MIDDLE EAST BANK

ANNUAL REPORT & FINANCIAL STATEMENTS

2017

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Board of directors:	Akber A K Esmail	-	Chairman
	Dhirendra Rana	-	Managing Director
	Anil D Raja		
	Nancy Kaminchia		
	Thomas Mulwa		
	Faith C Kibowen		

Company secretary:

Zainash Registrars
1st Floor, Reliance Centre
Woodvale Groove, Westlands
P.O Box 349 – 00606
Nairobi, Kenya

Registered office and principal place of business:

Mebank Tower
Milimani Road
P.O Box 47387 – 00100
Nairobi, Kenya

Tel:	+254 20 2723120
Fax:	+254 20 343776
Email:	ho@mebkenya.com
Website:	www.mebkenya.com

Auditor:

PricewaterhouseCoopers
PwC Tower
Waiyaki Way/Chiromo Road, Westlands
P.O Box 43963 – 00100
Nairobi, Kenya

Branches:

Milimani Road Branch
Mebank Tower
Milimani Road
P.O Box 47387 – 00100
Nairobi, Kenya

Industrial Area Branch
Butere Road
Off Dar es Salaam Road
P.O Box 18973 – 00400
Nairobi, Kenya

Mombasa Branch
Nyerere Avenue
P.O Box 90343 – 80100
Mombasa, Kenya

Eldoret Branch
Ronald Ngala Street
P.O Box 7847 – 30100
Eldoret, Kenya

Board and senior management committees

Board Audit Committee

A D Raja	-	Chairman
N Kaminchia		
T Mulwa		
F Kibowen		

Board Credit Committee

T Mulwa	-	Chairman
A A K Esmail		
D Rana		

Board Risk & Compliance Committee

N Kaminchia	-	Chairperson
A D Raja		
A A K Esmail		

Senior Management Committee

D Rana	-	Managing Director
M Gitahi	-	Head, Finance
S Musyoka	-	Head, Treasury
N Zein	-	Head, Operations
J Kinuthia	-	Head, Administration
S Tanui	-	Head, Credit
E Omolo	-	Head, Compliance
S Odiero	-	Head, Internal Audit
K Shah	-	Head, Retail
D Namwendwa	-	Head, Human Resource
G Settim	-	Head, ICT

Assets & Liabilities Committee

Managing Director	-	Chairman
Head, Treasury		
Head, Finance		
Head, Credit		
Head, Operations		

Risk Management Committee

Managing Director	-	Chairman
Head, Finance		
Head, Compliance		
Head, Internal Audit		
Head, Operations		
Head, Credit		
Head, Admin		
Head, Human Resources		
Head, ICT		

Management Credit Committee

Managing Director	-	Chairman
Head, Credit		

Board and Board Committee Meetings

Board Attendance

The main Board scheduled four ordinary meetings.

Director	April 2017	July 2017	November 2017	December 2017
A A K Esmail	√	√	√	√
D Rana	√	√	√	√
N Kaminchia	√	√	√	√
A D Raja	√	√	√	√
T Mulwa	√	√	√	√
F Kibowen	√	√	√	x

Board Audit Committee Attendance

The Board Audit Committee scheduled four meetings.

Director	March 2017	May 2017	October 2017	December 2017
A D Raja	√	√	√	√
N Kaminchia	√	√	√	√
T Mulwa	√	√	√	√
F Kibowen	√	x	√	√

Board Risk and Compliance Committee Attendance

The Board Risk and Compliance Committee scheduled four meetings.

Director	March 2017	May 2017	September 2017	December 2017
N Kaminchia	√	√	√	√
A D Raja	√	√	√	√
A A K Esmail	√	x	x	√

Board Credit Committee Attendance

The Board Credit Committee scheduled 2 meetings.

Director	March 2017	September 2017
A A K Esmail	√	√
D Rana	√	√
T Mulwa	√	√

√ Attended

x Absent

I present the 37th annual report and accounts for the year ended 31st December 2017 to the shareholders of our Bank.

The Kenyan economy experienced economic stability with sluggish growth despite challenges from a prolonged electioneering period, devolved system of Government and public sector wage bill pressure. The tourism sector which previously was heavily affected by terrorism has recovered tremendously with 16% projected growth in 2018. Further, this will be positively impacted by launch of direct US flights and visa on arrival initiative by the Kenyan Government.

In the domestic foreign exchange market, the US dollar experienced minimal volatility during the year and this impacted our foreign exchange income. The shilling fluctuated within a narrow range from Kshs 102.50 to US $ 1 at the beginning of the year and closed the year at Kshs 103.05. On the other hand, the GB Pound significantly fluctuated from Kshs 126.42 at the beginning of the year and closed at Kshs 139.30.

With the 2016 Interest Capping regulation passed by Parliament, Banks are lending at 4% above the Central Bank Rate (CBR) and deposit rates pegged at 70% of CBR. The CBR currently stands at 10% p.a. Interest capping has negatively impacted on profits in the entire Banking industry.

During the year, KBA launched the Kenya Interbank Transaction Switch (KITS) which facilitates real time transfer of customer funds between banks at reduced transaction costs. We were among the first Banks to roll out to customers and gradually all banks are expected to be on this industry platform.

The Cyber Security and Protection Act came into effect during the year. The principal object of this, is to provide increased security in cyber space and provide for the prohibition of certain acts in computer use. Cyber threats maybe used to disrupt essential services hence Central Bank of Kenya has also issued regulatory guidelines to Banks and expects compliance with these.

The Bank's financial position declined marginally in 2017 compared to previous year. Total assets stood at Kshs 5.126bn from Kshs 5.233bn in previous year. Balance sheet decline was largely attributed to decrease in customer deposits, provisioning for non performing accounts and losses incurred during the year. Total shareholder funds decreased from Kshs 1.192bn in 2016 to Kshs 1.164bn in 2017 largely due to losses incurred during the year. Decreased customer advances resulted in higher liquidity ratio of 47.9%. The interest suspended on non-performing advances continued to impact on net interest income during the year. The Bank continued with strong capital adequacy ratios and was well above the minimum statutory ratios.

Your Bank continued with its strategic focus on growth of the Bank's asset and deposit base with improved infrastructure. The Bank embarked on implementation of a new state of the art Core Banking System which was rolled out in May 2017 and has led to improved service delivery and enhanced operational controls.

Our outlook for 2018 is reduced credit growth with interest rates regulation which is expected to lead to lower investments in the private sector. However, the macroeconomic environment is expected to pick up largely on account of continued fiscal discipline, increased revenues through improved collection of various taxes and tourism boost. Regional integration of East African countries will further strengthen Kenya's economic development.

On corporate governance, the Bank continues to uphold this with close Board and management oversight. The various Board and Management Committees remained active with specific responsibilities that ensure they effectively carry out their monitoring roles to ensure regulatory compliance as well as the Bank's profitability.

Finally, I remain grateful for the support of my fellow Board Members and their efforts in working for the continued success of the Bank. At the same time, I must also express my sincere appreciation for the hard work and dedication of the members of staff in ensuring that the Bank meets its key objectives.

AAK Esmail
Chairman

The directors submit their report together with the audited financial statements of Middle East Bank Kenya Limited (the "Bank") for the year ended 31 December 2017.

BUSINESS REVIEW

The Bank is engaged in the business of banking and the provision of related services and is licensed under the Banking Act.

The Bank's activities are principally related to the use of financial instruments. The Bank accepts deposits from customers that are both interest bearing and non-interest bearing, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets while maintaining sufficient liquidity to meet all claims that might fall due.

The Bank's financial position declined marginally in 2017 compared to previous year. Total assets stood at Kshs 5.121bn from Kshs 5.233bn in previous year. Balance sheet decline was largely attributed to decrease in customer deposits, provisioning for non-performing accounts and losses incurred during the year. Loans and advances decreased by 23% due to the impact of interest rate capping and exit of the top customer in the year. Customer deposits slightly decreased by 2% due to tight liquidity in the market. The loss before tax was Kshs 41m largely due to provisions and interest capping. Interest income dropped to Kshs 455m while interest expense declined to Kshs 276m due to capping of interest rates. The interest suspended on non-performing advances also continued to impact on net interest income during the year. The Bank continued with strong capital adequacy ratios and was well above the minimum statutory ratios.

In the banking business, Banks are faced with exposure to various risks ranging from credit risk, liquidity risk to market risk.

Credit risk is the risk that a counter party will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the reporting date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration of the Bank's portfolio, could result in impairment losses. Management therefore carefully manages credit risk exposure and regularly undertakes a portfolio review to vet the potential risk of each economic sector that the Bank is exposed to.

Liquidity risk is the risk that the Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits and calls on cash settled contingencies. The Central Bank of Kenya requires that the Bank maintain a cash reserve ratio of 5.25% and minimum liquidity ratio of 20% which the Bank has complied with. The treasury department monitors liquidity ratios on a daily basis and this is closely reviewed by the Assets and Liability Committee (ALCO).

Market risk is the risk that changes in market prices, which include currency exchange rates and interest rates, will affect the fair value or future cash flows of a financial instrument. Currently, regulatory interest rates on customer advances and deposits are pegged at 14% and 7% respectively. ALCO has the responsibility of market risk management which is to manage and control market risk exposures within acceptable limits, while optimising the return on risk.

The Bank has a well-trained staff complement of 59 across the 4 branches. Staff understand the Bank's core values with strong emphasis on customer focus. The Bank has also heavily invested in Information Technology and rolled out a new core banking software to enhance availability and improved operational controls.

DIVIDEND

The loss for the year of Shs 25,188,000 (2016 loss: Shs 66,285,000) has been deducted from retained earnings. The directors recommend the approval of a final dividend of Shs 0.20 per share (2016: Shs 0.20 per share) amounting to Shs 5,068,000 (2016: Shs 5,068,000).

DIRECTORS

The directors who held office during the year and to the date of this report are presented on page one.

In line with Central Bank of Kenya Prudential Guidelines, all directors attended over 75% of the board meetings. The board and directors' evaluation has been conducted by means of peer and self evaluation.

AUDITOR

DISCLOSURES TO AUDITORS

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

(a) there was, as far as each director is aware, no relevant audit information of which the company's auditor is unaware; and

(b) each director had taken all steps that ought to have been taken as a director so as to be aware of any relevant audit information and to establish that the company's auditor is aware of that information

TERMS OF APPOINTMENT OF AUDITORS

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

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

By order of the Board

Zainash Registrars

Secretary

8 March 2018

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

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

i. Designing, implementing and maintaining internal control as they determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;

ii. Selecting suitable accounting policies and then apply them consistently; and

iii. Making judgements and accounting estimates that are reasonable in the circumstances

In preparing the financial statements, the directors have assessed the Bank's ability to continue as a going concern and disclosed, as applicable, matters relating to the use of going concern basis of preparation of the financial statements.

For reasons described in Note 2(a) (ii) to the financial statements, the directors are of the opinion that the Bank will remain a going concern for at least twelve months from the date of this statement.

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

Approved by the Board of Directors on 8 March 2018 and signed on its behalf by:

Dhirendra Rana	**Nancy Kaminchia**
Director	**Director**

REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF MIDDLE EAST BANK KENYA LIMITED

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Middle East Bank Kenya Limited (the "Bank") set out on pages 12 to 55 which comprise the statement of financial position at 31 December 2017, and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and the notes to the financial statements, which include a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 31 December 2017 and of its 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 2015.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA Code.

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

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report but does not include the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF MIDDLE EAST BANK KENYA LIMITED (CONTINUED)

Responsibilities of the directors for the financial statements

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

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

The directors are responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion.

REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF MIDDLE EAST BANK KENYA LIMITED (CONTINUED)

Auditor's responsibilities for the audit of the financial statements (continued)

Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Report on other matters prescribed by the Kenyan Companies Act, 2015

In our opinion the information given in the report of the directors on pages 6 and 7 is consistent with the financial statements.

The engagement partner responsible for the audit resulting in this independent auditor's report is CPA Kang'e Saiti – Practicing Certificate No. 1652.

Pricewaterhousecoopers

Certified Public Accountants 27 March 2018
Nairobi

Statement of comprehensive income

	Notes	2017 Shs'000	2016 Shs'000
Interest income	5(a)	455,503	586,619
Interest expense	5(b)	(276,284)	(369,806)
Net interest income		179,219	216,813
Credit impairment charges	16	(27,270)	(64,911)
Net interest income after credit impairment charges		151,949	151,902
Fee and commission income		43,011	38,715
Foreign exchange income		28,944	33,497
Other operating income	6	36,013	44,572
Net operating income		259,917	268,686
Operating expenses	7	(301,345)	(369,675)
Loss before income tax		(41,428)	(100,989)
Income tax credit	9	16,240	34,704
Loss for the year		(25,188)	(66,285)
Other comprehensive income		-	-
Total comprehensive loss for the year		(25,188)	(66,285)

Statement of financial position

	Notes	2017 Shs'000	2016 Shs'000
ASSETS			
Cash and balances with Central Bank of Kenya	12	810,308	301,026
Government securities at amortised cost	13	974,075	680,999
Deposits and balances due from banking institutions	14	90,126	256,715
Loans and advances to customers	16	2,769,120	3,616,626
Property and equipment	18	175,071	174,079
Prepaid operating lease rentals	19	74,409	75,374
Intangible assets	20	30,316	10,422
Other assets and prepayments	15	94,385	40,711
Current income tax		2,780	1,638
Deferred income tax	17	100,446	75,932
Total assets		5,121,036	5,233,522
LIABILITIES			
Customer deposits	21	3,907,675	3,996,055
Other liabilities and accrued expenses	22	51,508	45,358
Total liabilities		3,959,183	4,041,413
SHAREHOLDERS' EQUITY			
Share capital	23	506,831	506,831
Regulatory reserve	24	13,784	13,138
Retained earnings		641,238	672,140
Total shareholders' equity		1,161,853	1,192,109
Total equity and liabilities		5,121,036	5,233,522

The financial statements on pages 12 to 55 were approved for issue by the board of directors on 8 March 2018 and signed on its behalf by:

Dhirendra Rana **Director**	**Thomas Mulwa** **Director**
Nancy Kaminchia **Director**	**Zainash Registrars** **Company Secretary**

Statement of changes in equity

	Notes	Share capital Shs'000	Regulatory reserve Shs'000	Retained earnings Shs'000	Total Shs'000
Year ended 31 December 2016					
At start of year		506,831	10,194	746,437	1,263,462
Total comprehensive loss for the year					
Loss for the year		-	-	(66,285)	(66,285)
Transfer to regulatory reserve	24	-	2,944	(2,944)	-
Transactions with owners					
Dividends:					
- final for 2015 paid	11	-	-	(5,068)	(5,068)
At end of year		506,831	13,138	672,140	1,192,109
Year ended 31 December 2017					
At start of year		506,831	13,138	672,140	1,192,109
Total comprehensive loss for the year					
Loss for the year		-	-	(25,188)	(25,188)
Transfer to regulatory reserve	24	-	646	(646)	-
Transactions with owners					
Dividends:					
- final for 2016 paid	11	-	-	(5,068)	(5,068)
At end of year		506,831	13,784	641,238	1,161,853

Statement of cash flow

	Notes	2017 Shs'000	2016 Shs'000
Cash flows from operating activities			
Interest receipts		455,503	586,619
Interest payments		(276,284)	(369,806)
Fee and commission receipts		43,011	38,715
Foreign exchange receipts		28,944	33,497
Other income received		35,603	44,294
Payments to employees and suppliers		(283,199)	(356,986)
Income tax paid		(9,416)	(1,344)
Cash flows used in operating activities before changes in operating assets and liabilities		(5,838)	(25,011)
Changes in operating assets and liabilities:			
Gross loans and advances		820,236	49,618
Cash reserve requirement		6,633	36,171
Other assets and prepayments		(53,674)	10,282
Government securities at amortised cost		(293,076)	333,547
Customer deposits		(88,380)	(103,365)
Other liabilities and accrued expenses		6,150	(9,544)
Net cash generated from operating activities		392,051	291,698
Cash flows from investing activities			
Purchase of property and equipment	18	(14,218)	(2,323)
Purchase of intangible assets	20	(34,094)	-
Capital work in progress	20	10,245	(10,245)
Proceeds from disposal of property and equipment		410	278
Net cash used in investing activities		(37,657)	(12,290)
Cash flows from financing activities			
Dividends paid		(5,068)	(5,068)
Cash used in financing activities		(5,068)	(5,068)
Net increase in cash and cash equivalents		349,326	274,340
Cash and cash equivalents at start of year		393,221	118,881
Cash and cash equivalents at end of year	26	742,547	393,221

Notes

1 General information

The Bank is incorporated in Kenya under the Companies Act and is domiciled in Kenya. The address of its registered office is:

Mebank Tower
Milimani Road
P O Box 47387-00100
Nairobi, Kenya

2 Summary of significant accounting policies

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

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS) as issued by International Accounting Standards Board.

(i) Basis of measurement

The measurement basis applied 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 Bank 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:

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.

Notes (continued)

2 Summary of significant accounting policies

(a) Basis of preparation

(ii) *Going concern*

The Bank has reported a significant increase in performance with loss for the year of Shs 25.2 million, up from a loss of Shs 66.2 million in 2016.

The financial statements reflect adequate liquidity at the reporting date. Related parties hold substantial deposits at the year end. In line with Basel 111 guidelines on liquidity coverage, related parties depositors are considered stable depositors since they have established relationships with the Bank that make withdrawal highly unlikely.

The Bank's ratio of loans and advances to customer deposits is at 70.8% (2016: 90.5%). This compares well with the local banking industry which averages 78% across all tiers.

With the implementation of the Banking (Amendment) Bill 2015 in September 2016, the net interest margins across the banking industry have been significantly impacted and this has led to reduction in interest income. The full impact has been felt in 2017.

In addition, the bank has reduced its lending in 2017. Gross loans before provisions reduced from Kshs 3.771bn to Kshs 2.991 billion, translating to a decrease of Kshs 780m. During the year, the largest loan account exited the Bank in 2017 which was a major contributor to reduced loans and advances.

Consequently, directors have sought and received a letter of financial support from the shareholders that they will support the Bank to meet its financial obligation for the next twelve months from the date of signing these financial statements.

Long term measures currently being pursued by the Bank include:

- Raising additional capital
- Disposal of non-core assets owned by the Bank whose proceeds are likely to be higher by approximately Kes 575 Million than the carrying value as disclosed in the financial statements and will be used to increase capital of the bank.
- Mobilization of deposits to increase the Bank's funding and focus to increase the Bank's lending and effectively increase the net interest margin and profitability going forward.

Based on the above measures and factors, the directors believe that the going concern assumption is appropriate in the preparation of these financial statements

(b) Use of estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires the directors to exercise judgement in the process of applying the Bank's accounting policies. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statement are disclosed in Note 4.

Notes (continued)

2. Summary of significant accounting policies (continued)

c) Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

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

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

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

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

(ii) New and revised standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2017 and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except the following set out below;

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through other comprehensive income (OCI) and fair value through profit or loss (P/L). The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. 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.

Notes (continued)

2 Summary of significant accounting policies (continued)

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

(ii) New and revised standards and interpretations not yet adopted (continued)

The new impairment model requires the recognition of impairment provisions based on expected credit losses (ECL) rather than only incurred credit losses as is the case under IAS 39. It applies to financial assets classified at amortised cost, debt instruments measured at FVOCI, contract assets under IFRS 15 Revenue from Contracts with Customers, lease receivables, loan commitments and certain financial guarantee contracts. Based on the assessments undertaken to date, the Bank expects an increase in the loss allowance for loans and advances to customers by approximately 21% and in relation to debt investments held at amortised cost. The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Bank's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The IASB has amended IFRS 15 to clarify the guidance, but there were no major changes to the standard itself. The amendments comprise clarifications of the guidance on identifying performance obligations, accounting for licences of intellectual property and the principal versus agent assessment (gross versus net revenue presentation). The IASB has also included additional practical expedients related to transition to the new revenue standard. The standard is effective for annual periods beginning on or after 1 January 2018 and earlier application is permitted. The Bank is in the process of assessing the impact.

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

A lessee measures lease liabilities at the present value of future lease payments. A lessee measures lease assets, initially at the same amount as lease liabilities, and also includes costs directly related to entering into the lease. Lease assets are amortised in a similar way to other assets such as property, plant and equipment. This approach will result in a more faithful representation of a lessee's assets and liabilities and, together with enhanced disclosures, will provide greater transparency of a lessee's financial leverage and capital employed. One of the implications of the new standard is that there will be a change to key financial ratios derived from a lessee's assets and liabilities (for example, leverage and performance ratios).

IFRS 16 supersedes IAS 17, 'Leases', IFRIC 4, 'Determining whether an Arrangement contains a Lease', SIC 15, 'Operating Leases – Incentives' and SIC 27, 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'. The standards is effective for annual periods beginning 1 January 2019. Early adoption is permitted only if IFRS 15 is adopted at the same time.

There are no other standards that are not yet effective and that would be expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

Notes (continued)

2 Summary of significant accounting policies (continued)

(d) Interest income and expense

Interest income and expense are recognised in profit or loss for all interest bearing instruments measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

When loans and advances become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

(e) Fees and commissions

Fees and commissions income are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

Fees and commissions expense are generally recognised on an accrual basis when incurred.

(f) Translation of foreign currencies

(a) Functional and presentation currency

The accounting records are maintained in the currency of the primary economic environment in which the Bank operates (the “Functional Currency”). The financial statements are presented in Kenya Shillings, which is the Bank’s presentation currency. The figures shown in the financial statements are stated in Kenya Shillings (Shs), rounded to the nearest thousand.

(b) Transactions and balances

Transactions in foreign currencies during the year are translated into the Functional Currency using the exchange rates prevailing at the dates of the transaction or valuation where items are re-measured.

Monetary items denominated in foreign currency are translated at the closing rate as at the reporting date.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss (FVTPL) and financial assets at amortised cost. Management determines the appropriate classification of its financial assets at initial recognition.

(i) Financial assets at fair value through profit or loss (FVTPL)

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. A financial asset is held for trading if:

- It has been acquired principally for the purpose of selling it in the near term or derivative financial instruments like forwards and swaps; or
- On initial recognition it is part of a portfolio of identified financial instruments that the Bank manages together and has evidence of a recent actual pattern of short-term profit-taking.

Financial instruments in this category are recognized initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as 'Net gains/ (losses) on financial assets at fair value through profit or loss'.

(ii) Financial assets at amortised cost

Financial assets are measured at amortised cost if both of the following conditions are met:

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- The contractual terms of the instrument give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortised cost using the effective interest method less any impairment, with interest revenue recognised on an effective yield basis in investment revenue.

Subsequent to initial recognition, the Bank is required to reclassify financial assets from amortised cost to FVTPL if the objective of the business model changes so that the amortised cost criteria are no longer met.

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected /life of the financial asset, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(iii) Financial liabilities

The Bank measures financial liabilities initially at fair value (being issue proceeds net of transaction costs incurred). After initial recognition, financial liabilities including customer deposits, balances due to banking institutions and borrowings are measured at amortised cost using the effective interest method. Financial liabilities are derecognised when extinguished.

(iv) Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition).

Classification of financial instruments

The Bank classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table as follows:

Category (as defined by IFRS 9)		**Class (as determined by the Bank)**	**Subclasses**
	Financial assets at amortised cost	Cash and balances with Central Bank of Kenya	
		Government securities at amortised cost	
		Deposits and balances due from banking institutions	
		Loans and advances to customers	Commercial loans
			Overdrafts
			Personal loans
			Mortgages
	Financial liabilities at armortised cost	Deposits and balances due to banking institutions	
		Customer deposits	Current accounts and demand deposits
			Savings and transaction accounts
			Fixed deposit accounts
Off-balance sheet financial Instruments	Acceptances and letters of credit		
	Guarantee and performance bonds		
	Undrawn formal stand-by facilities, credit lines and other commitments to lend		

Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

(i) Assets carried at amortised cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

(a) significant financial difficulty of the issuer or obligor;
(b) a breach of contract, such as a default or delinquency in interest or principal payments;
(c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
(d) it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
(e) the disappearance of an active market for that financial asset because of financial difficulties; or
(f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
(i) adverse changes in the payment status of borrowers in the portfolio; and
(ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

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

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Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Impairment of financial assets (continued)

(i) Assets carried at amortised cost (continued)

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Bank's grading process that considers asset type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in property prices, payment status, or other factors indicative of changes in the probability of losses in the Bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Impairment charges relating to loans and advances to banks and customers are classified in loan impairment charges whilst impairment charges relating to investment securities (at amortised cost and loans and receivables categories) are classified in 'Net gains/(losses) on investment securities'.

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

Renegotiated loans
Loans whose terms have been renegotiated are treated as new loans and their classification is maintained unless:

- For loans that are not impaired, the loans have exhibited weaknesses which may weaken the assets or inadequately protect the institution's position at some future date, in which case they are classified as 'impaired'; or
- For impaired loans, all past due principal and interest is repaid in full at the time of renegotiation, in which case they may revert to 'past due but not impaired' classification. They may then be reclassified as 'neither past due nor impaired' if a sustained record of performance is maintained for six months from the date of renegotiation.

In subsequent years, the renegotiated terms apply in determining whether the asset is considered to be past due.

Notes (continued)

2 Summary of significant accounting policies (continued)

(i) Property and equipment

All property and equipment is stated at historical cost less depreciation. Depreciation is calculated on a straight line basis to write down the cost of each asset to its residual value over its estimated useful life as follows:

– Buildings	50 years
– Leasehold improvements	Over the period of the lease
– Fixtures, fittings and equipment	5 -10 years
– Computers software and hardware	3 years
– Motor vehicles	4 years

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

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit.

(j) Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. The Core banking Software has a maximum expected useful life of 8 years.

Notes (continued)

2 Summary of significant accounting policies (continued)

(k) Offsetting

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

(l) Income tax

(a) Current income tax

Income tax expense is the aggregate of the charge to the statement of comprehensive income in respect of current income tax and deferred income tax.

Current income tax is the amount of income tax payable on the profit for the year determined in accordance with the Kenyan Income Tax Act.

(b) Deferred income tax

Deferred income tax is provided in full, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from the 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, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted at 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 are recognised only to the extent that it is probable that future taxable profits will be available against which temporary differences can be utilised.

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.

(m) Employee benefits

Retirement benefit obligation

The Bank operates a defined contribution retirement benefit scheme for its permanent employees. A defined contribution plan is a pension plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The assets of the scheme are held in separate trustee administered funds, which are funded by contributions from both the Bank and employees. The Bank and its employees also contribute to the National Social Security Fund, which is a defined contribution scheme. The Bank's contributions to the defined contribution schemes are charged to profit or loss in the year to which they relate.

Notes (continued)

2 Summary of significant accounting policies (continued)

(m) Employee benefits (continued)

Employee entitlements

The estimated monetary liability for employees' accrued annual leave entitlement at the reporting date is recognised as an expense accrual.

(n) Dividends payable

Dividends on ordinary shares are charged to equity in the period in which they are declared. Proposed dividends are shown as a separate component of equity until declared.

(o) Forward foreign exchange contract

Forward foreign exchange contracts are carried at their fair value. Fair values are obtained from appropriate pricing models.

Gains and losses on forward foreign exchange contracts are included in foreign exchange income as they arise.

(p) Acceptances and letters of credit

Acceptances and letters of credit are accounted for as off-balance sheet transactions and disclosed as contingent liabilities.

(q) 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 leases are charged to profit or loss on a straight-line basis over the period of the lease.

(r) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with Banks, other short-term highly liquid investments with original maturities of three months or less, including cash and balances with Central Bank of Kenya, treasury and other eligible bills and amounts due from other banks. Cash and cash equivalents excludes the cash reserve requirements held with the Central Bank of Kenya.

(s) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are classified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in deposits and balances due to banking institutions or deposits due to customers, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to customers or deposits and balances from banking institutions as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Notes (continued)

2 Summary of significant accounting policies (continued)

(t) Share capital

Ordinary shares are classified as equity. Any premium received over and above the par value of the shares is classified as share premium in equity.

(u) Regulatory reserve

Where impairment losses required by Central Bank of Kenya Prudential Guidelines exceed those computed under IFRS, the excess is recognised as a regulatory reserve and is accounted for as an appropriation of retained earnings. The regulatory reserve is non-distributable.

3 Financial risk management

By their nature, the Bank's activities are principally related to the use of financial instruments including derivatives. The Bank accepts deposits from customers at both fixed and floating rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Bank seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Bank also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances; the Bank also enters into guarantees and other commitments such as letters of credit and performance, and other bonds.

(a) Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counter party will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the reporting date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration of the Bank's portfolio, could result in losses that are different from those provided for at the reporting date. Management therefore carefully manages its exposure to credit risk and regularly undertakes a portfolio review to vet the potential risk of each economic sector that the Bank is exposed to.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and are subject to annual review. Limits on the level of credit risk by product and industry sector are regularly reviewed and approved by the Board of Directors.

The exposure to any one borrower including banks is further restricted by sub-limits covering on and off balance sheet exposures.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Credit related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments.

However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Maximum exposure to credit risk before collateral held	**2017** **Shs'000**	**2016** **Shs'000**
Balances with Central Bank of Kenya (Note 12)	731,628	205,235
Government securities at armotised cost (Note 13)	974,075	680,999
Deposits and balances due from banking institutions (Note 14)	90,126	256,715
Loans and advances to customers (Note 16)	2,769,120	3,616,626
Other assets	77,112	29,013
Credit risk exposures relating to off-balance sheet items (Note 25):		
- Acceptances and letters of credit	21,960	99,613
- Guarantee and performance bonds	231,239	251,051
- Commitments to lend	306,117	315,308
	5,201,377	5,454,560

The maximum exposure table represents a worst case scenario of credit risk exposure to the Bank at 31 December 2017 and 2016, without taking account of any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on carrying amounts as reported in the balance sheet. As shown above, 52% of the total maximum exposure is derived from loans and advances to customers and deposits and balances from banking institutions (2016: 66%). 18% represents investments in government securities (2016: 12%).

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Loans and advances to customers and off balance sheet items, other than to major corporates, are secured by collateral in the form of charges over land and buildings and/or plant and machinery or corporate guarantees. All other financial assets have no collateral held on them.

Management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the Bank resulting from both its loan and advances portfolio and debt securities based on the following:

- the Bank exercises stringent controls over the granting of new loans;
- 45% of the loans and advances portfolio are neither past due nor impaired (2016: 68%);
- 95% of the loans and advances portfolio are backed by collateral; and
- 100% of the investments in debt securities are government securities.

Loans and advances

Loans and advances are summarised as follows:

	2017 **Shs'000**	**2016** **Shs'000**
Neither past due nor impaired	1,628,757	2,657,179
Past due but not impaired	185,863	187,562
Impaired	1,176,906	926,514
Gross	2,991,526	3,771,255
Less: allowance for impairment	(222,406)	(154,629)
Net	2,769,120	3,616,626

Loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed based on the Central Bank of Kenya rating which the Bank has adopted:

	2017 **Shs'000**	**2016** **Shs'000**
Normal – neither past due nor impaired	1,628,757	2,657,179
Watch – renegotiated loan (not past due nor impaired)	137,893	46,728
	1,766,650	2,703,907

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Loans and advances renegotiated

Of the total gross amount of loans and advances, the following amounts have been renegotiated:

	2017 Shs'000	2016 Shs'000
Renegotiated loans and advances	137,893	46,728

Loans and advances renegotiated in 2017 and 2016 were neither past due nor impaired.

Loans and advances past due but not impaired

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. The gross amounts of loans and advances that were past due but not impaired were as follows:

	2017 Shs'000	2016 Shs'000
Past due up to 30 days	41,633	82,813
Past due 31 - 90 days	144,230	104,749
	185,863	187,562

Loans and advances individually impaired

Of the total gross amount of impaired loans, the following amounts have been individually assessed:

	Loans		Overdrafts	
	2017 Shs'000	2016 Shs'000	2017 Shs'000	2016 Shs'000
Individually assessed impaired loans and advances	623,830	626,377	553,076	300,137
Fair value of collateral	500,314	574,987	543,643	488,950

The Bank assesses at each reporting date whether there is objective evidence that loans and advances are impaired. Objective evidence that loans and advances are impaired includes observable data that comes to the attention of the Bank about loss events such as significant financial difficulty of the borrower, breach of contract, bankruptcy or other financial re-organisation or local economic conditions that correlate with defaults on the assets in the group.

Notes (continued)

3 Financial risk management (continued)

(b) Concentration risk

Economic sector risk concentrations within the customer loan and deposit portfolios were as follows:

	2017		2016	
	Loans and advances %	Unused credit commitments %	Loans and advances %	Unused credit commitments %
Manufacturing	7.30	-	4.99	-
Wholesale and retail trade	40.25	-	31.89	-
Transport and communications	5.06	-	4.10	-
Business services	0.62	-	0.62	-
Agricultural	9.23	-	7.60	-
Individuals	3.13	-	2.02	-
Foreign Trade	9.11	-	25.45	-
Real estate	13.39	-	13.18	96.56
Building and construction	9.61	-	8.10	-
Other	2.30	100	2.05	3.44
	100.00	100.00	100.00	100.00

Customer deposits	2017 %	2016 %
Central Government	0.02	0.49
Insurance companies	0.98	1.39
Private enterprise	14.17	13.40
Non profit institutions & individuals	59.38	62.58
Resident foreign currency	4.24	3.78
Non resident foreign currency	21.21	18.36
	100.00	100.00

(c) Liquidity risk

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits and calls on cash settled contingencies. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

Notes (continued)

3 Financial risk management (continued)

(c) Liquidity risk (continued)

The matching and controlled mismatching of the maturities of assets and liabilities is fundamental to the management of the Bank. By the very nature of operations, it is unusual for banks to ever completely match assets and liabilities. The Central Bank of Kenya requires that the Bank maintain a cash reserve ratio and minimum liquidity ratios. In addition, the Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-Bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The treasury department monitors liquidity ratios on a daily basis and this is closely reviewed by the Assets and Liability Committee (ALCO).

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at 31 December 2017 to the contractual maturity date. All figures are in thousands of Kenya Shillings.

At 31 December 2017	**Up to 1 Month**	**1-6 Months**	**6-12 Months**	**1-5 Years**	**Over 5 Years**	**Total**
Assets						
Cash and balances with Central Bank of Kenya	810,308	-	-	-	-	810,308
Government securities at amortised cost	-	-	520,780	300,971	152,324	974,075
Deposits and balances due from banking institutions	90,126	-	-	-	-	90,126
Other assets	94,385	-	-	-	-	94,385
Loans and advances to customers	1,703,384	420,194	271,607	252,153	121,782	2,769,120
Total assets	2,698,203	420,194	792,387	553,124	274,106	4,738,014
Liabilities and equity						
Customer deposits	678,118	3,159,736	107,093	-	-	3,944,947
Other liabilities and accrued expenses	40,848	-	-	10,660	-	51,508
Shareholders' funds	-	-	-	-	1,161,853	1,161,853
Total liabilities and equity	718,966	3,159,736	107,093	10,660	1,161,853	5,158,308
Net liquidity gap	1,979,237	(2,739,542)	685,294	542,464	(887,747)	(420,294)

Notes (continued)

3 Financial risk management (continued)

(c) Liquidity risk (continued)

At 31 December 2016	Up to 1 Month	1-6 Months	6-12 Months	1-5 Years	Over 5 Years	Total
Assets						
Cash and balances with Central Bank of Kenya	301,026	-	-	-	-	301,026
Government securities at amortised cost	-	-	-	528,938	152,061	680,999
Deposits and balances due from banking institutions	256,715	-	-	-	-	256,715
Other assets	40,711	-	-	-	-	40,711
Loans and advances to customers	1,430,379	1,055,852	11,687	955,255	163,453	3,616,626
Total assets	2,028,831	1,055,852	11,687	1,484,193	315,514	4,896,077
Liabilities and equity						
Customer deposits	2,057,126	1,913,343	64,242	873	-	4,035,584
Other liabilities and accrued expenses	39,369	-	-	5,989	-	45,358
Shareholders' funds	-	-	-	-	1,192,109	1,192,109
Total liabilities and equity	2,096,495	1,913,343	64,242	6,862	1,192,109	5,273,051
Net liquidity gap	(67,664)	(857,491)	(52,555)	1,477,331	(876,595)	(376,974)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for Banks ever to be completely matched since business transacted is often of uncertain terms and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

Notes (continued)

3 Financial risk management (continued)

(d) Market risk

Market risk is the risk that changes in market prices, which include currency exchange rates and interest rates, will affect the fair value or future cash flows of a financial instrument. Market risk arises from open positions in interest rates and foreign currencies, both of which are exposed to general and specific market movements and changes in the level of volatility. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while optimising the return on risk. Overall responsibility for managing market risk rests with the Assets and Liabilities Committee (ALCO). The Treasury department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day to day implementation of those policies.

(i) Currency risk
The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored regularly by management. In addition, the Central Bank of Kenya monitors the foreign currency position on a regular basis.

The Bank had the following significant foreign currency positions (all amounts expressed in thousands of Kenya Shillings):

At 31 December 2017	USD	GBP	Euro	Other	Total
Assets					
Cash and balances with Central Bank of Kenya	579,193	4,110	9,417	198	592,918
Deposits and balances due from banking institutions	2,110	36,729	10,900	80	49,819
Loans and advances to customers	777,390	99	29	-	777,518
Other assets and prepayments	-	-	-	-	-
Total assets	1,358,693	40,938	20,346	278	1,420,255
Liabilities					
Customer deposits	952,698	41,230	18,919	-	1,012,847
Deposits and balances due to banking institutions	-	-	-	-	-
Other liabilities and accrued expenses	364	-	-	-	364
Total liabilities	953,062	41,230	18,919	-	1,013,211
Net balance sheet position	405,631	(292)	1,427	278	407,044
Net off-balance sheet position	(413,998)	-	-	-	(413,998)
Overall net position	(8,367)	(292)	1,427	278	(6,954)

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(i) Currency risk (continued)

	USD	GBP	Euro	Other	Total
At 31 December 2016					
Total assets	1,437,115	36,423	30,153	27	1,503,718
Total liabilities	796,153	37,591	29,266	-	863,010
Net balance sheet position	640,962	(1,168)	887	27	640,708
Net off-balance sheet position	(633,328)	-	-	-	(633,328)
Overall net position	7,634	(1,168)	887	27	7,380

The off-balance sheet position represents the difference between the notional amounts of foreign currency derivative financial instruments and their fair values.

At 31 December 2017, if the Shilling had strengthened/weakened by 5% against the major currencies with all other variables held constant, pre tax profit for the year would have been lower/higher by Shs 348,000 (2016: Shs 369,000) as illustrated below:

Impact on shilling strengthening per currency (Shs ‘000)

	USD	GBP	Euro	Other	Total
At 31 December 2017 (5%)	418	15	(71)	(14)	348
At 31 December 2016 (5%)	(382)	58	(44)	(1)	(369)

Impact on shilling weakening per currency (Shs ‘000)

	USD	GBP	Euro	Other	Total
At 31 December 2017 (5%)	(418)	(15)	71	14	(348)
At 31 December 2016 (5%)	382	(58)	44	1	369

(ii) Interest rate risk

The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily.

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(ii) Interest rate risk (continued)

The table below summarises the exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The Bank does not bear an interest rate risk on off balance sheet items. All figures are in thousands of Kenya Shillings.

At 31 December 2017	Up to 1 Month	1-3 Months	3-12 Months	1-5 Years	Non-interest bearing	Total
Assets						
Cash and balances with Central Bank of Kenya	-	-	-	-	810,308	810,308
Government securities at amortised cost	-	-	-	974,075	-	974,075
Deposits and balances due from banking institutions	40,000	-	-	-	50,126	90,126
Other assets and prepayments	-	-	-	-	94,385	94,385
Loans and advances to customers	1,804,158	-	-	-	964,962	2,769,120
Total assets	1,844,158	0	-	974,075	1,919,781	4,738,014
Liabilities and Shareholders' funds						
Customer deposits	363,065	2,621,933	612,168	-	310,509	3,907,675
Other liabilities and accrued expenses	-	-	-	-	51,508	51,508
Current income tax payable	-	-	-	-	-	-
Shareholders' funds	-	-	-	-	1,161,853	1,161,853
Total liabilities and shareholders' funds	363,065	2,621,933	612,168	-	1,523,870	5,121,036
Interest sensitivity gap	1,481,093	(2,621,933)	(612,168)	974,075	395,911	(383,022)

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(ii) Interest rate risk (continued)

At 31 December 2016	Up to 1 Month	1-3 Months	3-12 Months	1-5 Years	Non-interest Bearing	Total
Total assets	2,821,353	-	-	680,999	1,393,725	4,896,077
Total liabilities and shareholders' funds	1,801,951	1,460,213	481,971	801	1,488,586	5,233,522
Interest sensitivity gap	1,019,402	(1,460,213)	(481,971)	680,198	13,563	(337,445)

Fair values and effective interest rates of financial assets and liabilities

The effective interest rates by major currency for monetary financial instruments at 31 December 2017 and 2016 were in the following ranges:

	2017		2016	
	Shs	USD Euro	Shs	USD Euro
Assets				
Government securities (%)	8.38	-	7.03	-
Deposits with banking institutions (%)	-	-	-	-
Loans and advances to customers (%)	14.17	9.65	17.56	9.74
Liabilities				
Customer deposits (%)	8.21	3.67	7.52	4.22
Deposits and balances due to banking institutions (%)	-	-	-	-

The fair value of government securities at amortised cost at 31 December 2017 is estimated at Shs 948 million (2016: Shs 620 million) compared to their carrying value of Shs 974 million (2016: Shs 681 million).

The fair values of the Bank's other financial assets and liabilities approximate the respective carrying amounts, due to the generally short periods to contractual repricing or maturity dates as set out above. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the Bank at the reporting date.

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

Cash flow and fair value interest rate risk

Fixed interest rate financial instruments expose the company to fair value interest rate risk. Variable interest rate financial instruments expose the Bank to cashflow interest rate risk.

The Bank's fixed interest rate financial instruments are government securities, deposits with financial institutions and borrowings. The Bank's variable interest rate financial instruments are loans and advances. The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cashflows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date.

The Bank regularly monitors financial assets and liabilities. As at 31 December 2017, a 10 basis points increase in interest rates would have resulted in a decrease in pre tax profit of Shs 12 million (2016: Increase of Shs 57 million).

As at 31 December 2017, a 10 basis points decrease in interest rates would have resulted in a decrease in pre tax profit of Shs 12 million (2016: Increase of Shs 56 million).

(e) Fair value estimation

Effective 1 January 2009, the Bank adopted the amendment to IFRS 7 for financial instruments that are measured in the balance sheet at fair value, this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and
- Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry bank, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

There are no financial assets or liabilities measured at fair value as at 31 December 2017.

Notes (continued)

3 Financial risk management (continued)

(f) Capital management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the balance sheet, are:

- to comply with the capital requirements set by the Central Bank of Kenya;
- to safeguard the Bank's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- to maintain a strong capital base to support the development of its business.

Capital adequacy and use of regulatory capital are monitored regularly by management, employing techniques based on the guidelines developed by the Basel Committee, as implemented by the Central Bank of Kenya for supervisory purposes. The required information is filed with the Central Bank of Kenya on a monthly basis.

The Central Bank of Kenya requires each Bank to:
a) hold the minimum level of regulatory capital of Shs 1 billion;
b) maintain a ratio of core regulatory capital to the risk-weighted assets plus risk-weighted off-balance sheet assets (the 'Basel ratio') at or above the required minimum of 8%;
c) maintain core capital of not less than 8% of total deposit liabilities; and
d) maintain total capital of not less than 12% of risk-weighted assets plus risk-weighted off-balance sheet items.

The Bank's total regulatory capital is divided into two tiers:

- Tier 1 capital (core capital): share capital, share premium, plus retained earnings.
- Tier 2 capital (supplementary capital): 25% (subject to prior approval) of revaluation reserves, subordinated debt not exceeding 50% of Tier 1 capital and hybrid capital instruments. Qualifying Tier 2 capital is limited to 100% of Tier 1 capital.

The risk weighted assets are measured by means of a hierarchy of four risk weights classified according to the nature of and reflecting an estimate of the credit risk associated with each asset and counterparty. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

Notes (continued)

3 Financial risk management (continued)

(f) Capital management (continued)

The table below summarises the composition of regulatory capital and the ratios of the Bank for at 31 December:

	2017	2016
	Shs'000	**Shs'000**
Tier 1 capital	1,143,001	1,173,011
Tier 1 + Tier 2 capital	1,156,785	1,186,149
Risk-weighted assets		
On-balance sheet	1,972,701	2,910,233
Off-balance sheet	53,895	105,769
Total risk-weighted assets	2,026,596	3,016,002
Basel ratio		
Tier 1 (CBK minimum – 8%)	42.1%	38.9%
Tier 1 + Tier 2 (CBK minimum – 12%)	42.6%	39.3%

4 Critical accounting estimates and judgements in applying accounting policies

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

(a) Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at least once a year using judgement to determine whether objective evidence exists of a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Notes (continued)

5 Net Interest income

(a) Interest income

	2017 Shs'000	2016 Shs'000
Loans and advances to customers	395,811	532,782
Government securities at amortised cost	55,556	52,067
Cash and short term funds	4,136	1,770
	455,503	586,619

(b) Interest expense

Customer deposits	272,659	348,391
Deposits and balances due to banking institutions	3,625	21,415
	276,284	369,806

6 Other operating income

Rental income	34,586	43,351
Other income	1,427	1,221
	36,013	44,572

Notes (continued)

7 Operating expenses

	2017 Shs'000	2016 Shs'000
The following items are included within operating expenses:		
Employees benefits (Note 8)	201,528	187,681
Depreciation on property and equipment (Note 18)	13,226	11,488
Amortisation of prepaid operating lease rentals (Note 19)	965	965
Amortisation of intangible assets (Note 20)	3,955	236
Rent expense	12,713	11,957
Auditors' remuneration	4,150	3,667

8 Employee benefits

The following items are included within employees' benefits expense:

	2017 Shs'000	2016 Shs'000
Staff salaries	182,769	175,408
Retirement benefits cost	8,882	483
National Social Security Fund	147	150
Medical costs	8,107	7,855
Other staff costs	1,623	3,785
	201,528	187,681

The average number of employees during the year was 61 (2016: 62)

9 Income tax expense / (credit)

	2017 Shs'000	2016 Shs'000
Current income tax	8,274	10,008
Deferred income tax (Note 17)	(24,514)	(44,712)
Income tax credit	(16,240)	(34,704)

The tax on the Bank's loss or profit before income tax differs from the theoretical amount that would arise using the statutory income tax rate as follows:

	2017 Shs'000	2016 Shs'000
Loss before income tax	(41,428)	(100,989)
Tax calculated at the statutory income tax rate of 30% (2016: 30%)	(12,428)	(30,297)
Tax effect of:		
Expenses not deductible for tax purposes	9,179	8,500
Interest income on infrastructure bonds not subject to tax	(12,991)	(12,907)
Income tax credit	(16,240)	(34,704)

Notes (continued)

10 Earnings per share

Basic earnings per share are calculated on the loss attributable to shareholders of Shs 25,188,000 (2016: Shs 66,285,000) and on the weighted average number of ordinary shares outstanding during the period.

	2017	2016
Net loss attributable to shareholders (Shs thousands)	(25,188)	(66,285)
Number of ordinary shares in issue (Note 25)	25,341,547	25,341,547
Basic earnings per share (Shs)	(0.99)	(2.62)

There were no potentially dilutive shares outstanding at 31 December 2017 and 2016. Diluted earnings per share is therefore the same as basic earnings per share.

11 Dividends per share

At the forthcoming annual general meeting a dividend in respect of the year ended 31 December 2017 of Shs 0.20 per share amounting to a total of Shs 5,068,000 is to be proposed (2016: final dividend proposed of Shs 5,068,000).

The payment of dividends is subject to withholding tax at a rate of either 0%, 5% or 10% depending on the tax status of the respective shareholder.

12 Cash and balances with Central Bank of Kenya

	2017 Shs'000	2016 Shs'000
Cash in hand	78,680	95,791
Balances with Central Bank of Kenya	164,355	175,947
Foreign currency balances with Central Bank of Kenya	567,273	29,288
	810,308	301,026

13 Government securities at amortised cost

Treasury bills and bonds:		
Maturing after 90 days of the date of acquisition	974,075	680,999

Treasury bills and bonds are debt securities issued by the Republic of Kenya.

Notes (continued)

14 Deposits and balances due from banking institutions

	2017 Shs'000	2016 Shs'000
Foreign currency balances with foreign banks	49,819	176,313
Local currency deposits	40,307	80,402
	90,126	256,715

15 Other assets and prepayments

Uncleared effects	18,278	16,452
Stationery stocks	1,476	895
Derivative assets (currency forwards)	12,102	2,953
Prepayments	17,273	11,698
Other debtors	70,256	63,447
Less: provision for insurance receivable	(25,000)	(54,734)
	94,385	40,711

16 Loans and advances to customers

	2017 Shs'000	2016 Shs'000
Commercial loans	1,421,933	2,071,451
Overdrafts	1,364,865	1,452,387
Personal loans	141,466	158,232
Mortgages	63,262	89,185
Gross loans and advances	2,991,526	3,771,255
Less: provision for impairment of loans and advances		
- Identified impairment	(211,944)	(131,241)
- Unidentified impairment	(10,462)	(23,388)
	(222,406)	(154,629)
Net loans and advances	2,769,120	3,616,626
Current	1,804,158	2,821,353
Non-current	964,962	795,273
	2,769,120	3,616,626

Notes (continued)

16 Loans and advances to customers (continued)

The movements in provisions for impairment of loans and advances are as follows:

	Identified impairment		**Unidentified**	
	Overdrafts	**Loans**	**impairment**	**Total**
	Shs'000	**Shs'000**	**Shs'000**	**Shs'000**
At 1 January 2016	74,805	100,826	26,724	202,355
Charge to statement of comprehensive income				
Increase in provision	52,624	15,623	(3,336)	64,911
Amounts written off	(95,335)	(17,302)	-	(112,637)
At 31 December 2016	32,094	99,147	23,388	154,629
At 1 January 2017	32,094	99,147	23,388	154,629
Charge to statement of comprehensive income				
Increase in provision	40,196	-	(12,926)	27,270
Amounts written off	-	(956)	-	(956)
Amounts recovered	41,463	-	-	41,463
At 31 December 2017	113,753	98,191	10,462	222,406

All loans are written down to their estimated recoverable amount. The amount of non-performing loans (net of impairment losses) at 31 December 2017 was Shs 964,962,000 (2016: Shs 795,273,000).

There were no receivables under hire purchase contracts, loans written off or amounts recovered in 2017 and 2016.

Notes (continued)

17 Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 30% (2016: 30%). The movement on the deferred income tax account is as follows:

	2017 Shs'000	2016 Shs'000
At start of year	75,932	31,220
Credits to the statement of comprehensive income (Note 9)	24,514	44,712
At end of year	100,446	75,932

The deferred income tax asset and deferred income tax credit in the statement of comprehensive income and equity are attributable to the following items:

	1 January 2017 Shs'000	Credited/ (charged) to SOCI Shs'000	31 December 2017 Shs'000
Deferred income tax asset			
Provisions	65,296	11,377	76,673
Accelerated tax depreciation	5,402	(1,033)	4,369
Tax losses	6,119	16,916	23,035
Deferred income tax liability			
Unrealised exchange gain	(885)	(2,746)	(3,631)
Net deferred income tax asset	75,932	24,514	100,446

	1 January 2016 Shs'000	Credited/ (charged) to SOCI Shs'000	31 December 2016 Shs'000
Deferred income tax asset			
Provisions	28,141	37,155	65,296
Accelerated tax depreciation	5,619	(217)	5,402
Tax losses	-	6,119	6,119
Deferred income tax liability			
Unrealised exchange gain	(2,540)	1,655	(885)
Net deferred income tax asset	31,220	44,712	75,932

Notes (continued)

18 Property and equipment

	Buildings Shs'000	Leasehold Improvements Shs'000	Motor vehicles Shs'000	Fixtures, fittings and equipment Shs'000	Total Shs'000
Year ended 31 December 2016					
Cost					
At 1 January 2016	235,984	14,949	11,221	118,830	380,984
Additions	-	-	-	2,323	2,323
Disposals	-	-	(1,500)	-	(1,500)
At 31 December 2016	235,984	14,949	9,721	121,153	381,807
Depreciation					
At 1 January 2016	70,317	8,645	11,221	107,557	197,740
Charge for the year	4,721	2,521	-	4,246	11,488
On disposal	-	-	(1,500)	-	(1,500)
At 31 December 2016	75,038	11,166	9,721	111,803	207,728
Net book value					
At 31 December 2016	160,946	3,783	-	9,350	174,079
Year ended 31 December 2017					
Cost					
At 1 January 2017	235,984	14,949	9,721	121,153	381,807
Additions	-	-	-	14,218	14,218
Disposals	-	-	(3,183)	(23)	(3,206)
Write off			(71)		(71)
At 31 December 2017	235,984	14,949	6,467	135,348	392,748
Depreciation					
At 1 January 2017	75,038	11,166	9,721	111,803	207,728
Charge for the year	4,721	2,413	-	6,092	13,226
On disposal	-	-	(3,183)	(23)	(3,206)
Write off			(71)		(71)
At 31 December 2017	79,759	13,579	6,467	117,872	217,677
Net book value					
At 31 December 2017	156,225	1,370	-	17,476	175,071

Notes (continued)

19 Prepaid operating lease rentals

	2017 Shs'000	2016 Shs'000
At start of year	75,374	76,339
Amortisation charge for the year	(965)	(965)
At end of year	74,409	75,374
Cost	93,715	93,715
Accumulated amortisation	(19,306)	(18,341)
	74,409	75,374

20 Intangible assets

At start of the year	10,422	413
Additions	34,094	-
Capital Work-in-progress	(10,245)	10,245
Amortisation charge for the year	(3,955)	(236)
At end of year	30,316	10,422
Cost	78,196	44,102
Capital Work-in-progress	-	10,245
Accumulated amortisation	(47,880)	(43,925)
Net book value	30,316	10,422

21 Customer deposits

Current accounts and demand deposits	434,559	404,997
Savings and transaction accounts	239,881	246,135
Fixed deposit accounts	3,233,235	3,344,923
	3,907,675	3,996,055

Notes (continued)

22 Other liabilities and accrued expenses

Bills payable	1,522	3,518
Outstanding banker's drafts	2,297	2,429
Other	47,689	39,411
	51,508	45,358

23 Share capital	Number of Shares	Ordinary shares Shs'000
At 1 January 2016,31 December 2016 and 31 December 2017	25,341,547	506,831

The total authorised number of ordinary shares is 37,500,000 with a par value of Shs 20 per share. All issued shares are fully paid.

24 Regulatory reserve	2017 Shs'0000	2016 Shs'0000
At start of year	13,138	10,194
Transfer from retained earnings	646	2,944
At end of year	13,784	13,138

The regulatory reserve represents an appropriation from retained earnings to comply with the Central Bank of Kenya's Prudential Guidelines. The balance in the reserve represents the excess of impairment provisions determined in accordance with the Prudential Guidelines over the IFRS impairment provisions. The reserve is non-distributable.

Notes (continued)

25 Off balance sheet financial instruments, contingent liabilities and commitments

In common with other Banks, the Bank conducts business involving acceptances, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties. In addition, there are other off-balance sheet financial instruments including forward contracts for the purchase and sale of foreign currencies, whose nominal amounts are not reflected in the balance sheet.

	2017	**2016**
Contingent liabilities	**Shs'000**	**Shs'000**
Acceptances and letters of credit	21,960	99,613
Guarantee and performance bonds	231,239	251,051
	253,199	350,664

Nature of contingent liabilities

An acceptance is an undertaking by a Bank to pay a bill of exchange drawn on a customer. The Bank expects most acceptances to be presented, and reimbursement by the customer is normally immediate. Letters of credit commit the Bank to make payments to third parties, on production of documents, which are subsequently reimbursed by customers.

Guarantees are generally written by a 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 customer's default.

Commitments	**2017**	**2016**
	Shs'000	**Shs'000**
Undrawn formal stand-by facilities, credit lines and other commitments to lend	306,117	315,308
Foreign exchange forward contracts to sell currency	398,518	633,328

Nature of commitments

Commitments to lend are agreements to lend to a customer in future subject to certain conditions. Such commitments are normally made for a fixed period. The Bank may withdraw from its contractual obligation for the undrawn portion of agreed overdraft limits by giving reasonable notice to the customer.

Foreign exchange forward contracts are agreements to buy or sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate.

Bank facility

The Bank has a Domestic Foreign Currency Cheque Clearing facility (DFCC) with the Central Bank of Kenya. The Bank has given USD 133,000 in favour of Central Bank of Kenya to secure this facility.

Notes (continued)

26 Analysis of cash and cash equivalents as shown in the cash flow statement

	2017 Shs'000	2016 Shs'000
Cash and balances with Central Bank of Kenya (Note 12)	810,308	301,026
Deposits and balances due from banking institutions (Note 14)	90,126	256,715
Less: cash reserve requirement	(157,887)	(164,520)
	742,547	393,221

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition including: cash and balances with Central Bank of Kenya, deposits and balances due from or to banking institutions, treasury bills and other eligible bills. Cash and cash equivalents exclude the cash reserve requirement held with the Central Bank of Kenya

Banks are required to maintain a prescribed minimum average cash balance with the Central Bank of Kenya that is not available to finance the Bank's day-to-day activities. At year end, the amount was determined as 5.25**%** (2016: 5.25%) of the average outstanding customer deposits over a cash reserve cycle period of one month.

27 Related party disclosures

In the normal course of business, the Bank issues/ operates loans, advances and other facilities, current accounts and placements of foreign currencies with entities connected to some of the Bank's directors and/ or shareholders as follows:

Notes (continued)

27 Related party disclosures (continued)

(i) Loans and advances to related parties

Advances to customers include loans to directors, loans to companies connected to directors or their families and loans to employees as follows;

	2017 Shs'000	2016 Shs'000
At start of the year	81,154	305,322
Advances during the year	48,638	49,217
Repayments during the year	(47,558)	(273,385)
At end of year	82,234	81,154
Advances to Bank employees at end of year	82,190	81,154
Interest income earned on advances to employees, directors or entities controlled by directors	5,846	55,353

(ii) Guarantees to directors of the Bank (and their families) and companies controlled by directors:

At start of the year	1,090	7,914
Issues	-	-
Retirement	(-)	(6,824)
At end of year	1,090	1,090

(iii) Deposits from related parties

Deposits from staff and directors or entities controlled by directors	997,853	989,158
Interest expense paid on deposits by directors or entities connected to directors	28,590	34,126

Notes (continued)

27 Related party disclosures (continued)

(iv) Other transactions

In the normal course of business, the Bank earned rental income from an entity associated with the Bank as follows:

	2017 Shs'000	2016 Shs'000
Rental income earned	2,842	3,902

In 2017 Shs 3,619,000 rental income was receivable (2016: Shs 2,887,000).

(v) Key management compensation

	2017 Shs'000	2016 Shs'000
Salaries and other short-term employment benefits	77,137	68,879
Other long-term benefits	3,671	3,733
	80,808	72,612

The Bank has a compensation policy that is market oriented and is effective in ensuring that required skills are always available. The policy ensures compensation consistency within business units. The policy also provides employment stability, healthcare benefits and provident fund plan to employees. Bank's policy honours any Collective Bargaining Agreements that are applicable. The policy is non-discriminatory in nature.

(vi) Directors' remuneration

	2017 Shs'000	2016 Shs'000
Fees and other emoluments	22,650	22,225

Directors' remuneration is determined by the Bank's Board. To attract and retain directors, the Bank has a structure that is competitive in the industry and that is within the Bank's ability to pay.

Notes (continued)

28 Other Contingencies

In 2016, the Bank suffered fraud losses at one of its branches. All verified claims were refunded to the respective customers and the loss relating to the refunds has been accounted for in these financial statements. No provisions have been made in relation to the unverified claims from customers as the directors believe that the eventual loss from the unverified claims will not result in a material cash outflow to the Bank.

The Bank lodged a claim with their insurers for the fraud matter above. The total claim was for Shs 104 million (2016: Shs 55 million). The asset has not been recognised in these financial statements as the insurance company had not officially confirmed settlement of the claim. The directors believe that the future inflow to the Bank is probable.

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