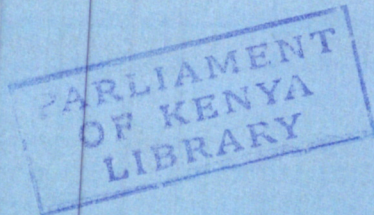


REPUBLIC OF KENYA



OFFICE OF THE AUDITOR-GENERAL



PAPER LAID  
BY THE LEADER  
OF THE MAJORITY  
PARTY ON  
16/5/2017  
IBM

**REPORT**

**OF**

**THE AUDITOR-GENERAL**

**ON**

**THE FINANCIAL STATEMENTS OF  
DEVELOPMENT BANK OF KENYA LIMITED**

**FOR THE YEAR ENDED  
31 DECEMBER 2016**





**DEVELOPMENT BANK OF KENYA LIMITED**  
**ANNUAL REPORT AND FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2016**

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**Registered office**

Finance House  
Loita Street  
PO 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

**Directors**

The directors who served during the year and to the date of this report are:

Prof. H.K. Mengech – Chairman  
K. Gatabaki  
Prof. J.H. Kimura  
Z. G.Mbugua – Resigned on 28<sup>th</sup> April 2016  
Industrial & Commercial Development Corporation (ICDC)  
Principal Secretary to the Treasury of Kenya

Development Bank of Kenya Limited  
Company Information  
For the year ended 31 December 2016

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**Secretary**

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

**Senior officers**

V.J.O. Kidiwa  
J.K. Kiniti

Chief Executive  
Head of Finance & Administration

**Auditors**

PricewaterhouseCoopers (PwC)  
PwC Towers  
Waiyaki Way/ Chiromo Road  
PO Box 43963 - 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

Nedbank  
PO Box 1144  
Johannesburg 2000, GTG  
South Africa

Standard Chartered Bank  
1 Basinghall Avenue,  
London EC2V 5DD  
Tel.+44 (020) 7885 8888

Standard Chartered Bank  
90 Matatma Gandhi Road  
Mumbai India 400 001  
Tel. + 91 22 226 70162

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

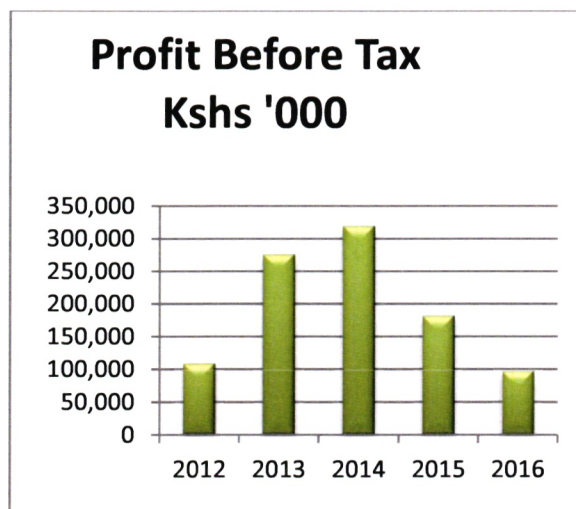
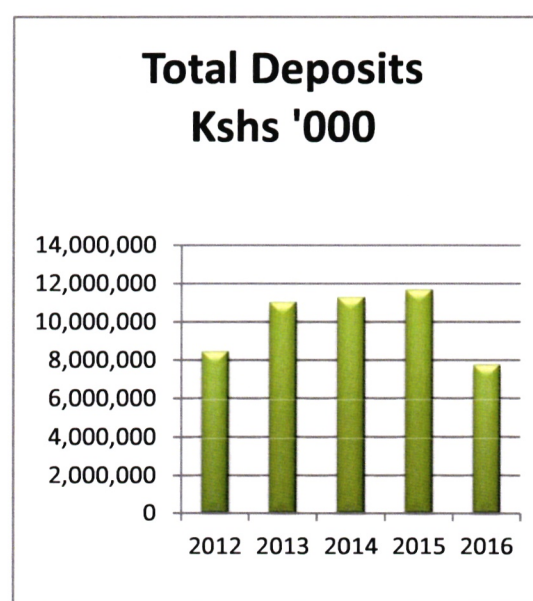
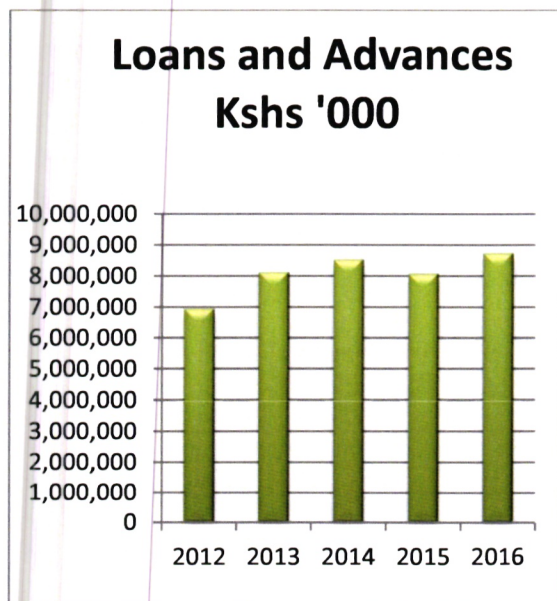
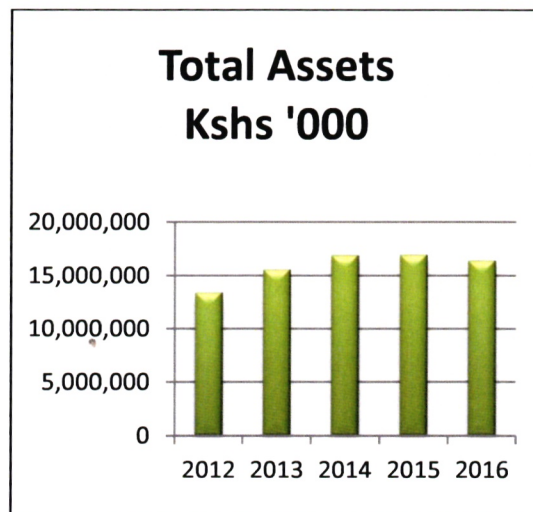
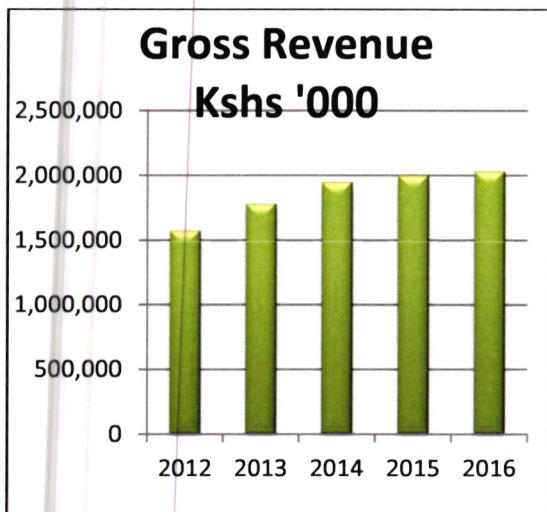
**Five-year Group financial summary**

	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>Shs'000</b>	<b>Shs'000</b>	<b>Shs'000</b>	<b>Shs'000</b>	<b>Shs'000</b>
Gross revenue	2,031,005	1,990,760	1,941,074	1,779,696	1,574,665
Profit before tax	97,755	180,468	319,326	275,289	106,259
Profit after tax	61,715	121,620	220,592	189,433	73,779
Gross loans and advances	9,823,634	8,868,029	9,225,833	8,646,163	7,300,320
Less impairment losses on loans and advances	(1,090,422)	(824,091)	(698,201)	(537,696)	(368,700)
Loans and advances to customers (net of impairment)	8,733,212	8,043,938	8,527,632	8,108,467	6,931,620
Total deposits	7,760,936	11,690,687	11,292,787	11,046,404	8,454,744
Loan capital	5,472,728	2,132,846	2,618,047	2,393,478	3,056,855
Shareholders' equity	2,915,665	2,853,950	2,772,330	1,830,359	1,640,936
Total assets	16,411,435	16,942,552	16,944,142	15,574,646	13,411,458

**KEY RATIOS**

Basic Earnings Per Share (EPS)	1.88	2.33	12.69	10.90	4.25
Return on Assets (ROA)	0.6%	1.1%	1.9%	1.8%	0.8%
Return on Equity (ROE)	3.4%	6.3%	11.7%	15.1%	6.5%
Capital Adequacy Ratio	21.60%	23.90%	25.7%	22.4%	20.9%

**KEY PERFORMANCE INDICATORS**



## **Introduction**

It gives me great pleasure to present to you the audited Financial Statements for the Bank and its wholly owned subsidiary for the year ended December 2016. The year was characterized by various challenges to the Banking Sector in Kenya. After the collapse of two banks in 2015 in quick succession, in April 2016 a third bank was placed under statutory management. This created significant challenges for the sector, especially the tier II and tier III banks. Customers' confidence declined to an all-time low leading to panic uplift of deposits coupled with deposit shift from the two tiers of banks to tier I institutions. This saw a number of banks face reduced liquidity. The Central Bank of Kenya came to the rescue of the various banks by offering short term funding.

Later in the year, the law capping interest rates for bank loans as well as customer deposits was passed by Parliament and assented to by the President. This has and will continue to impact bank business into the foreseeable future.

Being a tier III bank, Development Bank of Kenya's performance was no doubt affected by the unforeseen shocks described above.

## **Economic Overview**

The Kenyan economy expanded by 5.6% and 5.3% in 2015 and 2014 respectively (*Kenya Bureau of Statistics*). Growth was spearheaded by improved output from Agriculture, Construction, Real Estate, Financial and Insurance sectors of the economy. The outlook for 2016 has been up as quarter 1 GDP grew by a record 5.9%, the second highest GDP growth ever recorded in the economy after the 7.6% registered in quarter 1 of 2011. 2016 growth has been on the back drop of good weather, improved security and continued investment in infrastructure.

The World Bank's most recent economic update on Kenya project's a 5.6% growth in 2016, rising to 6.0% in 2017. The report attributed the positive outlook on low oil prices globally, good agricultural performance, supportive monetary policy and on-going infrastructure development. This forecast, however, may have to contend with resurgence of oil prices and the effects of prolonged drought in the latter part of 2016 stretching to 2017

This scenario is further compounded by the impact of the interest rate capping for the banks. In September 2016, the president signed into law, an amendment to the 2015 Banking bill which capped lending rates.

## **Developments in the Banking Sector**

Central Bank of Kenya (CBK) placed one more bank under statutory management in April 2016 hot on the heels of two closures late in 2015. This reduced the number of banks operating in the country to 40, 1 mortgage financing company, 12 microfinance banks, 8 representative offices of foreign banks, 86 foreign exchange bureaus, 14 money remittance providers and 3 credit reference bureaus.

The closure of the bank exacerbated lack of confidence in the sanctity of banking in the country leading to customer panic withdrawal of deposits. Furthermore, the sector experienced large deposit movement from tier II and III banks to tier I banks perceived as more secure. This resulted in a liquidity skew towards tier I banks and away from the other banks. Central Bank intervened by offering short term funding for the banks whose liquidity level had been impaired.

The Banking Act was amended in September 2016 resulting in capping of loan interest rates at 4% above the Central Bank Reference (CBR) rate. Further, Banks have to pay clients for their deposits at a minimum rate of 70% of the CBR. This new law as applied reduces the net interest margin of banks and simply does not compensate fully for the risks inherent on loans.

### The DBK's Performance

The bank recorded a lower profit before tax of KShs 97.8 million compared to the previous year's outcome of KShs 180.5 million. The reduced profits were mainly due to lower net interest income and increased non-performing loans compared 2015. The law on interest rate capping further shrunk bank margins due to reduced lending rates and increased cost of deposits. These were the main reasons behind reduced net interest income.

The Balance sheet shrunk to KShs 16.4 billion from KShs 16.9 billion reported in 2015. The liquidity crises emanating from the closure of the banks led to this Position as Funds moved to Tier 1 Banks.

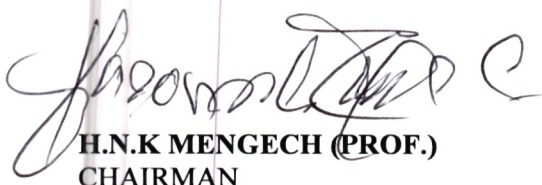
The loan book, at KShs 9.8 billion compared favourably to previous year's size. The quality of the loan book as measured by the percentage of Non-performing loans to gross loans worsened from 22.3% to 27.5%. After adjusting for additional provisions against non-performing loans, the net loans closed higher at KShs 8.7 billion compared to KShs 8.0 billion achieved in 2015. The bulk of credit was advanced to the real estate and trade investments as shown below.

SECTOR	Portfolio 2016	Portfolio 2015
Agriculture	7.4%	9.0%
Manufacturing	15.0%	13.8%
Building & Construction	2.7%	2.9%
Trade	26.7%	19.0%
Tourism, Restaurants & Hotels	3.7%	3.7%
Transport & Communication	3.8%	3.6%
Real Estate	31.0%	33.9%
Financial Services	0.2%	0.4%
Personal Households	9.5%	13.7%
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>

The primary sources of funding for the bank were deposits and long term loans.

### 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

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 six 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.

	<b>Composition &amp; Membership</b>	<b>Chairman</b>	<b>Members</b>	<b>Main Functions</b>
<b>Executive Committee</b>	Senior Management	CEO	V. Kidiwa J. Kiniti J. Mananda P. Pertet D. Kamunde B. Kakule W. Ogada O. Sechero M. Mwambire K. Gonna C. A. Otieno (Mrs)	Strategy decision making in accordance with powers conferred upon by the Board
<b>Board Audit Committee</b>	Three Non-Executive Directors, and Senior Management	Non-Executive Director	Prof. J. Kimura K. Gatabaki K. Wanderi V. Kidiwa F Ouma C. A. Otieno (Mrs) J. Kiniti	Strengthening the control environment, financial reporting and audit function
<b>Assets and Liabilities Committee</b>	Senior Management	CEO	V. Kidiwa J. Kiniti J. Mananda C. A. Otieno (Mrs) D. Kamunde C. Mulwa	Management of assets and investments
<b>Board Credit Committee</b>	Executive Directors, and Senior Management	Non-Executive Director	K. Gatabaki K. Wanderi V. Kidiwa J. Mananda C. A. Otieno (Mrs)	Appraisal and approval of credit applications
<b>Debt Collection Committee</b>	Senior Management	CEO	V. Kidiwa J. Kiniti O. Sechero J. Mananda C. A. Otieno (Mrs)	Monitoring and reviewing non-performing portfolio

	<b>Composition &amp; Membership</b>	<b>Chairman</b>	<b>Members</b>	<b>Main Functions</b>
<b>Automation Committee</b>	Four Non-Executive Directors and Senior Management	Non-Executive Director	Prof. J. Kimura K. Gatabaki V. Kidiwa J. Kiniti C. A. Otieno (Mrs)	Develops the long-term automation plan for the board's approval
<b>Human Resources</b>	Three Non-Executive Directors and Senior Management	Non-Executive Director	Prof. H. K. Mengech K. Gatabaki M. Mbithi V. Kidiwa C. A. Otieno (Mrs)	Management & development of human resources
<b>Strategy Committee</b>	Four Non-Executive Directors and Senior Management	Non-Executive Director	Prof. J. Kimura K. Gatabaki K. Wanderi J. Kiarii V. Kidiwa J. Kiniti J. Mananda C. A. Otieno (Mrs)	Overall Bank Strategy Policy Formulation and implementation
<b>Board Risk &amp; Compliance</b>	Three Non-Executive Directors and Senior Management	Non-Executive Director	K. Gatabaki Prof. J. Kimura J. Kiarii V. Kidiwa P Pertet C. A. Otieno (Mrs)	To ensure quality integrity and reliability of the institution's risk management

### 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 2016:

Names	7 <sup>th</sup> Mar	27 <sup>th</sup> Apr	18 <sup>th</sup> May	7 <sup>th</sup> Jun	6 <sup>th</sup> Jul	2 <sup>nd</sup> Aug	30 <sup>th</sup> Aug	29 <sup>th</sup> Sep	1 <sup>st</sup> Nov	29 <sup>th</sup> Nov	2 <sup>nd</sup> Dec	15 <sup>th</sup> Dec	19 <sup>th</sup> Dec	% Attendance
Prof. H. K. Mengech	X	X	X	X	X	X	X	X	X	X	X	X	X	100
Kungu Gatabaki	X	X	X	X	-	X	X	X	X	-	X	X	X	85
Prof. J. H. Kimura	X	X	-	X	X	X	X	X	X	-	X	X	X	85
Z. G. Mbugua*	-	X	-	-	-	-	-	-	-	-	-	-	-	8
Mbatha Mbithi	X	X	X	X	X	X	X	X	-	X	X	X	X	92
Joseph Kiarii	X	X	X	X	X	X	X	X	X	X	X	X	X	100
Kennedy Wanderi	X	X	X	-	X	X	-	-	X	X	X	X	X	77

\*Z. G. Mbugua resigned from the board on 28<sup>th</sup> April 2016.

### **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 of directors' performance is underway and is expected to be complete before 31 March 2017.

The directors submit their report together with the audited financial statements for the year ended 31 December 2016, which disclose the state of affairs of the Group and Company.

The annual report and financial statements have been prepared in accordance with Section 22 of the Banking Act and Sections 147 to 163 of the repealed Companies Act - Cap 486, which remain in force under the transition rules contained in the Sixth Schedule, the Transitional and Saving Provisions of the Companies Act 2015

**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 15.

**3. Dividend**

The directors do not recommend a dividend payment for the year ended 31 December 2016(2015: nil).

**4. Directors**

The directors who served during the year are set out on page 1.

**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 Group's and Bank'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.

PricewaterhouseCoopers, who were appointed by the Auditor-General, carried out the audit of the Bank's financial statements for the year ended 31 December 2016.

**7. Approval of financial statements**

The financial statements were approved at a meeting of the directors held on 9 March 2017.

**By order of the Board**



**Company Secretary**  
C.A. Otieno (Mrs)

**Date:**

The Kenyan Companies Act 2015 requires the directors to prepare financial statements for each financial year which give a true and fair view of the financial position of the Group and the Bank as at the end of the financial year and their financial performance for the year then ended. The directors are responsible for ensuring that the Group and the Bank keep proper accounting records that are sufficient to show and explain the transactions of the Group and the Bank; disclose with reasonable accuracy at any time the financial position of the Group and the Bank; and that enables them to prepare financial statements of the Group and the Bank that comply with prescribed financial reporting standards and the requirements of the Kenyan Companies Act 2015. They are also responsible for safeguarding the assets of the Group and the Bank and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

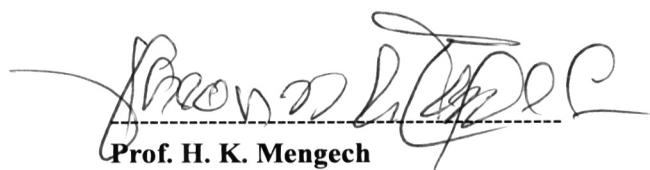
The directors accept responsibility for the preparation and presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act 2015. They also accept responsibility for:

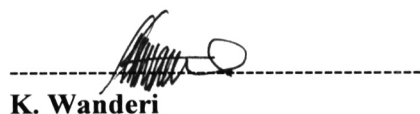
- i) Designing, implementing and maintaining internal control as they determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;
- ii) Selecting suitable accounting policies and then apply them consistently; and
- iii) Making judgements and accounting estimates that are reasonable in the circumstances

In preparing the financial statements, the directors have assessed the Bank's ability to continue as a going concern and disclosed, as applicable, matters relating to the use of going concern basis of preparation of the financial statements. Nothing has come to the attention of the directors to indicate that the Group will not remain a going concern for at least the next twelve months from the date of this statement.

The directors acknowledge that the independent audit of the financial statements does not relieve them of their responsibility.

Approved by the board of directors on 9<sup>th</sup> March 2017 and signed on its behalf by:

  
Prof. H. K. Mengech

  
K. Wanderi

# REPUBLIC OF KENYA

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Fax: +254-20-311482  
E-mail: oag@oagkenya.go.ke  
Website: www.kenao.go.ke



P.O. Box 30084-00100  
NAIROBI

## OFFICE OF THE AUDITOR-GENERAL

### REPORT OF THE AUDITOR-GENERAL ON DEVELOPMENT BANK OF KENYA LIMITED FOR THE YEAR ENDED 31 DECEMBER 2016

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#### REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

#### Opinion

The accompanying financial statements of Development Bank of Kenya Limited set out on pages 15 to 72, which comprise the consolidated and company statement of financial position at 31 December 2016 and the consolidated and company statements of comprehensive income, consolidated and company statements 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 M/S Pricewaterhouse coopers, Kenya auditors appointed under Section 23 of the Public Audit Act, 2015 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all information and explanations which to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, the consolidated and company's financial statements present fairly, in all material respects the financial position of Development Bank of Kenya as at 31 December 2016, and of its consolidated company's financial performance and its consolidated and company's cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Kenyan Companies Act, 2015.

#### Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). My responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated and Separate Financial Statements section of my report. I am independent of the Group and the Bank in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with ISSAI and in accordance with other ethical requirements applicable to performing of financial audits in Kenya.

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

#### Material Uncertainty Relating to Going Concern

I draw attention to Note 2(a) to the financial statements which describes the Director's application of going concern assumption in preparing the financial statements.

During the year, the group reported a significant decrease in profitability of Kshs.61,715,000 down from Kshs.121,620,000 in the year 2015. The group reported a net

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*Report of the Auditor-General on the Financial Statements of Development Bank of Kenya Limited for the year ended 31 December 2016*

current liability position of Kshs.1,917,157,000 determined after comparing the current assets of Kshs.6,290,339,000 and current liabilities of Kshs.8,207,496,000. The bank experienced a decrease in customer deposits from Kshs.9,652,794,000 as at 31 December 2015 to Kshs.5,768,453 as at 31 December 2016. Central Bank of Kenya has advanced the bank Kshs.4,243,454,000 to meet its obligations guaranteed on the bank's investment in government securities maturing after one year of Kshs.4,733,802,000. Since the group is having challenges meeting its short-term obligations as and when they fall due, long term measures to raise capital which include a rights issue and the sale of Finance House are being pursued by management and directors believe the measures will realize adequate capital to meet its short term obligations. My opinion is not qualified in respect of this matter.

### **Key Audit Matter**

Except for the matter described in the Material Uncertainty Related to Going Concern Section, I have determined that there are no other key audit matters to communicate in my report.

### **Director's Responsibility for the Financial Statements**

The Directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act 2015, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Those charged with governance are responsible for overseeing the Group's and Company's financial reporting process.

The Directors are also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 of the Public Audit Act, 2015.

### **Auditor-General's Responsibilities for the Audit of the Financial Statements**

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution of Kenya. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are

considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISSAIs, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:-

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

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

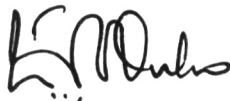
I also provide Directors with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

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

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Kenyan Companies Act, 2015 I report based on the audit, that:-

- I have obtained all the information and explanations which to the best of my knowledge and belief were necessary for the purposes of my audit;
- In my opinion adequate accounting records have been kept by the Group and Company, so far as appears from my examination of those books; and
- The Group and Company's financial statements are in agreement with the accounting records.



**FCPA Edward R. O. Ouko, CBS**  
**AUDITOR-GENERAL**

**Nairobi**

**03 May 2017**

**Consolidated statement of comprehensive income**

	Note	2016 KShs'000	2015 KShs'000
Interest income	5	1,907,433	1,902,489
Interest expense	6	<u>(1,265,375)</u>	<u>(1,358,092)</u>
<b>Net interest income</b>		642,058	544,397
Other income	7	<u>123,572</u>	<u>88,271</u>
<b>Operating income</b>		765,630	632,668
Impairment losses on loans and advances	17	(281,257)	(127,146)
Operating expenses	8	<u>(386,618)</u>	<u>(325,054)</u>
<b>Profit before income tax</b>	10	97,755	180,468
Income tax expense	11	<u>(36,040)</u>	<u>(58,848)</u>
<b>Profit for the year</b>		61,715	121,620
Other comprehensive income net of tax	18	<u>-</u>	<u>-</u>
<b>Total comprehensive income</b>		<u><u>61,715</u></u>	<u><u>121,620</u></u>
Earnings per share (KShs per share)	13	<u><u>1.88</u></u>	<u><u>2.33</u></u>
Dividends per share (KShs per share)	12	<u><u>-</u></u>	<u><u>-</u></u>

The notes set out on pages 21 to 72 form an integral part of these financial statements.

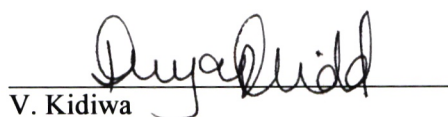
**Consolidated statement of financial position**

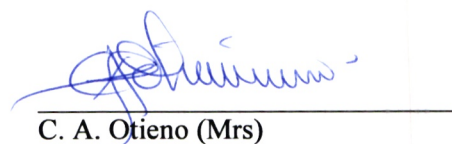
	Note	2016 KShs'000	2015 KShs'000
<b>ASSETS</b>			
Cash and balances with Central Bank of Kenya	14	373,204	698,633
Investment in government securities	15	5,128,119	5,137,455
Deposits and balances due from banking institutions	16	1,047,009	1,882,624
Net loans and advances to customers	17	8,733,212	8,043,938
Other assets	20	68,852	71,993
Equity investments	18	805,499	805,499
Tax recoverable		15,108	54,931
Deferred tax asset	21	7,374	2,613
Prepaid operating lease rentals	22	3,873	3,934
Property and equipment	23	229,185	240,932
<b>TOTAL ASSETS</b>		<b>16,411,435</b>	<b>16,942,552</b>
<b>LIABILITIES</b>			
Deposits from banks	24	1,992,483	2,037,893
Deposits from customers	25	5,768,453	9,652,794
Borrowings	26	5,472,728	2,132,846
Other liabilities	27	262,106	265,069
		13,495,770	14,088,602
<b>EQUITY</b>			
Share capital	28	1,042,500	1,042,500
Retained earnings		714,434	715,039
Statutory reserves		437,072	374,752
Other reserves		721,659	721,659
		2,915,665	2,853,950
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>16,411,435</b>	<b>16,942,552</b>

The financial statements set out on pages 15 to 72 were approved by the Board of Directors on 9<sup>th</sup> March 2017 and were signed on its behalf by:

  
 Prof. H. K. Mengech

  
 K. Wandari

  
 V. Kidiwa

  
 C. A. Otieno (Mrs)

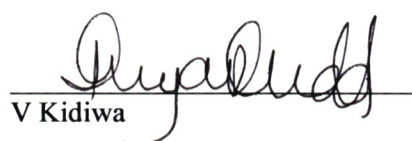
The notes set out on pages 21 to 72 form an integral part of these financial statements.

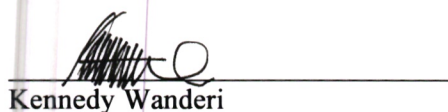
**Company statement of financial position**

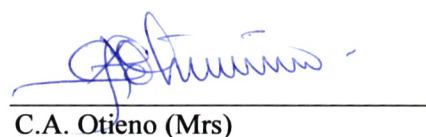
<b>ASSETS</b>	<b>Note</b>	<b>2016</b> <b>KShs'000</b>	<b>2015</b> <b>KShs'000</b>
Cash and balances with Central Bank of Kenya	14	373,204	698,633
Investment in government securities	15	5,107,015	5,110,306
Deposits and balances due from banking institutions	16	1,047,009	1,882,624
Net loans and advances to customers	17	8,733,212	8,043,938
Other assets	20	68,852	71,845
Equity investments	18	805,499	805,499
Investment in subsidiary	19	32,048	32,048
Tax recoverable		11,172	50,553
Deferred tax asset	21	7,313	2,402
Prepaid operating lease rentals	22	3,873	3,934
Property and equipment	23	229,185	240,932
<b>TOTAL ASSETS</b>		<b>16,418,382</b>	<b>16,942,714</b>
<b>LIABILITIES</b>			
Deposits and balances due to banking institutions	24	1,992,483	2,037,893
Customers' deposits	25	5,788,514	9,665,110
Borrowings	26	5,472,728	2,132,846
Other liabilities	27	261,313	263,245
		<b>13,515,038</b>	<b>14,099,094</b>
<b>EQUITY</b>			
Share capital	28	1,042,500	1,042,500
Retained earnings		702,113	704,709
Statutory reserves		437,072	374,752
Other reserves		721,659	721,659
		<b>2,903,344</b>	<b>2,843,620</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>16,418,382</b>	<b>16,942,714</b>

The financial statements set out on pages 15 to 72 were approved by the Board of Directors on 9<sup>th</sup> March 2017 and were signed on its behalf by:

  
 Prof. H Mengech

  
 V Kidiwa

  
 Kennedy Wanderi

  
 C.A. Otieno (Mrs)

The notes set out on pages 21 to 72 form an integral part of these financial statements.

**Consolidated statement of changes in equity**

	Share capital KShs'000	Statutory reserves KShs'000	Other reserves KShs'000	Retained earnings KShs'000	Proposed dividends KShs'000	Total KShs'000
<b>At 1 January 2015</b>	347,500	257,645	721,659	1,405,526	40,000	2,772,330
<b>Comprehensive income for the year</b>						
Profit for the year	-	-	-	121,620	-	121,620
Transfer to statutory reserves	-	117,107	-	(117,107)	-	-
Issue of bonus shares	695,000	-	-	(695,000)	-	-
<b>Total comprehensive income for the year</b>	695,000	117,107	-	(690,487)	-	121,620
<b>Transactions with owners</b>						
Dividends Paid	-	-	-	-	(40,000)	(40,000)
<b>Total transactions with owners</b>	-	-	-	-	(40,000)	(40,000)
<b>At 31 December 2015</b>	1,042,500	374,752	721,659	715,039	-	2,853,950
<b>At 1 January 2016</b>	1,042,500	374,752	721,659	715,039	-	2,853,950
<b>Comprehensive income for the year</b>						
Profit for the year	-	-	-	61,715	-	61,715
Transfer to statutory reserves	-	62,320	-	(62,320)	-	-
<b>Total comprehensive loss for the year</b>	-	62,320	-	(605)	-	61,715
<b>Transactions with owners</b>						
Dividends Paid	-	-	-	-	-	-
Proposed dividends	-	-	-	-	-	-
<b>Total transactions with owners</b>	-	-	-	-	-	-
<b>At 31 December 2016</b>	1,042,500	437,072	721,659	714,434	-	2,915,665

The notes set out on pages 21 to 72 form an integral part of these financial statements.

**Bank statement of changes in equity**

	Share capital KShs'000	Statutory reserves KShs'000	Other reserves KShs'000	Retained earnings KShs'000	Proposed dividends KShs'000	Total KShs'000
<b>At 1 January 2015</b>	347,500	257,645	721,659	1,396,797	40,000	2,763,601
<b>Comprehensive income for the year</b>						
Profit for the year	-	-	-	120,019	-	120,019
Transfer to statutory reserves	-	117,107	-	(117,107)	-	-
Transfer to share capital	695,000	-	-	(695,000)	-	-
<b>Total comprehensive income for the year</b>	695,000	117,107	-	(692,088)	-	120,019
<b>Transactions with owners</b>						
Dividend paid	-	-	-	-	(40,000)	(40,000)
Proposed dividends	-	-	-	-	-	-
<b>Total transactions with owners</b>	-	-	-	-	(40,000)	(40,000)
<b>At 31 December 2015</b>	1,042,500	374,752	721,659	704,709	-	2,843,620
<b>At 1 January 2016</b>	1,042,500	374,752	721,659	704,709	-	2,843,620
<b>Comprehensive income for the year</b>						
Profit for the year	-	-	-	59,724	-	59,724
Transfer to statutory reserves	-	62,320	-	(62,320)	-	-
<b>Total comprehensive income for the year</b>	-	62,320	-	(2,596)	-	59,724
<b>Transactions with owners</b>						
Dividend paid	-	-	-	-	-	-
Proposed dividends	-	-	-	-	-	-
<b>Total transactions with owners</b>	-	-	-	-	-	-
<b>At 31 December 2016</b>	1,042,500	437,072	721,659	702,113	-	2,903,344

The notes set out on pages 21 to 72 form an integral part of these financial statements.

**Consolidated statement of cash flows**

	Note	2016 KShs'000	2015 KShs'000
<b>Operating activities</b>			
Profit before taxation		97,755	180,468
Depreciation	23	19,704	21,229
Amortisation of prepaid operating lease rentals	22	61	61
Profit on disposal of property and equipment		(280)	(11)
Interest charged on loan capital		21,170	24,575
Tax paid		(978)	(117,130)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		137,432	109,192
<b>Changes in working capital items</b>			
(Increase)/decrease in net loans to customers		(689,274)	483,694
Decrease/ (Increase) in deposits held for regulatory purposes	14	203,427	(40,323)
Decrease in investments in treasury bonds		9,336	545,129
Decrease in other assets		3,141	7,524
(Decrease)/increase in customer's deposits		(3,884,341)	1,204,531
(Decrease)/increase in other liabilities		(2,963)	5,442
<b>Net cash (used in)/generated from operations</b>		(4,223,242)	2,315,189
<b>Cash flows from investing activities</b>			
Purchase of property and equipment	23	(7,966)	(111,115)
Proceeds from sale of property and equipment		289	81
<b>Net cash used in investing activities</b>		(7,677)	(111,034)
<b>Cash flows from financing activities</b>			
Interest paid on loan capital		(21,170)	(24,575)
Dividend paid		-	(40,000)
Loans received		4,243,454	-
Loans repaid		(903,572)	(485,201)
<b>Net cash generated from/(used in) financing activities</b>		3,318,712	(549,776)
Net (decrease)/increase in cash and cash equivalents		(912,207)	1,654,379
Opening cash and cash equivalents balances		76,013	(1,578,366)
<b>Closing cash and cash equivalents balances</b>		(836,194)	76,013

The notes set out on pages 21 to 72 form an integral part of these financial statements.

## Notes

### 1. General information

Development Bank of Kenya Limited (the “Bank” or 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.

The annual financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the requirements of the Kenyan 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.

On initial recognition, all transactions are recorded in the Functional Currency (the currency of the primary economic environment in which the Bank operates), which is the Kenya Shilling.

The consolidated financial statements are presented in thousands of Kenyan Shillings (KShs’000), the presentation currency of the Bank.

### 2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been applied consistently to all periods presented, unless otherwise stated.

#### (a) Going concern

The Group has reported a significant decrease in the profitability with profit for the year of KShs 61.7 million, down from KShs 121.6 million in 2015. The Group is also in a net current liability position of KShs 7.3 billion (2015: KShs 7.5 billion) as demonstrated by the maturity analysis for balances maturing within 1 to 12 months as presented under Note 4 (ii). The Group’s ratio of loans and advances to customer deposits has also increased significantly from 83% in 2015 to 151% in 2016.

With the implementation of the Banking (Amendment) Bill 2015 in September 2016, the net interest margins across the banking industry have been significantly impacted and it is expected that profitability will reduce going forward. This has impacted the Group results in the last quarter of 2016 and the impact will be felt into the foreseeable future. The Banking industry is also facing challenges with the increase in the level of non-performing loans and this too has impacted the Group as seen in the increase in the level of impairment provisions.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(a) Going concern (continued)**

The Group has further been significantly affected by the increase in the cost of funding attributed to the reduction in liquidity in the market and especially in the mid and lower tier Banks. This is evident from the decrease in customer deposits from KShs 9.7 billion as at 31 December 2015 to KShs 5.8 billion as at 31 December 2016. The Group is therefore currently reliant on CBK funding to be able to meet its current obligations. As at 31 December 2016, the borrowings from CBK comprised of short term borrowings payable within one month amounting to KShs 4.2 billion at an average interest rate of 10% p.a as disclosed in Note 26. These are renewable on an ongoing basis and are secured on the Group's portfolio of government securities of an equal amount.

The above factors are indicative of a decline in the Group's overall performance and the fact that the Group is having challenges with liquidity and may not be able to meet its obligations as and when they fall due. Management has put in place short term and long term measures to ensure that the Group continues to operate as a going concern. The borrowings from CBK are available to meet short term needs of the Group and are part of management's funding plans.

Long term measures currently being pursued by the Group include:

- Raising additional capital by issuing additional shares in form of a rights issue to existing shareholders and by private placement to potential investors. This is expected to raise in excess of KShs 3 billion;
- Disposal of Finance House owned by the Bank. This is expected to raise in excess of KShs 1 billion; and
- Ongoing mobilization of deposits to increase the Bank's funding and focus to increase the Group lending and effectively increase the net interest margin and profitability going forward.

Further details on the additional capital and disposal of Finance House have been disclosed in Note 35 on subsequent events.

Subsequent to the year end and in line with the provisions of the Banking Act, the Group obtained its 'licence to conduct banking business' from CBK in February 2017.

Based on the above measures and factors, the directors believe that it is appropriate for the financial statements to be prepared on a going concern basis.

**(b) Basis of preparation**

The consolidated financial statements have been prepared in accordance with IFRS and interpretations issued by the IFRS Interpretations Committee (IFRS IC) applicable to companies reporting under IFRS.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of land and buildings, available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 3.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(b) Basis of preparation (continued)**

**Changes in accounting policies and disclosures**

*New standards, amendments and interpretations adopted by the Group*

A number of amendments to standards arising from the annual improvement to IFRSs became effective for the first time in the financial year commencing 1 January 2016 and have been adopted by the group. None of them has had an effect on the group financial statements.

*New and revised standards and interpretations not yet adopted by the Group*

A number of new standards and interpretations have been published that are not mandatory for annual periods commencing 1 January 2016 and have not been early adopted by the group. The group's assessment of the impact of these new standards and interpretations is as follows:

- IFRS 9, '*Financial instruments*', addresses the classification, measurement and recognition of financial assets and financial liabilities and introduces new rules for hedge accounting. The complete version of IFRS 9 was issued in July 2015. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurements model and establishes three primary measurement categories for financial assets: amortised cost, fair value through other comprehensive income (OCI) and fair value through profit or loss. The basis of classification depends on the entity's model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to changes in fair value in OCI without recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there are no changes to the classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The group is yet to assess the full impact of IFRS 9.
- IFRS 15, '*Revenue from contracts with customers*', which replaces IAS 11, IAS 18 and their interpretations (SIC 13 and IFRIC 13, 15, and 18). It establishes a single and comprehensive framework for revenue recognition to apply consistently across transactions, industries and markets. It is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing concept of risks and rewards. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The new standard is effective for annual periods beginning on or after 1 January 2018. The group is currently assessing the impact of the amendment on its financial statements.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**Changes in accounting policies and disclosures (continued)**

*New and revised standards and interpretations not yet adopted by the Group (continued)*

- IFRS 16, 'Leases', will replace the current IAS 17 standard on leases. The new standard requires that for lessees all leases, regardless of whether they are operating or financial in nature, will be on balance sheet and accounted for as "financial leases". IFRS 16 will significantly change the way lessees account for leases, however lessor accounting remains largely the same and the classification as a finance lease or operating lease is still a consideration. This means that straight-lining of operating leases will remain for lessors. The effective date is 1 January 2019.

**(c) 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.

**(d) Foreign currency translation**

**(i) Functional and Presentation currency**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which entity operates ('the Functional Currency'). The consolidated financial statements presented in Kenya shillings, which is the Group's presentation currency. All financial information presented in these consolidated financial statements has been rounded off to the nearest thousand Kenya shillings.

**(ii) Transactions and balances**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within "finance income or costs". All other foreign exchange gains and losses are presented in the statement of profit or loss for the year within "other gains/losses-net".

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in other comprehensive income.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(e) Revenue recognition**

Income is recognised on an accrual basis.

**i. Interest**

Interest income and expense are recognised in the profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. 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.

**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 once the right to receive the dividends has been established.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(f) Financial assets**

**(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.

**(ii) Recognition and measurement**

Regular purchases and sales of financial assets are recognised on the trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the ‘financial assets at fair value through profit or loss’ category are presented in the income statement within ‘Other (losses)/gains – net’ in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the income statement as part of other income when the Group’s right to receive payments is established.

Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in other comprehensive income.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(f) Financial assets (continued)**

**(ii) Recognition and measurement (continued)**

When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as 'Gains and losses from investment securities'.

Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement as part of finance income. Dividends on available-for-sale equity instruments are recognised in the income statement as part of other income when the Group's right to receive payments is established.

**(g) Impairment of financial assets**

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indicator that the assets are impaired.

*i) Assets carried at amortised cost*

For loans and receivables, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in profit or loss. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's rating) the reversal of the previously recognized impairment loss is recognized in profit or loss.

*ii) Assets classified as available-for-sale*

If there is objective evidence of impairment for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in profit or loss.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(g) Impairment of financial assets (continued)**

*ii) Assets classified as available-for-sale (continued)*

Impairment losses on equity instruments that were recognised in profit or loss are not reversed through profit or loss in a subsequent period. If the fair value of a debt instrument classified as available-for-sale increases in a subsequent period and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

**(h) Impairment of assets**

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying value exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

**(i) Leases**

**i) The Bank is the lessee**

*Operating lease*

Leases in which a significant portion of the risks and rewards of ownership are retained by another party, the lessor, are classified as operating leases. Payments, including pre-payments, made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

The total payments made under operating leases are charged to infrastructure costs on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

*Finance lease*

Lease of assets where the Bank has substantially all the risks and rewards of ownership are classified as finance leases. These are capitalised at lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding.

The corresponding rental obligations, net of finance charges, are included in deposits from banks or deposits from customers depending on the counter party. The interest element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The leases entered into by the Bank are primarily operating leases.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(i) Leases (continued)**

ii) The Bank is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return.

**(j) Property and equipment**

All property and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of any component accounted for as a separate asset is derecognised when replaced. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, 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 the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'Other (losses)/gains – net' in the income statement.

**(k) Taxation**

**(i) Current income tax**

The tax expense for the period comprises current and deferred income tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity respectively.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(k) Taxation (continued)**

**(i) Current income tax (continued)**

The current income tax charge is calculated on the basis of tax laws enacted or substantively enacted at the reporting date. The directors periodically evaluate positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. They establish provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

**(ii) Deferred income tax**

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same entity or different taxable entities where there is an intention to settle the balances on a net basis.

**(l) 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.

**Notes (continued)**

**2. Summary of significant accounting policies (continued)**

**(m) 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.

**(n) 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.

**(o) 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.

**(p) Contingent liabilities**

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

**(q) 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.

**3. Critical accounting estimates and judgements**

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

**(a) 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.

**Notes (continued)**

**3. Critical accounting estimates and judgements**

**(a) Allowances for credit losses (continued)**

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

**(b) 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.

**(c) 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.

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 2 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.

**Notes (continued)**

**3. Critical accounting estimates and judgements**

**(c) Fair value of financial instruments (continued)**

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.

**4. Financial risk management**

**Introduction and overview**

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

- Credit risk;
- Liquidity risk; and
- Market risks, comprising of interest rate risk, currency risk and price risk

**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.

**(i) 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.

**Notes (continued)**

**4. Financial risk management (continued)**

**(i) Credit risk (continued)**

**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 grading 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.

Notes (continued)

4. Financial risk management (continued)

(i) Credit risk (continued)

Exposure to credit risk

Loans and advances to customers

	2016		2015	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
<b>Individually assessed</b>				
Grade 3: Substandard	120,948	120,948	20,447	20,447
Grade 4: Doubtful	2,473,513	2,473,513	1,849,384	1,849,384
Grade 5: Loss	55,503	-	55,748	-
	2,649,964	2,594,461	1,925,579	1,869,831
Allowances for impairment	(997,091)	(941,588)	(743,175)	(687,427)
<b>Carrying amounts</b>	<b>1,652,873</b>	<b>1,652,873</b>	<b>1,182,404</b>	<b>1,182,404</b>
<b>Collectively assessed</b>				
Grade 1: Normal	4,631,002	4,631,002	5,766,687	5,766,687
Grade 2: Watch	2,542,668	2,542,668	1,175,763	1,175,763
	7,173,670	7,173,670	6,942,450	6,942,450
Allowances for impairment	(93,331)	(93,331)	(80,916)	(80,916)
<b>Carrying amounts</b>	<b>7,080,339</b>	<b>7,080,339</b>	<b>6,861,534</b>	<b>6,861,534</b>
<b>Past due and not impaired</b>				
Grade 1: Normal	327,432	327,432	1,331,700	1,331,700
Grade 2: Watch	1,216,371	1,216,371	1,122,284	1,122,284
	1,543,803	1,543,803	2,453,984	2,453,984
<b>Past due and not impaired comprises</b>				
1-30 Days	327,432	327,432	1,331,700	1,331,700
31-60 Days	1,216,371	1,216,371	1,122,284	1,122,284
	1,543,803	1,543,803	2,453,984	2,453,984
<b>Neither past due nor impaired</b>				
Grade 1: Normal	4,303,570	4,303,570	4,434,987	4,434,987
Grade 2: Watch	1,326,297	1,326,297	53,479	53,479
	5,629,867	5,629,867	4,488,466	4,488,466

**Notes (continued)**

**4. Financial risk management (continued)**

**(i) 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 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.

**Notes (continued)**

**4. Financial risk management (continued)**

**(i) Credit risk (continued)**

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

	<b>Gross KShs'000</b>	<b>Net KShs'000</b>
<b>31 December 2016</b>		
Grade 3: Individually Impaired	120,948	97,495
Grade 4: Individually Impaired	2,473,513	1,555,376
Grade 5: Individually Impaired	55,503	-
	<u>2,649,964</u>	<u>1,652,871</u>
<b>31 December 2015</b>		
Grade 3: Individually Impaired	20,447	-
Grade 4: Individually Impaired	1,849,384	1,182,404
Grade 5: Individually Impaired	55,748	-
	<u>1,925,579</u>	<u>1,182,404</u>

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 2016 or 2015.

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

	<b>2016 KShs'000</b>	<b>2015 KShs'000</b>
<b>Loans and advances to customers</b>		
<b>Against individually impaired</b>		
Property	<u>1,239,220</u>	<u>978,121</u>
<b>Against collectively impaired</b>		
Property	12,025,916	12,678,374
Debt securities	2,289,492	2,126,795
Equities	54,856	3,200
Others	<u>1,907,106</u>	<u>2,151,680</u>

**Notes (continued)**

**4. Financial risk management (continued)**

**(i) Credit risk (continued)**

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
<b>Against past due but not impaired</b>		
Property	1,581,464	3,395,200
Debt securities	576,334	-
Equities	18,200	-
Others	644,393	494,611
	<u>                    </u>	<u>                    </u>
<b>Against neither past due nor impaired</b>		
Property	10,444,452	9,283,174
Debt securities	1,713,158	2,126,795
Equities	36,656	3,200
Others	1,262,713	1,657,069
	<u>                    </u>	<u>                    </u>

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

<b>Concentration by Sector</b>	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Agriculture	717,589	797,451
Manufacturing	1,475,612	1,223,143
Building and construction	264,155	256,055
Trade	2,813,139	1,885,905
Tourism, restaurants, and hotels	358,519	325,449
Transport and communication	377,788	316,383
Real estate	3,043,426	2,997,226
Financial services	22,414	-
Personal households	750,992	1,066,417
	<u>                    </u>	<u>                    </u>
	<u>9,823,634</u>	<u>8,868,029</u>

**Notes (continued)**

**4. Financial risk management (continued)**

**(ii) 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:

	<b>2016</b>	<b>2015</b>
Average for the period	20.4%	37.9%
Maximum for the period	42.4%	46.3%
Minimum for the period	1.7%	25.6%

**Notes (continued)**

**4. Financial risk management (continued)**

**(ii) Liquidity risk (continued)**

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:

**Residual contractual maturities of financial assets and financial liabilities for 2016**

<b>Group</b>	<b>0 to 1 month KShs'000</b>	<b>1 to 3 months KShs'000</b>	<b>3 to 12 months KShs'000</b>	<b>1 to 5 years KShs'000</b>	<b>Over 5 years KShs'000</b>	<b>Total KShs'000</b>
<b>Assets</b>						
Cash and balances with Central Bank of Kenya	109,555	-	-	-	263,924	373,204
Investment in government securities	-	-	304,891	779,249	4,043,979	5,128,119
Due from other banks	99,554	947,455	-	-	-	1,047,009
Net loans and advances to customers	825,664	1,422,141	1,481,406	1,468,650	3,535,351	8,733,212
Equity investments	-	-	-	-	805,499	805,499
Other assets	25,197	4,396	4,396	4,396	10,715	49,100
<b>Total assets</b>	<b>1,070,970</b>	<b>2,373,992</b>	<b>1,790,693</b>	<b>2,252,295</b>	<b>8,648,193</b>	<b>16,136,143</b>
<b>Liabilities</b>						
Due to banking institutions	-	1,099,179	893,304	-	-	1,992,483
Due to EIB	-	-	-	-	21,163	21,163
Customers' deposits	343,776	2,481,731	2,936,276	6,670	-	5,768,453
Borrowings	-	4,469,530	220,484	476,259	306,455	5,472,728
Other liabilities	3,476	3,476	39,545	3,476	212,133	262,106
<b>Total liabilities</b>	<b>347,252</b>	<b>8,053,916</b>	<b>4,089,609</b>	<b>486,405</b>	<b>539,751</b>	<b>13,516,933</b>
<b>Net liquidity position</b>	<b>723,718</b>	<b>(5,679,924)</b>	<b>(2,298,916)</b>	<b>1,765,890</b>	<b>8,108,442</b>	<b>2,619,210</b>

Notes (continued)

4. Financial risk management (continued)

(ii) Liquidity risk (continued)

Residual contractual maturities of assets and liabilities for 2015

Group

	0 to 1 month KShs'000	1 to 3 months KShs'000	3 to 12 months KShs'000	1 to 5 years KShs'000	Over 5 years KShs'000	Total KShs'000
<b>Assets</b>						
Cash and balances with Central Bank of Kenya	231,282	-	-	-	467,351	698,633
Investment in government securities	-	-	6,029	1,103,707	4,027,719	5,137,455
Due from other banks	1,474,019	380,068	-	28,537	-	1,882,624
Net loans and advances to customers	1,431,835	465,151	1,088,606	1,050,811	4,007,535	8,043,938
Equity investments	-	-	-	-	805,499	805,499
Other assets	24,548	3,884	3,884	3,884	3,884	40,083
<b>Total assets</b>	<b>3,161,684</b>	<b>849,103</b>	<b>1,098,519</b>	<b>2,186,939</b>	<b>9,311,988</b>	<b>16,608,232</b>
<b>Liabilities</b>						
Due to banking institutions	380,283	429,623	1,227,987	-	-	2,037,893
Due to EIB	-	-	-	-	21,163	21,163
Customers' deposits	565,195	8,474,309	593,748	19,542	-	9,652,794
Borrowings	324,221	116,506	470,297	915,924	284,735	2,111,683
Other liabilities	3,768	3,768	45,749	3,768	208,016	265,069
<b>Total liabilities</b>	<b>1,273,467</b>	<b>9,024,206</b>	<b>2,337,781</b>	<b>939,234</b>	<b>513,914</b>	<b>14,088,602</b>
<b>Net liquidity position</b>	<b>1,888,217</b>	<b>(8,175,103)</b>	<b>(1,239,262)</b>	<b>1,247,705</b>	<b>8,798,074</b>	<b>2,519,630</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(ii) Liquidity risk (continued)**

**Residual contractual maturities of financial assets and financial liabilities for 2016**

<b>Bank</b>	<b>0 to 1 month KShs'000</b>	<b>1 to 3 months KShs'000</b>	<b>3 to 12 months KShs'000</b>	<b>1 to 5 years KShs'000</b>	<b>Over 5 years KShs'000</b>	<b>Total KShs'000</b>
<b>Assets</b>						
Cash and balances with Central Bank of Kenya	109,555	-	-	-	263,924	373,204
Investment in government securities	-	-	304,891	779,249	4,022,875	5,107,015
Due from other banks	99,554	947,455	-	-	-	1,047,009
Net loans and advances to customers	825,664	1,422,141	1,481,406	1,468,650	3,535,351	8,733,212
Equity investments	-	-	-	-	805,499	805,499
Other assets	25,197	4,396	4,396	4,396	10,715	49,100
<b>Total assets</b>	<b>1,070,970</b>	<b>2,373,992</b>	<b>1,790,693</b>	<b>2,252,295</b>	<b>8,627,089</b>	<b>16,115,039</b>
<b>Liabilities</b>						
Due to banking institutions	-	1,099,179	893,304	-	-	1,992,483
Due to EIB	-	-	-	-	21,163	21,163
Customers' deposits	343,776	2,501,792	2,936,276	6,670	-	5,788,514
Borrowings	-	4,469,530	220,484	476,259	306,455	5,472,728
Other liabilities	3,542	3,542	38,489	3,542	212,198	261,313
<b>Total liabilities</b>	<b>347,318</b>	<b>8,074,043</b>	<b>4,088,553</b>	<b>486,471</b>	<b>539,816</b>	<b>13,536,201</b>
<b>Net liquidity position</b>	<b>723,652</b>	<b>(5,700,051)</b>	<b>(2,297,860)</b>	<b>1,765,824</b>	<b>8,087,273</b>	<b>2,578,838</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(ii) Liquidity risk (continued)**

**Residual contractual maturities of assets and liabilities for 2015**

**Bank**

	<b>0 to 1 month</b> KShs'000	<b>1 to 3 months</b> KShs'000	<b>3 to 12 months</b> KShs'000	<b>1 to 5 years</b> KShs'000	<b>Over 5 years</b> KShs'000	<b>Total</b> KShs'000
<b>Assets</b>						
Cash and balances with Central Bank of Kenya	231,282	-	-	-	467,351	698,633
Investment in government securities	-	-	-	1,103,707	4,006,599	5,110,306
Due from other banks	1,474,019	380,068	-	28,537	-	1,882,624
Net loans and advances to customers	1,431,835	465,151	1,088,606	1,050,811	4,007,535	8,043,938
Equity investments	-	-	-	-	805,499	805,499
Other assets	24,515	3,858	3,854	3,854	3,854	39,935
<b>Total assets</b>	<b>3,161,651</b>	<b>849,077</b>	<b>1,092,460</b>	<b>2,186,909</b>	<b>9,290,838</b>	<b>16,580,935</b>
<b>Liabilities</b>						
Due to banking institutions	380,283	429,623	1,227,987	-	-	2,037,893
Due to EIB	-	-	-	-	21,163	21,163
Customers' deposits	565,195	8,486,625	593,748	19,542	-	9,665,110
Borrowings	324,221	116,506	470,297	915,924	284,735	2,111,683
Other liabilities	3,834	3,834	43,662	3,834	208,081	263,245
<b>Total liabilities</b>	<b>1,273,533</b>	<b>9,036,588</b>	<b>2,335,694</b>	<b>939,300</b>	<b>513,979</b>	<b>14,099,094</b>
<b>Net liquidity position</b>	<b>1,888,118</b>	<b>(8,187,511)</b>	<b>(1,243,234)</b>	<b>1,247,609</b>	<b>8,776,859</b>	<b>2,481,841</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(iii) Market risk**

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.

**(a) 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:

<b>Yield Curve Parallel Shift</b>	<b>2016</b> <b>KShs '000</b>	<b>2015</b> <b>KShs '000</b>
100 Basis points upward parallel shift	(6,083)	(6,316)
50 Basis points upward parallel shift	(3,110)	(3,234)
25 Basis points upward parallel shift	(1,573)	(1,634)
100 Basis points downward parallel shift	1,609	1,677
50 Basis points downward parallel shift	3,256	3,395
25 Basis points downward parallel shift	6,666	6,960

Notes (continued)

4. Financial risk management (continued)

(iii) Market risk (continued)

(a) 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 2016 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Group

	Effective interest rate	0 to 3 months KShs'000	3 to 12 months KShs'000	1 to 5 years KShs'000	Over 5 years KShs'000	Non- interest bearing KShs'000	Total KShs'000
<b>Assets</b>							
Cash and balances with Central Bank of Kenya		-	-	-	-	373,204	373,204
Investments in government securities	11.53	-	-	1,084,140	4,043,979	-	5,128,119
Due from banking institutions	1.40	911,054	-	-	-	135,955	1,047,009
Net loans and advances to customers	12.47	2,247,805	1,481,406	1,468,650	3,548,002	-	8,745,863
Other assets		-	-	-	-	49,100	49,100
<b>Total assets</b>		<b>3,158,859</b>	<b>1,481,406</b>	<b>2,552,790</b>	<b>7,591,981</b>	<b>558,259</b>	<b>15,343,295</b>
<b>Liabilities</b>							
Due to banking institutions	1.90	1,159,642	832,841	-	-	-	1,992,483
Customers' deposits	8.20	4,174,615	1,591,166	2,672	-	-	5,768,453
Borrowings	8.51	4,469,530	220,484	476,259	306,455	-	5,472,728
Other liabilities		-	-	-	-	262,106	262,106
<b>Total liabilities</b>		<b>9,803,787</b>	<b>2,644,491</b>	<b>478,931</b>	<b>306,455</b>	<b>262,106</b>	<b>13,495,770</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(iii) Market risk (continued)**

**(a) 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 2015 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

**Group**

	<b>Effective interest rate</b>	<b>0 to 3 months KShs'000</b>	<b>3 to 12 months KShs'000</b>	<b>1 to 5 years KShs'000</b>	<b>Over 5 years KShs'000</b>	<b>Non-interest bearing KShs'000</b>	<b>Total KShs'000</b>
<b>Assets</b>							
Cash and balances with Central Bank of Kenya		-	-	-	-	698,633	698,633
Investments in government securities	11.53	-	6,029	1,103,707	4,027,719	-	5,137,455
Due from banking institutions	5.62	1,729,271	-	28,537	-	124,816	1,882,624
Net loans and advances to customers	16.30	1,896,986	1,088,606	1,050,811	4,007,535	-	8,043,938
Other assets		-	-	-	-	40,083	40,083
<b>Total assets</b>		<b>3,626,257</b>	<b>1,094,635</b>	<b>2,183,055</b>	<b>8,035,254</b>	<b>863,532</b>	<b>15,802,733</b>
<b>Liabilities</b>							
Due to banking institutions	2.01	809,906	1,227,987	-	-	-	2,037,893
Customers' deposits	15.28	9,039,504	593,748	19,542	-	-	9,652,794
Borrowings	6.52	440,727	470,297	915,924	305,898	-	2,132,846
Other liabilities		-	-	-	-	265,069	265,069
<b>Total liabilities</b>		<b>10,290,137</b>	<b>2,292,032</b>	<b>935,466</b>	<b>305,898</b>	<b>265,069</b>	<b>13,254,827</b>

Notes (continued)

4. Financial risk management (continued)

(iii) Market risk (continued)

(a) 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 2016 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Bank

	Effective interest rate	0 to 3 months KShs'000	3 to 12 months KShs'000	1 to 5 years KShs'000	Over 5 years KShs'000	Non-interest bearing KShs'000	Total KShs'000
<b>Assets</b>							
Cash and balances with Central Bank of Kenya		-	-	-	-	373,204	373,204
Investments in government securities	11.53	-	-	1,084,140	4,022,875	-	5,107,015
Due from banking institutions	1.40	911,054	-	-	-	135,955	1,047,009
Net loans and advances to customers	12.47	2,247,805	1,481,406	1,468,650	3,548,002	-	8,745,863
Other assets		-	-	-	-	49,100	49,100
<b>Total assets</b>		<b>3,158,859</b>	<b>1,481,406</b>	<b>2,552,790</b>	<b>7,570,877</b>	<b>558,259</b>	<b>15,322,191</b>
<b>Liabilities</b>							
Due to banking institutions	1.90	1,159,642	832,841	-	-	-	1,992,483
Customers' deposits	8.20	4,194,676	1,591,166	2,672	-	-	5,788,514
Borrowings	8.51	4,469,530	220,484	476,259	306,455	-	5,472,728
Other liabilities		-	-	-	-	262,106	262,106
<b>Total liabilities</b>		<b>9,823,848</b>	<b>2,644,491</b>	<b>478,931</b>	<b>306,455</b>	<b>262,106</b>	<b>13,515,831</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(iv) Market risk (continued)**

**(a) 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 2015 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

**Bank**

	Effective interest rate	0 to 3 months KShs'000	3 to 12 months KShs'000	1 to 5 years KShs'000	Over 5 years KShs'000	Non-interest bearing KShs'000	Total KShs'000
<b>Assets</b>							
Cash and balances with Central Bank of Kenya		-	-	-	-	698,633	698,633
Investments in Government securities	11.53	-	-	1,103,707	4,006,599	-	5,110,306
Due from banking institutions	5.62	1,729,271	-	28,537	-	124,816	1,882,624
Net loans and advances to customers	16.30	1,896,986	1,088,606	1,050,811	4,007,535	-	8,043,938
Other assets		-	-	-	-	40,083	40,083
<b>Total assets</b>		<b>3,626,257</b>	<b>1,088,606</b>	<b>2,183,055</b>	<b>8,014,134</b>	<b>863,532</b>	<b>15,775,584</b>
<b>Liabilities</b>							
Due to banking institutions	2.01	809,906	1,227,987	-	-	-	2,037,893
Customers' deposits	15.28	9,051,820	593,748	19,542	-	-	9,665,110
Borrowings	6.52	440,727	470,297	915,924	305,898	-	2,132,846
Other liabilities		-	-	-	-	265,069	265,069
<b>Total liabilities</b>		<b>10,302,453</b>	<b>2,292,032</b>	<b>935,466</b>	<b>305,898</b>	<b>265,069</b>	<b>14,100,918</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(iii) Market risk (continued)**

**(b) 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 and the Bank are exposed at 31 December 2016:

<b>At 31 December 2016</b>	<b>USD KShs'000</b>	<b>GBP KShs'000</b>	<b>Euro KShs'000</b>	<b>Other KShs'000</b>	<b>Total KShs'000</b>
<b>Assets</b>					
Cash and balances with Central Bank of Kenya	43,885	2,718	3,103	-	49,706
Deposits and balances due from banking institutions	463,316	1,323	20,143	593	485,375
Net loans and advances to customers	823,087	-	656,063	-	1,479,150
Other assets	5,461	-	-	-	5,461
<b>Total foreign currency assets</b>	<b>1,335,749</b>	<b>4,041</b>	<b>679,309</b>	<b>593</b>	<b>2,019,692</b>
<b>Liabilities</b>					
Loan Capital	958,111	-	-	-	958,111
Deposits and balances due to banking institutions	381,901	5,402	679,433	-	1,066,736
<b>Total foreign currency liabilities</b>	<b>1,340,012</b>	<b>5,402</b>	<b>679,433</b>	<b>-</b>	<b>2,024,847</b>
<b>Foreign currency exposure at 31 December 2016</b>	<b>(4,263)</b>	<b>(1,361)</b>	<b>(124)</b>	<b>593</b>	<b>(5,155)</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(iii) Market risk (continued)**

**(j) Currency risk (continued)**

<b>At 31 December 2015</b>	<b>USD KShs'000</b>	<b>GBP KShs'000</b>	<b>Euro KShs'000</b>	<b>Other KShs'000</b>	<b>Total KShs'000</b>
<b>Assets</b>					
Cash and balances with Central Bank of Kenya	47,383	2,170	7,396	-	56,949
Deposits and balances due from banking institutions	456,541	1,072	47,241	30	504,884
Net loans and advances to customers	1,051,797	-	734,061	-	1,785,858
Other assets	5,450	-	-	-	5,450
<b>Total foreign currency assets</b>	<b>1,561,171</b>	<b>3,242</b>	<b>788,698</b>	<b>30</b>	<b>2,353,141</b>
<b>Liabilities</b>					
Loan Capital	1,145,575	-	-	-	1,145,575
Deposits and balances due to banking institutions	429,012	2,804	784,876	-	1,216,692
<b>Total foreign currency liabilities</b>	<b>1,574,587</b>	<b>2,804</b>	<b>784,876</b>	<b>-</b>	<b>2,362,267</b>
<b>Foreign currency exposure at 31 December 2015</b>	<b>(13,416)</b>	<b>438</b>	<b>3,822</b>	<b>30</b>	<b>(9,126)</b>

**Notes (continued)**

**4. Financial risk management (continued)**

**(iv) Capital management**

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.
- 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:

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
<b>Core capital (Tier 1)</b>		
Paid up share capital	1,042,500	1,042,500
Retained earnings less deferred income tax	702,112	702,306
Other Reserves	281	281
	<hr/>	<hr/>
<b>Core capital</b>	<b>1,744,893</b>	<b>1,745,087</b>
Minimum statutory capital	1,000,000	1,000,000
	<hr/>	<hr/>
<b>Excess capital</b>	<b>744,893</b>	<b>745,087</b>
Supplementary capital (Tier 2)	280,935	272,764
	<hr/>	<hr/>
<b>Total capital</b>	<b>2,025,828</b>	<b>2,017,851</b>
	<hr/>	<hr/>
<b>Total risk weighted assets</b>	<b>7,675,088</b>	<b>6,780,387</b>
	<hr/>	<hr/>

**Notes (continued)**

**4. Financial risk management (continued)**

**(v) Capital management (continued)**

**Capital adequacy ratios**

	<b>2016</b>	<b>2015</b>
Percentage of Core Capital to Risk Weighted Asset ratio	21.60%	23.60%
Minimum requirement	10.0%	10.0%
Percentage of Total Capital to Risk Weighted Asset	25.10%	27.30%
Minimum requirement	14.50%	14.50%
Percentage of Core Capital to Deposits ratio	26.20%	14.90%
Minimum requirement	10.50%	10.50%

**Notes (continued)**

**4. Financial risk management (continued)**

**(vi) Fair value measurement**

**Fair value hierarchy**

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1 – fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – fair value measurements are derived from inputs other than quoted prices included in Level 1 that are observable for the assets or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 – fair values measurements are derived from valuation techniques that include inputs for assets or liabilities that are not based on observable market data (unobservable inputs).

<b>As at 31 December 2016</b>	<b>Level 1 KShs'000</b>	<b>Level 2 KShs'000</b>	<b>Level 3 KShs'000</b>	<b>Total KShs'000</b>
<b>Assets</b>				
Fair value through profit or loss - Held for trading government securities	-	89,427	-	89,427
Available for sale equity investments	-	-	805,499	805,499
<b>Total assets</b>	-	89,427	805,499	894,926

Notes (continued)

4. Financial risk management (continued)

(vi) Fair value measurement (continued)

Fair value hierarchy (continued)

As at 31 December 2015	Level 1 KShs'000	Level 2 KShs'000	Level 3 KShs'000	Total KShs'000
<b>Assets</b>				
Fair value through profit or loss - Held for trading government securities	-	90,065	-	90,065
Available for sale equity investments	-	-	805,499	805,499
<b>Total assets</b>	-	90,065	805,499	895,564

**Financial instruments in level 2**

The fair value of these financial assets is determined by using valuation techniques which maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. Specifically, the directors have used the discounted cash flow technique using quoted yields for the same or similar products.

**Financial instruments in level 3**

A reconciliation of the movements in financial assets under level 3 has been included under note 18.

**Notes (continued)**

**5. Interest income**

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Loans and advances to customers	614,097	807,066
Overdrafts	691,111	407,939
Treasury bonds	572,069	642,620
Deposits and balances due from banking institutions	30,166	44,864
	<u>1,907,443</u>	<u>1,902,489</u>

Included within various captions under interest income for the year ended 31 December 2016 is a total of KShs 155,165,000 (2015: KShs92,308,000) accrued on impaired financial assets.

Included within interest income on investment securities for the year ended 31 December 2016 is KShs 560,808,581(2015: KShs 640,175,715) relating to debt securities held-to-maturity.

**6. Interest expense**

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Customer deposits	910,726	1,149,548
Deposits and balances due to banking institutions	270,015	183,969
Borrowings	84,634	24,575
	<u>1,265,375</u>	<u>1,358,092</u>

**7. Other income**

Fee and commission income	35,922	36,190
Loss on disposal of government securities	-	(13,362)
Gains arising from dealing in foreign currencies	25,825	19,132
Rental income (net of provisions)	50,838	46,049
Other income	10,987	262
	<u>123,572</u>	<u>88,271</u>

**Notes (continued)**

**8. Operating expenses**

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Salaries and employee benefits (Note 9)	203,210	179,084
Occupancy expenses	61,064	32,357
Deposit Protection Fund	17,208	16,214
Depreciation	19,704	21,229
Amortisation of prepaid operating lease rentals	61	61
Directors' emoluments	11,506	12,264
Professional and legal services	15,640	11,615
Telecommunication	4,793	3,056
Other expenses	53,232	49,174
	<u>386,418</u>	<u>325,054</u>

**9. Salaries and employee benefits**

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Salaries	160,119	142,746
Contributions to defined contribution plans	19,198	16,519
National Social Security Fund	903	834
Other staff costs	22,990	18,985
	<u>203,210</u>	<u>179,084</u>

**10. Profit before taxation**

Profit before taxation is arrived at after charging:

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Depreciation expense (Note 23)	19,704	21,229
Amortisation of prepaid operating lease rentals (Note 22)	61	61
Director's emoluments		
– Fees as non-executive	1,400	1,400
– Other*	10,106	10,864
Auditors' remuneration– Current year	2,350	2,350
	<u>23,521</u>	<u>34,844</u>

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

**Notes (continued)**

**11. Taxation**

	<b>2016</b> <b>KShs'000</b>	<b>2015</b> <b>KShs'000</b>
Current tax at 30%	40,801	62,812
Deferred tax charge (Note 21)	<u>(4,761)</u>	<u>(3,964)</u>
	<u><u>36,040</u></u>	<u><u>58,848</u></u>

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

	<b>2016</b> <b>KShs'000</b>	<b>2015</b> <b>KShs'000</b>
Accounting profit before tax	97,755	180,468
Computed tax using the applicable corporation tax rate of 30% (2015: 30%)	29,327	54,140
Tax impact of expenses not deductible for tax purposes	<u>6,713</u>	<u>4,708</u>
Income tax expense	<u><u>36,040</u></u>	<u><u>58,848</u></u>

**12. Dividend per share**

	<b>2016</b>	<b>2015</b>
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>52,125</u>	<u>52,125</u>
Dividend per share (KShs)	<u><u>-</u></u>	<u><u>-</u></u>

**13. Earnings per share**

The calculation of basic earnings per share is based on:

Net profit for the year attributable to shareholders (KShs '000)	<u>97,755</u>	<u>121,620</u>
Number of ordinary shares ('000)	<u>52,125</u>	<u>52,125</u>
Earnings per share (KShs)	<u><u>1.88</u></u>	<u><u>2.33</u></u>

There were no potentially dilutive shares outstanding at 31 December 2016 and 2015.

**Notes (continued)**

**14. Cash and balances with Central Bank of Kenya**

<b>Group and Company</b>	<b>2015 KShs'000</b>	<b>2014 KShs'000</b>
Cash on hand	81,522	76,905
Balances with Central Bank of Kenya:		
– Local currency cash reserve ratio	263,924	467,351
– Other	27,758	154,377
	<u>373,204</u>	<u>698,633</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 2016, the cash reserve requirement was 5.25% (2015:5.25%) 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 the balance does not 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**

<b>Group</b>	<b>2016 KShs'000</b>	<b>2015 KShs'000</b>
<b>Held to maturity</b>		
<i>Treasury bonds:</i>		
Maturing within one year	304,890	6,029
Maturing after one year	4,733,802	5,041,361
<b>Total held to maturity</b>	<u>5,038,692</u>	<u>5,047,390</u>
<b>Held for trading</b>		
<i>Treasury bonds:</i>		
Maturing after one year	89,427	90,065
	<u>5,128,119</u>	<u>5,137,455</u>
<b>Company</b>		
<b>Held to maturity</b>		
<i>Treasury bonds:</i>		
Maturing within one year	304,890	-
Maturing after one year	4,712,698	5,020,241
<b>Total held to maturity</b>	<u>5,017,588</u>	<u>5,020,241</u>
<b>Held for trading</b>		
<i>Treasury bonds:</i>		
Maturing after one year	89,427	90,065
	<u>5,107,015</u>	<u>5,110,306</u>

The weighted average effective interest rate on government securities at 31 December 2016 was 11.53% (2015:11.53%).

Notes (continued)

16. Deposits and balances due from banking institutions

Group and Company	2016 KShs'000	2015 KShs'000
Due within 90 days	1,047,009	1,854,087
Due between 3 months and 1 year	-	-
Due between 1 year and 5 year	-	28,537
	<u>1,047,009</u>	<u>1,882,624</u>

The weighted average effective interest rate on placements with other banks at 31 December 2016 was 1.40% (2015:5.62%).

17. Loans and advances to customers

	2016		2015	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Overdrafts	4,406,957	4,406,957	3,562,188	3,562,188
Loans	5,134,216	5,078,713	5,041,090	4,985,342
Staff loans	282,461	282,461	264,751	264,751
	<u>9,823,634</u>	<u>9,768,131</u>	<u>8,868,029</u>	<u>8,812,281</u>
Less: Impairment losses reserves	<u>(1,090,422)</u>	<u>(1,034,919)</u>	<u>(824,091)</u>	<u>(768,343)</u>
	<u>8,733,212</u>	<u>8,733,212</u>	<u>8,043,938</u>	<u>8,043,938</u>
Maturing within one year	3,729,211	3,729,211	2,985,592	2,985,592
Over one year to three years	341,693	341,693	233,109	233,109
Over three years	4,662,308	4,662,308	4,825,237	4,825,237
	<u>8,733,212</u>	<u>8,733,212</u>	<u>8,043,938</u>	<u>8,043,938</u>

The weighted average effective interest rate on loans and advances to customers at 31 December 2016 was 12.70% (2015:16.30%).

Impairment losses reserves

Group	Specific impairment losses KShs'000	Portfolio impairment losses KShs'000	Total KShs'000
<b>2016</b>			
At 1 January 2016	743,175	80,916	824,091
Amounts written off during the year	(14,612)	-	(14,612)
Reversals on recovery during the year	(99,172)	-	(99,172)
Made during the year	367,700	12,415	380,115
<b>At 31 December 2016</b>	<u>997,091</u>	<u>93,331</u>	<u>1,090,422</u>

**Notes (continued)**

**17. Loans and advances to customers (continued)**

**Impairment losses reserves (continued)**

<b>Group</b>	<b>Specific</b>	<b>Portfolio</b>	<b>Total</b>
<b>2015</b>			
At 1 January 2015	622,577	75,624	698,201
Amounts written off during the year	(860)	-	(860)
Reversals on recovery during the year	(137,988)	-	(137,988)
Made during the year	259,446	5,292	264,738
<b>At 31 December 2015</b>	<b>743,175</b>	<b>80,916</b>	<b>824,091</b>
<b>Company</b>			
<b>2016</b>			
At 1 January 2016	687,427	80,916	768,343
Amounts written off during the year	(14,537)	-	(14,537)
Reversals on recovery during the year	(98,779)	-	(98,779)
Made during the year	367,477	12,415	379,892
<b>At 31 December 2016</b>	<b>941,588</b>	<b>93,331</b>	<b>1,034,919</b>
<b>2015</b>			
At 1 January 2015	565,936	75,624	641,560
Amounts written off during the year	(215)	-	(215)
Reversals on recovery during the year	(137,516)	-	(137,516)
Made during the year	259,222	5,292	264,514
<b>At 31 December 2015</b>	<b>687,427</b>	<b>80,916</b>	<b>768,343</b>

**Impairment losses on loans and advances charged to profit or loss**

<b>Group</b>	<b>2016 KShs'000</b>	<b>2015 KShs'000</b>
Provisions during the year	380,115	264,738
Recovered during the year	(99,172)	(137,988)
Direct write offs	314	396
Recoveries of amounts previously written off	-	-
	<u>281,257</u>	<u>127,146</u>
Interest on impaired loans and advances which has not yet been received in cash	<u>155,166</u>	<u>92,307</u>

**Impaired loans and advances**

Loans and advances include an amount of KShs 1,652,873 (2015: KShs 1,182,404) net of impairment losses which have been classified as impaired loans and advances.

Estimated value of underlying collaterals amount to KShs 1,239,220,000(2015: KShs 978,121,000). The directors are of the opinion that recovery of the principal amounts thereof is not doubtful.

Notes (continued)

18. Equity investments

Group and Company

	2016 KShs'000	2015 KShs'000
<b>Unquoted shares at cost:</b>		
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 2,258,017 ordinary shares of KShs 20 each	802,499	802,499
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	2,000	2,000
	810,479	810,479
<b>Provision for impairment loss on investments</b>		
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)
	(4,980)	(4,980)
	805,499	805,499

19. Investment in subsidiary

Company

**Shares at cost:**

Small Enterprises Finance Company Limited (SEFCO)	32,048	32,048
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SEFCO is a wholly owned subsidiary of the bank. The subsidiary company is incorporated in Kenya.

20. Other assets

	2016		2015	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Rent receivable	20,801	20,801	20,664	20,664
Uncleared effects	21,978	21,978	15,792	15,792
Prepayments	19,752	19,752	31,910	31,910
Other receivables	6,321	6,321	3,627	3,479
	68,852	68,852	71,993	71,845
	68,852	68,852	71,993	71,845

**Notes (continued)**

**21. Deferred tax asset/(liability)**

Deferred income tax is calculated in full on all temporary differences under the liability method using a principal tax rate of 30% (2015: 30%). The movement on the deferred tax account is as follows:

	2016		2015	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
At start of the year	2,613	2,402	(1,351)	(1,532)
Charged through profit or loss	4,761	4,911	3,964	3,934
Charged through other comprehensive income	-	-	-	-
	<u>7,374</u>	<u>7,313</u>	<u>2,613</u>	<u>2,402</u>

The deferred income tax assets and liabilities, deferred tax charge in the statement of profit or loss and deferred income tax charge through other comprehensive income are attributable to the following items:

**Group**

2015	At 1 January KShs'000	Charged to profit or loss KShs'000	Credited to other comprehensive income KShs'000	At 31 December KShs'000
<b>Deferred income tax liabilities</b>				
Fair value gain on equity investments	(37,967)	-	-	(37,967)
<b>Deferred income tax assets</b>				
Property and equipment	10,522	2,374	-	12,896
Portfolio impairment provisions on loans and advances	22,686	1,587	-	24,273
Other provisions	3,408	3	-	3,411
	<u>36,616</u>	<u>3,964</u>	<u>-</u>	<u>40,580</u>
	<u>(1,351)</u>	<u>3,964</u>	<u>-</u>	<u>2,613</u>

Notes (continued)

21. Deferred tax asset/(liability) (continued)

2016	At 1 January KShs'000	Charged to profit or loss KShs'000	Charge to other comprehensive income KShs'000	At 31 December KShs'000
<b>Deferred income tax liabilities</b>				
Fair value gain on equity investments	(37,967)	-	-	(37,967)
<b>Deferred income tax assets</b>				
Property and equipment	12,896	1,751	-	14,647
Portfolio impairment provisions on loans and advances	24,273	3,726	-	27,999
Other provisions	3,411	(716)	-	2,695
	40,580	4,761	-	45,341
	2,613	4,761	-	7,374
<b>Company</b>				
<b>2015</b>				
<b>Deferred income tax liabilities</b>				
Fair value gain on equity investments	(37,967)	-	-	(37,967)
<b>Deferred income tax assets</b>				
Property and equipment	10,522	2,374	-	12,896
Portfolio impairment provisions on loans and advances	22,686	1,587	-	24,273
Other provisions	3,227	(27)	-	3,200
	36,435	3,934	-	40,369
	(1,532)	3,934	-	2,402

**Notes (continued)**

**21. Deferred tax asset/(liability) (continued)**

2016	At 1 January KShs'000	Charged to profit or loss KShs'000	Charge to other comprehensive income KShs'000	At 31 December KShs'000
<b>Deferred income tax liabilities</b>				
Fair value gain on equity investments	(37,967)	-	-	(37,967)
<b>Deferred income tax assets</b>				
Property and equipment	12,896	1,751	-	14,647
Portfolio impairment provisions on loans and advances	24,273	3,726	-	27,999
Other provisions	3,200	(566)	-	2,634
	40,369	4,911	-	45,280
	2,402	4,911	-	7,313

**22. Prepaid operating lease rentals**

Group and Company	2016 KShs'000	2015 KShs'000
<b>Cost</b>		
At 1 January	6,000	6,000
<b>Amortisation</b>		
At 1 January	(2,066)	(2,005)
Amortisation for the year	(61)	(61)
At 31 December	(2,127)	(2,066)
<b>Net carrying amount at 31 December</b>	<b>3,873</b>	<b>3,934</b>

Notes (continued)

23. Property and equipment

Group and Company	Leasehold		Furniture	Computers	Motor	Capital	Total
	Building	improvements	and			work in	
	KShs'000	KShs'000	equipment	KShs'000	vehicles	progress	KShs'000
			KShs'000		KShs'000	KShs'000	KShs'000
<b>2015</b>							
<b>Cost</b>							
<b>At 1 January 2015</b>	123,425	63,038	103,109	47,570	31,117	5,714	373,973
<b>Additions</b>	-	-	673	2,695	10,317	97,430	111,115
<b>Disposals</b>	-	-	-	(80)	-	-	(80)
<b>At 31 December 2015</b>	123,425	63,038	103,782	50,185	41,434	103,144	485,008
<b>Depreciation</b>							
<b>At 1 January 2015</b>	(34,347)	(27,251)	(88,957)	(43,548)	(28,754)	-	(222,857)
<b>Charge for the year</b>	(1,356)	(10,546)	(3,638)	(2,879)	(2,810)	-	(21,229)
<b>Disposals</b>	-	-	-	10	-	-	10
<b>At 31 December 2015</b>	(35,703)	(37,797)	(92,595)	(46,417)	(31,564)	-	(244,076)
<b>Net book amount at 31 December</b>	87,722	25,241	11,187	3,768	9,870	103,144	240,932

Notes (continued)

23. Property and equipment (continued)

Group and Company	Building	Leasehold	Furniture	Computers	Motor	Capital	Total
2016	KShs'000	improvements	and	KShs'000	vehicles	work in	KShs'000
		KShs'000	equipment	KShs'000	KShs'000	progress	
			KShs'000			KShs'000	KShs'000
<b>Cost</b>							
At 1 January 2016	123,425	63,038	103,782	50,185	41,434	103,144	485,008
Additions	-	-	196	2,313	-	5,457	7,966
Disposals	-	-	(2,835)	(14,115)	(3,400)	-	(20,350)
At 31 December 2016	123,425	63,038	101,143	38,383	38,034	108,601	472,624
<b>Depreciation</b>							
At 1 January 2016	(35,703)	(37,797)	(92,595)	(46,417)	(31,564)	-	(244,076)
Charge for the year	(1,356)	(9,349)	(3,594)	(2,053)	(3,352)	-	(19,704)
Disposals	-	-	2,835	14,106	3,400	-	20,341
At 31 December 2016	(37,059)	(47,146)	(93,354)	(34,364)	(31,516)	-	(243,439)
<b>Net book amount at 31 December</b>	<b>86,366</b>	<b>15,892</b>	<b>7,789</b>	<b>4,019</b>	<b>6,518</b>	<b>108,601</b>	<b>229,185</b>

Notes (continued)

24. Deposits and balances due to other banks

<b>Group and Company</b>	<b>2016 KShs'000</b>	<b>2015 KShs'000</b>
Payable within 90 days	250,127	809,906
Payable between 3 months and one year	<u>1,742,356</u>	<u>1,227,987</u>
	<u><u>1,992,483</u></u>	<u><u>2,037,893</u></u>

The weighted average effective interest rate on deposits from other banks at 31 December 2016 was 1.90% (2015: 2.01%).

25. Deposits from customers

	<b>2016</b>		<b>2015</b>	
	<b>Group KShs'000</b>	<b>Company KShs'000</b>	<b>Group KShs'000</b>	<b>Company KShs'000</b>
From government and parastatals	816,847	816,847	1,160,993	1,160,993
From private sector and individuals	<u>4,951,606</u>	<u>4,971,667</u>	<u>8,491,801</u>	<u>8,504,117</u>
	<u><u>5,768,453</u></u>	<u><u>5,788,514</u></u>	<u><u>9,652,794</u></u>	<u><u>9,665,110</u></u>

Included in the Company customers deposits is KShs 20,061,000 (2015: KShs 12,316,000) due to the subsidiary company. Interest paid on these deposits during the year amounted to KShs 1,333,631 (2015: KShs 161,000).

The weighted average effective interest rate on customer deposits at 31 December 2016 was 8.20% (2015: 15.28%).

26. Borrowings

<b>Group and Company</b>	<b>2016 KShs'000</b>	<b>2015 KShs'000</b>
East African Development Bank (EADB)	-	16,887
European Investment Bank	21,163	21,163
Central Bank of Kenya	4,243,454	-
Oriental Commercial Bank	-	199,221
Standard Chartered Bank Kenya Limited	250,000	750,000
China Development Bank	<u>958,111</u>	<u>1,145,575</u>
	<u><u>5,472,728</u></u>	<u><u>2,132,846</u></u>

**Notes (continued)**

**26. Borrowings (continued)**

<b>Repayments</b>	<b>2016</b> <b>KShs'000</b>	<b>2015</b> <b>KShs'000</b>
Less than one year	4,690,014	565,727
Between one and five years	476,259	1,261,221
Over 5 years	306,455	305,898
	<u>5,472,728</u>	<u>2,132,846</u>

The weighted average effective interest rate on loan capital at 31 December 2016 was 8.51% (2015: 6.52%).

**Loan terms**

- The existing facility from Standard Chartered Bank was granted in 2014 for a period of 3 years. The loan matures in 2017 and interest is charged at the Central Bank Rate (CBR) plus 2.5%. Other facilities have been obtained from Standard Chartered between 2011 and 2014 and these have been fully repaid.
- The loan from China Development Bank was disbursed in 2008 and 2009 and is to be repaid over a period of 15 years. The loan matures in 2022. The loan is payable half yearly and interest is charged at 6 months LIBOR plus margin of 0.8%.
- Borrowings from the Central Bank of Kenya comprise of short term borrowings of up to 1 month at an average interest rate of 10% p.a.

**27. Other liabilities**

	<b>2016</b>		<b>2015</b>	
	<b>Group</b> <b>KShs'000</b>	<b>Company</b> <b>KShs'000</b>	<b>Group</b> <b>KShs'000</b>	<b>Company</b> <b>KShs'000</b>
Bills payable	11,904	11,904	9,080	9,080
Rent deposit	17,938	17,938	16,007	16,007
Deutsche Investitions-und EntwicklungsgesellschaftmbH (DEG) retained funds	125,438	125,438	122,959	122,959
Payable to Government of Kenya	65,281	65,281	65,281	65,281
Provisions and accruals	24,165	23,043	32,901	30,748
Other liabilities	17,380	17,709	18,841	19,170
	<u>262,106</u>	<u>261,313</u>	<u>265,069</u>	<u>263,245</u>

Notes (continued)

28. Share capital

	2016 KShs'000	2015 KShs'000
<b>Authorised, issued and fully paid</b>		
17,375,000 ordinary shares of KShs 20 each	347,500	347,500
34,750,000 ordinary shares of KShs 20 each	695,000	695,000
	<u>1,042,500</u>	<u>1,042,500</u>

During the year ended 31 December 2015, the Bank issued 34,750,000 bonus shares paid out of retained earnings. Total number of shares in issue as at 31 December 2015 was 52,125,000 (17,375,000 ordinary shares in respect of the years 2011 to 2014).

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.

Total number of shares in issue 52,125,000 (2015: 52,125,000).

29. Cash and cash equivalents

	2016 KShs'000	2015 KShs'000
<b>Group</b>		
Cash in hand (Note 14)	81,522	76,905
Balances with Central Bank of Kenya (Note 14)	27,758	154,377
Deposits and balances due from banks (Note 16)	1,047,009	1,882,624
Deposits and balances due to banks (Note 24)	(1,992,483)	(2,037,893)
	<u>(836,194)</u>	<u>76,013</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 2016, interest rates on loans and overdrafts ranged from 3.00 % to 14.00% (2015:3.00% to 20.24%). The contractual amounts of commitments are set out below:

a) Commitments to extend credit with respect to:

	2016 KShs'000	2015 KShs'000
Undrawn loans	269,480	474,720
Undrawn overdraft facilities	164,693	16,765
Unutilised guarantees and letters of credit	26,947	13,047
	<u>461,120</u>	<u>504,532</u>

**Notes (continued)**

**30. Contingencies (continued)**

**a) Commitments to extend credit with respect to (continued):**

At 31 December 2016, interest rate on facilities subject to commitments ranged from 3.00% to 14.00% (2015: 3.00% to 20.24%).

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

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Guarantees	652,173	714,403
Acceptances	21,667	46,459
Letters of credit	28,846	70,556
Undelivered spots	92	92
	<u>702,778</u>	<u>831,510</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:

	<b>2016</b>	<b>2015</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Less than one year	33,945	31,261
Between one and five years	136,157	135,689
Over five years	45,663	42,845
	<u>215,765</u>	<u>209,795</u>

Notes (continued)

32. Related party transactions

(a) Loans and advances to employees

	2016 KShs'000	2015 KShs'000
Balance at 1 January	254,084	215,251
Loans advanced during the year	101,715	108,566
Loans repayments received	(73,338)	(69,733)
<b>Balance at 31 December</b>	<b>282,461</b>	<b>254,084</b>

Interest earned on staff loans during the year amounted to KShs 17,325,386 (2015:KShs14,746,481).

(b) Loans and advances to directors and their associates

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

	2016 KShs'000	2015 KShs'000
Gross amount at 1 January	505,707	451,050
Interest charged	82,271	47,923
Loans disbursed	345,052	168,838
Cash received	(149,369)	(162,104)
<b>Net amount at 31 December</b>	<b>783,661</b>	<b>505,707</b>

(c) Included in deposits is KShs 20,061,000 (2015: KShs12,316,000) due to a subsidiary company. Interest paid on these deposits during the year amounted to KShs 1,334,000(2016: KShs161,000).

(d) Compensation to senior management for the year ended 31 December 2016 amounted to KShs 65,028,667(2015: KShs 59,690,842).

33. Assets pledged as security

Financial assets that may be repledged or resold by counterparties

As at 31 December 2016, Government securities amounting to KShs 4,705.5 million (2015: KShs 1,112.2 million) were pledged as security against loans from Standard Chartered Bank Kenya Limited and Central Bank of Kenya. These transactions are conducted under terms that are usual and customary to standard lending, and securities borrowing and lending activities.

**Notes (continued)**

**34. Reserves**

**(a) 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.

**(b) Other reserves**

Other reserves comprise of:

- i) KShs 280,000 of interest reserve established under a lending agreement between the bank and Industrial & Commercial Development Corporation (ICDC). 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.
- ii) KShs721,379,000 revaluation reserves on the equity investment in Kenya Hotel properties net of tax.

**35. Events after the reporting period**

- i) In December 2016, the Group started the process of raising additional capital by way of rights issue and private placement. In January 2017 necessary approvals were obtained from the board of directors and the Central Bank of Kenya in their capacity as the regulator. At the time of approval of the financial statements the process was still ongoing with the involvement of all stakeholders and it is expected to raise at least KShs 3 billion.
- ii) The board of directors approved the disposal of the 'Finance House' in line with Group overall strategy. The asset is included within property and equipment (Note 23) and is carried at historical cost less depreciation (Note 2 (j)). At the time of approval of the financial statements, management had received offers which were being evaluated. Management expects to sell the building for at least KShs 1 billion.