M Oriental

M Oriental Bank Limited

Annual Report & Financial Statements 2017

GROWTH
FUTURE
IDEAS
DEVELOPMENT
PRODUCTIVITY
SALES
GLOBAL
INTERNATIONAL
COOPERATION
INTEGRETED
STOCK MARKET
SUCCESS
COOPERATION
CONCEPTS
ADVICE
INTERNATIONAL
PROFIT
IDEA
SALES
VISION
CONNECT
NETWORK
IDEA
EXPERTIS
DATA
CONCEPTS
INTERNATIONAL
BUSINESS
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IDEA
INVESTMENT
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SALES
PLANS
ADVICE
COMMUNICATION
DATA
TEAM
FUTURE
DATA
TEAMWORK
IDEA

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Bank Information

FOR THE YEAR ENDED 31ST DECEMBER 2017

Board of directors	Shanti V. Shah - Chairman Nalinkumar M. Shah Jitendrakumar C. Patel Rupen M. Haria Jayesh G. Shah Simon D. Gregory
Company secretary	Joseph Kamau P.O. Box 14357 - 00800 Nairobi, Kenya.
Registered office	L.R. No.1870/1569, Apollo Centre, 2nd Floor Ring Road, Westlands P.O. Box 14357 - 00800 Nairobi, Kenya.
Independent auditor	RSM Eastern Africa Certified Public Accountants 1st Floor, Pacis Centre, Slip Road, Off Waiyaki Way, Westlands P.O. Box 349 - 00606 Nairobi, Kenya.
Principal correspondents	Standard Chartered Bank, New York, United States of America Standard Chartered Bank, London, United Kingdom Standard Chartered Bank, Frankfurt, Germany Axis Bank, Mumbai, India

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the 2018 Annual General Meeting of the Company will be held at Boma Inn, Red Cross Road, Eldoret, on 7th June 2018 at 2.00p.m. to conduct the following Ordinary Business:-

ORDINARY BUSINESS:

1. To table proxies, note the presence of a quorum and record apologies.
2. To receive and adopt the Annual Report and Financial Statements for the year ended 31st December 2017 together with the Directors and Auditors Reports therein.
3. To note that Directors do not recommend payment of dividend.
4. To elect Directors:In accordance with clauses 89, and 91 of Table A Mr. NM Shah, and Mr. SD Gregory retire by rotation and being eligible, offer themselves for re-election.
5. To approve the remuneration of the Directors.
6. To reappoint the Auditors.
7. Any other business which due notice has been received.

By Order of the Board
J Kamau
Company Secretary
Dated: 16th May 2018

Note:

1. A shareholder entitled to attend and vote at the meeting may appoint one or more proxies (who need not be members) to attend and vote in his stead. Proxy forms must be received at the Head Office of the Company, *Finance House, Koinange Street, Nairobi, PO Box 44080- 00100 Nairobi* not later than 48 hours before the time for holding the meeting.
2. Any shareholder wishing to propose a director for election at the Annual General Meeting should send the proposal to the Board signed by the proposer and the person seconding the proposal, so as for it to be received at the Registered Office at the address shown in Note (1) above, at least 10 days before the date of the meeting.
3. In accordance with Articles 128 and 132 of the Company's Articles of Association, shareholders are requested to obtain the full Annual Report and Financial Statements for the year ended 31 December 2017 at the Bank's website: *www.moriental.co.ke*
Any shareholder interested in printed copy of the reports may obtain it at any of the Bank's branches.

Chairman's Report

Shanti V. Shah

Chairman

It is my pleasure to present the Bank's annual report for the year 2017; an eventful year for Kenya, with an extended election period being the primary causal factor in the sluggish socio-economic climate that prevailed most of the year.

With Global GDP growth reaching 3.0% in 2017 and EAC economic growth averaging at 5.30% the same year, Kenya's economic growth decelerated to a 5 year low to an estimated 4.8% in 2017, from 5.8% a year earlier. A slowdown in Credit growth to the private sector occasioned primarily by the interest rate caps and poor rains compounded the existing dampening climate to weigh down the macro economic performance significantly.

In spite of all these headwinds faced, our deposits increased by 7.5% to close at KES 7.463 Bn with the loans and advances portfolio increasing by 9.5% to close at KES 7.272 Bn. It is worthy to note that even with sustained pressure on our margins occasioned by the interest rate caps, profitability increased by 226% to close with a Profit Before Tax level of KES 116 Mn in 2017. This was managed through the tight monitoring of Non-Performing Loans with a view to prevent any slippages, as well as close monitoring of all facets of our operations to introduce various initiatives aimed at maximising our yields, while delivering the best value to our clients at the same time. We further remained one of the few Banks in the sector who were not negatively affected by the Real Estate downturn with our Non-Performing Loan levels remaining stable in the face of an industry wide increase; this was afforded to us through a rigorous credit screening process and limited exposure in this sector through the foresight of the Board.

Notably, through advance strategic planning, the Bank worked pre-emptively and opened its new flagship Branch at the Sameer Business Park, along Mombasa Road in Nairobi in August, to counter the effects of the envisaged dampened macro climate. This state of the art branch offers an innovative banking experience to our discerning customer, by doing away with the traditional banking hall and offering a unique, private banking experience through our luxurious banking 'rooms'. Designed for the discerning Corporate and Private Banking client, the Branch has been the cornerstone of our strategic positioning for transformational growth in the next five years, and is considered to be one of a kind in the country.

Chairman's Report (continued)

Your Bank also participated, through sponsorship, in various Non Profit Institutions activities as part of our Corporate Social Responsibility. Our close association with the Catholic Diocese of Kitale provided an opportunity for the Bank to give back to society through various educational initiatives which were held during the year.

Additionally, during the year various client functions were held in Nairobi, Eldoret and Kitale as a token of appreciation to the loyalty and support of our clients. The functions were very well attended and are likely to become a regular feature as part of our Client Relationship Management goals.
I am also pleased to say that the outlook for 2018 remains positive and we are poised to take advantage of our strategic positioning and compound our growth trajectory. The Bank is also embarking on a number of new projects in the coming year designed to enhance our client experience.

My sincere vote of thanks to my Board of Directors, Staff and Management for their dedication and commitment during the year, as well as the Central Bank of Kenya for providing their valuable guidance, as always. It is indeed important to also express my gratitude to our Auditors, Messrs RSM Ashvir for their services rendered in the usual professional and timely manner. Last but not least, I take this opportunity to thank our outgoing CEO Mr Rakesh Kashyap, and welcome our Acting CEO Mr Alakh Kohli.

Shanti V Shah
Chairman

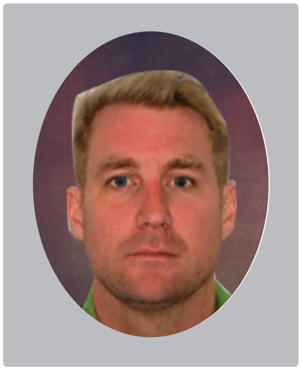
Board of Directors' Members

Shanti V. Shah

Jitendrakumar C. Patel

Nalinkumar M. Shah

Rupen M. Haria

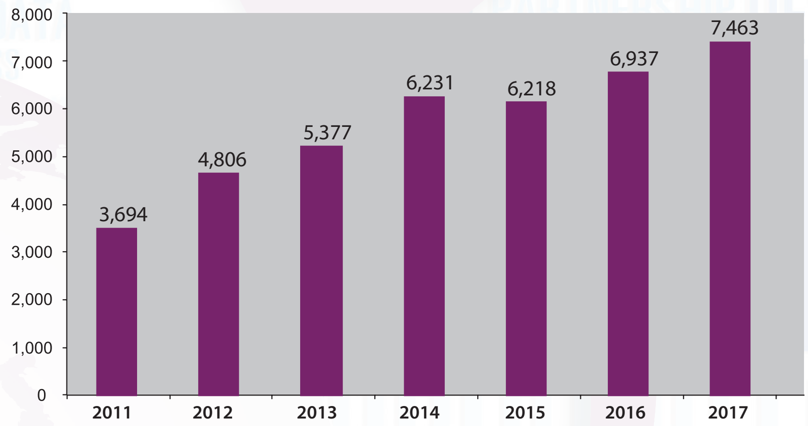


Simon Gregory

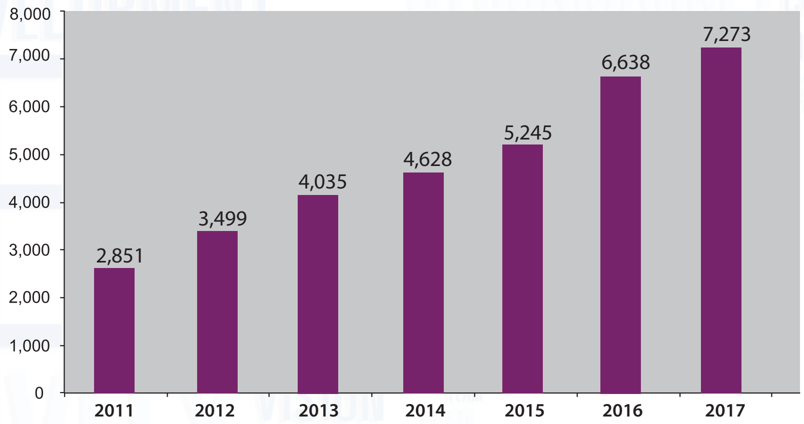
Jayesh Shah

Financial Highlights

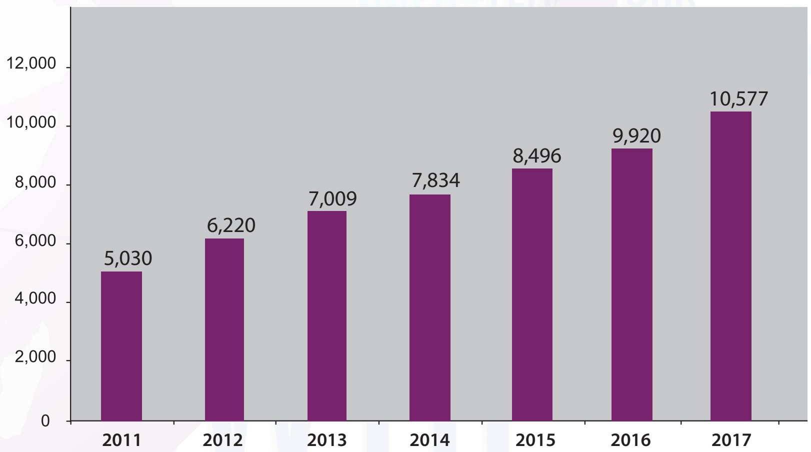
CUSTOMERS DEPOSITS IN Kshs. Millions



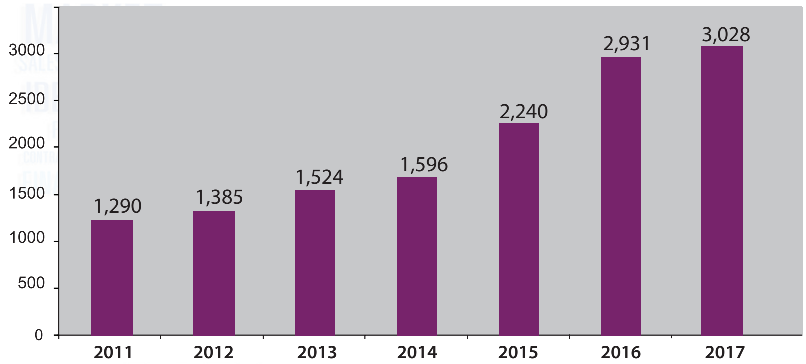
NET LOANS & ADVANCES IN Kshs. Millions



TOTAL ASSETS IN Kshs. Millions



SHAREHOLDERS' FUND IN Kshs. Millions



Corporate Governance Statement

FOR THE YEAR ENDED 31ST DECEMBER 2017

Corporate governance involves a set of relationships between a broad group of stakeholders, including shareholders, Board of Directors, management, employees, customers, suppliers, regulators and the general public that guides the way companies are directed and controlled. The Board of Directors recognises importance of good corporate governance and is fully committed to achieving and sustaining the highest standards of corporate governance.

Shareholders

The shareholders' roles are firstly to appoint the Directors and hold the Board accountable and responsible for efficient and effective governance of the Bank. Secondly they also appoint the Independent Auditors of the Bank.

Board of Directors

The Board meets regularly and had four sittings during the year 2017 as shown on page 13. Matters requiring urgent attention were resolved through circular resolutions. Apart from the regular Board meetings, communication between the Executive Management and the Board is on a continuous basis mainly by way of Board memoranda and electronic mail which are circulated to all Directors.

The Board has delegated the authority of day to day management to the CEO but retains the overall responsibility for financial and operating decisions as indicated on the statement of directors' responsibilities. The Board has access to the Company Secretary. To ensure effectiveness, the Board has set up various committees which operate within and in accordance with clearly set terms of reference. The committees report to the Board at periodic intervals and by circulation.

These committees are:-

1. Board Audit Committee

The role of the Board Audit Committee is to assist the board of directors in fulfilling its oversight responsibilities for the financial reporting process. It is also responsible for continually evaluating the effectiveness of internal control systems and regularly receives reports from internal and external auditors and management's corrective actions in response to the findings. The committee meets on a quarterly basis and its members are:

i. Jitendrakumar C. Patel - Chairman
ii. Nalinkumar M. Shah - Member
iii. Rupen M. Haria - Member
iv. Simon D. Gregory- Member

2. Board Risk and Compliance Committee

The Board Risk and Compliance Committee monitors all risk exposures against defined thresholds and appetite. The committee also monitors legal and regulatory changes in the external environment and oversees compliance with relevant laws, regulations and directives. The committee meets on a quarterly basis and its members are:

i. Jayesh G. Shah - Chairman
ii. Nalinkumar M. Shah - Member
iii. Jitendrakumar C. Patel - Member
iv. Rupen M. Haria - Member

3. Board Credit Committee

The function of this committee is to appraise and approve credit applications within the limits set by the Board and review of the quality of loans portfolio ensuring adequate loan loss provisions are held in line with the prudential guidelines. The committee also oversees and reviews the overall lending policies of the Bank. The committee meets as and when need arises. Members of this committee are:

i. Jayesh G. Shah - Chairman
ii. Shanti V. Shah - Member
iii. Rupen M. Haria - Member
iv. Nalinkumar M. Shah - Member

4. Board Appointment & Compensation Committee

The function of this committee is to oversee appointments and the compensation system's design and operation on behalf of the Board of Directors. The committee meets as and when the need arises. Members of this committee are:

i. Rupen M. Haria - Chairman
ii. Shanti V. Shah - Member
iii. Jayesh G. Shah - Member

Board Evaluation

The Board has had regular communication on its composition and effectiveness. Through the communications, directors are called upon on the functions requiring their expertise. This is taken into account in peer review performance.

A Board assessment and peer review on performance was undertaken for the year ended 31st December 2017. This performance evaluation is an annual exercise aimed at ensuring that the Board remains efficient and effective while discharging its responsibilities.

A detailed report has been separately submitted to Central Bank of Kenya as per Prudential Guidelines.

Management committees

For effective delegation the CEO has also set up various committees made up of senior officers of the Bank entrusted with different responsibilities which operate within prescribed Terms of Reference as approved by the Board. These Committees include Asset and Liabilities Committee (ALCO), Executive Credit Committee, Management Committee and Human Resource Committee.

Corporate Governance Statement (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

Tabulated below are the committees, their membership, frequency of meetings and functions.

	Asset and Liabilities Committee	**Management Credit Committee**	**Executive Committee**
Chairman	C.E.O	C.E.O	C.E.O
Members	Head - Treasury	Chief Credit Risk Officer	Chief Credit Risk Officer
	Chief Credit Officer	Financial Controller	Chief Operations Officer
	Chief Operations Officer		Financial Controller
	Financial Controller		
	Head - Risk & Compliance		
Frequency of meetings	Monthly	Monthly	Monthly
Main functions	Management of statement of financial position and liquidity	Appraisal and approval of credit applications	Strategy decision making

The Bank is a public limited company and fully complies with the Banking Act and the Central Bank of Kenya Prudential Guidelines. The Bank distributes its annual report and financial statements and also publishes quarterly reports and notices in the national dailies to ensure that the shareholders are fully informed of the Bank's performance. No individual shareholder has direct or indirect control powers to control the institution and all shareholders have access to the Bank and it's Company Secretary who responds to their correspondences. In accordance with the Companies Act the shareholders have access to the shares register.

Corporate Governance Statement (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

Board Meeting Attendance

Date of Meeting	S.V. Shah	N.M. Shah	R.M. Haria	J.C. Patel	S.D. Gregory	J.G. Shah
3/30/2017	√	√	√	√	√	x
6/20/2017	√	√	√	√	√	√
11/2/2017	√	√	√	√	√	√
12/15/2017	√	√	√	√	x	√
Total meetings attended	4	4	4	4	3	3
Percentage attendance	100%	100%	100%	100%	75%	75%

Shanti V. Shah
Chairman

Alakh Kohli
Ag. Chief Executive Officer

Report of the Directors

FOR THE YEAR ENDED 31ST DECEMBER 2017

The directors submit their report together with the audited financial statements for the year ended 31 December 2017, in accordance with Section 22 of the Banking Act and Section 653 of the Kenyan Companies Act, 2015, which disclose the state of affairs of the M-Oriental Bank (''the Bank'').

Incorporation

The Bank is domiciled in Kenya where it is incorporated as a company limited by shares under the Kenyan Companies Act, 2015. The address of the registered office is set out on page 1.

Directorate

The directors who held office during the year and to the date of this report are set out on page 4.

Principal activities

The Bank is licensed under the Banking Act and provides banking, financial and related services.

Dividend

The directors do not recommend the declaration of a dividend for the year.

Business review

Macro-economic difficulties notwithstanding, M-Oriental Bank experienced tremendous improvement in various performance measures and remained stable with a significant headroom for business growth. Profit after tax grew by 286% from KSh 33,686,000 in 2016 to KSh 96,510,000 in 2017. A limiting macro-economic environment prevailed in the year 2018. The prolonged electioneering period dampened business growth. Full impact of the Interest cap law that came into effect in September 2016 was felt in 2017 where Banks' interest margins were eroded.

Improved profitability reduced the Bank's accumulated losses to KSh 132,528,000 as at 31st December 2017 thereby bringing the bank closer to a position where it can declare dividends to the shareholders in the foreseeable future. Concerted efforts on loan recoveries are being made to ramp up the Bank's profitability. Our efforts were frustrated by slow economic growth in 2017, especially in the real estate sector coupled with slow judicial processes. Its expected that the situation will improve in 2018 going forward. Further, capping of interest rate will continue to be a detriment to the bank's profitability. We envisage that there will be a relaxation of the interest rate cap in 2018, if not a full withdrawal, given the negative economic consequences which are being seen as a result of setting a cap on the rates of interest below an equilibrium level. The Bank held a deferred tax asset of KSh 304,167,000 as at 31st December 2017 which relies on its future taxable profits to exhaust past tax losses. It's expected that the bank will be able to generate enough profits to offset the accumulated tax losses by end of 2019, especially through recoveries. A new accounting standard, IFRS 9 with an effective date of 1st January 2018, that basically requires impairment assessment on performing assets unlike the outgoing standard that focuses on non performing assets will also impact the bank's profitability.

In pursuit of a strategic position as a premier corporate Bank, a realignment of the bank's branch network was done in 2018. One branch, Nakumatt Mega branch, was closed and a new state of the art corporate branch at Sameer Business Park was opened. The Bank had 7 branches as at close of 2017 with 105 staff members across the branch network and Head office.

Report of the Directors (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

Statement as to disclosure to the Bank’s auditor

With respect to each director at the time this report was approved:
(a) there is, so far as the person is aware, no relevant audit information of which the Bank’s auditor is unaware; and

(b) the person has taken all the steps that the person ought to have taken as a director so as to be aware of any relevant audit information and to establish that the Bank’s auditor is aware of that information.

Terms of appointment of the auditor

The directors approve the annual audit engagement contract which sets out the terms of the auditor’s appointment and the related fees. The agreed auditor’s remuneration of KSh 4,250,000 has been charged to profit or loss in the year.

By order of the board

……………………………………………..
Chairman
tNairobi 20th March 2018

Statement of Directors' Responsibilities

FOR THE YEAR ENDED 31ST DECEMBER 2017

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Bank as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the Bank keeps proper accounting records that: (a) show and explain the transactions of the Bank; (b) disclose, with reasonable accuracy, the financial position of the Bank; and (c) enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Companies Act, 2015.

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 such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;
ii. selecting suitable accounting policies and applying them consistently; and
iii. making accounting estimates and judgements that are reasonable in the circumstances.

Having made an assessment of the Bank's ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the Bank's ability to continue as a going concern.

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

Approved by the board of directors on 20th March 2018 and signed on its behalf by:

....
Chairman

....
Ag. Chief Executive Officer

Report of the Independent Auditor
To the Members of M Oriental Bank Limited

Opinion

We have audited the accompanying financial statements of M-Oriental Bank Limited, set out on pages 19 to 63, which comprise the statements of financial position as at 31st December 2017, the profit and loss account, statement of changes in equity and cash flows for the year then ended, and notes, including a summary of significant accounting policies.

In our opinion the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31st December 2017 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and 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. 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 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, 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.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and fair presentation of the financial statements that give a true and fair view 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.

Report of the Independent Auditor To the Members of M Oriental Bank Limited (continued)

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 judgement 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 management.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If 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. Our conclusions are based on the audit evidence obtained up to the date of the 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 those charged with governance 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 legal requirements

In our opinion the information given in the report of the directors on page 14 and 15 is consistent with the financial statements.

The engagement partner responsible for the audit resulting in this independent auditor's report was FCPA Ashif Kassam, Practising Certificate No. 1126.

RSM Eastern Africa

RSM Eastern Africa
Certified Public Accountants
Nairobi
20th March 2018
054/2018

Profit and Loss Account

FOR THE YEAR ENDED 31ST DECEMBER 2017

	Note	2017 KSh'000	2016 KSh'000
Interest income	4	1,227,535	1,238,360
Interest expense	5	(576,702)	(591,988)
Net interest income		**650,833**	**646,372**
Fee and commission income	6	117,713	96,074
Fee and commission expense	6	(3,319)	(2,921)
Net fee and commission income		**114,394**	**93,153**
Net trading income	7	13,452	8,816
Changes in fair value of financial assets at fair value	8	10,541	(14,341)
Other income	9	4,265	4,152
Total income		**793,485**	**738,152**
Employee benefits expense		(242,041)	(195,375)
Other expenses		(273,799)	(255,353)
Net impairment losses on loans and advances	10	(161,630)	(251,919)
Profit before tax expense	11	**116,015**	**35,505**
Tax expense	12	(19,505)	(1,819)
Profit for the year attributable to the owners of the Bank		**96,510**	**33,686**
Earnings per share attributable to the owners of the Bank			
Basic and diluted (KSh per share)	13	**0.77**	**0.29**

Statement of Financial Position

AS AT 31ST DECEMBER 2017

	Note	2017 KSh'000	2016 KSh'000
ASSETS			
Cash and balances with Central Bank of Kenya	14	974,582	794,751
Loans and advances to banking institutions	15	561,922	445,731
Loans and advances to customers	16	7,272,765	6,638,054
Government securities at amortised cost	17	1,207,628	1,485,402
Other financial assets at amortised cost	17	16,070	19,320
Financial assets at fair value	18	45,698	39,765
Other receivables	19	69,550	88,383
Intangible assets	20	4,854	3,589
Property and equipment	21	119,289	81,580
Deferred income tax	22	304,167	323,672
Total assets		**10,576,525**	**9,920,247**
LIABILITIES			
Deposits from customers	23	7,463,416	6,936,717
Other payables	24	85,111	52,042
Total liabilities		**7,548,527**	**6,988,759**
SHAREHOLDERS' EQUITY			
Share capital	25	2,490,811	2,490,811
Shareholders' contributions pending allotment	25	9,189	9,189
Share premium	25	412,819	412,819
Regulatory reserve	26	247,707	233,378
Accumulated losses		(132,528)	(214,709)
Total shareholders' equity		**3,027,998**	**2,931,488**
Total liabilities and shareholders' equity		**10,576,525**	**9,920,247**

The financial statements on pages 19 to 63 were approved for issue by the board of directors on 20th March 2018 and were signed on its behalf by:

……………………………… **Chairman**

……………………………… **Ag. Chief Executive Officer**

……………………………… **Director**

……………………………… **Director**

Statement of Changes in Equity

FOR THE YEAR ENDED 31ST DECEMBER 2017

	Note	Share Capital KSh'000	Shareholders' contribution pending allotment contributions KSh'000	Share Premium KSh'000	Regulatory reserve KSh'000	Accumulated Losses KSh'000	Total KSh'000
At 1st January 2016		**2,052,673**	**8,849**	**193,580**	**208,778**	**(223,795)**	**2,240,085**
Changes in equity in 2016							
Profit for the year		-	-	-	-	33,686	33,686
Transfer from regulatory reserve	26	-	-	-	24,600	(24,600)	-
		2,052,673	8,849	193,580	233,378	(214,709)	2,273,771
Transactions with owners							
Allotment of new shares		438,478	-	219,239	-	-	657,717
Amendment of double allotment in prior years		(340)	340	-	-	-	-
At 31st December 2016		**2,490,811**	**9,189**	**412,819**	**233,378**	**(214,709)**	**2,931,488**
At 1st January 2017		2,490,811	9,189	412,819	233,378	(214,709)	2,931,488
Changes in equity in 2017							
Profit for the year		-	-	-	-	96,510	96,510
Transfer to regulatory reserve	26	-	-	-	14,329	(14,329)	-
At 31st December 2017		**2,490,811**	**9,189**	**412,819**	**247,707**	**(132,528)**	**3,027,998**

Statement of Cash Flows

FOR THE YEAR ENDED 31ST DECEMBER 2017

	Note	2017 KSh'000	2016 KSh'000
Cash flows from operating activities			
Interest receipts		1,225,053	1,269,862
Interest payments		(564,355)	(631,503)
Net fees and commission receipts		114,394	93,153
Net trading income		13,451	8,816
Other sundry income		1,070	2,007
Payments to employees and suppliers		(427,079)	(438,914)
Cash flows generated from operating activities before changes in operating assets and liabilities		**362,534**	**303,421**
Decrease/(increase) in operating assets and liabilities:			
- Cash reserve ratio		(29,225)	(25,102)
- Financial assets at amortised cost		283,506	(89,814)
- Loans and advances		(796,341)	(1,644,911)
- Other receivables		3,488	(4,928)
- Customer deposits		514,352	758,549
- Other payables		(3,975)	23,665
Net cash generated from/(used in) operating activities		**334,339**	**(679,120)**
Cash flows from investing activities			
Purchase of property, plant and equipment	21	(72,391)	(24,799)
Purchase of intangible assets	20	(3,117)	(2,586)
Proceeds from disposal of property plant and equipment		250	400
Purchase of financial assets at fair value		-	(702)
Proceeds from sale of financial assets at fair value		6,018	-
Divided received		1,698	2,111
Net cash used in investing activities		**(67,542)**	**(25,576)**
Cash flows from financing activities			
Proceeds from allotment of new shares		-	657,717
Net cash generated from financing activities		**-**	**657,717**
Net increase/(decrease) in cash and cash equivalents		**266,797**	**(46,979)**
Cash and cash equivalents at 1st January		**893,969**	**940,948**
Cash and cash equivalents at 31st December	27	**1,160,766**	**893,969**

1. Summary of significant accounting policies

The significant accounting policies adopted in the preparation of these financial statements are set out below:

a) Basis of preparation

The financial statements are prepared on a going concern basis and in compliance with International Financial Reporting Standards (IFRS). They are presented in Kenya Shillings, which is also the functional currency (see (c) below), rounded to the nearest thousand (KSh'000).

The financial statements comprise a profit and loss account (statement of comprehensive income), statement of financial position, statement of changes in equity, statement of cash flows and notes.

Measurement basis

The measurement basis used is the historical cost basis except where otherwise stated in the accounting policies sumarised 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 in a fair value hierarchy based on the degree to which the inputs to the measurement are observable and the significance of the inputs to the fair value measurement in its entirety:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from 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).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability 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.

b) New and revised standards

i) Adoption of new and revised standards

A number of amendments to standards became effective for the first time in the financial year beginning 1st January 2017 and have been adopted by the Bank. None of them has had an effect on the Bank's financial statements.

1. Summary of significant accounting policies(continued)

b) New and revised standards (continued)

ii) New and revised standards and interpretations which have been issued but are not effective

The Bank has not applied any new and revised standards and interpretations that have been published but are not yet effective for the year beginning 1st January 2017 (see Note 30).

The Directors do not plan to apply any of them until they become effective. Based on their assessment of the potential impact of application of the above, they do not expect that there will be a significant impact on the Bank's financial statements, other than in respect of the application of IFRS 9 Financial Instruments in 2018 and IFRS 16 Leases in 2019.

c) Translation of foreign currencies

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

Transactions in foreign currencies during the year are converted into the functional currency using the exchange rate prevailing at the transaction date. Monetary assets and liabilities at the balance sheet date denominated in foreign currencies are translated into the functional currency using the exchange rate prevailing as at that date. The resulting foreign exchange gains and losses from the settlement of such transactions and from year-end translation are recognised on a net basis in the profit and loss account in the year in which they arise, except for differences arising on translation of non-monetary available-for-sale financial assets, which are recognised in other comprehensive income.

d) Revenue recognition

Revenue is derived substantially from banking business and related activities and comprises interest income, fee and commission income and trading income, and is recognised only when it can be reliably measured and it is probable that the economic benefits associated with the transaction will flow to the Bank.

The specific revenue recognition policies for interest income, fee and commission income and trading income are set out in (e), (f) and (g) below.

e) Net interest income and expense

Interest income and expense on financial assets or liabilities carried at amortised cost are recognised in the profit and loss account using the effective interest method.

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 effective interest rate is established on the initial recognition of the financial asset or liability and is not revised subsequently. When estimating the future cash flows all contractual cash flows from the financial asset or liability are taken into consideration with the exception of the estimates of future credit losses. This includes all fees paid or received between parties to the contract, transaction costs and discounts or premiums received or paid.

1. Summary of significant accounting policies(continued)

e) Net interest income and expense

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is thereafter recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

f) Fee and commission income

Fee and commission income and expenses that are integral to the effective interest rate on financial assets or liabilities are included in the measurement of the effective interest rate. Other fee and commission income, including servicing fees, investment management fees and syndication fees are recognised as the related services are performed. 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.

Other fee and commission expenses relate mainly to transactions and services, which are expensed as the services are rendered.

g) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes and foreign exchange differences.

Foreign exchange income is recognised at the time of effecting the transactions and includes income from spot and forward deals and translation gains/losses.

h) Offsetting

Items of assets and liabilities are not offset unless there is a legally enforceable right to set off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Items of income and expenses are presented on a net basis only for gains and losses arising from a group of similar transactions such as foreign exchange trading activities.

i) Income taxes

Income tax expense is the aggregate amount charged/(credited) in respect of current tax and deferred tax in determining the profit or loss for the year. Tax is recognised in the profit and loss account except when it relates to items recognised directly in equity, in which case it is also recognised directly in equity.

Current tax

Current income tax is the amount of income tax payable on the taxable profit for the year, and any adjustment to tax payable in respect of prior years, determined in accordance with the Kenyan Income Tax Act.

1. Summary of significant accounting policies(continued)

i) Income taxes (continued)

Deferred income tax

Deferred tax is determined for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes, using tax rates and laws enacted or substantively enacted at the balance sheet date and expected to apply when the asset is recovered or the liability is settled.

The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets or liabilities.

Deferred tax liabilities are recognised for all taxable temporary differences except those arising on the initial recognition of an asset or liability, other than through a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss.

Deferred 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. Recognised and unrecognised deferred tax assets are reassessed at the end of each reporting period and, if appropriate, the recognised amount is adjusted to reflect the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

j) Share capital and share premium

Ordinary shares are recognised at par value and classified as ‘share capital’ in equity. Any amounts received over and above the par value of the shares issued are classified as ‘share premium’ in equity.

k) Earnings per share

Basic earnings per share is calculated by dividing profit or loss attributable to ordinary equity holders of the Bank (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period.

Diluted earnings per share is determined by adjusting the profit or loss attributable to ordinary equity holders of the Bank and the weighted average number of ordinary shares outstanding for the after-tax effect of all dilutive potential ordinary shares.

l) Financial instruments

i) Financial assets

Initial recognition

All financial assets are recognised initially using the trade date accounting which is the date the Bank becomes a party to the contractual provisions of the instrument, with the exception of loans and advances which are recognised on the day they are disbursed. On initial recognition all financial assets are measured at fair value plus, in the case of assets classified as ‘at amortised cost’, transaction costs that are directly attributable to the acquisition of the financial asset.

1. Summary of significant accounting policies(continued)

l) Financial instruments (continued)

i) Financial assets (continued)

Classification and measurement

The Bank classifies and measures its financial assets as follows:

- those financial assets that are held within a business model whose objective is to hold assets in order to collect contractual cash flows, and for which the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are classified and measured **at amortised cost;**
- all other financial assets are classified and measured **at fair value.**

All financial assets have been classified as ‘at amortised cost’, other than equity investments.

Amortised cost

Amortised cost is the amount at which the financial asset or liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and the maturity amount, and minus any reduction for impairment or uncollectibility.

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 (Note 1 (a)).

Reclassification

Financial assets are reclassified when, and only when, the Bank changes its business model for managing financial assets. Assets that are transferred between departments of the Bank with different business models are not reclassified.

Impairment

At the balance sheet date, all financial assets carried at amortised cost are individually assessed for impairment. Impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Financial assets are considered impaired when there is a default or delinquency by a borrower, restructuring of a loan or advance on terms that the Bank would not otherwise consider, indications that the borrower might not be able to continue as a going concern or is about to compound with his creditors or facing bankruptcy prospects, the disappearance of an active market for a security, or changes in the payment status of borrowers or issuers either individually or in a group.

1. Summary of significant accounting policies(continued)

I) Financial instruments (continued)

i) Financial assets (continued)

Impairment (continued)

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of the estimated cash flows discounted at the asset's original effective interest rate. In the case of loans and advances to customers, the estimated cash flows from the realisation of security held are also taken into account. Losses are recognised in the profit and loss account and reflected as a provision against the financial asset. When a subsequent event causes the amount of impairment loss to decrease or increase, the decrease or increase is recognised in the profit and loss account. Where the financial asset is deemed uncollectible, it is written off against the related provision for impairment. Subsequent recoveries of amounts previously written off are credited to the profit and loss account in the year of recovery.

Changes in impairment provisions attributable to time value are reflected as a component of interest income.

Gains and losses

All gains and losses on financial assets are recognised in profit or loss except for available for sale financial assets where changes in fair value subsequent to initial recognition are recognised in other comprehensive income and presented in the available for sale fair value reserve in equity.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial asset have expired or the Bank has transferred substantially all risks and rewards of ownership. Any interest in a transferred financial asset that is created or retained by the Bank is recognised as a separate financial asset. Where the Bank enters into transactions whereby it transfers a financial asset recognised on its balance sheet including repurchase transactions, but retains all risks and rewards of the transferred asset, the transferred asset is not derecognised from the balance sheet.

Where a transfer of a financial asset that is derecognised results in a new financial asset or the assumption by the Bank of a new financial liability, the Bank recognises the new financial asset or financial liability using the recognition principles applicable to its financial assets and financial liabilities.

Where the financial asset is derecognised in its entirety, the difference between the carrying value of the financial asset and the consideration received together with any gain or loss previously recognised in other comprehensive income, is recognised in the profit and loss account.

1. Summary of significant accounting policies (continued)

l) Financial instruments (continued)

ii) Financial liabilities

Initial recognition

All financial liabilities are recognised initially at fair value of the consideration given plus the transaction cost.

Classification and measurement

Subsequently, all financial liabilities are carried at amortised cost using the effective interest method.

Derecognition

Financial liabilities are derecognised only when the obligation specified in the contract is discharged or cancelled or expires.

iii) Sale and repurchase agreements

Securities sold under sale and repurchase agreements (Repos) are retained in the financial statements with the counter party liability included in amounts due to banking institutions.

Treasury Bills purchased from the Central Bank of Kenya under agreements to resell (Reverse Repos) are not negotiable or discountable during their tenure and are presented as 'balances with Central Bank of Kenya' until they are repurchased.

The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreement using the effective interest method.

m) Regulatory reserve

Banking institutions are required to comply with Central Bank of Kenya Prudential Guideline CBK/PG/04 - Risk Classification of Assets and Provisioning which sets out amongst other issues, provisioning guidelines for loans and advances to customers based on performance. Where the impairment provision calculated using CBK/PG/04 exceeds the impairment provision calculated in accordance with the Bank's accounting policy, the excess is shown as an appropriation of retained earnings, within equity.

Loans and advances to customers are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money directly to a debtor with no intention of trading the receivable. Loans and advances are initially measured at fair value plus increamental direct transaction costs, and subsequently measured at the amortised cost using the effective interest method.

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

1. Summary of significant accounting policies (continued)

n) Leases

Leases of assets where a significant proportion 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 the profit and loss account on a straight line basis over the lease period. Prepaid operating lease rentals are recognised as assets and are subsequently amortised over the lease period.

The Bank has not entered into any finance leases, either as lessor or lessee.

o) Post-employment benefit obligations

The Bank operates a defined contribution retirement benefits plan for its employees, the assets of which are held in a separate trustee administered scheme managed by an insurance company. A defined contribution plan is a plan under which the Bank pays fixed contributions into a separate fund, and has no legal or constructive obligation 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 or prior periods. The Bank's contributions are charged to the profit and loss account in the year to which they relate.

The Bank and the employees also contribute to the National Social Security Fund (NSSF), a national defined contribution scheme. Contributions are determined by local statute and the Bank's contributions are charged to the profit and loss account in the year to which they relate.

p) Short term employee benefits

The estimated monetary liability for employees' accrued annual leave entitlement at the balance sheet date is recognised as an employment cost accrual.

q) Property and equipment

All categories of property, plant and equipment are initially recognised at cost and subsequently carried at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure directly attributable to the acquisition of the assets. Computer software, including the operating system, that is an integral part of the related hardware is capitalised as part of the computer equipment.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. Repairs and maintenance expenses are charged to the profit and loss account in the year in which they are incurred.

1. Summary of significant accounting policies (continued)

q) Property and equipment (continued)

Depreciation is calculated using the straight line method to write down the cost of each asset to its residual value over its estimated useful life using the following annual rates:

	Rate - %
Furniture, fittings and equipment	10 - 25
Computers, copiers & faxes	25
Motor vehicles	25

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

r) Intangible assets

Software licence costs and computer software that is not an integral part of the related hardware are initially recognised at cost, and subsequently carried at cost less accumulated amortisation and accumulated impairment losses. Costs that are directly attributable to the production of identifiable computer software products controlled by the Bank are recognised as intangible assets. Amortisation is calculated using the straight line method to write down the cost of each licence or item of software to its residual value over its estimated useful life using an annual rate of 33.3%.

s) Impairment of non-financial assets

Non-financial assets that are carried at amortised cost are reviewed at the end of each reporting period for any indication that an asset may be impaired. If any such indication exists, an impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

t) Cash and cash equivalents

Cash and cash equivalents for the purposes of the cash flow statement comprise cash in hand, unrestricted balances with the Central Bank of Kenya, government securities and loans and advances to Banks with maturities of three months or less from the date of acquisition that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, less deposits from banking institutions. Cash and cash equivalents exclude the cash reserve requirement held with the Central Bank of Kenya. Cash flows from Repo agreements are included as part of cash flows from operating activities.

1. Summary of significant accounting policies (continued)

u) Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are accounted for as off balance sheet transactions and disclosed as contingent liabilities. Estimates of the outcome and of the financial effect of contingent liabilities is made by the management based on the information available up to the date the financial statements are approved for issue by the directors. Any expected loss is charged to the profit and loss account in the year in which it is determined.

2. Significant judgements and key sources of estimation uncertainty

In the process of applying the accounting policies adopted by the Bank, the directors make certain estimates and judgements that may affect the carrying values of assets and liabilities in the next financial period. Such estimates and judgements are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the current circumstances. The directors evaluate such estimates and judgements at each financial reporting date to ensure that they are still reasonable under the prevailing circumstances based on the information available.

a) Significant judgements made in applying the Bank's accounting policies

The judgements made by the directors in the process of applying the Bank's accounting policies that have the most significant effect on the amounts recognised in the financial statements include classification of loans and advances, including whether or not the loan or advance is impaired.

b) Key sources of estimation uncertainty

Key assumptions about the future made by the directors that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year include:

i. Impairment losses: estimates made in determining the impairment losses on financial assets. Such estimates include the determination of the net realisable value or the recoverable amount of the asset. The provision for impairment losses and the recoverable amount of loans and advances that are impaired is set out in Note 3(a)(i) above.

ii. The deferred tax asset on tax losses carried forward has been recognised based the successful achievement of the Bank's business plan resulting in future taxable profits that will be available for utilisation against the tax losses as at the end of the year.

iii. The Bank is exposed to various contingent liabilities in the normal course of business. Management evaluates the status of these exposures on a regular basis to assess the probability of the Bank incurring related liabilities. However, provisions are made in the financial statements only where, based on the management's evaluation, a reliable estimate of the obligation can be made.

3. Risk management objectives and policies

a) Financial risk management

The Bank's activities expose it to a variety of financial risks including credit, liquidity and market risks. The Bank's overall risk management policies are set out by the board and implemented by the management and involve analysis, evaluation, acceptance and management of some degree of risk or a combination of risks. Taking risk is core to the banking business, and compliance and regulatory risks, operational risks and reputational risks are a normal consequence of such a business undertaking. The bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects of such risks on the bank's financial performance.

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The bank regularly reviews its risk management policies and systems to reflect changes in markets, products and services offered, and emerging best practice. The Bank, through its training programme and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The board has established a Board Risk and Compliance Committee and an Asset and Liability Committee (ALCO), which are responsible for developing and managing the Bank's risk management policies in their specified areas. All board committees have both executive and non-executive members and report regularly to the Board of Directors on their activities.

The Board Audit Committee, through the Internal Audit Department, is responsible for monitoring compliance with the Bank's risk management policies and procedures and for reviewing the appropriateness of the risk management framework in line with the risks faced by the bank.

i) Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation and arises principally from the Bank's loans and advances to customers, to banking institutions, and investment securities. Management and control of credit risk is centralised at the credit and treasury departments of the Bank.

Loans and advances to customers

The maximum exposure to credit risk from loans and advances to customers is KSh 7,273 million (2016: KSh 6,638 million), which is 72% (2016: 70%) of total financial assets.

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 against loans and advances in the form of mortgage interests over property, other registered securities over assets and guarantees. The following factors are considered when assessing credit risk of loans and advances to customers:
- the probability of default by borrowers on their contractual obligations;
- current exposures to the borrowers and likely future developments, from which the Bank derives its exposure to risk; and
- the likely recovery ratio on the defaulted obligations.

3. Risk management objectives and policies (continued)

a) Financial risk management (continued)

i) Credit risk (continued)

Loans and advances to customers (continued)

The Bank structures the level 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 geographical and industry segments. In addition, the Kenyan Banking Act also sets the maximum exposure to a single party or group. It also sets the maximum exposure to insiders and places a ceiling on the total lending to insiders. Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product and industry sector are approved as and when required by the credit committee. The exposure to any one borrower is further restricted by sub-limits covering on and off balance sheet exposures in relation to trading items.

The Bank monitors default of individual borrowers by using internal rating methods, which are based on Central Bank of Kenya Prudential Guideline CBK/PG/04. As per the Prudential Guideline, loans and advances are graded into the following categories:

- Normal
- Watch
- Substandard
- Doubtful
- Loss

Management assesses the credit quality of each borrower, taking into account their financial position, past experience and other factors. Individual limits are set based on internal or external information and in accordance with guidelines set by the management. The utilisation of credit limits is regularly monitored and corrective action taken, where necessary.

The Bank also uses credit-related commitments as a control and mitigation measure for credit risk on loans and advances. The primary purpose of these instruments is to ensure that funds are available to a customer as and when required. Guarantees and letters of credit carry the same credit risk as loans and advances.

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.

3. Risk management objectives and policies (continued)

a) Financial risk management (continued)

i) Credit risk (continued)

Loans and advances to customers (continued)

The Bank's exposure to credit risk on loans and advances to customers is analysed as follows:

	2017 KSh'000	2016 KSh'000
Past due and individually impaired (sub-standard and doubtful)		
Gross loans and advances	740,642	749,856
Less: impairment provision	(218,504)	(204,657)
	522,138	545,199
Past due but not impaired (watch)		
Between 31 - 90 days	431,189	418,339
	431,189	418,339
Fully performing (normal)		
Gross loans and advances	6,319,438	5,674,516
Net loans and advances	**7,272,765**	**6,638,054**

The Bank holds collateral against loans and advances to customers in the form of residential and commercial property, plant and machinery, and pledged deposits. The fair value of collateral held is estimated at KSh 15,068 million (2016: KSh 10,248 million), which includes KSh1,004 million (2016: KSh 1,222 million) in respect of impaired loans and advances.

In certain cases, the Bank, in an effort to recover a past due or impaired loan and advance, renegotiates the repayment terms with the individual customers. Restructuring activities include extended payment arrangements, approved external management plans, modification and deferral of payments. Following restructuring, a previously overdue customer account is reset to a normal status and managed together with other similar accounts. Restructuring policies and practices are based on indicators or criteria which, in the judgment of the credit committee, indicate that payment will most likely continue. These policies are kept under continuous review.
Letters of credit are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct advance or loan.

3. Risk management objectives and policies (continued)

a) Financial risk management (continued)

i) Credit risk (continued)

Other financial assets

Credit risk on loans and advances to banking institutions is managed by dealing with institutions, taking into account internal ratings and placing limits on deposits that can be held with each institution.

Due to the inherent nature of Government securities, these are considered to have minimal credit risk. For other assets which are not material, credit risk is not managed.

The Bank's maximum exposure to credit risk on other financial assets is analysed as follows:

	2017 KSh'000	2016 KSh'000
Neither past due nor impaired		
Balances with Central Bank of Kenya	822,778	561,346
Loans and advances to banking institutions	561,922	445,731
Government securities at amortised cost	1,207,628	1,485,402
Other financial assets at amortised cost	16,070	19,320
Financial assets at fair value	45,698	39,765
Other receivables	49,356	52,843
On balance sheet exposure	2,703,452	2,604,407
Letters of credit	96,885	152,706
Guarantees	356,710	468,642
Total exposure	3,157,047	3,225,755

No impairment provisions are held against other financial assets.

3. Risk management objectives and policies (continued)

a) Financial risk management (continued)

ii) Liquidity risk

Liquidity risk is the risk that the company will encounter difficulty in meeting obligations associated with financial liabilities. The company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the company's reputation. This responsibility rests with the Assets and Liabilities Committee (ALCO).

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

The bank does not maintain cash resources to meet all liabilities as they fall due as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The bank maintains a portfolio of short-term liquid assets, made up of loans and advances to banking institutions and balances with Central Bank of Kenya to manage the day-to-day liquidity requirements. Management reviews the liquidity ratio of liquid assets to customer deposits on a daily basis and performs scenario testing to ensure that sufficient liquidity is maintained to meet maturing deposits. The bank fully complies with the Central Bank of Kenya's minimum Cash Reserve Ratio (5.25%) and liquidity ratio (20%) requirements, with the average liquidity maintained at 34% (2016: 38%) during the year. The bank has not defaulted on its Cash Reserve Ratio requirements.

The liquidity ratio at the balance sheet date was:

	2017 KSh'000	2016 KSh'000
Liquid assets	2,744,132	2,725,884
Deposits	7,463,416	6,936,717
Liquidity (%)	36.8	39.3

The scenario testing at 31st December 2017 indicated a liquidity ratio of 26 % (2016: 31%) in the worst case scenario.

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

3. Risk management objectives and policies (continued)

a) Financial risk management (continued)

ii) Liquidity risk (continued)

The table below analyses financial liabilities into the relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

At 31st December 2017	Up to 1 month KSh'000	1 - 3 months KSh'000	3 - 12 months KSh'000	1 - 5 years KSh'000	Total KSh'000
Financial liabilities					
Deposits from customers	4,024,025	2,897,721	541,670	-	7,463,416
Other payables	85,111	-	-	-	85,111
Total financial liabilities	**4,109,136**	**2,897,721**	**541,670**	**-**	**7,548,527**

At 31st December 2016	Up to 1 month KSh'000	1 - 3 months KSh'000	3 - 12 months KSh'000	1 - 5 years KSh'000	Total KSh'000
Financial liabilities					
Deposits from customers	4,110,799	2,471,582	353,460	876	6,936,717
Other payables	52,042	-	-	-	52,042
Total financial liabilities	**4,162,841**	**2,471,582**	**353,460**	**876**	**6,988,759**

3. Risk management objectives and policies (continued)

a) Financial risk management (continued)

iii) Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market price and 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 objectives of market risk management is to manage and control market risk exposures within acceptable limits, while optimising the return on risk. Overall the management of market risk rests with the Assets and Liability Committee (ALCO).

The Treasury Department is responsible for the development of detailed risk management policies, subject to review and approval by the board, and for the day to day implementation of these policies.

Market risks arise mainly from trading and non-trading activities. Trading portfolios include those positions arising from market-making transactions where the Bank acts as a principal with clients or with the market. Non-trading portfolios primarily arise from the interest rate management of the entity's retail and commercial banking assets and liabilities. Non-trading portfolio risks also include foreign exchange risk and risks arising from the Bank's government and other investment securities carried at amortised cost.

Interest rate risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The management closely monitors the interest rate trends to minimise the potential adverse impact of interest rate changes.

The Bank is exposed to cash flow interest rate risk on its variable rate financial instruments carried at amortised cost (loans and advances, call deposits and savings accounts, and government securities carried at amortised cost). If market interest rates were to increase/decrease by one percentage point, with all other factors remaining constant, post-tax profit would be higher/lower by KSh 47,602,000 (2016: KSh 43,637,000) in respect of cash flow interest rate risk.

Currency risk

The Bank operates wholly within Kenya and its assets and liabilities are reported in the local currency. It conducts trade with correspondent banks and takes deposits and lends in other currencies. The Bank's currency position and exposure are managed within the exposure guideline of 10% of the core capital as stipulated by the Central Bank of Kenya. This position is reviewed on a daily basis by the management.

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

3. Risk management objectives and policies (continued)

a) Financial risk management (continued)

iii) Market Risk (continued)

The significant currency positions are detailed below:

At 31st December 2017	US Shs '000	GB £ Shs '000	Euros Shs '000	Rupee Shs '000	Others Shs '000	Total Shs '000
Assets						
Cash in hand	12,295	792	5,160	-	1	18,248
Cash and balances with Central Bank of Kenya	17,463	3,493	719	-	-	21,675
Deposits and balances due from banking institutions	228,333	5,312	1,236	(117)	-	234,764
Loans and advances to customers	385,000	1	10,477	-	-	395,478
Total assets	**643,091**	**9,598**	**17,592**	**(117)**	**1**	**670,165**
Liabilities						
Deposits from customers	456,569	10,515	16,142	-	-	483,226
Other foreign liabilities	290	-	-	-	-	290
Total liabilities	**456,859**	**10,515**	**16,142**	**-**	**-**	**483,516**
Net balance sheet position	**186,232**	**(917)**	**1,450**	**(117)**	**1**	**186,649**
Off balance sheet net notional position	**-**	**-**	**-**	**-**	**-**	**-**
At 31st December 2016						
Total assets	358,756	10,111	31,961	1,330	433	402,591
Total liabilities	292,381	10,997	29,724	-	-	333,102
Net balance sheet position	**66,375**	**(886)**	**2,237**	**1,330**	**433**	**69,489**
Off balance sheet net notional position	**-**	**-**	**-**	**-**	**-**	**-**

Had the Kenya Shilling weakened by 10% against each currency, with all other variables held constant, post-tax profit would have decreased by KSh 13,065,000 (2016: KSh 4,864,000). If the Kenya Shilling strengthened against each currency, the effect would have been the opposite.

3. Risk management objectives and policies (continued)

b) Capital management

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

i. To comply with the capital requirements set by the Central Bank of Kenya;

ii. To safeguard the Bank's ability to continue as a going concern while at the same time maximise the returns to the shareholders and benefit the other stakeholders; and

iii. To maintain a strong capital base to support the development of its business.

The Bank monitors the adequacy of its capital using the minimum capital requirements and ratios established by Central Bank of Kenya. These ratios measure capital adequacy by comparing the Bank's core capital with total risk-weighted assets plus risk weighted off-balance sheet items, total deposit liabilities and total risk weighted off balance sheet items.

Assets are weighted according to broad categories of notional credit risk, being assigned a risk weighting according to the amount of capital deemed to be necessary to support them. Four categories of risk weights (0%, 20%, 50% and 100%) are applied. For example cash in hand (domestic and foreign), balances held with Central Bank of Kenya including securities issued by the Government of Kenya have a zero risk weighting, which means that no capital is required to support the holding of these assets. Property, plant and equipment carries a 100% risk weighting. Based on these guidelines, such assets must be supported by capital equal to 100% of their carrying amount. Other asset categories have intermediate weightings.

Off-balance sheet credit related commitments such as guarantees and acceptances, performance bonds, documentary credit etc, are taken into account by applying different categories of credit risk conversion factors, designed to convert these items into balance sheet equivalents. The resulting credit equivalent amounts are then weighted for credit risk using the same percentages as for balance sheet assets. Core capital (Tier 1) consists of paid-up share capital, retained profits less investments in equity instruments of other financial institutions. Supplementary capital (Tier 2) includes general provisions appropriated from revenue reserves, up to a maximum of 1.25% of total risk weighted assets.

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

3. Risk management objectives and policies (continued)

b) Capital management (continued)

	Balance sheet nominal amount		Risk weighted amount	
	2017 KSh'000	2016 KSh'000	2017 KSh'000	2016 KSh'000
Cash in hand and balances with Central Bank of Kenya	974,582	794,751	-	-
Placements and deposits with banking institutions	561,922	445,731	112,384	89,146
Loans and advances to customers	7,272,765	6,638,054	6,242,027	5,734,062
Government securities at amortised cost	1,207,628	1,485,402	-	-
Other financial assets at amortised cost	16,070	19,320	16,070	19,320
Other financial assets at fair value	45,698	39,765	45,698	39,765
Other receivables	69,550	88,383	69,550	88,383
Property, plant and equipment	119,289	81,580	119,289	81,580
Intangible assets	4,854	3,589	4,854	3,589
Deferred tax asset	304,167	323,672	304,167	323,672
	10,576,525	9,920,247	6,914,039	6,379,517
Off-balance sheet positions			353,620	415,547
Total credit risk weighted assets			7,267,659	6,795,064
Less: market risk qualifying assets			45,698	39,765
Adjusted credit risk weighted assets			7,221,961	6,755,299
Market risk equivalent assets			386,530	351,248
Operation risk equivalent assets			1,103,774	100,781
Total risk weighted assets			8,712,265	7,207,328

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

3. Risk management objectives and policies (continued)

b) Capital management (continued)

	2017 KSh'000	2016 KSh'000
Tier 1 capital	2,780,291	2,698,110
Tier 2 capital	108,903	90,092
Total capital	2,889,194	2,788,201
Total deposit liabilities	7,463,416	6,936,717

	Actual Ratios		Minimum Requirement	
	2017 %	2016 %	2017 %	2016 %
Core capital to total risk weighted assets	32	37	10.5	10.5
Total capital to total risk weighted assets	33	39	14.5	14.5
Core capital to deposit liabilities	37	39	8.0	8.0

The Kenyan Banking Act also sets out the minimum core capital requirement of KSh 1 Billion (2016: KSh 1 Billion) which the bank fully complied with.

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

4. Interest Income

	2016 KSh'000	2017 KSh'000
Loans and advances to customers	958,375	949,901
Interest income on impaired loans and advances	97,623	119,963
Placements with and loans and advances to banking institutions	49,418	64,583
Financial assets at amortised cost	122,119	103,913
	1,227,535	1,238,360

5. Interest expense

Customer deposits	575,334	590,611
Deposits from other banking institutions	1,368	1,377
	576,702	591,988

6. Net fee and commission income

Fee and commission income:		
Loans and advances	96,806	73,247
Other fees and commissions	20,907	22,827
	117,713	96,074
Fee and commission expense	(3,319)	(2,921)
	114,394	93,153

7. Net trading income

	2017 KSh'000	2016 KSh'000
Net foreign exchange trading income	14,230	7,480
Net foreign exchange loss	(778)	1,336
	13,452	8,816

8. Changes in fair value of financial assets at fair value

	2017 KSh'000	2016 KSh'000
Equity investments	10,541	(14,341)

9. Other income

	2017 KSh'000	2016 KSh'000
Dividend income from financial assets at fair value	1,698	2,111
Profit on sale of financial assets at fair value	1,410	-
Profit on disposal of property and equipment	87	34
Other sundry income	1,070	2,007
	4,265	4,152

10. Net impairment losses on loans and advances

	2017 KSh'000	2016 KSh'000
Net increase in specific provision charged to profit and loss account (Note 16(b))	177,294	260,963
Recoveries from loans and advances written off	(15,664)	(9,044)
Charge to the profit and loss account	161,630	251,919

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

11. Profit before tax expense

		2017 KSh'000	2016 KSh'000
(a)	**Items charged**		
	The following items have been charged in arriving at profit before tax expense:		
	Employee benefits expense (Note 11(b))	206,678	164,308
	Depreciation of property and equipment	34,161	33,510
	Operating lease rentals expense	40,698	45,493
	Amortisation of intangible assets	1,852	1,723
(b)	**Employee benefits expense**		
	Wages and salaries	199,904	158,243
	Retirement benefit costs:		
	- Defined benefit scheme	6,517	5,406
	- National Social Security Fund	257	659
		206,678	164,308

The average number of persons employed during the year, by category, were:

	Number	Number
Non-management	60	64
Management and administration	45	45
Total	105	109

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

12. Income tax expense

	2017 KSh'000	2016 KSh'000
Current income tax	-	-
Deferred income tax (Note 22)	19,505	1,819
Income tax expense	19,505	1,819

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

	2017	2016
Profit before income tax	116,015	35,505
Tax calculated at a rate of 30% (2016: 30%)	34,804	10,651
Tax effect of:		
Income not subject to tax	(15,421)	(14,296)
Expenses not deductible for tax purposes	313	5,464
Prior year under provision	(191)	-
Income tax expense	19,505	1,819

13. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to shareholders by the weighted average number of shares in issue during the year.

	2017	2016
Net profit attributable to shareholders	96,510	33,686
Weighted average number of ordinary shares in issue during the year ('000)	124,541	115,323
Basic earnings per share	0.77	0.29

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

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

14. Cash and balances with Central Bank of Kenya

	2017 KSh'000	2016 KSh'000
Cash in hand	151,804	233,405
Balances with Central Bank of Kenya:		
Restricted balances (Cash Reserve Ratio)	375,738	346,513
Unrestricted balances	447,040	214,833
	974,582	794,751

The Cash Reserve Ratio is non-interest bearing and is based on the value of customer deposits adjusted in accordance with Central Bank of Kenya requirements. As at 31st December 2017 the Cash Reserve Ratio requirement was 5.25% (2016: 5.25%) of all customer deposits. These funds are not available to finance the Bank's day to day operations.

15. Deposits and balances due from banking institutions

	2017 KSh'000	2016 KSh'000
Balances with banking institutions in Kenya	327,158	95,102
Balances with banking institutions abroad	234,764	350,629
	561,922	445,731

16. Loans and advances to customers

a) Loans and advances to customers	2017 KSh'000	2016 KSh'000
Overdrafts	3,683,989	3,383,507
Commercial loans	3,807,280	3,459,204
Gross loans and advances to customers	7,491,269	6,842,711
Less: Provision for impaired loans and advances (Note 16(b))	(218,504)	(204,657)
Net loans and advances	7,272,765	6,638,054
b) Impairment losses on loans and advances		
At 1st January	204,657	66,572
Interest income on impaired loans and advances	(97,623)	(119,963)
Net increase in provision for impairment charged to profit and loss account (Note 10)	177,294	260,963
Provisions utilised during the year for write off	(65,824)	(2,915)
At 31st December	218,504	204,657

Loans and advances have been written down to their recoverable amount. Non performing loans and advances on which provisions for impairment have been recognised amount to KSh 741 million (2016: KSh 749 million). These are included in the balance sheet net of provisions at KSh 522 million (2016: KSh 545million). In the opinion of the directors, sufficient securities are held to cover the exposure on such loans and advances.

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

16. Loans and advances to customers (continued)

c) Concentration of risk

Economic sector risk concentrations within the loans and advances portfolio are as follows:

	2017 KSh'000	2017 %	2016 KSh'000	2016 %
Manufacturing	1,285,149	17	1,312,945	19
Wholesale, retail trade and hotels	3,848,688	51	3,432,081	50
Transport and communications	233,139	3	389,232	6
Agriculture	270,133	4	141,362	2
Business services	425,886	6	178,390	3
Building, construction and real estate	1,246,757	17	1,299,304	19
Social, community and personal service	181,517	2	89,397	1
	7,491,269	100	6,842,711	100

17. Financial assets at amortised cost

	2017 KSh'000	2016 KSh'000
Government securities - Treasury bills	484,949	874,674
Government securities - Treasury bonds	722,679	610,728
	1,207,628	1,485,402
Corporate bonds	16,070	19,320
Maturing:		
- Within 1 year	855,136	1,118,922
- Over 1 year	368,562	385,800
	1,223,698	1,504,722

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

17. Financial assets at amortised cost (continued)

Included in the above are financial assets with a carrying amount of KSh 295 million and (2016: KSh 146 million) that is held by the Central Bank of Kenya under lien as security for Letters of Credit.

The fair value of the Treasury Bonds and Corporate Bonds carried at amortised cost at the balance sheet date, based on quoted prices (unadjusted) in active markets for identical assets was KSh 682 million (2016: KSh 544 million) and KSh 15 million (2016: KSh 18 million) respectively.

18. Financial assets at fair value:

	2017 KSh'000	2016 KSh'000
Equity investments	45,698	39,765

The fair values of the equity investments are based on quoted prices (unadjusted) in active markets for identical assets (Level 1).

19. Other receivables

	2017 KSh'000	2016 KSh'000
Clearing account	36,532	38,981
Prepayments	20,194	35,540
Other receivables	12,824	13,862
	69,550	88,383

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

20. Intangible assets

	Software costs 2015 KSh'000	Software costs 2016 KSh'000
Cost		
At 1st January	13,598	11,012
Additions	3,117	2,586
At 31st December	16,715	13,598
Amortisation		
At 1st January	10,009	8,286
Charge for the year	1,852	1,723
At 31st December	11,861	10,009
Net book amount	**4,854**	**3,589**

The amortisation charge is included in 'other expenses' in the profit and loss account.

21. Property and equipment

Year ended 31st December 2016	Computers, copiers & fax Shs '000	Motor vehicles Shs '000	Furniture, fittings & equipment Shs '000	Total Shs '000
Cost				
At 1st January 2016	**16,963**	**9,663**	**189,613**	**216,239**
Additions	1,443	-	23,356	24,799
Disposals	-	(675)	-	(675)
Write off's	-	-	(10,353)	(10,353)
At 31st December 2016	**18,406**	**8,988**	**202,616**	**230,010**
Depreciation				
At 1st January 2016	**12,383**	**6,514**	**104,461**	**123,358**
Disposals	-	(309)	-	(309)
Write off's	-	-	(8,129)	(8,129)
Charge for the year	1,853	1,291	30,366	33,510
At 31st December 2016	**14,236**	**7,496**	**126,698**	**148,430**
Net Book Value	**4,170**	**1,492**	**75,918**	**81,580**
At 31st December 2016				
Cost	18,406	8,998	202,616	230,010
Accumulated depreciation	(14,236)	(7,496)	(126,698)	(148,430)
	4,170	1,492	75,918	81,580
Year ended 31st December 2017				
Cost				
At 1st January 2017	**18,406**	**8,988**	**202,616**	**230,010**
Additions	1,484	-	70,907	72,391
Disposals	-	-	(1,310)	(1,310)
Write offs	(105)	-	(253)	(358)
At 31st December 2017	**19,785**	**8,988**	**271,960**	**300,733**
Depreciation				
At 1st January 2017	**14,236**	**7,496**	**126,698**	**148,430**
Disposals	-	-	(1,147)	(1,147)
Charge for the year	1,869	989	31,303	34,161
At 31st December 2017	**16,105**	**8,485**	**156,854**	**181,444**
Net Book Value	**3,680**	**503**	**115,106**	**119,289**
At 31st December 2017				
Cost	19,785	8,988	271,960	300,733
Accumulated depreciation	(16,105)	(8,485)	(156,854)	(181,444)
	3,680	503	115,106	119,289

Financial Notes (continued)

FOR THE YEAR ENDED 31ST DECEMBER 2017

22. Deferred income tax

Deferred income tax is calculated using the enacted tax rate of 30% (2016: 30%). Deferred tax assets and liabilities, and the deferred tax (charge) in the profit and loss account is attributable to the following items:

Year ended 31st December 2017	At 1st January 2017 KSh'000	(Charge) to profit & loss KSh'000	At 31st December 2017 KSh'000
Deferred income tax asset			
Property and equipment	17,014	2,049	19,063
Intangible assets	142	(109)	33
Staff leave accrual	1,364	87	1,451
Provisions for impaired loans and advances	103,994	23,901	127,895
Tax losses carried forward	201,158	(45,433)	155,725
	323,672	(19,505)	304,167

Year ended 31st December 2016	At 1st January 2016 KSh'000	(Charge) to profit & loss KSh'000	At 31st December 2016 KSh'000
Deferred income tax asset			
Property and equipment	12,729	4,285	17,014
Intangible assets	102	40	142
Staff leave accrual	1,603	(239)	1,364
Provisions for impaired loans and advances	62,569	41,425	103,994
Tax losses carried forward	248,488	(47,330)	201,158
	325,491	(1,819)	323,672

The Bank has an express approval from the National Treasury to carry the tax losses forward for a further for four (4) years, effective 30th June 2014. The directors have made an application for the further extension to the Cabinet Secretary, National Treasury through the Kenya Revenue Authority.

Arising in:	Tax losses KSh	Expiring:
2010	519,082,252	30th June 2018

The deferred tax asset on tax losses carried forward has been recognised based on the projected future taxable profits that will be available against which the losses can be utilised.

23. Deposits from customers

	2017 KSh'000	2016 KSh'000
Call deposits	11,741	33,839
Current and demand accounts	621,129	583,616
Savings accounts	460,723	370,399
Term deposits	6,369,823	5,948,863
	7,463,416	6,936,717

The economic sector concentrations within the customer deposits portfolio were as follows:

	2017 KSh'000	2017 %	2016 KSh'000	2016 %
Individuals	4,744,675	63%	4,578,356	66%
Non-profit institutions	171,338	2%	178,057	3%
Private companies	2,304,901	31%	1,852,729	27%
Insurance companies	242,502	3%	327,575	5%
	7,463,416	100%	6,936,717	100%

Included in customer deposits were deposits amounting to KSh 889,843,000 (2016: KSh 620,821,000) that were held as collateral for loans and advances.

24. Other payables

	2017 KSh'000	2016 KSh'000
Outstanding bankers cheques	8,671	11,186
Staff leave accrual	4,835	4,545
Sundry creditors	71,605	36,311
	85,111	52,042

25. Share capital

	No. of ordinary shares	Issued and paid up capital	Share premium
		KSh '000	KSh '000
At 1st January 2017 and 31st December 2017	124,540,569	2,490,811	412,819

The total number of authorised ordinary shares is 175,000,000 (2016: 175,000,000) with a par value of KSh 20 each.

The share premium account arose on issue of shares at a premium and is not distributable.

Shareholders' contributions pending allotment

The shareholders' contributions pending allotment relates to amounts received from shareholders in the past which the bank does not have sufficient details to make an allotment.

26. Regulatory reserve

	2017	2016
	KSh'000	KSh'000
At 1st January	233,378	208,778
Transfer from retained earnings	14,329	24,600
At 31st December	247,707	233,378

The regulatory reserve represents an appropriation from retained earnings to comply with the Central Bank of Kenya's Prudential Regulations. The balance represents the excess of impairment provisions determined in accordance with Prudential Regulations over the impairment provisions recognised in accordance with the Bank's accounting policy. The reserve is not distributable.

27. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following:

	2017 KSh'000	2016 KSh'000
Cash in hand (Note 14)	151,804	233,405
Unrestricted cash balances with Central Bank of Kenya (Note 14)	447,040	214,833
Placements with and loans and advances to banking institutions (Note 15)	561,922	445,731
	1,160,766	893,969

28. Off balance sheet contingencies and commitments

a) Contingent liabilities

In common with the banking business, the Bank conducts business involving acceptances, guarantees, performance bonds and letters of guarantees. The majority of these facilities are offset by corresponding obligations from third parties. At the year end, the contingencies were as follows:

	2017 KSh'000	2016 KSh'000
Letters of credit and acceptances	96,885	152,706
Guarantees	356,710	468,642
	453,595	621,348

Nature of contingent liabilities

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

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

iii) Guarantees are generally written by a bank to support the 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.

Based on the estimate of the financial effect of the contingencies and the corresponding obligations from third parties, no material loss is anticipated.

Financial Notes (continued)

28. Off balance sheet contingencies and commitments (continued)

b) Pending litigation and claims

	2017 KSh'000	2016 KSh'000
Pending litigation and claims	474,266	474,266

The bank had a number of pending claims and litigation cases at end of the year. The directors, having taken necessary professional consultations, are of the opinion that the above claims are unlikely to lead to any material financial loss to the bank.

c) Commitments

Undrawn formal stand-by facilities, credit lines and other commitments to lend at 31st December 2017 totalled KSh 664,135,000 (2016: KSh 520,984,000).

Commitments to lend are agreements to lend to customers 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 facilities by giving reasonable notice to the customer.

d) Operating lease commitments

The future minimum lease payments under non-cancellable operating leases are as follows:

	2017 KSh'000	2016 KSh'000
Not later than 1 year	41,083	39,380
Later than 1 year and not later than 5 years	86,636	125,741
	127,719	165,121

29. Related party transactions

Included in loans and advances and customer deposits are amounts advanced to/received from certain directors and companies in which directors are involved either as shareholders or directors (related companies). In addition, contingent liabilities (Note 28) include guarantees and letters of credit of KSh 12,275,000 (2016: KSh 104,940,000) which have been issued to related companies.

The following transactions were carried out with related parties:

	Directors		Related companies	
a) Outstanding loans and advances	**2017 KSh'000**	**2016 KSh'000**	**2017 KSh'000**	**2016 KSh'000**
At 1st January	-	18,285	625,303	345,838
Advances during the year	-	-	2,055,580	2,061,681
Interest charged during the year	-	1,330	97,882	88,146
Repayments during the year	-	(19,615)	(2,025,859)	(1,870,362)
At 31st December	-	-	752,906	625,303
Contingent liabilities	**-**	**45,829**	**12,275**	**104,940**

As at 31 December 2017, loans and advances to staff amounted to KSh 36,746,000 (2016: KSh 47,437,000).

The loans and advances to related parties are performing and are fully secured. No provisions have been recognised in respect of the loans and advances to directors, related parties or staff.

	Directors		Related companies	
b) Deposits	**2017 KSh'000**	**2016 KSh'000**	**2017 KSh'000**	**2016 KSh'000**
At 1st January	59,038	46,028	65,975	130,286
Deposits received during the year	703,430	437,040	1,459,484	3,506,375
Interest paid during the year	6,164	6,545	1,753	16,950
Withdrawals during the year	(643,827)	(430,575)	(1,514,119)	(3,587,636)
At 31st December	124,805	59,038	13,093	65,975

c) Directors' remuneration (key management compensation)

Directors' remuneration		
- Fees	6,556	7,635
	6,556	7,635

30. New and revised financial reporting standards

The Bank has not applied the following new and revised standards and interpretations that have been published but are not yet effective for the year beginning 1st January 2017.

IFRS 15 Revenue from Contracts with Customers (issued in May 2014)

The new standard, effective for annual periods beginning on or after 1st January 2018, replaces IAS 11, IAS 18 and their interpretations (SIC-31 and IFRIC 13, 15 and 18). It establishes a single and comprehensive framework for revenue recognition to apply consistently across transactions, industries and capital markets, with a core principle (based on a five-step model to be applied to all contracts with customers), enhanced disclosures, and new or improved guidance.

Under IFRS 15, revenue from sale of goods will be recognised when the customer obtains control of the goods. Revenue from sales of services will be recognised over time provided the consumption of the service by the customer is simultaneous with the performance of the service by the company. Having carried out a preliminary assessment, the directors do not expect there to be a material retrospective adjustment to retained earnings on initial application of the standard in the year ending 31st December 2018.

IFRS 9 Financial Instruments (issued in July 2014)

This standard will replace IAS 39 (and all the previous versions of IFRS 9) effective for annual periods beginning on or after 1st January 2018. It contains requirements for the classification and measurement of financial assets and financial liabilities, impairment, hedge accounting and derecognition, summarised as follows:

o IFRS 9 requires all financial assets to be measured at fair value on initial recognition and subsequently at amortised cost or fair value (through profit or loss or through other comprehensive income), depending on their classification by reference to the business model within which they are held and their contractual cash flow characteristics.

o For financial liabilities, the most significant effect of IFRS 9 relates to cases where the fair value option is taken: the amount of change in fair value of a financial liability designated as at fair value through profit or loss that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income (rather than in profit or loss), unless this creates an accounting mismatch.

o For the impairment of financial assets, IFRS 9 introduces an “expected credit loss” (ECL) model based on the concept of providing for expected losses at the inception of a contract; this will require judgement in quantifying the impact of forecast economic factors. For financial assets for which there has not been a significant increase in credit risk since initial recognition, the loss allowance should represent ECLs that would result from probable default events within 12 months from the reporting date (12-month ECLs). For financial assets for which there has been a significant increase in credit risk, the loss allowance should represent lifetime ECLs. A simplified approach is allowed for trade receivables and lease receivables, whereby lifetime ECLs can be recognised from inception.

o For hedge accounting, IFRS 9 introduces a substantial overhaul allowing financial statements to better reflect how risk management activities are undertaken when hedging financial and non-financial risk exposures.

o The derecognition provisions are carried over almost unchanged from IAS 39.

On 1st January 2018, financial assets currently classified as available-for-sale (at fair value through other comprehensive income) will be reclassified to ‘fair value through profit or loss’, with the consequent transfer of the balance on the fair value reserve to retained earnings.

30. New and revised financial reporting standards (continued)

In addition, provision will have to be made for either 12-month or lifetime ECLs for all financial assets measured at amortised cost, lease receivables, and debt instruments measured at fair value through other comprehensive income. The directors expect to apply the simplified approach for other receivables. In applying the requirements of IFRS 9, the Bank proposes to adopt the transitional trelief and will recognise the difference between the carrying amounts as at 1 January 2018 resulting from the application IFRS 9 in retained earnings. Based on current estimates, the adoption of IFRS 9 is expected to result in a further deterioration to the accumulated losses as at 1 January 2018 of approximately 42% before taxes. The impact is primarily attributable to increases in the allowance for credit losses of approximately to 26% under the new impairment requirements.

• Amendments to IAS 12 titled Recognition of Deferred Tax Assets (issued in January 2016) – The amendments, applicable to annual periods beginning on or after 1 January 2017, provide additional guidance on the estimation of future taxable profits when considering the recoverability of deferred tax assets.

Amendments to IFRS 10 and IAS 28 titled *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (issued in September 2014)
The amendments, applicable from a date yet to be determined, address a current conflict between the two standards and clarify that a gain or loss should be recognised fully when the transaction involves a business, and partially if it involves assets that do not constitute a business.

IFRS 16 *Leases* (issued in January 2016)
The new standard, effective for annual periods beginning on or after 1st January 2019, introduces a new lessee accounting model, and will require a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee will be required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

Application of IFRS 16 in 2019 will require right-of-use assets and lease liabilities to be recognised in respect of most operating leases where the company is the lessee. The impact has not yet been quantified, but will result in an increase in non-current assets, an increase in non-current and current liabilities, and a reduction in retained earnings.

Amendments to IFRS 2 titled *Classification and Measurement of Share-based Payment Transactions* (issued in June 2016)
The amendments, applicable to annual periods beginning on or after 1st January 2018, clarify the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments (SBP), the accounting for SBP transactions with a net settlement feature for withholding tax obligations, and the effect of a modification to the terms and conditions of a SBP that changes the classification of the transaction from cash-settled to equity-settled.

Amendments to IFRS 4 titled *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* (issued in September 2016)
The amendments, applicable to annual periods beginning on or after 1st January 2018, include a temporary exemption from IFRS 9 for insurers that meet specified criteria and an option for insurers to apply the overlay approach to designated financial assets.

30. New and revised financial reporting standards (continued)

Amendment to IFRS 1 - ***Annual Improvements to IFRSs 2014–2016 Cycle, issued in December 2016***
The amendment, applicable to annual periods beginning on or after 1st January 2018, deletes certain short-term exemptions and removes certain reliefs for first-time adopters.

Amendment to IAS 28 ***- Annual Improvements to IFRSs 2014–2016 Cycle, issued in December 2016***
The amendment, applicable to annual periods beginning on or after 1st January 2018, clarifies that exemption from applying the equity method is available separately for each associate or joint venture at initial recognition.

Amendments to IAS 40 ***titled Transfers of Investment Property (issued in December 2016)***
The amendments, applicable to annual periods beginning on or after 1st January 2018, clarify that transfers to or from investment property should be made when, and only when, there is evidence that a change in use of property has occurred.

IFRIC 22 titled ***Foreign Currency Transactions and Advance Consideration (issued in December 2016)***
The Interpretation, applicable to annual periods beginning on or after 1st January 2018, clarifies that the exchange rate to use in transactions that involve advance consideration paid or received in foreign currency is the one at the date of initial recognition of the non-monetary asset or liability.

IFRS 17 ***Insurance Contracts (issued in May 2017)***
The new standard, effective for annual periods beginning on or after 1st January 2021, establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued. The objective is to ensure that entities provide relevant information in a way that faithfully represents those contracts. The company does not issue insurance contracts.

IFRIC 23 ***Uncertainty over Income Tax Treatments (issued in June 2017)***
The Interpretation, applicable to annual periods beginning on or after 1st January 2019, clarifies how to apply the recognition and measurement requirements of IAS 12 when there is uncertainty over income tax treatments.

Amendments to IFRS 9 titled ***Prepayment Features with Negative Compensation (issued in October 2017)***
The amendments, applicable to annual periods beginning on or after 1 January 2019, allow entities to measure prepayable financial assets with negative compensation at amortised cost or fair value through other comprehensive income if a specified condition is met.

Amendments to IAS 28 titled ***Long-term Interests in Associates and Joint Ventures (issued in October 2017)***
The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that an entity applies IFRS 9, rather than IAS 28, in accounting for long-term interests in associates and joint ventures.

Amendments to IFRS 3 - ***Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017***
The amendments, applicable to annual periods beginning on or after 1st January 2019, provide additional guidance on applying the acquisition method to particular types of business combination.

30. New and revised financial reporting standards (continued)

Amendments to IFRS 11 - *Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017*
The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that when an entity obtains joint control of a business that is a joint operation, it does not remeasure its previously held interests.

Amendments to IAS 12 - *Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017*
The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that all income tax consequences of dividends should be recognised when a liability to pay a dividend is recognised, and that these income tax consequences should be recognised in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions to which they are linked.

Amendments to IAS 23 - *Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017*
The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that the costs of borrowings made specifically for the purpose of obtaining a qualifying asset that is substantially completed can be included in the determination of the weighted average of borrowing costs for other qualifying assets.

Amendments to IAS 19 titled *Plan Amendment, Curtailment or Settlement (issued in February 2018)*
The amendments, applicable to plan amendments, curtailments or settlements occurring on or after the beginning of the first annual reporting period that begins on or after 1st January 2019, requires an entity to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after the plan amendment, curtailment or settlement when the entity remeasures its net defined benefit liability (asset) in the manner specified in the amended standard.

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The Secretary,

Proxy Form

I/We ____

being a member/members of M-Oriental Bank Limited hereby appoint ______________________________

____

of ____

and failing him ____

and failing him, the Chairman of the Meeting as my/our proxy to vote for me/us and on my/our behalf at the Annual General Meeting of the Company to be held on Thursday, 7th June 2018 at 2.30 p.m. and at any adjournment thereof.

As witness my/our hand(s) this ____________________ day of ____________ 2018

Signatures: ______________________________

____

IMPORTANT NOTES:

1. *If you are unable to attend this meeting personally this form of proxy should be completed and returned to the Secretary at the Head Office, Finance House Koinange Street, Nairobi. PO Box 44080-00100 Nairobi. To be valid the proxy form must be received at the Head Office not later than 2.00 p.m. on Tuesday 5th June 2018. Alternatively duly signed proxy form may be scanned and emailed to mobl.proxy@moriental.co.ke in pdf format not later than 2.00 p.m. on 5th June 2018. In this case the original has to be presented at the registration desk.*

2. *If the shareholder is a corporation, this form must be under its common seal or under the hand of an officer or attorney duly authorised in writing.*

3. *A person appointed to act as a proxy need not be a member of the Company.*

4. *In case of joint holders, the signature of any one holder will be sufficient but the names of all joint holders should be stated.*

M Oriental

M Oriental Bank Limited

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Regulated by the Central Bank of Kenya