Equatorial Commercial Bank

Annual Report and Financial Statements 2011

ECB
Equatorial Commercial Bank

Equatorial Commercial Bank Limited Report And Financial Statements For the Year Ended 31 December 2011

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Board members and committees

DIRECTORS

Dan Ameyo, MBS	(Chairman)
Peter Harris*	(Managing Director)
Martin Ernest*	
Akif Hamid Butt	
Abdulali Kurji	(Appointed 7 April 2011)
M.H. Da Gama Rose	(Resigned 13 April 2011)
Thomas Mutugu	(Appointed 6 May 2011)

* British

SECRETARY

Fauzia B Shah (Resigned 29 February 2012)
P.O. Box 55358
00200 Nairobi

J. Hinga (Appointed 1 March 2012)
P.O. Box 52467
00200 Nairobi

BOARD AUDIT AND RISK COMMITTEE

Akif Hamid Butt	Chairman
Martin Ernest	
Abdulali Kurji	

BOARD CREDIT COMMITTEE

Martin Ernest	Chairman
Thomas Mutugu	

Corporate Information

NAIROBI BRANCHES

HEAD OFFICE
Equatorial Commercial Bank Centre, Nyerere Road
P.O. Box 52467 – 00200, Nairobi
Tel: +254(20) 4981000
Fax: +254(20) 2719625
Email: customerservice@ecb.co.ke

CHESTER HOUSE BRANCH
Chester House Ground Floor, Koinange Street
P.O. Box 1166 – 00400, Nairobi
Tel: +254 (20) 4981000,
Fax: +254 (20) 2246309
Email: customerservice@ecb.co.ke

WESTLANDS BRANCH
The Mall, Westlands (Ground Floor)
P.O. Box 39556 – 00623, Nairobi
Tel: +254(20) 4981000
Fax: +254(20) 4443505
Email: customerservice@ecb.co.ke

WAIYAKI WAY BRANCH
Equatorial Fidelity Centre, Waiyaki Way
P.O. Box 66171 – 00800, Nairobi
Tel: +254 (20) 4981000
Fax: +254 (20) 4445987
Email: customerservice@ecb.co.ke

MOMBASA ROAD BRANCH
Sameer Business Park, Mombasa Road
P.O. Box 27552 – 00506, Nairobi
Tel: +254(20) 3522617/8
Fax: +254(20) 3522619
Email: customerservice@ecb.co.ke

INDUSTRIAL AREA BRANCH
Avon Centre, Enterprise Road
P.O. Box 18142 – 00500, Nairobi
Tel: +254 (20) 4981000
Fax: +254 (20) 554128
Email: customerservice@ecb.co.ke

UPCOUNTRY BRANCHES

MOMBASA MOI AVENUE BRANCH
Equatorial Commercial Bank Building, Moi Avenue
P.O. Box 88608 - 80100, Mombasa
Tel: +254(20) 4981000
Fax: +254(41) 2222633
Email: customerservice@ecb.co.ke

NYALI BRANCH
Nyali Cinemax Complex, Kongowea Road
P.O. Box 34219 – 80118, Nyali
Tel: +254 (20) 4981000
Fax: +254 (41) 471004
Email: customerservice@ecb.co.ke

KISUMU BRANCH
Harley's House, Oginga Odinga Street
P.O. Box 2483 – 40100, Kisumu
Tel: +254 (20) 4981000
Fax: +254 (57) 2022744
Email: customerservice@ecb.co.ke

KAKAMEGA BRANCH
Jubilee Ironmongers Building, Canon Awori Road
P.O. Box 825 – 50100, Kakamega
Tel: +254 (20) 4981000
Fax: +254 (56) 30032
Email: customerservice@ecb.co.ke

ELDORET BRANCH
Zion Mall, Uganda Road
P.O. Box 6443 – 30100, Eldoret
Tel: +254 (20) 4981000
Fax: +254 (53) 2063459
Email: customerservice@ecb.co.ke

NAKURU BRANCH
Apple House, Nakuru-Nairobi Highway
P.O. Box 52467 – 00200, Nairobi
Tel: +254(20) 4981000
Fax: +254(20) 2719625
Email: customerservice@ecb.co.ke

For further details, contact: customerservice@ecb.co.ke

Corporate Information

REGISTERED OFFICE

Equatorial Commercial Bank Centre (HQ)
Nyerere Road
P.O. Box 52467
00200 Nairobi

AUDITORS

KPMG Kenya
16th Floor, Lonrho House
P.O. Box 40612
00100 Nairobi GPO

CORRESPONDENT BANKS

Habib American Bank Limited, New York
Habibson Bank Limited, London
Standard Chartered Bank, New York
Standard Chartered Bank, London
Standard Bank of South Africa, Johannesburg
Standard Chartered Bank Kenya Limited, Nairobi
Standard Chartered Bank Limited, Tokyo
Commerzbank AG, Frankfurt
ICICI Bank, Mumbai
UBS AG, Zurich
Standard Chartered Bank, Frankfurt
National Australia Bank, Melbourne

ADVOCATES

Aming'a, Opiyo, Masese & Co. Advocates
Anjarwalla & Khanna Advocates
C B Gor & Gor Advocates
Gathaiya & Associates Advocates
Gumbo & Associates
Iseme Kamau & Maema Advocates
J.Louis Onguto Advocates
Joseph Munyithya & Co. Advocates
Kwengu & Co. Advocates
Macharia-Mwangi & Njeru Advocates
Majanja Luseno & Co. Advocates
Muri Mwaniki & Wamiti Advocates
Muthaura Mugambi Ayugi & Njonjo Advocates
Ndung'u Njoroge & Kwach Advocates
Nyaundi Tuiyot & Company Advocates
Olel, Onyango Ingutia & Co. Advocates
Shapley Barret & Company Advocates
Shitsama & Co. Advocates
Sichangi & Co Advocates
Timamy & Co.
Wangai Nyuthe & Company Advocates

Chairman's Report

Economic review

2011 was characterized by a challenging local and global macroeconomic environment, slowed economic performance and credit rating downgrades of major economies such as United States, Italy, Greece, France, Portugal, and Spain. In Kenya, inflation increased due to surges in oil and food prices, and the consequential higher import bills resulted in a sustained widening of the current account deficit leading to a significant depreciation of the local currency.

The overall 12 month inflation rate in December 2011 was 18.9 %, compared to last year's 4.5% in December 2010. The average yield rate for the 91 day treasury bills, a benchmark for the general trend of interest rates, rose to 19.91% in December 2011, compared to 2.276% in December 2010. The Kenyan Shilling recorded its worst performance in recent years against major world currencies, recording an all time low of 107 against the United States Dollar before easing to close at 85 in December 2011, compared to 80 in December 2010.

As a result of the foregoing, Central Bank of Kenya (CBK) embarked on a significant monetary tightening stance, in an effort to reduce rising inflation and stabilize the Kenya shilling. The result was constrained private sector demand for credit, liquidity risks and funding costs rising faster for banks with limited access to interbank markets, retail and wholesale funds.

Business and performance review

Our balance sheet closed the year with total assets at Kshs. 12.9 billion, compared to Kshs. 10.4 billion in December 2010, a 24% year on year increase. Gross loans and advances stood at Kshs. 6.9 billion, compared to Kshs. 5.3 billion as at 31 December 2010. On the liabilities front, Customer Deposits closed the year at Kshs. 9.8 billion, compared to Kshs. 8.0 billion at the end of 2010, a 23% year on year increase.

The Bank recorded a profit after tax of Kshs. 72 million, compared to a loss of Kshs. 68 million in 2010. Net interest income was Kshs. 391 million, with the growth mostly coming from interest income on advances. This was, however, negatively impacted in the second half of the year by an increased cost of funds after the regulator's tightening of liquidity in the market. The Bank's non-interest income was Kshs. 353 million, mainly driven by commissions and fees from transactions, increased FX income, and income from associated companies. With a tight lid kept on costs, Operating expenses were Kshs. 665 million down from Kshs. 734 million in the previous year. The Bank further managed to significantly reduce its gross non-performing loans portfolio to stand at Kshs. 589 million from Kshs. 1.1 billion in the previous year.

Meanwhile, much work was undertaken to rebrand the Bank and upgrade office premises in order to project the image that ECB aspires to line up to. At the same time, time and effort has been put into upgrading technology platforms and developing products and services appropriate for these changing times.

Concluding remarks

I wish to take this opportunity to express my sincere gratitude to all employees of ECB who showed great fortitude in our first full year post merger and also express my deep appreciation to our customers who kept faith with us. The organizational transformation project with the objective of achieving an even more focused and results oriented institution will continue, as this is an integral part of an ongoing re-alignment of our strategy to further improve customer management and strongly position the bank in this increasingly competitive environment.

In conclusion, I wish to express my gratitude to our shareholders and my fellow directors for their commitment, guidance, dedication and support throughout the year. My sincere thanks to the management and staff for their invaluable contribution towards the progress the bank has made during the year, their hard work, loyalty and professionalism. I also take this opportunity to convey my appreciation to all our customers for giving ECB the opportunity to remain their financial institution of choice.

Chairman

Corporate Governance

Equatorial Commercial Bank Limited is committed to continually improving its corporate governance for the benefit of all stakeholders.

The Bank's Board of Directors is focused on achieving compliance with the qualitative aspects of good governance while ensuring that implementation permeates throughout the business.

The Board has also established Board Committees with delegated authority from the Board to assist it in providing Board oversight on management functions and in fulfilling the stated objectives of the Board. The Committees' roles and responsibilities are set out in Terms of Reference and agreed mandates, which are reviewed periodically to ensure they remain relevant.

Codes and regulations

As a licensed commercial bank, the Bank operates in a highly regulated industry and is committed to complying with the applicable legislation, regulations and codes of best practice while seeking to maintain the highest standards of transparency and accountability.

Board of Directors

The Bank is governed by the Board of Directors, which has ultimate responsibility for the management and strategic guidance of the company and assumes primary responsibility for the sustainability of the company's business.

Board composition

There are six directors on the Board of whom one is executive and five are non-executive. The Board is therefore compliant with guidelines issued by the Regulator on composition of the Board.

The members of the Board have the right mix of skills, expertise, competencies and experience to effectively guide the Bank and ensure that the objective of shareholder value maximization is achieved.

The Board profile is regularly reviewed to ensure that the Board composition remains relevant given the dynamics of the banking industry.

Strategy

The Board is fully aware of its obligations in forging the strategic direction that the Bank will follow. Currently, the Bank is pursuing the fulfillment of all aspects of the 5 year Strategic Plan approved in 2008 by the Board. Regular reports on progress are tabled at Board meetings for discussion while performance against financial objectives is monitored by the Board through management's monthly, quarterly and annual reporting.

Delegation and effective control

The ultimate responsibility for the Bank's operations rests with the Board. The Board retains effective control through a well developed structure of Board committees. These committees provide in-depth focus on specific areas.

Authority has been delegated to the Managing Director to manage the day to day activities of the business together with his management committees comprised of senior managers and unit heads.

Further delegations are managed through a defined process.

The Managing Director is tasked with the implementation of Board decisions and there is a clear flow of information between management and the Board, which facilitates both the qualitative and quantitative evaluation of the Bank's performance.

Corporate Governance

Evaluation of Board effectiveness

Annually, the ECB Board carries out a self review of its capacity, functionality and effectiveness. The evaluation measures the performance of the Board against its key duties and responsibilities.

Board meetings

The Board meets once every quarter at a minimum with additional meetings scheduled to discuss strategy. Additional meetings are held whenever deemed necessary. Directors are provided with comprehensive documentation at least seven days prior to each of the scheduled meetings.

The following table shows attendance of Board meetings by the current Directors:

Director's name	**Nationality**	**Executive/ Non-Executive**	**Profession**	**Attendance for Board meetings**
Dan Ameyo (MBS)	Kenyan	Non Executive	Advocate	100%
Peter Harris	British	Executive	Banker	100%
Martin Ernest	British	Non Executive	Chartered Accountant	100%
Akif Hamid Butt	Kenyan	Non Executive	Chartered Accountant	100%
Abdulali Kurji	Kenyan	Non Executive	Engineer	100%
Thomas Mutugu	Kenyan	Non Executive	University Lecturer	100%

Board committees

The Board has established the Board Audit and Risk Committee and the Board Credit Committee to assist it in discharging its responsibilities.

The role of the Board Audit and Risk Committee is to review the Bank's financial position and make recommendations to the Board on all financial matters. This includes assessing the integrity and effectiveness of accounting, financial, compliance and other control systems. This committee also provides Board oversight of the Bank's risk management framework.

The role of the Board Credit Committee is to review the Bank's Credit Policy and ensure adherence to the same by Management. This Committee also reviews facilities that are beyond the discretionary limits of the Management Credit Risk Committee and ensures that measures are in place to mitigate, measure, monitor and manage credit risk at all times.

Management committees

The following management committees are in place to ensure that the Bank carries out its obligations efficiently and effectively:

Asset and Liability Committee;
Risk Management Committee;
Product and IT Committee; and
Management Credit Risk Committee.

Fees

Non-executive directors receive fixed fees for their service on the Board. The Board reviews the non-executive directors' fees annually and makes appropriate recommendations to the Shareholders at the Annual General Meeting for approval.

Company Secretary

The Company Secretary provides the Board with guidance on its responsibilities and keeps directors up-to-date with changes to relevant legislation as well as governance best practices.

All directors have access to the services of the Company Secretary.

Directors' Report
For the year ended 31 December 2011

The Directors have pleasure in submitting their report together with the audited financial statements for the year ended 31 December 2011.

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

The company has a 20% (2010: 20%) investment in Equatorial Investment Bank Limited and 23.86% (2010: 23.86%) in Fidelity Shield Insurance Company Limited which have been accounted for as associate companies in the financial statements.

Results
The results for the year are set out on page 12.

Dividend
The Directors do not propose a dividend for the year (2010 - Nil).

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

Auditors
The auditors, KPMG Kenya, continue in office in accordance with Section 159(2) of the Kenyan Companies Act (Cap.486) and subject to Section 24(1) of the Banking Act (Cap.488).

Approval of financial statements
The financial statements were approved at a meeting of the Directors held on 1 March 2012.

BY ORDER OF THE BOARD

J Hinga
Company Secretary

Date: 1 March 2012

Statement Of Directors' Responsibilities

The Directors are responsible for the preparation and presentation of the financial statements of Equatorial Commercial Bank Limited set out on pages 10 to 55 which comprise the statement of financial position of the Bank as at 31 December 2011 and the Bank's statement of comprehensive income, statement of changes in equity and statement of cash flows, for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Under the Kenyan Companies Act, the Directors are required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Bank as at the end of the financial year and of the operating results of the Bank for that year. It also requires the Directors to ensure the Bank keeps proper accounting records which disclose with reasonable accuracy the financial position of the Bank.

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Bank and of its operating results.

The Directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

The Directors have made an assessment of the Bank's ability to continue as a going concern and have no reason to believe the Bank will not be a going concern for at least the next twelve months from the date of this statement.

Approval of the financial statements

The financial statements, as indicated above, were approved by the Board of Directors on 1 March 2012 and were signed on its behalf by:

Director

Director

Director

Secretary

Report of the independent auditors to the members of Equatorial Commercial Bank Limited

We have audited the financial statements of Equatorial Commercial Bank Limited set out on pages 10 to 55 which comprise the statement of financial position of the Bank at 31 December 2011, and the Bank's statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

As stated on page 8, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 31 December 2011, and the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act.

Report on other legal requirements

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

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

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

(iii) The statement of financial position and statement of comprehensive income are in agreement with the books of account.

KPMG Kenya

Date: 1 March 2012

Statement Of Comprehensive Income For The Year Ended 31 December 2011

	Notes	2011 KShs'000	2010 KShs'000
Interest income	7	1,076,040	687,116
Interest expense	8	(684,436)	(391,193)
Net interest income		**391,604**	**295,923**
Fee and commission income		120,016	105,938
Foreign exchange trading income		95,379	52,028
Other operating income	9	118,703	180,197
Operating income		**725,702**	**634,086**
Impairment losses on financial assets	19(b)	(192)	(75,432)
Operating expenses	10	(664,632)	(734,969)
Share of profit of associate companies	23	18,602	38,720
Profit/(loss) before taxation	**12**	**79,480**	**(137,595)**
Income tax (charge)/credit	13	(7,139)	69,531
Profit/(loss) for the year after taxation		**72,341**	**(68,064)**
Other Comprehensive Income			
Deferred tax on revaluation surplus		-	20,320
Transfer to statutory credit risk reserve		(56,507)	(18,042)
Total other comprehensive income		(56,507)	2,278
Total comprehensive income/(loss)		**15,834**	**(65,786)**
Basic and diluted earnings per share– KShs	**14**	**0.23**	**(0.32)**
Dividend per share – KShs	**15**	**-**	**-**

The notes on pages 14 to 55 form an integral part of these financial statements.

Statement Of Financial Position
As At 31 December 2011

	Note	2011 KShs'000	Restated 2010 KShs'000
ASSETS			
Cash and balances with Central Bank	16	981,435	656,778
Investments in government securities	17	3,630,868	2,996,145
Investments in corporate bonds	17	-	335,545
Placements with other banks	18	153,550	329,841
Loans and advances to customers	19(a)	6,635,194	4,792,435
Property and equipment	20	274,280	131,021
Intangible assets	21	13,712	14,894
Prepaid operating lease rentals	22	-	-
Investment in associate companies	23	191,378	172,776
Deferred tax asset	24	423,200	430,339
Investment property	25	-	-
Balance due from parent and subsidiary companies	26	498,462	403,525
Other assets	27	124,823	141,201
TOTAL ASSETS		**12,926,902**	**10,404,500**
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES			
Deposits from banking institutions		1,586,232	1,295,754
Customers deposits	28	9,833,985	8,036,584
Borrowed funds	37	200,415	-
Other liabilities	29	102,016	160,249
TOTAL LIABILITIES		**11,722,648**	**9,492,587**
SHAREHOLDERS' EQUITY			
Share capital	30(a)	1,723,238	1,503,238
Retained earnings - deficit		(672,143)	(687,977)
Statutory credit risk reserve	30(b)	153,159	96,652
TOTAL EQUITY ATTRIBUTABLE TO SHAREHOLDERS		**1,204,254**	**911,913**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**12,926,902**	**10,404,500**

The financial statements on pages 10 to 55 were approved by the Board of Directors on **1 March 2012** and were signed on its behalf by:

Director ____________________ Director ____________________

Director ____________________ Secretary ____________________

The notes on pages 14 to 55 form an integral part of these financial statements.

Statement Of Changes In Equity
For The Year Ended 31 December 2011

2011:	Share Capital KShs'000	Retained earnings KShs'000	Revaluation reserve KShs'000	Statutory credit risk reserve KShs'000	Total KShs'000
Balance at 1 January 2011	1,503,238	(628,998)	-	96,652	970,892
Prior year accounting error (Note 2(d))	-	(58,979)	-	-	(58,979)
Balance at 1 January 2011(Restated)	1,503,238	(687,977)	-	96,652	911,913
Comprehensive income/(loss) for the year					
Profit for the year	-	72,341	-	-	72,341
Other comprehensive income/(loss)					
Transfer to statutory Credit risk reserve	-	(56,507)	-	56,507	-
Total other comprehensive income/(loss)	**-**	**(56,507)**	**-**	**56,507**	**-**
Total comprehensive income/(loss) for the year	**-**	**15,834**	**-**	**56,507**	**72,341**
Transaction with owners recorded					
Directly in equity					
Issue of ordinary shares	220,000				220,000
At 31 December 2011	**1,723,238**	**(672,143)**	**-**	**153,159**	**1,204,254**
2010:					
Balance at 1 January 2010	461,622	(592,324)	47,412	78,352	(4,938)
Comprehensive income/(loss) for the year					
Loss for the year	-	(68,064)	-	-	(68,064)
Other comprehensive income/(loss)					
Revaluation Surplus on property	-	67,732	(67,732)	-	-
Acquisition through business combination	-	(41,100)	-	41,100	-
Appropriation to statutory Credit risk reserve	-	4,758	-	(22,800)	(18,042)
Deferred tax on revaluation surplus	-	-	20,320	-	20,320
Total other comprehensive income/(loss)	**-**	**31,390**	**(47,412)**	**18,300**	**2,278**
Total comprehensive income/(loss) for the year	**-**	**(36,674)**	**(47,412)**	**18,300**	**(65,786)**
Transaction with owners recorded					
Directly in equity					
Issue of ordinary shares on merger	1,041,616	-	-	-	1,041,616
At 31 December 2010	**1,503,238**	**(628,998)**	**-**	**96,652**	**970,892**

The notes on pages 14 to 55 form an integral part of these financial statements.

Statement Of Cashflow
For The Year Ended 31 December 2011

	Notes	2011 KShs'000	2010 KShs'000
Net cash outflow from/(used in) operating activities	32(a)	115,319	(1,509,422)
Cash flows from investing activities			
Purchase of property and equipment		(173,344)	(66,972)
Purchase of intangible assets		(3,331)	(1,527)
Proceeds from disposal of property and equipment		1,500	3,664
Proceeds from issue of shares		220,000	-
Net cash from/(used in) investing activities		44,825	(64,835)
Net cash acquired		-	391,774
Increase/(decrease) in cash and cash equivalents	32(b)	160,144	(1,182,483)

The notes on pages 14 to 55 form an integral part of these financial statements.

Notes To The Financial Statements For The Year Ended 31 December 2011

1. REPORTING ENTITY

The Bank is incorporated as a limited company in Kenya under the Kenyan Companies Act, and is domiciled in Kenya. The address of its registered office is as follows:

Equatorial Commercial Bank Centre (HQ)
Nyerere Road
P.O. Box 52467
00200 Nairobi

2. BASIS OF PREPARATION

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards and the Kenyan Companies Act. The financial statements are prepared under the historical cost basis as modified by the revaluation of property plant and equipment, investment property and financial instruments, classified as instruments available for sale, held for trading, instruments held at fair value through profit and loss and derivative instruments.

(b) Use of estimates and judgments

The preparation of financial statements in conformity with International Financial Reporting Standards requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the Directors' best knowledge of current events and actions, actual results ultimately may differ from the estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In particular, information about significant areas of estimation and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in financial statements are described in Note 5.

(c) Functional and presentation currency

The financial statements are presented in Kenya shillings, which is also the Bank's functional currency, the currency of the primary economic environment in which the entity operates. Except as indicated, financial information presented in Kenya shillings (KShs) has been rounded to the nearest thousand.

(d) Prior year accounting error

In the prior year, IFRS specific provisions amounting to KShs 58,979,000 were not recognised. The error has been corrected in the comparative information presented in the financial statements. Details of the impact of the prior year adjustment are disclosed in Note 38 to the financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of consolidation

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Bank.

Costs related to the acquisition, other than those associated with the issue of debt or equity securities that the Bank incurs in connection with a business combination are expensed as incurred.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in the profit and loss account.

(b) Revenue recognition

Revenue is derived substantially from banking business and related activities and comprises net interest income and non-interest income. Income is recognized on an accrual basis in the period in which it is earned.

(i) Net interest income

Interest income and expense for all interest bearing instruments are recognised in profit or loss as it accrues, taking into account the effective interest rate of the asset or an applicable floating rate. The effective interest rate is the rate that exactly discounts the estimated future cash flows through the expected life of the financial asset or liability to the carrying amount of the financial asset or liability. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

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

(ii) Fees and commission income

Fees and commission income is recognized on an accrual basis when the service is provided.

(iii) Foreign exchange trading income

Foreign exchange trading income comprises gains less losses related to trading assets and liabilities and includes all realized and unrealized exchange gains or losses.

(c) Recognition and measurement of financial instruments

The Bank classifies its financial assets into four categories described below. Management determines the appropriate classification of its financial instruments at the time of purchase and re-evaluates its portfolio on a regular basis to ensure that all financial assets are appropriately classified.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

Financial assets in this category held for trading are those that the Bank principally holds for the purpose of short-term profit taking and/or those designated at fair value through profit or loss at inception. These are recognised on the date the Bank commits to acquire the instruments.

Trading instruments are initially recognised at cost, including transaction costs. Subsequent to initial recognition, trading instruments are stated at fair value based on quoted bid prices. Where the fair value cannot be reliably measured, the assets are stated at cost less impairment losses. Changes in fair value are recognised in profit or loss.

(ii) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market.

They arise when the Bank provides money directly to borrowers, other than those created with the intention of short-term profit taking. They are recognised at the date money is disbursed to the borrower or when they are transferred to the Bank from a third party.

Subsequent to initial recognition, these are carried at amortised cost, which is the present value of the expected future cash flows, discounted at the instrument's original effective interest rate. Loan origination fees together with related direct costs are treated as part of the cost of the transaction.

Amortised cost is calculated using the effective interest rate method. The amortisation and accretion of premiums and discounts is included in interest income.

(iii) Held-to-maturity

These are financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. The sale of a significant amount of held-to-maturity assets would taint the entire category leading to reclassification as available-for-sale.

Subsequent to initial recognition, these are carried at amortised cost, which is the present value of the expected future cash flows, discounted at the instrument's original effective interest rate.

Amortised cost is calculated using the effective interest rate method. The amortisation and accretion of premiums and discounts is included in interest income.

(iv) Available-for-sale

Other financial assets held by the Bank are classified as available-for-sale and are initially recognised at cost, including transaction costs. Subsequent to initial recognition, available-for-sale financial assets are stated at fair value based on quoted bid prices. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity in the fair value reserve, net of deferred tax. When these investments are derecognised, the cumulative gain or loss previously directly recognised in equity is recognised in profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Derecognition

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

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

Held-to-maturity instruments and loans and receivables are derecognised on the day they are repaid in full or when they are transferred by the Bank to a third party.

(d) Identification and measurement of impairment of financial assets

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

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

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

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Identification and measurement of impairment of financial assets (continued)

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 the 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.

(e) Impairment for non-financial assets

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

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

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

(f) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at the exchange rate ruling at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rate ruling at the reporting date. Resulting exchange differences are recognised in profit or loss in the year in which they arise.

Non monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates ruling at the transaction date

(g) Property and equipment

(i) Recognition and measurement

Items of property and equipment are stated at cost or as professionally revalued from time to time less accumulated depreciation and impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset.

(ii) *Depreciation*

Depreciation is charged on a straight-line basis over the estimated useful lives of the assets. The rates of depreciation used are based on the following estimated useful lives:

• Motor vehicles (New)	7 years
• Motor vehicles (Used)	5 years

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Property and equipment (continued)

(ii) *Depreciation (continued)*

• Computer equipment	4 years
• Office equipment	8 years
• Fixtures and fittings	12 years
• Office furniture	8 years
• Leasehold improvements	12 years

Depreciation methods, useful lives and residual values are reassessed and adjusted, if appropriate, at each reporting date.

(iii) Subsequent costs

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

(iv) Disposal of property and equipment

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

(h) Intangible assets

The cost incurred to acquire and bring to use specific computer software licences are capitalised. The costs are amortised on a straight line basis over the expected useful lives, for a period not exceeding five years. Costs associated with maintaining software are recognised as an expense as incurred.

(i) Operating leases

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

(j) Income tax expense

Income tax expense comprises current tax and change in deferred tax. Current tax is the expected tax payable on the taxable income for the year using tax rates enacted at the reporting date, and any adjustment to tax payable in respect of a previous year.

Deferred tax is provided using the statement of financial position liability method on all temporary differences between the carrying amounts for financial reporting purposes and the amounts used for taxation purposes, except differences relating to the initial recognition of assets or liabilities which affect neither accounting nor taxable profit.

Deferred tax is calculated on the basis of the tax rates currently enacted.
A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Employee benefits

(i) Defined contribution plan

The majority of the Bank's employees are eligible for retirement benefits under a defined contribution plan.

Contributions to the defined contribution plan are charged to the profit or loss as incurred. Any difference between the charge to the profit or loss and the contributions payable is recorded in the statement of financial position under other receivables or other payables.

The company also contributes to a statutory defined contribution pension scheme, the National Social Security Fund (NSSF). Contributions are determined by local statute and are currently limited at KShs 200 per employee per month.

(ii) Leave accrual

The monetary value of the unutilised leave by staff as at year end is carried in the accruals as a payable and the movement in the year is debited /credited to the profit or loss.

(iii) Termination benefits

Termination benefits are recognised as an expense when the Group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognised if the Group has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

(l) Cash and cash equivalents

For the purpose of presentation of the cash flows in the financial statements the cash and cash equivalents include cash and balances with Central Bank of Kenya available to finance the Bank's day-to-day operations, net balances from Banking institutions and treasury bills and bonds which mature within 90 days or less from the date of acquisition.

(m) Dividends

Dividends are recognised as a liability in the period in which they are declared. Proposed dividends are disclosed as a separate component of equity.

(n) Related parties

In the normal course of business, transactions have been entered into with certain related parties. These transactions are at arm's length.

(o) Provisions

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Offsetting of financial assets and liabilities

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

(q) Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are accounted for as off statement of financial position transactions and disclosed as contingent liabilities. Estimates of the outcome and the financial effect of contingent liabilities is made by management based on the information available up to the date the financial statements are approved for issue by the Directors. Any expected loss is charged to profit or loss.

(r) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss for the year attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss for the year attributable to ordinary shareholders and the weighted average number of shares outstanding to the effects of all dilutive potential ordinary shares, if any.

(s) New standards and interpretations not yet adopted

The following standards, amendments to the standards and interpretation is not yet effective for the year ended 31 December 2011, and have not been applied in preparing these financial statements and the extent of the impact has not been determined:

- *Amendments to IAS 1-'Presentation of Items of Other Comprehensive Income'- effective 1 July 2012*
  The amendments require that an entity present separately the items of other comprehensive income that would be reclassified to profit or loss in the future if certain conditions are met from those that would never be reclassified to profit or loss. It however does not change the existing option to present profit or loss and other comprehensive income in two statements but changes the title of the statement of comprehensive income to the statement of profit or loss and other comprehensive income. However, an entity is still allowed to use other titles.

- *Amendments to IAS 12 –'Deferred Tax: Recovery of Underlying Assets Statements' – effective 1 January 2012.*
  The amendments introduce an exception to the general measurement requirements of IAS 12 'Income Taxes' in respect of investment properties measured at fair value. The measurement of deferred tax assets and liabilities, in this limited circumstance, is based on a rebuttable presumption that the carrying amount of the investment property will be recovered entirely through sale. The presumption can be rebutted only if the investment property is depreciable and held within a business model whose objective is to consume substantially all of the asset's economic benefits over the life of the asset.

- *IAS 19 'Employee Benefits' – effective 1 January 2013*
  The amended IAS 19 requires that actuarial gains and losses are recognised immediately in other comprehensive income; this change will remove the corridor method and eliminate the ability for entities to recognise all changes in the defined benefit obligation and in plan assets in profit or loss, which currently is allowed under IAS 19. It also requires that expected return on plan assets recognised in profit or loss is calculated based on the rate used to discount the defined benefit obligation.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(s) New standards and interpretations not yet adopted (continued)

- *IFRS 9 'Financial Instruments' (effective 1 January 2015)*
  It is a new standard on financial instruments that will eventually replace IAS 39. The published standard introduces changes to the current IAS 39 rules for classification and measurement of financial assets.

  Under IFRS 9 there will be two measurement bases for financial assets: amortised cost and fair value. Financial assets at fair value will be recorded at fair value through the profit and loss account with a limited opportunity to record changes in fair value of certain equity instruments through other comprehensive income. Financial liabilities are excluded from the scope of the standard.

  The standard also differs from existing requirements for accounting for financial assets in various other areas, such as embedded derivatives and the recognition of fair value adjustments in other comprehensive income.

  The standard will be applied retrospectively (subject to the standard's transitional provisions).

  The Bank is currently in the process of evaluating the potential effect of this standard. Given the nature of the Bank's operations, this standard is expected to have a pervasive impact on the Bank's financial statements.

- *IFRS 10 'Consolidated Financial Statements'*
  Effective 1 January 2013. This standard replaces the requirements and guidance in IAS 27 relating to consolidated financial statements. The objective of this standard is to improve the usefulness of consolidated financial statements by developing a single basis for consolidation and robust guidance for applying that basis to situations where it has proved difficult to assess control in practice and divergence has evolved. The basis for consolidation is control and it is applied irrespective of the nature of the investee.

- *IFRS 11 – 'Joint arrangements' – effective 1 January 2013*

  IFRS 11 supersedes IAS 31 and SIC-13 relating to Jointly Controlled Entities. The objective of this IFRS is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly. It focuses on the rights and obligations of joint arrangements, rather than the legal form (as is currently the case). It further distinguishes joint arrangements between joint operations and joint ventures; and requires the equity method for jointly controlled entities that are now called joint ventures.

- *IFRS 12 – 'Disclosure of interests in other entities' - effective 1 January 2013*
  The objective of this IFRS is to require an entity to disclose information that enables users of its financial statements to evaluate: the nature of, and risks associated with, its interests in other entities; and the effects of those interests on its financial position, financial performance and cash flows.

- *IFRS 13 – 'Fair value measurement' - effective 1 January 2013*
  IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other IFRSs. It does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards.

4. FINANCIAL RISK MANAGEMENT

(a) Introduction and overview

The Bank has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risks
- Operational risks

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

Risk management framework

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

The Bank's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

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

(b) Credit risk

The Bank's credit exposure at the reporting date from financial instruments held or issued for trading purposes is represented by the fair value of instruments with a positive fair value at that date, as recorded on the statement of financial position.

The risk that counter-parties to trading instruments might default on their obligations is monitored on an ongoing basis. In monitoring credit risk exposure, consideration is given to trading instruments with a positive fair value and to the volatility of the fair value of trading instruments.

To manage the level of credit risk, the Bank deals with counter-parties of good credit standing, enters into master netting agreements whenever possible, and when appropriate, obtains collateral. An assessment of the extent to which fair values of collaterals cover existing credit risk exposures on loans and advances to customers is highlighted in the later part of this section.

4. FINANCIAL RISK MANAGEMENT (continued)

(b) Credit risk (continued)

The Bank also monitors concentrations of credit risk that arise by industry and type of customer in relation to the Bank loans and advances to customers by carrying a balanced portfolio. The Bank has no significant exposure to any individual customer or counter-party.

The Bank exposure to credit risk is analysed as follows:

(i) Loans and advances to customers	**2011 KShs'000**	**2010 KShs'000**
Individually impaired		
Impaired (substandard)	141,999	403,590
Impaired (doubtful)	404,075	676,954
Impaired (loss)	42,964	117,564
Gross amount	589,038	1,198,108
Allowance for impairment	(211,252)	(531,609)
Carrying amount	**377,786**	**666,499**
Collectively impaired		
Neither Past due nor impaired	5,907,490	3,803,113
Past due and not impaired	366,822	336,068
Gross amount	6,274,312	4,139,181
Portfolio impairment provision	(16,904)	(13,245)
Carrying amount	**6,257,408**	**4,125,936**
Net loans and advances	**6,635,194**	**4,792,435**
(ii) Other financial assets		
Neither past due nor impaired		
Investment in Government securities	3,630,868	2,996,145
Corporate bonds	-	335,545
Placements with other Banks	153,550	329,841

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

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

4. FINANCIAL RISK MANAGEMENT (continued)

(b) Credit risk (continued)

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

Allowances for impairment
The 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 groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

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

For smaller balance standardised loans, charge off decisions generally are based on a product specific past due status.

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

Loans and advances to customers	Gross KShs'000	Net KShs'000
31 December 2011:		
Impaired (substandard)	141,999	75,821
Impaired (doubtful)	404,075	301,866
Impaired (loss)	42,964	99
	589,038	**377,786**
31 December 2010:		
Impaired (substandard)	403,590	300,365
Impaired (doubtful)	676,954	354,480
Impaired (loss)	117,564	11,654
	1,198,108	**666,499**

Fair value of collaterals

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2011 or 2010.

4. FINANCIAL RISK MANAGEMENT (continued)

(b) Credit risk (continued)

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

Loans and advances to customers

	2011 KShs'000	2010 KShs'000
Against individually impaired		
Property	166,795	949,912
Other	896	75,538
Against collectively impaired		
Property	600,099	3,728,664
Debt securities	-	375,306
Equities	-	142,254
Other	61,643	1,017,582
Against past due but not impaired		
Property	48,000	96,717
Debt securities	-	10,300
Other	22,000	72,000
Against neither past due nor impaired		
Property	5,075,713	3,631,947
Debt securities	60,400	365,006
Equities	174,000	142,254
Other	2,193,545	945,582

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

Gross loans and advances to customers:

	2011 KShs'000	2010 KShs'000
Carrying amount		
Building and construction	1,016,261	422,734
Wholesale and retail trade, restaurants and hotels	2,533,214	2,772,162
Finance and insurance	47,516	8,508
Manufacturing	792,232	734,845
Social, community, personal services	568,124	259,320
Agriculture	815,529	552,229
Others	1,090,474	587,490
	6,863,350	**5,337,288**

Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

4. FINANCIAL RISK MANAGEMENT (continued)

(b) Credit risk (continued)

For certain types of transactions the Bank mitigates this risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval/limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from Bank Risk.

(c) Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Bank has access to a diverse funding base. Funds are raised mainly from deposits and share capital. This enhances funding flexibility, limits dependence on any one source of funds and generally lowers the cost of funds. The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall Bank strategy.

In addition the Bank holds a portfolio of liquid assets as part of its liquidity risk management strategy.

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

Management of liquidity risk

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

Central Treasury receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business.

Central Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to Banks and other inter-Bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

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

4. FINANCIAL RISK MANAGEMENT (continued)

(c) Liquidity risk (continued)

Exposure to liquidity risk

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

Details of the reported Group ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2011	2010
At 31 December	34.4%	33.7%
Average for the period	36.5%	39.1%
Maximum for the period	41.9%	57.7%
Minimum for the period	30.4%	23.0%

The table below analyses financial liabilities of the Bank into relevant maturity groupings based on the remaining period at 31 December 2011 to the contractual maturity date.

31 December 2011:	On demand KShs'000	Due within 3 months KShs'000	Due between 3-12 months KShs'000	Due between 1-5 years KShs'000	Total KShs'000
LIABILITIES					
Deposits from banking institutions	-	1,586,232	-	-	**1,586,232**
Customer deposits	2,719,513	794,836	4,738,351	1,581,285	**9,833,985**
Borrowed funds	-	-	200,415	-	**200,415**
Other liabilities	102,016	-	-	-	**102,016**
TOTAL LIABILITIES	**2,821,529**	**2,381,068**	**4,938,766**	**1,581,285**	**11,722,648**
31 December 2010:					
LIABILITIES					
Deposits from banking institutions	-	1,295,754	-	-	**1,295,754**
Customer deposits	2,329,385	2,439,211	3,048,629	219,359	**8,036,584**
Other liabilities	160,249	-	-	-	**160,249**
TOTAL LIABILITIES	**2,489,634**	**3,734,965**	**3,048,629**	**219,359**	**9,492,587**

4. FINANCIAL RISK MANAGEMENT (continued)

(d) Market risk

Interest rate risk
The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest earning assets and interest bearing liabilities mature or reprice at different times or in differing amounts. Risk management activities are aimed at optimizing net interest income, given market interest rates levels consistent with the Bank's business strategies. The bank does not have any significant interest rate risk exposures.

This table shows the extent to which the Bank's interest rate exposures on assets and liabilities are matched. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and maturity date:

31 December 2011	Effective interest rate KShs'000	3 months or less KShs'000	Over 3 months KShs'000	Non-interest bearing KShs'000	Total KShs'000
ASSETS					
Cash and balances with Central Bank of Kenya	-	-	-	981,435	**981,435**
Investments in Government securities	8.21%	-	3,630,868	-	**3,630,868**
Placements with other banks	1.90%	153,550	-	-	**153,550**
Loans and advances to customers	14.22%	933,641	5,701,553	-	**6,635,194**
Balance due from group companies	-	-	-	498,462	**498,462**
Other assets – Items in transit	-	-	-	67,481	**67,481**
TOTAL ASSETS		**1,087,191**	**9,332,421**	**1,547,378**	**11,966,990**
Deposits from banking institutions	10.92%	1,586,232	-	-	**1,586,232**
Customer deposits	6.24%	3,514,311	6,319,674	-	**9,833,985**
Borrowed funds	12.00%	-	200,415	-	**200,415**
Other liabilities – Bills payable	-	-	-	21,150	**21,150**
TOTAL LIABILITES		**5,100,543**	**6,520,089**	**21,150**	**11,641,782**
Asset – liability gap 2011		**(4,013,352)**	**2,812,332**	**1,526,228**	**325,208**

4. FINANCIAL RISK MANAGEMENT (continued)

(d) Market risk (Continued)

31 December 2010:	Effective interest rate	3 months or less KShs'000	Over 3 months KShs'000	Non-interest bearing KShs'000	Total KShs'000
ASSETS					
Cash and balances with Central Bank of Kenya	-	-	-	656,778	**656,778**
Investments in Government securities	6.33%	268,900	2,727,245	-	**2,996,145**
Placements with other banks	2.74%	329,841	-		**329,841**
Investment in corporate bonds	12.50%	-	335,545	-	**335,545**
Loans and advances to customers	11.41%	3,174,477	1,617,958	-	**4,792,435**
Balance due from group companies	-	-	-	403,525	**403,525**
Other assets – Items in transit	-	-	-	106,761	**106,761**
TOTAL ASSETS		**3,773,218**	**4,680,748**	**1,167,064**	**9,621,030**
Deposits from banking institutions	2.46%	1,295,754	-	-	**1,295,754**
Customer deposits	5.32%	4,768,596	3,267,988	-	**8,036,584**
Other liabilities	-	-	-	91,442	**91,442**
TOTAL LIABILITES	-	**6,064,350**	**3,267,988**	**91,442**	**9,423,780**
Asset – liability gap 2010	**-**	**(2,291,132)**	**1,412,760**	**1,075,622**	**197,250**

(d) Market risk

Sensitivity analysis on interest rates
An increase of 1 percentage point in interest rates for the period would have increased/ (decreased) profit and loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. This analysis is performed on the same basis for 2010.

Effect in Kenya shillings thousands	**Profit or Loss**	
	2011	**2010**
Interest income	104,197	85,129
Interest expense	(116,209)	(933,323)
Net change in interest	**(12,012)**	**(8,194)**

A decrease of 1 percentage point in interest rates for the period would have had an equal but opposite effect on the profit and loss, on the basis that all other variables remain constant.

4. FINANCIAL RISK MANAGEMENT (continued)

(d) Market risk (continued)

Currency risk

The Bank is exposed to currency risk through transactions in foreign currencies. The Bank's transactional exposures give rise to foreign currency gains and losses that are recognised in the profit or loss. In respect of monetary assets and liabilities in foreign currencies, the Bank ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate.

The various currencies to which the Bank is exposed at 31 December 2011 are summarised in the table below (all expressed in Kenya Shillings thousands):

31 December 2011	USD	GBP	EURO	Total
ON BALANCE SHEET ITEMS				
ASSETS				
Cash and balances with Bank	248,265	66,954	41,256	**356,475**
Loans and advances to customers	792,949	1,814	157,708	**952,471**
Other assets	15	1	16,180	**16,196**
TOTAL ASSETS	**1,041,229**	**68,769**	**215,144**	**1,325,142**
Customer deposits	695,734	72,770	208,219	**976,723**
Borrowings	277,533	10	-	**277,543**
Other liabilities	38,139	586	562	**39,287**
TOTAL LIABILITIES	**1,011,406**	**73,366**	**208,781**	**1,293,553**
Net currency exposure – on balance sheet position	**29,823**	**(4,597)**	**6,363**	**31,589**
OFF BALANCE SHEET ITEMS LIABILITIES	**566,295**	**-**	**16,998**	**583,293**

Notes to the Financial Statements
For The Year Ended 31 December 2011(continued)

4. FINANCIAL RISK MANAGEMENT (continued)

(d) Market risk (continued)

31 December 2010	USD	GBP	EURO	Total
ON BALANCE SHEET ITEMS				
ASSETS				
Cash and balances with Bank	206,821	74,000	46,205	**327,026**
Loans and advances to customers	372,453	3	161,840	**534,296**
Other assets	147,665	-	-	**147,665**
TOTAL ASSETS	**726,939**	**74,003**	**208,045**	**1,008,987**
Customer deposits	497,199	75,973	82,545	**655,717**
Borrowings	278,760	-	-	**278,760**
Other liabilities	3,014	275	212,871	**216,160**
TOTAL LIABILITIES	**778,973**	**76,248**	**295,416**	**1,150,637**
Net currency exposure – on balance sheet position	**(52,034)**	**(2,245)**	**(87,371)**	**(141,650)**
OFF BALANCE SHEET ITEMS LIABILITIES	**789,473**	**-**	**19,954**	**809,427**

The following exchange rates were applied during the year:

	Average rate		Closing rates	
	2011	2010	2011	2010
US Dollar	88.73	79.47	85.30	80.80
Sterling Pound	142.39	122.58	131.47	124.74
Euros	124.22	104.71	110.45	107.21

Sensitivity analysis
A 10 percent increase in the rate of the Kenya shilling against the following currencies at 31 December would have increased/ (decreased) profit or loss for revaluation by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remains constant. The analysis is performed on the same basis for 2010.

Effect in Kenya shillings thousands	Profit or loss	
	2011	2010
As at 31 December		
US Dollar	2,982	(5,203)
Sterling pound	(460)	(225)
Euros	636	8,737

4. FINANCIAL RISK MANAGEMENT (continued)

(d) Market risk (continued)

A 10 percent decrease in the rate of the Kenya shilling against the above currencies at 31 December 2011 and 2010 would have had an equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

(e) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This is supported by the development of overall standards for the management of operational risk in areas such as compliance with regulatory requirements, ethical and business standards, training and professional development, documentation of controls and procedures and requirements for the reconciliation and monitoring of transactions amongst others.

(f) Capital management

Regulatory capital
The Central Bank of Kenya sets and monitors capital requirements for the Bank. The Bank's operations are directly supervised by local regulators.

In implementing current capital requirements The Central Bank of Kenya requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank uses its internal grading as the basis for risk weightings for credit risk.

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

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

• Tier 2 capital, which includes qualifying subordinated liabilities, statutory credit risk reserves and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 percent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There also are restrictions on the amount of Statutory Credit Risk Reserve that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of Banks and certain other regulatory items.

4. FINANCIAL RISK MANAGEMENT (continued)

(f) Capital management (continued)

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

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.

There have been no material changes in the Bank's management of capital during the period.

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

	2011 KShs'000	2010 KShs'000
Tier 1 capital		
Ordinary share capital	1,723,238	1,503,238
Retained earnings	(672,143)	(687,977)
	1,051,095	815,565
Tier 2 capital	100,920	77,140
Total regulatory capital	**1,152,015**	**892,705**
Risk-weighted assets		
On balance sheet risk weighted assets	7,377,877	5,669,759
Off balance sheet risk weighted assets	630,054	448,409
Total risk-weighted assets	**8,007,931**	**6,118,168**
Capital ratios		
Percentage of total regulatory capital to Risk-weighted assets	14.27%	14.46%
Minimum requirement	**12.00%**	**12.00%**
Percentage of core capital to risk weighted assets	13.02%	13.21%
Minimum requirement	**8.00%**	**8.00%**
Percentage of core capital to deposits	10.69%	10.14%
Minimum requirement	**8.00%**	**8.00%**

4. FINANCIAL RISK MANAGEMENT (continued)

(f) Capital management (continued)

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by the Risk Management Committee and Credit Committee, and is subject to review by the Board Audit Committee and the Board of Directors.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

The CBK amended the Banking Act in 2009 which requires banks to increase their core capital as follows

Compliance date	Minimum core capital KShs
31 December 2011	750 million
31 December 2012	1,000 million

The Bank is in compliance with the above requirements as at 31 December 2011.

5. USE OF ESTIMATES AND JUDGEMENTS

(a) Loan loss provisioning

The Bank's loan loss provisions are established to recognise incurred impairment losses either on specific loan assets or within a portfolio of loans and receivables.

Impairment losses for specific loan assets are assessed either on an individual or on a portfolio basis. Individual impairment losses are determined as the difference between the loan carrying value and the present value of estimated future cash flows, discounted at the loans' original effective interest rate. Impairment losses determined on a portfolio basis are assessed based on the probability of default inherent within the portfolio of impaired loans or receivables.

Estimating the amount and timing of future recoveries involves significant judgment, and considers the level of arrears as well as the assessment of matters such as future economic conditions and the value of collateral, for which there may not be a readily accessible market.

Loan losses that have been incurred but have not been separately identified at the reporting date are determined on a portfolio basis, which takes into account past loss experience and defaults based on portfolio trends. Actual losses identified could differ significantly from the impairment provisions reported as a result of uncertainties arising from the economic environment.

5. USE OF ESTIMATES AND JUDGEMENTS (continued)

(b) Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

All financial instruments are initially recognised at fair value, which is normally the transaction price. In certain circumstances, the initial fair value may be based on a valuation technique which may lead to the recognition of profits or losses at the time of initial recognition. However, these profits or losses can only be recognised when the valuation technique used is based solely on observable market inputs.

Subsequent to initial recognition, some of the Bank's financial instruments are carried at fair value, with changes in fair value either reported within the profit or loss or within equity until the instrument is sold or becomes impaired. Details of the type and classification of the Bank's financial instruments are set out in Note 6 to the financial statements.

(c) Depreciation of property and equipment

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

(d) Taxes

Determining income tax provisions involves judgment on the tax treatment of certain transactions. Deferred tax is recognised on tax losses not yet used and on temporary differences where it is probable that there will be taxable revenue against which these can be offset. Management has made judgments as to the probability of tax losses being available for offset at a later date.

6. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES

(a) Accounting classifications and fair values

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

	Held for Trading	Held to Maturity	Loans and Recievables	Available For Sale	Other Amortised Cost	Total Carrying Amount
	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
As at 31 December 2011:						
Assets						
Cash and cash equivalents	-	-	-	-	981,435	981,435
Deposits and balances due from other banks	-	-	-	-	153,550	153,550
Investments in corporate bond	-	-	-	-	-	-
Investments in Government securities	-	3,630,868	-	-	-	3,630,868
Loans and advances to customers	-	-	6,635,194	-	-	6,635,194
Total assets	**-**	**3,630,868**	**6,635,194**	**-**	**1,134,985**	**11,401,047**
Liabilities and shareholders' funds						
Deposits and balances due to banking institutions	-	-	-	-	1,586,232	1,586,232
Customers' deposits	-	-	-	-	9,833,985	9,833,985
Borrowed funds	-	-	-	-	200,415	200,415
Total liabilities	**-**	**-**	**-**	**-**	**11,620,632**	**11,620,632**
As at 31 December 2010:						
Assets						
Cash and cash equivalents	-	-	656,778	-	-	656,778
Deposits and balances due from other banks	-	-	329,841	-	-	329,841
Investments in corporate bond	-	335,545	-	-	-	335,545
Investments in Government securities	-	2,996,145	-	-	-	2,996,145
Loans and advances to customers	-	-	4,792,435	-	-	4,792,435
Total assets	**-**	**3,331,690**	**5,779,054**	**-**	**-**	**9,110,744**
Liabilities and shareholders' funds						
Deposits and balances due to banking institutions	-	-	-	-	1,295,754	1,295,754
Customers' deposits	-	-	-	-	8,036,584	8,036,584
Total liabilities	**-**	**-**	**-**	**-**	**9,332,338**	**9,332,338**

6. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES (continued)

(a) Accounting classifications and fair values (continued)

The following sets out the Bank's basis of establishing fair value of the financial instruments:

Cash and balances with Central Bank of Kenya

The fair value of cash and bank balances with the Central Bank of Kenya is their carrying amount.

Deposits and advances to banks

The fair value of floating rate placements and overnight deposits is their carrying amounts.

Loans and advances to customers

Loans and advances to customers are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates. Expected cash flows are discounted at current market rates to determine fair value. A substantial proportion of loans and advances reprice within 12 months and hence the carrying amount is a good proxy of the fair value.

Investments in Government securities and corporate bonds

Investments in Government securities and corporate bonds are carried at amortised cost using the effective interest rate method. The estimated fair value represents the discounted amount of future cash flows expected to be received. A substantial portion of investments in Government securities and corporate bonds mature within twelve months and hence the carrying amount is a good proxy of the fair value.

Deposits from banks and customers

The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits without quoted market prices is based on discounting cash flows using the prevailing market.

A substantial proportion of deposits mature within 6 months and hence the carrying amount is a good proxy of the fair value.

7. INTEREST INCOME

	2011 KShs'000	2010 KShs'000
Loans and advances to customers	804,768	506,540
Government securities	246,007	141,011
Placements with other banks	1,713	3,177
Corporate bonds	23,552	36,388
	1,076,040	**687,116**

8. INTEREST EXPENSE

	2011 KShs'000	2010 KShs'000
Customer deposits	541,498	366,972
Deposits from other banks and banking institutions	142,938	24,221
	684,436	**391,193**

9. OTHER OPERATING INCOME

	2011 KShs'000	2010 KShs'000
Profit on sale of property and equipment	1,320	1,707
Bond trading income	38,727	147,457
Other income	78,656	31,033
	118,703	**180,197**

10. OPERATING EXPENSES

	2011 KShs'000	2010 KShs'000
Salaries and employee benefits (Note 11)	289,145	238,385
Occupancy expenses	124,646	90,740
Deposit Protection Fund contribution	11,904	9,256
Integration/Merger costs	(8,299)	142,805
Other expenses	247,236	253,783
	664,632	**734,969**

Included in other expenses are support services payable to a related company of KShs 27,198,575 (2010 – KShs 39,106,000).

11. STAFF COSTS

	2011 KShs'000	2010 KShs'000
Salaries and wages	245,580	203,206
Contributions to defined contribution scheme	11,469	10,324
Social security contributions	424	405
Staff welfare	31,672	24,450
	289,145	**238,385**

The average numbers of employees engaged during the year were:	**2011**	**2010**
Management staff	176	172
Unionisable	5	13
	181	**185**

12. PROFIT/(LOSS) BEFORE TAXATION

	2011 KShs'000	2010 KShs'000
Profit/(Loss) before taxation is arrived at after charging/ (crediting):		
Depreciation expense	29,905	27,017
Amortisation of intangible assets	4,513	4,165
Directors' emoluments:		
Non-executives – Fees	590	1,677
Executives – Remuneration	16,897	11,990
Auditors' remuneration – Current year	3,800	4,150
(Gains) on sale of property and equipment	(1,320)	(1,707)

13. TAXATION

	2011 KShs'000	2010 KShs'000
Current tax at 30% on adjusted profit for tax purposes	-	-
Deferred tax charge (Note 24)	24,833	(51,058)
Prior year under provision of deferred tax asset	(17,694)	(18,473)
Tax charge / (credit) for the year	**7,139**	**(69,531)**

The tax on the Bank's profit/(loss) differs from the theoretical amount using the basic tax rate as follows:

	2011 KShs'000	2010 KShs'000
Accounting profit/(loss) before tax	**60,878**	**(137,596)**
Computed tax using the applicable tax rate of 30%	18,263	(41,278)
Non-deductible expenses and non-taxable income	6,570	(9,780)
Prior year under provision of deferred tax asset	(17,694)	(18,473)
Income tax charge / (credit)	**7,139**	**(69,531)**

14. BASIC AND DILUTED EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on:	2011 KShs'000	2010 KShs'000
Net Profit/ (Loss) for the year attributable to shareholders – KShs'000	**72,341**	**(68,064)**
Weighted average number of ordinary shares in issue at 31 December	**311,647**	**214,464**
Basic and diluted earnings per share	**0.23**	**(0.32)**

15. DIVIDENDS PER SHARE

No dividends were declared in 2011 (2010 - Nil).

16. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2011 KShs'000	2010 KShs'000
Cash on hand	161,337	111,314
Balances with Central Bank of Kenya:		
- Cash reserve ratio	62,878	365,134
- Other	757,220	180,330
	981,435	**656,778**

The cash ratio reserve with Central Bank of Kenya (CBK) is non-interest earning and is based on the value of deposits as adjusted for CBK requirements. At 31 December 2011, the cash reserve ratio requirement was 5.25 % of eligible deposits (2010 – 4.5%). The Bank is free to deviate from the 5.25% requirement on any given day, but not to fall below 3%, provided that the overall average for the month will be at least 5.25%.

17. INVESTMENTS HELD TO MATURITY

Government securities	2011 KShs'000	2010 KShs'000
Treasury bills – due after 90 days	-	148,900
Treasury bonds	3,630,868	2,847,245
	3,630,868	2,996,145
Corporate bonds	-	335,545
Total investments	**3,630,868**	**3,331,690**

The weighted average effective interest rate on government securities for the year 2011 was 8.21% (2010 - 6.33%).

18. PLACEMENTS WITH OTHER BANKS

	2011 KShs'000	2010 KShs'000
Due within 90 days	**153,550**	**329,841**

The weighted average effective interest rate on placements with other banks for the year 2011 was 1.9% (2010 - 2.74%).

19. LOANS AND ADVANCES TO CUSTOMERS

	2011 KShs'000	2010 KShs'000
(a) Overdrafts	2,641,805	2,416,908
Loans	3,892,327	2,566,315
Bills discounted	30,221	36,394
Others	298,997	317,670
Gross loans and advances	6,863,350	5,337,288
Less: Provisions for impairment losses on loans and advances	(228,156)	(544,853)
Net loans and advances	**6,635,194**	**4,792,435**

(b) Impairment losses on financial assets

31 December 2011:	**Specific impairment losses** KShs'000	**Portfolio impairment losses** KShs'000	**Total KShs'000**
At 1 January 2011	531,609	13,244	544,853
Acquisition through business combination	-	-	-
Amounts written off during the year	(316,889)	-	(316,889)
	214,720	13,244	227,964
Provisions made during the year	(3,468)	3,660	192
At 31 December 2011	**211,252**	**16,904**	**228,156**
At 1 January 2010	472,832	-	472,832
Acquisition through business combination	62,945	4,789	67,734
Amounts written off during the year	(130,124)	-	(130,124)
	405,653	4,789	410,442
Provisions made during the year	125,956	8,455	134,411
At 31 December 2010	**531,609**	**13,244**	**544,853**

The weighted average effective interest rate on loans and advances to customers for the year 2011 was 14.22% (2010 – 11.41%).

(c) Non performing loans and advances

Loans and advances include an amount of KShs 589,038 (2010 – KShs 1,198,108) which has been classified as impaired. These loans have been written down to their recoverable amount.

20. PROPERTY AND EQUIPMENT

2011:	Leasehold improvements KShs'000	Motor vehicles KShs'000	Furniture, fixtures and fittings KShs'000	Computer hardware KShs'000	Office equipment KShs'000	Capital work in progress KShs'000	Total KShs'000
Cost:							
At 1 January 2011	11,091	5,977	119,499	61,657	104,633	16,412	319,269
Additions	70,658	6,555	2,819	6,977	27,516	58,819	173,344
Disposals	-	(3,849)	-	-	-	-	(3,849)
At 31 December 2011	81,749	8,683	122,318	68,634	132,149	75,231	488,764
Depreciation:							
At 1 January 2011	778	3,906	51,904	43,838	87,822	-	188,248
Charge for the year	4,359	2,176	10,929	7,298	5,143	-	29,905
Disposals	-	(3,669)	-	-	-	-	(3,669)
At 31 December 2011	5,137	2,413	62,833	51,136	92,965	-	214,484
Net book value:							
At 31 December 2011	**76,612**	**6,270**	**59,485**	**17,498**	**39,184**	**75,231**	**274,280**
2010:							
Cost:							
At 1 January 2010	141,250	22,425	76,876	57,093	103,913	16,412	417,969
Acquisition through business combination	11,091	1,994	8,212	8,625	5,781	-	35,703
Additions	9,615	-	42,751	8,343	6,263	-	66,972
Disposals	(150,865)	(18,442)	(8,340)	(12,404)	(11,324)	-	(201,375)
At 31 December 2011	11,091	5,977	119,499	61,657	104,633	16,412	319,269
Depreciation:							
At 1 January 2010	-	18,721	54,617	51,148	85,298	-	209,784
Charge for the year	778	1,670	5,627	5,094	13,848	-	27,017
Disposals	-	(16,485)	(8,340)	(12,404)	(11,324)	-	(48,553)
At 31 December 2010	778	3,906	51,904	43,838	87,822	-	188,248
Net book value:							
At 31 December 2010	**10,313**	**2,071**	**67,595**	**17,819**	**16,811**	**16,412**	**131,021**

21. INTANGIBLE ASSETS

	2011 KShs'000	2010 KShs'000
Cost		
At 1 January	33,268	25,600
Acquisition through business combination	-	10,158
Additions in the year	3,331	1,527
Disposals	-	(4,017)
At 31 December	**36,599**	**33,268**
Amortisation		
At 1 January	18,374	18,226
Disposals	-	(4,017)
Charge for the year	4,513	4,165
At 31 December	**22,887**	**18,374**
Net book value	**13,712**	**14,894**

22. PREPAID OPERATING LEASE

Prepaid operating lease rentals are recognised at historical cost

The movement in prepaid operating lease rentals is as follows:

	2011 KShs'000	2010 KShs'000
Cost as at 1 January	-	12,788
Disposal	-	(12,788)
Cost at 31 December	**-**	**-**

The leasehold land was acquired in 2009 and sold to the Parent company in 2010.

23. INVESTMENTS IN ASSOCIATE COMPANIES

The Bank's share of profit of its equity accounted investees for the year was KShs 18,602,200(2010 – KShs 38,720,000). The following is the movement in the Bank's investment in the associates:

	2011 KShs'000	2010 KShs'000
Balance as at 1 January - Fidelity Shield Insurance Company	145,109	104,056
Balance as at 1 January - Equatorial Investment Bank	27,667	-
Acquired through business combination	-	30,000
Prior year overstated profits - Fidelity Shield Insurance Company	15,805	-
Prior year understated losses - Equatorial Investment Bank	(4,171)	-
Share of profit of associates - Fidelity Shield Insurance Company	13,516	41,053
Share of profit of associates - Equatorial Investment Bank	(6,548)	(2,333)
Net investment in associates	**191,378**	**172,776**

Notes to the Financial Statements For The Year Ended 31 December 2011(continued)

23. INVESTMENT IN ASSOCIATED COMPANIES (Continued)

Summary financial information for equity accounted investees, not adjusted for the percentage ownership held by the group:

	Ownership	Current assets KShs'000	Non-current asset KShs'000	Total assets KShs'000	Current liabilities KShs'000	Equity & Non-current liabilities KShs'000	Total Equity & liabilities KShs'000	Revenues KShs'000	Expenses KShs'000	Profit/(loss) KShs'000
2011										
Equatorial Investment Bank	20%	85,410	-	85,410	670	-	84,740	908	(33,650)	(32,742)
Fidelity Shield Insurance Company	23.86%	341,118	1,368,946	1,710,064	110,572	813,436	786,056	111,020	54,374	56,646
2010:										
Equatorial Investment Bank	20%	100,798	41,276	142,074	3,759	-	138,335	8,761	20,427	(11,666)
Fidelity Shield Insurance Company	23.86%	288,843	1,251,906	1,540,749	171,905	760,676	608,168	295,891	123,833	172,058

24. DEFERRED TAX

Deferred tax assets at 31 December 2011 and 2010 are attributable to movements in temporary differences between calculations of certain items for accounting and for taxation purposes as specified below:

2011:	Balance at 01/01/2011 KShs'000	Prior year under provision KShs'000	Acquisition during the year KShs'000	Recognised in equity KShs'000	Recognised in profit & loss KShs'000	Balance at 31/12/2011 KShs'000
Arising from:						
Plant and equipment	7,552	-	-	-	(1,454)	6,098
Carried forward tax loss	265,230	-	-	-	63,256	328,486
General provisions for loans and advances	145,762	17,694	-	-	(77,315)	86,141
Other provisions	11,795	-	-	-	(9,320)	2,475
	430,339	**17,694**	**-**	**-**	**(24,833)**	**423,200**

2010:	Balance at 01/01/2011 KShs'000	Prior year under provision KShs'000	Acquisition during the year KShs'000	Recognised in equity KShs'000	Recognised in profit & loss KShs'000	Balance at 31/12/2011 KShs'000
Arising from:						
Plant and equipment	12,136	-	-	-	(4,584)	7,552
Carried forward tax loss	342,852	-	-	-	(77,622)	265,230
General provisions for loans and advances	-	-	21,642	-	124,120	145,762
Revaluation surplus	(20,320)	-	-	20,320	-	-
Fair value gain on investment property	(23,233)	-	-	-	23,233	-
Other provisions	1,904	-	5,507	-	4,384	11,795
	313,339	**-**	**27,149**	**20,320**	**69,531**	**430,339**

25. INVESTMENT PROPERTY

	2011 KShs'000	2010 KShs'000
Balance at 1 January	-	163,749
Disposal during the year	-	(163,749)

26. BALANCE DUE FROM PARENT & SUBSIDIARY COMPANIES

The balance due from the Parent Company & Subsidiary companies represents amounts owed to the bank by Equatorial Commercial Holding Limited, Equatorial Investment Bank Limited and ECB Insurance Brokers Limited

	2011 KShs'000	2010 KShs'000
Equatorial Commercial Holding Limited	495,341	403,525
Equatorial Investment Bank Limited	614	-
ECB Insurance Brokers Limited	1,552	-
Transact Options Limited	955	-
	498,462	**403,525**

27. OTHER ASSETS

	2011 KShs'000	2010 KShs'000
Deposits and prepayments	57,342	34,440
Items in transit	67,481	106,761
	124,823	**141,201**

28. CUSTOMER DEPOSITS

From private sector & individuals	2011 KShs'000	2010 KShs'000
Non-profit institutions and individuals	2,919,589	2,009,997
Private enterprises	5,954,758	5,371,174
Foreign currency accounts	959,638	655,413
	9,833,985	**8,036,584**

Included in customers' deposits is KShs 826,593,366 (2010 – KShs 340,187,885) due to related parties. Interest paid on such deposits during the year amounted to KShs. 46,730,721 (2010 – KShs 49,788,134).

Weighted average cost of deposits was 6.24% (2010-5.32%)

29. OTHER LIABILITIES

	2011 KShs'000	2010 KShs'000
Bills payable	21,150	91,442
Sundry creditors	80,866	68,807
	102,016	**160,249**

30. SHARE CAPITAL AND RESERVES

	2011 KShs'000	2010 KShs'000
(a) Share capital		
Authorised		
The movement in number of shares is as follows:		
As at 1 January	300,647,555	92,324,155
Increase during the year	159,352,400	208,323,400
As at 31 December	**459,999,955**	**300,647,555**

	2011 KShs'000	2010 KShs'000
The movement in authorised share capital is as follows:		
As at 1 January	1,503,238	461,621
Increase during the year	796,762	1,041,617
As at 31 December	**2,300,000**	**1,503,238**
Issued and fully paid		
344,647,555 (2010 - 300,647,555) Ordinary shares of KShs 5 each	**1,723,238**	**1,503,238**
The movement in issued and fully paid share capital is as follows:		
As at 1 January	1,503,238	461,621
Increase during the year	220,000	1,041,617
As at 31 December	**1,723,238**	**1,503,238**

30. SHARE CAPITAL AND RESERVES (continued)

(b) Statutory credit risk reserve
Where impairment losses required by legislation or regulations exceed those computed under International Financial Reporting Standards (IFRSs), the excess is recognised as a statutory reserve and accounted for as an appropriation of retained profits. These reserves are not distributable.

31. ACQUISITION THROUGH BUSINESS COMBINATION

On 31 May 2010, Equatorial Commercial Bank Limited (ECB) and Southern Credit Banking Corporation Limited (SCBC) executed an asset and portfolio (business) transfer agreement for the transfer of ECB banking business to SCBC who paid a fair consideration for transfer of the business by issue of new shares in equal value to the assets and liabilities transferred as outlined below:

Merger at 31 May 2010	**Carrying amounts KShs'000**	**Fair value adjustments KShs'000**	**Recognised value KShs'000**
Cash acquired:			
	48,736	-	48,736
Local bank deposits	544,780	-	544,780
Foreign bank deposits	511,303	-	511,303
Balances due to Central Bank	(159,930)	-	(159,930)
Deposits from banking Institutions	(553,115)	-	(553,115)
Total cash acquired	**391,774**	**-**	**391,774**
Other assets and liabilities acquired:			
Cash ratio reserve	159,853	-	159,853
Government securities	1,707,359	-	1,707,359
Corporate bond	93,200	-	93,200
Loans and advances (net)	2,513,401	-	2,513,401
Investments in associate companies	30,000	-	30,000
Property and equipment	35,703	-	35,703
Intangible assets	10,158	-	10,158
Deferred tax asset	27,149	-	27,149
Other assets	55,767	-	55,767
Customer deposits	(3,916,056)	-	(3,916,056)
Tax payable	(17,538)	-	(17,538)
Other liabilities	(49,154)	-	(49,154)
Total other assets and liabilities acquired	**649,842**		**649,842**
Net identifiable assets and liabilities	**1,041,616**		**1,041,616**
Consideration satisfied by issue of share			1,041,616
Net cash outflow			-

31. ACQUISITION THROUGH BUSINESS COMBINATION (continued)

The merger transaction was structured in four interlinked phases:

(i) In order to raise additional capital of KShs 264 million to meet the capital adequacy requirements of the merged Bank, ECB implemented a rights issue to increase its authorized and issued share capital by an additional Two Million Six Hundred and Forty One Thousand Seven Hundred and Ten (2,641,710) ordinary shares which were issued to the existing shareholders pro rata to their shareholding at par value;

(ii) ECB acquired new shares in SCBC in exchange for its own shares, thereby making SCBC a subsidiary of ECB. By way of a Share Acquisition and Swap Agreement, ECB acquired Seventy Seven Million, Five Hundred and Eleven Thousand, One Hundred and Thirty (77,511,130) new ordinary shares in SCBC representing 83.96% of the authorized and issued share capital of SCBC as consideration for acquiring One Million and Ninety Five Thousand Four Hundred and Twenty Eight (1,095,428) new ordinary shares representing 11.25% of the issued share capital of ECB;

(iii) ECB and SCBC then executed an Asset and Portfolio (Business) Transfer Agreement for the merger of ECBs banking business, assets and liabilities in to SCBC who paid a fair consideration for the merger of the business by the issue of 208,323,400 new shares equal in value to the assets and liabilities being merged of KShs 1,041,616,000; and

(iv) The merged Bank adopted the name Equatorial Commercial Bank Limited and former ECB changed its name to Equatorial Holding Limited and became the holding company of the merged Bank.

32.NOTES TO THE CASH FLOW STATEMENT

	2011 KShs'000	2010 KShs'000
(a) Reconciliation of loss before taxation to cash flows from operating activities		
Profit before taxation	79,481	(137,595)
Share of profit of associates	(18,602)	(38,720)
Depreciation	29,905	27,017
Amortisation of intangible assets	4,513	4,165
Profit on disposal of property and equipment	(1,320)	(1,707)
Net cash outflow from trading activities	**93,977**	**(146,840)**
Decrease/(increase) in operating assets		
Central Bank of Kenya cash reserve	302,256	(14,340)
Investment in government securities maturing after 90 days	(634,723)	(596,735)
Loans and advances to customers	(1,842,759)	(402,756)
Investment in corporate bonds	335,545	(6,945)
Balances due from Parent company	(94,937)	(76,123)
Other assets	16,377	1,545
	(1,918,241)	**(1,095,354)**
Increase/(decrease) in operating liabilities		
Customers deposits	1,797,401	(187,168)
Borrowed funds	200,415	-
Other liabilities	(58,233)	(80,060)
	1,939,583	**(267,228)**
Net cash inflow from operations	**115,319**	**(1,509,422)**
Tax paid	-	-
Net cash flow from operating activities	**115,319**	**(1,509,422)**

32.NOTES TO THE CASH FLOW STATEMENT (continued)

(b) Analyses of the balance of cash and cash equivalents

	2011 KShs'000	2010 KShs'000	Change in the year KShs'000
Cash and balances with Central Bank of Kenya	918,557	291,644	626,913
Balances due from Banking institutions	153,550	329,841	(176,291)
Deposits and Balances due to banking Institutions	(1,586,232)	(1,295,754)	(290,478)
	(514,125)	**(674,269)**	**160,144**

33 RETIREMENT BENEFIT OBLIGATIONS

The Bank contributes to a provident fund established for the benefit of its employees. This scheme is classified as a defined contribution scheme, whereby the Bank matches contributions to the fund made by employees at; 5% (former ECB) and 7.5% (former SCBC) of the employee's basic salary. During the year, the Bank incurred costs of KShs 11,468,976 as contributions payable (2010 – KShs 10,457,887).

34. CONTINGENT LIABILITIES

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognised at the reporting date if counter parties failed completely to perform as contracted.

	2011 KShs'000	2010 KShs'000
Commitments with respect to:		
Irrevocable letters of credit	17,027	51,192
Guarantees	645,699	508,569
Acceptances	35,738	922
Inward foreign documentary bills	88,570	190,239
Forward deals outstanding	94,250	195,617
	881,284	**946,539**

Nature of contingent liabilities
Letters of credit commit the Bank to make payments to third parties, on production of documents, which are subsequently reimbursed by the customers.

Guarantees are generally written by the Bank to support performance by a customer to third parties. The Bank will only be required to meet these obligations in the event of the customers default.

An acceptance is an undertaking by the Bank to pay a bill of exchange drawn on a customer. The Bank expects most of the acceptances to be presented, and reimbursement by the customer is almost immediate.

34. CONTINGENT LIABILITIES (continued)

Bills for collection are cheques, drawn against foreign or local Banks, deposited by the Bank's customers, which are in the process of clearing with the correspondent Banks.

Inward foreign documentary bills are extended by the Bank to its customers to enable them import goods from overseas suppliers. The Bank however does not pay the exporters if the importer does not meet his/her contractual obligations.

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Inward foreign documentary bills are extended by the Bank to its customers to enable them import goods from overseas suppliers. The Bank however does not pay the exporters if the importer does not meet his/her contractual obligations.

35. ASSETS PLEDGED AS SECURITY

	2011	2010
Cash pledged to Central Bank domestic foreign currency clearing	**USD 100,000**	**USD 100,000**

The above funds pledged as security are not available to finance the Bank's day-to-day operations.

36. RELATED PARTY TRANSACTIONS

In the ordinary cause of business, transactions are entered into with Equatorial Commercial Holding Limited, the parent company, other subsidiaries and other companies related to Equatorial Commercial Bank through common shareholders or common directorship.

The Bank has entered into transactions with some of its directors, affiliates and employees:

The aggregate amount of loans:	2011 KShs'000	2010 KShs'000
Directors and affiliates		
Balance at the beginning of the year	68,102	14,965
Loans advanced during the year	13,831	58,145
Interest charged during the year	2,301	5,613
Loans repayments received	(59,899)	(10,621)
	24,335	**68,102**
Guarantees	**17,273**	**7,377**

36. RELATED PARTY TRANSACTIONS (continued)

The loans to related parties were given on commercial terms and conditions. The related interest income in the year was KShs 2,301,000 (2010 – KShs 5,613,000).

	2011 KShs'000	2010 KShs'000
Employees:		
Balance at the beginning of the year	40,516	30,790
Loans advanced during the year	64,211	17,865
Loans repayments received	(32,113)	(8,139)
	72,614	**40,516**
Guarantees	**100**	**100**

The related interest income in the year was KShs 5,264,606 (2010 - KShs 3,780,231).

37. BORROWED FUNDS

	2011 KShs'000	2010 KShs'000
Borrowed funds	**200,415**	**-**

The Bank entered into a loan arrangement in August 2011 of KShs 200,415,000 at a fixed rate of 12% for a period of one year. The loan will mature on 27 July 2012.

38. PRIOR YEAR ADJUSTMENT

The prior year adjustment relates to an accounting error in regard to IFRS specific provisions not recognised in the prior year. Details of the accounting error are disclosed in Note 2(d) and affect the following:

Effects on statement of financial position: **Description**	**Amounts initially reported at 31 December 2010** **KShs '000**	**Change arising from prior year adjustment** **KShs '000**	**Restated balance at 31 December 2010** **KShs '000**
Loans and advances (Note 36)	4,851,414	(58,979)	4,792,435
Retained earnings (deficit)	(693,673)	(58,979)	(752,652)

39. OPERATING LEASE

	2011 KShs'000	2010 KShs'000
Operating lease rentals are payable as follows:		
Tenancy:		
Less than one year	42,328	51,970
Between one and five years	181,525	117,157
Due after five years	8,348	8,053
	232,201	**177,180**

The Bank leases a number of Bank premises under operating leases. The leases typically run for an initial period of between five and eight years with an option to renew the lease after that date. None of the leases include contingent rentals. During the year ended 31 December 2011, KShs 60,954,210 (2010 – KShs 49,322,528) was recognised as an expense in the profit or loss in respect of operating leases.

The head office is leased from a related company for a period of five years, three months until 31 March 2012. The amount paid during the year in respect of head office lease was KShs 27,198,575 (2010 – KShs 25,264,800).

40. CAPITAL COMMITMENTS

Capital commitments of KShs 28,617,936 (2010 – Nil) were outstanding at the year end.

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