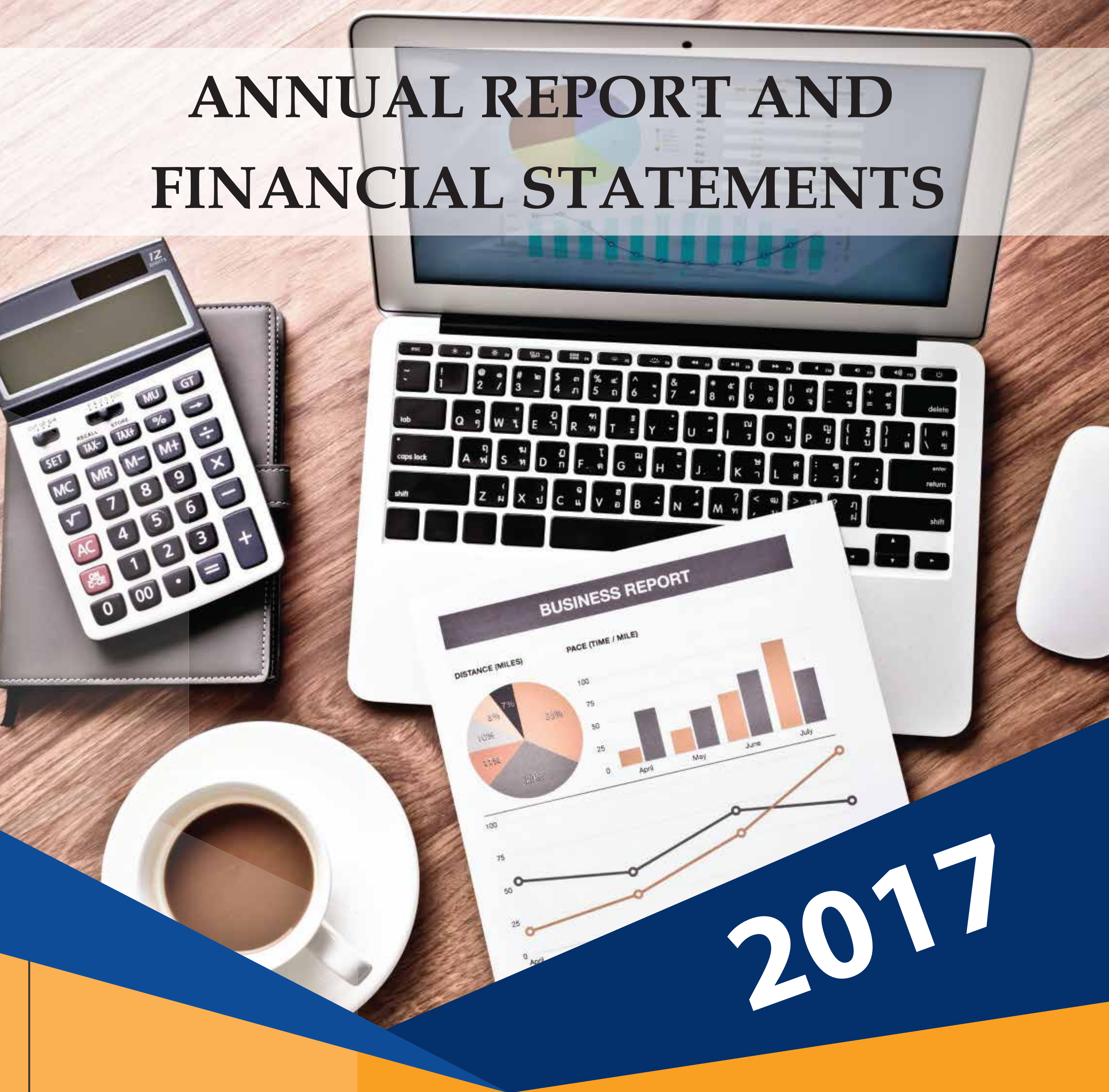
ANNUAL REPORT AND FINANCIAL STATEMENTS



2017

PARAMOUNT BANK

Enabling you to reach your peak

Contents

BRANCH NETWORK

HEAD OFFICE Sound Plaza, 4th Floor, Woodvale Grove, Westlands P.O. Box 14001 - 00800, Nairobi-Kenya Email: info@paramountbank.co.ke	Telephone: (+254)20 4449266 / 7 / 8 0709 935 000 / 0723 564 254 0734 258 020 / 0735 445 506 0735 445 507 Priority Line : 0709 935 000
Card Centre (24 hours Customer Service) Email: cardcentre@paramountbank.co.ke	Telephone: (+254)20 4444751
WESTLANDS BRANCH Sound Plaza, 4th Floor, Woodvale Grove, Westlands P.O. Box 14001 - 00800, Nairobi-Kenya Email: westlandsbranch@paramountbank.co.ke	Telephone: (+254)20 4449266 / (+254)20 4449268 Wireless: 020 2597793 Additional Line: 0723 564 254 / 0734 258 020 / 0735 445 506 / 0735 445 507 Priority Line : 0709 935 000
PARKLANDS BRANCH Diamond Plaza, New Wing-Ground Floor, Masari Road, Highridge P.O. Box 13677 - 00800, Nairobi-Kenya Email: parklandsbranch@paramountbank.co.ke	Telephone: (+254)20 3753484 / Additional Line: 0733 600 119 / 0724 255 325 Priority Line : 0709 935 000
KOINANGE BRANCH Cianda House, Ground Floor, Koinange Street P.O. Box 42363 - 00100, Nairobi-Kenya Email: koinangebranch@paramountbank.co.ke	Telephone: (+254)20 2215468 / Additional Line: 0732 445 508 / 0732 445 590 Priority Line : 0709 935 000
MOMBASA BRANCH Jubilee Building, Ground Floor, Moi Avenue, City Centre P.O. Box 88775 - 80100, Mombasa-Kenya Email: msabranch@paramountbank.co.ke	Telephone: (+254)41 2319635 / (+254)41 2319636 (+254)41 2319637 Additional Line: 0738 998 976 / 0728 606 652 Priority Line : 0709 935 000
ELDORET BRANCH Karims, Ground Floor - Oloo Street, P.O. Box 4362 - 30100, Eldoret-Kenya Email: eldbranch@paramountbank.co.ke	Telephone: 0704 385 731 / 0736 445 507 / 0738 445 507 Priority Line : 0709 935 000
INDUSTRIAL AREA BRANCH Ambaji House – Ground Floor, Dar es Salam Rd P.O Box 14001 - 00800 Nairobi, Kenya. Email: industrialarea@paramountbank.co.ke	Telephone: (+254)723 564254 / (+254)734 258020 / (+254)735 445506 (+254)735 445507 Priority Line : 0709 935 000
KISUMU BRANCH Tuffoam Mall P.O. Box 3788 - 40100, Kisumu-Kenya Email: kisumubranch@paramountbank.co.ke	Telephone: 0709 935 000 (+254)20 4449266 / 7 / 8 Priority Line : 0709 935 000

Bank to Bank Transfer

Pesa Link

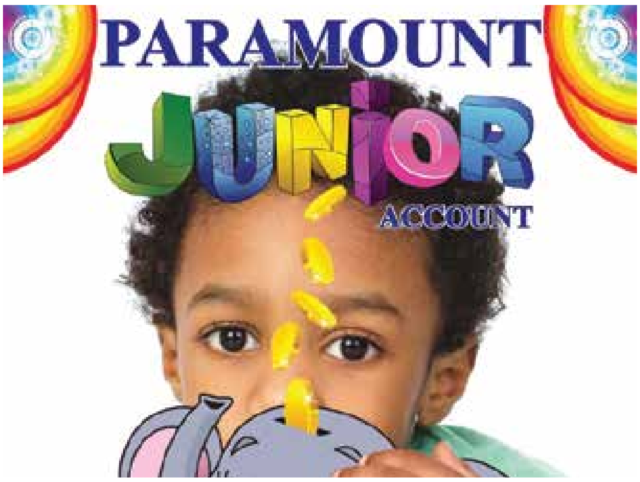
Easy . Affordable . Instant .

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

Parabank
Insurance Agency

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

Credit Card with Chip + Pin



CORPORATE INFORMATION

DIRECTORS	Anwarali Padany - Chairman Ayaz Merali - Chief Executive Officer (CEO) Noorez Padamshi Muhammad Mujtaba Mercy Kamau Eunice Wamaitha
AUDIT COMMITTEE	Eunice Wamaitha - Chairlady Noorez Padamshi Mercy Kamau Henry Onkunya Deluxe Atanga
CREDIT COMMITTEE	Mercy Kamau - Chairlady Eunice Wamaitha Anwarali Padany Ayaz Merali Muhammad Mujtaba Michael Riitho Kapil Deo Sharma
ASSET LIABILITY COMMITTEE	Ayaz Merali - Chairman Nicholas Odera Muhammad Mujtaba Fred Maina Kapil Deo Sharma
RISK MANAGEMENT COMMITTEE	Eunice Wamaitha - Chairlady Anwarali Padany Noorez Padamshi Stanley Ngaruiya Ndungu
BOARD NOMINATIONS AND REMUNERATION COMMITTEE	Anwarali Padany - Chairman Noorez Padamshi Eunice Wamaitha
COMPANY SECRETARY	Winniefred Nyagoha Jumba Certified Public Secretary (Kenya) 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

Standard Bank of South Africa, Johannesburg
HDFC Bank, India
BMCE, Spain

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 submit their report together with the audited financial statements for the year ended 31 December 2017, in accordance with Section 653(1) of the Kenyan Companies Act, 2015, which discloses the state of affairs of Paramount Bank Limited (the "Group and the Bank").

INCORPORATION

The bank and its subsidiary, Parabank Insurance Agency Limited, are both incorporated in the Republic of Kenya under the Companies Act, 2015, and are domiciled in Kenya.

ACTIVITIES

The principal activity of the bank, which is licensed under the Banking Act, is the provision of banking, financial and related services. The principal activity of the subsidiary is to provide bank assurance services through insurance agency services.

GROUP RESULTS

The following is the summary of the results for the year ended 31 December 2017:

	Group		Bank	
	2017	2016	2017	2016
	Sh'000	Sh'000	Sh'000	Sh'000
Profit before taxation	96,508	104,882	95,965	104,666
Taxation	20,991	1,557	21,154	1,622
Profit for the year	177,499	106,439	177,119	106,288

BUSINESS REVIEW

The Bank

Paramount Bank Ltd began operations under the name Combined Finance Ltd in 1993. Their paid up capital was KES 25m and the services offered were general deposits and minor personal lending. Over the years it has grown into a fully-fledged bank offering almost all services that are offered in the banking industry today. It has seven branch spread across major towns in the country. For more information on the bank please refer to the bank's website www.paramount-bank.co.ke.

External Environment

The external environment remained challenging with a slowdown in agricultural activity following the drought, tighter credit conditions following the interest rate caps, and political uncertainty on the back of two disputed elections have contributed to a difficult year for Kenya, with the country scaling down internal growth forecasts. GDP growth was expected to reach 5% in 2017, down from 5.8% in 2016. We expect some recovery in first half of 2018.

The Bank's Performance

Given the unfavourable economic conditions the bank has been stable and has done fairly well. There has been a 26% improvement in Net Interest Income from Sh 263M in the previous year to Sh 373m in the current year indicating an improvement in operating margins. Other operating income in the current year declined to a third of what it was in the previous year i.e from Sh 114 million in the year 2016 to Sh 35 million in the current year mainly as a result of reduced income from trade in government securities. The overall effect is a 9% drop in profit before tax from Sh 104million to Sh 96million.

REPORT OF THE DIRECTORS (Continued)

On the Balance Sheet there was a 2% increase in Loans and Advances from Sh 5.8billion to Sh 5.9billion as compared to the previous year following the bank's decision to go slow on its lending as a result of the interest rate capping law and the prevailing economic environment. Deposits growth was at 1% from Sh 7.6billion to Sh 7.7 billion as compared to the previous year. The overall growth in total assets was flat in the year. The bank's operating statutory ratios like core capital ratio, total capital ratio and Liquidity ratio all remain strong and well above the statutory minimum.

Looking ahead

The outlook for 2018 is favourable with an expected improvement in economic conditions. However some challenges could be presented by the implementation of The International Financial Reporting Standards 9 (IFRS9) which took effect on January 1. The most fundamental change is recognition of credit risk losses. Previously, financial institutions would recognise a credit loss at the point of default. They will be expected to recognise this at the beginning and during the loan's life cycle and make the necessary provisions in the books. However, the bank has already assessed the likely impact of this standard on its books and operations and is well-placed to counter any challenges that may emanate as a result.

DIVIDENDS

The directors do not recommend the payment of a dividend in respect of the year ended 31 December 2017 (2016: Sh Nil).

DIRECTORS

The present members of the Board of Directors are shown on page 4.

DIRECTORS' STATEMENT AS TO INFORMATION GIVEN TO AUDITORS

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Group's auditors are unaware; and
- the Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

AUDITORS

Deloitte & Touche, having expressed their willingness, continue in office in accordance provisions of section 719 (2) of the Kenyan Companies Act, 2015, and subject to approval by the Central Bank of Kenya in accordance with Section 24 of the Banking Act. The Directors monitor the effectiveness, objectivity and independence of the auditor. The Directors also approve the annual audit engagement contract, which sets out the terms of the auditor's appointment and the related fees.

BY ORDER OF THE BOARD

Secretary

31.03.2018 Nairobi

PARAMOUNT BANK LIMITED
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 Group's overall internal control over financial, operational and compliance issues. Details of attendance for each member of board are as below.

Directors	No. of meetings attended 2017
Anwarali Padany - (Chairman)	4
Ayaz Merali - Chief Executive Officer (CEO)	4
Noorez Padamshi	4
Muhammed Mujtaba	4
Mercy Kamau	4
Eunice Wamaitha	4

Directors' remuneration

Two executive directors are paid a monthly salary and are eligible for pension scheme membership. The other two non-executive directors are paid sitting allowance for Board meetings and Board sub-committee meetings. Directors emoluments are shown in note 30.

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

The board has constituted Nominations and Remuneration Committee.The committee deals 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 is also responsible for overseeing the compensation system in place on behalf of the Board of Directors.

Statement on risk management

The Bank 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 that are commensurate 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.

Compliance

The Bank operates within the requirements of the Banking Act, among other Acts, and adopts certain universally accepted principles in the areas of human rights, labour standards and environment in its commitment to best practice. Additionally, the Group prepares its financial statements in accordance with International Financial Reporting Standards (IFRS).

-- --

Director **Director**

31st March 2018

CHAIRMAN'S REPORT FOR YEAR 2017

On behalf of the Board of Directors of Paramount Bank, I would like to present to you the Audited Financial results for the year 2017.

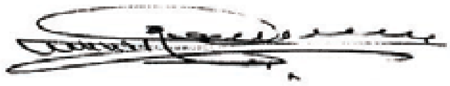
The business environment was greatly impacted by the prolonged electioneering period that took the better part of the second half of 2017. The prevailing uncertainty in the political situation of the country had profound effects on economic activities across the board. The country's GDP dropped from 5.8% in 2016 to around 5% in 2017. Such a trend is of concern to all citizens but more so to the banking industry. Low economic growth together with political uncertainty is usually a recipe for an extremely fluid and challenging operating environment. The risk of loan portfolios becoming non-performing increases and banks have to be vigilant to ensure that the situation is well managed. It is against such operating environment that the Board presents these results.

The difficult operating environmentnotwithstanding, the bank's performance was reasonable and in line with the expectations for the year. Profit after taxes grew from 108 million in 2016 to 117 million in 2017. Earnings per Share (EPS) also went up from 106.40 shillings to 117.50 shillings indicating constant growth in shareholder wealth. Net interest income also increased by 26% to 373 million compared to 296 million in 2016. This was commendable given that total assets only grew by 1% and customer deposits by 1.5% during the year. This was a year that the bank adopted a cautious approach in terms of balance sheet growth. Consolidation of the balance sheet and risk mitigation measures were of the utmost priority. The bank's liquidity remains very healthy and robust giving the bank's management the flexibility and capacity to take advantage of emerging new opportunities.

The current year of 2018 promises to be a much favorable one given that the political tension has reduced and the business environment has returned to normalcy. We anticipate good fortunes for the bank this year. The bank was once again recognized in the now well known Think Business Banking awards. We believe that this was only possible through the collaborative of all our stakeholders. As a bank, we shall continue to enhance our value propositions to all our customers to ensure that our products meet their expectations. This is the path of growth we shall follow in 2018.

CHAIRMAN'S REPORT FOR YEAR 2017 (Continued)

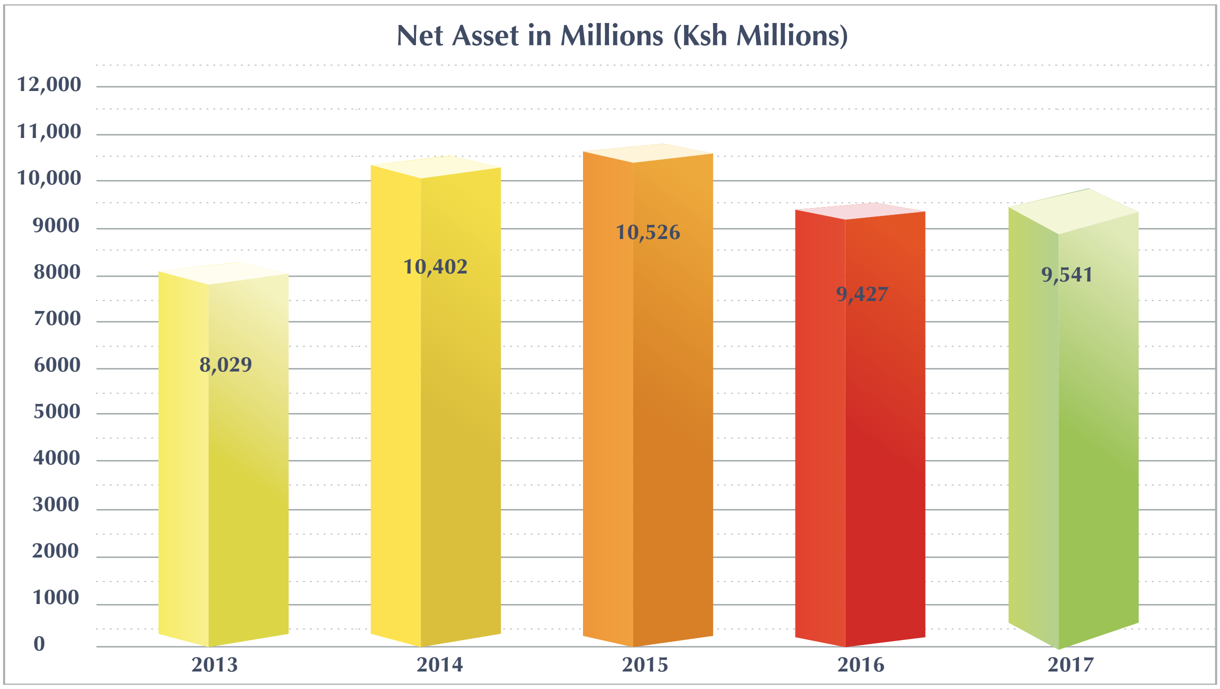
Thank you.

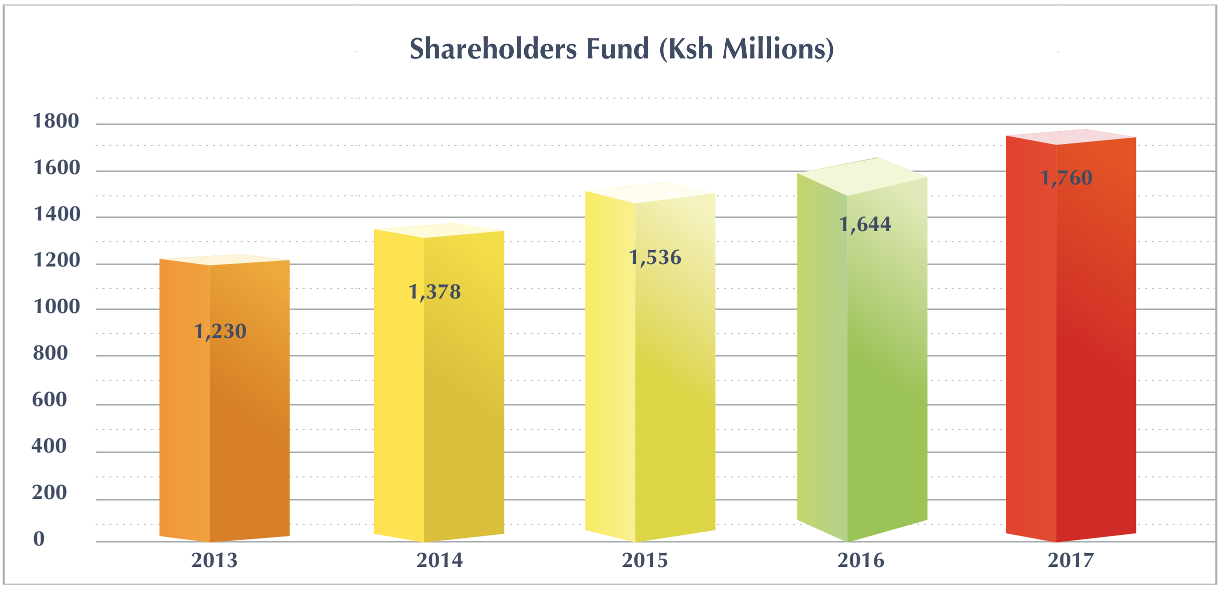


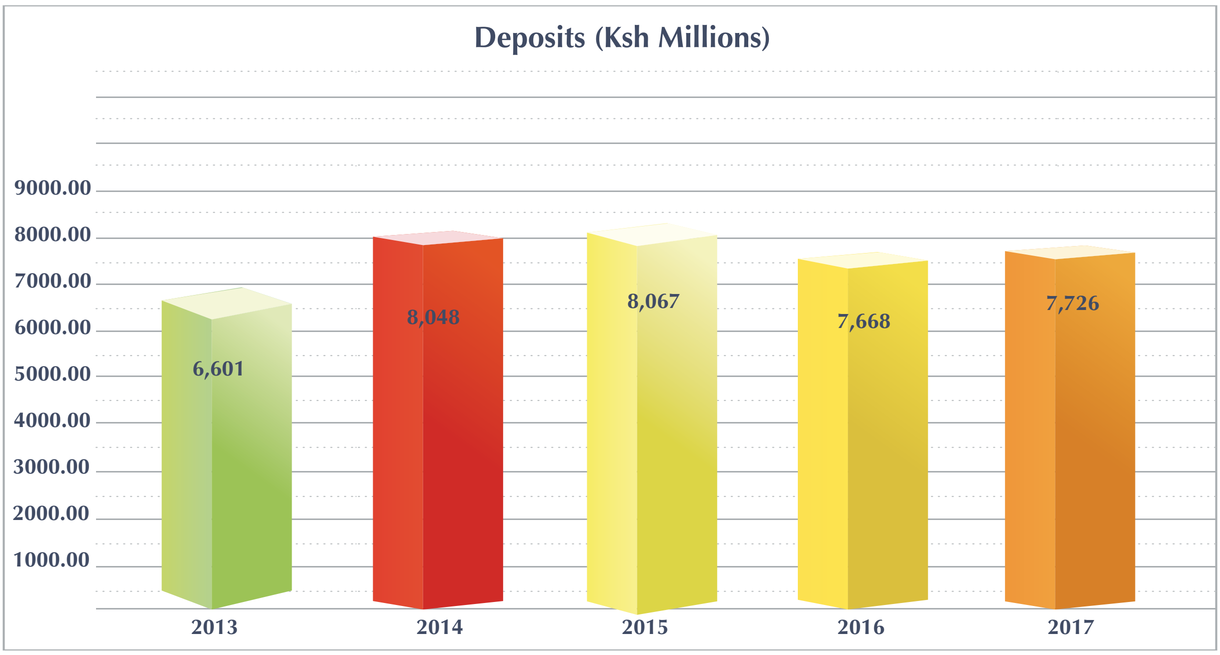
Anwarali Padany.

Chairman.

GRAPHIC REPORT

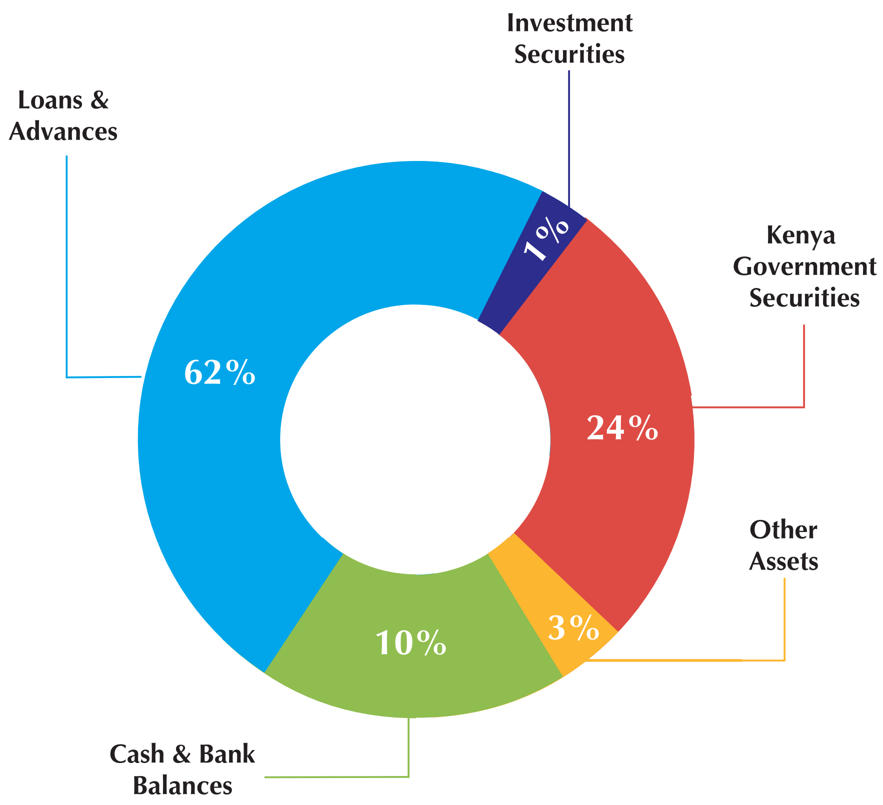




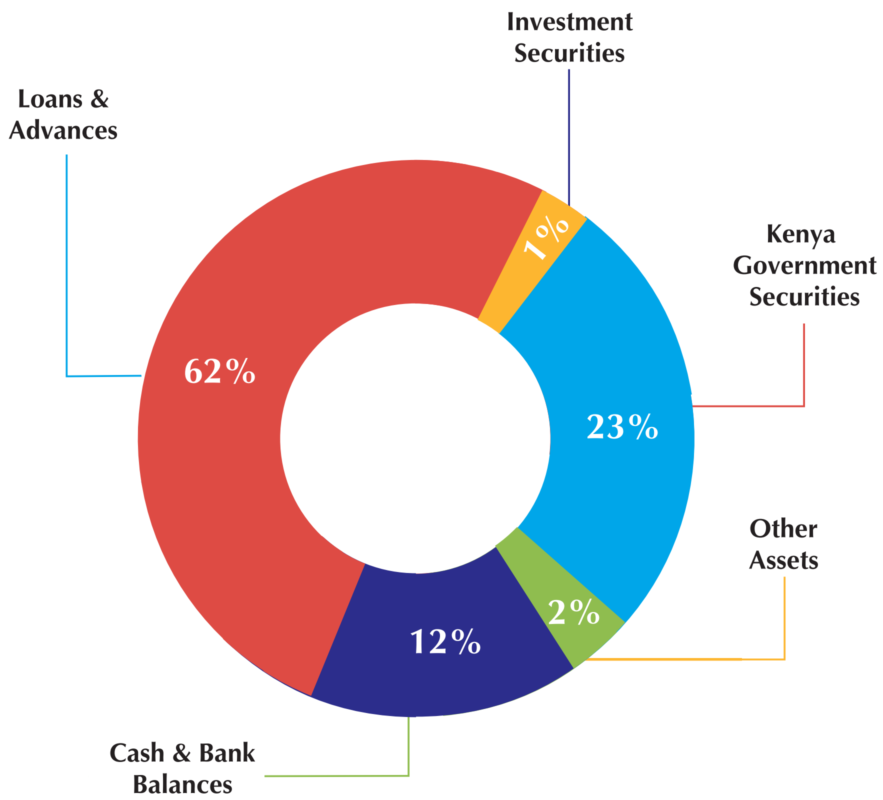


GRAPHIC REPORT

% Assets Distribution 2016



% Assets Distribution 2017



STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the bank and its subsidiary as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the bank and its subsidiary maintains proper accounting records that are sufficient to show and explain the transactions of the Group and disclose, with reasonable accuracy, the financial position of the Group. The directors are also responsible for safeguarding the assets of the bank and its subsidiary, and for taking reasonable steps for the prevention and detection of fraud and error.

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

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

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

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

Approved by the board of directors on 31st March 2018 and signed on its behalf by

--- ---

Director **Director**

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

Tel: +254 (20) 423 0000 I +254 (0) 719 039 000

Dropping Zone No. 92
Email: admin@deloitte.co.ke
www.deloitte.com

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PARAMOUNT BANK LIMITED

Report on the financial statements

Opinion

We have audited the accompanying financial statements of Paramount Bank Limited (the "Bank") and its subsidiary (together the "Group") set out on pages 17 to 69, which comprise the consolidated and bank statements of financial position as at 31 December 2017, and the consolidated and bank statements of profit or loss and other comprehensive income, the consolidated and bank statements of changes in equity and the consolidated and bank statements of cash flows for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies.

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

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISA"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), together with the ethical requirements that are relevant to our audit of the financial statements in Kenya. We have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion

Other information

The directors are responsible for the other information, which comprises the information included in the report of directors, the statement of corporate governance, the chairman's report and the graphic report. The other information does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities Of The Directors 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, the requirements of the Kenyan Companies Act, the Banking Act and for such internal controls as directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern. Refer to the going concern uncertainty included under key audit matters.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entity or business activities within the Group to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain responsible for our audit opinion

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters.

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

In our opinion the information given in the Report of the Directors on pages 5 to 6 is consistent with the financial statements.

The engagement partner responsible for the audit resulting in this independent auditor's report is **CPA Charles Munkonge Luo - P/No 2294.**

Deloitte & Touche

Certified Public Accountants (Kenya)
31 March 2018

CONSOLIDATED AND BANK STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2017

		Group		Bank	
		2017	2016	2017	2016
	Note	Sh'000	Sh'000	Sh'000	Sh'000
INTEREST INCOME	4	1,016,207	1,182,008	1,016,207	1,182,008
INTEREST EXPENSE	5	(643,239)	(886,321)	(643,239)	(886,321)
NET INTEREST INCOME		372,968	295,687	372,968	295,687
Fees and commission income	6	54,705	58,737	51,313	55,787
Gains on foreign exchange dealings	7	10,260	12,222	10,260	12,222
Other operating income	8	35,985	114,625	35,985	114,625
OPERATING INCOME		473,918	481,271	470,526	478,321
Operating expenses	9	(329,300)	(316,056)	(326,451)	(313,322)
Impairment losses on loans and advances	18	(48,110)	(60,333)	(48,110)	(60,333)
PROFIT BEFORE TAXATION		96,508	104,882	95,965	104,666
TAXATION CHARGE	11(a)	20,991	1,557	21,154	1,622
PROFIT FOR THE YEAR		117,499	106,439	117,119	106,288
OTHER COMPREHENSIVE INCOME					
Fair value loss on available for sale treasury bonds		-	(108)	-	(108)
Fair value gain on available for sale infrastructure bonds		-	1,744	-	1,744
		-	1,636	-	1,636
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	15(d)	117,499	108,075	117,119	107,924
		Sh	Sh	Sh	Sh
EARNINGS PER SHARE – Basic and diluted	12	117.50	106.44	117.11	106.29

CONSOLIDATED AND BANK STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2017

		Group		Bank	
		2017	2016	2017	2016
	Note	Sh'000	Sh'000	Sh'000	Sh'000
ASSETS					
Cash and balances with Central Bank of Kenya	13	1,065,129	758,326	1,065,129	758,326
Deposits and balances due from banking institutions	14	121,721	215,173	121,721	215,173
Government securities	15	2,167,646	2,304,319	2,167,646	2,304,319
Corporate bonds	16	74,681	114,445	74,681	114,445
Advances to customers (net)	17	5,902,032	5,799,544	5,902,032	5,799,544
Other assets	19	95,848	126,325	95,302	124,676
Corporate tax recoverable	11(c)	17,645	17,453	17,418	17,418
Equipment	20	57,572	71,776	57,572	71,776
Intangible assets	21	11,277	13,963	11,217	13,874
Deferred taxation asset	22	27,535	6,517	27,534	6,380
Investment in subsidiary	23	-	-	1,000	1,000
TOTAL ASSETS		9,541,086	9,427,841	9,541,252	9,426,931
LIABILITIES					
Customer deposits	24	7,725,963	7,665,713	7,729,302	7,667,902
Deposits and balances due to banking institutions	25	-	51,334	-	51,334
Other liabilities	26	55,370	66,904	52,258	63,486
TOTAL LIABILITIES		7,781,333	7,783,951	7,781,560	7,782,722
SHAREHOLDERS' FUNDS					
Share capital	27	1,000,000	1,000,000	1,000,000	1,000,000
Retained earnings		689,159	559,770	689,098	560,089
Statutory reserve		70,594	82,484	70,594	82,484
Fair value reserve		-	1,636	-	1,636
TOTAL SHAREHOLDERS' FUNDS		1,759,753	1,643,890	1,759,692	1,644,209
TOTAL SHAREHOLDERS' FUNDS AND LIABILITIES		9,541,086	9,427,841	9,541,252	9,426,931

The financial statements on pages 17 to 69 were approved and authorised for issue by the board of directors on 31st March 2018 and were signed on its behalf by:

______________________________ Director

______________________________ Director

______________________________ Chief Executive Officer

______________________________ Company Secretary

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017

	Share capital Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Fair value reserve Sh'000	Total Sh'000
At 1 January 2016	1,000,000	454,118	81,697	-	1,535,815
Total comprehensive income for the year	-	106,439	-	-	106,439
Other comprehensive income	-	-	-	1,636	1,636
Transfer to statutory reserve	-	(787)	787	-	-
At 31 December 2016	1,000,000	559,770	82,484	1,636	1,643,890
At 1 January 2017	1,000,000	559,770	82,484	1,636	1,643,890
Total comprehensive income for the year	-	117,499	-	-	117,499
Other comprehensive income	-	-	-	(1,636)	(1,636)
Transfer to statutory reserve	-	(11,890)	(11,890)	-	-
At 31 December 2017	1,000,000	689,159	70,594	-	1,759,753

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 as per the Central Bank of Kenya prudential guidelines over impairment of loans and receivables computed as per IAS 39. The statutory reserve is not distributable.

Retained earnings relates to the cumulative earnings from operations and is distributable.

BANK STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017

	Share capital Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Fair value reserve Sh'000	Total Sh'000
At 1 January 2016	1,000,000	454,588	81,697	-	1,536,285
Total comprehensive income for the year	-	106,288	-	-	106,288
Other comprehensive income	-	-	-	1,636	1,636
Transfer to statutory reserve	-	(787)	787	-	-
At 31 December 2016	1,000,000	560,089	82,484	1,636	1,644,209
At 1 January 2017	1,000,000	560,089	82,484	1,636	1,644,209
Total comprehensive income for the year	-	117,119	-	-	117,119
Other comprehensive income	-	-	-	(1,636)	(1,636)
Transfer to statutory reserve	-	11,890	(11,890)	-	-
At 31 December 2017	1,000,000	689,098	70,594	-	1,759,692

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 rep resents the excess of loans provisions as computed as per the Central Bank of Kenya prudential guidelines over impairment of loans and receivables computed as per IAS 39. The statutory reserve is not distributable.

Retained earnings relates to the cumulative earnings from operations and is distributable.

CONSOLIDATED BANK STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017

		Group		Bank	
		2017	2016	2017	2016
	Note	Sh'000	Sh'000	Sh'000	Sh'000
CASH FLOWS FROM OPERATING ACTIVITIES					
Cash used in operations	28(a)	218,938	(398,639)	218,719	(398,639)
Tax paid during the year	11(c)	(219)	(14,223)	-	(14,223)
		218,719	(412,862)	218,719	(412,862)
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of equipment	20	(5,049)	(16,555)	(5,049)	(16,555)
Purchase of intangible assets	21	(814)	(10,827)	(814)	(10,827)
Proceeds from sale of Motor vehicle		405	-	405	
Net cash used in investing activities		(5,458)	(27,382)	(5,458)	(27,382)
INCREASE IN CASH AND CASH EQUIVALENTS		213,261	(440,244)	213,261	(440,244)
CASH AND CASH EQUIVALENTS AT 1 JANUARY		963,259	1,403,503	963,259	1,403,503
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	28(b)	1,176,520	963,259	1,176,520	963,259

PARAMOUNT BANK LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31ST DECEMBER 2016

1. ACCOUNTING POLICIES

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), the Kenyan Companies Act, 2015 and the Banking Act.

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.

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

i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2017

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.

IAS 7 Disclosure Initiative	The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both cash and non-cash changes. The amendments apply prospectively. Entities are not required to present comparative information for earlier periods when they first apply the amendments.
IAS 12 Recognition of Deferred Tax Assets for Unrealized Losses	The amendments clarify the following: 1. Unrealised losses on a debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference, irrespective of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use, or whether it is probable that the issuer will pay all the contractual cash flows; 2. When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, and the tax law restricts the utilisation of losses to deduction against income of a specific type (e.g. capital losses can only be set off against capital gains), an entity assesses a deductible temporary difference in combination with other deductible temporary differences of that type, but separately from other types of deductible temporary differences. 3. The estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and 4. In evaluating whether sufficient future taxable profits are available, an entity should compare the deductible temporary differences with future taxable profits excluding tax deductions resulting from the reversal of those deductible temporary differences. The amendments apply retrospectively.

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

ii) Relevant new standards and amendments to published standards effective for the year ended 31 december 2017

New and Amendments to standards	Effective for annual periods beginning on or after
IFRS 9 Financial Instruments	1 January 2018, with earlier application permitted
IFRS 15 Revenue from contracts with customers	1 January 2018, with earlier application permitted only if IFRS 16 is also adopted
IFRS 16 Leases	1 January 2019, with earlier application permitted
Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions	1 January 2018, with earlier application permitted
Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Effective for annual periods beginning on or after a date to be determined
Amendments to IAS 40 Transfers of Investment Property	1 January 2018, with earlier application permitted
IFRIC 22 Foreign Currency Transactions and Advance Consideration	1 January 2018, with earlier application permitted
Annual Improvements to IFRS Standards 2014-2016 Cycle	Effective for annual periods beginning on or after 1 January 2018

(iii) Impact of relevant new and amended standards in issue but not yet effective in the year ended 31 December 2017.

IFRS 9 Financial Instruments

In July 2015, the IASB finalised the reform of financial instruments accounting and issued IFRS 9 (as revised in 2015), which contains the requirements for:

a) the classification and measurement of financial assets and financial liabilities;
b) impairment methodology; and
c) general hedge accounting.

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

(iii) Impact of relevant new and amended standards in issue but not yet effective in the year ended 31 December 2017 (continued).

Key requirements of IFRS 9:

Classification and measurement. Financial assets are classified by reference to the business model within which they are held and their contractual cash flow characteristics. The 2015 version of IFRS 9 introduces a 'fair value through other comprehensive income' category for certain debt instruments. Financial liabilities are classified in a similar manner to under IAS 39, however there are differences in the requirements applying to the measurement of an entity's own credit risk.

Impairment. The 2015 version of IFRS 9 introduces an 'expected credit loss' model for the measurement of the impairment of financial assets, so it is no longer necessary for a loss event to have occurred before a credit loss is recognised

Hedge accounting. Introduces a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

De-recognition. The requirements for de-recognition of the financial assets and liabilities are carried forward from IAS 39.

IFRS 9 replaces the incurred loss model under IAS 39 with a forward looking expected loss model and requires a loss allowance to be recognised at an amount equal to either 12 months expected loss (ECL) or lifetime ECL. Life time ECLs are the ECLs that result from all possible default events over the expected life of a financial instruments whereas 12 months ECLs are the portion of ECLs that result from default events that are possible within the 12 months after reporting date. The bank will recognize 12 months ECLs for all financial assets for which credit risk has not significantly increased and lifetime ECLs for financial assets whose credit risk has significantly increased since initial recognition. The key input in measurement of ECLs are Probability of default, loss given default (LGD) and exposure at default (EAD). PD estimates at a certain date will be calculated based statistical models based on internally compiled data comprising both quantitative and qualitative factors. LGD is the magnitude of likely loss if there is a default and will be estimated based on historical recovery rates against defaulted counterparties. The LGD will consider the structure, collateral, counterparty industry and recovery costs of any collateral as well as loan to value ratio. The EAD represents the expected exposure at the time of default. The bank will derive EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortisation and prepayments. For lending commitments and financial guarantees, the EAD will be based on amount drawn as well the potential future amount that may be drawn or repaid under the contract based on historical conversation ratios and forward looking forecasts.

The directors of the Group are assessing the impact of the application of IFRS 9. It is not practical to provide a reasonable estimate to this effect until a detailed review has been completed.

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

(iii) Impact of relevant new and amended standards in issue but not yet effective in the year ended 31 December 2017 (continued).

IFRS 15 Revenue from Contracts with Customers:

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related Interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when ‘control’ of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

In April 2017, the IASB issued Clarifications to IFRS 15 in relation to the identification of performance obligations, principal versus agent considerations, as well as licensing application guidance.

The Directors have assessed the impact of the application of IFRS 15 on the Bank’s financial statements and concluded that the impact is not significant. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

IFRS 16 Leases

IFRS 16 specifies how an entity will recognise, measure, present and disclose leases. The standard provides a single lease accounting model, requiring lesses to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance lease, with IFRS 16, approach to lessor accounting unchanged from its predecessor, IAS 17.

IFRS 16 applies to annual reporting periods beginning on or after 1 January 2019. The Directors anticipate that the adoption of IFRS 16 will not have a significant impact on the Group and Bank’s financial statements.

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

(iii) Impact of relevant new and amended standards in issue but not yet effective in the year ended 31 December 2017 (continued).

Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Continued)

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted. The Directors of the Company do not anticipate that the application of the amendments in the future will have a significant impact on the financial statements. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

Amendments to IAS 40 Transfers of Investment Property

The amendments clarify that a transfer to, or from, investment property necessitates an assessment of whether a property meets, or has ceased to meet, the definition of investment property, supported by observable evidence that a change in use has occurred.

The amendments further clarify that the situations listed in IAS 40 are not exhaustive and that a change in use is possible for properties under construction (i.e. a change in use is not limited to completed properties).

The amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The Directors of the Company do not anticipate that the application of the amendments in the future will have a significant impact on the financial statements. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

IFRIC 22 Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

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

(iii) Impact of relevant new and amended standards in issue but not yet effective in the year ended 31 December 2017 (continued).

IFRIC 22 Foreign Currency Transactions and Advance Consideration (Continued)

The Interpretation specifies that the date of transaction is the date on which the entity initially recognises the non-monetary asset or non- monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration.

The Interpretation is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The Directors of the Comapny do not anticipate that the application of these amendments will have a material impact on the financial statements. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

Annual Improvements to IFRSs 2014 – 2016 Cycle

The Annual Improvements to IFRSs 2014 – 2016 Cycle include a number of amendments to various IFRSs, which are summarised below:

The amendments to IFRS 1 deletes certain short-term exemptions because the reporting period to which the exemptions applied have already passed. As such, these exemptions are no longer applicable. The Directors of the Company do not anticipate that the application of these amendments will have any impact on the financial statements.

The amendments to IAS 28 clarify that the option for a venture capital organisation and other similar entities to measure investments in associates and joint ventures at FVTPL is available separately for each associate or joint venture, and that election should be made at initial recognition of the associate or joint venture.

In respect of the option for an entity that is not an investment entity (IE) to retain the fair value measurement applied by its associates and joint ventures that are IEs when applying the equity method, the amendments make a similar clarification that this choice is available for each IE associate or IE joint venture.
The amendments apply retrospectively with earlier application permitted. The Directors of the Company do not anticipate that the application of these amendments will have a material impact on the financial statements. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

(iv) Early adoption of standards

The Group and Bank did not early-adopt any new or amended standards in 2017.

The principal accounting policies applied in the preparation of the financial statements are set out below. These policies have been applied consistently.

1. ACCOUNTING POLICIES (Continued)

Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis except for certain properties and financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which is described as follows:-

- Level 1 inputs are quoted in prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement dated.

- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly, and

- Level 3 inputs are unobservable inputs for the asset or liability.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Group and entities controlled by the Bank and its subsidiaries. Control is achieved when the Bank:

- has power over the investee
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns

The Group considers all relevant facts and circumstances in assessing whether or not the company's voting rights in an investee are sufficient to give it power over the investee, including:

- the size of the Group's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Group, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Group has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholder's meetings.

1. ACCOUNTING POLICIES (Continued)

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.

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%

=====

1. ACCOUNTING POLICIES (Continued)

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.

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.

1. ACCOUNTING POLICIES (Continued)

Taxation

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

(i) Current taxation

The corporate 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. Deferred tax assets are generally recognised for all deductible 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.

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.

1. ACCOUNTING POLICIES (Continued)

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.

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.

1. ACCOUNTING POLICIES (Continued)

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.

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.

1. ACCOUNTING POLICIES (Continued)

Impairment and uncollectability of financial assets (Continued)

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.

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 diffi culties 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 avail able.
- The extent and complexity of other creditors commitment ranking pari passu with the bank and the like lihood of other creditors continuing to support the customer.

1. ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

(i) Loans and receivables (Continued)

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.

(i) Loans and receivables

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.

(ii) 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.

1. ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

(i) Loans and receivables (Continued)

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.

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) Bank's defined contribution retirement benefit scheme

The bank operates a defined contribution retirement benefit scheme for its permanent employees. The assets of the scheme are held and administered independently of the bank's assets by an insurance company. The scheme is funded by contributions from both the bank and employees.

ii) 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. The bank's contributions to the statutory retirement benefit scheme are charged to the profit or loss for the year to which they relate.

1. ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Offsetting financial instruments

iii) 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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.

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.

1. ACCOUNTING POLICIES (Continued)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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

i) 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.

Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgement is required to determine the amount of deferred tax asset that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

3. FINANCIAL RISK MANAGEMENT

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 (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:-

	2017 Sh '000	%	2016 Sh '000	%
On balance sheet items				
Items in the course of collection from other banks (note 19)	12,954	-	15,052	-
Deposits and balances due from banking institution (note 14)	121,721	1	215,173	3
Loans and receivables to customers (note 17)	5,902,032	71	5,799,544	69
Government securities (note 15)	2,167,645	26	2,304,319	27
Corporate bonds (note 16)	74,681	1	114,445	1
Total	8,279,033	100	8,448,533	100
Off – balance sheet items (note 29 (a))				
Letters of credit	56,315	11	92,782	25
Letters of guarantee and performance bonds	172,342	33	165,064	44
Bills for collection	289,678	56	117,430	31
	518,335	100	375,276	100
Grand total	8,797,368		8,823,809	

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT (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 2017				
Neither past due nor impaired	4,672,267	-	4,672,267	79
Past due but not impaired	974,747	-	974,747	16
Impaired	389,735	(134,747)	254,988	4
Total	6,036,749	(134,747)	5,902,002	100
At 31 December 2016				
Neither past due nor impaired	4,090,293	-	4,090,293	70
Past due but not impaired	1,505,566	-	1,505,566	26
Impaired	348,676	(144,991)	203,685	4
Total	5,944,535	(144,991)	5,799,544	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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT (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:

	2017 Sh '000	2016 Sh '000
Loans and advances to customers		
Discounted value of securities for past due and impaired loans		
90 - 180 days	312,900	270,802
180 days +	63,900	148,525
Total	376,800	419,327

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:

	2017 Sh '000	%	2016 Sh '000	%
Real estate	1,543,533	26	1,562,628	26
Social community and personal services	322,790	5	329,036	6
Manufacturing	426,453	7	431,270	7
Transport and communications	245,139	4	251,692	4
Other	3,498,834	58	3,369,909	57
Total	6,036,749	100	5,944,535	100

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

a) Credit risk (Continued)

Concentration of risk (Continued)

ii) Customer deposits

	2017 Sh '000	%	2016 Sh '000	%
Co-operatives societies	-	-	-	-
Private enterprises	5,874,270	76	5,825,417	76
Non profit institutions and individuals	1,855,032	24	1,840,296	24
Total	7,729,302	100	7,665,713	100

iii) Off – balance sheet items

	2017 Sh '000	%	2016 Sh '000	%
Business services	36,283	7	26,269	7
Wholesale and retail	419,851	81	303,974	81
Transport and communications	20,733	4	15,011	4
Other	41,467	8	30,022	8
Total	518,335	100	375,276	100

Summary of credit risk exposure taking into account collateral

	2017 Sh '000	2016 Sh '000
Loans and advances		
Individually impaired		
Grade 5 : Impaired (loss)	-	-
Grade 3 & 4 : Impaired (doubtful)	389,735	479,961
Gross amount	389,735	479,961
Allowance for impairment	(134,747)	(144,991)
Carrying amount	254,988	334,970
Collectively impaired		
Grade 1 : Normal	4,672,267	4,072,662
Grade 2 : Watch	974,747	1,391,912
Gross amount	5,647,014	5,464,574
Carrying amount	5,902,032	5,799,544

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 2017 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	2017 %	2016 %
Average for the period	42	41
Maximum for the period	45	43
Minimum for the period	41	39
Statutory minimum requirement by Central Bank of Kenya	20	20
	====	====

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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
As at 31 December 2017						
FINANCIAL ASSETS						
Cash and balances with CBK	1,065,129	-	-	-	-	1,065,129
Deposits and balances from banking institutions	121,721	-	-	-	-	121,721
Government securities	-	30,515	641,531	1,370,893	1,154,703	3,197,642
Other investments	-	-	42,321	37,981	-	80,302
Advances to customers	491,199	962,818	1,276,430	2,447,684	732,901	5,902,032
	1,678,049	993,333	1,960,282	3,856,558	1,878,604	10,366,826
FINANCIAL LIABILITIES						
Customer deposits	1,410,464	5,359,736	477,928	481,174	-	7,729,302
	1,410,464	5,359,736	477,928	481,174	-	7,729,302
Net liquidity gap	267,585	(4,366,403)	1,482,354	3,375,384	1,878,604	2,637,524
As at 31 December 2016						
Total financial assets	1,050,700	1,617,649	1,763,811	3,215,355	1,556,811	9,204,326
Total financial liabilities	1,544,629	5,014,897	488,526	668,995	-	7,717,047
Net liquidity gap	(493,929)	(3,397,248)	1,275,285	2,546,360	1,556,811	1,487,279

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

c) Market Risk (Continued)

(i) Interest rate risk (Continued)

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

	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	-	-	-	-	-	109,453	109,453
Balances with Central Bank of Kenya	-	-	-	-	-	955,676	955,676
Deposits and balances due from banking institutions	121,721	-	-	-	-	-	121,721
Government securities	-	-	252,158	602,758	1,312,759	-	2,167,645
Corporate bonds	-	-	-	74,681	-	-	74,681
Advances to customers	400,256	926,818	1,276,430	2,447,684	759,901	90,943	5,902,032
Total financial assets	521,977	926,818	1,528,588	3,125,093	2,072,660	1,156,072	9,331,208
FINANCIAL LIABILITIES							
Customer deposits	-	5,458,871	477,928	478,479	-	1,314,024	7,729,302
Total financial liabilities	-	5,458,871	477,928	478,479	-	1,314,024	7,729,302
Interest rate sensitivity gap	521,977	(4,532,053)	1,050,660	2,646,614	2,072,660	(157,952)	1,601,906
As at 31 December 2016							
Total financial assets	215,173	1,376,66	1,385,497	2,937,390	2,423,583	853,495	9,191,807
Total financial liabilities	97,738	5,552,476	514,414	514,500	-	1,037,919	7,717,047
Interest rate sensitivity gap	117,435	(4,175,807)	871,083	2,422,890	2,423,583	(184,424)	1,474,760

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 2017

	Amount Sh'000	Scenario 10% Increase in net margin Sh'000	Scenario 10% Decrease in net margin Sh'000
Profit before taxation	94,329	130,757	57,900
Adjusted core capital	1,663,060	1,699,488	1,626,632
Adjusted total capital	1,739,026	1,775,454	1,702,598
Risk weighted assets (RWA)	5,879,538	5,879,538	5,879,538
Adjusted core capital to RWA	28%	29%	28%
Adjusted total capital to RWA	30%	30%	30%
	=======	=======	========

Interest rate risk – stress test-as at 31 December 2016

	Amount Sh'000	Scenario 10% increase in net margin Sh'000	Scenario 10% decrease in net margin Sh'000
Profit before taxation	104,665	120,669	88,660
Adjusted core capital	1,555,345	1,571,349	1,539,341
Adjusted total capital	1,637,829	1,653,833	1,621,825
Risk weighted assets (RWA)	5,973,616	5,973,616	5,973,616
Adjusted core capital to RWA	26%	26%	26%
Adjusted total capital to RWA	27%	28%	27%
	=======	=======	========

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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 Sh '000	GBP Sh '000	USD Sh '000	EURO Sh '000	OTHERS Sh '000	Total Sh '000
At 31 December 2017						
FINANCIAL ASSETS						
Cash in hand	87,224	1,814	12,665	7,743	7	109,453
Balances with CBK	945,346	13,879	55,666	5,129	8	1,020,028
Deposits and balances due from banking institutions	9,397	73	37,664	11,021	539	58,695
Government securities	2,167,645	-	-	-	-	2,167,645
Other securities	74,681	-	-	-	-	74,681
Advances to customers	5,265,360	1,542	545,955	89,174	-	5,902,032
Other assets	96,302	49,860	-	-	-	146,162
Total financial assets	8,645,955	67,168	651,950	113,067	554	9,478,694
FINANCIAL LIABILITIES						
Customer deposits	6,949,009	67,219	650,797	62,277	-	7,729,302
Other Liabilities	2,174	-	-	50,084	-	52,258
Total financial liabilities	6,951,183	67,219	650,797	112,361	-	7,781,560
Net balance sheet position	1,694,772	(51)	1,153	706	554	1,697,134
At 31 December 2016						
Total financial assets	8,428,795	45,014	548,987	284,333	3,263	9,310,392
Total financial liabilities	6,902,722	46,074	550,372	283,554	-	7,782,722
Net balance sheet position	1,526,073	(1,060)	(1,385)	779	3,263	1,527,670

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 2017

	Amount Sh'000	Scenario 10% increase in foreign currency rate Sh'000	Scenario 10% decrease in foreign currency rate Sh'000
Profit before taxation	94,329	114,290	74,367
Adjusted core capital	1,663,060	1,681,205	1,641,283
Adjusted total capital	1,739,026	1,751,799	1,711,877
Risk weighted assets (RWA)	5,879,538	5,879,538	5,879,538
Adjusted core capital to RWA	28%	29%	28%
Adjusted total capital to RWA	30%	30%	29%
	=======	=======	========

At 31 December 2016

	Amount Sh'000	Scenario 10% increase in foreign currency rate Sh'000	Scenario 10% decrease in foreign currency rate Sh'000
Profit before taxation	104,665	85,507	123,822
Adjusted core capital	1,555,345	1,534,550	1,572,865
Adjusted total capital	1,637,829	1,617,034	1,655,349
Risk weighted assets (RWA)	5,973,616	5,973,616	5,973,616
Adjusted core capital to RWA	26%	26%	26%
Adjusted total capital to RWA	27%	27%	28%
	=======	=======	========

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 Nil (2016: Sh 8,850,367).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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 2016, 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 2016.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

iv) 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	
ASSETS	2017 Sh'000	2016 Sh'000	2017 Sh'000	2016 Sh'000
Cash (including foreign notes and coins)	109,453	104,398	-	-
Cash balances with Central Bank of Kenya	955,676	653,928	-	-
Government securities	2,167,645	2,304,319	-	-
Corporate bonds	74,681	114,445	-	-
Deposits and balances due from banking institutions	121,721	215,173	11,100	37,057
Loans and advances to customers	5,902,032	5,799,544	4,299,271	4,454,101
Other assets	96,302	125,676	96,302	125,676
Property and equipment	57,572	71,776	57,572	71,776
Intangible assets	11,217	13,874	11,217	13,874
Deferred tax asset	27,534	6,380	6,380	6,380
Tax recoverable	17,418	17,418	17,418	17,418
Total assets on balance sheet	9,541,251	9,426,931	4,520,414	4,726,282
Total asset off balance sheet	518,335	375,276	443,291	323,096
Total risk weighted assets	10,059,586	9,802,207	4,963,705	5,049,378
Tier 1 Capital	1,663,060	1,555,345		
Tier 1 + Tier 2 Capital	1,739,026	1,637,829		
Basel ratio				
Tier 1 (CBK minimum – 8%)	28%	26%		
Tier 1 + Tier 2 (CBK min – 12%)	30%	27%		

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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.

i) 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 2010-2017. The next strategic plan cycle plan is being developed.

ii) 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.

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.'

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

e) Operating risk (Continued)

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.

iii) 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.

iv) 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, Occupational Safety and Health Administration (OSHA) and National Environment Management Authority (NEMA) etc.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

e) Operating risk (Continued)

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

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 Committees 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.

v) 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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)

		Group		Bank	
		2017	2016	2017	2016
	Note	Shs'000	Shs'000	Shs'000	Shs'000
31 December 2016					
Financial assets designated as available for sale					
Treasury bonds	15	-	91,294	-	91,294
		=======	=======	======	========

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

There were no transfers between levels 1, 2, and 3 in the period (2016: none).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4. INTEREST INCOME

	Group		Bank	
	2017 Sh'000	2016 Sh'000	2017 Sh'000	2016 Sh'000
Advances to customers	767,682	941,817	767,682	941,817
Government securities - Held to maturity	220,667	121,284	220,667	121,284
Government securities - At fair value through profit or loss and Available for sale	-	91,294	-	91,294
Corporate bonds - Held to maturity	11,207	15,561	11,207	15,561
Deposits/balances due from other financial institutions	16,651	12,052	16,651	12,052
	1,016,207	1,182,008	1,016,207	1,182,008

5. INTEREST EXPENSE

	Group		Bank	
Customer deposits	643,239	871,855	643,239	871,855
Deposits and balances due to banking institutions	-	14,466	-	14,466
	643,239	886,321	643,239	886,321

6. FEES AND COMMISSION INCOME

	Group		Bank	
	2017	2016	2017	2016
Transaction related fees	28,844	34,157	25,452	31,207
Credit related fees and commissions	25,861	24,580	25,861	24,580
	54,705	58,737	51,313	55,787

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

8. OTHER OPERATING INCOME

	Group		Bank	
	2017 Sh'000	2016 Sh'000	2017 Sh'000	2016 Sh'000
Locker rental income	1,228	1,266	1,228	1,266
Other operating income	7,048	10,371	7,048	10,371
Net gains from trading – treasury bonds (at fair value through profit or loss) (Note 15 (c))	-	102,988	-	102,988
Net gains from trading – treasury bonds (Available for sale) (Note 15 (d))	26,073	-	26,073	-
Reclassification of fair value on disposal of available for sale infrastructure bonds (Note 15(d))	1,636	-	1,636	-
	35,985	114,625	35,985	114,625

9. OPERATING EXPENSES

	Group		Bank	
Staff costs (note 10)	136,193	137,762	134,843	135,683
Contribution to Deposit Protection Fund	11,971	12,230	11,971	12,230
Depreciation (note 20)	19,252	21,152	19,252	21,152
Amortisation of intangible assets (note 21)	3,500	1,555	3,471	1,525
Directors' emoluments	26,292	26,192	26,292	26,192
Auditors' remuneration	3,440	3,275	3,190	2,750
Rent and rates	35,302	32,848	35,302	32,848
Legal and professional fees	15,718	14,233	15,718	14,283
Insurance	5,432	5,420	5,432	5,420
Security	14,275	10,357	14,275	10,357
Telephone and postage	11,938	10,847	11,938	10,847
Repairs and maintenance	4,866	4,626	4,866	4,626
Commission expenses	704	438	-	
Other expenses	40,417	35,121	39,901	35,409
	329,300	316,056	326,451	313,322

10. STAFF COSTS

	Group 2017 Sh'000	Group 2016 Sh'000	Bank 2017 Sh'000	Bank 2016 Sh'000
Salaries and allowances	127,573	129,912	126,289	127,833
Staff training	267	259	267	259
Terminal dues	1,972	635	1,972	635
NSSF contributions	-	408	-	408
Pension contributions-defined contribution scheme	4,950	4,756	4,884	4,756
Leave pay expense	-	966	-	966
Medical expenses	1,431	826	1,431	826
	136,193	137,762	134,843	135,683

11. TAXATION

	Group		Bank	
(a) Taxation charge				
Current taxation based on the taxable profit for the period at 30%	27	-	-	-
Deferred taxation (credit)/charge (note 22):-				
- current year (credit)	(16,885)	(1,557)	(17,021)	(1,622)
- prior year under provision	(4,133)	-	(4,133)	-
	(20,991)	(1,557)	(21,154)	(1,622)

	Group		Bank	
(b) Reconciliation of taxation charge to the expected taxation based on profit before taxation				
Profit before taxation	96,508	104,882	95,965	104,666
Tax at the applicable rate of 30%	28,952	31,465	28,780	31,400
Effect of expenses disallowed for taxation purposes	4,125	35,839	4,125	35,839
Effect of income not subject to taxation	(49,935)	(68,861)	(49,926)	(68,861)
Prior year underprovision	(4,133)	-	(4,133)	-
Taxation charge	(20,991)	(1,557)	(21,154)	(1,622)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

(c) Corporate tax recoverable	Group 2017 Sh'000	Group 2016 Sh'000	Bank 2017 Sh'000	Bank 2016 Sh'000
At 1 January	17,453	3,230	17,418	3,195
Taxation charge	(27)	-	-	-
Tax paid in the year	219	14,223	-	14,223
At 31 December	17,645	17,453	17,418	17,418

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.

	Group 2017	Group 2016	Bank 2017	Bank 2016
Earnings **Earnings for the year attributable to ordinary shareholders (Sh'000)**	117,499	106,439	117,119	106,288
Number of shares **Weighted average number of ordinary shares in issue**	1,000,000	1,000,000	1,000,000	1,000,000
Earnings per share-Basic (Sh) **Ordinary shares**	117.50	106.44	117.11	106.29

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 2017 or 31 December 2016 respectively.

13. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	Group 2017 Sh'000	Group 2016 Sh'000	Bank 2017 Sh'000	Bank 2016 Sh'000
Cash on hand	109,453	104,398	109,453	104,398
Balances with Central Bank of Kenya				
- Cash ratio requirement	405,613	402,565	405,613	402,565
- Deposits held under lien	10,330	10,240	10,330	10,240
- Current account with CBK	539,733	241,123	539,733	241,123
	955,676	653,928	955,676	653,928
	1,065,129	758,326	1,065,129	758,326

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 2017 the cash reserve ratio requirement was 5.25% (2016: 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

14. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	Group 2017 Sh'000	Group 2016 Sh'000	Bank 2017 Sh'000	Bank 2016 Sh'000
Deposits due from banking institutions	-	50,800	-	50,800
Balances due from banking institutions	121,721	164,373	121,721	164,373
	121,721	215,173	121,721	215,173

The weighted average effective interest rate for deposits and balances due from banking institutions at 31 December 2017 was 6.0% (2016 – 8.5%).

MATURITY ANALYSIS OF DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

Group & Bank	2017 Sh'000	2016 Sh'000
Due on demand	121,721	50,800
Maturing within one month	-	164,373
	121,721	215,173

15. GOVERNMENT SECURITIES - Group and Bank

Group & Bank	2017 Sh'000	2016 Sh'000
(a) **Treasury bills held to maturity**		
At amortized cost – maturing within 90 days		
Face value	-	150,000
Less: unearned discount	-	(7,003)
	-	142,997

	2017 Sh'000	2016 Sh'000
(b) Treasury bonds		
At fair value through profit or loss - maturing after 3 years	-	-
At Fair value – Available for sale – maturing after 3 years	-	91,636
Held to maturity – at amortised cost (maturing within 5 years)	854,509	1,361,337
Held to maturity – at amortised cost (maturing after 5 years)	1,313,137	708,349
	2,167,646	2,069,686
	2,167,646	2,304,319

NOTES TO THE FINANCIAL STATEMENTS (Continued)

(c) Movement in treasury bonds (at fair value through profit or loss) can be summarised as follows:

	2017 Shs'000	2016 Shs'000
At 1 January	-	1,521,596
Additions	-	5,839,700
Disposals	-	(7,258,308)
Net gains on trading	-	(102,988)
At 31 December	-	-

The weighted average effective interest rate for treasury bonds as at 31 December 2017 was 9.56 % (2016 – 11%).Included in the above balances are treasury bonds amounting to Sh 130,000,000 (2016 – Sh 130,000,000) pledged with local commercial banks as security for letters of credit and guarantee facilities.

(d) Movement in treasury bonds (Available for sale) can be summarised as follows:

	Group &	Bank
	2017 Shs'000	2016 Shs'000
At 1 January	91,636	-
Additions	6,775,000	90,000
Disposals	(6,838,927)	-
Gains from changes in fair value	-	1,636
Net gains on trading	(26,073)	-
Reclassification of fair value gains on disposals	(1,636)	-
At 31 December	-	91,636

16. CORPORATE BONDS - Group and Bank

Held to maturity- at amortised cost		
Corporate bonds maturing within 5 years	74,681	114,445

The weighted average effective interest rate on the bonds at 31 December 2017 was 8.1% (2016 – 7%).

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

	2017 Shs'000	2016 Shs'000
At 1 January	114,445	155,701
Redemption	(34,725)	(34,725)
Net amortisation	(5,039)	(6,531)
At 31 December	74,681	114,445

NOTES TO THE FINANCIAL STATEMENTS (Continued)

17. ADVANCES TO CUSTOMERS

	Group 2017 Sh'000	Group 2016 Sh'000	Bank 2017 Sh'000	Bank 2016 Sh'000
Loans and advances to customers	6,035,879	5,941,941	6,035,879	5,941,941
Bills discounted	900	2,594	900	2,594
	6,036,779	5,944,535	6,036,779	5,944,535
Provision for impaired loans and advances (note 18)	(134,747)	(144,991)	(134,747)	(144,991)
	5,902,032	5,799,544	5,902,032	5,799,544

The weighted average effective interest rate on advances to customers as at 31 December 2017 13.6% (2016 – 15.38%).
Included in net advances are loans and advances amounting to Sh 264,347,000 (2016 – Sh 334,970,000), net of specific provisions, which have been classified as non-performing.
Advances to related parties are disclosed in note 30.

	Group 2017 Sh'000	Group 2016 Sh'000	Bank 2017 Sh'000	Bank 2016 Sh'000
Analysis of gross advances by maturity:				
Maturing within one year	2,730,447	2,678,869	2,730,447	2,678,869
Over one year to three years	2,447,684	1,215,191	2,447,684	1,215,191
Over three to five years	858,648	2,050,475	858,648	2,050,475
	6,036,779	5,944,535	6,036,779	5,944,535

18. PROVISION FOR IMPAIRED LOANS AND ADVANCES

	Group 2017	Group 2016	Bank 2017	Bank 2016
At 1 January	144,991	103,692	144,991	103,692
Provisions in the year charged to profit or loss	48,110	60,333	48,110	60,333
Write offs	(58,354)	(19,034)	(58,354)	(19,034)
At 31 December	134,747	144,991	134,747	144,991

19. OTHER ASSETS

	Group 2017	Group 2016	Bank 2017	Bank 2016
Items in course of collection	12,954	15,052	12,954	15,052
Prepayments	49,068	64,521	49,068	64,521
Other receivables	33,826	46,752	33,280	45,103
	95,848	126,325	95,302	124,676

NOTES TO THE FINANCIAL STATEMENTS (Continued)

20. EQUIPMENT - Group and Bank

	Computers & office equipment Sh'000	Motor vehicles Sh'000	Furniture, fittings and office renovations Sh'000	Total Sh'000
COST				
At 1 January 2016	80,506	9,808	160,013	250,327
Additions	8,387	725	7,443	16,555
At 31 December 2016	88,893	10,533	167,456	266,882
At 1 January 2017	88,893	10,533	167,456	266,882
Additions	3,957	760	332	5,049
Disposal	-	(830)	-	(830)
At 31 December 2017	92,850	10,463	167,788	271,101
DEPRECIATION				
At 1 January 2016	61,264	5,665	107,025	173,954
Charge for the year	6,244	1,332	13,576	21,152
At 31 December 2016	67,508	6,997	120,602	195,107
At 1 January 2017	67,508	6,997	120,602	195,107
Additions	6,661	1,513	11,078	19,252
Disposal	-	(830)	-	(830)
At 31 December 2017	74,169	7,680	131,680	213,529
NET BOOK VALUE				
At 31 December 2017	18,681	2,783	36,108	57,572
At 31 December 2016	21,385	3,536	46,855	71,776

Included in equipment are assets with a cost of Sh 114,783,246 (2016 - Sh 128,908,362) which were fully depreciated. The notional depreciation charge in respect of these assets for the year is Sh 17,217,487 (2016 – Sh 20,975,227).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

21. INTANGIBLE ASSETS COMPUTER SOFTWARE

	2017 Sh'000	2016 Sh'000	2017 Sh'000	2016 Sh'000
COST				
At 1 January	43,089	32,262	42,904	32,113
Additions	814	10,827	814	10,827
At 31 December	43,903	43,089	43,754	42,940
AMORTISATION				
At 1 January	29,126	27,571	29,066	27,541
Charge for the year	3,500	1,555	3,471	1,525
At 31 December	32,626	29,126	32,537	29,066
NET BOOK VALUE				
At 31 December	11,277	13,963	11,277	13,874

22. DEFERRED TAXATION ASSET

	Group		Bank	
The deferred tax asset, computed at the enacted rate of 30%, is attributable to the following items:				
Accelerated capital allowances	6,082	4,645	6,082	4,645
Leave pay provision	1,427	1,630	1,427	1,630
Other provisions	3,838	596	3,838	596
Unrealised fair vaue gain on financial assets	-	(484)	-	(491)
Tax losses	16,188	130	16,187	-
	27,535	6,517	27,534	6,380
The movement on the deferred tax asset account is as follows:				
As at 1 January	6,517	4,960	6,380	4,758
Credit for the year – note 11(a)	16,885	1,557	17,021	1,662
Prior year underprovision - note 11(a)	4,133	-	4,133	-
At 31 December	27,535	6,517	27,534	6,380

NOTES TO THE FINANCIAL STATEMENTS (Continued)

23. INVESTMENT IN SUBSIDIARY – Bank

	No. of shares	Holding	2017 Sh'000	2016 Sh'000
Parabank Insurance Agency Limited	1,000	100%	1,000	1,000

The subsidiary is wholly owned Limited Liability Company incorporated and domiciled in Kenya. The company was incorporated on 22 May 2016 and licenced to operate Insurance Agency/ brokerage business. The principal activity of the company is insurance agency business.

24. CUSTOMER DEPOSITS

	Group		Bank	
	2017 Sh'000	2016 Sh'000	2017 Sh'000	2016 Sh'000
Current accounts	635,924	540,283	639,263	542,472
Savings accounts	394,809	284,464	394,809	284,464
Call deposits	285,114	252,647	285,114	252,647
Fixed deposits	6,410,116	6,588,319	6,410,116	6,588,319
	7,725,963	7,665,713	7,729,302	7,667,902
Analysis of customer deposits by maturity:				
Payable within 90 days	6,766,861	6,635,474	6,770,200	6,637,663
Payable after 90 days and within one year	477,928	514,500	477,928	514,500
Payable after one year	481,174	515,739	481,174	515,739
	7,725,963	7,665,713	7,729,302	7,667,902

The weighted average effective interest rate on interest bearing customer deposits at 31 December 2017 was 8.3 % (2016 – 12.25%).

Customers deposits from related parties are disclosed in note 30 and concentrations of customer deposits are covered under note 3(a).

25. DEPOSITS AND BALANCES DUE TO BANKING INSTITUTIONS – Group & Bank

	2017 Sh'000	2016 Sh'000
Deposits due to banking institutions	-	51,334

The weighted average effective interest rate for deposits and balances due to banking institutions at 31 December 2017 was NIL (2016 – 5%).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

26. OTHER LIABILITIES

	Group		Bank	
	2017 Sh'000	2016 Sh'000	2017 Sh'000	32,514 Sh'000
Sundry payables	32,514	40,089	32,514	40,089
Accruals	16,340	18,169	14,989	17,964
Premiums payable	1,761	3,213	-	-
Leave pay provision	4,755	5,433	4,755	5,433
	55,370	66,904	52,258	63,486

27. SHARE CAPITAL

	Group & Bank	
	2017 Sh'000	2016 Sh'000
Authorised, issued and fully paid		
1,000,000 ordinary shares of Sh 1,000 each	1,000,000	1,000,000

28. NOTES TO THE STATEMENT OF CASH FLOWS

(a) Reconciliation of profit before taxation to cash (used in)/generated from operations

	Group		Bank	
	2017 Sh '000	2016 Sh '000	2017 Sh '000	2016 Sh '000
Profit before taxation	96,508	104,882	95,965	104,666
Adjustments for:				
Depreciation	19,252	21,152	19,252	21,152
Amortization of intangible assets	3,500	1,555	3,471	1,525
Gain on sale of motor vehicle	(405)	-	(405)	-
Fair value changes in treasury bonds	-	1,636	-	1,636
Reclassication of fair value on disposal of available for sale infrastructure bonds	(1,636)	-	(1,636)	-
Working capital changes :	117,219	129,225	116,647	128,979
Increase in balances held by Central Bank of Kenya under lien	(90)	(10)	(90)	(10)
Decrease/(Increase) in advances to customers	(102,488)	72,173	(102,488)	72,173
Decrease in treasury bonds	136,674	592,334	136,674	592,334
Decrease in corporate bonds	39,764	41,256	39,764	41,256
(Decrease)/Increase in other assets	30,477	(25,975)	29,374	(26,669)
(Decrease)/Increase in customer deposits	60,250	(399,489)	61,400	(399,205)
(Decrease) in advances from other local banks	(51,334)	(832,703)	(51,334)	(832,703)
Increase/(Decrease) in other liabilities	(11,534)	24,550	(11,228)	25,206
Cash (used in) operations	218,938	(398,639)	218,719	(398,639)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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

	Group 2017 Sh '000	Group 2016 Sh '000	Bank 2017 Sh '000	Bank 2016 Sh '000
(b) Analysis of balances of cash and cash equivalents as shown in the financial position and notes (Noted 13)				
Cash on hand	109,453	104,398	109,453	104,398
Deposits and balances due from banking institutions	121,721	215,173	121,721	215,173
Current account with Central Bank of Kenya	945,346	643,688	945,346	643,688
	1,176,520	963,259	1,176,520	963,259

For the purposes of the statement of cash flows, cash equivalents include short term liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the dates of the advances.

29. CONTINGENCIES AND COMMITMENTS INCLUDING OFF FINANCIAL POSITION ITEMS

	2017 Sh'000	2016 Sh'000
(a) Contingent liabilities		
Letters of credit	56,315	92,782
Letters of guarantee and performance bonds	172,342	165,064
Bills for collection	289,678	117,430
	518,335	375,276

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 2017 amounted to Sh 7,250,000 (2016- Sh 10,700,000).

(b) The bank had no capital commitments as at 31 December 2017 (2016 – 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)

29. 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:

	2017 Sh'000	2016 Sh'000
Within one year	19,236	8,179
In the second to fifth year inclusive	64,618	32,782
	83,854	40,961

30. 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.

Placements at 31 December 2017 include placements made in the bank by directors, their associates and companies associated to directors. Advances to customers and deposits at 31 December 2017 include loans and advances to companies associated to directors employees of the bank and, also deposits held with related parties respectively. Contingent liabilities at 31 December 2017 include guarantees and letters of credit for companies associated to directors.

These balances are included in the loans and advances and deposits balances at year end.

	Directors' associated companies		Employees/staff	
	2017 Sh'000	2016 Sh'000	2017 Sh'000	2016 Sh'000
Movement in related party balances was as follows:				
Loans and advances:				
At 1 January	332,852	437,688	72,994	43,352
Net movement during the year	278,088	(104,836)	(1,011)	29,642
At 31 December	610,940	332,852	71,983	72,994
Interest earned	85,532	53,256	6,838	6,934
Deposits:				
At 1 January	385,749	348,633	16,974	11,409
Net movement during the year	81,092	37,116	(5,398)	5,565
At 31 December	466,841	385,749	11,576	16,974
Interest paid	46,684	38,575	926	1,358

NOTES TO THE FINANCIAL STATEMENTS (Continued)

30. RELATED PARTY TRANSACTIONS (Continued)

	2017 Sh'000	2016 Sh'000
Guarantees and letters of credit to companies associated to directors	29,308	30,834

Key management compensation

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

	2017 Sh'000	2016 Sh'000
Key management salaries and other benefits	61,606	63,409
Directors emoluments	26,292	26,192

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.

31. FIDUCIARY ACTIVITIES

At 31 December 2017, the bank did not hold asset security documents on behalf of customers (2016: 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), the bank's functional and presentation currency.

34. EVENTS AFTER REPORTING PERIOD

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

Sound Plaza 4th Floor
Woodvale Groove Westlands
P. O. Box 14001-00800
Nairobi, Kenya
Telephone: (+254) 20 444 9266
Priority Line: 0709 935 000
Email: info@paramountbank.co.ke
www.paramountbank.co.ke