

REPUBLIC OF KENYA



KENYA NATIONAL AUDIT OFFICE



REPORT

OF

THE AUDITOR-GENERAL

ON

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

**FOR THE YEAR ENDED
31 DECEMBER 2014**

DEVELOPMENT BANK OF KENYA LIMITED
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2014

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Email: dbk@devbank.com
Telegrams DEVBANK.KE
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Subsidiary

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

Shareholders

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

Trans-Century Limited
PO Box 42588, 00100
Nairobi
Kenya

Directors

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

Prof. H.K. Mengech	Chairman
K. Gatabaki	
Prof. J.H. Kimura	
Z. G. Mbugua	
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
NairobiGPO

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

Commerzbank AG
D – 60261
Frankfurt am Main,
Germany

Nedbank
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ICICI Bank Limited
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ING BHF Bank
Bockenheimer
Landstrasse 10
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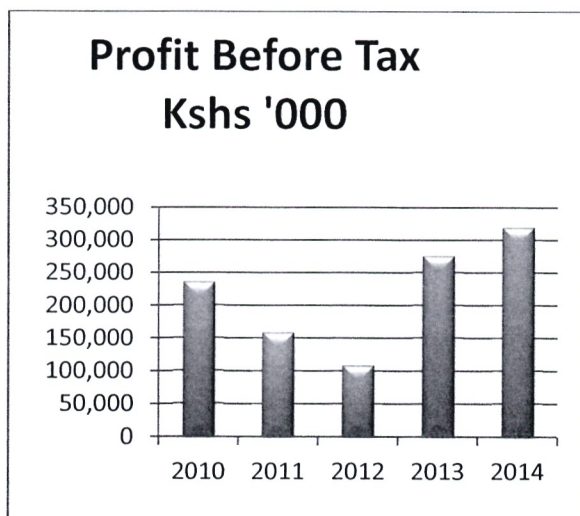
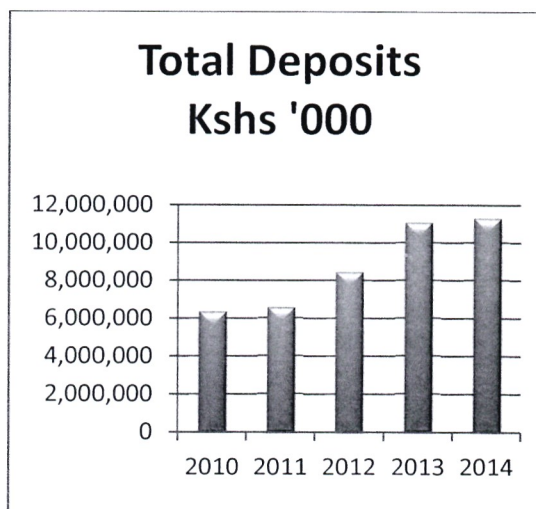
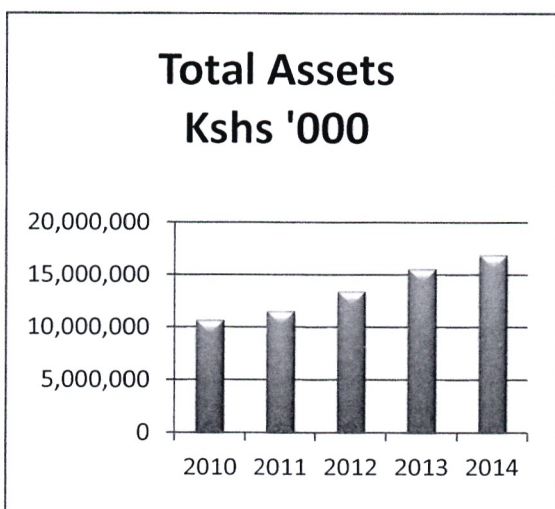
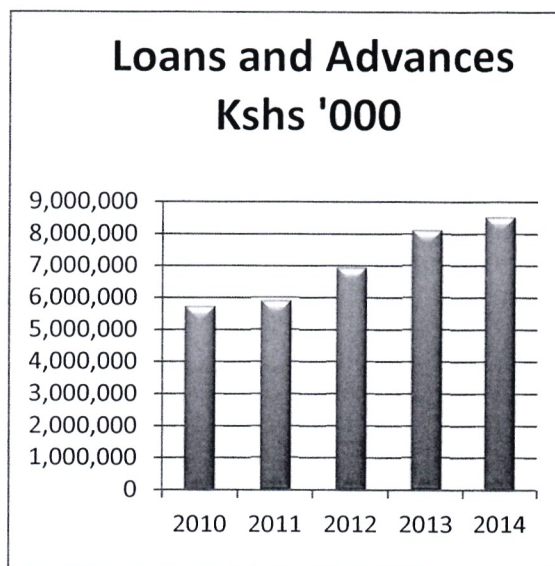
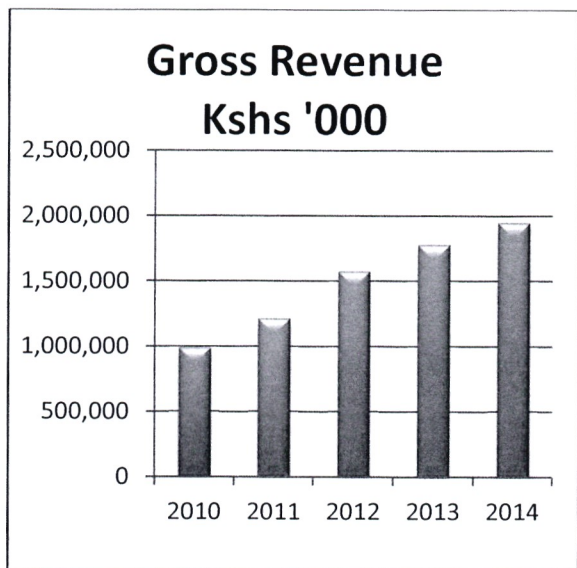
Five-year Group financial review

	2014	2013	2012	2011	2010
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
Gross revenue	1,941,074	1,779,696	1,574,665	1,210,509	988,350
Profit before tax	319,326	275,289	106,259	159,001	235,623
Profit after tax	220,592	189,433	73,779	109,168	159,955
Gross loans and advances	9,225,833	8,646,163	7,300,320	6,247,942	5,732,795
Less impairment losses on loans and advances	(698,201)	(537,696)	(368,700)	(346,148)	(340,359)
Loans and advances to customers (net of impairment)	8,527,632	8,108,467	6,931,620	5,901,794	5,392,436
Total deposits	11,292,787	11,046,404	8,454,744	6,544,356	6,324,050
Loan capital	2,618,047	2,393,478	3,056,855	3,110,310	2,531,965
Shareholders' equity	2,772,330	1,830,359	1,640,936	1,567,147	1,492,979
Total assets	16,944,142	15,574,646	13,411,458	11,517,988	10,644,841

KEY RATIOS

Basic Earnings Per Share (EPS)	12.64	10.90	4.25	6.28	9.21
Return on Assets (ROA)	1.9%	1.8%	0.8%	1.4%	2.2%
Return on Equity (ROE)	11.7%	15.1%	6.5%	10.1%	15.8%
Capital Adequacy Ratio	25.7%	22.4%	20.9%	23.7%	25.3%

KEY PERFORMANCE INDICATORS



Introduction

Introduction

It is my great pleasure to present to you the audited consolidated Financial Statements for the Bank and its wholly owned subsidiary for the year ended December 2014. The year was characterized by a relatively stable macro-economic environment. The key indicators of inflation and exchange rate remained fairly stable throughout the year, although the Kenya shilling did lose marginally to other foreign currencies towards the end of the year. Liquidity was relatively high in the market leading to sustained pressure on interest rates. In order to rein in the relatively high lending rates and to have a common basis for pricing loans, Central Bank of Kenya (CBK), introduced a base reference rate referred to as Kenya Bankers Reference Rate (KBRR). The implementation of this rate will inevitably affect the results going forward.

During the year, the Bank leveraged on the stability in the market to increase its asset base to Kshs 16.9 billion from Kshs 15.6 billion as at the end of 2013. Equally profit before tax rose by 11.4% to Kshs 319.3 million compared to Kshs 275.3 million achieved in the previous year.

Economic Overview

The Kenyan economy continued to exhibit resilience over global economic challenges to record an output of 5.7% in 2013, an improvement from the 4.5% achieved in 2012. This year though, has seen growth decelerate from 5.2% and 7.2% in quarter one and two of 2013 to 4.1% and 5.8% respectively. The depressed performance has been attributed to bad weather and insecurity. Agricultural output, the mainstay sector of the economy, has been hampered largely by the drought experienced in the country for most of the year. On the other hand negative travel advisories issued by key tourist source countries based on security assessment continue to depress the Tourism Sector of the economy. Based on these statistics, Treasury has had to revise annual GDP projections for the year to between 5.3% and 5.5%.

On the Money Market front, the much anticipated reduction in interest rates on the back of the successful issuance of the Eurobond

is yet to take effect. In order to check inflation and the depreciation of the shilling, the Monetary Policy Committee (MPC) held constant the Central Bank Rate (CBR) at 8.5% throughout the year.

Developments in the Banking Sector

The Kenyan banking sector comprised of 43 Commercial Banks, 1 Mortgage Finance Company, 9 microfinance banks, 7 representative offices of foreign banks, 90 Foreign Exchange Bureaus and 2 Credit Reference Bureaus as at the end of November 2014.

According to Central Bank of Kenya statistics, pre – tax profits for the entire sector rose by 13.5% from Kshs 111.5 billion in November 2013 to Kshs 126.6 billion as at the end of November 2014. Profitability in the sector was largely driven by increased revenue, which grew by 15.0% or Kshs 48.8 billion to Kshs 374.5 billion during the year. This increase more than offset a 15.7% or Kshs 33.6 billion increase in expenses from a base of Kshs 214.0 million in 2013.

The aggregate balance sheet increased by 20.4% to Kshs 3,168.7 billion from Kshs 2,631.6 billion on the back of higher loans and advances, deposits and retention of profits. Loans and advances rose by 22.6% (Kshs 1,588.9 billion to Kshs 1,948.4 billion) during this period. The bulk of the lending was to households, trade, and manufacturing and real estate sectors. Customer deposits grew during the period to Kshs 2,279.8 billion from Kshs 1,916.1 billion as at November 2013.

The quality of the sector's loan asset, as measured by the ratio of gross non-performing loans to gross loans, deteriorated further to 5.5% compared to 5.1% registered in 2013. The value of non-performing loans grew to Kshs 108.0 billion during the period from Kshs 81.4 billion, an increase of 32.7%.

The DBK's Performance

In 2014, the financial sector experienced a sustained liquidity with minimal changes in interest rates as MPC maintained its benchmark lending rate throughout the year. DBK was able to use this opportunity to grow its asset base and keep its cost of funds relatively lower. The bank therefore continued with improved Net Interest Margins (NIM) throughout the year.

The bank recorded a higher profit before tax of Kshs 319.3 million compared to the previous year's outcome of Kshs 275.3 million. The increase in profits was attributable to higher NIM the bank enjoyed throughout 2014. Net assets also grew to close at Kshs 16.9 billion compared to Kshs 15.6 billion attained in 2013

The growth in net assets was mainly as a result of increased lending and revaluation of equity investment of the bank. The loan portfolio rose from Kshs 8.6 billion to Kshs 9.2 billion, representing 7.0% growth. However, the portfolio's quality as measured by the percentage of Non-performing loans to gross loans decreased from 13.9% to 14.9%. After adjusting for additional provisions against non-performing loans, the net loans closed at Kshs 8.5 billion compared to Kshs 8.1 billion. This translates to annualized growth rate of 5.2%. The bulk of credit was advanced to the real estate and household investments as shown below.


SECTOR	Portfolio 2014	Portfolio 2013
Agriculture	7.3%	8.1%
Manufacturing	11.8%	16.8%
Building		
Construction	2.2%	1.7%
Trade	18.2%	18.2%
Tourism, Restaurants & Hotels	1.3%	1.6%
Transport		
Communication	2.7%	2.6%
Real Estate	35.9%	31.3%
Financial Services	2.2%	2.2%
Personal Households	18.4%	17.5%
TOTAL	100.0%	100.0%

During the year, the growth was funded by deposits and borrowed funds. Deposits grew from Kshs 11.0 billion to Kshs 11.2 billion or 2.2% whereas borrowed funds increased from Kshs 2.4 billion to Kshs 2.6 billion which translates to an increase of 9.4%.

NIM has continued to be the single most significant driver of profitability. During the year, interest income rose from Kshs 1.68 billion to Kshs 1.8 billion. However, interest expenses rose marginally from Kshs 1.04 billion to Kshs 1.15 billion or 10.9%. Despite this, the bank recorded an increase in NIM from Kshs 638.1 million to Kshs 683.8 million reflecting annualized increase of 7.2%

Appreciation

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


H.N.K MENGINECH (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 seven directors inclusive of a non-executive chairman.

Board and Management Committees

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

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

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 2014:

Names	March	April	July	October	December	% Attendance
Prof. H.K. Mengech	X	X	X	X	X	100
KunguGatabaki	X	X	X	X	X	100
Prof. J.H. Kimura	X	X	X	X	X	100
Z.G. Mbugua	-	X	X	X	X	80
Peter Kimurwa	X	X	-	X	X	80
MbathaMbithi	X	X	X	-	X	80
Joseph Kiarii*	-	-	-	X	X	40

- Director Joseph Kiarii was appointed to the Board in August 2014 to represent the Cabinet Secretary Treasury.

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 2015.

The directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2014, which disclose the state of affairs of the Group and the Company.

1. Principal activities

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

2. Results

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

3. Dividend

The directors recommend the approval of a final dividend for the year ended 31 December 2014 of KShs2.30 (2013: Nil) per share amounting to KShs 40,000,000 (2013: Nil).

4. Directors

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

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

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

6. Auditors

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

PricewaterhouseCoopers, who were appointed by the Auditor-General, carried out the audit of the Bank's financial statements for the year ended 31 December 2014.

7. Approval of financial statements

The financial statements were approved at a meeting of the directors held on

By order of the Board


Company Secretary

Date: 27 March 2015

The Kenyan Companies Act requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the Company maintains proper accounting records that disclose, with reasonable accuracy, the financial position of the Company. The directors are also responsible for safeguarding the assets of the Company.


The directors accept responsibility for the preparation and fair presentation of financial statements that are free from material misstatements whether due to fraud or error. 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 and applying appropriate accounting policies; and
- (iii) Making accounting estimates and judgements that are reasonable in the circumstances.

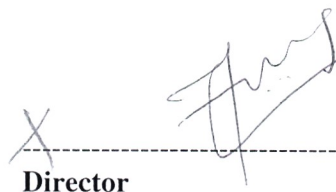
The Directors are of the opinion that the financial statements give a true and fair view of the financial position of the Group and the Company at 31 December 2014 and of the Group financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.

Nothing has come to the attention of the Directors to indicate that the Company and its subsidiaries will not remain a going concern for at least the next twelve months from the date of this statement.

Approved by the board of directors on 27 March-----2015 and signed on its behalf by:



Director



Director



REPORT OF THE INDEPENDENT AUDITOR TO THE AUDITOR GENERAL

Report on the financial statements

We have audited the accompanying consolidated financial statements of Development Bank of Kenya Limited (the "Company") and its subsidiary (together the "Group") as set out on pages 13 to 68. These financial statements comprise the consolidated statement of financial position at 31 December 2014 and the consolidated statements of and comprehensive income, changes in equity and cash flows for the years then ended, together with the statement of financial position of the Company standing alone at 31 December 2014 and the statement of changes in equity of the Company for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement.

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

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

Opinion

In our opinion the accompanying financial statements give a true and fair view of the financial position of the Group and the Company at 31 December 2014 and of the financial performance and cash flows of the Group for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act.

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KENYA NATIONAL AUDIT OFFICE

REPORT OF THE AUDITOR-GENERAL ON DEVELOPMENT BANK OF KENYA LIMITED FOR THE YEAR ENDED 31 DECEMBER 2014

REPORT ON THE FINANCIAL STATEMENTS

The accompanying financial statements of Development Bank of Kenya Limited set out on pages 13 to 68, which comprise the consolidated statement of financial position as at 31 December 2014, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by PricewaterhouseCoopers CPA auditors appointed under Section 39 of the Public Audit Act, 2003 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

Directors' Responsibility for the Financial Statements

The directors of Development Bank of Kenya are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

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

Auditor-General's Responsibility

My responsibility is to express an opinion on the financial statements based on the audit and report in accordance with the provisions of Section 15(2) and (3) of the Public Audit Act, 2003 and submit the audit report in compliance with Article 229(7) of the Constitution of Kenya. The audit was conducted in accordance with International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

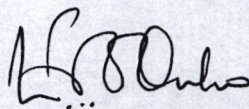
Opinion

In my opinion, the financial statements present fairly, in all material respects the financial position of the Bank as at 31 December 2014, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Companies Act, Cap 486 of the Laws of Kenya.

REPORT ON OTHER LEGAL REQUIREMENTS

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

- i. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit;
- ii. In my opinion, proper books of account have been kept by the Bank, so far as appears from the examination of those books; and
- iii. The Bank's statement of financial position and statement of comprehensive income are in agreement with the books of account.



Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

31 March 2015

**Consolidated statement of comprehensive income
 For the year ended 31 December 2014**

	Note	2014 KShs'000	2013 KShs'000
Interest income	5	1,837,286	1,678,802
Interest expense	6	<u>(1,153,472)</u>	<u>(1,040,670)</u>
Net interest income		683,814	638,132
Non-interest income	7	<u>103,788</u>	<u>100,894</u>
Operating income		787,602	739,026
Impairment losses on loans and advances	17	(166,227)	(173,488)
Non-interest expenses	8	<u>(302,049)</u>	<u>(290,249)</u>
Profit before income tax	10	319,326	275,289
Income tax expense	11	<u>(98,734)</u>	<u>(85,856)</u>
Profit for the year		220,592	189,433
Other comprehensive income net of tax	18	<u>721,379</u>	<u>-</u>
Total comprehensive income		<u><u>941,971</u></u>	<u><u>189,433</u></u>
Earnings per share (KShs per share)	13	<u><u>12.69</u></u>	<u><u>10.90</u></u>
Dividends per share (KShs per share)	12	<u><u>2.30</u></u>	<u><u>-</u></u>

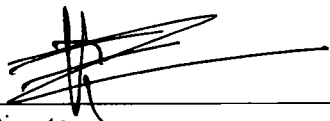
The notes set out on pages 19 to 68 form an integral part of these financial statements.

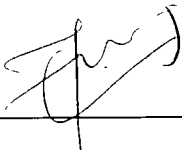
**Consolidated statement of financial position
 As at 31 December 2014**

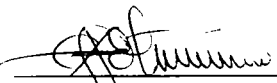
	Note	2014 KShs'000	2013 KShs'000
ASSETS			
Cash and balances with Central Bank of Kenya	14	926,188	703,422
Investment in government securities	15	5,682,584	4,850,068
Deposits and balances due from banking institutions	16	766,998	1,588,464
Net loans and advances to customers	17	8,527,632	8,108,467
Equity investments	18	805,499	46,153
Other assets	20	79,517	71,539
Tax recoverable		613	4,698
Deferred tax asset	21	-	32,637
Prepaid operating lease rentals	22	3,995	4,056
Property and equipment	23	151,116	165,142
TOTAL ASSETS		16,944,142	15,574,646
LIABILITIES			
Deposits from banks	24	2,844,524	2,643,413
Deposits from customers	25	8,448,263	8,402,991
Loan capital	26	2,618,047	2,393,478
Tax payable		-	40,238
Deferred tax liability	21	1,351	-
Other liabilities	27	259,627	264,167
		14,171,812	13,744,287
EQUITY			
Share capital	28	347,500	347,500
Retained earnings		1,405,526	1,213,412
Statutory reserves		257,645	269,167
Proposed Dividend		40,000	-
Other reserves		721,659	280
		2,772,330	1,830,359
TOTAL LIABILITIES AND EQUITY		16,944,142	15,574,646

The financial statements set out on pages 13 to 68 were approved by the Board of Directors on 27 March 2015 and were signed on its behalf by:


 Director


 Director

X 
 Director


 Company Secretary

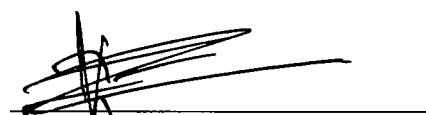
The notes set out on pages 19 to 68 form an integral part of these financial statements.

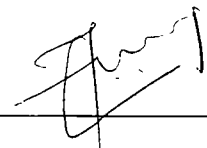
**Company statement of financial position
 As at 31 December 2014**

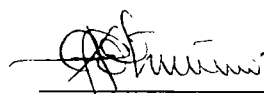
ASSETS	Notes	2014 KShs'000	2013 KShs'000
Cash and balances with Central Bank of Kenya	14	926,188	703,422
Investment in government securities	15	5,661,449	4,828,918
Deposits and balances due from banking institutions	16	766,998	1,588,464
Net loans and advances to customers	17	8,527,632	8,108,467
Equity investments	18	805,499	46,153
Investment in subsidiary	19	32,048	32,048
Other assets	20	79,302	71,474
Deferred tax asset	21	-	32,486
Prepaid operating lease rentals	22	3,995	4,056
Property and equipment	23	151,116	165,142
TOTAL ASSETS		<u>16,954,227</u>	<u>15,580,630</u>
LIABILITIES			
Deposits and balances due to banking institutions	24	2,844,524	2,643,413
Customers' deposits	25	8,464,547	8,418,675
Loan capital	26	2,618,047	2,393,478
Deferred tax liability	21	1,532	-
Tax payable		4,052	40,238
Other liabilities	27	257,924	262,553
		<u>14,190,626</u>	<u>13,758,357</u>
EQUITY			
Share capital	28	347,500	347,500
Retained earnings		1,396,797	1,205,326
Statutory reserves		257,645	269,167
Proposed Dividend		40,000	-
Other reserves		721,659	280
		<u>2,763,601</u>	<u>1,822,273</u>
TOTAL LIABILITIES AND EQUITY		<u>16,954,227</u>	<u>15,580,630</u>

The financial statements set out on pages 13 to 68 were approved by the Board of Directors on 27 March 2015 and were signed on its behalf by:


 Director


 Director

X 
 Director


 Company Secretary

The notes set out on pages 19 to 68 form an integral part of these financial statements.

**Consolidated statement of changes in equity
 For the year ended 31 December 2014**

	Share capital KShs'000	Statutory reserves KShs'000	Other reserves KShs'000	Retained earnings KShs'000	Proposed dividends KShs'000	Total KShs'000
At 1 January 2013	347,500	261,858	280	1,031,288	-	1,640,926
Comprehensive income for the year						
Profit for the year	-	-	-	189,433	-	189,433
Transfer to statutory reserves	-	7,309	-	(7,309)	-	-
Total comprehensive income for the year	-	7,309	-	182,124	-	189,433
At 31 December 2013	347,500	269,167	280	1,213,412	-	1,830,359
At 1 January 2014	347,500	269,167	280	1,213,412	-	1,830,359
Comprehensive income for the year						
Profit for the year	-	-	-	220,592	-	220,592
Transfer to statutory reserves	-	(11,522)	-	11,522	-	-
Other comprehensive income net of tax	-	-	721,379	-	-	721,379
Total comprehensive income for the year	-	(11,522)	721,379	232,114	-	941,971
Transactions with owners						
Proposed dividends	-	-	-	(40,000)	40,000	-
Total transactions with owners	-	-	-	(40,000)	40,000	-
At 31 December 2014	347,500	257,645	721,659	1,405,526	40,000	2,772,330

The notes set out on pages 19 to 68 form an integral part of these financial statements.

**Bank statement of changes in equity
 For the year ended 31 December 2014**

	Share capital KShs'000	Statutory reserves KShs'000	Other reserves KShs'000	Retained earnings KShs'000	Proposed dividends KShs'000	Total KShs'000
At 1 January 2013	347,500	261,858	280	1,024,057	-	1,633,695
Comprehensive income for the year						
Profit for the year	-	-	-	188,578	-	188,578
Transfer to statutory reserves	-	7,309	-	(7,309)	-	-
Total comprehensive income for the year	-	7,309	-	181,269	-	188,578
At 31 December 2013	347,500	269,167	280	1,205,326	-	1,822,273
At 1 January 2014	347,500	269,167	280	1,205,326	-	1,822,273
Comprehensive income for the year						
Profit for the year	-	-	-	219,949	-	219,949
Transfer to statutory reserves	-	(11,522)	-	11,522	-	-
Other comprehensive income net of tax	-	-	721,379	-	-	721,379
Total comprehensive income for the year	-	(11,522)	721,379	231,471	-	941,328
Transactions with owners						
Proposed dividends	-	-	-	(40,000)	40,000	-
Total transactions with owners	-	-	-	(40,000)	40,000	-
At 31 December 2014	347,500	257,645	721,659	1,396,797	40,000	2,763,601

The notes set out on pages 19 to 68 form an integral part of these financial statements.

**Consolidated statement of cash flows
 For the year ended 31 December 2014**

	Notes	2014 KShs'000	2013 KShs'000
Operating activities			
Profit before taxation		319,326	275,289
Depreciation	23	20,832	19,568
Amortisation of prepaid operating lease rentals		61	61
Loss on disposal of property and equipment		-	233
Interest charged on loan capital		196,572	195,558
Tax paid		(138,867)	(37,366)
Cash flows from operating activities before changes in operating assets and liabilities		397,924	453,343
Changes in working capital items			
Increase in net loans and advances to customers		(419,165)	(1,176,847)
Increase in deposits held for regulatory purposes	14	(23,320)	(58,806)
Increase in investments in treasury bonds		(832,516)	(845,267)
Increase in other assets		(7,978)	(6,565)
Increase in customer's deposits		45,272	1,464,495
(Decrease)/increase in other liabilities		(4,540)	5,234
Net cash used in operations		(844,323)	(164,413)
Cash flows from investing activities			
Purchase of property and equipment		(6,805)	(18,573)
Proceeds from sale of property and equipment		-	220
Net cash outflows from investing activities		(6,805)	(18,353)
Cash flows from financing activities			
Interest paid on loan capital		(196,572)	(195,558)
Loans received		1,000,000	-
Loans repaid		(775,431)	(663,377)
Net cash generated from/(used in) financing activities		27,997	(858,935)
Net decrease in cash and cash equivalents		(823,131)	(1,041,701)
Opening cash and cash equivalents balances		(755,235)	286,466
Closing cash and cash equivalents balances	29	(1,578,366)	(755,235)

The notes set out on pages 19 to 68 form an integral part of these financial statements.

Notes

1. Reporting entity

Development Bank of Kenya Limited (the “Bank” or the “Company”) is incorporated as a limited company in Kenya under the Kenyan Companies Act, and is domiciled in Kenya. The address of its registered office is as follows:

Finance House
Loita Street
PO Box 30483, 00100
Nairobi

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

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) Basis of preparation

(i) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and IFRS Interpretations Committee (IFRIC) applicable to companies reporting under IFRS and the Kenya Companies Act.

For Kenyan Companies Act reporting purposes, the balance sheet is represented by the statement of financial position and the profit and loss account by the statement of comprehensive income in these financial statements.

(ii) Basis of measurement

The measurement basis used is the historical cost basis except where otherwise stated in the accounting policies below.

For those assets and liabilities measured at fair value, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When measuring the fair value of an asset or a liability, the Company uses market observable data as far as possible. If the fair value of an asset or a liability is not directly observable, it is estimated by the Bank using valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs (e.g. by use of the market comparable approach that reflects recent transaction prices for similar items or discounted cash flow analysis). Inputs used are consistent with the characteristics of the asset / liability that market participants would take into account.

Fair values are categorised into three levels of fair value hierarchy based on the degree to which the inputs to the measurements are observable and the significance of the inputs to the fair value measurement in its entirety:

Notes (continued)

2. Summary of significant accounting policies (continued)

(b) Basis of preparation (continued)

(ii) Basis of measurement (continued)

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 used 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).

Transfers between levels of the fair value hierarchy are recognised by the bank at the end of the reporting period during which the change occurred.

(iii) Use of estimates and judgements

The preparation of consolidated financial statements in conformity with IFRS's requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation and critical judgement in applying accounting policies that have the most significant effect on the amount recognised in the consolidated financial statements as described in Note 3.

(iv) Changes in accounting policies and disclosures

New standards, amendments and interpretations adopted by the Group

The following standards have been adopted by the Group for the first time for the financial year beginning on or after 1 January 2014 and have a material impact on the Group:

- Amendments to IAS 32, '*Financial instruments: Presentation*' on offsetting financial assets and financial liabilities. This amendment clarifies that the right of set-off must not be contingent on a future event. It must also be legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amendment also considers settlement mechanisms. The amendment did not have a significant effect on the Group financial statements.

Other standards, amendments and interpretations which are effective for the financial year beginning on 1 January 2014 are not material to the Group.

Notes (continued)

2. Summary of significant accounting policies (continued)

(b) Basis of preparation (continued)

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

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

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2014, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except the following:

- IFRS 9, '*Financial instruments*', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued on July 2014. It replaces the guidance in IAS 30 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurements model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through profit or loss. The basis of classification depends on the entity's model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to changes in fair value in OCI 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 the classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Group is yet to assess the full impact of IFRS 9.
- IFRS 15, '*Revenue from contracts with customers*', 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 new standard is effective for annual periods beginning on or after 1 January 2017, and replaces IAS 11 and IAS 18.

There are no other standards or interpretations that are not yet effective that would be expected to have a material impact on the Group financial statements.

Notes (continued)

2. Summary of significant accounting policies (continued)

(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 incomestatement, 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 in profit or loss on the date that the dividend is received.

Notes (continued)

2. Summary of significant accounting policies (continued)

(f) Recognition and measurement of financial instruments

(i) Classification

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

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

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

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

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

(ii) Recognition

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

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

Notes (continued)

2. Summary of significant accounting policies (continued)

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

(iii) Measurement

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

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

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

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

(iv) Derecognition

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

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

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

Notes (continued)

2. Summary of significant accounting policies (continued)

(g) Identification and measurement of impairment of financial assets

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

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

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

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

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

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

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

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

Notes (continued)

2. Summary of significant accounting policies (continued)

(h) Impairment for non-financial assets

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

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

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

(i) Operating leases

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

(j) Property and equipment

(i) Recognition and measurement

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

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

(ii) Subsequent costs

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

(iii) Disposal of property and equipment

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

Notes (continued)

2. Summary of significant accounting policies (continued)

(j) Property and equipment (continued)

(iv) Depreciation

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

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

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

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

(k) Taxation

(i) Current income tax

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

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.

Notes (continued)

2. Summary of significant accounting policies (continued)

(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.

(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) Offsetting of financial assets and liabilities

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

Notes (continued)

2. Summary of significant accounting policies (continued)

(q) Financial guarantees

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

(r) Earnings per share

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

3. Critical accounting estimates and judgements

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

(a) Allowances for credit losses

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

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.

Notes (continued)

3. Critical accounting estimates and judgements (continued)

(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.

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.

(d) Impairment of property and equipment

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

Notes (continued)

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;
- Market risks; and
- Operational risks.

Group's risk management framework

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

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

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

(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 gradings in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of five grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate. Risk grades are subject to regular reviews by Group Risk;
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to Group Credit on the credit quality of local portfolios and appropriate corrective action is taken; and
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of credit risk. Each business unit is required to implement Group credit policies and procedures, with credit approval authorities delegated from the Group Credit Committee.

Notes (continued)

4. Financial risk management (continued)

(i) Credit risk (continued)

Exposure to credit risk

Loans and advances to customers

	2014		2013	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Individually impaired				
Grade 5: Loss	56,641	-	56,418	-
Grade 4: Doubtful	1,272,243	1,272,243	1,152,733	1,152,733
Grade 3: Substandard	50,022	50,022	37,198	37,198
	<u>1,378,906</u>	<u>1,322,265</u>	<u>1,246,349</u>	<u>1,189,931</u>
Allowances for impairment	(622,577)	(565,936)	466,976	(410,558)
Carrying amounts	<u><u>756,329</u></u>	<u><u>756,329</u></u>	<u><u>779,373</u></u>	<u><u>779,373</u></u>
Collectively impaired				
Grade 1: Normal	7,007,266	7,007,266	6,551,858	6,551,858
Grade 2: Watch	831,191	831,191	847,956	847,956
	<u>7,838,457</u>	<u>7,838,457</u>	<u>7,399,814</u>	<u>7,399,814</u>
Allowances for impairment	(75,624)	(75,624)	70,720	(70,720)
Carrying amounts	<u><u>7,762,833</u></u>	<u><u>7,762,833</u></u>	<u><u>7,329,094</u></u>	<u><u>7,329,094</u></u>
Past due and not impaired				
Grade 1: Normal	1,680,382	1,680,382	1,724,095	1,724,095
Grade 2: Watch	801,556	801,556	812,033	812,033
	<u>2,481,938</u>	<u>2,481,938</u>	<u>2,536,128</u>	<u>2,536,128</u>
Past due comprises				
1-30 Days	1,680,382	1,680,382	1,724,095	1,724,095
31-60 Days	801,556	801,556	812,033	812,033
	<u>2,481,938</u>	<u>2,481,938</u>	<u>2,536,128</u>	<u>2,536,128</u>
Neither past due nor impaired				
Grade 1: Normal	5,326,884	5,326,884	4,827,763	4,827,763
Grade 2: Watch	29,635	29,635	35,923	35,923
	<u>5,356,519</u>	<u>5,356,519</u>	<u>4,863,686</u>	<u>4,863,686</u>

Notes (continued)

4. Financial risk management (continued)

(i) Credit risk (continued)

Impaired loans and securities

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

Past due but not impaired loans

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

Loans with renegotiated terms

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

Allowances for impairment

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

Write-off policy

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

Notes (continued)

4. Financial risk management (continued)

(i) Credit risk (continued)

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

	Gross KShs'000	Net KShs'000
31 December 2014		
Grade 3: Individually Impaired	50,022	48,612
Grade 4: Individually Impaired	1,272,243	707,717
Grade 5: Individually Impaired	56,641	-
	<u>1,378,906</u>	<u>756,329</u>
31 December 2013		
Grade 3: Individually Impaired	37,198	34,364
Grade 4: Individually Impaired	1,152,733	745,009
Grade 5: Individually Impaired	56,418	-
	<u>1,246,349</u>	<u>779,373</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 2014 or 2013.

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

	2014 KShs'000	2013 KShs'000
Loans and advances to customers		
Against individually impaired		
Property	<u>635,374</u>	<u>572,651</u>
Against collectively impaired		
Property	12,880,264	13,030,784
Debt securities	2,119,959	2,624,945
Equities	197,136	8,400
Others	<u>2,610,419</u>	<u>2,637,976</u>

Notes (continued)

4. Financial risk management (continued)

(i) Credit risk (continued)

	2014 KShs'000	2013 KShs'000
Against past due but not impaired		
Property	6,270,508	5,984,593
Debt securities	323,145	51,305
Equities	197,136	2,675
Others	86,378	320,823
	<u>6,877,167</u>	<u>6,309,396</u>
Against neither past due nor impaired		
Property	-	6,609,756
Debt securities	1,796,814	2,573,640
Equities	-	5,725
Others	2,524,041	2,317,153
	<u>4,320,855</u>	<u>11,506,274</u>

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

Concentration by Sector	2014 KShs'000	2013 KShs'000
Agriculture	674,371	697,067
Manufacturing	1,084,665	1,452,726
Building and construction	206,502	143,055
Trade	1,626,901	1,577,265
Tourism, restaurants, and hotels	111,636	136,813
Transport and communication	248,747	223,022
Real estate	3,314,863	2,710,775
Financial services	199,634	190,785
Personal households	1,758,513	1,514,655
	<u>9,225,832</u>	<u>8,646,163</u>

Notes (continued)

4. Financial risk management (continued)

(ii) Liquidity risk

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

Management of liquidity risk

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

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

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

Exposure to liquidity risk

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

	2014	2013
Average for the period	32.8%	43.1%
Maximum for the period	39.1%	48.6%
Minimum for the period	27.9%	37.5%

Notes (continued)

4. Financial risk management (continued)

(ii) Liquidity risk (continued)

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

Residual contractual maturities of financial assets and financial liabilities for 2014

	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
Assets						
Cash and balances with Central Bank of Kenya	499,160	-	-	-	427,028	926,188
Investment in Government Securities	-	-	351,986	530,623	4,799,975	5,682,584
Due from other banks	59,403	680,066	27,529	-	-	766,998
Net loans and advances to customers	934,305	871,767	1,008,990	1,151,891	4,560,679	8,527,632
Equity investments	-	-	-	-	805,499	805,499
Total assets	1,492,868	1,551,833	1,388,505	1,682,514	10,593,181	16,708,901
Liabilities						
Due to banking institutions	-	2,618,018	226,506	-	-	2,844,524
Due to DEG	-	-	-	-	21,163	21,163
Customers' deposits	387,329	6,375,440	1,669,304	16,190	-	8,448,263
Loan capital	-	293,423	509,398	1,268,368	525,695	2,596,884
Total liabilities	387,329	9,286,881	2,405,208	1,284,558	546,858	13,910,834

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

Notes (continued)

4. Financial risk management (continued)

(ii) Liquidity risk (continued)

Residual contractual maturities of assets and liabilities for 2013

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

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

Notes (continued)

4. Financial risk management (continued)

(iii) Market risk

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

Management of market risks

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

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

(a) Exposure to interest rate risk

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

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

Yield Curve Parallel Shift	2014	2013
	KShs '000	KShs '000
100 Basis points upward parallel shift	(6,523)	(25,651)
50 Basis points upward parallel shift	(3,344)	(13,176)
25 Basis points upward parallel shift	(1,693)	(6,679)
100 Basis points downward parallel shift	1,737	6,865
50 Basis points downward parallel shift	3,520	13,927
25 Basis points downward parallel shift	7,226	28,655

Notes (continued)

4. Financial risk management (continued)

(iii) Market risk (continued)

(a) Exposure to interest rate risk (continued)

The table below summarises the exposure to interest rate risks. Included in the table below are the Group's assets and liabilities for 2014 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

	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
Assets							
Cash and balances with Central Bank of Kenya	-	-	-	-	-	926,188	926,188
Investments in Government securities	11.52	-	351,986	530,623	4,799,975	-	5,682,584
Due from banking institutions	2.68	739,469	27,529	-	-	-	766,998
Net loans and advances to customers	13.92	1,806,072	1,008,990	1,151,891	4,560,679	-	8,527,632
Total assets		2,545,541	1,388,505	1,682,514	9,360,654	926,188	15,903,402
Liabilities							
Due to banking institutions	3.87	2,618,018	226,506	-	-	-	2,844,524
Customers' deposits	9.05	6,762,769	1,669,304	16,190	-	-	8,448,263
Loan capital	6.67	293,423	509,398	1,268,368	525,695	-	2,596,884
Total liabilities		9,674,210	2,405,208	1,284,558	525,695	-	13,889,671

Notes (continued)

4. Financial risk management (continued)

(iii) Market risk (continued)

(a) Exposure to interest rate risk (continued)

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

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

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 is exposed at 31 December 2014:

At 31 December 2014	USD KShs'000	GBP KShs'000	Euro KShs'000	Other KShs'000	Total KShs'000
Assets					
Cash and balances with Central Bank of Kenya	69,066	2,323	26,430	-	97,819
Deposits and balances due from banking institutions	462,771	1,508	42,874	44	507,197
Net loans and advances to customers	1,027,149	-	479,069	-	1,506,218
Other assets	5,642	-	-	-	5,642
Total foreign currency assets	1,564,628	3,831	548,373	44	2,116,876
Liabilities					
Loan Capital	1,183,229	-	-	-	1,183,229
Deposits and balances due to banking institutions	383,414	2,175	547,244	-	932,833
Total foreign currency liabilities	1,566,643	2,175	547,244	-	2,116,062
Foreign currency exposure at 31 December 2014	(2,015)	1,656	1,129	44	814

Notes (continued)

4. Financial risk management (continued)

(iii) Market risk (continued)

(b) Currency risk (continued)

At 31 December 2013

Assets

Cash and balances with Central Bank of Kenya
 Deposits and balances due from banking institutions
 Loans and advances to customers (net)
 Other assets

	USD KShs'000	GBP KShs'000	Euro KShs'000	Other KShs'000	Total KShs'000
Cash and balances with Central Bank of Kenya	44,683	1,304	6,318	-	52,305
Deposits and balances due from banking institutions	656,781	1,166	70,693	31	728,671
Loans and advances to customers (net)	1,142,393	-	531,104	-	1,673,497
Other assets	5,384	-	-	-	5,384

Total foreign currency assets

	1,849,241	2,470	608,115	31	2,459,857
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Liabilities

Loan Capital
 Other liabilities
 Deposits and balances due to banking institutions

Loan Capital	1,290,732	-	-	-	1,290,732
Other liabilities	252,506	253	201,096	-	453,855
Deposits and balances due to banking institutions	303,135	-	405,128	-	708,263

Total foreign currency liabilities

	1,846,373	253	606,224	-	2,452,850
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Foreign currency exposure

at 31 December 2013

	2,868	2,217	1,891	31	7,007
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Notes (continued)

4. Financial risk management (continued)

(iv) Operational risk

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

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

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

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

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

Notes (continued)

4. Financial risk management (continued)

(v) Capital management

Regulatory capital

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

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

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

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

	2014	2013
	KShs'000	KShs'000
Core capital (Tier 1)		
Paid up share capital	347,500	347,500
Retained earnings less Deferred Tax	1,396,796	1,205,326
Other reserves	281	281
	<hr/>	<hr/>
Core capital	1,744,577	1,553,107
Minimum Statutory capital	1,000,000	1,000,000
	<hr/>	<hr/>
Excess capital	744,577	553,107
	<hr/>	<hr/>
Supplementary capital (Tier 2)	265,100	269,167
	<hr/>	<hr/>
Total capital	2,009,677	1,822,274
	<hr/>	<hr/>
Total risk weighted assets	6,780,387	6,944,129
	<hr/>	<hr/>

Notes (continued)

4. Financial risk management (continued)

(v) Capital management

Regulatory capital (continued)

Capital adequacy ratios

	2014	2013
Percentage of Core Capital to Risk Weighted Asset ratio	25.70%	22.40%
Minimum requirement	10.50%	10.50%
Percentage of Total Capital to Risk Weighted Asset	29.6%	23.60%
Minimum requirement	14.50%	14.50%
Percentage of Core Capital to Deposits ratio	16.20%	14.40%
Minimum requirement	10.50%	10.50%

Notes (continued)

4. Financial risk management (continued)

(vi) Fair value measurement

Financial assets and liabilities and their fair values

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

As at 31 December 2014	Held for trading KShs'000	Held to maturity KShs'000	Loans and receivables KShs'000	Available-for-sale KShs'000	Other amortised cost KShs'000	Total carrying amount KShs'000	Fair value KShs'000
Assets							
Cash and cash equivalents	-	-	-	-	926,188	926,188	926,188
Due from other banks	-	-	-	-	766,998	766,998	766,998
Investments in Government securities	97,902	5,584,682	-	-	-	5,682,584	5,682,584
Loans and advances to customers	-	-	8,527,632	-	-	8,527,632	8,527,632
Equity investments	-	-	-	805,499	-	805,499	805,499
Total assets	97,902	5,584,682	8,527,632	805,499	1,693,186	16,708,901	16,708,901
Liabilities							
Due to banking institutions	-	-	-	-	2,844,524	2,844,524	2,844,524
Customers' deposits	-	-	-	-	8,448,263	8,448,263	8,448,263
Loan capital	-	-	-	-	2,618,047	2,618,047	2,618,047
Total liabilities	-	-	-	-	13,910,834	13,910,834	13,910,834

Notes (continued)

4. Financial risk management (continued)

(vi) Fair value measurement

Financial assets and liabilities and their fair values

As at 31 December 2013	Held for trading KShs'000	Held to maturity KShs'000	Loans and receivables KShs'000	Available-for-sale KShs'000	Other amortised cost KShs'000	Total carrying amount KShs'000	Fair value KShs'000
Assets							
Cash and cash equivalents	-	-	-	-	703,422	703,422	703,422
Due from other banks	-	-	-	-	1,588,464	1,588,464	1,588,464
Investments in Government securities	342,060	4,508,008	-	-	-	4,850,068	4,850,068
Loans and advances to customers	-	-	8,108,467	-	-	8,108,467	8,108,467
Equity investments	-	-	-	46,153	-	46,153	46,153
Total assets	342,060	4,508,008	8,108,467	46,153	2,291,886	15,296,574	15,296,574
Liabilities and shareholders' funds							
Due to banking institutions	-	-	-	-	2,643,413	2,643,413	2,643,413
Customers' deposits	-	-	-	-	8,402,991	8,402,991	8,402,991
Loan capital	-	-	-	-	2,393,478	2,393,478	2,393,478
Total liabilities	-	-	-	-	13,439,882	13,439,882	13,439,882

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

Notes (continued)

5. Interest income

	2014 KShs'000	2013 KShs'000
Loans and advances to customers	852,376	839,095
Overdrafts	342,843	264,732
Treasury bonds	627,558	545,843
Deposits and balances due from banking institutions	14,509	29,132
	<u>1,837,286</u>	<u>1,678,802</u>

Included within various captions under interest income for the year ended 31 December 2014 is a total of KShs 77,335,000 (2013: KShs 86,622,000) accrued on impaired financial assets.

Included within interest income on investment securities for the year ended 31 December 2014 is KShs 596,606,132 (2013: KShs 510,494,426) relating to debt securities held-to-maturity.

6. Interest expense

	2014 KShs'000	2013 KShs'000
Customer deposits	887,514	772,778
Loan capital and income notes	196,572	195,558
Deposits and balances due to banking institutions	69,386	72,334
	<u>1,153,472</u>	<u>1,040,670</u>

7. Non-interest income

Fee and commission income	33,246	38,847
Gains on disposal of Government securities	11,198	3,854
Gains arising from dealing in foreign currencies	17,288	21,402
Rental income (Net of provisions)	40,132	36,934
Other income	1,924	-143
	<u>103,788</u>	<u>100,894</u>

Notes (continued)

8. Operating expenses

	2014	2013
	KShs'000	KShs'000
Salaries and employee benefits (Note 9)	170,052	163,815
Occupancy expenses	33,851	34,250
Deposit Protection Fund	14,181	11,175
Depreciation	20,832	19,568
Amortisation of prepaid operating lease rentals	61	61
Directors' emoluments	11,896	10,782
Professional and legal services	7,858	7,260
Telecommunication	2,309	2,276
Other expenses	41,009	41,062
	<u>302,049</u>	<u>290,249</u>

9. Salaries and employee benefits

	2014	2013
	KShs'000	KShs'000
Salaries	134,964	133,101
Contributions to defined contribution plans	16,338	16,115
National Social Security Fund	519	512
Other staff costs	18,231	14,087
	<u>170,052</u>	<u>163,815</u>

10. Profit before taxation

Profit before taxation is arrived at after charging/(crediting):

	2014	2013
	KShs'000	KShs'000
Depreciation expense	20,832	19,568
Amortisation of prepaid operating lease rentals	61	61
Director's emoluments		
– Fees as non-executive	1,400	1,400
– Other*	10,496	9,382
Auditors' remuneration– Current year	2,350	2,780
	<u>20,832</u>	<u>19,568</u>

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

Notes (continued)

11. Taxation

	2014 KShs'000	2013 KShs'000
Current tax at 30%	102,714	89,845
Deferred tax debit (Note 21)	<u>(3,980)</u>	<u>(3,989)</u>
	<u>98,734</u>	<u>85,856</u>

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

	2014 KShs'000	2013 KShs'000
Accounting profit before tax	319,326	275,289
Computed tax using the applicable corporation tax rate	95,797	82,587
Non-deductible costs, on ineligible assets	<u>2,937</u>	<u>3,269</u>
Income tax expense	<u>98,734</u>	<u>85,856</u>

12. Dividend per share

	2014	2013
The calculation of dividend per share is based on:		
Dividend proposed for the year (KShs'000)	<u>40,000</u>	<u>-</u>
Number of ordinary shares ('000)	<u>17,375</u>	<u>17,375</u>
Dividend per share (KShs)	<u>2.3</u>	<u>-</u>

13. Earnings per share

The calculation of basic earnings per share is based on:

	2014	2013
Net profit for the year attributable to shareholders (KShs '000)	<u>220,592</u>	<u>189,433</u>
Number of ordinary shares ('000)	<u>17,375</u>	<u>17,375</u>
Earnings per share (KShs)	<u>12.69</u>	<u>10.90</u>

There were no potentially dilutive shares outstanding at 31 December 2014 and 2013.

Notes (continued)

14. Cash and balances with Central Bank of Kenya

Group and Company	2014 KShs'000	2013 KShs'000
Cash on hand	73,145	94,186
Balances with Central Bank of Kenya:		
– Local currency cash reserve ratio	427,028	403,708
– Other	426,015	205,528
	<u>926,188</u>	<u>703,422</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 2014, the cash reserve requirement was 5.25% (2013– 5.25%) of all customer deposits. These funds are available to finance the bank's day-to-day operations in a limited way provided that on any given day the balance does not fall below the 3% minimum daily requirements and provided that the overall average in the month is at least 5.25%.

15. Investment in government securities

Group	2014 KShs'000	2013 KShs'000
Held to maturity		
<i>Treasury bonds:</i>		
Maturing within one year	351,986	-
Maturing after one year	5,232,696	4,508,008
Total held to maturity	<u>5,584,682</u>	<u>4,508,008</u>
Held for trading		
<i>Treasury bonds:</i>		
Maturing after one year	97,902	342,060
	<u>5,682,584</u>	<u>4,850,068</u>
Company		
Held to maturity		
<i>Treasury bonds:</i>		
Maturing within one year	351,986	-
Maturing after one year	5,211,561	4,486,858
Total held to maturity	<u>5,563,547</u>	<u>4,486,858</u>
Held for trading		
<i>Treasury bonds:</i>		
Maturing after one year	97,902	342,060
	<u>5,661,449</u>	<u>4,828,918</u>

The weighted average effective interest rate on government securities at 31 December 2014 was 11.52% (2013 – 11.43%).

Notes (continued)

16. Deposits and balances due from banking institutions

Group and Company

	2014 KShs'000	2013 KShs'000
Due within 90 days	739,469	1,558,693
Due between 3 months and 1 year	<u>27,529</u>	<u>29,771</u>
Due within 90 days	<u><u>766,998</u></u>	<u><u>1,588,464</u></u>

The weighted average effective interest rate on placements with other banks at 31 December 2014 was 2.68% (2013 – 6.53%).

17. Loans and advances to customers

	2014		2013	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Overdrafts	2,284,119	2,284,119	2,100,153	2,100,153
Loans	6,726,463	6,669,822	6,338,023	6,281,605
Staff loans	<u>215,251</u>	<u>215,251</u>	<u>207,987</u>	<u>207,987</u>
	9,225,833	9,169,192	8,646,163	8,589,745
Less: Impairment losses reserves	<u>(698,201)</u>	<u>(641,560)</u>	<u>(537,696)</u>	<u>(481,278)</u>
	<u><u>8,527,632</u></u>	<u><u>8,527,632</u></u>	<u><u>8,108,467</u></u>	<u><u>8,108,467</u></u>
Maturing within one year	2,573,992	2,573,992	2,379,294	2,379,294
Over one year to three years	776,432	776,432	874,930	874,930
Over three years	<u>5,177,208</u>	<u>5,177,208</u>	<u>4,854,243</u>	<u>4,854,243</u>
	<u><u>8,527,632</u></u>	<u><u>8,527,632</u></u>	<u><u>8,108,467</u></u>	<u><u>8,108,467</u></u>

The weighted average effective interest rate on loans and advances to customers at 31 December 2014 was 13.92% (2013 – 14.72%).

Impairment losses reserves

Group	Specific impairment losses	Portfolio impairment losses	Total
	KShs'000	KShs'000	KShs'000
2014			
At 1 January 2014	466,976	70,720	537,696
Amounts written off during the year	(5,412)	-	(5,412)
Reversals on recovery during the year	(152,664)	-	(152,664)
Made during the year	<u>313,677</u>	<u>4,904</u>	<u>318,581</u>
At 31 December 2014	<u><u>622,577</u></u>	<u><u>75,624</u></u>	<u><u>698,201</u></u>

Notes (continued)

17. Loans and advances to customers (continued)

Impairment losses reserves (continued)

Group	Specific KShs'000	Portfolio KShs'000	Total KShs'000
2013			
At 1 January 2013	315,709	52,991	368,700
Amounts written off during the year	(5,156)	-	(5,156)
Reversals on recovery during the year	(31,814)	-	(31,814)
Made during the year	188,237	17,729	205,966
At 31 December 2013	466,976	70,720	537,696
Company			
2014			
At 1 January 2013	410,558	70,720	481,278
Amounts written off during the year	(5,412)	-	(5,412)
Reversals on recovery during the year	(152,664)	-	(152,664)
Made during the year	313,454	4,904	318,358
At 31 December 2014	565,936	75,624	641,560
2013			
At 1 January 2013	259,425	52,991	312,416
Amounts written off during the year	(5,156)	-	(5,156)
Reversals on recovery during the year	(31,725)	-	(31,725)
Made during the year	188,014	17,729	205,743
At 31 December 2013	410,558	70,720	481,278

Impairment losses on loans and advances charged to profit or loss

Group	2014 KShs'000	2013 KShs'000
Provisions during the year	318,581	205,966
Recovered during the year	(152,664)	(31,814)
Direct write offs	310	261
Recoveries of amounts previously written off	-	(925)
	166,227	173,488
Interest on impaired loans and advances which has not yet been received in cash	77,335	86,623

Impaired loans and advances

Loans and advances include an amount of KShs756,328,000 (2013: KShs779,373,000) net of impairment losses which have been classified as impaired loans and advances.

Estimated value of underlying collaterals amount to KShs635,374,000 (2013: KShs572,651,000). The directors are of the opinion that recovery of the principal amounts thereof is not doubtful.

Notes (continued)

18. Equity investments

Group and Company

	2014 KShs'000	2013 KShs'000
Unquoted shares at cost:		
Chemelil Sugar Company Limited 150,000 ordinary shares of KShs 20 each	3,000	3,000
Pan African Paper Mills Limited 104,000 ordinary shares of KShs 20 each	2,080	2,080
Kenya Hotel Properties Limited 2,258,017 ordinary shares of KShs 20 each	802,499	43,153
Kenya United Steel Company Limited 180,000 ordinary shares of KShs 5 each	900	900
East Africa Sugar Industries Limited 100,000 ordinary shares of KShs 20 each	2,000	2,000
	<u>810,479</u>	<u>51,133</u>
Provision for impairment loss on investments		
East Africa Sugar Industries Limited	(2,000)	(2,000)
Pan African Paper Mills Limited	(2,080)	(2,080)
Kenya United Steel Company Limited	(900)	(900)
	<u>(4,980)</u>	<u>(4,980)</u>
	<u>805,499</u>	<u>46,153</u>

The above equity investments are accounted for at cost where there is no market or a reliable basis for fair valuing, otherwise they are carried at their fair values. The movement in the investments is as below:

	2014 KShs'000	2013 KShs'000
As at 1 January	46,153	46,153
Fair value adjustment (gross)	759,346	-
At 31 December	<u>805,499</u>	<u>46,153</u>

The fair value adjustment relates to the investment in Kenya Hotel Properties Limited which was fair valued in the year. The fair value gain has been recognised in other comprehensive income net of deferred capital gains tax of 5% as at 31 December 2014 (Note21).

19. Investment in subsidiary

Company	2014 KShs'000	2013 KShs'000
Shares at cost:		
Small Enterprises Finance Company Limited (SEFCO)	<u>32,048</u>	<u>32,048</u>

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

Notes (continued)

20. Other assets

	2014		2013	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Rent receivable	23,683	23,683	14,977	14,977
Uncleared effects	15,829	15,829	20,839	20,839
Prepayments	36,820	36,820	24,273	24,273
Other receivables	3,185	2,970	11,450	11,385
	<u>79,517</u>	<u>79,302</u>	<u>71,539</u>	<u>71,474</u>

21. Deferred tax asset/(liability)

Deferred income tax is calculated in full on all temporary differences under the liability method using a principal tax rate of 30% (2013: 30%). The movement on the deferred tax account is as follows:

	2014		2013	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
At start of the year	32,637	32,486	28,648	28,527
Charged through profit or loss	3,980	3,949	3,989	3,959
Charged through other comprehensive income	(37,967)	(37,967)	-	-
	<u>(1,351)</u>	<u>(1,532)</u>	<u>32,637</u>	<u>32,486</u>

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

Group

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

Notes (continued)

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

Group

2014	At 1 January KShs'000	Charged to profit or loss KShs'000	Credited to other comprehensive income KShs'000	At 31 December KShs'000
Deferred income tax liabilities				
Fair value gain on equity investments	-	-	(37,967)	(37,967)
Deferred income tax assets				
Property and equipment	8,703	1,819	-	10,522
Portfolio impairment provisions on loans and advances	21,216	1,470	-	22,686
Other provisions	2,718	690	-	3,408
	32,637	3,980	-	36,616
	32,637	3,980	(37,967)	(1,351)

Company

2013	At 1 January KShs'000	Charged to profit or loss KShs'000	At 31 Decemb er KShs'000
Property and equipment	7,593	1,110	8,703
Portfolio impairment provisions on loans and advances	15,897	5,319	21,216
Other provisions	5,037	(2,470)	2,567
	28,527	3,959	32,486

Notes (continued)

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

2014	At 1 January KShs'000	Charged to profit or loss KShs'000	Credited to other comprehensive income KShs'000	At 31 December KShs'000
Deferred income tax liabilities				
Fair value gain on equity investments	-	-	(37,967)	(37,967)
Deferred income tax assets				
Property and equipment	8,703	1,819	-	10,522
Portfolio impairment provisions on loans and advances	21,216	1,470	-	22,686
Other provisions	2,567	660	-	3,227
	<u>32,486</u>	<u>3,949</u>	<u>-</u>	<u>36,616</u>
	<u>32,486</u>	<u>3,949</u>	<u>(37,967)</u>	<u>(1,532)</u>

22. Prepaid operating lease rentals

Group and Company	2014 KShs'000	2013 KShs'000
Cost		
At 1 January and 31 December	6,000	6,000
Amortisation		
At 1 January	1,944	1,883
Amortisation for the year	<u>61</u>	<u>61</u>
At 31 December	<u>2,005</u>	<u>1,944</u>
Net carrying amount at 31 December	<u><u>3,995</u></u>	<u><u>4,056</u></u>

Notes (continued)

23. Property and equipment

Group and Company 2013	Building KShs'000	Leasehold improvements KShs'000	Furniture and equipment KShs'000	Computers KShs'000	Motor vehicles KShs'000	Capital work inprogress KShs'000	Total KShs'000
Cost							
At 1 January 2013	123,425	25,790	100,725	43,984	30,490	27,852	352,266
Additions	-	12,188	2,011	1,284	3,090	-	18,573
Transfers from capital work in progress	-	24,521	-	-	-	(24,521)	-
Disposals	-	-	(1,208)	-	(2,463)	-	(3,671)
At 31 December 2013	123,425	62,499	101,528	45,268	31,117	3,331	367,168
Depreciation							
At 1 January 2013	31,635	8,312	82,580	36,584	26,563	-	185,674
Charge for the year	1,356	8,383	3,623	4,094	2,112	-	19,568
Disposals	-	-	(754)	-	(2,463)	-	(3,217)
At 31 December 2013	32,991	16,695	85,449	40,678	26,212	-	202,025
Net book amount at 31 December	90,434	45,804	16,079	4,590	4,905	3,330	165,142

Notes (continued)

23. Property and equipment (continued)

Group and Company 2014	Building KShs'000	Leasehold improvements KShs'000	Furniture and equipment KShs'000	Computers KShs'000	Motor vehicles KShs'000	Capital work in progress KShs'000	Total KShs'000
Cost							
At 1 January 2014	123,425	62,499	101,528	45,268	31,117	3,331	367,168
Additions	-	539	1,581	2,302	-	2,383	6,805
At 31 December 2014	123,425	63,038	103,109	47,570	31,117	5,714	373,973
Depreciation							
At 1 January 2014	32,991	16,695	85,449	40,678	26,212	-	202,025
Charge for the year	1,356	10,556	3,508	2,870	2,542	-	20,832
At 31 December 2014	34,347	27,251	88,957	43,548	28,754	-	222,857
Net book amount at 31 December	89,078	35,787	14,152	4,022	2,363	5,714	151,116

Notes (continued)

24. Deposits and balances due to other banks

Group and Company	2014 KShs'000	2013 KShs'000
Payable within 90 days	2,618,018	1,295,028
Payable between 3 months and one year	<u>226,506</u>	<u>1,348,385</u>
	<u><u>2,844,524</u></u>	<u><u>2,643,413</u></u>

The weighted average effective interest rate on deposits from other banks at 31 December 2014 was 3.87% (2013: 3.59%).

25. Deposits from customers

	2014		2013	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
From government and parastatals	881,728	881,728	1,224,171	1,224,171
From private sector and individuals	<u>7,566,535</u>	<u>7,582,819</u>	<u>7,178,820</u>	<u>7,194,504</u>
	<u><u>8,448,263</u></u>	<u><u>8,464,547</u></u>	<u><u>8,402,991</u></u>	<u><u>8,418,675</u></u>

Included in the Company customers deposits is KShs16,284,000 (2013: KShs15,684,000) due to the subsidiary company. Interest paid on these deposits during the year amounted to KShs151,000 (2013: KShs156,000).

The weighted average effective interest rate on customer deposits at 31 December 2014 was 9.05% (2013 – 10.99%).

26. Loan capital

Group and Company	2014 KShs'000	2013 KShs'000
East African Development Bank (EADB)	109,677	229,558
European Investment Bank	21,163	21,163
Industrial & Commercial Development Corporation (ICDC)	53,369	100,000
Standard Chartered Bank Kenya Limited	1,250,609	752,025
China Development Bank	<u>1,183,229</u>	<u>1,290,732</u>
	<u><u>2,618,047</u></u>	<u><u>2,393,478</u></u>

Notes (continued)

26. Loan capital (continued)

Repayments	2014 KShs'000	2013 KShs'000
Less than one year	802,821	863,484
Between one and five years	1,268,368	1,027,592
Over 5 years	546,858	502,402
	<u>2,618,047</u>	<u>2,393,478</u>

The weighted average effective interest rate on loan capital at 31 December 2014 was 6.67% (2013 – 6.57%).

27. Other liabilities

	2014		2013	
	Group KShs'000	Company KShs'000	Group KShs'000	Company KShs'000
Bills payable	10,331	10,331	16,586	16,586
Rent deposit	14,842	14,842	13,096	13,096
Deutsche Investitions-und EntwicklungsgesellschaftmbH (DEG) retained funds	120,531	120,531	118,151	118,151
Payable to Government of Kenya	65,281	65,281	65,281	65,281
Provisions and accruals	38,271	36,239	36,625	34,681
Other liabilities	10,371	10,700	14,428	14,758
	<u>259,627</u>	<u>257,924</u>	<u>264,167</u>	<u>262,553</u>

28. Share capital

	2014 KShs'000	2013 KShs'000
Authorised, issued and fully paid		
17,375,000 ordinary shares of KShs 20 each	<u>347,500</u>	<u>347,500</u>

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

Notes (continued)

29. Cash and cash equivalents

	2014 KShs'000	2013 KShs'000
Group		
Cash in hand	73,145	94,186
Balances with Central Bank of Kenya	426,015	205,528
Deposits and balances due from banks	766,998	1,588,464
Deposits and balances due to banks	(2,844,524)	(2,643,413)
	<u>(1,578,366)</u>	<u>(755,235)</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 2014, interest rates on loans and overdrafts ranged from 4.00% to 21.00% (2013– 4.44% to 25.25%). The contractual amounts of commitments are set out below:

a) Commitments to extend credit with respect to:

	2014 KShs'000	2013 KShs'000
Undrawn loans	197,632	807,173
Undrawn overdraft facilities	155,297	277,574
Unutilised guarantees and letters of credit	5,580	11,057
	<u>358,509</u>	<u>1,095,804</u>

At 31 December 2014, interest rate on facilities subject to commitments ranged from 5.00% to 19.50% (2013: 4.00% to 21.00%).

b) Commitments with respect to outstanding off-balance items

	2014 KShs'000	2013 KShs'000
Guarantees	555,213	748,757
Acceptances	44,174	34,872
Letters of credit	62,283	194,103
Undelivered spots	92	92
	<u>661,762</u>	<u>977,824</u>

Notes (continued)

30. Contingencies (continued)

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:

	2014	2013
	KShs'000	KShs'000
Less than one year	28,159	32,555
Between one and five years	27,333	26,196
Over five years	146,580	-
	<u>202,072</u>	<u>58,751</u>

The leases typically run for an initial period of between two to six years with an option to renew the lease after that date. None of the leases include contingent rentals. During the year KShs40,132,000 (2013: KShs 36,934,000) was recognised as rental income in the statement of comprehensive income and KShs 5,591,953 (2013: KShs18,853,236) in respect of repairs and maintenance relating to the building.

Notes (continued)

32. Related party transactions

(a) Loans and advances to employees

	2014 KShs'000	2013 KShs'000
Balance at 1 January	207,987	189,080
Loans advanced during the year	49,513	57,644
Loans repayments received	(42,250)	(38,737)
Balance at 31 December	215,250	207,987

Interest earned on staff loans during the year amounted to KShs13,708,625(2013:KShs12,554,014).

(b) Loan and advances to directors and their associates

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

	2014 KShs'000	2013 KShs'000
Gross amount at 1 January	384,263	208,359
Interest charged	43,755	43,646
Loans disbursed	66,415	137,675
Cash received	(43,383)	(5,417)
Net amount at 31 December	451,050	384,263

(c) Included in deposits is KShs16,284,000 (2013: KShs15,684,000) due to a subsidiary company. Interest paid on these deposits during the year amounted to KShs151,000 (2013: KShs156,000).

(d) Compensation to senior management for the year ended 31 December 2014 amounted KShs 49,067,876 (2013: KShs 48,465,317).

33. Assets pledged as security

Financial assets that may be repledged or resold by counterparties

As at 31 December 2014, Government securities amounting to KShs 1,517.8million(2013: KShs1,084.5million) were pledged as security against loans from Standard Chartered Bank Kenya Limited and East African Development Bank. These transactions are conducted under terms that are usual and customary to standard lending, and securities borrowing and lending activities.

Notes (continued)

34. Reserves

(a) Statutory reserves

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

(b) Other reserves

Other reserves comprise of:

- i) KShs 280,000 of interest reserve established under a lending agreement between the bank and Industrial & Commercial Development Corporation (ICDC). Under the agreement, part of the interest payable on the loan capital balance was retained as interest reserve and is available for furtherance of the bank's business. The interest reserve is not available for distribution.
- ii) KShs 721,379,000 revaluation reserves on the equity investment in Kenya Hotel properties net of tax.