

REPUBLIC OF KENYA



*Paper laid by
The Leader of
Majority on 23/4/14
Shauri*

KENYA NATIONAL AUDIT OFFICE



*Volume
7*

**REPORT OF
THE
AUDITOR-GENERAL**

KENYA NATIONAL AUDIT OFFICE

ON

**THE FINANCIAL STATEMENTS
OF DEVELOPMENT BANK OF KENYA
LIMITED FOR THE YEAR ENDED
31 DECEMBER 2013**



DEVELOPMENT BANK OF KENYA LIMITED

REPORT AND FINANCIAL STATEMENTS

AT

31 DECEMBER 2013

DEVELOPMENT BANK OF KENYA LIMITED

REPORT AND FINANCIAL STATEMENTS FOR THE YEAR TO 31 DECEMBER 2013

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DEVELOPMENT BANK OF KENYA LIMITED

DIRECTORS, OFFICERS, ADMINISTRATION AND SHAREHOLDERS

REGISTERED OFFICE

Finance House
Loita Street
P. O. Box 30483, 00100
Telephone (254) 020 340401/2/3
Telefax (254) 020 250399
Telex 22662
Email: dbk@devbank.com
Telegrams DEVBANK.KE
Nairobi
Kenya

SUBSIDIARY

Small Enterprises Finance Company Limited (SEFCO)
PO Box 34045, 00100
Telephone (254) 020 340401/2/3
Telex 22662
Nairobi
Kenya

SHAREHOLDERS

Industrial & Commercial Development Corporation (ICDC)
PO Box 45519, 00100
Nairobi
Kenya

Trans-Century Limited
PO Box 42588, 00100
Nairobi
Kenya

DEVELOPMENT BANK OF KENYA LIMITED

DIRECTORS, OFFICERS, ADMINISTRATION AND SHAREHOLDERS (CONTINUED)

DIRECTORS

The directors of the institution during the year were:

Prof. H.K. Mengech	Chairman
K. Gatabaki	
Prof. J.H. Kimura	
Z. G. Mbugua	
Industrial & Commercial Development Corporation (ICDC)	
Principal Secretary to the Treasury of Kenya	

SECRETARY

C.A. Otieno (Mrs)
Finance House
Loita Street
PO Box 30483, 00100
Nairobi GPO

SENIOR OFFICERS

V.J.O. Kidiwa	Chief Executive
J.K. Kiniti	Head of Finance & Administration

AUDITORS

KPMG Kenya
8th Floor, ABC Towers
Waiyaki Way
PO Box 40612 - 00100
Nairobi GPO

On behalf of: The Auditor-General
Kenya National Audit Office
Anniversary Towers
University Way
PO Box 30084 - 00100
Nairobi GPO

CORRESPONDENT BANKS

Standard Chartered Bank
One Madison Avenue
New York, 10010-3603
USA

Commerzbank AG
D - 60261
Frankfurt am Main,
Germany

Nedbank
P O Box 1144
Johannesburg 2000, GTG
South Africa

ICICI Bank Limited
ICICI Bank Towers
Bandra-Kurla Complex
Mumbai 400051
Maharashtra, India
Tel: + 91 22 26531414

ING BHF Bank
Bockenheimer
Landstrasse 10
D - 60323
Frankfurt Am Main -
Germany

Bank of Communications China
188 Yin Cheng Zhong Road
Shanghai 200120 - China
Tel : + 86 21 58408478

DEVELOPMENT BANK OF KENYA LIMITED

FIVE-YEAR GROUP FINANCIAL REVIEW

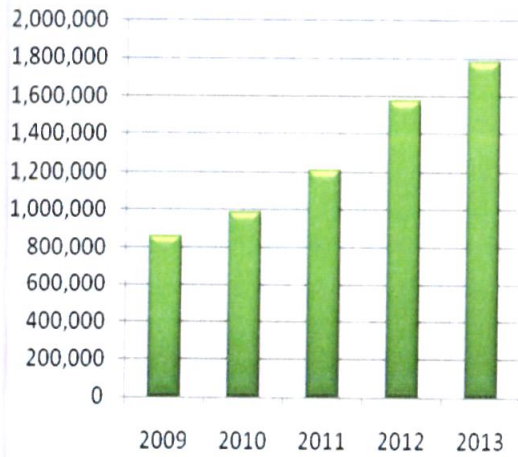
	2013	2012	2011	2010	2009
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
Gross revenue	1,779,696	1,574,665	1,210,509	988,350	875,656
Profit before tax	275,289	106,259	159,001	235,623	189,275
Profit after tax	189,433	73,779	109,168	159,955	135,842
Gross loans and advances	8,646,163	7,300,320	6,247,942	5,732,795	5,039,000
Less impairment losses on loans and advances	(537,696)	(368,700)	(346,148)	(340,359)	(270,421)
Loans and advances to customers (net of impairment)	8,108,467	6,931,620	5,901,794	5,392,436	4,768,579
Total deposits	11,046,404	8,454,744	6,544,356	6,324,050	4,190,281
Loan capital	2,393,478	3,056,855	3,110,310	2,531,965	2,267,801
Shareholders' equity	1,830,359	1,640,936	1,567,147	1,492,979	1,368,024
Total assets	15,574,646	13,411,458	11,517,988	10,644,841	8,109,411

KEY RATIOS

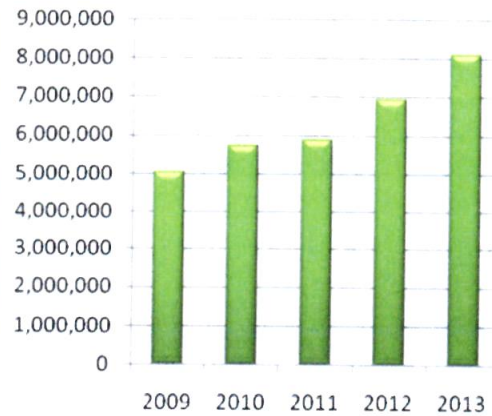
Basic Earnings Per Share (EPS)	10.90	4.25	6.28	9.21	7.82
Return on Assets (ROA)	1.8%	0.8%	1.4%	2.2%	2.3%
Return on Equity (ROE)	15.1%	6.5%	10.1%	15.8%	13.8%
Capital Adequacy Ratio	22.4%	20.9%	23.7%	25.3%	25.1%

Key Performance Indicators

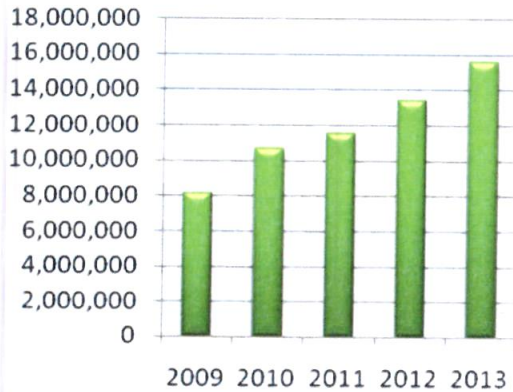
Gross Revenue Kshs '000



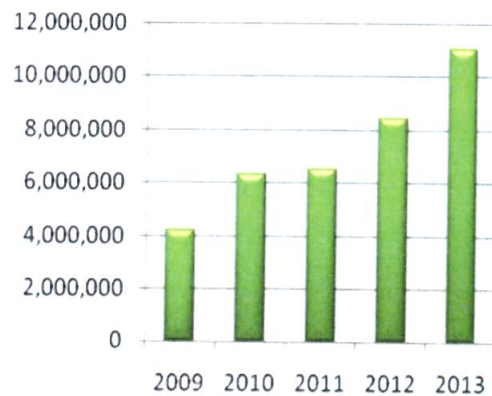
Loans and Advances Kshs '000



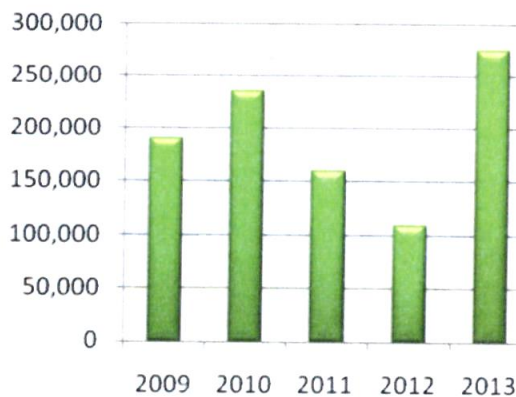
Total Assets Kshs '000



Total Deposits Kshs '000



Profit Before Tax Kshs '000





DEVELOPMENT BANK OF KENYA LIMITED

CHAIRMAN'S STATEMENT

Introduction

It is my great pleasure to present to you the Audited Financial Statements for the bank and its wholly owned subsidiary for the year ended December 2013. Unlike the previous year, 2013 was much fairer economically. The various measures taken by government in 2012 to correct the hyper inflationary environment appeared to bear fruit. Inflation was not only brought down but contained to single digit throughout the year. This created increased liquidity in the market and reduced interest rates. The bank took advantage of these changes to grow its net assets base to KShs 15.6 billion from KShs 13.4 billion achieved in 2012. Equally, the Bank enjoyed wider interest spreads leading to increased profit before tax from KShs 106.3 million in 2012 to KShs 275.3 million.

Economic Overview

The Kenyan economy recovered from the slump in 2011 to register growth of 4.6% in 2012. This was after the economy had decelerated from an expansion of 5.8% in 2010 to 4.4% in 2011. For one and a half years the Monetary Policy Committee (MPC) maintained a very tight monetary policy through June 2012 in order to stem out hyper inflation and a rapidly depreciating shilling. Its efforts began to bear fruit and in late 2012, the MPC began a process of easing off its policy by downward revision of the Central Bank Borrowing Rate (CBR) from a high of 18.5% to 8.5% in 2013. This has helped put the economy on a recovery trend.

In its most recent report on the economy, the Kenya National Bureau of Statistics (KNBS) indicated that the economy grew by 5.2% and 4.3% in the first and second quarters of 2013 compared to 3.9% and 4.4% for similar quarters in 2012. The economy, however showed dismal performance growing by 4.4% (2012 - 4.5%) in the third quarter, which was heavily weighed down by increased cost of living, surging insecurity after Westgate Mall attack, depreciation of the shilling and widening current account deficit as the country continues to import more than it exports. It is for this reason that the government has revised

downward expected full year growth to 5.0% from 5.6% as previously projected.

The Government projection is also supported by estimates from the World Bank who forecast a similar rate of expansion. In their recent issue of the African Economic Outlook, The African Development Bank (AFDB) was however cautious projecting a growth rate of 4.5% this year and 5.0% in 2014. This may be the more realistic expectation given the slowdown in economic performance recorded in third quarter of 2013.

Developments in the Banking Sector

The banking sector comprised of 43 Commercial Banks, 1 Mortgage Finance Company, 9 Deposit Taking Micro Finance Companies, 7 representative offices of foreign banks, 105 Foreign Exchange Bureaus and 2 Credit Reference Bureaus as at the end of October 2013.

Pre – Tax Profits for the entire sector rose by 13% from KShs 90.0 billion in October 2012 to KShs 101.8 billion as at the end of October 2013. Whereas gross revenues recorded marginal changes, it is the decline in expenses by 6% mainly on the back of lower cost of funds that explain the improvement in profitability.

The aggregate balance sheet increased by 13.2% to KShs 2,622.6 billion from KShs 2,316.1 billion driven mainly by growth in loans and advances, deposits and retention of profits. Loans and advances rose by 15.6% (KShs 1,340.7 billion to KShs 1,549.9 billion) during this period. The bulk of the lending was to households, trade, manufacturing and real estate sectors.

Customer deposits remained the single most important source of funds for lending purposes accounting for 72.7% of total funding liabilities. As at end of October, customer deposit balances stood at KShs 1,906.3 billion compared to October 2012 level of KShs 1,728.7 billion.

On the flip side, loan repayment default rate increased significantly due to the higher lending rates, reduced economic activity and the introduction of more stringent prudential

guidelines. The stock of non-performing loans (NPL) increased by 32.2% from KShs 62.5 billion in 2012 to KShs 82.7 billion in 2013. The ratio of NPL to gross loan book also grew to 5.3% from 4.7% in 2012. On the other hand, the quality of assets as measured by the proportion of net non-performing loans to gross loans deteriorated to 2.4% from the 1.7% level in 2012.

The DBK's Performance

In 2013, the financial sector was characterised by increased liquidity and declining interest rates after the MPC eased off its previously tight monetary policy. DBK was able to use this window to not only grow its asset base but also renegotiate renewal of funds at lower cost. The bank therefore operated at improved Net Interest Margins (NIM) throughout the year.

The bank returned a profit before tax of KShs 275.3 million which was significantly higher than the previous year's performance of KShs 106.3 million. The increase in profits was largely attributable to higher NIM the bank enjoyed throughout 2013. Net assets also grew to close at KShs 15.6 billion compared to KShs 13.4 billion achieved in 2012.

The growth in net assets was primarily driven by increased Lending. The loan book rose from KShs 7.3 billion to KShs 8.6 billion, an annualized increase of 17.9%. The portfolio's quality as measured by the percentage of Non-performing loans to gross loans improved from 15.6% to 13.9%. After adjusting for additional provisions against non-performing loans, the net loans closed at KShs 8.1 billion compared to KShs 6.9 billion. This translates to an-year-on-year growth rate of 24.6%. The bulk of credit was extended to the manufacturing Sector, real estate and household investments.

This is reflected in the exit distribution of the loan portfolio shown below:

SECTOR	Portfolio 2013	Portfolio 2012
Agriculture	8.1%	9.2%
Manufacturing	16.8%	13.2%
Building and construction	1.7%	1.1%
Trade	18.2%	17.5%
Tourism, Restaurants & Hotels	1.6%	4.4%
Transport & Communication	2.6%	2.9%
Real Estate	31.3%	36.9%
Financial Services	2.2%	4.0%
Personal Households	17.5%	10.8%
TOTAL	100.0%	100.0%

Growth in the year was heavily funded through higher customer deposits. As at the end of the year, deposits had grown from KShs 8.5 billion to KShs 11.0 billion or 24.4% increase.

As indicated earlier the single most significant driver of profitability was NIM. During the year, interest income rose from KShs 1.46 billion to KShs 1.68 billion. On the other hand interest expenses dropped from KShs 1.16 billion to KShs 1.04 billion giving rise to a 213.3% increase in NIM from KShs 299.1 million to KShs 638.1 million.

Appreciation

Finally, I take this opportunity to extend my appreciation to our esteemed customers and partners for their continued support and the confidence they have demonstrated in us. I also wish to thank my fellow directors, management and staff of the bank for their able stewardship of the bank without which it would have been difficult to achieve such great results.


H.N.K MENGECH (PROF.)
 CHAIRMAN

DEVELOPMENT BANK OF KENYA LIMITED

CORPORATE GOVERNANCE

The Shareholders being the ultimate owners of the Bank appoint a Board of Directors to conduct the business of the bank on their behalf. The Board executes its responsibilities through Management and Board Committees that it creates from time to time. The responsibilities for daily operations are delegated to a management team appointed by the Board. A clear segregation of responsibilities between the Board and management is always maintained. The Board makes all policy decisions while management implements the decisions of the Board.

Board of Directors

The current Board is made up of seven directors inclusive of a non-executive chairman.

Board and Management Committees

Tabulated below are Board and Management Committees, their composition and membership, functions and the frequency of meetings.

	Executive Committee	Board Audit Committee	Assets and Liabilities Committee	Board Credit Committee	Debt Collection Committee	Strategy Committee	Automation Committee	Human Resources
Composition & Membership	Senior Management	Three non-Executive Directors and Senior Management	Senior Management	Three non – executive directors and Senior Management	Senior Management	Three non-Executive Directors and Senior Management	Non-Executive Director and Senior Management	Three non-executive directors and senior management
Chairman	CEO	Non-Executive Director	CEO	Non-executive Director	CEO	Non-Executive Director	Non-Executive Director	Non-Executive Director
Members	V. Kidiwa, J. Kiniti, C. A. Otieno (Mrs), Peter Pertet, J. Mananda, Dayana Kamunde	Prof J H Kimura, H. Rotich, Kungu . Gatabaki, V Kidiwa, C. A. Otieno (Mrs), J. Kiniti	V.Kidiwa, J. Kiniti, Peter Pertet, Dayana Kamunde, David Njogu	Z.G. Mbugua Kungu Gatabaki, P Kimurwa, V.Kidiwa, J. Mananda	V. Kidiwa, C. A. Otieno (Mrs), J. Kiniti, Jacob Mananda	Prof J H Kimura, K. Gatabaki, P Kimurwa, V Kidiwa, C. A. Otieno (Mrs), J. Kiniti	Prof J H Kimura, K. Gatabaki, Z. Mbugua, V.K idiwa, J. Kiniti, Peter Pertet, Walter Ogada	Prof. H. K. Mengech , Mbatha Mbithi, K Gatabaki, V. Kidiwa, C. A. Otieno (Mrs)
Main Functions	Strategy decision making in accordance with powers conferred upon by the Board	Strengthenin g the control environment, financial reporting and audit function.	Management of the statement of financial position, and the liquidity of the Bank.	Appraisal and approval of credit applications	Monitoring and reviewing non-performing loan portfolio	Spearhead the Bank’s strategic focus	Develops the long-term automation plan for the board’s approval	Management & development of human resources
Frequency of Meetings	Monthly	Quarterly	Monthly	Quarterly	Monthly	Quarterly	Quarterly	Quarterly

DEVELOPMENT BANK OF KENYA LIMITED

CORPORATE GOVERNANCE (CONTINUED)

Board attendance

Prudential regulations require that every Board member attend a minimum of 75% of all Board meetings. Below is an extract from the attendance register for the Board meetings held in 2013:

Names	March	April	July	October	December	% Attendance
Prof. H.K. Mengech	X	X	X	X	X	100
Kungu Gatabaki	X	X	X	X	X	100
Prof. J.H. Kimura	X	X	X	X	X	100
Z.G. Mbugua	X	X	X	X	-	80
Peter Kimurwa	X	X	-	-	X	60
Mbatha Mbithi	-	X	X	X	X	80
Henry Rotich	X	X	-	-	-	40

Directors Evaluation Report

It is a requirement that the performance of every Director and the Chairman of the Board be evaluated once every year. Evaluation for 2013 financial year is in progress and will be submitted to Central Bank by 31 March 2014.

DEVELOPMENT BANK OF KENYA LIMITED

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2013

The directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2013, which disclose the state of affairs of the group and the company.

1. Principal activities

The company is engaged in the business of development and commercial banking. The company is licensed under the Kenyan Banking Act.

2. Results

The results for the year are set out on page 13.

3. Dividend

The directors do not propose a dividend payment for 2013 (2012 – Nil).

4. Directors

The directors who served during the year are set out on page 2.

5. Operations by the subsidiary company (Small Enterprises Finance Company Limited)

The subsidiary company has ceased financing new development projects and is currently pursuing recovery of existing project loans and advances.

6. Auditors

The Auditor-General is responsible for the statutory audit of the company's books of account in accordance with Section 14 and 39(i) of the Public Audit Act. This Act empowers the Auditor-General to appoint other auditors to carry out the audit on his behalf.

KPMG Kenya, who were appointed by the Auditor-General, carried out the audit of the Bank's financial statements for the year ended 31 December 2013.

7. Approval of financial statements

The financial statements were approved at a meeting of the directors held on 5 March 2014.

BY ORDER OF THE BOARD


Secretary

Date: 5 March 2014

DEVELOPMENT BANK OF KENYA LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and presentation of the financial statements of Development Bank of Kenya Limited set out on pages 13 to 58 which comprise the statement of financial position of the group and the company at 31 December 2013, and the group's statement of comprehensive income, group and company statements of changes in equity and group statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Under the Kenyan Companies Act, the Directors are required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the group and the company as at the end of the financial year and of the operating results of the group for that year. It also requires the Directors to ensure the group keeps proper accounting records which disclose with reasonable accuracy the financial position of the group and the company.

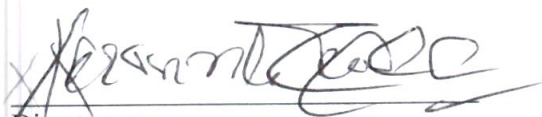
The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the group and the company and of the group operating results.

The Directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

The Directors have made an assessment of the group and the company's ability to continue as a going concern and have no reason to believe the group and the company will not be a going concern for at least the next twelve months from the date of this statement.

Approval of the financial statements

The financial statements, as indicated above, were approved by the Board of Directors on 5 March 2014 and were signed on its behalf by:



Director



Director



Director



KPMG Kenya
Certified Public Accountants
8th Floor, ABC Towers
Waiyaki Way
PO Box 40612 00100 GPO
Nairobi, Kenya

Telephone +254 20 2806000
Fax +254 20 2215695
Email info@kpmg.co.ke
Internet www.kpmg.com/eastafrica

DEVELOPMENT BANK OF KENYA LIMITED

REPORT OF THE AUTHORISED AUDITORS (APPOINTED UNDER SECTION 39(1) OF THE PUBLIC AUDIT ACT, ACT NO.12 OF 2003) TO THE AUDITOR-GENERAL

We have audited the group financial statements of Development Bank of Kenya Limited set out on pages 13 to 58 which comprise the statement of financial position of the group and the company at 31 December 2013, and the group's statement of comprehensive income, group and company statements of changes in equity and group statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibilities for the financial statements

As stated on page 10, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Authorised auditor's responsibility

Our responsibility is to report on the outcome of our audit of the financial statements to the Auditor-General.

Auditor-General's responsibility

The Auditor-General is responsible for reporting on his examination of the financial statements to the Cabinet Secretary responsible for the bank for presentation to the National Assembly.

Basis of opinion

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the group and the company at 31 December 2013, and the group's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act.

Report on other legal requirements

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

- (i) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of our audit;
- (ii) In our opinion, proper books of account have been kept by the company, so far as appears from our examination of those books; and
- (iii) The statement of financial position of the company is in agreement with the books of account.

The engagement partner responsible for the report of the authorised auditors (appointed under section 39(1) of the Public Audit Act, Act no. 12 of 2003) to the Auditor-General is CPA Jacob Maina Gathecha - P/1610.

KPMG Kenya

Date: *5 March 2014*



KENYA NATIONAL AUDIT OFFICE

REPORT OF THE AUDITOR-GENERAL ON DEVELOPMENT BANK OF KENYA LIMITED FOR THE YEAR ENDED 31 DECEMBER 2013

REPORT ON THE FINANCIAL STATEMENTS

The accompanying financial statements of Development Bank of Kenya Limited set out on pages 13 to 58, which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information have been audited on my behalf by KPMG (Kenya), auditors appointed under Section 39 of the Public Audit Act, 2003. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 13 of the Public Audit Act, 2003.

Auditor-General's Responsibility

My responsibility is to express an opinion on these financial statements based on the audit and report in accordance with the provisions of Section 15(2) of the

Public Audit Act, 2003 and submit the audit report in compliance with Article 229(7) of the Constitution of Kenya. The audit was conducted in accordance with International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2013, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with Companies Act, Cap 486 of the Laws of Kenya.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Kenyan Companies Act, I report, based on my audit, that;

- i. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of my audit;
- ii. In my opinion, proper books of account have been kept by the Bank, so far as appears from my examination of those books; and'

- iii. The Bank's statement of financial position and statement of comprehensive income are in agreement with the books of account.



Edward R.O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

18 March 2014

DEVELOPMENT BANK OF KENYA LIMITED

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 KShs'000	2012 KShs'000
INTEREST INCOME	6	1,678,802	1,460,891
INTEREST EXPENSE	7	(1,040,670)	(1,161,818)
NET INTEREST INCOME		638,132	299,073
NON INTEREST INCOME	8	100,894	113,774
OPERATING INCOME		739,026	412,847
IMPAIRMENT LOSSES ON LOANS AND ADVANCES	17(c)	(173,488)	(49,759)
NON INTEREST EXPENSES	9	(290,249)	(256,829)
PROFIT BEFORE TAXATION	10	275,289	106,259
INCOME TAX EXPENSE	11	(85,856)	(32,480)
PROFIT FOR THE YEAR		189,433	73,779
OTHER COMPREHENSIVE INCOME		-	-
TOTAL COMPREHENSIVE INCOME		<u>189,433</u>	<u>73,779</u>
BASIC EARNINGS PER SHARE (KShs)	13	<u>10.90</u>	<u>4.25</u>
DIVIDENDS PER SHARE (KShs)	12	<u>-</u>	<u>-</u>

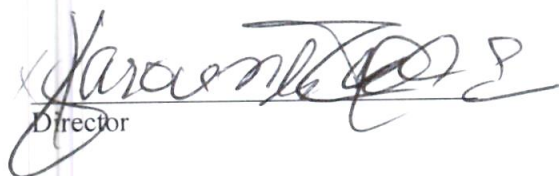
The notes set out on pages 19 to 58 form an integral part of these financial statements.

DEVELOPMENT BANK OF KENYA LIMITED

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2013

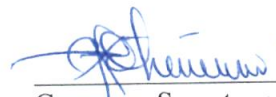
	Note	2013 KShs'000	2012 KShs'000
ASSETS			
Cash and balances with Central Bank of Kenya	14	703,422	624,854
Investment in Government securities	15	4,850,068	4,103,444
Deposits and balances due from banking institutions	16	1,588,464	1,424,119
Loans and advances to customers (Net)	17(a)	8,108,467	6,931,620
Equity investments	18	46,153	46,153
Other assets	20	71,539	64,974
Tax recoverable		4,698	16,937
Deferred tax asset	21	32,637	28,648
Prepaid operating lease rentals	22	4,056	4,117
Property and equipment	23	<u>165,142</u>	<u>166,592</u>
TOTAL ASSETS		<u>15,574,646</u>	<u>13,411,458</u>
LIABILITIES			
Deposits from banks	24	2,643,413	1,516,248
Deposits from customers	25	8,402,991	6,938,496
Loan capital	26	2,393,478	3,056,855
Tax Payable		40,238	-
Other liabilities	27	<u>264,167</u>	<u>258,933</u>
		<u>13,744,287</u>	<u>11,770,532</u>
SHAREHOLDERS' FUNDS (Page 16)			
Share capital	28	347,500	347,500
Reserves		<u>1,482,859</u>	<u>1,293,426</u>
		<u>1,830,359</u>	<u>1,640,926</u>
TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS		<u>15,574,646</u>	<u>13,411,458</u>

The financial statements set out on pages 13 to 58 were approved by the Board of Directors on 5 March 2014 and were signed on its behalf by:


Director


Director


Director


Company Secretary

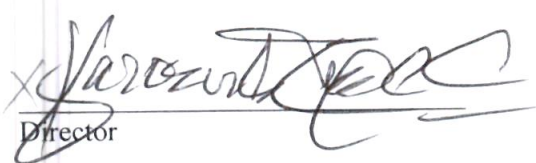
The notes set out on pages 19 to 58 form an integral part of these financial statements.

DEVELOPMENT BANK OF KENYA LIMITED

COMPANY STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2013

ASSETS	Note	2013 KShs'000	2012 KShs'000
Cash and balances with Central Bank of Kenya	14	703,422	624,854
Investment in Government securities	15	4,828,918	4,082,284
Deposits and balances due from banking institutions	16	1,588,464	1,424,119
Loans and advances to customers (Net)	17(a)	8,108,467	6,931,620
Equity investments	18	46,153	46,153
Investment in subsidiary	19	32,048	32,048
Other assets	20	71,474	64,814
Tax recoverable		-	11,967
Deferred tax asset	21	32,486	28,527
Prepaid operating lease rentals	22	4,056	4,117
Property and equipment	23	<u>165,142</u>	<u>166,592</u>
TOTAL ASSETS		<u>15,580,630</u>	<u>13,417,095</u>
LIABILITIES			
Deposits and balances due to banking institutions	24	2,643,413	1,516,248
Customers' deposits	25	8,418,675	6,952,883
Loan capital	26	2,393,478	3,056,855
Tax Payable		40,238	-
Other liabilities	27	<u>262,553</u>	<u>257,414</u>
		<u>13,758,357</u>	<u>11,783,400</u>
SHAREHOLDERS' FUNDS (Page 17)			
Share capital	28	347,500	347,500
Reserves		<u>1,474,773</u>	<u>1,286,195</u>
		<u>1,822,273</u>	<u>1,633,695</u>
TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS		<u>15,580,630</u>	<u>13,417,095</u>

The financial statements set out on pages 13 to 58 were approved by the Board of Directors on 5 March 2014 and were signed on its behalf by:



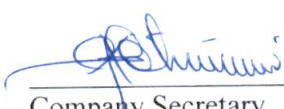
Director



Director



Director



Company Secretary

The notes set out on pages 19 to 58 form an integral part of these financial statements.

DEVELOPMENT BANK OF KENYA LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR TO 31 DECEMBER 2013

	Share capital KShs'000	Statutory reserve KShs'000	Interest reserve KShs'000	Retained earnings KShs'000	Proposed dividend KShs'000	Total KShs'000
At 1 January 2012	347,500	137,978	280	1,081,389	-	1,567,147
Comprehensive income for the year						
Net profit for the year	-	-	-	73,779	-	73,779
Other comprehensive income						
Statutory reserves	-	123,880	-	(123,880)	-	-
Total comprehensive income for the year	-	123,880	-	(50,101)	-	73,779
Transactions with owners						
Dividend paid	-	-	-	-	-	-
Proposed dividends	-	-	-	-	-	-
Total transactions with owners	-	-	-	-	-	-
At 31 December 2012	347,500	261,858	280	1,031,288	-	1,640,926
Comprehensive income for the year						
Net profit for the year	-	-	-	189,433	-	189,433
Other comprehensive income						
Statutory reserves	-	7,309	-	(7,309)	-	-
Total comprehensive income for the year	-	7,309	-	182,124	-	189,433
Transactions with owners						
Dividend paid	-	-	-	-	-	-
Proposed dividends	-	-	-	-	-	-
Total transactions with owners	-	-	-	-	-	-
At 31 December 2013	347,500	269,167	280	1,213,412	-	1,830,859

The notes set out on pages 19 to 58 form an integral part of these financial statements.

DEVELOPMENT BANK OF KENYA LIMITED

COMPANY STATEMENT OF CHANGES IN EQUITY FOR THE YEAR TO 31 DECEMBER 2013

	Share capital KShs'000	Statutory reserve KShs'000	Interest reserve KShs'000	Retained earnings KShs'000	Proposed dividend KShs'000	Total KShs'000
At 1 January 2012	347,500	137,978	280	1,075,984	-	1,561,742
Comprehensive income for the year						
Net profit for the year	-	-	-	71,953	-	71,953
Other comprehensive income						
Statutory reserves	-	123,880	-	(123,880)	-	-
Total comprehensive income for the year	-	123,880	-	(51,927)	-	71,953
Transactions with owners						
Dividend paid	-	-	-	-	-	-
Proposed dividends	-	-	-	-	-	-
Total transactions with owners	-	-	-	-	-	-
At 31 December 2012	347,500	261,858	280	1,024,057	-	1,633,695
Comprehensive income for the year						
Net profit for the year	-	-	-	188,578	-	188,578
Other comprehensive income						
Statutory reserves	-	7,309	-	(7,309)	-	-
Total comprehensive income for the year	-	7,309	-	181,269	-	188,578
Transactions with owners						
Dividend paid	-	-	-	-	-	-
Proposed dividends	-	-	-	-	-	-
Total transactions with owners	-	-	-	-	-	-
At 31 December 2013	347,500	269,167	280	1,205,326	-	1,822,273

The notes set out on pages 19 to 58 form an integral part of these financial statements.

DEVELOPMENT BANK OF KENYA LIMITED

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 KShs'000	2012 KShs'000
Operating activities			
Profit before taxation		275,289	106,259
Depreciation		19,568	17,937
Amortisation of prepaid operating lease rentals		61	61
Net loss on disposal of Property and equipment		233	-
Interest charged on loan capital		<u>195,558</u>	<u>247,051</u>
Operating profit before working capital changes		490,709	371,308
Changes in working capital items			
Increase in loans and advances to customers (net)		(1,176,847)	(1,029,826)
Increase in deposits held for regulatory purposes		(58,806)	(133,166)
Increase in investments in treasury bonds		(845,267)	(490,309)
(Decrease)/Increase in other assets		(6,565)	4,332
Increase in customer's deposits		1,464,495	2,779,760
Increase/(decrease) in other liabilities		<u>5,234</u>	<u>(37,242)</u>
		(127,047)	1,464,857
Tax paid		<u>(37,366)</u>	<u>(34,793)</u>
Net cash outflows from operations		(164,413)	1,430,064
Cash flows from investing activities			
Purchase of property and equipment		(18,573)	(32,613)
Proceeds from sale of property and equipment		<u>220</u>	<u>-</u>
Net cash outflows from investing activities		(18,353)	(32,613)
Cash flows from financing activities			
Interest paid on loan capital		(195,558)	(247,051)
Dividends paid		-	-
Loans received		-	1,000,000
Loans repaid		<u>(663,377)</u>	<u>(1,053,455)</u>
Net cash inflows from financing activities		(858,935)	(300,506)
Net (decrease)/increase in cash and cash equivalents		(1,041,701)	1,096,945
Opening cash and cash equivalents balances		<u>286,466</u>	<u>(810,479)</u>
Closing cash and cash equivalents balances	29	(755,235)	<u>286,466</u>

The notes set out on pages 19 to 58 form an integral part of these financial statements.

DEVELOPMENT BANK OF KENYA LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1. REPORTING ENTITY

The company is incorporated as a limited company in Kenya under the Kenyan Companies Act, and is domiciled in Kenya. The address of its registered office is as follows:

Finance House
Loita Street
PO Box 30483, 00100
Nairobi

The Group is primarily engaged in the business of development and commercial banking. The company is licensed under the Kenyan Banking Act. Industrial and Commercial Development Corporation (ICDC), which owns 89.3% of the shares of the company is 100% owned by the Government of Kenya.

2. BASIS OF PREPARATION

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and the Kenya Companies Act. For Kenyan Companies Act reporting purposes, the balance sheet is represented by the statement of financial position and the profit and loss account by the statement of comprehensive income in these financial statements.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- Financial instruments at fair value through profit or loss are measured at fair value
- Available-for-sale financial assets are measured at fair value

(c) Functional and presentation currency

These consolidated financial statements are presented in Kenya shillings (KShs), which is the Bank's functional currency. All financial information presented in these consolidated financial statements has been rounded off to the nearest thousand Kenya shillings.

(d) Use of estimates and judgements

The preparation of consolidated financial statements in conformity with IFRS's 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 and critical judgement in applying accounting policies that have the most significant effect on the amount recognized in the consolidated financial statements as described in Note 3(c), (d), (e), (g) and (i).

2. BASIS OF PREPARATION (Continued)

(d) Use of estimates and judgements (continued)

In determining the carrying amounts of certain assets and liabilities, the Group makes assumptions of the effects of uncertain future events on those assets and liabilities at the reporting date. The Group's estimates and assumptions are based on historical experience and expectation of future events and are reviewed periodically. This disclosure excludes uncertainty over future events and judgments in respect of measuring financial instruments. Further information about key assumptions concerning the future, and other key sources of estimation uncertainty are set out in the notes.

(i) *Allowances for credit losses*

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about counterparty's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired loans and advances and held-to-maturity investment securities, but the individual impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions.

(ii) *Income taxes*

The company is subject to income taxes in Kenya. Significant judgment is required in determining the Group's provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(iii) *Fair value of financial instruments*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

2. BASIS OF PREPARATION (Continued)

(d) Use of estimates and judgements (continued)

(iii) Fair value of financial instruments - continued

All financial instruments are initially recognised at fair value, which is normally the transaction price. In certain circumstances, the initial fair value may be based on a valuation technique which may lead to the recognition of profits or losses at the time of initial recognition. However, these profits or losses can only be recognised when the valuation technique used is based solely on observable market inputs.

Subsequent to initial recognition, some of the Group's financial instruments are carried at fair value, with changes in fair value either reported within the statement of comprehensive income or within other comprehensive income until the instrument is sold or becomes impaired. Details of the type and classification of the Group's financial instruments are set out in note 4 and the accounting policy set out in note 3 to the accounts.

The fair values of quoted financial instruments in active markets are based on current prices. If the market for a financial instrument is not active, and for unlisted securities, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Where representative prices are unreliable because of illiquid markets, the determination of fair value may require estimation of certain parameters, which are calibrated against industry standards and observable market data, or the use of valuation models that are based on observable market data.

The fair value for the majority of the Group's financial instruments is based on observable market prices or derived from observable market parameters.

Equity investments that do not have an observable market prices are fair valued by applying various valuation techniques, such as earnings multiples, net assets multiples, discounted cash flows, and industry valuation benchmarks. These techniques are generally applied prior to any initial public offering after which an observable market price becomes available. Disposal of such investments are generally by market trades or private sales.

(iv) Impairment of property and equipment

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

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements:

(a) Consolidation principles

The consolidated financial statements include the financial statements of Development Bank of Kenya Limited (DBK) and its wholly owned subsidiary company, Small Enterprises Finance Company Limited (SEFCO), which is controlled by the bank. Control exists when the bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All inter-company balances and transactions have been eliminated on consolidation.

(b) Revenue recognition

Income is recognised on an accrual basis.

(i) Interest

Interest income and expense are recognised in the statement of comprehensive income 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. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

The calculation of the effective interest rate includes all fees 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 statement of comprehensive income include:

- interest on financial assets and liabilities at amortised cost on an effective interest rate basis and interest on available-for-sale investment securities on an effective interest basis
- interest income and expense on all trading assets and liabilities are considered to be incidental to the Group's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

Fair value changes on other derivatives held for risk management purposes, and other financial assets and liabilities carried at fair value through profit or loss, are presented in net income on other financial instruments carried at fair value in profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Revenue recognition (continued)

(ii) Fees and commission income

Fees and commission income 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, including account servicing fees, investment are recognised as the related services are performed.

(iii) Dividend income

Dividend income is recognised in profit or loss on the date that the dividend is received.

(c) Recognition and measurement of financial instruments

(i) Classification

A financial instrument is a contract that gives rise to both a financial asset of one enterprise and a financial liability of another enterprise. These are classified as follows:

Financial assets at fair value through profit or loss: This category has two subcategories; financial assets held for trading, and those designated at fair value through profit or loss at inception. Financial instruments reclassified in this category are those that the group holds principally for the purpose of short-term profit taking. These comprise mainly certain Treasury bonds.

Loans and receivables are created by the bank providing money to a debtor with no intention of trading the receivable. Loans and receivables comprise loans and advances to banks and customers with fixed or determinate payment that are not quoted in active market.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the bank has positive intent and ability to hold to maturity. Were the group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale. These include Treasury bills and Treasury bonds purchased from the secondary market.

Available-for-sale assets are the non-derivative financial assets that are designated as available for sale or are not classified as held for trading purposes, loans and receivables or held to maturity. These include cash and balances with the Central Bank of Kenya.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Recognition and measurement of financial instruments (continued)

(ii) Recognition

The group recognises financial assets held for trading and available-for-sale assets on the date it commits to purchase the assets. From this date any gains and losses arising from changes in fair value of the assets are recognised.

Held-to-maturity, loans and receivables are recognised on the date they are transferred to the group.

(iii) Measurement

Financial instruments are measured initially at cost, including transaction costs.

Subsequent to initial recognition all trading instruments and all available-for-sale assets are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities, loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument. Portfolio impairments computation model is adjusted to reflect political risk.

Gains and losses arising from a change in the fair value of available-for-sale assets is recognised as equity until the instrument is derecognised or impaired at which time the cumulative gain or loss is recognised in profit or loss and trading instruments gains or losses are recognised in profit or loss in the period it arises.

(iv) Derecognition

A financial asset is derecognised when the bank loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished.

Available-for-sale assets and assets held for trading that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the bank commits to sell the assets. The bank uses the specific identification method to determine the gain or loss on derecognition.

Held-to-maturity instruments and originated loans and receivables are derecognised on the date they are transferred by the bank.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Identification and measurement of impairment of financial assets

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

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

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would 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, the Group uses 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 trends. Default rate, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on 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 at the assets' original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of equity to profit or loss. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Impairment for non-financial assets

The carrying amounts of the Group's non-financial assets, other than investment property and 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 assets' 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. Impairment losses are recognised in profit or loss. 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 unit (group of 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.

(f) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at the exchange rate ruling at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rate ruling at the reporting date. Resulting exchange differences are recognised in the profit or loss for the year. Non-monetary assets and liabilities denominated in foreign currency are recorded at the exchange rate ruling at the date of transaction.

(g) Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset.

(ii) Subsequent costs

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

(iii) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives.

3. **SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(g) Property and equipment (continued)

(iii) Depreciation - continued

The estimated useful lives for the current and comparative periods are as follows:

Buildings on leasehold land	over the lease period
Furniture and equipment	8 years
Computers	3 years
Motor vehicles	4 years
Leasehold improvements	6 years

The assets' residual values and useful lives are reviewed and adjusted if appropriate, at each reporting date.

(iv) Disposal of property and equipment

Gains and losses on disposal of property and equipment are determined by reference to the carrying amount and are recognized in profit or loss in the year in which they arise.

(h) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating lease arrangements (whether prepaid or post paid) are charged to profit or loss on a straight line basis over the period of the lease.

(i) Taxation

Income tax expense comprises current tax and change in deferred tax.

Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, except differences relating to the initial recognition of assets and liabilities which affect neither accounting nor taxable profit. Deferred tax is calculated on the basis of the tax rates currently enacted.

Deferred tax assets and liabilities are offset if there is legally enforceable right to offset current liabilities against current tax assets and the relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Employee benefits

(i) Post-employment benefits

The majority of the group's employees are eligible for retirement benefits under a defined contribution plan.

Obligations for contributions to the defined contribution plan are recognised as an expense in profit or loss as incurred. Any difference between the charge to profit or loss income and the contributions payable is recorded in the statement of financial position under other assets or liabilities.

(ii) Leave

All employees are entitled to such leave as is determined by the Bank from time to time. All annual leave must be taken in the year it is earned subject to a maximum of 15 days carried forward. The bank does not compensate staff leave days carried forward in excess of 15 days unless sanctioned and supported by the head of department.

Leave days not taken within policy are accrued for at the individual staff salary scale.

(k) Cash and cash equivalents

For the purpose of presentation of the cash flows in the financial statements the cash and cash equivalents include cash and balances with Central Bank of Kenya net of cash ratio reserve, net balances from banking institutions, uncleared effects and investment in government securities with a maturity of three months or less from the date of acquisition.

(l) Dividends

Dividends are recognised as a liability in the period in which they are declared. Proposed dividends are disclosed as a separate component of equity.

(m) Provisions

Provisions are recognised when the company has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

(n) Offsetting of financial assets and liabilities

Financial assets and liabilities are offset and the net amount reported on the statement of financial position when there is a legally enforceable right to set-off the recognised amount and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(o) Financial guarantees

Financial guarantees are contracts that require the group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of the debt instrument.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) Earnings per share

The group presents basic Earnings Per Share (EPS) data for its ordinary share. Basic EPS is calculated by dividing the profit or loss attributable for ordinary shareholders of the Bank by the number of ordinary shares outstanding during the period.

(q) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2013, and have not been applied in preparing these consolidated financial statements as follows:

- IFRS 9 *Financial Instruments*. IFRS 9 This will become effective on January 2018.
- *Investment entities* (Amendments to IFRS 10, IFRS 12 and IAS 27). This will become effective for years ending 31 December 2014.
- *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32). This will become effective for years ending 31 December 2014.
- *Recoverable amount disclosures for Non-Financial Assets* (Amendments to IAS 36). This will become effective for years ending 31 December 2014.
- *Novation of Derivatives and continuation of Hedge Accounting* (Amendments to IAS 39). This will become effective for years ending 31 December 2014.
- *Defined benefit plans: Employee contributions* (Amendments to IAS 19). This will become effective for years ending 30 June 2015.
- IFRIC 21 *Levies*. This will become effective for years ending 31 December 2014.

The Group is currently in the process of evaluating the potential effect of these standards.

4. FINANCIAL RISK MANAGEMENT

(i) *Introduction and overview*

The Group has exposure to the following risks from its use of financial instruments:

- Credit risk;
- Liquidity risk;
- Market risks; and
- Operational risks.

Group's risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has established the Asset and Liability (ALCO), Credit and Risk and Debt collection committees, which are responsible for developing and monitoring the group's risk management policies in their specified areas. All Board committees have both executive and non-executive members and report regularly to the main Board on their activities.

The group's risk management policies are established to identify and analyse the risks faced by the group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Group Audit Committee is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

4. FINANCIAL RISK MANAGEMENT (Continued)

(ii) *Credit risk*

Credit risk is the risk of financial loss to the group if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the group's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the group considers and consolidates all elements of credit risk exposure.

For risk management purposes, credit risk arising on trading securities is managed independently, but reported as a component of market risk exposure.

Management of credit risk

The Board of Directors has delegated responsibility for the management of credit risk to its Board Credit Committee. The Board Credit Committee is responsible for oversight of the Group's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements;
- Establishing the authorisation structure for the approval and renewal of credit facilities;
- Reviewing and assessing credit risk. Group credit assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process;
- Limiting concentrations of exposure to counterparties and industries for loans and advances;
- Developing and maintaining the Group's risk gradings in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of five grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate. Risk grades are subject to regular reviews by Group Risk;
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to Group Credit on the credit quality of local portfolios and appropriate corrective action is taken; and
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of credit risk. Each business unit is required to implement Group credit policies and procedures, with credit approval authorities delegated from the Group Credit Committee.

4. FINANCIAL RISK MANAGEMENT (Continued)

(ii) Credit risk - continued

Exposure to credit risk

Loans and advances to customers

	2013		2012	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Individually impaired				
Grade 5: Loss	56,418	-	56,284	-
Grade 4: Doubtful	1,152,733	1,152,733	836,763	836,763
Grade 3: Substandard	<u>37,198</u>	<u>37,198</u>	<u>295,637</u>	<u>295,637</u>
	1,246,349	1,189,931	1,188,684	1,132,400
Allowances for impairment	(<u>466,976</u>)	(<u>410,558</u>)	(<u>315,709</u>)	(<u>259,425</u>)
Carrying amounts	<u>779,373</u>	<u>779,373</u>	<u>872,975</u>	<u>872,975</u>
Collectively impaired				
Grade 1: Normal	6,551,858	6,551,858	5,395,174	5,395,174
Grade 2: Watch	<u>847,956</u>	<u>847,956</u>	<u>716,462</u>	<u>716,462</u>
	7,399,814	7,399,814	6,111,636	6,111,636
Allowances for impairment	(<u>70,720</u>)	(<u>70,720</u>)	(<u>52,991</u>)	(<u>52,991</u>)
Carrying amounts	<u>7,329,094</u>	<u>7,329,094</u>	<u>6,058,645</u>	<u>6,058,645</u>
Past due and not impaired				
Grade 1: Normal	1,724,095	1,724,095	1,634,795	1,634,795
Grade 2: Watch	<u>812,033</u>	<u>812,033</u>	<u>429,886</u>	<u>429,886</u>
	<u>2,536,128</u>	<u>2,536,128</u>	<u>2,064,681</u>	<u>2,064,681</u>
Past due comprises				
01-30 Days	1,724,095	1,724,095	1,634,795	1,634,795
31-60 Days	<u>812,033</u>	<u>812,033</u>	<u>429,886</u>	<u>429,886</u>
	<u>2,536,128</u>	<u>2,536,128</u>	<u>2,064,681</u>	<u>2,064,681</u>
Neither past due nor impaired				
Grade 1: Normal	4,827,763	4,827,763	3,760,379	3,760,379
Grade 2: Watch	<u>35,923</u>	<u>35,923</u>	<u>286,576</u>	<u>286,576</u>
	<u>4,863,686</u>	<u>4,863,686</u>	<u>4,046,955</u>	<u>4,046,955</u>
Carrying amounts				
Includes accounts with renegotiated terms	<u>55,995</u>	<u>55,995</u>	<u>979,729</u>	<u>979,729</u>

4. FINANCIAL RISK MANAGEMENT (Continued)

(ii) Credit risk – continued

Impaired loans and securities

Impaired loans and securities are loans for which the group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan agreement(s). These loans are graded 3 (substandard) to 5 (loss) in the group's internal credit risk and grading system.

Past due but not impaired loans

These are loans 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.

Loans with renegotiated terms

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

Allowances for impairment

The group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-off policy

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

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of individually impaired assets by risk grade:

Loans and advances	Gross KShs'000	Net KShs'000
31 December 2013		
Grade 3: Individually Impaired	37,198	44,669
Grade 4: Individually Impaired	1,152,733	734,704
Grade 5: Individually Impaired	<u>56,418</u>	<u>-</u>
	<u>1,246,349</u>	<u>779,373</u>
31 December 2012		
Grade 3: Individually Impaired	295,637	256,594
Grade 4: Individually Impaired	836,763	616,381
Grade 5: Individually Impaired	<u>56,284</u>	<u>-</u>
	<u>1,188,684</u>	<u>872,975</u>

4. **FINANCIAL RISK MANAGEMENT (Continued)**

(ii) Credit risk – continued

The group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral is usually not held against investment securities, and no such collateral was held at 31 December 2013 or 2012.

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

Loans and advances to customers	2013	2012
	KShs'000	KShs'000
Against individually impaired		
Property	<u>572,651</u>	<u>756,146</u>
Against collectively impaired		
Property	13,030,784	12,661,902
Debt securities	2,624,945	2,405,151
Equities	8,400	37,392
Others	<u>2,637,976</u>	<u>1,678,881</u>
Against past due but not impaired		
Property	5,984,593	6,673,009
Debt securities	51,305	486,001
Equities	2,675	2,675
Others	<u>320,823</u>	<u>214,385</u>
Against neither past due nor impaired		
Property	7,046,191	5,988,893
Debt securities	2,573,640	1,919,150
Equities	5,725	34,717
Others	<u>2,317,153</u>	<u>1,464,496</u>

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

Concentration by Sector	2013	2012
	KShs'000	KShs'000
Agriculture	697,067	675,053
Manufacturing	1,452,726	962,352
Building and construction	143,055	83,233
Trade	1,577,265	1,277,921
Tourism, restaurants, and hotels	136,813	318,860
Transport and communication	223,022	209,977
Real estate	2,710,775	2,697,135
Financial services	190,785	291,122
Personal households	<u>1,514,655</u>	<u>784,667</u>
	<u>8,646,163</u>	<u>7,300,320</u>

4. FINANCIAL RISK MANAGEMENT (Continued)

(iii) Liquidity risk

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

Management of liquidity risk

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

Treasury receives information from other departments of the bank regarding cash requirements and Integrates this information in form of projected cash flows. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the bank as a whole.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

Exposure to liquidity risk

The key measure used by the Group for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. Details of the reported Group ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2013	2012
Average for the period	43.1%	39.9%
Maximum for the period	48.6%	47.0%
Minimum for the period	37.5%	32.8%

The table below shows the maturities profile of the group's assets and liabilities using undiscounted cash flows on the basis of their earliest possible contractual maturity. The group's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance:

4. FINANCIAL RISK MANAGEMENT (Continued)

Residual contractual maturities of financial assets and financial liabilities for 2013

	On demand KShs'000	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Total KShs'000
Assets						
Cash and balances with Central Bank of Kenya	299,715	-	-	-	403,708	703,423
Investment in Government Securities	-	-	-	1,135,394	3,714,674	4,850,068
Deposits and balances due from other banks	103,589	1,455,104	29,771	-	-	1,588,464
Loans and advances to customers (net)	521,330	823,881	970,951	1,348,652	4,443,653	8,108,467
Equity investments	-	-	-	-	46,153	46,153
Total assets	924,634	2,278,985	1,000,722	2,484,046	8,608,188	15,296,575
Liabilities and shareholders' funds						
Deposits and balances due to banking institutions	-	1,295,028	1,348,385	-	-	2,643,413
Due to DEG	-	-	-	-	118,151	118,151
Customers' deposits	340,315	6,174,955	1,710,444	22,880	-	8,248,594
Loan capital	-	257,952	605,532	1,027,592	502,402	2,393,478
Total liabilities	340,315	7,727,935	3,664,361	1,050,472	620,553	13,403,636

Customer deposits represent current, savings, call and fixed deposit balances, which past experience have shown to be stable.

4. FINANCIAL RISK MANAGEMENT (Continued)

Residual contractual maturities of assets and liabilities for 2012

	On demand KShs'000	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Total KShs'000
Assets						
Cash and balances with Central Bank of Kenya	279,952	-	-	-	344,902	624,854
Investment in Government Securities	-	98,643	768,291	203,943	3,032,567	4,103,444
Deposits and balances due from other banks	1,424,119	-	-	-	-	1,424,119
Loans and advances to customers (net)	321,009	584,317	760,457	1,635,821	3,630,016	6,931,620
Equity investments	-	-	-	-	46,153	46,153
Total assets	2,025,080	682,960	1,528,748	1,839,764	7,053,638	13,130,190
Liabilities and shareholders' funds						
Deposits and balances due to banking institutions	-	856,869	659,379	-	-	1,516,248
Due to DEG	-	-	-	-	115,818	115,818
Customers' deposits	394,226	5,046,005	1,493,927	4,338	-	6,938,496
Loan capital	-	134,192	559,834	1,982,073	380,756	3,056,855
Total liabilities	394,226	6,037,066	2,713,140	1,986,411	496,574	11,627,417

Customer deposits represent current, savings, call and fixed deposit balances, which past experience have shown to be stable.

4. FINANCIAL RISK MANAGEMENT (Continued)

(iv) Market risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

Overall authority for market risk is vested in ALCO. The group separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios mainly are held by the Treasury Department, and include positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

The group is primarily exposed to interest rate risk and foreign exchange risk.

i. Exposure to interest rate risk

This is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the Group's interest rate gap position reflecting assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates is shown on the next page.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a regular basis include a 100,50, and 25 basis point (bp) parallel fall or rise in all yield curves. An analysis of the Group's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

Yield Curve Parallel Shift	2013 KShs '000	2012 KShs '000
100 Basis points upward parallel shift	(25,651)	(13,278)
50 Basis points upward parallel shift	(13,176)	(6,818)
25 Basis points upward parallel shift	(6,679)	(3,455)
100 Basis points downward parallel shift	6,865	6,125
50 Basis points downward parallel shift	13,927	7,202
25 Basis points downward parallel shift	28,655	14,817

4. FINANCIAL RISK MANAGEMENT (Continued)

(iv) Market risks (continued)

i. Exposure to interest rate risk - continued

The table below summarises the exposure to interest rate risks. Included in the table below are the group's assets and liabilities for 2013 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Assets	Effective interest rate	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Non interest bearing KShs'000	Total KShs'000
Cash and balances with Central Bank of Kenya		-	-	-	-	703,423	703,423
Investments in Government securities	11.43	-	-	1,135,394	3,714,674	-	4,850,068
Deposits and balances due from banking institutions	6.53	1,484,875	-	-	-	103,589	1,588,464
Loans and advances to customers (net)	14.72	1,345,211	970,951	1,348,652	4,443,653	-	8,108,467
Total assets		2,830,086	970,951	2,484,046	8,158,327	807,012	15,250,422
Liabilities and shareholders' funds							
Deposits and balances due to banking institutions	3.59	1,295,028	1,348,385	-	-	-	2,643,413
Customers' deposits	10.99	6,515,270	1,710,444	22,880	-	-	8,248,594
Loan capital	6.57	257,952	605,532	1,027,592	502,402	-	2,393,478
Total liabilities and Shareholder's funds		8,068,250	3,664,361	1,050,472	502,402	-	13,285,485

4. FINANCIAL RISK MANAGEMENT (Continued)

(iv) Market risks (continued)

i. Exposure to interest rate risk - continued

The table below summarises the exposure to interest rate risks. Included in the table below are the group's assets and liabilities for 2012 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Assets	Effective interest rate	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Non interest bearing KShs'000	Total KShs'000
Cash and balances with Central Bank of Kenya		-	-	-	-	624,854	624,854
Investments in Government securities	11.24	98,643	768,291	203,943	3,032,567	-	4,103,444
Deposits and balances due from banking institutions	3.52	1,424,119	-	-	-	-	1,424,119
Loans and advances to customers (net)	16.45	905,326	760,457	1,635,821	3,630,016	-	6,931,620
Total assets		2,428,088	1,528,748	1,843,764	6,662,583	624,854	13,084,037
Liabilities and shareholders' funds							
Deposits and balances due to banking institutions	3.83	856,869	659,379	-	-	-	1,516,248
Customers' deposits	12.74	5,440,231	1,493,927	4,338	-	-	6,938,496
Loan capital	6.77	134,192	559,834	1,982,073	380,756	-	3,056,855
Total liabilities and Shareholder's funds		6,431,292	2,713,140	1,986,411	380,756	-	11,511,599

4. FINANCIAL RISK MANAGEMENT (Continued)

(iv) Market risks (continued)

ii. Currency risk

The group is exposed to currency risk through transactions in foreign currencies. The group's transactional exposures give rise to foreign currency gains and losses that are recognised in profit or loss. In respect of monetary assets and liabilities in foreign currencies, the group ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate.

The table below analyses the currencies to which the group is exposed at 31 December 2013:

At 31 December 2013	USD KShs'000	GBP KShs'000	EURO KShs'000	OTHER KShs'000	TOTAL KShs'000
Assets					
Cash and balances with Central Bank of Kenya	44,683	1,304	6,318	-	52,305
Deposits and balances due from banking institutions	656,781	1,166	70,693	31	728,671
Loans and advances to customers (net)	1,142,393	-	531,104	-	1,673,497
Other assets	5,384	-	-	-	5,384
Total foreign currency assets	1,849,241	2,470	608,115	31	2,459,857
Liabilities					
Loan Capital	1,290,732	-	-	-	1,290,732
Other liabilities	252,506	253	201,096	-	453,855
Deposits and balances due to banking institutions	303,135	-	405,128	-	708,263
Total foreign currency liabilities	1,846,373	253	606,224	-	2,452,850
Foreign currency exposure at 31 December 2013	2,868	2,217	1,891	31	7,007

4. FINANCIAL RISK MANAGEMENT (Continued)

(iv) Market risks (continued)

ii. Currency risk (continued)

At 31 December 2012	USD KShs'000	GBP KShs'000	EURO KShs'000	OTHER KShs'000	TOTAL KShs'000
Assets					
Cash and balances with Central Bank of Kenya	26,392	1,997	16,162	-	44,551
Deposits and balances due from banking institutions	558,245	951	63,748	62	623,006
Loans and advances to customers (net)	992,968	-	504,130	-	1,497,098
Other assets	5,924	-	6,823	-	12,747
Total foreign currency assets	1,583,529	2,948	590,863	62	2,177,402
Liabilities					
Loan Capital	1,448,379	-	-	-	1,448,379
Other liabilities	132,279	1,205	192,783	-	326,267
Deposits and balances due to banking institutions	-	-	397,812	-	397,812
Total foreign currency liabilities	1,580,658	1,205	590,595	-	2,172,458
Foreign currency exposure at 31 December 2012	2,871	1,743	268	62	4,944

4. FINANCIAL RISK MANAGEMENT (Continued)

(v) *Operational risks*

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

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

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Group standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective.

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

(vi) *Capital management*

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the Group as a whole.

In implementing current capital requirements the Central Bank of Kenya requires the bank to maintain a prescribed ratio of total capital to total risk-weighted assets.

The bank's regulatory capital is analysed into two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings, translation reserve and minority interests after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

4. FINANCIAL RISK MANAGEMENT (Continued)

(vi) Capital management (continued)

Regulatory capital - Continued

- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Group recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Group has complied with all externally imposed capital requirements throughout the period. There have been no material changes in the Group's management of capital during the period.

The Group's regulatory capital position at 31 December was as follows:

	2013 KShs'000	2012 KShs'000
Core capital (Tier 1)		
Paid up share capital	347,500	347,500
Retained earnings less Deferred Tax	1,205,326	1,024,057
Other reserves	<u>281</u>	<u>280</u>
Core capital	1,553,107	1,371,837
Minimum Statutory capital	<u>1,000,000</u>	<u>1,000,000</u>
Excess capital	<u>553,107</u>	<u>371,837</u>
Supplementary capital (Tier 2)	<u>269,167</u>	<u>261,858</u>
Total capital	<u>1,822,274</u>	<u>1,633,695</u>
On statement of financial position risk weighted assets	6,120,702	5,911,081
Off statement of financial position assets risk weighted assets	<u>823,427</u>	<u>647,003</u>
Total risk weighted assets	<u>6,944,129</u>	<u>6,558,084</u>
Capital adequacy ratios		
Percentage of Core Capital to Risk Weighted Asset ratio	22.4%	20.9%
Minimum requirement	8.0%	8.0%
Percentage of Total Capital to Risk Weighted Asset ratio	26.2%	24.9%
Minimum requirement	12.0%	12.0%
Percentage of Core Capital to Deposits ratio	14.4%	16.2%
Minimum requirement	8.0%	8.0%

5. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES

The table below sets out the group's classification of each class of financial assets and liabilities, and their fair values (excluding accrued interest):

	Held for trading	Held to maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
As at 31 December 2013							
Assets							
Cash and cash equivalents	-	-	-	-	703,422	703,422	703,422
Deposits and balances due from other banks	-	-	-	-	1,588,464	1,588,464	1,588,464
Investments in Government securities	342,060	4,508,008	-	-	-	4,850,068	4,850,068
Loans and advances to customers	-	-	8,108,467	-	-	8,108,467	8,108,467
Equity investments	-	-	-	46,153	-	46,153	46,153
Total assets	342,060	4,508,008	8,108,467	46,153	2,291,886	15,296,574	15,296,574
Liabilities and shareholders' funds							
Deposits and balances due to banking institutions	-	-	-	-	2,643,413	2,643,413	2,643,413
Customers' deposits	-	-	-	-	8,402,991	8,402,991	8,402,991
Loan capital	-	-	-	-	2,393,478	2,393,478	2,393,478
Total liabilities	-	-	-	-	13,439,882	13,439,882	13,439,882
As at 31 December 2012							
Assets							
Cash and cash equivalents	-	-	-	-	624,854	624,854	624,854
Deposits and balances due from other banks	-	-	-	-	1,424,119	1,424,119	1,424,119
Investments in Government securities	265,901	3,837,543	-	-	-	4,103,444	4,103,444
Loans and advances to customers	-	-	6,931,620	-	-	6,931,620	6,931,620
Equity investments	-	-	-	46,153	-	46,153	46,153
Total assets	265,901	3,837,543	6,931,620	46,153	2,048,973	13,130,190	13,130,190
Liabilities and shareholders' funds							
Deposits and balances due to banking institutions	-	-	-	-	1,516,248	1,516,248	1,516,248
Customers' deposits	-	-	-	-	6,938,496	6,938,496	6,938,496
Loan capital	-	-	-	-	3,056,855	3,056,855	3,056,855
Total liabilities	-	-	-	-	11,511,599	11,511,599	11,511,599

The standard requires disclosure of fair values of all financial instruments. Other than governments securities held for trading, that are actively traded in the market, the other financial instruments have been disclosed at either original cost or amortised cost or the fair values at the date they were last actively traded. Loans and advances have been disclosed at amortised cost. Available for sale instruments are mainly investments in unquoted companies and as a result are disclosed at cost.

6.	INTEREST INCOME	2013 KShs'000	2012 KShs'000
	Loans and advances to customers	839,095	819,122
	Overdrafts	264,732	186,930
	Treasury bills and Repos	-	3,078
	Treasury bonds	545,843	423,612
	Deposits and balances due from banking institutions	<u>29,132</u>	<u>28,149</u>
		<u>1,678,802</u>	<u>1,460,891</u>

Included within various captions under interest income for the year ended 31 December 2013 is a total of KShs 86,622,000 (2012 – KShs 26,941,000) accrued on impaired financial assets.

Included within interest income on investment securities for the year ended 31 December 2013 is KShs 510,494,426 (2012 - KShs 414,015,000) relating to debt securities held-to-maturity.

7.	INTEREST EXPENSE	2013 KShs'000	2012 KShs'000
	Customer deposits	772,778	789,372
	Loan capital and income notes	195,558	247,051
	Deposits and balances due to banking institutions	<u>72,334</u>	<u>125,395</u>
		<u>1,040,670</u>	<u>1,161,818</u>

8.	NON INTEREST INCOME	2013 KShs'000	2012 KShs'000
	Fee and commission income	38,847	41,288
	Gains on disposal of Government securities	3,854	-
	Gains arising from dealing in foreign currencies	21,402	10,936
	Rental income (Net of provisions)	36,934	38,545
	Dividend income	-	7,795
	Other income	<u>(143)</u>	<u>15,210</u>
		<u>100,894</u>	<u>113,774</u>

9.	NON INTEREST EXPENSES	2013 KShs'000	2012 KShs'000
	Salaries and employee benefits	163,815	138,492
	Occupancy expenses	34,250	28,897
	Deposit Protection Fund	11,175	9,624
	Depreciation	19,568	17,937
	Amortisation of prepaid operating lease rentals	61	61
	Directors' emoluments	10,782	11,917
	Professional and legal services	7,260	9,272
	Telecommunication	2,276	4,094
	Other expenses	<u>41,062</u>	<u>36,535</u>
		<u>290,249</u>	<u>256,829</u>

Included in salaries and employee benefits are contributions to the defined contribution plan for employees. During the year, the group expensed KShs 16,114,835 in contributions payable (2012 – KShs 14,156,529).

10. PROFIT BEFORE TAXATION

	2013	2012
	KShs'000	KShs'000
Profit before taxation is arrived at after charging/(crediting):		
Depreciation expense	19,568	17,937
Amortisation of prepaid operating lease rentals	61	61
Director's emoluments – Fees as non executive	1,400	1,400
– Other*	9,382	10,517
Auditors' remuneration – Current year	<u>2,780</u>	<u>2,578</u>

* Directors emoluments 'other' includes sitting allowances, chairman's honorarium and director's travel expenses.

	2013	2012
	KShs'000	KShs'000
11. TAXATION		
Current tax at 30%	89,845	34,373
Deferred tax debit (Note 21)	<u>(3,989)</u>	<u>(1,893)</u>
	<u>85,856</u>	<u>32,480</u>

The tax on the group's profit differs from the theoretical amount using the basic tax rate as follows:

	2013	2012
	KShs'000	KShs'000
Accounting profit before tax	<u>275,289</u>	<u>106,259</u>
Computed tax using the applicable corporation tax rate	82,587	31,878
Non-deductible costs, on ineligible assets	<u>3,269</u>	<u>602</u>
Income tax expense	<u>85,856</u>	<u>32,480</u>

12. DIVIDEND PER SHARE

	2013	2012
The calculation of dividend per share is based on:		
Dividend proposed for the year (KShs'000)	<u>–</u>	<u>–</u>
Number of ordinary shares ('000)	<u>17,375</u>	<u>17,375</u>
Dividend per share (KShs)	<u>–</u>	<u>–</u>

13. EARNINGS PER SHARE

	2013	2012
The calculation of basic earnings per share is based on:		
Net profit for the year attributable to shareholders (KShs '000)	<u>189,433</u>	<u>73,779</u>
Number of ordinary shares ('000)	<u>17,375</u>	<u>17,375</u>
Earnings per share (KShs)	<u>10.90</u>	<u>4.25</u>

There were no potentially dilutive shares outstanding at 31 December 2013 and 2012.

14. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2013	2012
Group and Company	KShs'000	KShs'000
Cash on hand	94,186	76,263
Balances with Central Bank of Kenya:		
– Local currency cash reserve ratio	403,708	344,902
– Other	<u>205,528</u>	<u>203,689</u>
	<u>703,422</u>	<u>624,854</u>

The cash reserve ratio is non-interest earning and is based on the value of deposits as adjusted for Central Bank of Kenya requirements. At 31 December 2013, the cash reserve requirement was 5.25% (2012 – 5.25%) of all customer deposits. These funds are available to finance the bank's day-to-day operations in a limited way provided that on any given day these balance does fall below the 3% minimum daily requirements and provided that the overall average in the month is at least 5.25%.

15. INVESTMENT IN GOVERNMENT SECURITIES

Group	2013	2012
	KShs'000	KShs'000
Held to maturity		
<i>Treasury bonds:</i>		
Maturing within one year	-	967,975
Maturing after one year	4,508,008	2,869,568
Total held to maturity	<u>4,508,008</u>	<u>3,837,543</u>
Held for trading		
<i>Treasury bonds:</i>		
Maturing within one year	-	102,901
Maturing after one year	342,060	163,000
Total held for trading	<u>342,060</u>	<u>265,901</u>
	<u>4,850,068</u>	<u>4,103,444</u>
Company		
Held to maturity		
<i>Treasury bonds:</i>		
Maturing within one year	-	967,975
Maturing after one year	4,486,858	2,848,408
Total held to maturity	<u>4,486,858</u>	<u>3,816,383</u>
Held for trading		
<i>Treasury bonds:</i>		
Maturing within one year	-	102,901
Maturing after one year	342,060	163,000
Total held for trading	<u>342,060</u>	<u>265,901</u>
	<u>4,828,918</u>	<u>4,082,284</u>

The weighted average effective interest rate on government securities at 31 December 2013 was 11.43% (2012 – 11.24%).

16. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

Group and Company	2013	2012
	KShs'000	KShs'000
Due within 90 days	1,558,693	1,424,119
Due between 3 months and 1 year	<u>29,771</u>	-
Due within 90 days	<u>1,588,464</u>	<u>1,424,119</u>

The weighted average effective interest rate on placements with other banks at 31 December 2013 was 6.53% (2012 – 3.52%).

17. LOANS AND ADVANCES TO CUSTOMERS AT AMORTISED COST

	2013		2012	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
(a) Overdrafts	2,100,153	2,100,153	1,132,745	1,132,745
Loans	6,338,023	6,281,605	5,983,062	5,926,778
Staff loans	<u>207,987</u>	<u>207,987</u>	<u>184,513</u>	<u>184,513</u>
	8,646,163	8,589,745	7,300,320	7,244,036
Less: Impairment losses reserves	(537,696)	(481,278)	(368,700)	(312,416)
	<u>8,108,467</u>	<u>8,108,467</u>	<u>6,931,620</u>	<u>6,931,620</u>
Maturing within one year	2,379,294	2,379,294	1,665,783	1,665,783
Over one year to three years	874,930	874,930	691,430	691,430
Over three years	<u>4,854,243</u>	<u>4,854,243</u>	<u>4,574,407</u>	<u>4,574,407</u>
	<u>8,108,467</u>	<u>8,108,467</u>	<u>6,931,620</u>	<u>6,931,620</u>

The weighted average effective interest rate on loans and advances to customers at 31 December 2013 was 14.72% (2012 – 16.45%).

(b) Group	Specific	Portfolio	Total KShs'000
	impairment losses KShs'000	impairment losses KShs'000	
2013:			
At 1 January 2013	315,709	52,991	368,700
Amounts written off during the year	(5,156)	-	(5,156)
Reversals on recovery during the year	(31,814)	-	(31,814)
Made during the year	<u>188,237</u>	<u>17,729</u>	<u>205,966</u>
At 31 December 2013	<u>466,976</u>	<u>70,720</u>	<u>537,696</u>
2012:			
At 1 January 2012	304,185	41,963	346,148
Amounts written off during the year	(27,268)	-	(27,268)
Reversals on recovery during the year	(101,158)	-	(101,158)
Made during the year	<u>139,950</u>	<u>11,028</u>	<u>150,978</u>
At 31 December 2012	<u>315,709</u>	<u>52,991</u>	<u>368,700</u>
Company			
2013:			
At 1 January 2013	259,425	52,991	312,416
Amounts written off during the year	(5,156)	-	(5,156)
Reversals on recovery during the year	(31,725)	-	(31,725)
Made during the year	<u>188,014</u>	<u>17,729</u>	<u>205,743</u>
At 31 December 2013	<u>410,558</u>	<u>70,720</u>	<u>481,278</u>

17. **LOANS AND ADVANCES TO CUSTOMERS AT AMORTISED COST (Continued)**

(b) **Impairment losses reserves (continued)**

Company	Specific KShs'000	Portfolio KShs'000	Total KShs'000
At 1 January 2012	245,479	41,963	287,442
Amounts written off during the year	(26,020)	-	(26,020)
Reversals on recovery during the year	(99,554)	-	(99,554)
Made during the year	139,520	11,028	150,548
At 31 December 2012	<u>259,425</u>	<u>52,991</u>	<u>312,416</u>

(c) **Impairment losses on loans and advances charged to the statement of comprehensive income**

Group	2013 KShs'000	2012 KShs'000
Provisions during the year (Note 17(b))	205,966	150,978
Recovered during the year (Note 17(b))	(31,814)	(101,158)
Direct write offs	261	150
Recoveries of amounts previously written off	(925)	(211)
	<u>173,488</u>	<u>49,759</u>
Interest on impaired loans and advances which has not yet been received in cash	<u>86,623</u>	<u>26,941</u>

(d) **Impaired loans and advances**

Loans and advances include an amount of KShs 530,445,000 (2012 – KShs 635,768,160) net of impairment losses which have been classified as impaired loans and advances.

Estimated value of underlying collaterals amount to KShs 572,651,000 (2012 – KShs 756,146,000). The directors are of the opinion that recovery of the principal amounts thereof is not doubtful.

18. **EQUITY INVESTMENTS**

Group and Company	2013 KShs'000	2012 KShs'000
Unquoted shares at cost:		
Chemelil Sugar Company Limited 150,000 ordinary shares of KShs 20 each	3,000	3,000
Pan African Paper Mills Limited 104,000 ordinary shares of KShs 20 each	2,080	2,080
Kenya Hotel Properties Limited 2,157,661 ordinary shares of KShs 20 each	43,153	43,153
Kenya United Steel Company Limited 180,000 ordinary shares of KShs 5 each	900	900
East Africa Sugar Industries Limited 100,000 ordinary shares of KShs 20 each	<u>2,000</u>	<u>2,000</u>
	<u>51,133</u>	<u>51,133</u>

18. EQUITY INVESTMENTS (Continued)

Group and Company - continued	2013 KShs'000	2012 KShs'000
Provision for impairment loss on investments		
East Africa Sugar Industries Limited	(2,000)	(2,000)
Pan African Paper Mills Limited	(2,080)	(2,080)
Kenya United Steel Company Limited	(900)	(900)
	<u>(4,980)</u>	<u>(4,980)</u>
	<u>46,153</u>	<u>46,153</u>

The above equity investments are accounted for at cost as they do not have a quoted market price in an active market and in the directors' opinion, other methods of estimating fair value are unlikely to yield an accurate estimate.

19. INVESTMENT IN SUBSIDIARY

Company	2013 KShs'000	2012 KShs'000
Shares at cost:		
Small Enterprises Finance Company Limited (SEFCO)	<u>32,048</u>	<u>32,048</u>

SEFCO is a wholly owned subsidiary of the bank. The subsidiary company is incorporated in Kenya.

20. OTHER ASSETS

	2013		2012	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Rent receivable	14,977	14,977	10,759	10,759
Uncleared effects	20,839	20,839	19,679	19,679
Prepayments	24,273	24,273	30,934	30,934
Other receivables	<u>11,450</u>	<u>11,385</u>	<u>3,602</u>	<u>3,442</u>
	<u>71,539</u>	<u>71,474</u>	<u>64,974</u>	<u>64,814</u>

21. DEFERRED TAX ASSET

The net deferred tax asset at 31 December 2013 and 31 December 2012 are attributable to the following:

Movements during the year are as follows:

2013:	At 1 January 2013 KShs'000	Recognised profit or loss KShs'000	At 31 December 2013 KShs'000
Group:			
Arising from:			
Property and equipment	7,593	1,110	8,703
Portfolio impairment provisions on loans and advances	15,897	5,319	21,216
Other provisions	5,158	(2,440)	2,718
	<u>28,648</u>	<u>3,989</u>	<u>32,637</u>

21. DEFERRED TAX ASSET (Continued)

2012:	At 1 January 2012	Recognised profit or loss	At 31 December 2012
Group:	KShs'000	KShs'000	KShs'000
Arising from:			
Property and equipment	6,332	1,261	7,593
Portfolio impairment provisions on loans and advances	12,590	3,307	15,897
Other provisions	7,615	(2,457)	5,158
Tax losses	218	(218)	-
	<u>26,755</u>	<u>1,893</u>	<u>28,648</u>

2013:	At 1 January 2013	Recognised profit or loss	At 31 December 2013
Company:	KShs'000	KShs'000	KShs'000
Arising from:			
Property and equipment	7,593	1,110	8,703
Portfolio impairment provisions on loans and advances	15,897	5,319	21,216
Other provisions	5,037	(2,470)	2,567
	<u>28,527</u>	<u>3,959</u>	<u>32,486</u>

2012:	At 1 January 2012	Recognised profit or loss	At 31 December 2012
Company:	KShs'000	KShs'000	KShs'000
Arising from:			
Property and equipment	6,332	1,261	7,593
Portfolio impairment provisions on loans and advances	12,590	3,307	15,897
Other provisions	7,525	(2,488)	5,037
	<u>26,447</u>	<u>2,080</u>	<u>28,527</u>

22. PREPAID OPERATING LEASE RENTALS

Group and Company	2013 KShs'000	2012 KShs'000
Cost		
At 1 January and 31 December	<u>6,000</u>	<u>6,000</u>
Amortisation		
At 1 January	1,883	1,822
Amortisation for the year	<u>61</u>	<u>61</u>
At 31 December	<u>1,944</u>	<u>1,883</u>
Net carrying amount at 31 December	<u>4,056</u>	<u>4,117</u>

23. PROPERTY AND EQUIPMENT

Group and Company:

2013:	Building KShs'000	Leasehold improvements KShs'000	Furniture and equipment KShs'000	Computers KShs'000	Motor vehicles KShs'000	Capital work in progress KShs'000	Total KShs'000
Cost							
At 1 January 2013	123,425	25,790	100,725	43,984	30,490	27,852	352,266
Additions	-	12,188	2,011	1,284	3,090	-	18,573
Transfers from Capital Work	-	24,521	-	-	-	(24,521)	-
In progress	-	-	(1,208)	-	(2,463)	-	(3,671)
Disposals	-	-	-	-	-	-	-
At 31 December 2013	123,425	62,499	101,528	45,268	31,117	3,331	367,168
Depreciation							
At 1 January 2013	31,635	8,312	82,580	36,584	26,563	-	185,674
Charge for the year	1,356	8,383	3,623	4,094	2,112	-	19,568
Disposals	-	-	(754)	-	(2,463)	-	(3,217)
At 31 December 2013	32,991	16,695	85,449	40,678	26,212	-	202,025
Net book value							
At 31 December 2013	90,434	45,804	16,079	4,590	4,905	3,330	165,142
2012:							
Cost							
At 1 January 2012	123,425	21,258	99,688	38,465	30,490	6,327	319,653
Additions	-	3,135	1,037	589	-	27,852	32,613
Transfers from Capital Work	-	1,397	-	4,930	-	(6,327)	-
In progress	-	-	-	-	-	-	-
At 31 December 2012	123,425	25,790	100,725	43,984	30,490	27,852	352,266
Depreciation							
At 1 January 2012	30,280	4,548	79,120	32,914	20,875	-	167,737
Charge for the year	1,355	3,764	3,460	3,670	5,688	-	17,937
At 31 December 2012	31,635	8,312	82,580	36,584	26,563	-	185,674
Net book value							
At 31 December 2012	91,790	17,478	18,145	7,400	3,927	27,852	166,592

Included in equipment are assets with a gross value of KShs 129,739,934 (2012 - KShs 124,815,371) which are fully depreciated and still in use. Such assets would have attracted a notional depreciation of KShs 25,239,957 (2012 - KShs 24,553,066).

24. DEPOSITS AND BALANCES DUE TO OTHER BANKS

Group and company	2013 KShs'000	2012 KShs'000
Payable within 90 days	1,295,028	856,869
Payable between 3 months and one year	<u>1,348,385</u>	<u>659,379</u>
	<u>2,643,413</u>	<u>1,516,248</u>

The weighted average effective interest rate on deposits from other banks at 31 December 2013 was 3.59% (2012 – 3.83%).

25. DEPOSITS FROM CUSTOMERS

Group and company	2013		2012	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
(a) From Government and Parastatals	1,224,171	1,224,171	888,674	888,674
(b) From private sector and Individuals	<u>7,178,820</u>	<u>7,194,504</u>	<u>6,049,822</u>	<u>6,064,209</u>
	<u>8,402,991</u>	<u>8,418,675</u>	<u>6,938,496</u>	<u>6,952,883</u>

Included in the company customers deposits is KShs 15,684,000 (2012 – KShs 14,387,000) due to the subsidiary company. Interest paid on these deposits during the year amounted to KShs 156,000 (2012 – KShs 156,000).

The weighted average effective interest rate on customer deposits at 31 December 2013 was 10.99% (2012 – 12.74%).

26. LOAN CAPITAL

Group and company	2013 KShs'000	2012 KShs'000
East African Development Bank (EADB)	229,558	387,313
European Investment Bank	21,163	21,163
Industrial & Commercial Development Corporation (ICDC)	100,000	200,000
Standard Chartered Bank Kenya Limited	752,025	1,000,000
China Development Bank	<u>1,290,732</u>	<u>1,448,379</u>
	<u>2,393,478</u>	<u>3,056,855</u>
Repayments:		
Less than one year	863,484	694,026
Between one and five years	1,027,592	1,982,073
Over 5 years	<u>502,402</u>	<u>380,756</u>
	<u>2,393,478</u>	<u>3,056,855</u>

The weighted average effective interest rate on loan capital at 31 December 2013 was 6.57% (2012 – 6.77%).

27. OTHER LIABILITIES

Group and company:	2013		2012	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Bills payable	16,586	16,586	8,614	8,614
Rent deposit	13,096	13,096	13,096	13,096
Deutsche Investitions-und Entwicklungsgesellschaft mbH (DEG) retained funds	118,151	118,151	115,818	115,818
Payable to Government of Kenya	65,281	65,281	65,281	65,281
Provisions and accruals	36,625	34,681	44,942	43,424
Other liabilities	<u>14,428</u>	<u>14,758</u>	<u>11,182</u>	<u>11,181</u>
	<u>264,167</u>	<u>262,553</u>	<u>258,933</u>	<u>257,414</u>

28. SHARE CAPITAL

	2013 KShs'000	2012 KShs'000
Authorised, issued and fully paid		
17,375,000 ordinary shares of KShs 20 each	<u>347,500</u>	<u>347,500</u>

The shareholders are entitled to receive dividends declared from time to time and are entitled to one vote per share at annual and other general meetings of the company.

29. CASH AND CASH EQUIVALENTS

	2013 KShs'000	2012 KShs'000
Group		
Cash in hand	94,186	76,263
Balances with Central Bank of Kenya	205,528	203,689
Deposits and balances due from banks	1,588,464	1,424,119
Treasury Bills	-	98,643
Deposits and balances due to banks	<u>(2,643,413)</u>	<u>(1,516,248)</u>
	<u>(755,235)</u>	<u>286,466</u>

30. CONTINGENCIES

At any time the group has outstanding commitments to extend credit. These commitments take the form of approved loans and overdraft facilities. At 31 December 2013, interest rates on loans and overdrafts ranged from 4.00% to 21.00% (2012 – 4.44% to 25.25%). The contractual amounts of commitments are set out below:

(a) Commitments to extend credit with respect to	2013 KShs'000	2012 KShs'000
Undrawn loans	807,173	840,043
Undrawn overdraft facilities	277,574	295,759
Unutilised guarantees and letters of credit	<u>11,057</u>	<u>42,781</u>
	<u>1,095,804</u>	<u>1,178,583</u>

At 31 December 2013, interest rate on facilities subject to commitments ranged from 4.00% to 21.00% (2012 – 4.44% to 25.25%).

30. CONTINGENCIES (Continued)

(b) Commitments with respect to outstanding off-balance items

	2013 KShs'000	2012 KShs'000
Guarantees	748,757	585,450
Acceptances	34,872	39,223
Letters of credit	194,103	26,180
Undelivered spots	<u>92</u>	<u>92</u>
	<u>977,824</u>	<u>650,945</u>

(c) Nature of contingent liabilities

Letters of credit commit the bank to make payments to third parties, on production of documents, which are subsequently reimbursed by the customers.

Guarantees are generally written by the bank to support performance by a customer to third parties. The bank will only be required to meet these obligations in the event of the customers' default.

An acceptance is an undertaking by the bank to pay a bill of exchange drawn on a customer. The bank expects most of the acceptances to be presented, and reimbursement by the customer is almost immediate.

(d) Litigations against Small Enterprises Finance Company Limited (SEFCO)

Litigations against the subsidiary company, SEFCO, arising from normal cause of business have been lodged by some customers. The likely outcome of these cases cannot be objectively determined as at the date of signing of these financial statements. However, the Directors do not anticipate that any liability will arise from these suits.

31. OPERATING LEASES

The company leases out part of its building under operating leases. The operating lease rentals receivable are as follows:

	2013 KShs'000	2012 KShs'000
Less than one year	32,555	26,759
Between one and five years	26,196	39,670
Over five years	<u>-</u>	<u>29,006</u>
	<u>58,751</u>	<u>95,435</u>

The leases typically run for an initial period of between two to six years with an option to renew the lease after that date. None of the leases include contingent rentals. During the year KShs 36,934,000 (2012 – KShs 38,545,000) was recognised as rental income in the statement of comprehensive income and KShs 18,853,236 (2012 – KShs 3,068,790) in respect of repairs and maintenance relating to the building.

32. **RELATED PARTY TRANSACTIONS**

	2013	2012
(a) Loans and advances to employees	KShs'000	KShs'000
Balance at 1 January	189,080	173,883
Loans advanced during the year	57,644	49,408
Loans repayments received	(38,737)	(34,211)
Balance at 31 December	<u>207,987</u>	<u>189,080</u>

Interest earned on staff loans during the year amounted to KShs 12,554,014 (2012 – KShs 11,546,056).

(b) Loan and advances to directors and their associates

The Group has entered into transactions with its directors and their associates as follows:

	2013	2012
	KShs'000	KShs'000
Gross amount at 1 January	208,359	2,157
Interest charged	43,646	915
Loans disbursed	137,675	204,100
Cash received	(5,417)	1,187
Net amount at 31 December	<u>384,263</u>	<u>208,359</u>

There were no loans and advances to companies where relationship exists by virtue of shareholding and/or representation in the respective companies board of directors (2012 – KShs 62,914,700). The companies in which the group is a shareholder are set out under Note 18. The advances are at arms length in the ordinary course of business and are adequately secured.

- (c) Included in deposits is KShs 15,684,000 (2012 – KShs 14,387,000) due to a subsidiary company. Interest paid on these deposits during the year amounted to KShs 156,000 (2012 – KShs 156,000).
- (d) All the transactions with the related parties are priced on arm's length basis and have been entered into in the normal course of business.
- (e) Compensation to senior management for the year ended 31 December 2013 amounted KShs 48,465,317 (2012 – KShs 42,419,080).
- (f) Other related party balances with the government and parastatals have been disclosed in Note 25 and 26.

33. ASSETS PLEDGED AS SECURITY

Financial assets that may be repledged or resold by counterparties

As at 31 December 2013, Government securities amounting to KShs 1,084.5 million (2012 - KShs 1,303.3 million) were pledged as security against loans from Standard Chartered Bank Kenya Limited and East African Development Bank. These transactions are conducted under terms that are usual and customary to standard lending, and securities borrowing and lending activities.

34. RESERVES

(a) Interest reserve

The interest reserve was established under a lending agreement between the bank and Industrial & Commercial Development Corporation. Under the agreement, part of the interest payable on the loan capital balance was retained as interest reserve and is available for furtherance of the bank's business. The interest reserve is not available for distribution.

(b) Statutory reserves

The statutory reserve represents an appropriation from retained earnings to comply with Central Bank of Kenya's prudential guidelines on impairment of loans and advances. It represents the excess loan provisions as computed in accordance with Central Bank of Kenya's prudential guidelines over the impairment arrived at in accordance with International Financial Reporting Standards.