6.00 | 6.05 | 6.00 |
| **Market value (K'000)** | | | | |
| Illovo Sugar (Malawi) Limited | 2 066 487 | 2 970 574 | 2 066 487 | 2 970 574 |
| National Investment Trust Limited | 876 065 | 1 417 165 | 876 065 | 1 417 165 |
| Telekom Networks Malawi Limited | 231 949 | 230 032 | 231 949 | 230 032 |
| | 3 174 501 | 4 617 771 | 3 174 501 | 4 617 771 |

Fair value measurement of investments in listed companies has been categorised as level 1 fair value based on quoted prices on the Malawi Stock Exchange.

## 14. INVESTMENTS IN SUBSIDIARIES

| | Shares ('000) | Shareholding | 2016 K'000 | 2015 K'000 |
|---|---|---|---|---|
| **Investment in subsidiaries** | | | | |
| The Leasing and Finance Company of Malawi Limited | 18 343 | 100.0% | 65 911 | 65 911 |
| Capital Bank Limited – Mozambique | 4 057 | 70.0% | 4 776 240 | 3 295 131 |
| ICB Malawi Limited | 7 149 | 100.0% | 148 791 | 148 791 |
| FMB Capital Markets Limited | 500 | 100.0% | 50 000 | 50 000 |
| FMB Forex Bureau Limited | 10 000 | 100.0% | 10 000 | 10 000 |
| FMB Pensions Limited | 1 000 | 100.0% | – | – |
| Capital Bank Limited – Botswana | 31 588 | 38.6% | 903 854 | 903 854 |
| First Capital Bank Zambia Limited | 50 960 | 49.0% | 3 393 251 | 3 393 251 |
| | | | 9 348 047 | 7 866 938 |
| **Movement during the year was as follows:** | | | | |
| **As at 1 January** | | | 7 866 938 | 7 075 393 |
| Additions during the year | | | 1 481 109 | 791 545 |
| **As at 31 December** | | | 9 348 047 | 7 866 938 |
| **Subscription in shares in subsidiaries were as follows:** | | | | |
| First Merchant Bank's contribution: | | | | |
| Capital Bank Limited – Mozambique (70%) | | | 1 481 109 | 791 545 |
| non-controlling interest's contribution: | | | | |
| Capital Bank Limited – Mozambique (30%) | | | 634 761 | 339 233 |

## 15. (A) INTANGIBLE ASSETS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| **Cost** | | | | |
| As at 1 January | **5 842 613** | 2 413 936 | **2 964 998** | 631 546 |
| Transfer | **–** | 1 780 007 | **–** | 1 511 551 |
| Disposals | **(27 453)** | – | **–** | – |
| Effects of changes in exchange rates | **(319 493)** | (6 250) | **–** | – |
| Additions | **1 864 592** | 1 654 920 | **1 414 264** | 821 901 |
| **As at 31 December** | **7 360 259** | 5 842 613 | **4 379 262** | 2 964 998 |
| **Accumulated amortisation** | | | | |
| As at 1 January | **1 798 921** | 1 216 056 | **740 725** | 474 587 |
| Effects of changes in exchange rates | **(21 517)** | (6 251) | | |
| Charge for the year | **823 198** | 589 116 | **434 080** | 266 138 |
| **As at 31 December** | **2 600 602** | 1 798 921 | **1 174 805** | 740 725 |
| **Carrying amount** | **4 759 657** | 4 043 692 | **3 204 457** | 2 224 273 |

Intangible assets relate to computer software and are measured at cost incurred in the acquisition and development of computer software, including website development costs.

## 15. (B) PROPERTY AND EQUIPMENT

| CONSOLIDATED | Freehold property K'000 | Leasehold improve-ments K'000 | Motor vehicles K'000 | Motor vehicles – operating lease K'000 | Equipment, fixtures and fittings K'000 | Capital work in progress K'000 | Total K'000 |
|---|---|---|---|---|---|---|---|
| **Cost or valuation** | | | | | | | |
| **Balance at 1 January 2016** | **4 092 676** | **3 466 387** | **860 971** | **459 223** | **6 215 445** | **444 215** | **15 538 917** |
| Additions | **–** | **54 010** | **495 968** | **217 639** | **783 746** | **325 894** | **1 877 257** |
| Effects of changes in exchange rates | **187 130** | **(50 582)** | **(32 996)** | **–** | **133 953** | **18 233** | **255 738** |
| Revaluation surplus | **456 508** | **245 811** | **–** | **–** | **–** | **–** | **702 319** |
| Disposals | **(19 660)** | **–** | **(88 726)** | **–** | **(12 299)** | **(146 555)** | **(267 240)** |
| Transfers | **(490 487)** | **202 670** | **–** | **–** | **(90 826)** | **(111 844)** | **(490 487)** |
| **Balance at 31 December 2016** | **4 226 167** | **3 918 296** | **1 235 217** | **676 862** | **7 030 019** | **529 943** | **17 616 504** |
| **Accumulated depreciation** | | | | | | | |
| **Balance at 1 January 2016** | **220 194** | **510 034** | **478 737** | **28 800** | **3 971 378** | **–** | **5 209 143** |
| Charge for the year | **112 953** | **252 078** | **188 603** | **–** | **767 372** | **–** | **1 321 006** |
| Released on disposal | **(483)** | **–** | **(84 196)** | **–** | **(12 299)** | **–** | **(96 978)** |
| Effects of changes in exchange rates | **24 852** | **(40)** | **(19 849)** | **–** | **144 535** | **–** | **149 498** |
| Charge on operating lease | **–** | **–** | **–** | **139 015** | **–** | **–** | **139 015** |
| Eliminated on revaluation | **(143 827)** | **(58 171)** | **–** | **–** | **–** | **–** | **(201 998)** |
| **Balance at 31 December 2016** | **213 689** | **703 901** | **563 295** | **167 815** | **4 870 986** | **–** | **6 519 686** |
| **Cost or valuation** | | | | | | | |
| **Balance at 1 January 2015** | 3 504 452 | 2 687 264 | 675 779 | – | 4 823 995 | 3 202 345 | 14 893 835 |
| Additions | 360 068 | 588 200 | 212 507 | 459 223 | 598 849 | 462 496 | 2 681 343 |
| Effects of exchange rate changes | 84 109 | (112 123) | 4 093 | – | 177 931 | (16 873) | 137 137 |
| Disposals | (86 000) | – | (46 865) | – | (39 178) | (99 525) | (271 568) |
| Transfers | 230 047 | 303 046 | 15 457 | – | 653 848 | (3 104 228) | (1 901 830) |
| **Balance at 31 December 2015** | 4 092 676 | 3 466 387 | 860 971 | 459 223 | 6 215 445 | 444 215 | 15 538 917 |
| **Accumulated depreciation** | | | | | | | |
| **Balance at 1 January 2015** | 97 821 | 339 374 | 360 921 | – | 3 236 906 | – | 4 035 022 |
| Charge for the year | 100 186 | 151 250 | 115 014 | – | 547 448 | – | 913 898 |
| Released on disposal | (850) | – | (27 039) | – | (37 847) | – | (65 736) |
| Effects of exchange rate changes | 23 037 | 19 410 | 29 841 | – | 224 871 | – | 297 159 |
| Charge on operating lease | – | – | – | 28 800 | – | – | 28 800 |
| **Balance at 31 December 2015** | 220 194 | 510 034 | 478 737 | 28 800 | 3 971 378 | – | 5 209 143 |
| **Carrying amount** | | | | | | | |
| At 31 December 2016 | **4 012 478** | **3 214 395** | **671 922** | **509 047** | **2 159 033** | **529 943** | **11 096 818** |
| At 31 December 2015 | 3 872 482 | 2 956 353 | 382 234 | 430 423 | 2 244 067 | 444 215 | 10 329 774 |

## 15. (B) PROPERTY AND EQUIPMENT (continued)

| SEPARATE | Freehold property K'000 | Leasehold improve-ments K'000 | Motor vehicles K'000 | Equipment, fixtures and fittings K'000 | Capital work in progress K'000 | Total K'000 |
|---|---|---|---|---|---|---|
| **Cost or valuation** | | | | | | |
| **Balance at 1 January 2016** | 2 387 571 | 1 928 610 | 349 522 | 3 400 621 | 319 451 | 8 385 775 |
| Additions | – | 50 852 | 485 241 | 624 468 | – | 1 160 561 |
| Revaluation surplus | 433 355 | 245 811 | – | – | – | 679 166 |
| Disposals | (19 660) | – | (8 491) | (11 909) | (146 555) | (186 615) |
| Transfers | – | 51 364 | – | – | – | (51 364) |
| **Balance at 31 December 2016** | 2 801 266 | 2 276 637 | 826 272 | 4 013 180 | 121 532 | 10 038 887 |
| **Accumulated depreciation** | | | | | | |
| **Balance at 1 January 2016** | 77 449 | 54 699 | 260 239 | 2 090 964 | – | 2 483 351 |
| Charge for the year | 80 108 | 45 136 | 102 682 | 455 752 | – | 683 678 |
| Released on disposal | (483) | – | (8 491) | (11 909) | – | (20 883) |
| Eliminated on revaluation | (140 907) | (58 171) | – | – | – | (199 078) |
| **Balance at 31 December 2016** | 16 167 | 41 664 | 354 430 | 2 534 807 | – | 2 947 068 |
| **Cost or valuation** | | | | | | |
| **Balance at 1 January 2015** | 2 387 571 | 1 619 157 | 347 963 | 2 454 382 | 2 152 331 | 8 961 404 |
| Additions | – | 176 366 | 7 000 | 575 841 | 320 859 | 1 080 066 |
| Disposals | – | – | (5 441) | (39 178) | (99 525) | (144 144) |
| Transfers | – | 133 087 | – | 409 576 | (2 054 214) | (1 511 551) |
| **Balance at 31 December 2015** | 2 387 571 | 1 928 610 | 349 522 | 3 400 621 | 319 451 | 8 385 775 |
| **Accumulated depreciation** | | | | | | |
| Balance at 1 January 2015 | 2 980 | 15 368 | 216 659 | 1 813 466 | – | 2 048 473 |
| Charge for the year | 74 469 | 39 331 | 49 021 | 315 345 | – | 478 166 |
| Released on disposal | – | – | (5 441) | (37 847) | – | (43 288) |
| **Balance at 31 December 2015** | 77 449 | 54 699 | 260 239 | 2 090 964 | – | 2 483 351 |
| **Carrying amount** | | | | | | |
| At 31 December 2016 | 2 785 099 | 2 234 973 | 471 842 | 1 478 373 | 121 532 | 7 091 819 |
| At 31 December 2015 | 2 310 122 | 1 873 911 | 89 283 | 1 309 657 | 319 451 | 5 902 424 |

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

Capital work in progress represents development costs on the Bank's various branches.

The freehold properties and leasehold improvements were last revalued on 31 December 2016 by Don Whayo BSc; MRICS; MSIM of Knight Frank Malawi Limited, independent valuers, on an open market value basis. The resultant surplus was credited to revaluation reserve in 2016. This is not available for distribution until realised.

The fair value measurement for properties has been categorised as Level 3 fair value based on inputs to the valuation techniques used.

The following table shows the valuation technique used in measuring the fair values of freehold properties and leasehold improvements, as well as the significant unobservable inputs used.

| Valuation technique | Significant unobservable inputs |
|---|---|
| **Open market value basis** | |
| Open market value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion. | The valuation approach adopted takes cognisance of the performance of the property market at the time of valuation. The approach relies on sales data and all relevant factors pertaining to the property market. |
| The valuation process makes comparisons between the subject property and comparable property which has gone through the market in order to formulate an opinion as to a fair market value using an estimate of the future potential net income capable of being generated by the use of the property. | The method recognises that property can be assembled, not only for occupation and use of the owner, but also to let to one or more tenants who will pay the owner rent for the right to the use and occupation of the property. |

## 15. (C) INVESTMENT PROPERTY

| | CONSOLIDATED | |
|---|---|---|
| | **2016** | 2015 |
| Balance at 1 January | **–** | – |
| Reclassification from property and equipment (note 15b) | **490 487** | – |
| Change in fair value | **387 688** | – |
| Balance at 31 December | **878 175** | – |

Investment property relates to land held by First Capital Bank Zambia Limited for capital appreciation rather than for administrative purposes as a bank.

## 16. DEFERRED TAX

**Movements in temporary differences during the year**

CONSOLIDATED

| 2016 | Opening balance K'000 | Recognised in profit or loss K'000 | Recognised in other comprehensive income K'000 | Effect of changes in exchange rate K'000 | Closing balance K'000 |
|---|---|---|---|---|---|
| Property and equipment | **567 511** | **369 665** | **–** | **(105 344)** | **831 832** |
| Accrued income | **964 890** | **418 555** | **–** | **–** | **1 383 445** |
| Revaluation of property | **214 306** | **–** | **91 131** | **–** | **305 437** |
| Tax losses | **–** | **(343 756)** | **–** | **(18 163)** | **(361 919)** |
| Gratuity and severance pay liabilities | **(105 028)** | **(192 284)** | **–** | **–** | **(297 312)** |
| Subordinated debt revaluation | **(605 603)** | **605 603** | **–** | **–** | **–** |
| Other temporary differences | **61 058** | **(63 609)** | **–** | **(96 938)** | **(99 489)** |
| | **1 097 134** | **794 174** | **91 131** | **(220 445)** | **1 761 994** |
| **2015** | | | | | |
| Property and equipment | 32 252 | 576 503 | – | (41 244) | 567 511 |
| Accrued income | 295 942 | 668 948 | – | – | 964 890 |
| Revaluation of property | 228 675 | – | (14 369) | – | 214 306 |
| Tax losses | (2 736) | 2 736 | – | – | – |
| Gratuity and severance pay liabilities | (50 860) | (54 168) | – | – | (105 028) |
| Subordinated debt revaluation | (92 506) | (513 097) | – | – | (605 603) |
| Other temporary differences | 48 636 | 45 220 | – | (32 798) | 61 058 |
| | 459 403 | 726 142 | (14 369) | (74 042) | 1 097 134 |

## 16. DEFERRED TAX (continued)

SEPARATE

| 2016 | Opening balance K'000 | Recognised in profit or loss K'000 | Recognised in other comprehensive income K'000 | Closing balance K'000 |
|---|---|---|---|---|
| Property and equipment | 412 510 | 256 113 | – | 668 623 |
| Accrued income | 728 248 | 473 999 | – | 1 202 247 |
| Revaluation of property | 213 604 | – | 89 727 | 303 331 |
| Gratuity and severance pay liabilities | (95 958) | (190 915) | – | (286 873) |
| Subordinated debt revaluation | (605 603) | 605 603 | – | – |
| Other temporary differences | – | (18 501) | – | (18 501) |
| | 652 801 | 1 126 299 | 89 727 | 1 868 827 |
| **2015** | | | | |
| Property and equipment | (22 491) | 435 001 | – | 412 510 |
| Accrued income | 164 526 | 563 722 | – | 728 248 |
| Revaluation of property | 213 604 | – | – | 213 604 |
| Gratuity and severance pay liabilities | (52 509) | (43 449) | – | (95 958) |
| Subordinated debt revaluation | (92 506) | (513 097) | – | (605 603) |
| | 210 624 | 442 177 | – | 652 801 |

## 17. BALANCES DUE TO OTHER BANKS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Local banks | 20 908 445 | 14 179 322 | 20 536 346 | 5 436 632 |
| European Investment Bank | 8 645 038 | 9 343 004 | 8 645 038 | 9 343 004 |
| Norsad Agency | – | 38 316 | – | 38 316 |
| Total balance due to other banks | 29 553 483 | 23 560 642 | 29 181 384 | 14 817 952 |
| **Payable as follows:** | | | | |
| Due within one year | 23 163 334 | 15 496 031 | 22 791 235 | 6 753 341 |
| Due between two and five years | 6 390 149 | 8 064 611 | 6 390 149 | 8 064 611 |
| | 29 553 483 | 23 560 642 | 29 181 384 | 14 817 952 |

All balances due to other banks are stated at amortised cost. Balances due to local banks represent short-term borrowings by the Group and a Currency Swap liability which First Merchant Bank Limited entered into with Reserve Bank of Malawi (RBM) in which the bank received Malawi Kwacha from RBM. The liability outstanding as at year-end was K20.1 billion (2015: K5.4 billion). The corresponding asset under the arrangement has been disclosed under note 37.

The credit line facilities with European Investment Bank (EIB) and NORSAD Agency were made available to the Bank for on lending to customers in specified economic sectors. The EIB line of credit which is denominated in US Dollars, carries interest between 2.9% and 5.6% per annum and is repayable in equal bi annual instalments ending on 15 March 2019.

The NORSAD Agency credit line granted on behalf of the NORSAD Fund was denominated in US dollars, carried interest at 7% and was fully repaid during the year.

## 18. CUSTOMER DEPOSITS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Current and savings accounts | **78 207 309** | 62 330 063 | **43 730 973** | 34 981 682 |
| Foreign currency accounts | **54 850 083** | 44 609 301 | **28 377 206** | 28 938 754 |
| Term deposit accounts | **92 180 843** | 84 284 710 | **6 407 911** | 14 413 923 |
| Total customer deposits | **225 238 235** | 191 224 074 | **78 516 090** | 78 334 359 |
| **Payable as follows:** | | | | |
| Maturing within three months | **192 713 006** | 161 005 577 | **78 348 985** | 78 008 752 |
| Maturing after three months | **32 525 229** | 30 218 497 | **167 105** | 325 607 |
| | **225 238 235** | 191 224 074 | **78 516 090** | 78 334 359 |

## 19. OTHER PAYABLES

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Accrued expenses | **1 991 997** | 1 574 756 | **1 129 506** | 1 057 364 |
| Bankers cheques issued and uncleared | **874 799** | 622 884 | **589 733** | 403 662 |
| Bills payable | **1 262 106** | 228 873 | **227 514** | 170 005 |
| Interest payable | **586 739** | 485 722 | **380 191** | 325 429 |
| Margins on letters of credit and other instruments | **11 186 741** | 108 819 | **11 186 741** | 108 819 |
| Trade payables | **2 031 731** | 828 387 | **998 861** | 99 661 |
| Other employee benefits | **74 453** | 75 227 | **74 453** | 75 227 |
| Total payables | **18 008 566** | 3 924 668 | **14 586 999** | 2 240 167 |

Margins on letters of credit and other instruments are fully cash collateralised.

## 20. SHARE CAPITAL

| | | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|---|
| | | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| (a) | Share capital | **116 813** | 116 813 | **116 813** | 116 813 |

Share capital represent authorised, issued and fully paid up 2 336 250 000 ordinary shares at 5 tambala each.

| | | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|---|
| | | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| (b) | Share premium | **1 565 347** | 1 565 347 | **1 565 347** | 1 565 347 |

On 19 June 2006, following an offer to the public, 225 000 000 ordinary shares of 5 tambala each were allotted at a premium of 245 tambala per share.

The resultant premium on issue of K551.25 million less offer expenses of K37.215 million was credited to share premium account. In 2009, the company issued by way of bonus issue from retained earnings, 111 250 000 ordinary shares of 5 tambala each at 950 tambala per share giving rise to a share premium of K1.051 billion which was also credited to the share premium account.

## 21. PROPERTY REVALUATION RESERVE

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Property revaluation reserve | **3 447 824** | 2 634 331 | **3 339 180** | 2 550 356 |

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

## 22. LOAN LOSS RESERVE

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Loan loss reserve | **1 260 194** | 1 796 397 | **776 191** | 1 345 670 |

**Loans loss reserve**

In order to comply with asset classification directives by central banks, the directors have made a transfer to the loan loss reserve in addition to provisions charged to profit or loss in accordance with International Financial Reporting Standards.

## 23. NON-DISTRIBUTABLE RESERVES

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Non-distributable reserves | **350 000** | 350 000 | **–** | – |

This represents the capitalisation of retained earnings in The Leasing and Finance Company of Malawi Limited in 2009.

## 24. TRANSLATION RESERVE

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | Restated 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Translation reserve | **1 893 679** | 1 508 298 | **–** | – |

This represents retranslation differences arising on retranslation of foreign investments at the reporting date.

## 25. INTEREST INCOME

| | CONSOLIDATED 2016 K'000 | CONSOLIDATED Restated 2015 K'000 | SEPARATE 2016 K'000 | SEPARATE 2015 K'000 |
|---|---|---|---|---|
| Loans and advances | **20 780 113** | 16 139 911 | **11 318 991** | 9 640 398 |
| Finance leases | **1 429 742** | 1 469 485 | **–** | – |
| Treasury bills | **7 161 339** | 4 372 437 | **5 196 174** | 2 629 396 |
| Local registered stocks | **–** | 159 068 | **–** | 6 375 |
| Promissory notes | **2 655 926** | 405 367 | **2 281 398** | 343 318 |
| Placements with other banks | **1 974 750** | 1 010 253 | **244 541** | 109 044 |
| Total interest income | **34 001 870** | 23 556 521 | **19 041 104** | 12 728 531 |

## 26. (LOSS)/INCOME FROM INVESTMENTS

| | CONSOLIDATED 2016 K'000 | CONSOLIDATED Restated 2015 K'000 | SEPARATE 2016 K'000 | SEPARATE 2015 K'000 |
|---|---|---|---|---|
| Dividend income | **69 705** | 55 539 | **480 538** | 555 539 |
| Movement in fair value of investments | **(1 443 270)** | (408 102) | **(1 443 270)** | (408 102) |
| Total (loss)/income from investments | **(1 373 565)** | (352 563) | **(962 732)** | 147 437 |

## 27. STAFF AND TRAINING COSTS

| | CONSOLIDATED 2016 K'000 | CONSOLIDATED Restated 2015 K'000 | SEPARATE 2016 K'000 | SEPARATE 2015 K'000 |
|---|---|---|---|---|
| Salaries and wages | **7 737 668** | 6 018 913 | **3 553 091** | 2 801 545 |
| Training and other staff costs | **3 130 129** | 2 707 320 | **2 134 337** | 2 018 174 |
| Contributions to defined contribution pension plans | **429 720** | 287 296 | **256 534** | 204 487 |
| Total staff and training costs | **11 297 517** | 9 013 529 | **5 943 962** | 5 024 206 |

## 28. OTHER EXPENSES

| | CONSOLIDATED 2016 K'000 | CONSOLIDATED Restated 2015 K'000 | SEPARATE 2016 K'000 | SEPARATE 2015 K'000 |
|---|---|---|---|---|
| Administration expenses | **562 835** | 532 690 | **160 206** | 90 983 |
| Auditor's remuneration | **316 319** | 156 704 | **72 112** | 58 124 |
| Bank charges | **528 056** | 343 654 | **140 862** | 90 522 |
| Non-executive directors' remuneration | **390 242** | 268 889 | **258 264** | 169 779 |
| Insurance | **170 423** | 187 531 | **97 590** | 95 506 |
| Legal and consultancy fees | **274 098** | 299 920 | **145 857** | 99 117 |
| Marketing costs | **524 023** | 697 196 | **355 040** | 361 984 |
| Motor vehicle running costs | **197 201** | 146 307 | **153 300** | 145 319 |
| Repairs and maintenance | **215 175** | 510 973 | **130 240** | 97 771 |
| Operational losses | **397 614** | 226 283 | **38 531** | 36 564 |
| Postage | **156 644** | 124 194 | **128 346** | 97 155 |
| Printing and stationery | **560 322** | 485 069 | **402 065** | 283 951 |
| Professional subscriptions | **70 748** | 50 939 | **62 421** | 47 056 |
| Telephone expenses | **259 262** | 203 799 | **117 491** | 128 750 |
| Travel expenses | **434 281** | 387 491 | **302 675** | 183 733 |
| Utilities | **306 120** | 318 613 | **228 770** | 148 705 |
| Total other expenses | **5 363 363** | 4 940 252 | **2 793 770** | 2 135 019 |

## 29. INCOME TAX EXPENSE

Recognised in the statement of comprehensive income

| | | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|---|
| | | 2016 | Restated 2015 | 2016 | 2015 |
| *(a)* | ***Current tax expense*** | | | | |
| | Current year at 30% (2015: 30%) based on profits | **2 931 052** | 1 204 424 | **1 686 595** | 1 255 207 |
| | Origination and reversal of temporary differences | **794 174** | 726 142 | **1 126 299** | 442 177 |
| | | **3 725 226** | 1 930 566 | **2 812 894** | 1 697 384 |
| *(b)* | ***Reconciliation of effective tax rate*** | | | | |
| | Profit before income tax expense | **11 386 242** | 6 193 773 | **7 996 600** | 5 610 397 |
| | Tax using the domestic tax rate 30% (2015: 30%) | **3 415 873** | 1 858 132 | **2 398 980** | 1 683 119 |
| | Non-deductible expenses | **143 783** | 39 057 | **125 094** | 58 496 |
| | Losses of subsidiary companies not tax deductible | **–** | 212 682 | **–** | – |
| | Prior year adjustment in a subsidiary | **–** | (73 536) | **–** | – |
| | Tax exempt income | **165 570** | (105 769) | **288 820** | (44 231) |
| | | **3 725 226** | 1 930 566 | **2 812 894** | 1 697 384 |
| *(c)* | ***Income tax (recoverable)/payable*** | | | | |
| | As at 1 January | **(922 527)** | 149 909 | **(331 530)** | 367 144 |
| | Charges for the year | **2 931 052** | 1 204 424 | **1 686 595** | 1 255 207 |
| | Paid during the year | **(3 091 690)** | (2 276 860) | **(1 838 951)** | (1 953 881) |
| | As at 31 December | **(1 083 165)** | (922 527) | **(483 886)** | (331 530) |

## 30. BASIC AND DILUTED EARNINGS PER SHARE

The calculation of basic and diluted earnings per share at 31 December 2016 was based on profit attributable to ordinary shareholders of K6 387 300 000 (2015: K4 073 496 000) and a weighted average number of ordinary shares outstanding of 2 336 250 000 (2015: 2 336 250 000) calculated as follows:

| | CONSOLIDATED | |
|---|---|---|
| | 2016 | Restated 2015 |
| Profit attributable to ordinary shareholders (thousands) | **6 387 300** | 4 073 496 |
| Weighted average number of ordinary shares in issue (thousands) | **2 336 250** | 2 336 250 |
| Basic and diluted earnings per share (tambala) | **273** | 174 |

# 31. GROUP SUBSIDIARIES

## (a) List of subsidiaries

The table below provides details of the subsidiaries of the Group.

| Company name | Principal place of business | Ownership interest 2016 | Ownership interest 2015 |
|---|---|---|---|
| The Leasing and Finance Company of Malawi Limited | Malawi | **100.0%** | 100.0% |
| Capital Bank Limited | Mozambique | **70.0%** | 70.0% |
| FMB Capital Markets Limited | Malawi | **100.0%** | 100.0% |
| Capital Bank Limited | Botswana | **38.6%** | 38.6% |
| First Capital Bank Zambia Limited | Zambia | **49.0%** | 49.0% |
| FMB Forex Bureau Limited (dormant) | Malawi | **100.0%** | 100.0% |
| International Commercial Bank Limited (dormant) | Malawi | **100.0%** | 100.0% |
| FMB Pensions Limited (dormant) | Malawi | **100.0%** | 100.0% |

## (b) Non-controlling interest in subsidiaries

The following table summarises the information relating to the Group's subsidiaries that have material non-controlling interests (NCI).

| NCI percentage and voting rights | 30% | 30% | 61.40% | 61.40% | 51% | 51% | | |
|---|---|---|---|---|---|---|---|---|
| | Capital Bank Limited – Mozambique | | Capital Bank Limited – Botswana | | First Capital Bank Zambia Limited | | Total | |
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| **Assets** | | | | | | | | |
| Cash and cash equivalents | **6 558 679** | 6 095 876 | **42 758 602** | 23 244 461 | **10 872 551** | 14 282 419 | **60 189 832** | 43 622 756 |
| Money market investments | **577 808** | 1 755 238 | **10 265 753** | 15 089 632 | **4 861 649** | 2 905 290 | **15 705 210** | 19 750 160 |
| Loans and advances to customers | **8 263 715** | 11 799 722 | **55 663 900** | 37 906 656 | **19 834 542** | 14 170 556 | **83 762 157** | 63 876 934 |
| Other assets | **136 089** | 173 868 | **389 321** | 570 946 | **180 022** | 198 528 | **705 432** | 943 342 |
| Current tax asset | **323 837** | 377 405 | **–** | 66 699 | **411 511** | 283 329 | **735 348** | 727 433 |
| Intangible assets | **306 968** | 619 345 | **657 475** | 621 080 | **588 882** | 575 872 | **1 553 325** | 1 816 297 |
| Investment property | **–** | – | **–** | – | **878 175** | – | **878 175** | – |
| Property and equipment | **635 217** | 1 030 193 | **1 606 100** | 1 381 690 | **986 374** | 1 375 478 | **3 227 691** | 3 787 361 |
| Total assets | **6 802 313** | 21 851 647 | **111 341 151** | 78 881 164 | **38 613 706** | 33 791 472 | **166 757 170** | 134 524 283 |
| **Liabilities** | | | | | | | | |
| Customer deposits | **12 394 628** | 16 338 857 | **96 567 061** | 66 476 462 | **29 642 794** | 21 595 094 | **138 604 483** | 104 410 413 |
| Balances due to other financial institutions | **–** | 2 352 386 | **–** | – | **372 099** | 3 994 221 | **372 099** | 6 346 607 |
| Other payables | **317 028** | 240 207 | **1 185 941** | 1 234 926 | **1 486 626** | 2 863 757 | **2 989 595** | 4 338 890 |
| Income tax payable | **–** | – | **41 906** | – | **–** | – | **41 906** | – |
| Deferred tax liabilities | **–** | – | **227 085** | 174 923 | **(532 882)** | (562 994) | **(305 797)** | (388 071) |
| Subordinated debt | **–** | – | **2 031 122** | 1 735 834 | **–** | – | **2 031 122** | 1 735 834 |
| Total liabilities | **12 711 656** | 18 931 450 | **100 053 115** | 69 622 145 | **30 968 637** | 27 890 078 | **143 733 408** | 116 443 673 |
| **Net assets** | **4 090 657** | 2 920 197 | **11 288 036** | 9 259 019 | **7 645 069** | 5 901 394 | **23 023 762** | 18 080 610 |
| Net assets attributable to NCI | **1 227 197** | 876 059 | **6 930 854** | 5 685 038 | **3 898 985** | 3 009 711 | **12 057 036** | 9 570 808 |
| Carrying amount of NCI | **1 227 197** | 876 059 | **6 930 854** | 5 685 038 | **3 898 985** | 3 009 711 | **12 057 036** | 9 570 808 |

## 31. GROUP SUBSIDIARIES (continued)

### (b) Non-controlling interest in subsidiaries (continued)

| | Capital Bank Limited – Mozambique | | Capital Bank Limited – Botswana | | First Capital Bank Zambia Limited | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Interest income | **2 412 444** | 1 417 899 | **5 517 139** | 3 945 517 | **4 018 652** | 2 498 475 | **11 948 235** | 7 861 891 |
| Interest expense on deposits and other accounts | **(1 006 277)** | (550 909) | **(1 367 669)** | (1 473 942) | **(1 844 726)** | (913 735) | **(4 218 672)** | (2 938 586) |
| Fees and commissions | **335 505** | 334 128 | **1 429 596** | 788 418 | **1 244 320** | 576 106 | **3 009 421** | 1 698 652 |
| Gain on foreign exchange transactions | **1 505 830** | 1 116 843 | **692 706** | 528 631 | **780 613** | (9 640) | **2 979 149** | 1 635 834 |
| **Total income** | **3 247 502** | 2 317 961 | **6 271 772** | 3 788 624 | **4 198 859** | 2 151 206 | **13 718 133** | 8 257 791 |
| Staff and training costs | **1 368 571** | 1 338 297 | **2 113 191** | 1 394 191 | **1 590 707** | 1 169 121 | **5 072 469** | 3 901 609 |
| Premises and equipment costs | **757 602** | 586 220 | **469 579** | 378 871 | **620 902** | 419 376 | **1 848 083** | 1 384 467 |
| Depreciation expense | **288 387** | 218 081 | **362 015** | 263 199 | **348 865** | 258 450 | **999 267** | 739 730 |
| Other expenses | **406 446** | 468 557 | **1 055 091** | 603 860 | **965 614** | 576 120 | **2 427 151** | 1 648 537 |
| Impairment loss on loans and advances | **185 252** | 415 747 | **201 953** | 203 971 | **68 560** | 107 876 | **455 765** | 727 594 |
| **Total expenses** | **3 006 258** | 3 026 902 | **4 201 829** | 2 844 092 | **3 594 648** | 2 530 943 | **10 802 735** | 8 401 937 |
| Income tax expense | **–** | – | **491 684** | 208 647 | **148 736** | (282 795) | **640 420** | (74 148) |
| **Operating profit/(loss)** | **241 244** | (708 941) | **1 578 259** | 735 885 | **455 475** | (96 942) | **2 274 978** | (69 998) |
| Other comprehensive income | **–** | – | **–** | – | **–** | – | **–** | – |
| **Total comprehensive income** | **241 244** | (708 941) | **1 578 259** | 735 885 | **455 475** | (96 942) | **2 274 978** | (69 998) |
| **Profit/(loss) allocated to NCI** | **72 373** | (212 682) | **969 051** | 451 833 | **232 292** | (49 440) | **1 273 716** | 189 711 |

## 32. DIVIDENDS

Last year's final dividend of K467.25 million (20 tambala per share) was paid during the year. There was no interim dividend for the year 2016. The directors propose a final dividend of K 1 168 125 million (50 tambala per share) for approval at the forthcoming Annual General Meeting.

## 33. RELATED PARTY TRANSACTIONS

The Bank 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 Bank are set out below:

### Loans to directors, senior management and other related parties

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 (K'000) | 2015 (K'000) | 2016 (K'000) | 2015 (K'000) |
| **Corporate bodies directly or indirectly related to directors*** | | | | |
| Balance at the beginning of the year | 1 086 275 | 1 763 488 | 1 029 742 | 1 747 566 |
| Loans granted during the year | 1 083 765 | 58 203 | 1 062 068 | – |
| Repayments | (1 379 080) | (735 416) | (1 324 377) | (717 824) |
| **Balance at the end of the year** | 790 960 | 1 086 275 | 767 433 | 1 029 742 |
| **Subsidiary companies** | | | | |
| Balance at the beginning of the year | – | – | – | – |
| Loans granted during the year | 599 697 | – | 599 697 | – |
| Repayments | (599 697) | – | (599 697) | – |
| **Balance at the end of the year** | – | – | – | – |
| **Senior management** | | | | |
| Balance at the beginning of the year | 427 530 | 374 065 | 189 566 | 198 227 |
| Loans granted during the year | 459 594 | 225 160 | 184 784 | 124 026 |
| Repayments | (433 893) | (171 695) | (112 468) | (132 687) |
| **Balance at the end of the year** | 453 231 | 427 530 | 261 882 | 189 566 |

Advances to directors and parties related thereto are in the normal course of business. All loans are secured and, other than staff loans to senior management in the ordinary course of business as part of employment practices, are made on an arms' length basis. They are approved on terms no more favourable than those, which would be offered under prevailing conditions to persons other than related parties. Other than staff loans in the ordinary course of business, credit decisions on loans to related parties are made only by the board of directors exclusive of the relevant related parties.

Included in loans to corporate bodies directly or indirectly related to directors is an overdraft facility for Telekom Networks Malawi Limited (a related party through common directors). The balance at year-end was K722 million (2015: K1 billion).

Loans to senior management, like all other staff loans are approved by Credit executive and/or the Managing Director. Advances to employees include K36.9 million (2015: K16.6 million) of interest free advances and K1.1 billion (2015: K774 million) 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 arm's length basis on normal commercial terms.

There were no non-performing loans and overdrafts to related parties.

## 33. RELATED PARTY TRANSACTIONS (continued)

Details of related party transactions and balances between the Bank and its subsidiaries, The Leasing and Finance Company of Malawi Limited, FMB Forex Bureau Limited, FMB Pensions Limited, FMB Capital Markets Limited, First Capital Bank Zambia Limited and Capital Bank Botswana which have been eliminated on consolidation are as follows:

| | 2016 K'000 | 2015 K'000 |
|---|---|---|
| Loans and overdrafts | **200 815** | 220 815 |
| Deposits | **400 912** | 309 766 |
| Fees and commissions received | **10 420** | 10 362 |
| Net interest income | **26 141** | 56 635 |
| Dividends received | **410 833** | 500 000 |
| First Capital Bank Zambia Limited | **54 291** | 111 194 |
| Capital Bank Limited Botswana | **193 971** | 152 003 |
| FMB Capital Markets Limited | **271** | – |

During the year, the bank obtained US$15 million from Capital Bank Botswana through three separate deals of US$7 million, US$5 million and US$3 million at 6% interest rate. The amount was fully repaid as at year-end.

Compensation for First Merchant Bank's key personnel is as follows:

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| **Executive directors** | | | | |
| Salaries | **253 332** | 220 201 | **253 332** | 220 201 |
| Bonuses | **85 000** | 135 000 | **85 000** | 135 000 |
| **Non-executive directors** | | | | |
| Fees | **390 242** | 268 889 | **258 264** | 169 779 |
| | **728 574** | 624 090 | **596 596** | 524 980 |

In addition to their salaries, First Merchant Bank also provides non-cash benefits to executive directors. The estimated value of total non-cash benefits to directors amounts to K20.2 million (2015: K5.6 million).

Any director who performs services which are outside the scope of the ordinary duties of a director, are paid extra remuneration determined by other directors and approved by the general meeting. These payments have been included as part of remuneration for non-executive directors.

### Other related parties

First Merchant Bank has three separate agreements with Livingstone Exports Limited, in which FMB director, Mr H N Anadkat, is beneficially interested:

| | Agreement date | 2016 K'000 | 2015 K'000 |
|---|---|---|---|
| Chief M'Mbelwa Building | 7 June 2003 | **80 000** | 80 000 |
| Livingstone Towers | 3 October 2003 | **142 900** | 142 900 |
| Livingstone Car Park | 26 June 2014 | **151 774** | 151 774 |
| | | **231 774** | 231 774 |

- ## Chief M'Mbelwa Building

  On 7 June 2003, FMB entered into a debenture agreement which has no fixed term with Livingstone Exports Limited. The agreement required FMB to loan K80 million to Livingstone Exports Limited secured by way of the registered debenture giving FMB a proportionate share of office space in Chief M'Mbelwa Building. FMB uses the office space determined in the debenture agreement on a peppercorn rental basis. Total expenditure to convert and renovate the proportionate share of the premises for use by FMB was K138.1 million and was capitalised in 2004. This office space currently houses FMB's Capital City Branch and Leasing and Finance Company of Malawi Limited head office.

- ## Livingstone Towers Building

  On 3 October 2003, FMB entered into a 99-year (expiring 30 June 2102) lease agreement with Livingstone Exports Limited. FMB paid a single lease premium of K9 million and erected at its cost and expense office space. Total expenditure incurred of K142.9 million was capitalised in 2004. This office space within Livingstone Towers currently houses FMB's head office, First Corporate Service Branch, International Banking Department and Leasing and Finance Company of Malawi Limited.

- ## Livingstone Car Park

  On 26 June 2014, FMB entered into a debenture agreement which has no fixed term with Livingstone Exports Limited. The agreement required FMB to loan K151.7 million to Livingstone Exports Limited secured by way of the registered debenture for development of a car park opposite Livingstone Towers. FMB was given a proportionate (68.85%) share in the property comprising 42 vehicle parking spaces used by FMB. The parking spaces are used by the FMB on a peppercorn rental basis.

## Directors' interests

As at 31 December 2016, 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 | |
|---|---|---|
| | **2016** | 2015 |
| H N Anadkat | **1 071 163 931** | 1 071 354 449 |
| R C Kantaria | **525 000 000** | 525 000 000 |
| D Dikshit | **12 000 000** | 2 000 000 |
| J M O'Neill | **1 309 391** | 1 309 391 |
| M Msisha | **1 050 000** | 1 050 000 |

# 34. 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:

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | **2016 K'000** | Restated 2015 K'000 | **2016 K'000** | 2015 K'000 |
| **Contingent liabilities** | | | | |
| Acceptances and letters of credit | **16 982 273** | 27 315 858 | **15 511 819** | 26 117 340 |
| Financial guarantees | **29 141 027** | 26 862 656 | **16 273 796** | 13 209 783 |
| | **46 123 300** | 54 178 514 | **31 785 615** | 39 327 123 |
| **Other contingent liabilities** | | | | |
| Legal claims | **219 000** | 15 000 | **89 000** | 89 000 |

## 34. CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES (continued)

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.

Other contingent liabilities represent civil litigation matters that will crystallise into a liability only in the unlikely event of an unfavourable judgement

### Capital commitments

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 K'000 | 2015 K'000 | 2016 K'000 | 2015 K'000 |
| Capital expenditure | | | | |
| Authorised but not contracted | **1 694 500** | 474 000 | **1 600 000** | 694 360 |

## 35. STATUTORY REQUIREMENTS

In accordance with Financial Services (Capital Adequacy for Banks) Directive 2012 and Directive No. LRR-07 FMO-Liquidity Reserve Requirement, 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 7.5% (2015: 7.5%) of the preceding weeks total deposit liabilities. In the last two weeks of December 2016, the liquidity reserve was 7.99% (2015: 9.91%) of total customer deposits.

***(ii) Capital Adequacy Requirement***

Reserve Bank of Malawi requires the bank to maintain a minimum capital of Tier 1 and Total Capital of 10% and 15%, respectively as a percentage of total risk-weighted assets.

The total capital is made up of the following:

1. Tier 1 capital, which includes paid-up share capital, share premium, retained earnings, non- distributable reserves less investment in unconsolidated financial institutions; and
2. Tier 2 capital, which includes subordinated debt, asset revaluation reserves, translation reserves, loan loss reserves and non-controlling interests.

As at 31 December 2016, the Group's Tier 1 capital ratio of its risk bearing assets and Total capital ratio were as follows:

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016 % | Restated 2015 % | 2016 % | 2015 % |
| Tier 1 risk based capital ratio (minimum 10%) | **13.9** | 12.6 | **17.1** | 12.7 |
| Total risk-weighted capital ratio (minimum 15%) | **21.1** | 20.2 | **23.3** | 19.2 |

## 36. SUBORDINATED DEBT

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016<br>K'000 | Restated<br>2015<br>K'000 | 2016<br>K'000 | 2015<br>K'000 |
| Carrying amount | **9 031 122** | 8 380 285 | **7 000 000** | 6 644 451 |
| Movement during the year: | | | | |
| As at 1 January | **8 380 285** | 6 092 280 | **6 644 451** | 4 644 276 |
| Additions | **7 000 000** | – | **7 000 000** | – |
| Repayments | **(7 225 451)** | – | **(7 225 451)** | – |
| Unamortised issue cost | **(3 099)** | (18 569) | **–** | – |
| Effects of changes in exchange rates | **879 387** | 2 306 574 | **581 000** | 2 000 175 |
| **As at 31 December** | **9 031 122** | 8 380 285 | **7 000 000** | 6 644 451 |

(a) On 5 April 2013, FMB issued a fixed interest note of US$10 million bearing interest at 10.6% per annum payable quarterly in arrears with maturity date of 5 April 2019. In accordance with relevant provisions within the Placement Document of the note, the bank opted for early redemption of the note on 4 July 2016.

(b) On 3 June 2016, FMB issued through private placement K7 billion, fixed-term unsecured floating rate subordinated note and will mature in its entirety on 3 June 2023. This debt was a replacement of the US Dollar-denominated placement which was redeemed on 4 July 2016. Interest is referenced against the published average yield for 91-day Treasury Bills for auctions preceding repricing dates and is payable quarterly in arrears.

(c) Capital Bank Botswana issued P30 million floating rates notes maturing on 18 January 2022 which earn interest at 70 basis points below the bank rate.

(d) The subordinated debt notes constitute direct, subordinated and unsecured obligations of First Merchant Bank Limited and Capital Bank Botswana, respectively. The notes rank *pari passu* among themselves and are subordinated to general creditors and claims of depositors.

## 37. DERIVATIVE ASSET

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | 2016<br>K'000 | Restated<br>2015<br>K'000 | 2016<br>K'000 | Restated<br>2015<br>K'000 |
| Currency swaps | **19 288 094** | 5 980 005 | **19 288 094** | 5 980 005 |
| **Movement during the year was as follows:** | | | | |
| As at 1 January | **5 980 005** | – | **5 980 005** | – |
| Additions | **19 288 094** | 5 980 005 | **19 288 094** | 5 980 005 |
| Maturities | **(5 980 005)** | – | **(5 980 005)** | – |
| As at 31 December | **19 288 094** | 5 980 005 | **19 288 094** | 5 980 005 |

## 37. DERIVATIVE ASSET (continued)

| Funds under currency swap | Trade date | Maturity date | K'000 | Spot/Forward Rate (MK) |
|---|---|---|---|---|
| **31 December 2015** | | | | |
| US$5.0 million | 27 Nov 2015 | 27 May 2016 | 3 322 225 | 592.56/635.59 |
| US$2.5 million | 8 Dec 2015 | 7 Jun 2016 | 1 661 113 | 619.51/664.50 |
| US$1.5 million | 29 Dec 2015 | 29 Mar 2016 | 996 667 | 660.67/684.95 |
| | | | 5 980 005 | |
| 31 December 2016 | | | | |
| US$5.0 million | 27 May 2016 | 1 Mar 2017 | 3 616 553 | 708.35/785.90 |
| US$2.5 million | 12 Jun 206 | 4 Apr 2017 | 1 808 277 | 709.44/791.95 |
| US$7.0 million | 16 Jun 2016 | 16 Jun 2017 | 5 183 535 | 710.04/810.93 |
| US$5.0 million | 19 Aug 2016 | 17 Feb 2017 | 3 616 554 | 720.98/773.33 |
| US$7.0 million | 20 Oct 2016 | 20 Apr 2017 | 5 063 175 | 720.87/773.22 |
| | | | 19 288 094 | |

The bank entered into a Currency Swap arrangement with Reserve Bank of Malawi (RBM) in which the bank sold US Dollars to RBM. The deals are listed above. The corresponding liability under the arrangement has been disclosed as note 17.

## 38. IMPAIRMENT LOSSES ON FINANCIAL ASSETS

| | CONSOLIDATED | | SEPARATE | |
|---|---|---|---|---|
| | **2016 K'000** | Restated 2015 K'000 | **2016 K'000** | 2015 K'000 |
| **Impairment allowance on loans and advances** | | | | |
| Credit impairments charge | **1 789 356** | 3 290 596 | **1 182 666** | 2 378 081 |
| Recoveries | **(1 324 559)** | (2 412 146) | **(1 173 634)** | (2 213 346) |
| | **464 797** | 878 450 | **9 032** | 164 735 |
| **Impairment allowance on finance leases** | | | | |
| Credit impairment charge | **73 057** | 189 659 | **–** | – |
| Recoveries | **(40 891)** | (81 331) | **–** | – |
| | **32 166** | 108 328 | **–** | – |
| ***Comprising:*** | | | | |
| **Impairment allowance on loans and advances (note 9)** | | | | |
| Net specific credit impairment charges | **329 796** | 794 567 | **(944)** | 116 213 |
| Collective credit impairment charges | **135 001** | 83 883 | **9 976** | 48 522 |
| | **464 797** | 878 450 | **9 032** | 164 735 |
| **Impairment allowance on finance leases** | | | | |
| Net specific credit impairments charges | **7 152** | 76 940 | **–** | – |
| Collective credit impairment charges | **25 014** | 31 388 | **–** | – |
| | **32 166** | 108 328 | **–** | – |

## 39. 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 Malawi National Consumer Price Index, which represent an official measure of inflation.

| Exchange rates | 2016 Kwacha | 2015 Kwacha |
|---|---|---|
| Malawi Kwacha/GBP | **894.3** | 989.8 |
| Malawi Kwacha/Rand | **53.6** | 43.4 |
| Malawi Kwacha/US Dollar | **723.3** | 664.4 |
| Malawi Kwacha/Euro | **763.6** | 729.5 |
| Malawi Kwacha/Pula | **67.8** | 58.4 |
| Malawi Kwacha/Meticais | **10.1** | 14.5 |
| Malawi Kwacha/Zambia Kwacha | **73.5** | 60.4 |
| **Inflation rate %** | **20.0** | 24.9 |
| As at the date of approval of the financial statements, the above noted exchange rates had moved as follows: | | |
| Malawi Kwacha/GBP | **901.5** | 966.1 |
| Malawi Kwacha/Rand | **56.0** | 44.9 |
| Malawi Kwacha/US Dollar | **724.3** | 682.9 |
| Malawi Kwacha/Euro | **784.4** | 762.3 |
| Malawi Kwacha/Pula | **70.0** | 60.6 |
| Malawi Kwacha/Meticais | **10.9** | 13.7 |
| Malawi Kwacha/Zambia Kwacha | **77.1** | 60.7 |

## 40. EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES

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

| | |
|---|---|
| **Assets** | |
| Government securities | 26 – 29% |
| Deposits with banking institutions | 25 – 26% |
| Loans and advances to customers (base rate) | 33 – 38% |
| **Liabilities** | |
| Customer deposits | 0.15 – 10% |

## 41. 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 – dormant
- FMB Pensions Limited – dormant
- Capital Bank Limited – corporate and retail banking in Botswana
- First Capital Bank Zambia Limited – corporate and retail banking in Zambia
- Capital Bank Limited Mozambique – corporate and retail banking in Mozambique
- FMB Capital Markets Limited – asset management in Malawi
- International Commercial Bank Limited – dormant

## 41. SEGMENTAL REPORTING (continued)

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 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.

FMB Pensions Limited, International Commercial Bank Limited and FMB Capital Markets Limited do 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.

| | MALAWI | | | |
|---|---|---|---|---|
| | Corporate and Retail Banking K'000 | Asset Finance K'000 | Others K'000 | Subtotal K'000 |
| Interest income – external | 19 041 104 | 3 024 458 | 14 214 | 22 079 776 |
| Interest expense – external | (6 872 063) | (1 890 711) | – | (8 762 774) |
| **Net interest income** | 12 169 041 | 1 133 747 | 14 214 | 13 317 002 |
| Fees and commissions | 6 149 151 | 209 387 | 33 045 | 6 391 583 |
| Loss from investments | (962 732) | – | – | (962 732) |
| Gain on foreign exchange transactions | 2 256 583 | – | – | 2 256 583 |
| **Total operating income** | 19 612 043 | 1 343 134 | 47 259 | 21 002 436 |
| Staff and training costs | (5 943 962) | (281 086) | – | (6 225 048) |
| Premises and equipment | (1 750 921) | (10 224) | (1 798) | (1 762 943) |
| Depreciation | (1 117 758) | (25 930) | (1 250) | (1 144 938) |
| Other expenses | (2 793 770) | (132 945) | (19 917) | (2 946 632) |
| Impairment of financial assets | (9 032) | (32 167) | – | (41 199) |
| **Total expenditure** | (11 615 443) | (482 352) | (22 965) | (12 120 760) |
| **Profit before income tax expense** | 7 996 600 | 860 782 | 24 294 | 8 881 676 |
| Income tax expense | (2 812 894) | (262 447) | (9 464) | (3 084 805) |
| **Profit for the year** | 5 183 706 | 598 335 | 14 830 | 6 796 871 |
| **Other comprehensive income** | | | | |
| Revaluation surplus on property | 878 244 | 26 073 | – | 904 317 |
| Deferred tax on revalued property | (89 727) | (1 405) | – | (91 131) |
| Other movements | 307 | – | – | 307 |
| **Total other comprehensive income for the period** | 788 824 | 24 668 | – | 813 492 |
| **Total comprehensive income for the period** | 5 972 530 | 623 003 | 14 830 | 6 610 363 |
| **Total segment assets** | 158 127 350 | 11 657 686 | 981 942 | 170 098 842 |
| **Total segment liabilities** | 131 153 300 | 9 018 888 | 4 652 | 139 508 704 |

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 K70.96 million (2015: K13.01 million). All other revenues are attributable to the country in which the respective operating segment is domiciled.

During the year the Bank earned K5.2 billion (2015: K2.6 billion) interest on Government of Malawi treasury bills and K95 million (2015: K350 million) interest on loans and advances to enterprises controlled by Government of Malawi.

Included in income from investments for the Bank is K411 million (2015: nil) dividend received during the year from Capital Bank Limited – Botswana. In 2016 nil (2015: K500 million) dividend was received from The Leasing and Finance Company of Malawi Limited. These have been eliminated on consolidation.

| MOZAMBIQUE | BOTSWANA | ZAMBIA | | | |
|---|---|---|---|---|---|
| Corporate and Retail Banking K'000 | Corporate and Retail Banking K'000 | Corporate and Retail Banking K'000 | Total before adjustments K'000 | Consolidation adjustments K'000 | Total K'000 |
| 2 412 444 | 5 517 139 | 4 018 652 | 34 028 011 | (26 141) | 34 001 870 |
| (1 006 277) | (1 367 668) | (1 844 726) | (12 981 445) | 26 141 | (12 955 304) |
| 1 406 167 | 4 149 471 | 2 173 926 | 21 046 566 | – | 21 046 566 |
| 335 505 | 1 429 595 | 1 244 320 | 9 401 003 | (10 420) | 9 390 583 |
| – | – | – | (962 732) | (410 833) | (1 373 565) |
| 1 505 830 | 692 706 | 780 613 | 5 235 732 | – | 5 235 732 |
| 3 247 502 | 6 271 772 | 4 198 859 | 34 720 569 | (421 253) | 34 299 316 |
| (1 368 571) | (2 113 191) | (1 590 707) | (11 297 517) | – | (11 297 517) |
| (757 602) | (469 579) | (620 902) | (3 611 026) | – | (3 611 027) |
| (288 387) | (362 014) | (348 865) | (2 144 204) | – | (2 144 204) |
| (406 446) | (1 055 091) | (965 614) | (5 373 783) | 10 420 | (5 363 363) |
| (185 252) | (201 953) | (68 560) | (496 964) | – | (496 963) |
| (3 006 258) | (4 201 828) | (3 594 648) | (22 923 494) | 10 420 | (22 913 074) |
| 241 244 | 2 069 944 | 604 211 | 11 797 075 | (410 833) | 11 386 242 |
| – | (491 685) | (148 736) | (3 725 226) | – | (3 725 226) |
| 41 244 | 1 578 259 | 455 475 | 8 071 849 | (410 833) | 7 661 016 |
| – | – | – | 904 317 | – | 904 317 |
| – | – | – | (91 131) | – | (91 131) |
| 1 515 089 | (1 186 660) | 1 288 200 | 1 616 936 | – | 1 616 936 |
| 1 515 089 | (1 186 660) | 1 288 200 | 2 430 122 | – | 2 430 122 |
| 1 756 333 | 391 599 | 1 743 675 | 10 501 971 | (410 833) | 10 091 138 |
| 16 802 313 | 111 341 151 | 39 087 343 | 337 329 649 | (10 584 072) | 327 413 713 |
| 12 711 664 | 100 053 115 | 31 442 275 | 283 715 758 | (790 494) | 283 593 400 |

# SHAREHOLDER INFORMATION

As at 31 December 2016

| Industry | Holders | Holder % | Total shares | Shares % |
|---|---|---|---|---|
| Foreign companies | 14 | 0.79 | 1 736 921 426 | 74.35 |
| Local companies | 59 | 3.33 | 211 222 034 | 9.04 |
| Citizen resident individuals | 1 475 | 83.19 | 110 394 602 | 4.73 |
| Other resident individuals | 7 | 0.39 | 109 303 283 | 4.68 |
| Investment companies and trusts | 25 | 1.41 | 94 726 133 | 4.05 |
| Pension funds | 33 | 1.86 | 47 496 614 | 2.03 |
| Insurance companies | 6 | 0.34 | 7 901 843 | 0.34 |
| Banks | 5 | 0.28 | 4 852 790 | 0.21 |
| Non-residents | 27 | 1.52 | 3 986 239 | 0.17 |
| Nominees local | 25 | 1.35 | 3 395 551 | 0.15 |
| Financials | 1 | 0.06 | 1 912 000 | 0.08 |
| Employees | 76 | 4.29 | 1 389 675 | 0.06 |
| Other organisations | 6 | 0.34 | 1 162 271 | 0.05 |
| Permanent resident | 1 | 0.06 | 534 152 | 0.02 |
| Non-resident citizens | 5 | 0.28 | 526 317 | 0.02 |
| Holding company | 2 | 0.11 | 419 720 | 0.02 |
| Leasing and finance | 5 | 0.28 | 101 150 | 0.00 |
| Deceased estates | 1 | 0.06 | 4 200 | 0.00 |
| **Grand total of holders total** | 1 773 | Grand total of Shares | 2 336 250 000 | |

| Range | Shares | Total shares % | Holders | Total holders % |
|---|---|---|---|---|
| 1 – 5 000 | 1 112 679 | 0.05 | 474 | 26.73 |
| 5 001 – 10 000 | 1 760 670 | 0.08 | 259 | 14.61 |
| 10 001 – 25 000 | 6 069 261 | 0.26 | 391 | 22.05 |
| 25 001 – 50 000 | 6 243 275 | 0.27 | 165 | 9.31 |
| 50 001 – 100 001 | 8 169 091 | 0.35 | 119 | 6.71 |
| 100 001 – 200 000 | 16 273 672 | 0.70 | 133 | 7.50 |
| 200 001 – 500 000 | 41 071 750 | 1.76 | 141 | 7.95 |
| 500 001 – 1 000 000 | 29 842 080 | 1.28 | 41 | 2.31 |
| 1 000 001 and above | 2 225 707 522 | 95.27 | 50 | 2.82 |
| **Total Shares** | 2 336 250 000 | Total shares | 1 773 | |

| Country | Holders | Holders % | Total shares | Total shares % |
|---|---|---|---|---|
| Botswana | 1 | 0.06 | 10 500 | 0.00 |
| Cayman Islands | 1 | 0.06 | 990 | 0.00 |
| Channel Islands | 1 | 0.06 | 766 266 044 | 32.80 |
| Kenya | 3 | 0.17 | 525 002 750 | 22.47 |
| Malawi | 1 696 | 95.77 | 509 531 843 | 21.81 |
| Portugal | 8 | 0.45 | 2 335 200 | 0.10 |
| South Africa | 4 | 0.23 | 135 015 | 0.01 |
| United Kingdom | 10 | 0.56 | 530 857 896 | 22.72 |
| USA | 6 | 0.34 | 665 268 | 0.03 |
| Warrant not presentable | 40 | 2.26 | 1 022 855 | 0.04 |
| Zimbabwe | 3 | 0.17 | 421 639 | 0.02 |
| **Totals** | 1 773 | 100.11 | 2 336 250 000 | 100.00 |

# PROXY FORM

FIRST MERCHANT BANK LIMITED

I/We ______________________________________________ of

______________________________________________ (address), being a

Member/members of the abovenamed company hereby appoint ______________________

______________________ of ______________________ or failing him/her

______________________________________________ of

______________________________________________ as my/our

proxy to vote for me/us on my/our behalf at the 21st Annual General Meeting of the Company to be held on 6 June 2017 and at any adjournment thereof.

This form is to be used as follows:

| | In favour | Against | Abstain |
|---|---|---|---|
| Resolution number 1 | | | |
| Resolution number 2 | | | |
| Resolution number 3 | | | |
| Resolution number 4.1 | | | |
| Resolution number 4.2 | | | |
| Resolution number 4.3 | | | |
| Resolution number 4.4 | | | |
| Resolution number 4.5 | | | |
| Resolution number 4.6 | | | |
| Resolution number 4.7.1 | | | |
| Resolution number 4.7.2 | | | |
| Resolution number 5.1 | | | |
| Resolution number 5.2 | | | |

Unless otherwise instructed, the proxy will vote as he/she thinks fit

Date ______________________ Signed ______________________

**A PROXY NEED NOT BE A MEMBER OF THE COMPANY**

# NOTES

FIRST MERCHANT BANK LIMITED

For a full version of the annual report please contact FMB Malawi:

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Or download the full annual report from our website
www.fmbmalawi.com/annual-reports

2016 Abridged Annual Report