CONTENTS

Vision

To be one of the best regarded Banks in Kenya providing the highest-quality products and services.

Mission

To develop a motivated professional staff that will profitably deliver high-quality customer services that fill the the financial needs of our customers and their businesses.

CORPORATE INFORMATION

DIRECTORS	Anwarali Merali - Chairman Ayaz Merali - Chief Executive Officer (CEO) Noorez Padamshi Mohamed Mujtaba Mercy Kamau
AUDIT COMMITTEE	Noorez Padamshi - Chairman Anwarali Merali Kapil Deo Sharma Henry Onkunya
CREDIT COMMITTEE	Ayaz Merali - Chairman Mohamed Mujtaba Michael Riitho
ASSET LIABILITY COMMITTE	Ayaz Merali - Chairman Nicholas Odera Mohamed Mujtaba Fred Maina
RISK MANAGEMENT COMMITTEE	Mercy Kamau - Chairman Noorez Padamshi Stanley Ngaruiya Ndungu
COMPANY SECRETARY	Winniefred Nyagoha Jumba Certified Public Secretary (Kenya) Winniefred Nyagoha Jumba C/o Livingstone Associates P O Box 30029 Nairobi - GPO 00100
REGISTERED OFFICE	LR Plot No 1870/IX/140 4th Floor, Sound Plaza Woodvale Groove P O Box 14001Nairobi - Westlands 00800

AUDITORS

Deloitte & Touche
Certified Public Accountants (Kenya)
Deloitte Place, Waiyaki Way, Muthangari
P O Box 40092 Nairobi GPO 00100

PRINCIPAL CORRESPONDENTS

Deutsche Bank AG, Germán
Deutsche Bank Trust Co, New York
Habibsons Bank Limited, London
Standard Bank of South Africa, Johannesburg
Standard Chartered Bank, New York
Standard Chartered Bank, London
HDFC Bank, India

LEGAL ADVISERS

Walker Kontos - Hakika House, Bishops Road
P O Box 60680 - Nairobi City Square 00200

Ngatia & Associates Advocates - Bishop Garden Towers, 1st Ngong Avenue
P O Box 56688 - Nairobi City Square 00200

Mwaniki Gachoka & Co Advocates
Design Centre, 3rd Floor Office suite no.1A & 3A
P O Box 13439 Nairobi GPO 00800

REPORT OF THE DIRECTORS

The directors have the pleasure of submitting their report together with the audited financial statements for the year ended 31 December 2013, in accordance with Section 22 of the Banking Act and Section 157 of the Companies Act, which disclose the state of affairs of Paramount Universal Bank Limited ("the Bank").

PRINCIPAL ACTIVITY

The principal activity of the bank, which is licensed under the Banking Act, is the provision of banking, financial and related services.

FINANCIAL RESULTS FOR THE YEAR

	Sh'000
Profit before taxation	105,816
Taxation charge	(11,158)
Profit for the year transferred to retained earnings	94,658

DIVIDENDS

The directors do not recommend the payment of a dividend in respect of the year ended 31 December 2013
(2012: Sh nil).

DIRECTORS

The present members of the Board of Directors are shown on page 2.

AUDITORS

Deloitte & Touche, having expressed their willingness, continue in office in accordance with section159 (2) of the Kenyan Companies Act and subject to approval by the Central Bank of Kenya under section 24(1) of the Banking Act.

BY ORDER OF THE BOARD

Secretary

27th March 2014 Nairobi

STATEMENT ON CORPORATE GOVERNANCE

The bank's board of directors is responsible for the governance of the bank and is accountable to the shareholders for ensuring that the bank complies with the law, the highest standards of corporate governance and business ethics. The directors attach great importance to the need to conduct the business and operation of the bank with integrity and in accordance with generally accepted corporate practice and endorse the internationally developed principles of good corporate governance.

Board of Directors

The full board meets at least four times a year. The directors are given appropriate and timely information so that they can maintain full and effective control over strategic, financial, operational and compliance issues.

Except for direction and guidance on general policy, the board has delegated authority for conduct of day-to-day business to the Chief Executive Officer. The board nonetheless retains responsibility for establishing and maintaining the bank's overall internal control of financial, operational and compliance issues.

Every board member attended at least 80% of the board meetings. An evaluation of the board members was undertaken during the period and it was regarded reasonable.

Committees of the Board

Audit Committee

The board has constituted an audit committee that meets as required. Its responsibilities include review of financial information, budgets, development plans, compliance with accounting standards in financial reporting, and liaison with the external auditors, remuneration of external auditors and overseeing internal control systems. Internal and external auditors and other executives attend audit committee meetings as required.

Credit Committee

The board has constituted a credit committee that meets as required. Its responsibilities include a review of the overall lending policy of the bank, ensuring that there are effective policies and procedures to effectively manage credit risk, monitor and review all matters, which may materially impact the present and future quality of the institution's credit risk management.

Assets Liability Committee

The board has constituted an Assets and Liabilities Committee (ALCO) that meets as required. Its responsibilities include deriving the most appropriate strategy in respect of the assets and liabilities of the bank given future expectations, changes and consequence of liquidity constraints, interest rate movements, changes in prices and foreign exchange exposures.

Risk Management Committee

The board has constituted a Risk Management Committee that meets as required. Its responsibilities include carrying out risk assessment and putting in place risk indicators and monitoring the risk.

Board Nominations and Remuneration Committee

This committee is to be constituted in the next financial year 2014 in line with the new prudential guidelines released by the Central Bank of Kenya. The committee will deal with all aspects of appointment of an institution's directors, review the mix of skills and experience and other qualities in order to assess the effectiveness of the board. The committee will also be responsible for overseeing the compensation system in place on behalf of the Board of Directors.

Statement on risk management

Paramount Universal Bank Limited recognises the responsibility to manage risks related to its business as a financial institution. The bank has built strong internal systems to ensure that sound banking practices results in income streams commensurating with the risks taken.

The Integrated Risk Management Policy of the bank is fully committed to adopting best practices in identifying, measuring, controlling and monitoring the risks faced.

Corporate Governance Statement on Conflict of Interest

The board of directors has approved a code of conduct that gives disclosure guidance on potential conflicts of interest situations. Reporting procedures are in place for this. The code of conduct has to be signed annually by all staff members.

The bank aims at:

- Integrating risk management into the culture of the organization.
- Eliminating or reducing risk to the lowest acceptable levels.
- Developing risk sensitivity as a core competency of all stakeholders.
- Continually identifying potential risks and pro-actively mitigating them.
- Focusing on key risks and controlling them cost-effectively.

The bank has developed a risk infrastructure that is appropriate to the size and volatility of the business. Decision making at all levels are inspired by the aspiration to be a risk intelligent organization. Risk management is used as an enabler to exploit the potential for increased business by taking informed risks with awareness and control.

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Director **Director**

27th March 2014

CHAIRMAN'S REPORT

It is my pleasure to present to you on behalf of the Board of Directors, the Annual Financial Results for the year 2013. The year was an eventful one but very positive for the bank in terms of its expectations and performance. I would like to highlight the following important aspects:

Operating Environment

The country held a peaceful general election under the new Constitution promulgated in 2010. This brought about the transition from a fully centralized governance structure to a system with devolved units known as counties running alongside the traditional structure. This has presented numerous challenges in terms of protocol, power, sharing of public assets and restructuring of the public financial management system. The delays experienced in streamlining government operations slowed down the economy but the impact was minimal.

The country's currency remained stable during the year well supported by a stable interest rate regime. Interest rates have been declining gradually in line with falling inflation levels. The Central Bank Rate is pursuing a loose or tight momentary policy. The inflation and interest rates have direct impact on investment return expectations. Good management of these key macroeconomic variables is critical to the performance of the economy. The year did not exhibit the damaging volatility experienced in 2011.

The country's Gross Domestic Product remains healthy at just above 4.5% but with prospects of better performance in the years ahead provided we have political and social stability. Major infrastructure projects like the Standard Gauge Railway line from Mombasa to Kigali with a branch to Kisumu, Lamu Port Project linking Ethiopia and South Sudan to the sea as well as other major projects like the Konza Techno City project are expected to be the main drivers of the economy in the coming year. The above projects when executed will facilitate better trade and lower transportation costs thus giving the country the competitive advantage it requires in achieving the goals outlined in Vision 2030.

However, it is also worth noting that major challenges to impressive economic growth still exists. The threat of terrorism and general insecurity can have adverse effects on the economy unless urgent solutions are found by the government. Insecurity has a direct impact on the country's risk profile and can be a big factor in discouraging foreign investments in the country. As Africa opens up, countries that are perceived to be safer will attract more capital inflows and thus will be able to grow their economies faster than the insecure ones. The cost of doing business still remains high due to a punitive taxation regime, administrative bureaucracy bottlenecks, expensive power and inadequate physical infrastructure in the form of roads, railway, airports and a congested port of Mombasa.

All the challenges cited above notwithstanding, the banking sector performed well with most banks registering better financial results than the previous year indicating that the industry is still profitable, suitable, stable and sustainable. This is true given the high level of competition between banks for customers and market share, there has been no instability in the industry and the future outlook is good. Customers are the backbone of any bank and their confidence in the services offered is a vote for shareholders and bank employees that they are delivering value to all.

Thus commercial banks continue to be innovative in the use of technology and alternative business models like agency banking. Mobile banking and internet banking are now integral parts of the product offerings available in banks. Investment in these alternative banking channels will be a great catalyst in enabling banks serve more customers in cost effective ways.

CHAIRMAN'S REPORT (CONTINUED)

Bank Performance

A summary of the bank's performance for the year is listed below:

Customer deposits grew by 11% from Kenya Shillings 6 Billion to Kenya Shillings 6.6 Billion.

Total Assets grew by 9.5% from Kenya Shillings 7.3 Billion to Kenya Shillings 8 Billion.

Operating Income grew by 10.5% from Kenya Shillings 315 Million to Kenya Shillings 348 Million.

Profit before tax grew by 18% from Ksh. 89million to Ksh. 105million.

Profit after tax decreased by 15% from Ksh. 110million to Ksh. 95million on account of increased tax expense.

The bank maintains sufficient liquidity which is critical in meeting its obligations when they fall due. The bank also maintains adequate ratios in line with the Central Bank Prudential Guidelines and the Board's Risk appetite.

I would like to thank all our partners and stakeholders who are largely responsible for the bank's performance during the year and have high hopes that the coming years shall yield even more satisfaction. It is only through their support and commitment to the Paramount Bank brand that we are in a position to be very optimistic about future prospects.

Future Outlook

The Board of Directors recognizes that the bank is in a competitive and dynamic industry. In line with one of the long term strategic objectives of the bank of being nationwide, Eldoret branch opened its doors to customers in November. The bank will continue to expand its footprint by opening in areas that will increase both visibility and value of the bank. The coming year will see an additional branch within Nairobi's Industrial Area in line with our customers' demands and expectations.

We shall continue to invest in both physical and technical infrastructure in order to remain competitive and attractive in our value proposition. In an industry where yesterday's solutions quickly become obsolete, the bank continues to invest in alternative banking channels such as mobile and internet banking in order to meet our customer expectations.

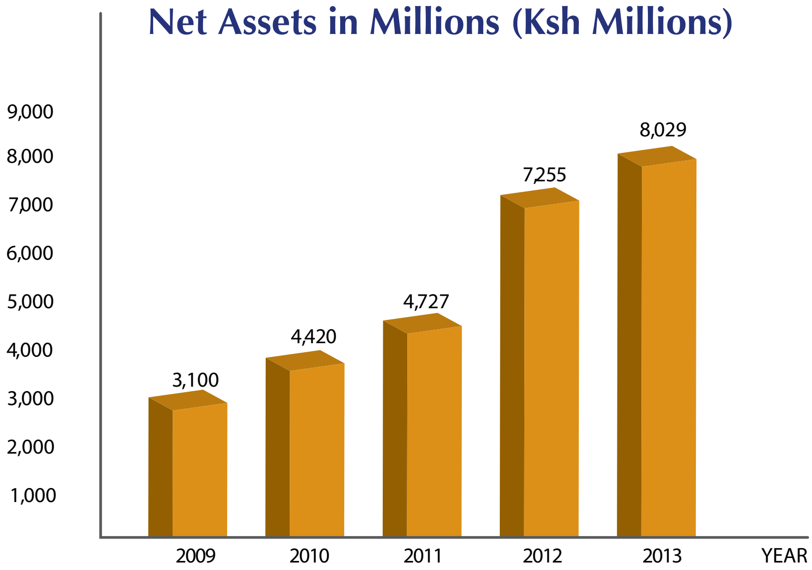
This will continue in the coming year as we strive to enhance our delivery platforms so as to provide cost effective banking solutions. The bank will also strive to match the investment in infrastructure by equipping the staff with better skills to harness the potential that the technology provides. Human Resource capacity building remains key to the bank as it consolidates its position in the industry.

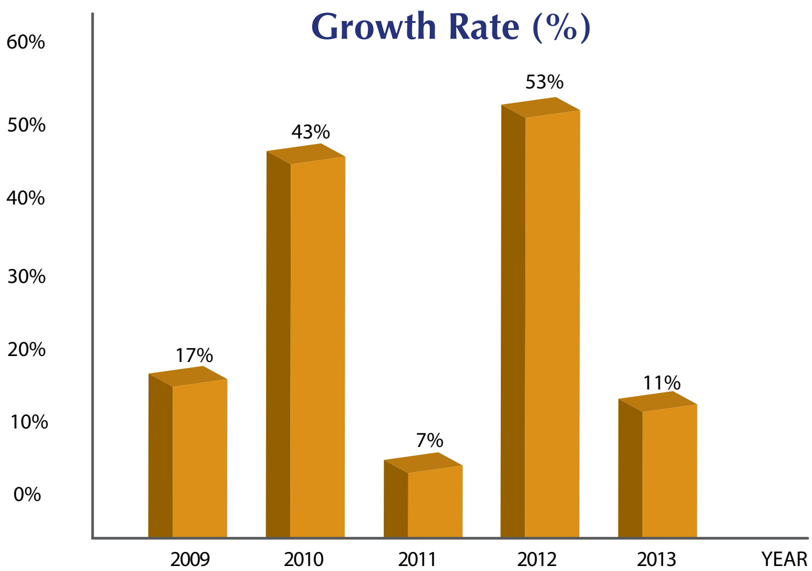
Finally, the Board of Directors would like to acknowledge and thank all the stakeholders who continue to be the pillar of the bank through the hard and good times and look forward to strengthening the relationship in the coming year.

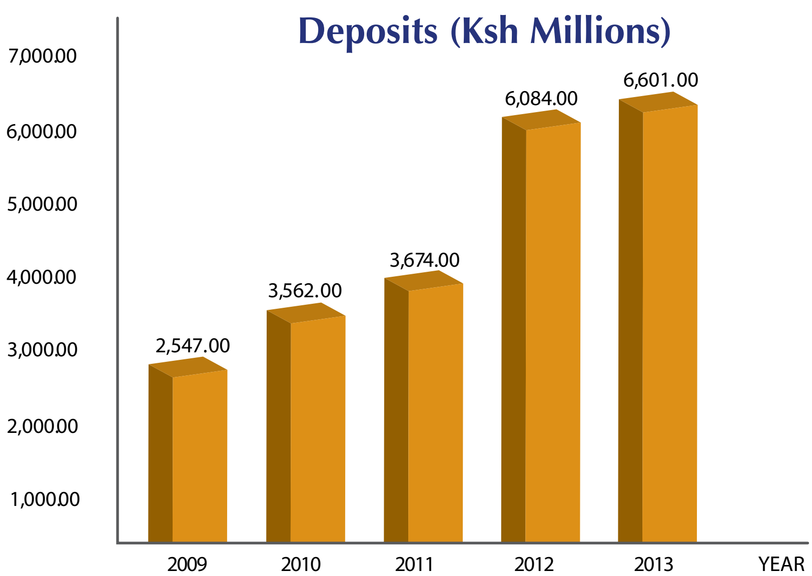
Thank you.

Anwarali Padany
Chairman
Board of Directors
27th March 2014

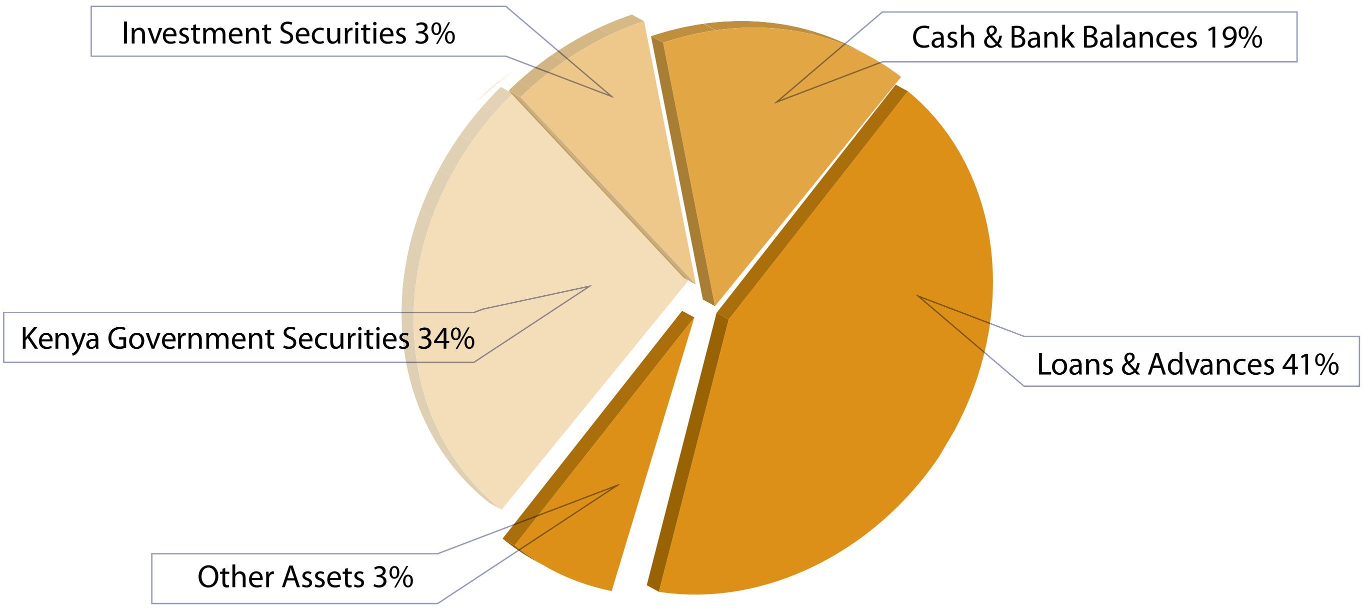
GRAPHIC REPORT



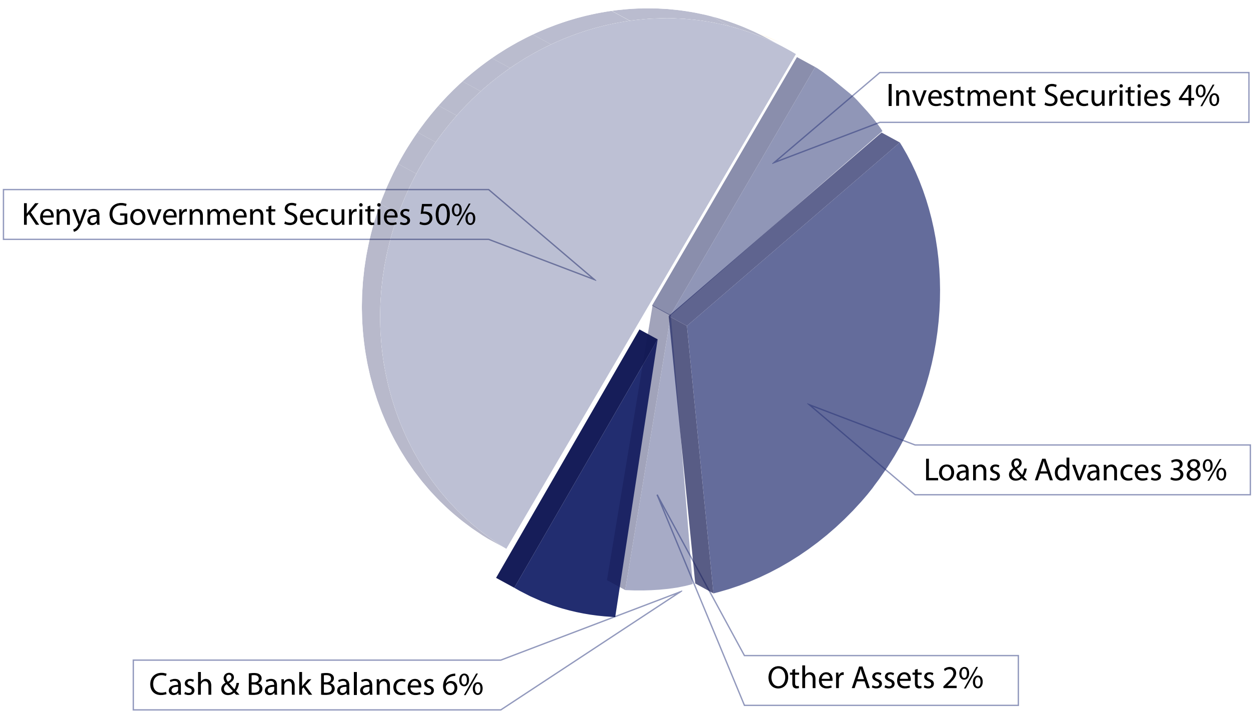




% Assets Distribution 2013



% Assets Distribution 2012

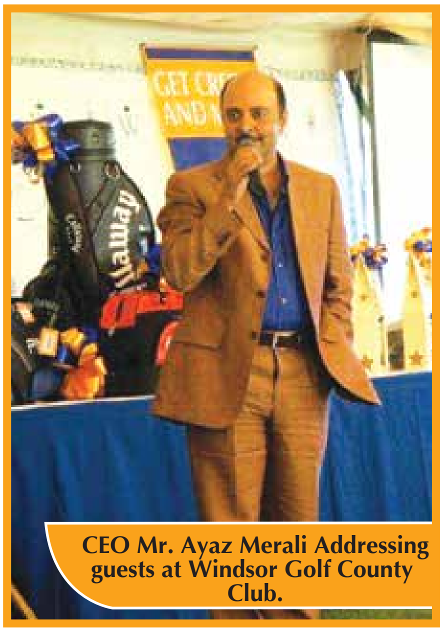


COMING SOON

We will be opening our new branch at Industrial Area to serve you better

KEY ACTIVITIES

1.) Sponsoring of the Captain's Prize at Windsor Hotel County Club.


CEO Mr. Ayaz Merali Addressing guests at Windsor Golf County Club.


Sponsorship of the Captain's prize Golf tournament.

2.) Sponsoring the National day of Colombia at Colombian embassy.


Colombian citizens at the Colombian Embassy during their national day.


Colombian Ambassador Mrs. Maria Euginia Correa Olarte and Paramount Bank CEO Mr. Ayaz Merali at the Colombian national day event.

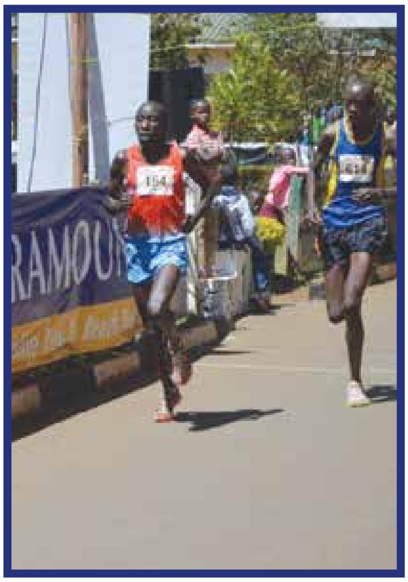
3.)Opening of our Eldoret Branch.

CEO Mr. Ayaz Merali and some of the Paramount Bank Staff.

The chief guest Governor of Uasin Gishu County Hon. Jackson Mandago, Chairman of the bank Mr. Merali Padany & Eldoret Branch Manager Charity Carol Cheptoo during opening of Eldoret Branch.

4.) Sponsoring of lions club of Thika chania falls.

5.) Sponsoring of Discovery Kenya Half and cross country marathon in Eldoret, we were the only local sponsor with NIKE.



STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Kenyan Companies Act requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the bank as at the end of the financial year and of its operating results for that year. It also requires the directors to ensure that the bank keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the bank. They are also responsible for safeguarding the assets of the bank.

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the requirements of the Kenya Companies Act, and for such internal controls as the directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the bank and of its operating results. The directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

Nothing has come to the attention of the directors to indicate that the bank will not remain a going concern for at least the next twelve months from the date of this statement.

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Director **Director**

27th March 2014

Deloitte & Touche Certified Public Accountants (Kenya)
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www.deloitte.com

Deloitte.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PARAMOUNT UNIVERSAL BANK LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of Paramount Universal Bank Limited, set out on pages 16 to 64, which comprise the statement of financial position as at 31 December 2013, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of financial affairs of the bank as at 31 December 2013 and of its profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act and the Banking Act.

Report on Other Legal Requirements

As required by the Kenyan Companies Act we report to you, based on our audit, that:

i) we have obtained all the information and explanations, which to the best of our knowledge and belief, were necessary for the purposes of our audit;

ii) in our opinion, proper books of account have been kept by the bank, so far as appears from our examination of those books; and

iii) the bank's statement of financial position (balance sheet) and statement of profit or loss (profit and loss account) are in agreement with the books of account.

The engagement partner responsible for the audit resulting in this independent auditors' report is Anne Muraya - P/No. 1697.

Deloitte & Touche

Certified Public Accountants (Kenya)
27th March 2014

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 Sh'000	2012 Sh'000
INTEREST INCOME	4	976,342	678,533
INTEREST EXPENSE	5	(666,650)	(556,554)
		________	________
NET INTEREST INCOME		309,692	121,979
Fees and commission income	6	42,379	43,557
Gains on foreign exchange dealings		7,182	9,389
Net trading (loss)/income	8(a)	(18,237)	130,231
Other operating income	8(b)	7,178	9,894
		________	________
OPERATING INCOME		348,194	315,050
Operating expenses	9	(228,673)	(217,170)
Impairment losses on loans and advances	18	(13,705)	(8,052)
		________	________
PROFIT BEFORE TAXATION		105,816	89,828
TAXATION (CHARGE)/CREDIT	11(a)	(11,158)	20,420
		________	________
PROFIT FOR THE YEAR		94,658	110,248
OTHER COMPREHENSIVE INCOME		-	-
		________	________
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		94,658	110,248
		=======	=======
		Sh	Sh
EARNINGS PER SHARE – Basic and diluted	12	94.66	110.25
		=======	=======

STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 Sh'000	2012 Sh'000
ASSETS			
Cash and balances with Central Bank of Kenya	13	394,460	336,853
Deposits and balances due from banking institutions	14	1,124,377	104,502
Government securities	15	2,782,597	3,619,009
Corporate bonds	16	242,215	287,295
Advances to customers (net)	17	3,272,190	2,739,613
Other assets	19	118,242	64,238
Taxation recoverable	11(c)	21,221	21,221
Equipment	20	58,337	57,148
Intangible assets	21	4,629	2,916
Deferred taxation asset	22	10,608	21,766
TOTAL ASSETS		8,028,876	7,254,561
LIABILITIES			
Customer deposits	23	6,600,517	6,084,285
Amount due to local banks	24	135,676	-
Other liabilities	25	62,269	34,520
TOTAL LIABILITIES		6,798,462	6,118,805
SHAREHOLDERS' FUNDS			
Share capital	26	1,000,000	1,000,000
Retained earnings		186,044	105,871
Statutory reserve		44,370	29,885
TOTAL SHAREHOLDERS' FUNDS		1,230,414	1,135,756
TOTAL SHAREHOLDERS' FUNDS AND LIABILITIES		8,028,876	7,254,561

The financial statements on pages 16 to 64 were approved and authorised for issue by the board of directors on 2014 and were signed on its behalf by:

Director **Director**

Chief Executive Officer **Company Secretary**

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2013

	Share capital Sh'000	share capital Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Total Sh'000
At 1 January 2012	865,000	25,000	113,020	22,488	1,025,508
Total comprehensive income for the year	-	-	110,248	-	110,248
Bonus shares issued	110,000	-	(110,000)	-	-
Transfer from unalloted share capital	25,000	(25,000)	-	-	-
Transfer to statutory reserve	-	-	(7,397)	7,397	-
At 31 December 2012	1,000,000	-	105,871	29,885	1,135,756
At 1 January 2013	1,000,000	-	105,871	29,885	1,135,756
Total comprehensive income for the year	-	-	94,658	-	94,658
Transfer to statutory reserve	-	-	(14,485)	14,485	-
At 31 December 2013	1,000,000	-	186,044	44,370	1,230,414

On 30 March 2012, the shareholders, through a special resolution, approved capitalisation of Sh 110, 000,000 out of revenue reserves of the bank as at 31 December 2011.

In 2011, the company had received Sh 25,000,000 as subscription towards new shares.The shares were allotted in 2012.

The statutory reserve represents an appropriation from retained earnings in compliance with Central Bank of Kenya's prudential guidelines on impairment of loans and advances. It represents the excess of loans provisions as computed with the Central Bank of Kenya prudential guidelines over impairment of loans and receivables computed as per IAS 39. The statutory reserve is not distributable.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 Sh'000	2012 Sh'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash generated from/(used in) operations	27(a)	1,096,341	(171,239)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of equipment	20	(16,167)	(6,277)
Purchase of intangible assets	21	(2,722)	(987)
Net cash used in investing activities		(18,889)	(7,264)
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		1,077,452	(178,503)
CASH AND CASH EQUIVALENTS AT 1 JANUARY		432,750	611,253
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	27(b)	1,510,202	432,750

NOTES TO THE FINANCIAL STATEMENTS

ACCOUNTING POLICIES

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards.

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

Adoption of new and revised International Financial Reporting Standards (IFRSs)

i) New standards and amendments to published standards effective for the year ended 31 December 2013

The following new and revised IFRSs were effective in the current year and had no material impact on the amounts reported in these financial statements.

Amendments to IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities	The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement. The application of the amendment had no effect on the bank's financial statements as the bank did not have any significant offsetting arrangements in place.
New and revised standards on consolidation joint arrangements, associates and disclosures	In May 2011, a package of five standards in consolidation joint arrangements, associates and disclosures was issued comprising IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, IASs 27 (as revised in 2011) Separate Financial Statements and IAS 28 (as revised in 2011) Investments in Associates and Joint Ventures. Subsequent to the issue of these standards, amendment to IFRS 10, IFRS 11 and IFRS 12 were issued to clarify certain guidance on first application of the standards. Application of these standards has not had any impact on the disclosures or the amounts recognised in these financial statements as the bank does not have material subsidiaries, joint arrangements and associates.
IFRS 13 Fair Value Measurement	The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except for share-based payment transactions that are within the scope of IFRS 2 Share-based Payment, leasing transactions that are within the scope of IAS 17 Leases, and measurements that have some similarities to fair value but are not fair value (e.g. net realisable value for the purposes of measuring inventories or value in use for impairment assessment purposes). IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes extensive disclosure requirements.

NOTES TO THE FINANCIAL STATEMENTS (continued)

1 ACCOUNTING POLICIES (Continued)

Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

i)New standards and amendments to published standards effective for the year ended 31 December 2013 (Continued)

	IFRS 13 requires prospective application from 1 January 2013. In addition, specific transitional provisions were given to entities such that they need not apply the disclosure requirements set out in the Standard in comparative information provided for periods before the initial application of the Standard. In accordance with these transitional provisions, the bank has not made any new disclosures required by IFRS 13 for the 2012 comparative period. Other than the additional disclosures, the application of IFRS 13 has not had any material impact on the amounts recognised in the financial statements.
Amendments to IAS 1 Presentation of Items of Other Comprehensive Income	The bank has applied the amendments to IAS 1, **Presentation of Items of Other Comprehensive Income,** for the first time in the current year. The amendments introduce new terminology, whose use is not mandatory, for the statement of comprehensive income and income statement. Under the amendments to IAS 1, the 'statement of comprehensive income' is renamed as the 'statement of profit or loss and other comprehensive income' (and the 'income statement' is renamed as the 'statement of profit or loss'). The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis - the amendments do not change the option to present items of other comprehensive income either before tax or net of tax. The new terminology have been adopted in these financial statements. In other respects the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income of the bank.
Amendments to IAS 1 Presentation of Financial Statements (as part of the Annual Improvements to IFRSs 2009 - 2011 Cycle issued in May 2012)	The Annual Improvements to IFRSs 2009 - 2011 have made a number of amendments to IFRSs. The amendments that are relevant to the bank are the amendments to IAS 1 regarding when a statement of financial position as at the beginning of the preceding period (third statement of financial position) and the related notes are required to be presented. The amendments specify that a third statement of financial position is required when a) an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items in its financial statements, and b) the retrospective application, restatement or reclassification has a material effect on the information in the third statement of financial position. The amendments specify that related notes are not required to accompany the third statement of financial position. The application of the amendment had no effect on the bank's financial statements as the bank did not restate its financial statements.

1ACCOUNTING POLICIES (Continued)

Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

i) New standards and amendments to published standards effective for the year ended 31 December 2013 (Continued)

IAS 19 Employee Benefits (as revised in 2011)	IAS 19 (as revised in 2011) changes the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets. The amendments require the recognition of changes in defined benefit obligations and in the fair value of plan assets when they occur, and hence eliminate the 'corridor approach' permitted under the previous version of IAS 19 and accelerate the recognition of past service costs. All actuarial gains and losses are recognised immediately through other comprehensive income in order for the net pension asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus. Furthermore, the interest cost and expected return on plan assets used in the previous version of IAS 19 are replaced with a 'net interest' amount under IAS 19 (as revised in 2011), which is calculated by applying the discount rate to the net defined benefit liability or asset. The application of the amendment had no effect on the bank's financial statements as the bank does not have defined benefit obligations and plan assets.

ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2013

New and Amendments to standards	Effective for annual periods beginning on or after
IFRS 9	1 January 2015
Amendments to IFRS 9 and IFRS 7	1 January 2015
Amendments to IFRS 10, IFRS 12 and IAS 27	1 January 2014
Amendments to IAS 32	1 January 2014
Annual improvements 2011-2013 cycle	1 January 2014
Annual improvements 2010-2014 cycle	1 January 2014

iii) Impact of new and amended standards and interpretations on the financial statements for the year ended 31 December 2013 and future annual periods

IFRS 9 Financial Instruments

IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition.

Key requirements of IFRS 9:

- All recognised financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement are required to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods.

1. ACCOUNTING POLICIES (Continued)

Adoption of new and revised International Financial Reporting Standards (IFRSs) (Continued)

iii) Impact of new and amended standards and interpretations on the financial statements for the year ended 31 December 2013 and future annual periods (Continued)

IFRS 9 Financial Instruments (Continued)

- All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognised in profit or loss.
- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss.

  Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value through profit or loss is presented in profit or loss.

  The directors of the bank anticipate that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the bank's financial assets and financial liabilities (e.g. the bank will classify financial assets as subsequently measured at either amortised cost or fair value). However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed.

Amendments to IFRS 10, IFRS 12 and IAS 27 Investment Entities

The amendments to IFRS 10 define an investment entity and require a reporting entity that meets the definition of an investment entity not to consolidate its subsidiaries but instead to measure its subsidiaries at fair value through profit or loss in its consolidated and separate financial statements.

To qualify as an investment entity, a reporting entity is required to:

- Obtain funds from one or more investors for the purpose of providing them with professional investment management services.
- Commit to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both.
- Measure and evaluate performance of substantially all of its investments on a fair value basis

Consequential amendments have been made to IFRS 12 and IAS 27 to introduce new disclosure requirements for investment entities.

The directors of the bank do not anticipate that the investment entities amendments will have any effect on the bank's financial statements as the bank is not an investment entity.

Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities

The amendments to IAS 32 clarify the requirements relating to the offset of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and 'simultaneous realisation and settlement'.

NOTES TO THE FINANCIAL STATEMENTS (continued)

1. ACCOUNTING POLICIES (Continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (Continued)

iii) Impact of new and amended standards and interpretations on the financial statements for the year ended 31 December 2013 and future annual periods (Continued)

Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)

Amends IAS 36 Impairment of Assets to reduce the circumstances in which the recoverable amount of assets or cash-generating units is required to be disclosed, clarify the disclosures required, and to introduce an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount (based on fair value less costs of disposal) is determined using a present value technique.

The directors of the bank do not anticipate that the application of these amendments to IAS 36 will have a significant impact on the bank's financial statements.

Annual Improvements 2011-2013 Cycle

Makes amendments to the following standards:

- IFRS 1 — Clarify which versions of IFRSs can be used on initial adoption (amends basis for conclusions only)
- IFRS 3 — Clarify that IFRS 3 excludes from its scope the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself
- IFRS 13 — Clarify the scope of the portfolio exception in paragraph 52
- IAS 40 — Clarifying the interrelationship of IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property

These IFRS improvements are effective for accounting periods beginning on or after 1 January 2014. The directors of the bank do not anticipate that the application of these improvements to IFRSs will have a significant impact on the bank's financial statements.

(iv) Early adoption of standards

The bank did not adopt new or amended standards early in 2013.

Basis of preparation

The bank prepares its financial statements under the historical cost convention, as modified to include the revaluation of certain financial assets.

Interest income and expense

Interest income and interest expense for all interest bearing financial instruments are accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Interest income and expense on all trading assets and liabilities are considered to be incidental to the bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income. Fair value changes on other financial assets and liabilities carried at fair value through profit or loss, are also presented in net trading income included in the profit or loss.

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

Interest income includes interest on loans and receivables, placements with other banks and investments in government securities, and is recognised in the year in which it is earned.

NOTES TO THE FINANCIAL STATEMENTS (continued)

1. ACCOUNTING POLICIES (Continued)

Fees and commission income

In the normal course of business, the bank earns fees and commission income from a diverse range of services to its customers. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment management fees, placement fees and syndication fees, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period. Fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

Net trading income

Net trading income arises from the margins which are achieved through market marking and customer business and from changes in market caused by movements in interest and exchange rates, prices and other market variables. It comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes.

Equipment

Equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight line basis at annual rates estimated to write off the cost of equipment over their expected useful lives using the following rates:

Computers and office equipment	20%
Motor vehicles	25%
Furniture, fittings and office renovations	12.5%

Intangible assets-computer software costs

Generally, costs associated with developing computer software programmes are recognised as an expense incurred. However, a cost that is clearly associated with an identifiable and unique product which will be controlled by the bank and has a probable benefit exceeding the cost beyond one year, are recognised as an intangible asset.

1. ACCOUNTING POLICIES (Continued)

Interest income and expense (Continued)

Expenditure which enhances and extends computer software programmes beyond their original specifications and lives is recognised as a capital improvement and added to the original costs of the software. Computer software development costs recognised as assets are stated at cost less amortisation. Amortisation is calculated on a straight line basis over the estimated useful lives not exceeding a period of 5 years.

Impairment of non-financial assets

At the end of each reporting period, the bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

(i) Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

(ii) Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

1. ACCOUNTING POLICIES (Continued)

Taxation (Continued)

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in associates, except where the bank is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

(iii) Current and deferred tax for the year

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in the equity respectively.

Foreign currencies

Transactions in foreign currencies during the year are translated at the rates ruling at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Kenya Shillings at the rates of exchange ruling at the end of each reporting date. Non-monetary items that are measured in terms of historical costs in a foreign currency are not retranslated. Gains and losses on exchange of monetary items are dealt with in the profit or loss in the period in which it arises.

Provisions

Provisions are recognised when the bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations and a reliable estimate of the amount of the obligation can be made.

Statutory reserve

IAS 39 requires the bank to recognise an impairment loss when there is objective evidence that loans and receivables are impaired. However, Central Bank of Kenya prudential guidelines require the bank to set aside amounts for impairment losses on loans and advances in addition to those losses that have been recognised under IAS 39. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining profit or loss. These amounts are dealt with in the statutory reserve.

1. ACCOUNTING POLICIES (Continued)

Financial instruments

i) Recognition

A financial asset or liability is recognised when the bank becomes party to the contractual provisions of the instrument.

ii) Classification and measurement

Financial assets

The bank classifies its financial assets into the following categories:

- Financial assets at fair value through profit or loss.
- Loans and receivables.
- Held to maturity financial assets.
- Available for sale financial assets.

Management determines the appropriate classification of its investments at initial recognition.

Financial assets at fair value through profit or loss

Financial assets are classified as fair value through profit or loss (FVTPL) when the financial asset is either held for trading or is designated as at FVTPL. A financial asset is classified as held for trading if acquired principally for the purpose of selling in the short term; or on initial recognition it is part of a portfolio of identified financial instruments that the bank manages together and has a recent actual pattern of short term profit taking; or it is a derivative that is not designated and effective as a hedging instrument. Financial assets at FVTPL are stated at fair value, with gains or losses arising on re-measurement recognised in profit or loss.

Loans and receivables

Loans and receivables including advances originated by the bank are non-derivative financial assets with fixed or determinable payments with fixed maturities that are not quoted in an active market. Loans and receivables are recognised when cash is advanced to borrowers. These are held to maturity and are measured at amortised cost using the effective interest method, less any impairment.

Held to maturity investments

Financial assets with fixed or determinable payments and fixed maturity where the bank has the positive intent and ability to hold to maturity other than loans and receivables originated by the bank are classified as held to maturity investments and are measured at amortised cost using effective interest rate method less any impairments with revenue recognised on an effective yield basis.

Available-for-sale financial assets

Financial assets that are not (a) loans and receivable originated by the company, (b) held–to-maturity investments, or (c) financial assets held for trading are measured at their fair values. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve with the exception of impairment losses; interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognised in profit or loss. Where the investment is disposed and or if determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserves is reclassified to profit or loss.

Fair values of quoted investments in active markets are based on quoted bid prices. Equity securities for which fair values cannot be measured reliably are measured at cost less impairment.

1. ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Impairment and uncollectability of financial assets

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

If it is probable that the bank will not be able to collect all amounts due (principal and interest) according to the contractual terms of loans and receivables, or held-to-maturity investments carried at amortised cost, an impairment or bad debt loss has occurred. The amount of the loss is the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate (recoverable amount). The carrying amount of the asset is reduced to its estimated recoverable amount through use of the provision for bad and doubtful debts account. The amount of the loss incurred is included in profit or loss for the period.

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

(i) Assets carried at amortised cost

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instruments effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss.

(ii) Loans and receivables

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and receivables is established when there is objective evidence that the bank will not be able to collect all amounts due according to the original terms of the loans. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the profit or loss as 'impairment loss on loans and receivables'. When a loan or advance is uncollectible, it is written off against the related allowance account. Subsequent recoveries of amounts previously written off are credited through profit or loss.

1. ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Impairment and uncollectability of financial assets (Continued)

(ii) Loans and receivables (Continued)

Objective evidence that loans and receivables are impaired can include significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group are considered indicators that the loans or receivable is impaired.

In assessing impairment losses, the bank considers the following factors, in each category:

a) Individually assessed loans

- The aggregate exposure to the bank.
- The viability of the customer's business model and its capacity to trade successfully out of financial difficulties and generate sufficient cash flows to meet its debt obligations.
- The realisable value of the security (or other mitigants) and likelihood of successful repossession net of any costs involved in recovery of amounts.
- The amount and timing of expected receipts and, in cases of liquidation or bankruptcy, dividend available.
- The extent and complexity of other creditors commitment ranking pari passu with the bank and the likelihood of other creditors continuing to support the customer.

b) Collectively assessed

- For loans not subject to individual assessment, to cover losses which have been incurred but have not yet been identified.
- For homogeneous groups of loans that are not considered individually significant, where there is objective evidence of impairment.

Homogeneous groups of loans

For homogeneous groups of loans that are not considered individually significant, or in other cases, when the portfolio size is small or when information is insufficient or not reliable enough, the bank adopts a formulaic approach which allocates progressively higher percentage loss rates in line with the period of time for which a customer's loan is overdue. Loss rates are calculated from the discounted expected future cash flows from a portfolio. These rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Loan write–offs

An uncollectible loan is written off against the relevant provision for impairment, either partially or in full, when there is no realistic prospect of recovery and the proceeds from realising the security have been substantially or fully recovered.

1. ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Impairment and uncollectability of financial assets (Continued)

(iii) Available-for-sale financial assets

In the case of investment classified as available for sale, significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the asset is impaired. Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of equity to profit or loss. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

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

Financial liabilities

After initial recognition, the bank measures all financial liabilities including customer deposits other than liabilities held for trading at amortised cost. Liabilities held for trading (financial liabilities acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin) are subsequently measured at their fair values.

Derecognition of financial liabilities

Financial liabilities are derecognised when and only when the bank obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

Offsetting financial instruments

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

Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with Central Bank of Kenya (CBK), items in the course of collection from other banks, deposits held at call with banks and treasury bills with original maturities of less than three months. Such assets are generally subject to insignificant risk of changes in their fair value, and are used by the bank in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Rentals payable under operating leases are charged to profit or loss for the year on a straight-line basis over the term of the relevant lease.

Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are generally written by the bank to support performance by a customer to third parties. The bank will only be required to meet these obligations in the event of the customer's default. These obligations are accounted for as off financial position transactions and disclosed as contingent liabilities.

1. ACCOUNTING POLICIES (Continued)

Fiduciary activities

Assets and income arising thereon together with related undertakings to return such assets to customers are excluded from these financial statements where the bank acts in a fiduciary capacity such as nominee, trustee or agent.

Employee benefit costs

i) Statutory defined benefit obligation pension scheme

The bank contributes to the National Social Security Fund (NSSF). This is a defined contribution scheme registered under the National Social Security Act. Contributions are determined by local statute and are currently limited to Sh 200 per employee per month. The bank's contributions to the statutory retirement benefit scheme are charged to the profit or loss for the year to which they relate.

ii) Other employee entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the liability for annual leave outstanding at the financial position date.

Comparatives

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE BANK'S ACCOUNTING POLICIES

In the process of applying the bank's accounting policies, management has made estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are dealt with below:

i) Critical judgements in applying the bank's policies

Impairment losses on loans and receivables

The bank reviews its loan portfolios to assess impairment regularly. In determining whether an impairment loss should be recorded in the profit or loss for the year, the bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a bank, or national or local economic conditions that correlate with defaults on assets in the bank.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE BANK'S ACCOUNTING POLICIES (CONTINUED)

Financial instruments (Continued)

i) Critical judgements in applying the bank's policies (Continued)

Held -to-maturity investments

The bank follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgement. In making this judgement, the bank evaluates its intention and ability to hold such investments to maturity. If the bank fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortised cost.

ii) Key sources of estimation uncertainty

Equipment

Critical estimates are made by directors in determining the useful lives and residual values for equipment and intangible assets based on the intended use of the assets and the economic lives of those assets. Subsequent changes in circumstances such as technological advances or prospective utilisation of the assets concerned could result in the actual useful lives or residual values differing from initial estimates.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES

The Board of Directors retains the overall responsibility for the risk management of the bank. The Board Risk Management Committee (RMC) is responsible for monitoring compliance with the bank's risk management policies and procedures, and review of the adequacy of risk management framework in relation to the risks faced by the bank. The Board Risk Management Committee is assisted in these functions by various management committees which undertake both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Board.

The following are the key risk categories that have been elaborated in these financial disclosures:

- Credit risk
- Liquidity risk
- Market risk
  - Interest rate risk
  - Foreign exchange risk
  - Price risk
- Capital management
- Operational risk

a) Credit risk

Credit risk refers to the current or prospective risk to earnings and capital arising from an obligator's failure to meet the terms of any contract with the bank or if an obligator otherwise fails to perform as agreed. It arises principally from lending, leasing, trade finance and treasury activities. The bank's credit risk is primarily attributable to its loans and receivables. The amounts presented in the statement of financial position are net of allowances for doubtful advances, estimated by the bank's management based on prior experience and their assessment of the current economic environment.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

Management of credit risk

The Board of directors has delegated responsibility for the management of credit risk to its Credit Committee (CC).

The bank structures the level of credit risk it undertakes by placing limits on amounts of risk accepted in relation to one borrower or a group of borrowers. Such risks are monitored on a revolving basis and are subject to annual or more frequent review.

Credit risk is the risk of financial loss to the bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the bank's loans and receivables to customers and other banks and investment securities.

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 limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate guarantees.

Maximum exposure to credit risk before collateral held

The amount that best represents the bank's maximum exposure to credit at the end of the period is analysed as follows:-

	2013 Sh '000	%	2012 Sh '000	%
On balance sheet items				
Items in the course of collection from other banks (note 19)	5,131	0	10,834	0
Deposits and balances due from banking institution (note 14)	1,124,377	15	104,502	2
Loans and receivables to customers (note 17)	3,272,190	44	2,739,613	40
Government securities (note 15)	2,782,597	37	3,619,009	54
Corporate bonds (note 16)	242,215	3	287,295	4
Total	7,426,510	100	6,761,253	100
Off – balance sheet items (note 28 (a))				
Letters of credit	102,516	43	68,900	29
Letters of guarantee and performance bonds	100,797	43	122,793	52
Bills for collection	32,805	14	44,149	19
	236,118	100	235,842	100
Grand total	7,662,628		6,997,095	

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

a) Credit risk (Continued)

The table below represents the worst case scenario of credit exposure for both years, without taking account of any collateral held or other credit enhancements attached.

Classification of loans and receivables to customers

	Gross loan amount Sh '000	Impairment allowance Sh '000	Net loan amount Sh '000	%
At 31 December 2013				
Neither past due nor impaired	2,429,728	-	2,429,728	74
Past due but not impaired	669,077	-	669,077	20
Impaired	335,772	162,387	173,385	5
	_______	_______	_______	____
Total	3,434,577	162,387	3,272,190	100
	=======	=======	=======	====
At 31 December 2012				
Neither past due nor impaired	2,362,629	-	2,362,629	86
Past due but not impaired	208,665	-	208,665	8
Impaired	320,550	152,231	168,319	6
	_______	_______	_______	____
Total	2,891,844	152,231	2,739,613	100
	========	=======	========	====

Apart from the loans and receivables to customers all other credit exposures are neither past due nor impaired.

Neither past due nor impaired

These are well documented facilities granted to financially sound customers where no weaknesses exist. All such facilities are performing in accordance with the contractual terms and are expected to continue doing so. Loans in this category are normally fully protected by the current sound net worth and paying capacity of the borrower. These exposures are categorised as normal in line with Central Bank of Kenya (CBK) prudential guidelines and a provision of 1 % is made and appropriated under statutory reserves.

Past due but not impaired

These are accounts which may be currently protected but, though not past due, reveal weaknesses in the financial conditions or credit worthiness of the borrower. Such weaknesses, if not corrected, may weaken the asset or inadequately protect the bank's position at some future date. These exposures are graded category 2 in line with CBK guidelines.

Impaired

Impaired loans and securities are loans and securities for which the bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan / securities agreement(s). These loans are graded categories 3 to 5 in the bank's internal credit risk grading system. These accounts under CBK guidelines are termed as non-performing loans.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

a) Credit risk (Continued)

Allowances for impairment

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

Collateral held

The bank holds collateral against loans and advances to customers in the form of mortgage interests over property, registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired.

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

	2013 Sh '000	2012 Sh '000
Loans and advances to customers		
Discounted value of securities for past due and impaired loans		
90 - 180 days	46,697	11,500
180 days +	190,011	257,871
	_______	_______
Total	236,708	269,371
	======	======

Concentration of risk

The bank has no significant concentration of credit risk, with exposure spread over a diversity of personal and commercial customers as set out in the table below:

a) Advances to customers

	2013 Sh '000	%	2012 Sh '000	%
Real estate	1,421,563	41	1,351,715	47
Social community and personal services	159,271	5	152,501	5
Manufacturing	13,253	0	12,505	1
Transport and communications	652,627	19	446,860	15
Other	1,187,863	35	928,263	32
	_______		_______	
Total	3,434,577	10 0	2,891,844	10 0
	========		========	

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

a) Credit risk (Continued)

b) Customer deposits

	2013 Sh '000	%	2012 Sh '000	%
Co-operatives societies	3,127	-	2,874	-
Private enterprises	5,015,821	76	4,603,696	76
Non profit institutions and individuals	1,581,569	24	1,477,715	24
Total	6,600,517	100	6,084,285	100

c) Off – balance sheet items

	2013 Sh '000	%	2012 Sh '000	%
Business services	16,072	7	41,461	18
Wholesale and retail	191,257	81	175,933	75
Transport and communications	9,800	4	10,033	4
Other	18,989	8	8,415	3
Total	236,118	100	235,842	100

Summary of credit risk exposure taking into account collateral

Loans and advances		
Individually impaired		
Grade 5 : Impaired (loss)	16,990	19,728
Grade 3 & 4 : Impaired (doubtful)	316,112	300,822
Gross amount	333,102	320,550
Allowance for impairment	(162,387)	(152,231)
Carrying amount	170,715	168,319
Collectively impaired		
Grade 1 : Normal	2,429,728	2,362,629
Grade 2 : Watch	669,077	208,665
Gross amount	3,098,805	2,571,294
Carrying amount	3,269,520	2,739,613

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

a) Credit risk (Continued)

Write-off policy

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the profit or loss for the year.

b) Liquidity risk

Liquidity risk is the risk that the bank cannot obtain the necessary funds to meet its obligations associated with financial instruments as they fall due. The amount of liquidity required depends very much on the banks ability to forecast demand and its access to outside sources. The board of directors has assigned the authority for the management oversight of the liquidity risk policy to the Assets and Liability Committee (ALCO). The committee which is composed of the CEO, Treasury Manager, and other bank officers as necessary review various liquidity and funding decisions and related risks. Formal minutes pertaining to committee actions are recorded and maintained for review by the board of directors.

Liquidity management

The bank manages the liquidity structure of assets, liabilities and commitments so that cash flows are appropriately matched to ensure that all funding obligations are met when due. Banking operations are such that mismatch of assets and liabilities according to their maturity profiles cannot be avoided. However, management ensures that the mismatch is controlled in line with allowable risk levels. Liquidity is managed on a daily basis and incorporates assets and liabilities of the bank based on the remaining period up to 31 December 2013 to the contractual maturity date.

Liquidity risk is addressed through the following measures:

- The bank enters into lending contracts subject to availability of funds.
- The bank has an aggressive strategy aimed at increasing the customer deposit base.
- The bank invests in short term liquid instruments which can easily be sold in the market when the need arises.
- Investments in equipment are properly budgeted for and done when the bank has sufficient cash flows.

The table below details the liquidity ratio trends over the year:

As at 31 December	2013 %	2012 %
Average for the period	67	60
Maximum for the period	70	67
Minimum for the period	63	55
Statutory minimum requirement by Central Bank of Kenya	20	20
	====	====

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

b) Liquidity risk (Continued)

Undiscounted cash flows

The table below shows the undiscounted cash outflows on the bank's financial liabilities based on their contractual maturity dates and the undiscounted cash inflows on the bank's financial assets based on their expected maturity dates. The banks expected cash flows on these instruments could vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognised loan commitments are not all expected to be drawn down immediately

	Upto 1 Month Sh '000	1-3 Months Sh '000	4-12 Months Sh '000	1-5 Years Sh '000	Over 5 Years Sh '000	Total Sh'000
FINANCIAL ASSETS						
Cash and balances with CBK	358,875	26,673	8,912	-	-	394,460
Deposits and balances from banking institutions	1,124,377	-	-	-	-	1,124,377
Treasury bonds	1,259,431	1,005	18,122	735,202	768,837	2,782,597
Corporate bonds	-	-	20,291	181,427	40,497	242,215
Advances to customers	484,323	749,748	991,535	848,552	198,032	3,272,190
	3,227,006	777,426	1,038,860	1,765,181	1,007,366	7,815,839
FINANCIAL LIABILITIES						
Customer deposits	6,605,576	490,947	164,045	-	-	7,260,568
Amounts due to local banks	142,460	-	-	-	-	142,460
	6,748,038	490,947	164,045	-	-	7,403,028
Net liquidity gap	(3,521,032)	286,479	874,815	1,765,181	1,007,366	412,811
As at 31 December 2012						
Total financial assets	2,666,261	841,823	875,729	1,448,418	1,255,041	7,087,272
Total financial liabilities	1,185,711	4,051,102	466,961	716,384	-	6,420,218
Net liquidity gap	1,480,550	(3,209,279)	408,768	732,034	1,255,041	667,114

The gross nominal inflow/(outflow) disclosed is the contractual, undiscounted cash flow on the financial liability or commitment.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

c) Market Risk

(i) Interest rate risk

The bank is exposed to the risk that the value of a financial instrument will fluctuate due to changes in market interest rate. Interest rates on advances to customers are either pegged to the bank's base lending rate or Treasury bill rate. The interest rates, therefore, fluctuate depending on the movement in the market interest rates. The bank also invests in fixed interest rate instruments issued by the Central Bank of Kenya. Interest rate on customer deposits is negotiated between the bank and the customer. The bank has the discretion to change the rates in line with changes in market trends.

The board of directors has assigned the authority for the management oversight of the interest rate risk policy to the Assets and Liability Committee (ALCO). The committee which is composed of the CEO, Treasury Manager, and other bank officers meets as necessary for specific credit risk situations, reviews various liquidity and funding decisions and related risks. Formal minutes pertaining to committee actions are recorded and maintained for review by the board of directors.

The table below summarises the exposure to interest rate risks. Included in the table are the bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The bank does not bear an interest rate risk on off financial position items. All figures are in thousand of shillings.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

c) Market Risk (Continued)

(i) Interest rate risk (Continued)

	Up to 1 Month Sh '000	1-3 Months Sh '000	4-12 Months Sh '000	1-5 years Years Sh '000	Over 5 Years Sh '000	Non-interest bearing Sh '000	Total Sh'000
FINANCIAL ASSETS							
Cash in hand	-	-	-	-	-	67,233	67,233
Balances with Central Bank of Kenya	-	-	-	-	-	327,227	327,227
Deposits and balances due from banking institutions	800,000	-	-	-	-	324,377	1,124,377
Government securities	1,259,431	1,005	18,122	735,202	768,837	-	2,782,597
Corporate bonds	-		20,291	181,427	40,497	-	242,215
Advances to customers	3,272,190	-	-	-	-	-	3,272,190
Total financial assets	5,331,621	1,005	38,413	916,629	809,334	718,837	7,815,839
FINANCIAL LIABILITIES							
Customer deposits	110,923	4,432,363	449,816	463,244	-	1,144,171	6,600,517
Amounts due to local banks	135,676	-	-	-	-	-	135,676
Total financial liabilities	246,599	4,432,363	449,816	463,244	-	1,144,171	6,736,193
Interest rate sensitivity gap	5,085,022	(4,431,358)	(411,403)	453,385	809,334	(425,334)	1,079,646
As at 31 December 2012							
Total financial assets	2,499,547	629,271	851,228	1,410,830	1,255,041	441,355	7,087,272
Total financial liabilities	272,880	3,984,784	475,080	439,092	-	912,449	6,084,285
Interest rate sensitivity gap	2,226,667	(3,355,513)	376,148	971,738	1,255,041	(471,094)	1,002,987

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the bank. It is unusual for a bank's interest to completely be matched due to the nature of business terms and types.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

c) Market Risk (Continued)

(i) Interest rate risk (Continued)

Exposure to interest rate risk

The bank is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows. ALCO closely monitors the interest rate trends to minimize the potential adverse impact of interest rate changes. The table below summarises the exposure to interest rate risk at the statement of financial position date.

Interest rate risk – stress test-as at 31 December 2013

	Amount Sh'000	Scenario 10% increase in net margin Sh'000	Scenario 10% decrease in net margin Sh'000
Profit before taxation	105,816	120,120	91,512
Adjusted core capital	1,175,436	1,292,980	1,057,892
Adjusted total capital	1,219,805	1,341,786	1,097,825
Risk weighted assets (RWA)	2,914,374	3,205,811	2,622,937
Adjusted core capital to RWA	40%	40%	40%
Adjusted total capital to RWA	42%	42%	42%
	=======	=======	========

Interest rate risk – stress test-as at 31 December 2012

	Amount Sh'000	Scenario 10% Increase in net margin Sh'000	Scenario 10% Decrease in net margin Sh'000
Profit before taxation	89,828	96,951	63,258
Adjusted core capital	1,105,870	1,092,594	1,079,305
Adjusted total capital	1,135,756	1,122,479	1,109,190
Risk weighted assets (RWA)	2,390,255	2,390,255	2,390,255
Adjusted core capital to RWA	46%	47%	45%
Adjusted total capital to RWA	48%	49%	46%
	=======	=======	=======

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

c) Market Risk (Continued)

ii) Foreign exchange risk (Continued)

Foreign exchange risk is the risk that may occur to earnings or capital that results from movement of foreign exchange rates. This type of risk affects the bank due to cross-border investing and operating activities. The board of directors has assigned authority for management oversight of the foreign exchange risk policy to the CEO and Treasury manager.

Management of foreign exchange risk

The bank operates wholly within Kenya and its assets and liabilities are reported in the local currency. The bank's currency risk is managed within the Central Bank of Kenya exposure guideline of 20% core capital. The bank's management monitors foreign currency exposure on a daily basis.

The bank's currency position is as follows:

	KES	GBP	USD	EURO	OTHERS	Total
FINANCIAL ASSETS	Sh '000	Sh '000	Sh '000	Sh '000	Sh '000	Sh '000
Cash in hand	39,514	1,195	23,040	3,478	6	67,233
Balances with CBK	303,927	125	24,251	(1,076)	-	327,227
Deposits and balances due from	804,489	19,469	231,938	66,064	2,417	1,124,377
banking institutions	2,782,597	-	-	-	-	2,782,597
Government securities	242,215	-	-	-	-	242,215
Other securities	3,124,598	-	113,086	34,506	-	3,272,190
Advances to customers						
	7,297,340	20,789	392,315	102,972	2,423	7,815,839
Total financial assets						
FINANCIAL LIABILITIES						
Customer deposits	6,149,052	21,938	358,362	71,166	-	6,600,518
Amounts due to local banks	135,676	-	-	-	-	135,676
Total financial liabilities	6,284,728	21,938	358,362	71,166	-	6,736,193
Net balance sheet position	1,012,612	(1,149)	33,953	31,806	2,423	1,079,645
	=======	=======	=======	=======	======	=======
At 31 December 2012						
Total financial assets	6,816,478	19,969	225,621	25,155	49	7,087,272
Total financial liabilities	5,798,875	17,528	240,966	26,916		6,084,285
Net balance sheet position	1,017,603	2,441	(15,345)	(1,761)	49	1,002,987
	========	=======	=======	=======	=======	=======

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

c) Market Risk (Continued)

ii) Foreign exchange risk (Continued)

The table below shows the foreign exchange risk sensitivity analysis. The net position is after a 10% increase or decrease in foreign currency exchange rates against the Kenya shilling.

At 31 December 2013

	Amount Sh'000	Scenario 10% increase in foreign currency rate Sh'000	Scenario 10% decrease in foreign currency rate Sh'000
Profit before taxation	105,816	120,120	91,512
Adjusted core capital	1,175,436	1,292,980	1,057,892
Adjusted total capital	1,219,805	1,341,786	1,097,825
Risk weighted assets (RWA)	2,914,374	3,205,811	2,622,937
Adjusted core capital to RWA	40%	40%	40%
Adjusted total capital to RWA	42%	42%	42%
	=======	=======	========

At 31 December 2012

	Amount Sh'000	Scenario 10% increase in foreign currency rate Sh'000	Scenario 10% decrease in foreign currency rate Sh'000
Profit before taxation	89,828	90,161	82,664
Adjusted core capital	1,105,870	1,106,204	1,078,308
Adjusted total capital	1,135,756	1,136,089	1,108,193
Risk weighted assets (RWA)	2,390,255	2,390,255	2,390,255
Adjusted core capital to RWA	46%	46%	45%
Adjusted total capital to RWA	48%	48%	46%
	=======	=======	=======

iii) Price risk

Treasury bonds held at fair value are stated at their market value on the last day of business in the year .These are subject to frequent variations due to changes in their market prices.

An increase or decrease in rates by 10% with all other variables held constant, will have a decrease/increase in shareholders' equity of Sh 9,922,057 (2012:Sh 3,441,041)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

d) Capital Management

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the bank.

The bank's objectives when managing capital are:

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

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

The Central Bank of Kenya requires each bank to:

a) Hold the minimum level of regulatory capital of Sh 1 billion.

b) Maintain a ratio of total regulatory capital; to risk weighted assets plus risk weighted off balance assets at above the required minimum of 8%;

c) Maintain a core capital of not less than 8% of total deposit liabilities and

d) Maintain total capital of not less than 12% of risk weighted assets plus risk weighted off financial position items.

In addition to the above minimum capital adequacy ratios of 8% and 12%, with effect from 1 January 2013, institutions are required to hold a capital conservation buffer of 2.5% over and above these minimum ratios to enable institutions withstand future periods of stress. This brings the minimum core capital to risk weighted assets and total capital to risk weighted assets requirements to 10.5% and 14.5% respectively. The capital conservation buffer is made up of high quality capital which should comprise mainly of common equity, premium reserves and retained earnings.

Institutions that currently meet the minimum capital ratios of 8% and 12% but remain below the buffer-enhanced ratios of 10% and 14.5% should maintain prudent earnings retention policies with a view to meeting the conservation buffer within 24 months effective from 1 January 2013.

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

- Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, after deductions for intangible assets (excluding computer software), investments in equity instruments of other institutions and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, which includes 25% revaluation surplus which have received prior CBK approval, qualifying subordinated liabilities and collective impairment allowances.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

d) Capital Management (Continued)

The bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The bank has complied with all externally imposed capital requirements throughout the period.

The bank's regulatory capital position at 31 December was as follows:

	Nominal financial position amounts		Risk weighted amounts	
	2013 Sh'000	2012 Sh'000	2013 Sh'000	2012
ASSETS				
Cash (including foreign notes and coins)	67,233	104,538	-	-
Cash balances with Central Bank of Kenya	327,227	232,315	-	-
Government securities	2,782,597	3,619,009	-	-
Corporate bonds	242,215	287,295	-	287,295
Deposits and balances due from banking institutions	1,124,377	104,502	221,943	17,363
Loans and advances to customers	3,272,190	2,739,613	2,270,203	1,745,898
Other assets	118,242	64,238	118,242	64,238
Property and equipment	58,337	57,148	58,337	57,148
Intangible assets	4,629	2,916	4,629	2,916
Deferred tax asset	10,608	21,766	10,608	21,766
Tax recoverable	21,221	21,221	21,221	21,221
Total assets on balance sheet	8,028,876	7,254,561	2,705,183	2,217,845
Total asset off balance sheet	236,118	235,842	209,212	172,468
Total risk weighted assets	8,264,994	7,490,403	2,914,395	2,390,313
Tier 1 Capital	1,175,436	1,105,870		
Tier 1 + Tier 2 Capital	1,219,805	1,135,756		
Basel ratio				
Tier 1 (CBK minimum – 8%)	40%	46%		
Tier 1 + Tier 2 (CBK min – 12%)	42%	47%		

The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Risk and Credit, and is subject to review by the Credit Committee or ALCO as appropriate.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

e) Operating risk

Non-financial risk management disclosures

The Board of Directors has put in place a framework for management of non-financial risk management of the bank. The Board Risk Management Committee (BMRC) is responsible for monitoring compliance of this framework with the bank's overall risk management policies and procedures, and review of the adequacy of the risk management framework in relations to non-financial risks faced by the bank.

The key non-financial risks the bank faces are strategic risk, operational risks, reputational risk, compliance/legal risk.

a) Strategic risk

Strategic risk is a function of the internal and the external environment. The strategic risk policy of the bank provides direction and guidance to the board of directors for anticipating change, both externally and internally.

The bank uses key indicators to measure strategic risk such as: Current and forecasted economic conditions such as economic growth, inflation, interest rates, foreign exchange trends and other useful key economic data such as demography and demographic structures; trends within the banking sector such as, Competition both from existing players and new entrants; Merger and acquisition activities; Changes in customer needs, wants and behaviour; development of new products and use of technology; Changes in the bank's various sector exposures and the associated risks; and achievement of the targets, goals and objectives set by the board.

Responsibilities of strategic risk

The board of directors is responsible for the formulation and overall implementation of the bank's strategy. Strategy execution, strategic risk planning and overall strategic risk management is delegated to managing director.

Management of strategic risk

The board and management use the board, committees, and strategic plan to manage strategic risk. Regular and adhoc meetings of the board, the board committees review reports of the management and take corrective action. The execution of the bank's 5 year strategic plan is a key tool for strategic risk with the current strategic plan being 2010-2015. The next strategic plan cycle plan is being developed.

b) Bank operational risk

The bank's operational risk framework is designed to identify risks, measures and mitigate operational risks. These are risks associated with human error, system failures or technological failure, inadequate procedures and controls, unforeseen catastrophes, or other operational problems which may result in unexpected losses.

Responsibilities for operational risk management

The General Manager-Operations, continually reports to the Managing Director on all the key risks of the bank. Risk & Compliance department as well as Internal Audit reports both report to the managing director and their respective board committees.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

e) Operating risk (Continued)

b) Bank operational risk (Continued)

Management of operational risk

Through use of key performance indicators (KPI's) so as to adequately reflect the key risk area, and report on them. KPI's are reported monthly, quarterly, or on emergencies, whichever is appropriate. An examples of a KPI is 'Incident /Fraud / Suspicious Activities and Transaction Reports.
These detail those process related operational risk incidents combined with what remedial action was taken and what steps implemented to avoid a repeat occurrence. These reports are submitted as soon as the incident is discovered and notable trends reported quarterly on a summary report.

Reporting operational risk is a key part of risk management and staff are required to report all incidents which could fall within any of the six key risk areas (as above) – whether or not they resulted in any actual loss to the Bank.

c) Reputational risk

Reputational risk is the potential that negative publicity may lead to decline of its customer base, costly litigation, revenue reduction and subsequently its value and brand. All other risks may lead to reputational risks.

Main source of reputational risks are: business viability, business practices, fraudulent activities, litigations, customer satisfaction, anti-money laundering (AML) and rumours.

Responsibilities for reputational risk

The responsibility for management of reputational risk lies with the board of directors of the bank. Nonetheless, risk and audit management committees are responsible for reviewing adequacy and effectiveness of internal control systems relating to reputation risk and means through which exposures related to reputation risk are managed. Their purpose is to ensure that all stakeholders meet the bank's reputational risk objectives.

Management of Reputational risk

Overall, the bank promotes a corporate culture that adequately addresses stakeholder concerns and result in a gain of confidence. Internally, the bank have developed a code of conduct for directors and senior management and all staff. The bank also fully complies with applicable laws, legislation, and regulations. Finally, we continually communicate to the staff and regulators and the public on our compliance and standards.

d) Compliance (legal/regulatory) risk

Compliance risk refers to the potential of loss arising from non-compliance or violation of laws, rules, regulations, obligatory practices/standards, contractual agreements. The bank is variously exposed to compliance risk due to relations with a wide number of stakeholders, e.g. regulators, customers, counter parties, as well as tax authorities, local authorities and other authorized agencies. The bank meets high standards of compliance with the Central Bank of Kenya, County governments, OSHA and NEMA etc.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

e) Operating risk (Continued)

d) Compliance (legal/regulatory) risk (Continued)

Management of regulatory and legal risk

The risk & compliance department identifies and monitors the key risks and is responsible for ensuring that the day to day business controls comply with applicable legislation and are in line with best practice. Internal and external legal counsel work closely with business units to identify areas of existing and potential regulatory/legal risks and actively manage them to reduce the bank's exposures.

The board risk management committee receive the risk & compliance department's report on the strength of the bank's compliance risk framework to enable them determine whether it is under control.

Management of regulatory risks

The board of directors and senior management through adoption of the bank's corporate governance and code of conduct sets a culture of integrity. All employees are required to attest to this code when they join the bank and thereafter annually, indicating that they have understood it and that they have complied with its provisions.

The bank has implemented compliance risk in key areas such as Know Your Customer (KYC) policy. Customer due diligence (CDD) and transactions monitoring has been ongoing. Cash transaction reporting (CTR) and Suspicious Account Transactions Reporting (SATR) is done as required by FRC. The risk and compliance department periodically update business units on the Anti Money Laundering's on UN Security Committee's reports on individuals and entities who been place on travel ban and funds frozen and embargo on arms as well as other regional and national bodies involved in fighting Money Laundering and Combating terrorism including the FAFT 40 and the Wolfsberg-Private Banking Principles.

e) IT risk

The bank's information technology risk management ensures presence of an effective mechanism to identify, measure, monitor, and control the risks inherent in the banks' IT systems, ensure data integrity, availability, confidentiality and consistency and provide the relevant early warning mechanism.

Responsibilities for Management of IT Risk

The three key functions responsible are the board, senior management and IT Head. The board ensures there is an IT governance structure that meets its risk tolerance. Senior management ensures staff understands and adheres to IT Risk Management. The Head of IT is key in decision making on business development that require the use of IT and that such system meet the bank's needs.

Management of IT Risk

By restricted access to both the IT system and physical access to IT infrastructure(s), IT security deployment and periodic IT Audit.

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

f) Fair value of financial assets and liabilities

The table below shows an analysis of financial instruments at fair value by level of the fair value hierarchy. The financial instruments are grouped into levels 1 to 3 based on the degree to which the fair value is observable.

i) Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
ii) 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 (i.e. as a price) or indirectly (i.e. derived from prices); and
iii) 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)

	Note	Level 1 Shs'000	Level 2 Shs'000	Level 3 Shs'000	Total Shs'000
31 December 2013					
Financial assets designated at fair value through profit and loss					
Treasury bonds	15	1,259,431	-	-	1,259,431
		=======	=======	======	========
31 December 2012					
Financial assets designated at fair value through profit or loss					
Treasury bonds	15	2,073,552	-	-	2,073,552
		=======	=======	======	=======

The above were valued at quoted bid prices in an active market (Nairobi Securities Exchange). Except as detailed above, the directors consider that the carrying amounts of financial assets and liabilities recognised in the statement of financial position approximate their fair values.

Fair value of the bank's financial assets and liabilities that are measured at fair value on a recurrent basis

Some of the bank's financial assets and financial liabilities are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets and financial liabilities are determined (in particular, the valuation technique(s) and inputs used).

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

f) Fair value of financial assets and liabilities (Continued)

Fair value of the bank's financial assets and liabilities that are measured at fair value on a recurrent basis (Continued)

Financial liabilities	Fair value as at		Fair value hierarchy	Valuation technique (s) and key inputs	Significant unobservable inputs	Relationship of unobservable inputs to fair value
	31/12/13 Sh'000	31/12/12 Sh'000				
Treasury bonds	1,259,431	2,073,552	Level 1	Quoted bid prices in an active market	N/A	N/A

There were no transfers between levels 1, 2 and 3 in the period (2012: none).

Reconciliation of level 3 fair value measurements

There were no financial assets or financial liabilities measured at fair value on level 3 fair value measurement (2012: none).

4

	2013 Sh'000	2012 Sh'000
INTEREST INCOME		
Advances to customers	615,568	492,080
Government securities: - Held to maturity	100,069	45,027
Government securities: - At fair value through profit or loss	218,544	100,701
Corporate bonds: - Held to maturity	18,940	22,188
Deposits/balances due from other financial institutions	23,221	18,537
	976,342	678,533

5

	2013 Sh'000	2012 Sh'000
INTEREST EXPENSE		
Customer deposits	666,500	556,554
Amounts due to local banks	150	-
	666,650	556,554

6

	2013 Sh'000	2012 Sh'000
FEES AND COMMISSION INCOME		
Transaction related fees	31,695	28,359
Credit related fees and commissions	10,684	15,198
	42,379	43,557

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

f) Fair value of financial assets and liabilities (Continued)

7. GAIN ON FOREIGN EXCHANGE DEALINGS

Gains on foreign currency dealings arose from trading in foreign currency transactions and also on the translation of foreign currency assets and liabilities.

8. OTHER OPERATING INCOME

	2013 Sh'000	2012 Sh'000
a) Net trading (loss)/income		
Gain arising on financial assets designated at fair value		
Income on treasury bonds trading	11,064	87,344
Fair value (loss)/gains on treasury bonds (note 15)	(29,301)	42,887
	(18,237)	130,231
b) Other operating income		
Bad debts recovered	3,549	2,487
Locker rental income	1,228	905
Other operating income	2,401	6,502
	7,178	9,894

9. OPERATING EXPENSES

	2013 Sh'000	2012 Sh'000
Staff costs (note 10)	74,240	69,363
Contribution to Deposit Protection Fund	7,884	5,596
Depreciation (note 20)	14,978	15,640
Amortisation of intangible assets (note 21)	1,009	2,962
Directors' emoluments	17,522	16,182
Auditors' remuneration	3,110	2,436
Rent and rates	32,389	29,425
Legal and professional fees	8,468	6,768
Insurance	7,842	5,285
Security	6,274	4,772
Telephone and postage	7,374	7,371
Repairs and maintenance	3,840	3,652
Other expenses	43,743	47,718
	228,673	217,170

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

10. STAFF COSTS

	2013 Sh'000	2012 Sh'000
Salaries and allowances	71,789	65,878
Staff training	38	68
Terminal dues	2,071	3,142
NSSF contributions	153	150
Medical expenses	189	125
	74,240	69,363

11. TAXATION

(a) Taxation credit		
Current taxation based on the taxable profit for the period at 30%	-	-
Deferred taxation charge/(credit) (note 22):-		
- current year charge/(credit)	11,158	(20,420)
	11,158	(20,420)

(b) Reconciliation of taxation credit to the expected taxation based on accounting profit		
Accounting profit before taxation	105,816	89,828
Tax at the applicable rate of 30%	31,745	26,948
Effect of expenses disallowed for taxation purposes	22,442	9,473
Effect of income not subject to taxation	(43,029)	(56,841)
	11,158	(20,420)

(c) Taxation recoverable movement		
At 1 January and 31 December	(21,221)	(21,221)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

12 . EARNINGS PER SHARE

Earnings per share are calculated by dividing the profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	2013 Sh'000	2013 Sh'000
Earnings		
Earnings for the year attributable to ordinary shareholders (Sh'000)	94,658	110,248
	=======	=======
Number of shares		
Weighted average number of ordinary shares in issue	1,000,000	1,000,000
	========	========
Earnings per share-Basic (Sh)		
Ordinary shares	94.66	110.25
	======	=======

The diluted earnings per share is the same as the basic earnings per share as there were no potentially dilutive shares as at 31 December 2013 or 31 December 2012.

13. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2013 Sh'000	2012 Sh'000
Cash on hand	67,233	104,538
Balances with Central Bank of Kenya		
- Cash ratio requirement	205,505	167,269
- Deposits held under lien	8,635	8,605
- Current account with CBK	113,087	56,441
	394,460	336,853
	=======	=======

The cash ratio requirement is based on the customer deposits with the bank as adjusted by the Central Bank of Kenya requirements. As at 31 December 2013 the cash reserve ratio requirement was 5.25% (2012: 5.25%) of all customer deposits. The deposits held under lien are to support foreign currency clearing. These funds are not available for the day to day operations of the bank.

14. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	2013 Sh'000	2012 Sh'000
Deposits due from banking institutions	800,000	-
Balances due from banking institutions	324,377	104,502
	1,124,377	104,502
	=======	=======

The weighted average effective interest rate for deposits and balances due from banking institutions at 31 December 2013 was 12.1 % (2012 – 4.67%).

15. GOVERNMENT SECURITIES

(a) Treasury bonds	2013 Sh'000	2012 Sh'000
At fair value through profit or loss - maturing after 3 years	1,259,431	2,073,552
Held to maturity – at amortised cost (maturing within 5 years)	754,329	723,012
Held to maturity – at amortised cost (maturing after 5 years)	768,837	822,445
	2,782,597	3,619,009

(b) Movement in available for sale treasury bonds can be summarised as follows

	2013 Shs'000	2012 Shs'000
At 1 January	2,073,552	-
Additions	51,592	2,030,665
Disposals	(836,412)	-
(Losses)/gains from changes in fair value	(29,301)	42,887
At 31 December	1,259,431	2,073,552

The weighted average effective interest rate for treasury bonds as at 31 December 2013 was 9.00 % (2012 – 6.83%).Included in the above balances are treasury bonds amounting to Sh 70,000,000 (2012 – Sh nil) pledged with local commercial banks as security for letters of credit and guarantee facilities.

16. CORPORATE BONDS

	2013 Sh'000	2012 Sh'000
Held to maturity- at amoritsed cost		
Corporate bonds maturing within 5 years	201,717	208,367
Corporate bonds maturing after 5 years	40,498	78,928
	242,215	287,295

The weighted average effective interest rate on the bonds at 31 December 2013 was 7.00 % (2012 – 7.69%).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

16. CORPORATE BONDS (Continued)

Movement in corporate bonds held to maturity can be summarised as follows:

	2013 Shs'000	2012 Shs'000
At 1 January	287,295	333,436
Redemption	(34,725)	(34,725)
Net amortisation	(10,355)	(11,416)
At 31 December	242,215	287,295

17. ADVANCES TO CUSTOMERS

	2013 Sh'000	2012 Sh'000
Loans and advances to customers	3,427,470	2,884,737
Bills discounted	7,107	7,107
	3,434,577	2,891,844
Provision for impaired loans and advances (note 18)	(162,387)	(152,231)
	3,272,190	2,739,613

The weighted average effective interest rate on advances to customers as at 31 December 2013 was 18% (2012 –21%).

Included in net advances are loans and advances amounting to Sh 170,715,000 (2012 – Sh 168,319,000), net of specific provisions, which have been classified as non-performing.

Advances to related parties are disclosed in note 29.

	2013 Sh'000	2012 Sh'000
Analysis of gross advances by maturity:		
Maturing within one year	2,364,620	1,990,962
Over one year to three years	494,017	415,952
Over three to five years	575,940	484,930
	3,434,577	2,891,844

18. PROVISION FOR IMPAIRED LOANS AND ADVANCES

	2013 Sh'000	2012 Sh'000
At 1 January	152,231	145,015
Provisions in the year	13,705	8,052
Write offs	(3,549)	(836)
At 31 December	162,387	152,231

19. OTHER ASSETS

	2013 Shs'000	2012 Shs'000
Items in course of collection	5,131	10,834
Prepayments	59,604	14,376
Other receivables	53,507	39,028
	118,242	64,238

20. EQUIPMENT

	Computers & office equipment Sh'000	Motor vehicles Sh'000	Furniture, fittings and office renovations Sh'000	Total Sh'000
COST				
At 1 January 2012	55,586	6,147	113,947	175,680
Additions	3,927	-	2,350	6,277
At 31 December 2012	59,513	6,147	116,297	181,957
At 1 January 2013	59,513	6,147	116,297	181,957
Additions	5,922	1,800	8,445	16,167
Disposal	-	(800)	-	(800)
At 31 December 2013	65,435	7,147	124,742	197,324
DEPRECIATION				
At 1 January 2012	40,312	3,815	65,042	109,169
Charge for the year	4,547	1,537	9,556	15,640
At 31 December 2012	44,859	5,352	74,598	124,809
At 1 January 2013	44,859	5,352	74,598	124,809
Charge for the year	5,262	383	9,333	14,978
Disposal	-	(800)	-	(800)
At 31 December 2013	50,121	4,935	83,931	138,987
NET BOOK VALUE				
At 31 December 2013	15,314	2,213	40,811	58,337
At 31 December 2012	14,654	795	41,699	57,148

Included in equipment are assets with a cost of Sh 74,896,453 (2012 - Sh 71,244,000) which were fully depreciated. The notional depreciation charge in respect of these assets for the year is Sh 12,218,713 (2012 – Sh 11,356,000).

21. INTANGIBLE ASSETS COMPUTER SOFTWARE

	2013 Sh'000	2012 Sh'000
COST		
At 1 January	26,572	25,585
Additions	2,722	987
	_______	_______
At 31 December	29,294	26,572
	_______	_______
AMORTISATION		
At 1 January	23,656	20,694
Charge for the year	1,009	2,962
	_______	_______
At 31 December	24,665	23,656
NET BOOK VALUE	_______	_______
At 31 December	4,629	2,916
	======	======

22. DEFERRED TAXATION ASSET

The deferred tax asset, computed at the enacted rate of 30%, is attributable to the following items:	2013 Sh'000	2012 Sh'000
Accelerated capital allowances	2,517	1,986
Leave pay provision	1,179	1,149
Other provisions	-	273
Tax losses	6,912	18,358
	________	________
	10,608	21,766
	=======	=======
The movement on the deferred tax account is as follows:		
As at 1 January	21,766)	1,346
(Charge)/credit for the year – note 11 (a)	(11,158)	20,420
	________	________
At 31 December	10,608	21,766
	=======	=======

As at 31 December 2013, the bank had accumulated tax losses amounting to Sh 23,039,157 (2012:61,163,360) available for set off against future taxable income. Under the Kenyan tax legislation, tax losses can only be carried forward to a maximum of four years.

23. CUSTOMER DEPOSITS

	2013 Sh'000	2012 Sh'000
Current accounts	556,801	519,858
Savings accounts	285,676	207,692
Call deposits	320,878	188,397
Fixed deposits	5,437,162	5,168,338
	6,600,517	6,084,285
Analysis of customer deposits by maturity:		
Payable within 90 days	5,192,497	4,786,387
Payable after 90 days and within one year	468,117	431,505
Payable after one year	939,903	866,393
	6,600,517	6,084,285

The weighted average effective interest rate on interest bearing customer deposits at 31 December 2013 was 10.00 % (2012 – 13.07 %).

Customers deposits from related parties are disclosed in note 29 and concentrations of customer deposits are covered under note 3(a).

24. DEPOSITS AND BALANCES DUE TO BANKING INSTITUTIONS

	2013 Sh'000	2012 Sh'000
Deposits due to banking institutions	135,676	-

The weighted average effective interest rate for deposits and balances due to banking institutions at 31 December 2013 was 5.99 %.

25. OTHER LIABILITIES

	2013 Sh'000	2012 Sh'000
Sundry payables	42,148	20,062
Accruals	16,192	10,629
Leave pay provision	3,929	3,829
	62,269	34,520

26. SHARE CAPITAL

	2013 Sh'000	2012 Sh'000
Authorised, issued and fully paid: 1,000,000 ordinary shares of Sh 1,000 each	1,000,000	1,000,000
	========	========

The movement in share capital is as follows:

	No of shares	Shs'000
At 1 January 2013	1,000,000	865,000
- Bonus issue	-	110,000
- Additional issued shares	-	25,000
At 31 December 2013	1,000,000	1,000,000
	========	========

On 30 March 2012, the shareholders, through a special resolution, approved capitalisation of Sh 110, 000,000 out of revenue reserves of the Bank as at 31 December 2011.

In 2011, the company received Sh 25,000,000 as subscriptions towards new shares. These were allotted in the year 2012.

27. NOTES TO THE STATEMENT OF CASH FLOWS

	2013 Sh'000	2012 Sh'000
(a) Reconciliation of profit before taxation to cash generated from operations		
Profit before taxation	105,816	89,828
Adjustments for:		
Depreciation	14,978	15,640
Amortization of intangible assets	1,009	2,962
Working capital changes :	121,803	108,430
Increase in balances held by Central Bank of Kenya under lien	(30)	(90)
Increase in advances to customers	(532,577)	(672,601)
Decrease/(increase) in treasury bonds	836,412	(2,051,42)
Decrease in corporate bonds	45,080	46,141
Increase in other assets	(54,004)	(18,772)
Increase in customer deposits	516,232	2,410,447
Increase in advances from other local banks	135,676	-
Increase in other liabilities	27,749	6,627
Cash generated from/(used in) operations	1,096,341	(171,239)
	=======	=======

27. NOTES TO THE STATEMENT OF CASH FLOWS (Continued)

	2013 Sh'000	2012 Sh'000
(b) Analysis of balances of cash and cash equivalents as shown in the financial position and notes		
Cash on hand	67,233	104,538
Deposits and balances due from banking institutions	1,124,377	104,502
Current account with Central Bank of Kenya	318,592	223,710
	1,510,202	432,750

28. CONTINGENCIES AND COMMITMENTS INCLUDING OFF FINANCIAL POSITION ITEMS

	2013 Sh'000	2012 Sh'000
(a) Contingent liabilities		
Letters of credit	102,516	68,900
Letters of guarantee and performance bonds	100,797	122,793
Bills for collection	32,805	44,149
	236,118	235,842

Letters of credit are commitments by the bank to make payments to third parties, on production of documents, on behalf of customers and are reimbursed by customers.

Letters of guarantee and performance bonds are issued by the bank, on behalf of customers, to guarantee performance by customers to third parties. The bank will only be required to meet these obligations in the event of default by the customers.

Contingent liabilities arising from law suits as at 31 December 2013 amounted to Sh 36,814,592 (2012- Sh 59,374,805)

(b) The bank had capital commitments of Sh 15,853,487 as at 31 December 2013 (2012 – Sh nil).

(c) Commitments to extend credit

Commitments to lend are agreements to lend to a customer in future subject to certain conditions. Such commitments are normally made for a fixed period. The bank may withdraw without incurring any charges from its contractual obligation to extend credit by giving reasonable notice to the customer.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28. CONTINGENCIES AND COMMITMENTS INCLUDING OFF FINANCIAL POSITION ITEMS (Continued)

(d) Operating lease arrangements

The bank as a lessee

At the financial position date, the bank had outstanding commitments under operating leases which fall due as follows:

	2013 Sh'000	2012 Sh'000
Within one year	25,084	30,472
In the second to fifth year inclusive	32,608	53,234
	57,692	83,706

29. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

Placings are made in the bank by directors, their associates and companies associated to directors. Advances to customers at 31 December 2013 include advances and loans to companies associated to directors employees of the bank. Contingent liabilities at 31 December 2013 include guarantees and letters of credit for companies associated to directors.

	Directors' associated companies		Employees/staff	
Movement in related party balances was as follows:	2013 Sh'000	2012 Sh'000	2013 Sh'000	2012 Sh'000
Loans and advances:				
At 1 January	262,183	141,133	14,442	16,767
Net movement during the year	62,909	121,050	8,352	(2,325)
At 31 December	325,092	262,183	22,794	14,442
Interest earned	58,517	47,193	3647	2,311
Deposits:				
At 1 January	301,976	174,930	11,827	23,737
Net movement during the year	10,790	127,046	(2,018)	(11,910)
At 31 December	312,766	301,976	9,809	11,827
Interest paid	31,277	48,316	981	1,892

29. RELATED PARTY TRANSACTIONS (Continued)

	2013	2012
	Sh'000	Sh'000
Guarantees and letters of credit to companies associated to directors	60,098	12,112
	======	======

Key management compensation

The remuneration of directors and other members of key management during the year were as follows:

	2013 Sh'000	2012 Sh'000
Key management salaries and other benefits	31,805	30,931
	=======	=======
Directors emoluments	17,522	16,182
	=======	=======

The remuneration of directors and key executives is determined by the board of directors having regard to the performance of the individuals and market trends.

30. FAIR VALUE

The directors consider that there is no material difference between the fair value and carrying value of the company's financial assets and liabilities where fair value details have not been presented.

31. FIDUCIARY ACTIVITIES

At 31 December 2013, the bank did not hold asset security documents on behalf of customers (2012: none).

32. COUNTRY OF INCORPORATION

The company is incorporated in Kenya under the Companies Act and domiciled in Kenya.

33. CURRENCY

The financial statements are presented in Kenya Shillings thousands (Sh'000).

34. EVENTS AFTER REPORTING PERIOD

There are no significant events after the reporting period which has been reported in these financial statements.