

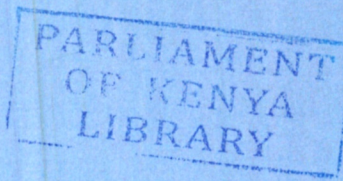
REPUBLIC OF KENYA



*Paper laid by the  
Leader of Majority  
on 06/06/2018  
Quamli.*

OFFICE OF THE AUDITOR-GENERAL

**REPORT**



**OF**

**THE AUDITOR-GENERAL**

**ON**

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

**FOR THE YEAR ENDED  
31 DECEMBER 2017**



REPUBLIC OF KENYA



OFFICE OF THE AUDITOR-GENERAL

**REPORT**

**OF**



**THE AUDITOR-GENERAL**

**ON**

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

**FOR THE YEAR ENDED  
31 DECEMBER 2017**

**DEVELOPMENT BANK OF KENYA LIMITED**  
**ANNUAL REPORT AND FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2017**

OFFICE OF THE AUDITOR GENERAL  
P. O. Box 30084 - 00100 NAIROBI  
28 MAR 2018  
**RECEIVED**

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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  
Prof. J.H. Kimura  
Industrial & Commercial Development Corporation (ICDC)  
Principal Secretary to the Treasury of Kenya

**Secretary**

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

**Senior officers**

V.J.O. Kidiwa  
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

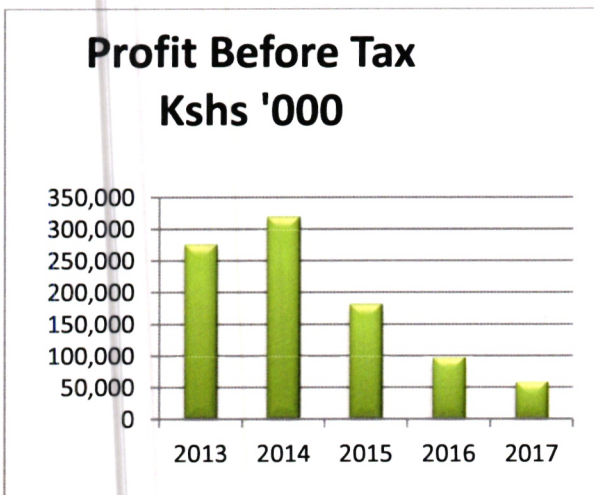
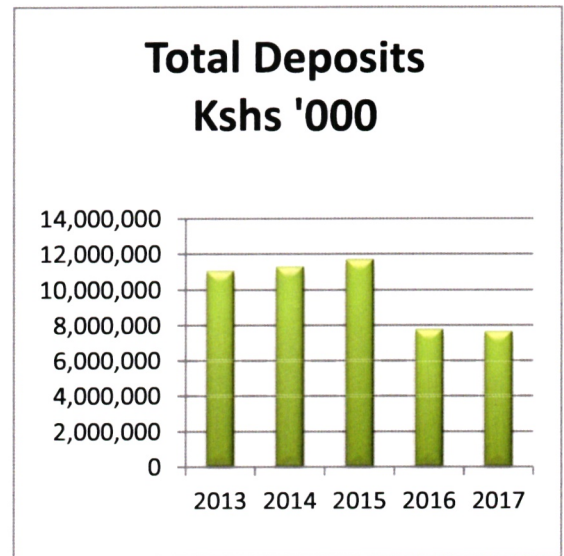
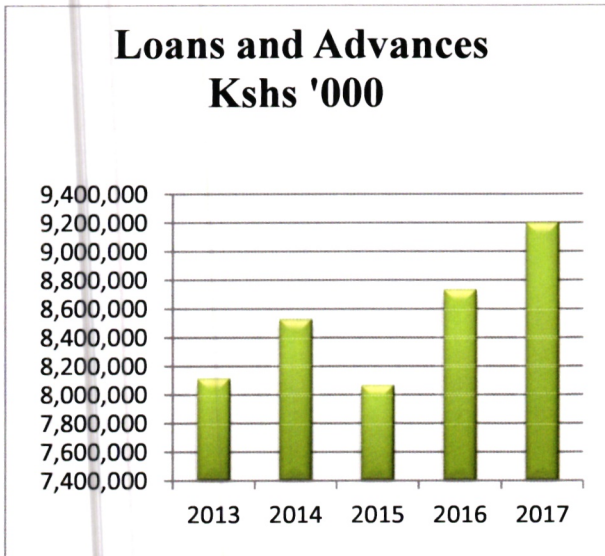
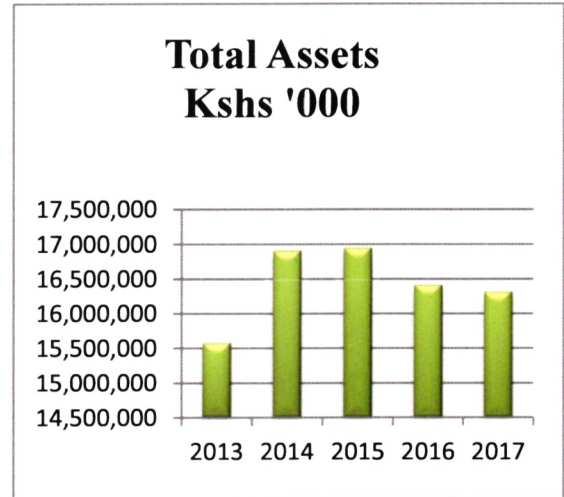
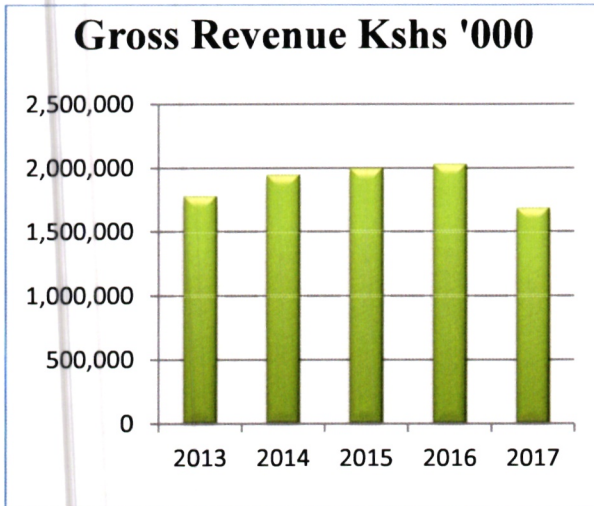
**Five-year Group financial summary**

	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	<b>Shs'000</b>	<b>Shs'000</b>	<b>Shs'000</b>	<b>Shs'000</b>	<b>Shs'000</b>
Gross revenue	1,684,587	2,031,005	1,990,760	1,941,074	1,779,696
Profit before tax	59,426	97,755	180,468	319,326	275,289
Profit after tax	27,658	61,715	121,620	220,592	189,433
Gross loans and advances	10,312,685	9,823,634	8,868,029	9,225,833	8,646,163
Less impairment losses on loans and advances	(1,112,906)	(1,090,422)	(824,091)	(698,201)	(537,696)
Loans and advances to customers (net of impairment)	9,199,779	8,733,212	8,043,938	8,527,632	8,108,467
Total deposits	7,643,952	7,760,936	11,690,687	11,292,787	11,046,404
Loan capital	5,435,938	5,472,728	2,132,846	2,618,047	2,393,478
Shareholders' equity	2,943,323	2,915,665	2,853,950	2,772,330	1,830,359
Total assets	16,309,056	16,411,435	16,942,552	16,944,142	15,574,646

**KEY RATIOS**

Basic Earnings Per Share (EPS)	1.14	1.88	2.33	12.69	10.90
Return on Assets (ROA)	0.4%	0.6%	1.1%	1.9%	1.8%
Return on Equity (ROE)	2.2%	3.4%	6.3%	11.7%	15.1%
Capital Adequacy Ratio	20.10%	21.60%	23.90%	25.7%	22.4%

**KEY PERFORMANCE INDICATORS**



## **Introduction**

I am pleased to present to you the audited Financial Statements for the Bank and its wholly owned subsidiary for the year ended December 2017.

The year saw banks absorb in full the impact of the interest rate capping law enacted late 2016. As expected the law impacted negatively on interest revenue and cost of banks as well as availability of credit in the market. Furthermore, effects of the closure of three banks in the previous year continued to be felt throughout 2017

Being a small bank, Development Bank of Kenya took a significant hit on results from the rate capping law and the collapse of the three banks in the years 2015 and 2016

## **Economic Overview**

The Kenyan economy recorded growth of 5.8% in 2016, vis-à-vis the 5.6% and 5.3% achieved in 2015 and 2014 respectively. Growth in the year was on the backdrop of expansion in accommodation and food services, information and technology, real estate, transport and storage among other factors.

Credit growth, however, which is the fuel for economic growth remained depressed throughout the year due to the impact of the law capping interest rates. Banks remained reluctant to extend credit due to their inability to price risk in a controlled interest rate environment. Instead most of the investments by banks that were liquid continue to be directed at buying government securities which are viewed as offering less risk. Various Economic analysts including the World Bank, based on these facts and the prolonged electioneering period, have downgraded growth expectation for year 2017 to below 5.0%. This is the same view held by Treasury. According to Treasury, political jitters will shave at least a percentage point of the projected growth of 6.0% in national wealth in 2017.

Growth in 2018 is however expected to improve to between 5.25% and 5.75% on a rebound in public and private investments and improved farming activities according to various analysts including World Bank and African Development Bank (AFDB).

## **Developments in the Banking Sector**

The Banking landscape in Kenya did not change much in 2017. In the year, however, the Central Bank of Kenya (CBK) lifted the moratorium on licensing of new banks that had been placed in 2015. This allowed for the licensing of Dubai Islamic Bank (DIB) and Mayfair Bank.

The sector had to contend fully with the implementation of the interest rate capping law. As discussed above, this law has resulted in reduced lending to the private sector due to the difficulty in pricing risk.

The sector will in 2018 have to implement a new accounting standard International Financial Reporting Standard number 9 which requires a totally new way of assessing credit risk on all financial instruments. In the past, Banks applied a model of incurred credit losses to assess impairment in financial instruments. This is thought to have delayed the booking of impairment. Under the new standard, such losses will have to be assessed based on an expected credit loss model. Under this new approach credit losses are likely to be booked early and will be possibly higher than in previous years.

## **The DBK's Performance**

The Bank's profit before tax declined to Kshs 57.6 million from the previous year's outcome of Kshs 94.9 million. The lower results were mainly due to reduced interest margins caused by the implementation of the law on interest rate capping.

The Balance sheet shrunk marginally to Kshs 16.3 billion from Kshs 16.4 billion reported in 2016. This was primarily due to repayment of maturing loan obligation.

Despite the credit squeeze in the market, the loan book grew by 5.0% to Kshs 10.3 billion. Equally, the quality of the book as measured by the percentage of non-performing loans to gross loans improved from 27.5% in 2016 to 22.6%. After adjusting for additional provisions against non-performing loans, the net loans closed higher at Kshs 9.2 billion compared to Kshs 8.7 billion attained in 2016. The bulk of credit was advanced to the real estate and trade investments sectors as shown below.

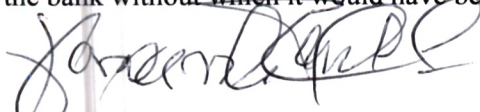
SECTOR	Portfolio 2017	Portfolio 2016
Agriculture	7.8%	7.4%
Manufacturing	13.1%	15.0%
Building & Construction	3.1%	2.7%
Trade	27.1%	26.7%
Tourism, Restaurants & Hotels	3.7%	3.7%
Transport & Communication	3.4%	3.8%
Real Estate	37.0%	31.0%
Financial Services	0.4%	0.2%
Personal Households	3.6%	9.5%
Mining & Quarrying	0.9	-
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>

The primary sources of funding for the bank remain deposits and short term loans.

#### Appreciation

I take this opportunity to express my sincere gratitude to all our esteemed clients for their continued support and confidence that they have expressed in us during these challenging times.

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 the results we have.



**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. Gonah 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.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	Management of assets and investments
<b>Board Credit Committee</b>	Executive Directors, and Senior Management	Non-Executive Director	Prof. J. Kimura 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 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 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.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	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 2017:

<b>Names</b>	<b>20<sup>th</sup> Jan</b>	<b>8<sup>th</sup> Feb</b>	<b>9<sup>th</sup> Mar</b>	<b>3<sup>rd</sup> May</b>	<b>26<sup>th</sup> Jul</b>	<b>27<sup>th</sup> Sep</b>	<b>10<sup>th</sup> Oct</b>	<b>19<sup>th</sup> Oct</b>	<b>31<sup>st</sup> Oct</b>	<b>22<sup>nd</sup> Nov</b>	<b>20<sup>th</sup> Dec</b>	<b>% Attendance</b>
Prof.H.K. Mengech	X	X	X	X	X	X	X	X	X	X	X	100
Kungu Gatabaki	X	X	X	-	-	-	-	-	-	-	-	27
Prof.J.H. Kimura	X	X	X	X	X	X	X	X	X	X	-	91
Mbatha Mbithi	X	X	X	X	X	X	X	-	-	X	X	82
Joseph Kiarii	X	X	X	X	X	X	-	X	X	-	X	82
Kennedy Wanderi	X	X	X	X	X	X	X	X	X	X	X	100

\*Kungu Gatabaki resigned from the board on 3<sup>rd</sup> March 2017.

### **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 2018.

The directors submit their report together with the audited financial statements for the year ended 31 December 2017.

## **BUSINESS REVIEW**

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

During the year 2017, the Group recorded a profit of Kshs 57.6 million which is 39% lower than the previous year's profit of Kshs 94.9 million. The decrease was attributable to the effects of the implementation of the interest rate capping as well as tight liquidity in the market directed at tier III banks.

Total assets reduced marginally to Kshs 16.3 billion (2016 – Kshs 16.4 billion).

Loan portfolio grew by 5% to Kshs 10.3 billion. Its quality as measured by the Non-performing ratio to the gross loan book improved from 27.5% (2016) to 22.6% (2017).

Customer deposits increased by 7% to Kshs 6.2 billion (2016: Kshs 5.8 billion). The increase is attributed to deposit mobilisation effort during the year

## **DIVIDEND**

The net profit for the year of Shs 27,658,000 (2016: Shs 61,715,000) has been added to retained earnings. The directors do not recommend a dividend payment for the year ended 31 December 2017(2016: nil).

## **DIRECTORS**

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

## **DISCLOSURES TO AUDITORS**

The directors confirm that with respect to each director at the time of approval of this report:

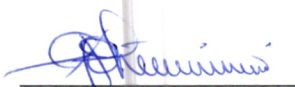
- (a) there was, as far as each director is aware, no relevant audit information of which the company's auditor is unaware; and
- (b) each director had taken all steps that ought to have been taken as a director so as to be aware of any relevant audit information and to establish that the company's auditor is aware of that information

## **TERMS OF APPOINTMENT OF AUDITORS**

PricewaterhouseCoopers continue in office in accordance with the Company's Articles of Association and Section 719 of the Kenyan Companies Act, 2015.

The directors monitor the effectiveness, objectivity and independence of the auditor. This responsibility includes the approval of the audit engagement contract and the associated fees on behalf of the shareholders.

By order of the Board



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

6 March 2018

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the company as at the end of the financial year and of its profit or loss for that year. The directors are responsible for ensuring that the company keeps proper accounting records that are sufficient to show and explain the transactions of the company; disclose with reasonable accuracy at any time the financial position of the company; and that enables them to prepare financial statements of the company 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 company and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

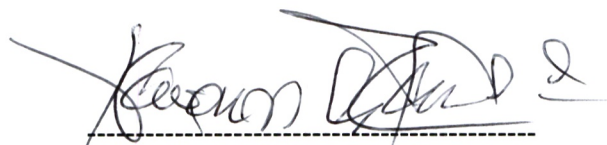
The directors accept responsibility for the preparation and presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Companies Act 2015. They also accept responsibility for:

- 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 judgments and accounting estimates that are reasonable in the circumstances

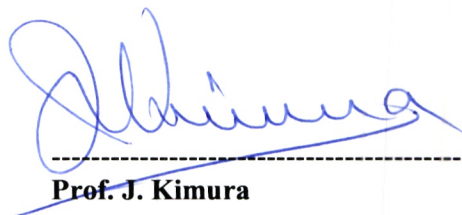
In preparing the financial statements, the directors have assessed the Company's ability to continue as a going concern and disclosed, as applicable, matters relating to the use of going concern basis of preparation of the financial statements. Nothing has come to the attention of the directors to indicate that the Company 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.

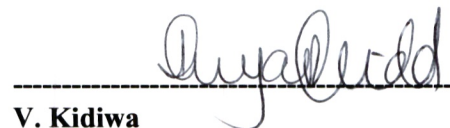
Approved by the board of directors on 6 March 2018 and signed on its behalf by:



**Prof. H. K. Mengech**



**Prof. J. Kimura**



**V. Kidiwa**

# REPUBLIC OF KENYA

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Fax: +254-20-311482  
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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 2017

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#### REPORT ON THE GROUP FINANCIAL STATEMENTS

#### Opinion

The accompanying financial statements of Development Bank of Kenya Limited set out on pages 15 to 76, which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated and company statements of comprehensive income, consolidated statement of changes in equity and consolidated company statements 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 PricewaterhouseCoopers, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, the consolidated and company financial statements present fairly, in all material respects, the financial position of Development Bank of Kenya Limited as at 31 December 2017, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with Kenya Companies Act, 2015.

In addition, as required by Article 229(6) of the Constitution, except for matters described on the Material Uncertainty Related to Going Concern and Other Matter sections of my report, I confirm that, nothing has come to my attention to cause me to believe that public money has not been applied lawfully and in an effective way.

#### Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Development Bank of Kenya Limited in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

#### Material Uncertainty Related to Going Concern

As reported in the previous year, I draw attention to Note 2(a) to the financial statements which describe the Director's application of going concern assumption in

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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 2017*

preparing the financial statements. During the year the group reported a significant decrease in profitability of Kshs.26.4M down from Kshs.61.7M in the year 2016. The group reported a net current liability position of Kshs.6.9B determined after comparing the current assets and current liabilities. The bank experienced increase in customer savings from Kshs.5.8M in the year 2016 to Kshs.6.2M in the year 2017. Central Bank has advanced the bank Kshs.4.6B to meet its obligation guaranteed on the bank's investment in government securities maturing after one year of an equivalent amount. Since the group is having challenges meeting its short term obligations as and when they fall due, both short term and long term measures to ensure that the group continues to operate as a going concern have been put in place by management and include the borrowing from CBK option to meet short term needs of the group.

### **Key Audit Matters**

Key audit matters are those matters that, in my professional judgement, are of most significance in the audit of the financial statements. Except for the matters described in the Material Uncertainty Related to Going Concern and Other Matter sections of my report, there were no Key Audit Matters to report in the year under review.

### **Other Matter**

#### **1. Lack of Monitoring of Super User Activities on the Systems**

There was no monitoring of super user activities by independent users/system owners on four(4) key systems of the bank at application, database and operating systems levels namely:-

MIPS	System
Payroll	System
Micro banker	OS System
AD	System

It could therefore not be confirmed that there was no abuse of privileges during the year on the user activities due to lack of periodic monitoring.

#### **2. Inadequate Control on Events Logging and Monitoring**

It was noted that "Event logging" had been enabled on the network devices yet there was no remote server configured to store the logs on three systems (DBK-SWI; DBK-SW2 and Pfsense-FW). The risk is, in case of a system compromise, lack of audit logs interferes with forensic process and also results in loss of audit data. It could therefore not be confirmed that risky events did not take place during the year.

### **Responsibilities of Management and Those Charged With Governance for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of

financial statements that are free from material misstatement, whether due to fraud or error.

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

Management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provision of Section 47 of the Public Audit Act, 2015.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

### **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. 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 conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism 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, and for the purpose of giving an assurance on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on

the Bank's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's 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 Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Group to express an opinion on the consolidated and separate financial statements.
- Perform such other procedures as I consider necessary in the circumstances.


I communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

I also provide management 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.

#### 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 Bank and returns adequate for the audit have been received from branches not visited, so far as appears from my examination of those books; and
- The Bank's financial statements are in agreement with the accounting records and returns.



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

**Nairobi**

**15 May 2018**

**Consolidated statement of comprehensive income**

	Note	2017 KShs'000	2016 KShs'000
Interest income	5	1,576,725	1,907,433
Interest expense	6	(1,070,754)	(1,265,375)
<b>Net interest income</b>		505,971	642,058
Net fees and commission income		27,308	35,922
Other income	7	80,554	87,650
<b>Operating income</b>		613,833	765,630
Impairment losses on loans and advances	17	(169,590)	(281,257)
Operating expenses	8	(384,817)	(386,618)
<b>Profit before income tax</b>	10	59,426	97,755
Income tax expense	11	(31,768)	(36,040)
<b>Profit for the year</b>		27,658	61,715
Other comprehensive income net of tax		-	-
<b>Total comprehensive income</b>		<u>27,658</u>	<u>61,715</u>
Earnings per share (KShs per share)	13	<u>1.14</u>	<u>1.88</u>
Dividends per share (KShs per share)	12	<u>-</u>	<u>-</u>

**Company statement of comprehensive income**

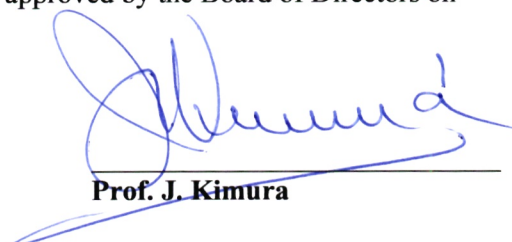
	Note	2017 KShs'000	2016 KShs'000
Interest income	5	1,574,490	1,905,313
Interest expense	6	<u>(1,071,312)</u>	<u>(1,266,709)</u>
<b>Net interest income</b>		503,178	638,604
Net fees and commission income		27,308	35,922
Other income	7	<u>80,554</u>	<u>87,650</u>
<b>Operating income</b>		611,040	762,176
Impairment losses on loans and advances	17	(169,367)	(281,504)
Operating expenses	8	<u>(384,041)</u>	<u>(385,762)</u>
<b>Profit before income tax</b>	10	57,632	94,910
Income tax expense	11	<u>(31,230)</u>	<u>(35,186)</u>
<b>Profit for the year</b>		26,402	59,724
Other comprehensive income net of tax		<u>-</u>	<u>-</u>
<b>Total comprehensive income</b>		<u><u>26,402</u></u>	<u><u>59,724</u></u>
Earnings per share (KShs per share)	13	<u>1.11</u>	<u>1.82</u>
Dividends per share (KShs per share)	12	<u>-</u>	<u>-</u>

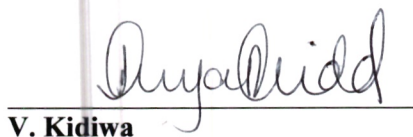
**Consolidated statement of financial position**

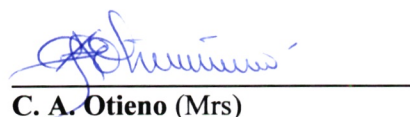
	Note	2017 KShs'000	2016 KShs'000
<b>ASSETS</b>			
Cash and balances with Central Bank of Kenya	14	351,112	373,204
Investment in government securities	15	4,825,382	5,128,119
Deposits and balances due from banking institutions	16	835,952	1,047,009
Loans and advances to customers	17	9,199,779	8,733,212
Other assets	20	52,703	68,852
Equity investments	18	805,499	805,499
Current income tax		-	15,108
Deferred income tax	21	16,376	7,374
Prepaid operating lease rentals	22	3,812	3,873
Property and equipment	23	218,441	229,185
<b>TOTAL ASSETS</b>		<b>16,309,056</b>	<b>16,411,435</b>
<b>LIABILITIES</b>			
Deposits from banks	24	1,416,138	1,992,483
Deposits from customers	25	6,227,814	5,768,453
Borrowings	26	5,435,938	5,472,728
Current income tax		13,698	-
Other liabilities	27	272,145	262,106
		<b>13,365,733</b>	<b>13,495,770</b>
<b>EQUITY</b>			
Share capital	28	1,042,500	1,042,500
Retained earnings		588,030	714,434
Statutory reserves		591,134	437,072
Other reserves		721,659	721,659
		<b>2,943,323</b>	<b>2,915,665</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>16,309,056</b>	<b>16,411,435</b>

The financial statements set out on pages 15 to 76 were approved by the Board of Directors on 6 March 2018 and were signed on its behalf by:

  
 Prof. H. K. Mengech

  
 Prof. J. Kimura

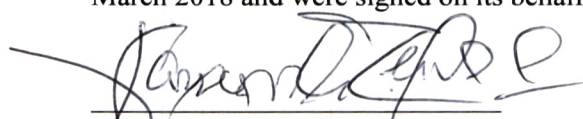
  
 V. Kidiwa

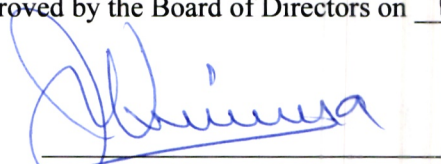
  
 C. A. Otieno (Mrs)

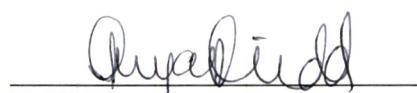
**Company statement of financial position**


<b>ASSETS</b>	<b>Note</b>	<b>2017 KShs'000</b>	<b>2016 KShs'000</b>
Cash and balances with Central Bank of Kenya	14	351,112	373,204
Investment in government securities	15	4,804,293	5,107,015
Deposits and balances due from banking institutions	16	835,952	1,047,009
Loans and advances to customers	17	9,199,779	8,733,212
Other assets	20	52,703	68,852
Equity investments	18	805,499	805,499
Investment in subsidiary	19	32,048	32,048
Tax recoverable		-	11,172
Deferred income tax	21	16,285	7,313
Prepaid operating lease rentals	22	3,812	3,873
Property and equipment	23	218,441	229,185
<b>TOTAL ASSETS</b>		<b>16,319,924</b>	<b>16,418,382</b>
<b>LIABILITIES</b>			
Deposits and balances due to banking institutions	24	1,416,138	1,992,483
Customers deposits	25	6,249,316	5,788,514
Borrowings	26	5,435,938	5,472,728
Tax Payable		17,374	-
Other liabilities	27	271,413	261,313
		<b>13,390,179</b>	<b>13,515,038</b>
<b>EQUITY</b>			
Share capital	28	1,042,500	1,042,500
Retained earnings		574,452	702,113
Statutory reserves		591,134	437,072
Other reserves		721,659	721,659
		<b>2,929,745</b>	<b>2,903,344</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>16,319,924</b>	<b>16,418,382</b>

The financial statements set out on pages 15 to 76 were approved by the Board of Directors on 6 March 2018 and were signed on its behalf by:

  
**Prof. H. K. Mengech**

  
**Prof. J. Kimura**

  
**V. Kidiwa**

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

**Consolidated statement of changes in equity**

	<b>Share capital</b>	<b>Statutory reserves</b>	<b>Other reserves</b>	<b>Retained earnings</b>	<b>Proposed dividends</b>	<b>Total</b>
	<b>KShs'000</b>	<b>KShs'000</b>	<b>KShs'000</b>	<b>KShs'000</b>	<b>KShs'000</b>	<b>KShs'000</b>
<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 income for the year</b>	-	62,320	-	(605)	-	61,715
<b>At 31 December 2016</b>	1,042,500	437,072	721,659	714,434	-	2,915,665
<b>At 1 January 2017</b>	1,042,500	437,072	721,659	714,434	-	2,915,665
<b>Comprehensive income for the year</b>						
Profit for the year	-	-	-	27,658	-	27,658
Transfer to statutory reserves	-	154,062	-	(154,062)	-	-
<b>Total comprehensive loss for the year</b>	-	154,062	-	(126,404)	-	27,658
<b>At 31 December 2017</b>	1,042,500	591,134	721,659	588,030	-	2,943,323

**Bank statement of changes in equity**

	<b>Share capital KShs'000</b>	<b>Statutory reserves KShs'000</b>	<b>Other reserves KShs'000</b>	<b>Retained earnings KShs'000</b>	<b>Proposed dividends KShs'000</b>	<b>Total KShs'000</b>
<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>At 31 December 2016</b>	1,042,500	437,072	721,659	702,113	-	2,903,344
<b>At 1 January 2017</b>	1,042,500	437,072	721,659	702,113	-	2,903,344
<b>Comprehensive income for the year</b>						
Profit for the year	-	-	-	26,401	-	26,401
Transfer to statutory reserves	-	154,062	-	(154,062)	-	-
<b>Total comprehensive income for the year</b>	-	154,062	-	(127,661)	-	26,401
<b>At 31 December 2017</b>	1,042,500	591,134	721,659	574,452	-	2,929,745

**Consolidated statement of cash flows**

	Note	2017 KShs'000	2016 KShs'000
<b>Operating activities</b>			
Profit before taxation		59,426	97,755
Depreciation	23	18,673	19,704
Amortisation of prepaid operating lease rentals	22	61	61
Profit on disposal of property and equipment		(95)	(280)
Interest charged on borrowings		19,101	21,170
Tax paid		(11,964)	(978)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		85,202	137,432
Changes in operating assets and liabilities			
Loans to customers		(466,567)	(689,274)
Deposits held for regulatory purposes		(22,633)	203,427
Investments in treasury bonds		302,737	9,336
Other assets		16,149	3,141
Customer's deposits		459,361	(3,884,341)
Other liabilities		10,039	(2,963)
<b>Net cash generated from /(used in) operations</b>		384,288	(4,223,242)
<b>Cash flows from investing activities</b>			
Purchase of property and equipment	23	(8,000)	(7,966)
Proceeds from sale of property and equipment		166	289
<b>Net cash used in investing activities</b>		(7,834)	(7,677)
<b>Cash flows from financing activities</b>			
Interest paid on borrowings		(19,101)	(21,170)
Loans receipts		398,832	4,243,454
Loans repayments		(435,622)	(903,572)
<b>Net cash (used in)/generated from financing activities</b>		(55,891)	3,318,712
<b>Net increase/(decrease) in cash and cash equivalents</b>		320,563	(912,207)
Cash and cash equivalents balances as at start of year		(836,194)	76,013
<b>Cash and cash equivalents at end of year</b>		(515,631)	(836,194)

**Bank statement of cash flows**

	Note	2017 KShs'000	2016 KShs'000
<b>Operating activities</b>			
Profit before taxation		57,632	94,910
Depreciation	23	18,673	19,704
Amortisation of prepaid operating lease rentals	22	61	61
Profit on disposal of property and equipment		(95)	(280)
Interest charged on borrowings		19,101	21,170
Tax paid		(11,657)	(716)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		83,715	134,849
Changes in operating assets and liabilities			
Loans to customers		(466,567)	(689,274)
Deposits held for regulatory purposes		(22,633)	203,427
Investments in treasury bonds		302,722	3,291
Other assets		16,149	2,993
Customer's deposits		460,802	(3,876,596)
Other liabilities		10,100	(1,932)
<b>Net cash generated from/(used in) operations</b>		384,288	(4,223,242)
<b>Cash flows from investing activities</b>			
Purchase of property and equipment	23	(8,000)	(7,966)
Proceeds from sale of property and equipment		166	289
<b>Net cash used in investing activities</b>		(7,834)	(7,677)
<b>Cash flows from financing activities</b>			
Interest paid on loan capital		(19,101)	(21,170)
Dividend paid		-	-
Loans received		398,832	4,243,454
Loans repaid		(435,622)	(903,572)
<b>Net cash (used in)/generated from financing activities</b>		(55,891)	3,318,712
<b>Net increase/(decrease) in cash and cash equivalents</b>		320,563	(912,207)
Cash and cash equivalents as at start of year		(836,194)	76,013
<b>Cash and cash equivalents at end of year</b>		(515,631)	(836,194)

## 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

### 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 27.6 million, down from KShs 61.7 million in 2016. The Group is also in a net current liability position of KShs 6.9 billion (2015: KShs 7.3 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 as at 31 December 2017 was 148% (2016: 151%).

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 year 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.

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. The Group is therefore currently reliant on CBK funding to be able to meet its current obligations. As at 31 December 2017, 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.

**Notes (continued)**

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

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

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 1.2 billion;
- 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 and;
- Proposed merger of six Government institutions which include; Development Bank of Kenya, Industrial Development Bank of Kenya, Uwezo Fund, Youth Enterprise Development Fund, Women Enterprise Development Fund and Kenya Industrial Estates.

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.

**Changes in accounting policies and disclosures**

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

The following standards and amendments have been applied by the company for the first time for the financial year beginning 1 January 2017:

Amendment to IAS 12 – Income taxes, the amendments were issued to clarify the requirements for recognising deferred tax assets on unrealised losses. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. The amendments clarify the existing guidance under IAS 12. They do not change the underlying principles for the recognition of deferred tax assets

**Notes (continued)**

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

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

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

*i. New standards, amendments and interpretations adopted by the Group (continued)*

Amendment to IAS 7 – Cash flow statements, the amendments introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment responds to requests from investors for information that helps them better understand changes in an entity's debt. The amendment will affect every entity preparing IFRS financial statements. However, the information required should be readily available. Preparers should consider how best to present the additional information to explain the changes in liabilities arising from financing activities.

Annual improvements 2014–2016 – IFRS 12, 'Disclosure of interests in other entities' regarding clarification of the scope of the standard. The amendment clarifies that the disclosures requirement of IFRS 12 are applicable to interest in entities classified as held for sale except for summarised financial information. Previously, it was unclear whether all other IFRS 12 requirements were applicable for these interests

The revised standards did not have any effect on the Bank's reported earnings or financial statement position and had no impact on the accounting policies.

*ii. 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 2017 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. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement 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 (P/L). The basis of classification depends on the entity's business 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 present changes in fair value in OCI not 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 were no changes to 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.

**Notes (continued)**

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

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

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

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 has reviewed its financial assets and liabilities and is expecting the following impact from the adoption of the new standard on 1 January 2018:

Based on the assessments undertaken to date, no change in classification of financial instruments is required. However, the Bank expects an increase in the loss allowance for loans and advances of between 5% and 30% and no change in relation to debt investments held at amortised cost. This additional provisions will have a marginal impact on Capital adequacy ratio.

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the group's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. 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 standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The IASB has amended IFRS 15 to clarify the guidance, but there were no major changes to the standard itself. The amendments comprise clarifications of the guidance on identifying performance obligations, accounting for licences of intellectual property and the principal versus agent assessment (gross versus net revenue presentation). The IASB has also included additional practical expedients related to transition to the new revenue standard. The standard is effective for annual periods beginning on or after 1 January 2018 and earlier application is permitted. Management does not expect the standard to have a material impact on the financial statements.

*IFRS 16, 'Leases'* After ten years of joint drafting by the IASB and FASB they decided that lessees should be required to recognise assets and liabilities arising from all leases (with limited exceptions) on the balance sheet. Lessor accounting has not substantially changed in the new standard.

The model reflects that, at the start of a lease, the lessee obtains the right to use an asset for a period of time and has an obligation to pay for that right. In response to concerns expressed about the cost and complexity to apply the requirements to large volumes of small assets, the IASB decided not to require a lessee to recognise assets and liabilities for short-term leases (less than 12 months), and leases for which the underlying asset is of low value (such as laptops and office furniture).

**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 supersedes IAS 17, 'Leases', IFRIC 4, 'Determining whether an Arrangement contains a Lease', SIC 15, 'Operating Leases – Incentives' and SIC 27, 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'. The standards is effective for annual periods beginning 1 January 2019. Early adoption is permitted only if IFRS 15 is adopted at the same time.

**(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) Income tax**

**(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.

**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 a 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 (continued)**

**(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 (continued)

#### (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**

	2017		2016	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Balances with Central Bank of Deposits and balances due from banking institutions	351,112	351,112	373,204	373,204
Loans and advances to customers	835,952	835,952	1,047,009	1,047,009
Government and other securities held to maturity	9,199,779	9,199,779	8,733,212	8,733,212
Other assets	4,825,382	4,804,293	5,128,119	5,107,015
Equity investments	35,699	35,699	49,100	49,100
	805,499	805,499	805,499	805,499
	<hr/>	<hr/>	<hr/>	<hr/>
	16,053,423	16,032,334	16,136,143	16,115,039
	<hr/>	<hr/>	<hr/>	<hr/>

Notes (continued)

4. Financial risk management (continued)

(i) Credit risk (continued)

Loans and advances to customers

	2017		2016	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
<b>Individually assessed</b>				
Grade 3: Substandard	40,894	40,894	120,948	120,948
Grade 4: Doubtful	2,265,850	2,266,060	2,473,513	2,473,513
Grade 5: Loss	55,725	-	55,503	-
	<u>2,362,469</u>	<u>2,306,954</u>	<u>2,649,964</u>	<u>2,594,461</u>
Allowances for impairment	(998,564)	(943,049)	(997,091)	(941,588)
<b>Carrying amounts</b>	<u>1,363,905</u>	<u>1,363,905</u>	<u>1,652,873</u>	<u>1,652,873</u>
<b>Collectively assessed</b>				
Grade 1: Normal	5,046,760	5,046,760	4,631,002	4,631,002
Grade 2: Watch	2,903,456	2,903,456	2,542,668	2,542,668
	<u>7,950,216</u>	<u>7,950,216</u>	<u>7,173,670</u>	<u>7,173,670</u>
Allowances for impairment	(114,342)	(114,342)	(93,331)	(93,331)
<b>Carrying amounts</b>	<u>7,835,874</u>	<u>7,835,874</u>	<u>7,080,339</u>	<u>7,080,339</u>
<b>Past due and not impaired</b>				
Grade 1: Normal	478,543	478,543	327,432	327,432
Grade 2: Watch	1,045,108	1,045,108	1,216,371	1,216,371
	<u>1,523,651</u>	<u>1,523,651</u>	<u>1,543,803</u>	<u>1,543,803</u>
<b>Past due and not impaired comprises</b>				
1-30 Days	478,543	478,543	327,432	327,432
31-60 Days	1,045,108	1,045,108	1,216,371	1,216,371
	<u>1,523,651</u>	<u>1,523,651</u>	<u>1,543,803</u>	<u>1,543,803</u>
<b>Neither past due nor impaired</b>				
Grade 1: Normal	4,568,217	4,568,217	4,303,570	4,303,570
Grade 2: Watch	1,858,348	1,858,348	1,326,297	1,326,297
	<u>6,426,565</u>	<u>6,426,565</u>	<u>5,629,867</u>	<u>5,629,867</u>

**Notes (continued)**

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

**(ii) Credit risk (continued)**

**Impaired loans and securities**

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

**Past due but not impaired loans**

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

**Loans with renegotiated terms**

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

**Allowances for impairment**

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

**Write-off policy**

The Group writes off a loan balance (and any related allowances for impairment losses) when Group Credit determines that the loans are uncollectible. This 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 2017</b>		
Grade 3: Individually Impaired	40,894	38,370
Grade 4: Individually Impaired	2,265,850	1,260,241
Grade 5: Individually Impaired	55,725	-
	<u>2,362,469</u>	<u>1,298,611</u>
<b>31 December 2016</b>		
Grade 3: Individually Impaired	120,948	97,495
Grade 4: Individually Impaired	2,473,513	1,555,378
Grade 5: Individually Impaired	55,503	-
	<u>2,649,964</u>	<u>1,652,873</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 2017 or 2016.

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

<b>Loans and advances to customers</b>	<b>2017 KShs'000</b>	<b>2016 KShs'000</b>
<b>Against individually impaired</b>		
Property	<u>1,011,204</u>	<u>1,239,220</u>
<b>Against collectively impaired</b>		
Property	11,690,246	11,973,916
Debt securities	2,069,548	2,289,492
Equities	39,856	54,856
Others	<u>2,039,814</u>	<u>1,880,001</u>

Notes (continued)

4. Financial risk management (continued)

(i) Credit risk (continued)

	2017 KShs'000	2016 KShs'000
<b>Against past due but not impaired</b>		
Property	3,730,792	1,581,464
Debt securities	-	576,334
Equities	34,856	18,200
Others	68,067	644,393
	<u>3,833,705</u>	<u>2,820,391</u>
<b>Against neither past due nor impaired</b>		
Property	7,966,455	10,392,452
Debt securities	2,069,548	1,713,158
Equities	5,000	36,656
Others	1,971,747	1,235,608
	<u>12,012,750</u>	<u>13,377,874</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>	2017 KShs'000	2016 KShs'000
Agriculture	813,341	726,711
Manufacturing	1,439,711	1,475,612
Building and construction	321,350	264,155
Trade	2,825,176	2,624,058
Tourism, restaurants, and hotels	380,232	358,519
Transport and communication	346,859	377,788
Real estate	3,782,601	3,043,426
Financial services	45,987	22,414
Personal households	357,428	930,951
	<u>10,312,685</u>	<u>9,823,634</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 from customers at the reporting date and during the reporting period were as follows:

	<b>2017</b>	<b>2016</b>
Average for the period	1.2%	20.4%
Maximum for the period	12.2%	42.4%
Minimum for the period	-9.6%	1.7%

**Notes (continued)**

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

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

The table below analyses the Company's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows :

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>At 31 December 2017</b>						
<b>Liabilities</b>						
Due to banking institutions	340,720	1,075,418	-	-	-	1,416,138
Due to EIB	-	-	-	-	21,163	21,163
Customer deposits	2,805,222	3,051,466	368,480	2,646	-	6,227,814
Borrowings	4,642,286	101,223	96,229	575,037	-	5,414,775
Other liabilities	37,229	15,742	36,484	36,484	146,207	272,146
<b>Total liabilities</b>	<b>7,825,457</b>	<b>4,243,849</b>	<b>501,193</b>	<b>614,167</b>	<b>167,370</b>	<b>13,352,036</b>
<b>At 31 December 2016</b>						
<b>Liabilities</b>						
Due to banking institutions	-	1,099,179	893,304	-	-	1,992,483
Due to EIB	-	-	-	-	21,163	21,163
Customer 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>

**Notes (continued)**

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

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

**Bank**

**At 31 December 2017**

	<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	351,112	-	-	-	-	351,112
Investment in government securities	-	-	205,470	933,177	3,665,646	4,804,293
Due from other banks	358,772	366,664	66,084	44,432	-	835,952
Loans and advances to customers	1,756,932	890,976	1,612,445	1,953,713	2,985,713	9,199,779
Equity investments	-	-	-	-	837,548	837,548
Other assets	14,568	6,355	12,710	12,710	6,360	52,703
<b>Total assets</b>	<b>2,481,384</b>	<b>1,263,995</b>	<b>1,896,709</b>	<b>2,944,032</b>	<b>7,495,267</b>	<b>16,081,387</b>

**At 31 December 2016**

<b>Liabilities</b>						
Due to banking institutions	-	1,099,179	893,304	-	-	1,992,483
Due to EIB	-	-	-	-	21,163	21,163
Customer 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>

**Notes (continued)**

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

**(ii) 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>2017 KShs '000</b>	<b>2016 KShs '000</b>
100 Basis points upward parallel shift	(5,820)	(6,083)
50 Basis points upward parallel shift	(2,972)	(3,110)
25 Basis points upward parallel shift	(1,501)	(1,573)
100 Basis points downward parallel shift	1,534	1,609
50 Basis points downward parallel shift	3,102	3,256
25 Basis points downward parallel shift	6,340	6,666

**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 Bank's assets and liabilities for 2017 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	-	-	-	-	-	351,112	351,112
Investments in government securities	11.51	-	205,470	933,177	3,686,735	-	4,825,382
Due from banking institutions	8.17	700,289	-	44,432	-	91,231	835,952
Loans and advances to customers	12.63	2,647,908	1,612,445	1,953,713	2,985,713	-	9,199,779
Other assets		-	-	-	-	52,703	52,703
<b>Total assets</b>		<b>3,348,197</b>	<b>1,817,915</b>	<b>2,931,322</b>	<b>6,672,448</b>	<b>495,046</b>	<b>15,264,928</b>
<b>Liabilities</b>							
Due to banking institutions	2.19	1,416,138	-	-	-	-	1,416,138
Customers' deposits	8.72	4,637,646	1,361,426	226,242	-	-	6,225,314
Borrowings	8.92	4,743,509	96,229	575,037	21,163	-	5,435,938
Other liabilities		-	-	-	-	272,146	272,146
<b>Total liabilities</b>		<b>10,797,293</b>	<b>1,457,655</b>	<b>801,279</b>	<b>21,163</b>	<b>272,146</b>	<b>13,349,536</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 Bank's assets and liabilities for 2016 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		-	-	-	-	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
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 Bank's assets and liabilities for 2017 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	-	-	-	-	-	351,112	351,112
Investments in government securities	11.51	-	205,470	933,177	3,665,646	-	4,804,293
Due from banking institutions	8.17	700,289	-	44,432	-	91,231	835,952
Loans and advances to customers	12.63	2,647,908	1,612,445	1,953,713	2,985,713	-	9,199,779
Other assets		-	-	-	-	52,703	52,703
<b>Total assets</b>		<b>3,348,197</b>	<b>1,817,915</b>	<b>2,931,322</b>	<b>6,651,359</b>	<b>495,046</b>	<b>15,243,839</b>
<b>Liabilities</b>							
Due to banking institutions	2.19	1,416,138	-	-	-	-	1,416,138
Customers' deposits	8.72	4,659,148	1,361,426	226,242	-	-	6,246,816
Borrowings	8.92	4,743,509	96,229	575,037	21,163	-	5,435,938
Other liabilities		-	-	-	-	271,413	271,413
<b>Total liabilities</b>		<b>10,818,795</b>	<b>1,457,655</b>	<b>801,279</b>	<b>21,163</b>	<b>271,413</b>	<b>13,370,305</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 Bank's assets and liabilities for 2016 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

**Bank**

	<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		-	-	-	-	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
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)**

**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 2017:

<b>At 31 December 2017</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	35,618	2,184	1,200	-	39,002
Deposits and balances due from banking institutions	56,182	1,121	26,257	216	83,776
Loans and advances to customers	765,940	-	707,163	-	1,473,103
<b>Total foreign currency assets</b>	<b>857,740</b>	<b>3,305</b>	<b>734,620</b>	<b>216</b>	<b>1,595,881</b>
<b>Liabilities</b>					
Borrowings	772,489	-	-	-	772,489
Deposits and balances due to banking institutions	-	-	712,414	-	712,414
<b>Total foreign currency liabilities</b>	<b>772,489</b>	<b>-</b>	<b>712,414</b>	<b>-</b>	<b>1,484,903</b>
<b>Foreign currency exposure at 31 December 2017</b>	<b>85,251</b>	<b>3,305</b>	<b>22,206</b>	<b>216</b>	<b>110,978</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
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>					
Borrowings	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)**

**(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>2017</b>	<b>2016</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	574,452	702,112
Other Reserves	281	281
	<hr/>	<hr/>
<b>Core capital</b>	<b>1,617,233</b>	<b>1,744,893</b>
Minimum statutory capital	1,000,000	1,000,000
	<hr/>	<hr/>
<b>Excess capital</b>	<b>617,233</b>	<b>744,893</b>
Supplementary capital (Tier 2)	281,099	280,935
	<hr/>	<hr/>
<b>Total capital</b>	<b>1,898,332</b>	<b>2,025,828</b>
	<hr/>	<hr/>
<b>Total risk weighted assets</b>	<b>8,060,325</b>	<b>7,675,088</b>
	<hr/>	<hr/>

**Notes (continued)**

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

**(iv) Capital management (continued)**

**Capital adequacy ratios**

	<b>2017</b>	<b>2016</b>
Percentage of Core Capital to Risk Weighted Asset ratio	20.10%	21.60%
Minimum requirement	10.5%	10.5%
Percentage of Total Capital to Risk Weighted Asset ratio	23.60%	25.10%
Minimum requirement	14.50%	14.50%
Percentage of Core Capital to Deposits ratio	23.30%	26.20%
Minimum requirement	10.50%	10.50%

**Notes (continued)**

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

**(v) 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 2017</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	-	91,449	-	91,449
Available for sale equity investments	-	-	805,499	805,499
<b>Total assets</b>	<b>-</b>	<b>91,449</b>	<b>805,499</b>	<b>896,948</b>

**Notes (continued)**

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

**(vi) Fair value measurement (continued)**

**Fair value hierarchy (continued)**

<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>	<b>-</b>	<b>89,427</b>	<b>805,499</b>	<b>894,926</b>

**Financial instruments in level 2**

The fair value of these financial assets is determined by using valuation techniques which maximize 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**

**Group**

	<b>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Loans and advances to customers	517,849	614,097
Overdrafts	460,392	691,111
Treasury bonds	552,889	572,069
Deposits and balances due from banking institutions	45,595	30,166
	<u>1,576,725</u>	<u>1,907,443</u>

**Bank**

Loans and advances to customers	517,849	614,097
Overdrafts	460,392	691,111
Treasury bonds	550,654	569,939
Deposits and balances due from banking institutions	45,595	30,166
	<u>1,574,490</u>	<u>1,905,313</u>

Included within various captions under interest income for the year ended 31 December 2017 is a total of KShs 107,162,000 (2016 KShs 155,165,000) accrued on impaired financial assets.

Included within interest income on investment securities for the year ended 31 December 2017 is KShs 541,639,000 (KShs 560,808,581) relating to debt securities held-to-maturity.

**6. Interest expense**

**Group**

	<b>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Customer deposits	562,796	910,726
Deposits and balances due to banking institutions	15,604	270,015
Borrowings	492,354	84,634
	<u>1,070,754</u>	<u>1,265,375</u>

**Bank**

Customer deposits	563,354	912,060
Deposits and balances due to banking institutions	15,604	270,015
Borrowings	492,354	84,634
	<u>1,071,312</u>	<u>1,266,709</u>

**Notes (continued)**

**7. Other income**

	<b>2017</b> <b>KShs'000</b>	<b>2016</b> <b>KShs'000</b>
Gains arising from dealing in foreign currencies	26,491	25,825
Rental income	52,203	50,838
Other income	1,860	10,987
	<u>80,554</u>	<u>87,650</u>

**8. Operating expenses**

**Group**

Salaries and employee benefits (Note 9)	202,218	203,210
Occupancy expenses	48,615	61,064
Deposit Protection Fund	14,597	17,208
Depreciation	18,673	19,704
Amortisation of prepaid operating lease rentals	61	61
Directors' emoluments	10,019	11,506
Professional and legal services	9,651	15,640
Telecommunication	3,262	4,793
Other expenses	77,721	53,232
	<u>384,817</u>	<u>386,418</u>

**Bank**

Salaries and employee benefits (Note 9)	202,218	203,210
Occupancy expenses	48,615	61,064
Deposit Protection Fund	14,597	17,208
Depreciation	18,673	19,704
Amortisation of prepaid operating lease rentals	61	61
Directors' emoluments	9,919	11,406
Professional and legal services	9,651	15,640
Telecommunication	3,262	4,793
Other expenses	77,045	52,676
	<u>384,041</u>	<u>385,762</u>

**Notes (continued)**

**9. Salaries and employee benefits**

	2017 KShs'000	2016 KShs'000
Salaries	158,739	160,119
Contributions to defined contribution plans	18,629	19,198
National Social Security Fund	893	903
Other staff costs	23,957	22,990
	<u>202,218</u>	<u>203,210</u>

**10. Profit before taxation**

Profit before taxation is arrived at after charging:

**Group**

Depreciation expense (Note 23)	18,673	19,704
Amortisation of prepaid operating lease rentals (Note 22)	61	61
Director's emoluments		
– Fees as non-executive	1,400	1,400
– Other*	8,619	10,106
Auditors' remuneration	2,662	2,350

**Bank**

Depreciation expense (Note 23)	18,673	19,704
Amortisation of prepaid operating lease rentals (Note 22)	61	61
Director's emoluments		
– Fees as non-executive	1,500	1,500
– Other*	8,619	10,106
Auditors' remuneration	2,662	2,350

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

**11. Income tax expense**

Group	2017		2016	
	Group KShs'000	Company	Group KShs'000	Company KShs'000
Current income tax	40,770	40,202	40,801	40,097
Deferred income tax (Note 21)	(9,002)	(8,972)	(4,761)	(4,911)
	<u>31,768</u>	<u>31,230</u>	<u>36,040</u>	<u>35,186</u>

**Notes (continued)**

**11 Income tax expense (continued)**

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

<b>Group</b>	<b>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Accounting profit before tax	59,426	97,755
Computed tax using the applicable corporation tax rate of 30% (2016: 30%)	17,828	29,327
Tax impact of expenses not deductible for tax purposes	13,940	6,713
Income tax expense	<u>31,768</u>	<u>36,040</u>
<b>Bank</b>		
Accounting profit before tax	57,632	94,910
Computed tax using the applicable corporation tax rate of 30% (2016: 30%)	17,290	28,473
Tax impact of expenses not deductible for tax purposes	13,940	6,713
Income tax expense	<u>31,230</u>	<u>35,186</u>

**12. Dividend per share**

The bank did not pay an interim dividend in the year (2016: Nil). The company does not propose payment of a final dividend (2016: Nil)

**13. Earnings per share**

The calculation of basic earnings per share is based on:

<b>Group</b>	<b>2017</b>	<b>2016</b>
Net profit for the year attributable to shareholders (KShs '000)	<u>59,426</u>	<u>97,755</u>
Number of ordinary shares ('000)	<u>52,125</u>	<u>52,125</u>
Earnings per share (KShs)	<u>1.14</u>	<u>1.88</u>

**Notes (continued)**

**13. Earnings per share (continued)**

**Bank**

Net profit for the year attributable to shareholders (KShs '000)	57,632	94,910
	<u>                    </u>	<u>                    </u>
Number of ordinary shares ('000)	52,125	52,125
	<u>                    </u>	<u>                    </u>
Earnings per share (KShs)	<u>          1.11          </u>	<u>          1.82          </u>

There were no potentially dilutive shares outstanding at 31 December 2017 and 2016.

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

<b>Group and Company</b>	<b>2017 KShs'000</b>	<b>2016 KShs'000</b>
Cash on hand	64,555	81,522
Balances with Central Bank of Kenya:		
– Local currency cash reserve ratio	286,557	263,924
– Other	<u>                    -</u>	<u>                    27,758</u>
	<u>          351,112          </u>	<u>          373,204          </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 2017, the cash reserve requirement was 5.25% (2016:5.25%) 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 fall below the 3% minimum daily requirements and provided that the overall average in the month is at least 5.25%.

Notes (continued)

15. Investment in government securities

	2017 KShs'000	2016 KShs'000
<b>Group</b>		
<b>Held to maturity</b>		
<i>Treasury bonds:</i>		
Maturing within one year	205,470	304,890
Maturing after one year	<u>4,528,463</u>	<u>4,733,802</u>
<b>Total held to maturity</b>	<u>4,733,933</u>	<u>5,038,692</u>
<b>Held for trading</b>		
<i>Treasury bonds:</i>		
Maturing after one year	<u>91,449</u>	<u>89,427</u>
	<u>4,825,382</u>	<u>5,128,119</u>
<b>Company</b>		
<b>Held to maturity</b>		
<i>Treasury bonds:</i>		
Maturing within one year	205,470	304,890
Maturing after one year	<u>4,507,374</u>	<u>4,712,698</u>
<b>Total held to maturity</b>	<u>4,712,844</u>	<u>5,017,588</u>
<b>Held for trading</b>		
<i>Treasury bonds:</i>		
Maturing after one year	<u>91,449</u>	<u>89,427</u>
	<u>4,804,293</u>	<u>5,107,015</u>

The weighted average effective interest rate on government securities at 31 December 2017 was 11.51% (2016:11.53%).

16. Deposits and balances due from banking institutions

<b>Group and Company</b>	2017 KShs'000	2016 KShs'000
Due within 90 days	725,436	1,047,009
Due between 3 months and 1 year	66,084	-
Due between 1 year and 5 year	<u>44,432</u>	<u>-</u>
	<u>835,952</u>	<u>1,047,009</u>

The weighted average effective interest rate on placements with other banks at 31 December 2017 was 8.71% (2016:1.40%).

Notes (continued)

17. Loans and advances to customers

	2017		2016	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Overdrafts	4,973,608	4,973,608	4,406,957	4,406,957
Loans	5,040,937	4,985,212	5,134,216	5,078,713
Staff loans	298,140	298,140	282,461	282,461
	10,312,685	10,256,960	9,823,634	9,768,131
Less: Impairment losses reserves	(1,112,906)	(1,057,181)	(1,090,422)	(1,034,919)
	9,199,779	9,199,779	8,733,212	8,733,212
Maturing within 1 year	4,215,921	4,215,921	3,729,211	3,729,211
Between 1 and 3 years	854,116	854,116	341,693	341,693
Over 3 years	4,129,742	4,129,742	4,662,308	4,662,308
	9,199,779	9,199,779	8,733,212	8,733,212

The weighted average effective interest rate on loans and advances to customers at 31 December 2017 was 12.63% (2016:12.70%).

Impairment losses reserves

Group	Identified impairment KShs'000	Unidentified impairment KShs'000	Total KShs'000
<b>2017</b>			
At 1 January 2017	997,091	93,331	1,090,422
Amounts written off during the year	(146,931)	-	(146,931)
Reversals on recovery during the year	(106,761)	-	(106,761)
Made during the year	255,165	21,011	276,176
<b>At 31 December 2017</b>	<b>998,564</b>	<b>114,342</b>	<b>1,112,906</b>

Notes (continued)

17. Loans and advances to customers (continued)

Impairment losses reserves (continued)

Group	Identified impairment KShs'000	Unidentified impairment 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>	<b>997,091</b>	<b>93,331</b>	<b>1,090,422</b>
<b>Company</b>			
<b>2017</b>			
At 1 January 2017	941,588	93,331	1,034,919
Amounts written off during the year	(146,931)	-	(146,931)
Reversals on recovery during the year	(106,761)	-	(106,761)
Made during the year	254,943	21,011	275,954
<b>At 31 December 2017</b>	<b>942,839</b>	<b>114,342</b>	<b>1,057,181</b>
<b>2016</b>			
At 1 January 2015	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>

Impairment losses on loans and advances charged to profit or loss

Group	2017 KShs'000	2016 KShs'000
Provisions during the year	276,176	380,115
Recovered during the year	(106,761)	(99,172)
Direct write offs	175	314
	<u>169,590</u>	<u>281,257</u>
Interest on impaired loans and advances which has not yet been received in cash	<u>107,162</u>	<u>155,166</u>
<b>Bank</b>		
Provisions during the year	275,953	380,115
Recovered during the year	(106,761)	(98,925)
Direct write offs	175	314
	<u>169,367</u>	<u>281,504</u>
Interest on impaired loans and advances which has not yet been received in cash	<u>107,162</u>	<u>155,166</u>

**Notes (continued)**

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

**Impaired loans and advances (continued)**

Loans and advances include an amount of KShs 1, 298,611,000 (2016: KShs 1, 652,873,000) net of impairment losses which have been classified as impaired loans and advances.

Estimated value of underlying collaterals amount to KShs 1,011,204,000 (2016: Kshs 1,239,220,000). The directors are of the opinion that recovery of the principal amounts thereof is not doubtful.

**18. Equity investments**

**Group and Company**

	<b>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
<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
	<u>810,479</u>	<u>810,479</u>
<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)
	<u>(4,980)</u>	<u>(4,980)</u>
	<u><u>805,499</u></u>	<u><u>805,499</u></u>

**19. Investment in subsidiary**

**Company**

**Shares at cost:**

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

Notes (continued)

20. Other assets

	2017		2016	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Rent receivable	21,691	21,691	20,801	20,801
Uncleared effects	7,362	7,362	21,978	21,978
Prepayments	17,004	17,004	19,752	19,752
Other receivables	6,646	6,646	6,321	6,321
	<u>52,703</u>	<u>52,703</u>	<u>68,852</u>	<u>68,852</u>

21. Deferred income tax

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		2016	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
At start of the year	7,374	7,313	2,613	2,402
Credited to profit or loss	9,002	8,972	4,761	4,911
	<u>16,376</u>	<u>16,285</u>	<u>7,374</u>	<u>7,313</u>

The deferred income tax assets and liabilities, deferred tax credit/ (charge) in the statement or profit or loss are attributable to the following items:

Notes (continued)

21. Deferred income tax (continued)

Group

2016	At 1 January KShs'000	(Charge)/Credit to profit or loss 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>2017</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	14,647	1,585	16,232
Portfolio impairment provisions on loans and advances	27,999	6,304	34,303
Other provisions	2,695	1,113	3,808
	45,341	9,002	54,343
	7,374	9,002	16,376

Notes (continued)

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

Company

2016	At 1 January KShs'000	(Charge)/Credit to profit or loss 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
<b>2017</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	14,647	1,585	16,232
Portfolio impairment provisions on loans and advances	27,999	6,304	34,303
Other provisions	2,634	1,083	3,717
	45,280	8,972	54,252
	7,313	8,972	16,285

22. Prepaid operating lease rentals

Group and Company	2017 KShs'000	2016 KShs'000
<b>Cost</b>		
At 1 January	6,000	6,000
<b>Amortisation</b>		
At 1 January	2,127	(2,066)
Amortisation for the year	(61)	(61)
At 31 December	2,188	(2,127)
<b>Net carrying amount at 31 December</b>	<b>3,812</b>	<b>3,873</b>

Notes (continued)

23 Property and equipment

Group and Company	Building KShs'000	Leasehold improvements KShs'000	Furniture and equipment KShs'000	Computers KShs'000	Motor vehicles KShs'000	Capital work in progress KShs'000	Total KShs'000
<b>2016</b>							
<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)

23. Property and equipment (continued)

Group and Company	Building	Leasehold improvements	Furniture and equipment	Computers	Motor vehicles	Capital work in progress	Total
2017	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
<b>Cost</b>							
At 1 January 2017	123,425	63,038	101,143	38,383	38,034	108,601	472,624
Additions	-	2,108	334	4,908	-	650	8,000
Transfer from WIP	-	-	-	1,596	-	(1,596)	-
Disposals	-	-	-	(169)	-	-	(169)
At 31 December 2017	123,425	65,146	101,477	44,718	38,034	107,655	480,455
<b>Depreciation</b>							
At 1 January 2017	(37,059)	(47,146)	(93,354)	(34,364)	(31,516)	-	(243,439)
Charge for the year	(1,356)	(7,052)	(3,337)	(3,706)	(3,222)	-	(18,673)
Disposals	-	-	-	98	-	-	98
At 31 December 2017	(38,415)	(54,198)	(96,691)	(37,972)	(34,738)	-	262,014
<b>Net book amount at 31 December</b>	<b>85,010</b>	<b>10,948</b>	<b>4,786</b>	<b>6,746</b>	<b>3,296</b>	<b>107,655</b>	<b>218,441</b>

Notes (continued)

24. Deposits and balances due to other banks

Group and Company	2017 KShs'000	2016 KShs'000
Payable within 90 days	1,416,138	250,127
Payable between 3 months and one year	-	1,742,356
	<u>1,416,138</u>	<u>1,992,483</u>

The weighted average effective interest rate on deposits from other banks at 31 December 2017 was 2.19% (2016: 1.90%).

25. Deposits from customers

	2017		2016	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
From government and parastatals	865,661	865,661	816,847	816,847
From private sector and individuals	<u>5,362,153</u>	<u>5,383,655</u>	<u>4,951,606</u>	<u>4,971,667</u>
	<u>6,227,814</u>	<u>6,249,316</u>	<u>5,768,453</u>	<u>5,788,514</u>

Included in the Company customers deposits is KShs 21,502,000 (2016: KShs 20,061,000) due to the subsidiary company. Interest paid on these deposits during the year amounted to KShs 558,000 (2016: KShs 1,333,631).

The weighted average effective interest rate on customer deposits at 31 December 2017 was 8.72% (2016: 8.20%).

26. Borrowings

Group and Company	2017 KShs'000	2016 KShs'000
European Investment Bank	21,163	21,163
Central Bank of Kenya	4,642,286	4,243,454
Standard Chartered Bank Kenya Limited	-	250,000
China Development Bank	<u>772,489</u>	<u>958,111</u>
	<u>5,435,938</u>	<u>5,472,728</u>

**Notes (continued)**

**26. Borrowings (continued)**

<b>Maturities</b>	<b>2017</b> <b>KShs'000</b>	<b>2016</b> <b>KShs'000</b>
Less than one year	4,839,738	4,690,014
Between one and five years	575,037	476,259
Over 5 years	21,163	306,455
	<u>5,435,938</u>	<u>5,472,728</u>

The weighted average effective interest rate on loan capital at 31 December 2017 was 8.92% (2016:8.51%).

**Loan terms**

- 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>2017</b>		<b>2016</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	11,329	11,329	11,904	11,904
Rent deposit	18,150	18,150	17,938	17,938
Deutsche Investitions-und EntwicklungsgesellschaftmbH (DEG) retained funds	127,965	127,965	125,438	125,438
Payable to Government of Kenya	65,281	65,281	65,281	65,281
Provisions and accruals	34,290	34,290	24,165	23,043
Other liabilities	15,130	14,398	17,380	17,709
	<u>272,145</u>	<u>271,413</u>	<u>262,106</u>	<u>261,313</u>

**Notes (continued)**

**28. Share capital**

	<b>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
<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>

Total number of shares in issue 52,125,000 (2016: 52,125,000).

**29. Cash and cash equivalents**

**Group**

Cash in hand (Note 14)	64,555	81,522
Balances with Central Bank of Kenya (Note 14)	-	27,758
Deposits and balances due from banks (Note 16)	835,952	1,047,009
Deposits and balances due to banks (Note 24)	<u>(1,416,138)</u>	<u>(1,992,483)</u>
	<u>(515,631)</u>	<u>(836,194)</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% (2016:3.00% to 14.00%). The contractual amounts of commitments are set out below:

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

	<b>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Undrawn loans	426,690	269,480
Undrawn overdraft facilities	-	164,693
Unutilised guarantees and letters of credit	<u>85,730</u>	<u>26,947</u>
	<u>512,420</u>	<u>461,120</u>

**Notes (continued)**

**30. Contingencies (continued)**

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

At 31 December 2017, interest rate on facilities subject to commitments ranged from 3.00% to 14.00% (2016: 3.00% to 14.00%).

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

	<b>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Guarantees	531,368	652,173
Acceptances	48,038	21,667
Letters of credit	32,142	28,846
Undelivered spots	92	92
	<u>611,640</u>	<u>702,778</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>2017</b>	<b>2016</b>
	<b>KShs'000</b>	<b>KShs'000</b>
Less than one year	35,395	33,945
Between one and five years	120,607	136,157
Over five years	18,506	45,663
	<u>174,508</u>	<u>215,765</u>

Notes (continued)

32. Related party transactions

(a) Loans and advances to employees

	2017 KShs'000	2016 KShs'000
At 1 January	282,461	254,084
Advances in the year	114,279	101,715
Repayments in the year	(98,600)	(73,338)
<b>At 31 December</b>	<u>298,140</u>	<u>282,461</u>

Interest earned on staff loans during the year amounted to KShs 18,235,851 (2016: KShs 17,325,386).

(b) Loans and advances to directors and their associates

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

	2017 KShs'000	2016 KShs'000
Gross amount at 1 January	783,661	505,707
Interest charged	38,061	82,271
Loans disbursed	19,971	345,052
Write offs	(63,203)	-
Cash received	(124,278)	(149,369)
<b>Net amount at 31 December</b>	<u>654,212</u>	<u>783,661</u>

(c) Related party deposits

Included in deposits is KShs 21,502,000 (2016: KShs 20,061,000) due to a subsidiary company. Interest paid on these deposits during the year amounted to KShs 558,000 (2016: KShs 1,334,000).

(d) Key management compensation

Compensation to senior management for the year ended 31 December 2017 amounted to KShs 65,024,769 (2016: KShs 65,028,667).

(e) Directors remuneration

	2017 Shs'000	2016 Shs'000
Fees for services as a director	1,400	1,400
Other emoluments	8,619	10,106
	<u>10,019</u>	<u>11,506</u>

**Notes (continued)**

**33. Assets pledged as security**

**Financial assets that may be repledged or resold by counterparties**

As at 31 December 2017, Government securities amounting to KShs 4,714.9 million (2016: KShs 4,705.5 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.

**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) KShs 721,379,000 revaluation reserves on the equity investment in Kenya Hotel properties net of tax.