# EQUATORIAL COMMERCIAL BANK LIMITED

*Banking to your liking*

# ANNUAL REPORT & ACCOUNTS

# 2009

## About us

Equatorial Commercial Bank (ECB) was established as a Finance Company in 1983. It was later converted into a fully -fleged Commercial Bank in 1995.

## Our Vision

"To be come the leading retail and Corporate Bank In East Africa".

Here we endeavour to become the retail and Corporate Bank of choice across East Africa through constant innovation of customer centered services - meeting the retail needs of customers.

Our immediate strategy is to tap the niche market and enhance strategic alliances.

On the retail front, we shall focus on creative strategic product development amongst other innovative services.

## Our Mission

"To continuosly provide personalised, quality and excellent financial services to customers and to increase shareholder value.

ECB puts into place strategic objectives that cater for the stability of the Bank and secure the future for its clients.

# Contents

# BOARD MEMBERS & COMMITTEES

## DIRECTORS

| | |
|---|---|
| Dan Ameyo, MBS | Chairman |
| Peter Harris | Managing Director |
| M.H. Da Gama Rose | |
| Akif Hamid Butt | |
| Martin Ernest | |

## SECRETARY

Fauzia B Shah (Mrs)
PO Box 55358
00200 Nairobi GPO

## AUDIT & RISK COMMITTEE

| | |
|---|---|
| Martin Ernest | Chairman |
| Akif Hamid Butt | |
| M.H. Da Gama Rose | |

## CREDIT COMMITTEE

| | |
|---|---|
| Martin Ernest | Chairman |

# CORPORATE INFORMATION

## BRANCHES

Equatorial Commercial Bank Centre (HQ)
Nyerere Road
Nairobi

Sameer Industrial Park
Mombasa Road
Nairobi

Equatorial Commercial Bank Centre
Moi Avenue Road
Mombasa

The Mall
Waiyaki Way
Westlands, Nairobi

## REGISTERED OFFICE

Equatorial Commercial Bank Centre (HQ)
Nyerere Road
PO Box 52467
00100 Nairobi GPO

## AUDITORS

KPMG Kenya
16th Floor, Lonrho House
PO 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
Commerze Bank AG Frankfurt A.M.
ICICI Bank, Mumbai
United Bank of Switzerland

## ADVOCATES

Ndungu Njoroge & Kwach Advocates
Shapley Barret & Company Advocates
Wangai Nyuthe & Company Advocates
Anjarwalla & Khanna Advocates
Njoroge Regeru & Company Advocates
Iseme Kamau & Maema Advocates
Waruhiu, K'Owade & Ng'ang'a Advocates
Gathaiya & Associates
Walker Kontos Advocates
A.B. Patel & Patel Advocates
Daly & Figgis Advocates
Hamilton Harrison & Mathews

# CHAIRMAN'S STATEMENT

I am pleased to present the Equatorial Commercial Bank Annual Report and Financial Statements for the year ended 31st December 2009.

## Political and economic review

2009 was a year that saw the Country's economy slowly recover from a GDP of 1.7 percent registered in 2008 to 2.5 percent in 2009, although lower than the 7.1 percent in 2007.

Growth rates during the first and second quarters of 2009 were equivalent to 4.0 and 2.1 percent respectively, down to zero percent in the third quarter of 2009. The slowdown was as result of various shocks, particularly the persistent drought which affected the agricultural and power sectors and rising fuel prices which suppressed the transport and manufacturing sectors. Global economic issues and the lag effects of the post election crisis experienced in 2008, also affected growth.

However, the financial sector remained resilient with most banks recording albeit minimal, improved performances.

## Financial Results

In 2009 Equatorial Commercial Bank recorded a profit after tax of Shs. 53M, a significant improvement on the prior year results of Shs. 5M which had been impacted by an impairment charge on account of Triton.

Factors contributing to increased profitability included; increased operating income as a result of reduced cost of funding and cost containment, with overall operating costs increasing by only 6%.

## Strategy

In the early part of the year the Board adopted a Five year strategy plan which aims to grow the Bank to compete in the upper levels of Tier II organizations in the market. This will be achieved by, but not limited to, a focus on niche sectors of the economy, supported by ongoing investment in technology and people to meet the demands of the modern market place.

## Corporate governance statement

A corporate governance report is included on pages 5 to 6.

## Key developments

In the year ahead, we anticipate increased competition in a relatively volatile and uncertain global and local economic climate, which will no doubt impact the banking sector.

In line with our strategy, the Bank has been in discussion with Southern Credit Banking Corporation since early December 2009 with a view to explore the viability of pooling interest in the form of a merger to form a bigger and more competitive Bank.

## Appreciation

I would like to thank the Management and Staff of ECB for what they have been able to accomplish in the last year. We remain confident that we now have the skills and resources necessary to manage the significant opportunities and challenges that lie ahead. I also thank my colleagues on the Board for their sound guidance and support during the year. To our customers, I sincerely thank you for your continued support. To our shareholders, whose confidence has sanctioned important strategic developments, we extend our gratitude.

# CORPORATE GOVERNANCE

ECB is committed to implementing ongoing initiatives to improve corporate governance for the benefit of all stakeholders.
The Bank's Board of Directors is focused on achieving compliance with qualitative aspects of good governance while ensuring that implementation meets the business needs.
A number of committees have been established that assist the Board in fulfilling its stated objectives. The committees' roles and responsibilities are set out in terms of agreed mandates, which are reviewed annually 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 legislation, regulations and codes of best practice and seeks to maintain the highest standards of governance, including transparency and accountability.
The Bank complies with applicable legislation, regulations, standards and codes, with the Board continually monitoring regulatory compliance with guidelines issued by the Central Bank of Kenya and other best practices.

### Board of Directors

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

### Board composition

There are five directors on the Board of whom one is executive and four are non-executive.
The Board has the right mix of skills, expertise, competencies and experience to effectively guide the company and ensure that the objective of shareholder value maximization is achieved.
The Board profile is regularly reviewed to ensure that the board composition remains appropriate given the dynamics of the banking industry.

### Strategy

The Board is fully aware of its obligations to shareholders and other stakeholders for forging the strategic direction that the company will follow, and in so doing meets with the executive committee to consider and approve the company's strategy for the years ahead.
The 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 operations rests with the Board. The Board retains effective control through a well developed governance structure of Board committees. These committees provide in depth focus on specific areas of Board responsibility.
Authority has been delegated to the Managing Director to manage the business together with his management committees comprising 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 company's performance.

### 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 at a minimum of once every quarter 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.

### 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.
The role of the Board Credit Committee is to provide oversight of risk management within the Bank.

### 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 and
- Product and IT Committee.

### Fees

Non-executive directors receive fixed fees for service on the Board and on Board committees. The Board reviews the nonexecutive directors' fees and makes recommendation to the AGM 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

The Directors have pleasure in submitting their report together with the audited financial statements for the year ended 31 December 2009.

## 1. Activities

The company is engaged in the business of banking and provision of related services and is licensed under the Banking Act.
The company has a 20% investment in Equatorial Investment Bank Limited which has been accounted for as an associate company in the consolidated financial statements.

## 2. Results

The results for the year are set out on page 10.

## 3. Dividend

The Directors do not propose a dividend for the year (2008 - Nil).

## 4. Directors

The Directors who served during the year are set out on page 1. The following table shows the rate of attendance of Board meetings by the Directors:

| Director's name | Nationality | Executive/Non Executive | Profession | Attendance for Board meetings |
|---|---|---|---|---|
| M.H. Da Gama Rose | Kenyan | Non Executive | Advocate | 100% |
| Akif Hamid Butt | Kenyan | Non Executive | Chartered Accountant | 100% |
| Peter Harris | British | Executive | Banker | 100% |
| Martin Ernest | British | Non Executive | Chartered Accountant | 100% |
| Dan Ameyo, MBS | Kenyan | Non Executive | Advocate | 100% |

## 5. Auditors

The auditors, KPMG Kenya, have indicated their willingness to 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).

## 6. Approval of financial statements

The financial statements were approved at a meeting of the Directors held on 18th March 2010

**BY ORDER OF THE BOARD**

F Shah

Fauzia B Shah (Mrs)
**Company Secretary**
**18th March 2010**

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and presentation of the Group financial statements of Equatorial Commercial Bank Limited set out on pages 10 to 58 which comprise the statement of financial position of the group and the company at 31 December 2009, the group'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.

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 group and the company as at the end of the financial year and of the operating results of the group for that year. It also requires the Directors to ensure the group keeps proper accounting records which disclose with reasonable accuracy the financial position of the group and the company.

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the group and the company and of the group 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 group and the company's ability to continue as a going concern and have no reason to believe the group and the company 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 18 March 2010 and were signed on its behalf by:

**Chairman**

18th March 2010

**Director**

18th March 2010

**Director**

18thMarch2010

# REPORT OF THE INDEPENDENT AUDITORS
## TO THE MEMBERS OF EQUATORIAL COMMERCIAL BANK LIMITED

We have audited the Group financial statements of Equatorial Commercial Bank Limited set out on pages 10 to 58 which comprise the statement of financial position of the Group and the company at 31 December 2009, and the Group's statement of comprehensive income, statement of changes in equity and cash flow statement 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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**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 Group and the company at 31 December 2009, and the Group'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**

The Kenyan Companies Act requires us to expressly 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 company, so far as appears from our examination of those books; and

(iii) The statement of financial position of the company is in agreement with the books of account.

**18 March 2010**

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
## FOR THE YEAR ENDED 31 DECEMBER 2009

| | Notes | 2009<br>KShs'000 | 2008<br>KShs'000 |
|---|---|---|---|
| INTEREST INCOME | 7 | 442,693 | 467,209 |
| INTEREST EXPENSE | 8 | (157,048) | (196,806) |
| NET INTEREST INCOME | | 285,645 | 270,403 |
| FEE AND COMMISSION INCOME | | 52,385 | 51,222 |
| FOREIGN EXCHANGE TRADING INCOME | | 14,210 | 26,782 |
| OTHER OPERATING INCOME | 9 | 1,390 | 340 |
| **OPERATING INCOME** | | **353,630** | **348,747** |
| IMPAIRMENT LOSSES ON FINANCIAL ASSETS | 10 | (8,296) | (101,992) |
| OPERATING EXPENSES | 11 | (268,682) | (254,670) |
| SHARE OF LOSS FROM ASSOCIATED COMPANY | 24 | (2,393) | (1,731) |
| **PROFIT/(LOSS) BEFORE TAXATION** | **13** | **74,259** | **(9,646)** |
| INCOME TAX CREDIT/ (EXPENSE) | 14 | (22,953) | 13,621 |
| **PROFIT AFTER TAXATION** | | **51,306** | **3,975** |
| **BASIC AND DILUTED EARNINGS PER SHARE – KShs** | **15** | **8.55** | **0.66** |
| **DIVIDEND PER SHARE – KShs** | **16** | **-** | **-** |

The notes on pages 16 to 58 form an integral part of these financial statements.

# CONSOLIDATED STATEMENT OF FINANCIAL POSTION
## AS AT 31 DECEMBER 2009

| ASSETS | Note | 2009 KShs'000 | 2008 KShs'000 |
|---|---|---|---|
| Cash and balances with Central Bank | 17 | 201,541 | 282,058 |
| Investments in government securities | 18 | 699,764 | 406,063 |
| Investments in corporate bonds | | 95,115 | - |
| Investment in commercial paper and loan notes | 19 | - | 258,819 |
| Placements with other Banks | 20 | 558,365 | 914,353 |
| Loans and advances to customers (net) | 21(a) | 2,749,529 | 2,306,663 |
| Property and equipment | 22 | 39,785 | 40,951 |
| Intangible assets | 23 | 10,195 | 11,244 |
| Investment in associate | 24 | 25,876 | 28,269 |
| Deferred tax asset | 25 | 25,913 | 31,289 |
| Tax recoverable | | 5,867 | 23,445 |
| Other assets | 26 (a) | 49,471 | 105,565 |
| **TOTAL ASSETS** | | **4,461,421** | **4,408,719** |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **LIABILITIES** | | | |
| Deposits from Banking institutions | | 179,852 | 5,000 |
| Customers deposits | 27 | 3,522,174 | 3,667,533 |
| Other liabilities | 28 | 33,857 | 61,954 |
| **TOTAL LIABILITIES** | | **3,735,883** | **3,734,487** |
| **SHAREHOLDERS' EQUITY (Page 13)** | | | |
| Share capital | 29(a) | 600,000 | 600,000 |
| Retained earnings | | 84,438 | 46,558 |
| Statutory credit risk reserve | 29(b) | 41,100 | 27,674 |
| **TOTAL EQUITY ATTRIBUTABLE TO SHAREHOLDERS** | | **725,538** | **674,232** |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | | **4,461,421** | **4,408,719** |

The financial statements on pages 10 to 58 were approved by the Board of Directors on and were signed on its behalf by:

Director ______________ Director ______________

Director ______________ Secretary ______________

The notes on pages 16 to 58 form an integral part of these financial statements.

# COMPANY STATEMENT OF FINANCIAL POSITION
## AT 31 DECEMBER 2009

| | Note | 2009 KShs'000 | 2008 KShs'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with Central Bank | 17 | 201,541 | 282,058 |
| Investments in government securities | 18 | 699,764 | 406,063 |
| Investments in corporate bonds | | 95,115 | |
| Investment in commercial paper and loan notes | 19 | - | 258,819 |
| Placements with other Banks | 20 | 558,365 | 914,353 |
| Loans and advances to customers (net) | 21(a) | 2,749,529 | 2,306,663 |
| Property and equipment | 22 | 39,785 | 40,951 |
| Intangible assets | 23 | 10,195 | 11,244 |
| Investment in associate | 24 | 30,000 | 30,000 |
| Deferred tax asset | 25 | 25,913 | 31,289 |
| Tax recoverable | | 5,867 | 23,445 |
| Other assets | 26 (b) | 49,453 | 105,550 |
| **TOTAL ASSETS** | | **4,465,528** | **4,410,435** |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **LIABILITIES** | | | |
| Deposits from Banking institutions | | 179,852 | 5,000 |
| Customers deposits | 27 | 3,522,174 | 3,667,533 |
| Other liabilities | 28 | 33,857 | 61,956 |
| **TOTAL LIABILITIES** | | **3,735,883** | **3,734,489** |
| **SHAREHOLDERS' EQUITY (Page 13)** | | | |
| Share capital | 29(a) | 600,000 | 600,000 |
| Retained earnings | | 88,545 | 48,272 |
| Statutory credit risk reserve | 29(b) | 41,100 | 27,674 |
| **TOTAL EQUITY ATTRIBUTABLE TO SHAREHOLDERS** | | **729,645** | **675,946** |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | | **4,465,528** | **4,410,435** |

The financial statements on pages 10 to 58 were approved by the Board of Directors on and were signed on its behalf by:

Director ______________________ Director ______________________

Director ______________________ Secretary ______________________

The notes on pages 16 to 58 form an integral part of these financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
## FOR THE YEAR ENDED 31 DECEMBER 2009

| | Share Capital KShs'000 | Retained earnings KShs'000 | Statutory credit risk reserve KShs'000 | Total KShs'000 |
|---|---|---|---|---|
| Balance at 1 January 2008 | 600,000 | 70,257 | - | 670,257 |
| **Total comprehensive income for the year:** | | | | |
| Profit for the year | - | 3,975 | - | 3,975 |
| **Transaction with owners recorded directly in equity:** | | | | |
| Appropriation to statutory | | | | |
| Credit risk reserve | - | (27,674) | 27,674 | - |
| **At 31 December 2008** | **600,000** | **46,558** | **27,674** | **674,232** |
| **Total comprehensive income for the year:** | | | | |
| Profit for the year | - | 51,306 | | 51,306 |
| **Transaction with owners recorded directly in equity:** | | | | |
| Appropriation to statutory | | | | |
| credit risk reserve | - | (13,426) | 13,426 | - |
| **At 31 December 2009** | **600,000** | **84,438** | **41,100** | **725,538** |

The notes on pages 16 to 58 form an integral part of these financial statements.

# COMPANY STATEMENT OF CHANGES IN EQUITY
## FOR THE YEAR ENDED 31 DECEMBER 2009

| | Share Capital KShs'000 | Retained earnings KShs'000 | Statutory credit risk reserve KShs'000 | Total KShs'000 |
|---|---|---|---|---|
| Balance at 1 January 2008 | 600,000 | 70,240 | - | 670,240 |
| **Total comprehensive income for the year:** | | | | |
| Profit for the year | - | 5,706 | - | 5,706 |
| **Transaction with owners Recorded directly in equity:** | | | | |
| Appropriation to statutory credit risk reserve | - | (27,674) | 27,674 | - |
| **At 31 December 2008** | **600,000** | **48,272** | **27,674** | **675,946** |
| **Total comprehensive income for the year:** | | | | |
| Profit for the year | - | 53,699 | | 53,699 |
| **Transaction with owners recorded directly in equity:** | | | | |
| Appropriation to statutory credit risk reserve | - | (13,426) | 13,426 | - |
| **At 31 December 2009** | **600,000** | **88,545** | **41,100** | **729,645** |

The notes on pages 16 to 58 form an integral part of these financial statements.

# CONSOLIDATED CASHFLOW STATEMENT
## FOR THE YEAR ENDED 31 DECEMBER 2009

| | Note | 2009<br>KShs'000 | 2008<br>KShs'000 |
|---|---|---|---|
| Net cash outflow from operating activities | 30(a) | (554,477) | (789,594) |
| Cash flows from investing activities | | | |
| Purchase of property and equipment | | (11,915) | (12,919) |
| Purchase of intangible assets | | (1,517) | (2,487) |
| Proceeds from disposal of property and equipment | | 400 | 341 |
| **Net cash used in investing activities** | | **(13,032)** | **(15,065)** |
| **Decrease in cash and cash equivalents** | 30(b) | **(567,509)** | **(804,659)** |

The notes on pages 16 to 58 form an integral part of these financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
## FOR THE YEAR ENDED 31 DECEMBER 2009

### 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
PO Box 52467
00100 Nairobi GPO

### 2. BASIS OF PREPARATION

#### (a) Statement of compliance

The financial statements are prepared in accordance with and comply with International Financial Reporting Standards. The financial statements are prepared under the historical cost basis as modified by the revaluation of financial instruments, classified as instruments available for sale, held for trading, instruments held at fair value through statement of comprehensive income 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 reported 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 consolidated financial statements are presented in Kenya shillings, which is the Group's functional currency. Except as indicated, financial information presented in Kenya shillings has been rounded to the nearest thousand.

Items included in the financial statements are measured using the currency of primary economic environment in which the entity operates i.e. Kenya shillings.

### (d) New accounting standards adopted

On 1 January 2009, the group retrospectively adopted IAS 1 'Presentation of Financial Statements' (revised 27). As a result, in the Group's financial statements certain terminology has changed.

## 3. SIGNIFICANT ACCOUNTING POLICIES

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

### (a) Basis of consolidation

The consolidated financial statements include the company and its associate made up to the end of the financial year. The associates is set out on Note 24.

### (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 the income statement 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. 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.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (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.

#### (i) Financial assets at fair value through the income statement

Financial assets in this category held for trading are those that the Group principally holds for the purpose of short-term profit taking and/or those designated at fair value through the statement of comprehensive income at inception. These are recognised on the date the Group 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 the statement of comprehensive income.

#### (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.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 the statement of comprehensive income.

### 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.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 statement of comprehensive income.

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 statement of comprehensive income.

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.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (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 the statement of comprehensive income for the year.

### (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 4 years
- Computer equipment 4 years
- Office equipment 5 years
- Fixtures and fittings 4 to 10 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 the statement of comprehensive income 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 statement of comprehensive income 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 three years. Costs associated with maintaining software are recognised as an expense as incurred.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (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 the consolidated statement of comprehensive income 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 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 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.

### (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 consolidated statement of comprehensive income as incurred. Any difference between the charge to the consolidated statement of comprehensive income 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 consolidated statement of comprehensive income.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (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 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.

### (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 the consolidated statement of comprehensive income.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (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 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 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

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2009, and have not been applied in preparing these consolidated financial statements as follows:

• Revised IFRS 3 Business Combinations (2008) incorporates the following changes that are likely to be relevant to the Group's operations:

- The definition of a business has been broadened, which may result in more acquisitions being treated as business combinations.
- Contingent consideration will be measured at fair value, with subsequent changes in fair value recognised in profit or loss.
- Transaction costs, other than share and debt issue costs, will be expensed as incurred.
- Any pre-existing interest in an acquiree will be measured at fair value, with the related gain or loss recognised in profit or loss.
- Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of an acquiree, on a transaction-by-transaction basis.

Revised IFRS 3, which becomes mandatory for the Group's 2010 consolidated financial statements, will be applied prospectively and therefore there will be no impact on prior periods in the Group's 2010 consolidated financial statements.

• Amended IAS 27 Consolidated and Separate Financial Statements (2008) requires accounting for changes in ownership interests in a subsidiary that occur without loss of control, to be recognised as an equity transaction. When the Group loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss.

The amendments to IAS 27, which become mandatory for the Group's 2010 consolidated financial statements, are not expected to have a significant impact on the consolidated financial statements.

• Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments will become mandatory for the Group's 2010 consolidated financial statements, with retrospective application required. The Group is currently in the process of evaluating the potential effect of this amendment.

• IFRS 9 Financial Instruments, published on 12 November 2009 as part of phase I of the IASB's comprehensive project to replace IAS 39, deals with classification and measure of financial assets. The requirements of this standard represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. A financial asset would be measured at amortised cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets would be measured at fair value. The standard eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivables. For an investment in an equity instrument which is not held for trading, the standard permits an irrevocable election, on initial recognition, on an individual share by share basis, to present all fair value changes from the investment in other comprehensive income. No amount recognised in other comprehensive income would ever be reclassified to profit or loss at a later date. However, dividends on such investments are recognised in profit or loss, rather than other comprehensive income unless they clearly represent a partial recovery of the cost of investment. Investments in equity instruments in respect of which an entity does not elect to present fair value changes in other comprehensive income would be measured at fair value with changes in fair value recognised in profit or loss.

The standard requires that derivatives embedded in contracts with a host that is a financial asset within the scope of the scope of the standard are not separated; instead the hybrid financial instrument is assessed in its entirety as to whether it should be measured at amortised cost or fair value.

The standard is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

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

## 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

## 4. FINANCIAL RISK MANAGEMENT (Continued)

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.

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 group exposure to credit risk is analysed as follows:

| ***(i) Loans and advances to customers*** | **2009** | **2008** |
|---|---|---|
| | **KShs'000** | **KShs'000** |
| *Individually impaired* | | |
| Impaired (substandard) | 242,405 | 54,101 |
| Impaired doubtful) | 157,682 | 148,313 |
| Impaired (loss) | 4,467 | 12,748 |
| Gross amount | 404,554 | 215,162 |
| Allowance for impairment | (62,945) | (66,831) |
| **Carrying amount** | **341,609** | **148,331** |
| *Collectively impaired* | | |
| Neither Past due nor impaired | 2,394,174 | 1,907,410 |
| Past due and not impaired | 18,536 | 255,380 |
| Gross amount | 2,412,710 | 2,162,790 |
| Portfolio impairment provision | (4,790) | (4,458) |
| Carrying amount | 2,407,920 | 2,158,332 |
| Carrying amount | 2,749,529 | 2,306,663 |

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

| *(ii) Other financial assets* | 2009 KShs'000 | 2008 KShs'000 |
|---|---|---|
| *Neither past due nor impaired* | | |
| Investment in Government securities | 699,764 | 406,063 |
| Corporate Bonds | 95,115 | - |
| Placements | 558,365 | 914,353 |
| Commercial paper and loan notes | - | 258,819 |
| | 1,353,244 | 1,579,235 |
| *Past due and impaired* | | |
| Commercial paper and loan notes | 100,230 | 100,230 |
| Impairment provision | (100,230) | (100,230) |
| | - | - |

***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***

Loans and securities where contractual interest or principal payments are past due but the Group 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 Group.

***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 Group 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.

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

***Write-off policy***

The Group writes off a loan / security balance (and any related allowances for impairment losses) when Group Credit determines that the loans / securities are uncollectible. 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 | Net |
| | KShs'000 | KShs'000 |
| **31 December 2009:** | | |
| Impaired (substandard) | 242,405 | 200,919 |
| Impaired (doubtful) | 157,682 | 137,180 |
| Impaired (loss) | 4,467 | 3,510 |
| | 404,554 | 341,609 |
| **31 December 2008:** | | |
| Impaired (substandard) | 54,101 | 46,903 |
| Impaired (doubtful) | 148,313 | 98,521 |
| Impaired (loss) | 12,748 | 2,905 |
| | **215,162** | **148,329** |

The Group 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 2009 or 2008.

## 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 | |
|---|---|---|
| | 2009 | 2008 |
| | KShs'000 | KShs'000 |
| *Against individually impaired* | | |
| Property | 436,350 | 190,176 |
| Other | 91,903 | 122,957 |
| *Against collectively impaired* | | |
| Property | 3,166,974 | 2,392,833 |
| Debt securities | 392,534 | 14,000 |
| Equities | 65,299 | 104,476 |
| Other | 523,813 | 792,988 |
| *Against past due but not impaired* | | |
| Property | 12,250 | 200,750 |
| Debt securities | 1,300 | - |
| Equities | 10,640 | - |
| Other | 14,304 | 6,250 |
| *Against neither past due nor impaired* | | |
| Property | 3,154,724 | 2,192,083 |
| Debt securities | 391,234 | 14,000 |
| Equities | 54,659 | 104,476 |
| Other | 520,149 | 951,695 |

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

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

| | Loans and advances to customers | |
|---|---|---|
| | 2009 | 2008 |
| | KShs'000 | KShs'000 |
| **Carrying amount** | | |
| Building and construction | 230,379 | 75,796 |
| Wholesale and retail trade, restaurants and hotels | 633,193 | 839,220 |
| Finance and insurance | 3,074 | - |
| Manufacturing | 474,764 | 411,030 |
| Social, community, personal services | 136,541 | 61,393 |
| Agriculture | 229,682 | 75,777 |
| Business services | 236,588 | 368,945 |
| Others | 805,308 | 474,502 |
| | **2,749,529** | **2,306,663** |

**Settlement risk**

The Group'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.

For certain types of transactions the Group 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 Group 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

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

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 Group will encounter difficulty in meeting obligations from its financial liabilities.

### Management of liquidity risk

The Group'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 Group'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 Group and operating subsidiaries and foreign branches. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

### 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:

| | 2009 | 2008 |
|---|---|---|
| At 31 December | 35.89% | 44.02% |
| Average for the period | 35.86% | 43.97% |
| Maximum for the period | 49.82% | 66.30% |
| Minimum for the period | 26.49% | 30.03% |

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

The table below analyses financial liabilities of the Bank into relevant maturity groupings based on the remaining period at 31 December 2009 to the contractual maturity date.

| 31 December 2009: | 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 | 179,852 | - | - | - | 179,852 |
| Customer deposits | 1,569,862 | 1,816,662 | 77,810 | 57,840 | 3,522,174 |
| Other liabilities | 33,857 | - | - | - | 33,857 |
| **TOTAL LIABILITIES** | **1,783,571** | **1,816,662** | **77,810** | **57,840** | **3,735,883** |
| **31 December 2008:** | | | | | |
| **LIABILITIES** | | | | | |
| Deposits from Banking institutions | - | 5,000 | - | - | 5,000 |
| Customer deposits | 1,679,463 | 1,559,667 | 428,403 | - | 3,667,533 |
| Other liabilities | 61,954 | - | - | - | 61,954 |
| **TOTAL LIABILITIES** | **1,741,417** | **1,564,667** | **428,403** | **-** | **3,734,487** |

### (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 company's business strategies. The company does not have any significant interest rate risk exposures.

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risk (continued)

This table shows the extent to which the group'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 2009: | Effective interest rate | 3 months Or less | Between 3-12 months | Non-interest bearing | Total |
|---|---|---|---|---|---|
| | % | KShs'000 | KShs'000 | KShs'000 | KShs'000 |
| **ASSETS** | | | | | |
| Cash and balances with Central Bank of Kenya | - | - | - | 201,541 | **201,541** |
| Investments in Government securities | 9.58% | - | 699,764 | - | **699,764** |
| Placements with other Banks | 4.62% | 558,365 | - | - | **558,365** |
| Investment in Corporate Bonds | 12.50% | - | 95,115 | - | **95,115** |
| Loans and advances to customers | 13.02% | 1,823,962 | 925,567 | - | **2,749,529** |
| Property and equipment | - | - | - | 39,785 | **39,785** |
| Intangible assets | - | - | - | 10,195 | **10,195** |
| Investment in associate | - | - | - | 25,876 | **25,876** |
| Deferred tax asset | - | - | - | 25,913 | **25,913** |
| Tax recoverable | - | - | - | 5,867 | **5,867** |
| Other Assets | - | - | - | 49,471 | **49,471** |
| **TOTAL ASSETS** | | **2,382,327** | **1,720,446** | **358,648** | **4,461,421** |
| Deposits from Banking institutions | 3.13% | 179,852 | - | - | **179,852** |
| Customer deposits | 4.69% | 3,386,524 | 135,650 | | **3,522,174** |
| Other liabilities | - | - | - | 33,857 | **33,857** |
| Share capital | - | - | - | 600,000 | **600,000** |
| Reserves | - | - | - | 125,538 | **125,538** |
| **TOTAL LIABILITES** | | **3,566,376** | **135,650** | **759,395** | **4,461,421** |
| **Asset – liability gap 2009** | | **(1,184,049)** | **1,584,796** | **(400,747)** | **(0)** |

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risk (continued)

| 31 December 2008: | Effective interest rate | 3 months Or less | Between 3-12 months | Non-interest bearing | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with Central Bank of Kenya | - | - | - | 282,058 | **282,058** |
| Investments in Government securities | 8.50% | 208,112 | 197,951 | - | 406,063 |
| Placements with other Banks | 5.30% | 914,353 | - | - | 914,353 |
| Investment in commercial paper and loan notes | 10.53% | 258,819 | - | - | **258,819** |
| Loans and advances to customers | 13.63% | 1,362,243 | 944,420 | - | **2,306,663** |
| Property and equipment | - | - | - | 40,951 | **40, 951** |
| Intangible assets | - | - | - | 11,244 | **11,244** |
| Investment in associate | - | - | - | 28,269 | **28,269** |
| Deferred tax asset | - | - | - | 31,289 | **31,289** |
| Other assets | - | - | - | 105,565 | **105,565** |
| Tax recoverable | - | - | - | 23,445 | **23,445** |
| **TOTAL ASSETS** | | **2,743,527** | **1,142,371** | **522,822** | **4,408,719** |
| Deposits from Banking institutions | 6.6% | 5,000 | - | - | 5,000 |
| Customer deposits | 5.01% | 3,239,130 | 428,403 | | 3,667,533 |
| Other liabilities | - | - | - | 61,954 | 61,954 |
| Share capital | - | - | - | 600,000 | 600,000 |
| Reserves | - | - | - | 74,232 | 74,232 |
| **TOTAL LIABILITES** | | **3,244,130** | **428,403** | **736,186** | **4,408,719** |
| **Asset – liability gap 2008** | | **(500,603)** | **713,968** | **(213,364)** | **-** |

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risk (continued)

**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 2008.

**Effect in shillings thousands**

| | Profit or loss | |
|---|---|---|
| | **2009** | **2008** |
| Interest Income | 41,027 | 40,753 |
| Interest expense | (37,020) | (39,908) |
| **Net change in interest** | **4,007** | **845** |

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.

**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 consolidated statement of comprehensive income. 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.

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risk (continued)

The various currencies to which the Bank is exposed at 31 December 2009 are summarised in the table below (all expressed in Kenya Shillings):

| 31 December 2009 | USD | GBP | EURO | OTHER | Total |
|---|---|---|---|---|---|
| **ON BALANCE SHEET ITEMS** | | | | | |
| **ASSETS** | | | | | |
| Cash and balances with Bank | 74,575 | 79,787 | 96 | | **154,458** |
| Loans and advances to customers | 172,089 | 2 | 3 | - | **172,094** |
| **TOTAL ASSETS** | **246,664** | **79,789** | **99** | **-** | **326,552** |
| Customer deposits | 159,332 | 89,761 | 14,127 | - | **263,220** |
| **TOTAL LIABILITIES** | **159,332** | **89,761** | **14,127** | **-** | **263,220** |
| **Net currency exposure – on balance sheet position** | **87,332** | **(9,972)** | **(14,028)** | **-** | **63,332** |
| **OFF BALANCE SHEET ITEMS** | | | | | |
| **LIABILITIES** | **375,765** | | **1,832** | | **377,597** |
| | | | | | |
| **Net currency exposure** | **(288,433)** | **(9,972)** | **(15,860)** | | **(314,265)** |

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risk (continued)

| 31 December 2008 | USD | GBP | EURO | OTHER | Total |
|---|---|---|---|---|---|
| **ON BALANCE SHEET ITEMS** | | | | | |
| **ASSETS** | | | | | |
| Cash and balances with Bank | 507,314 | 78,172 | 115,953 | 6,064 | **707,503** |
| Loans and advances to customers | 226,394 | 13 | 13 | | **226,420** |
| **TOTAL ASSETS** | **733,708** | **78,185** | **115,966** | **6,064** | **933,923** |
| Customer deposits | 771,235 | 73,528 | 127,337 | - | **972,100** |
| **TOTAL LIABILITIES** | **771,235** | **73,528** | **127,337** | **-** | **972,100** |
| **Net currency exposure – on balance sheet position** | **(37,527)** | **4,657** | **(11,371)** | **6,064** | **(38,177)** |
| **OFF BALANCE SHEET ITEMS** | | | | | |
| **LIABILITIES** | | | | | |
| Letters of credit and acceptances | (306,840) | - | - | (16,303) | **(323,143)** |
| **Net currency exposure** | **(344,367)** | **4,657** | **(11,371)** | **(10,239)** | **(361,320)** |

The following exchange rates were applied during the year:

| | Average rate | | Closing rates | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| US Dollar | 77.37 | 69.57 | 75.85 | 77.85 |
| Sterling Pound | 121.45 | 127.41 | 121.97 | 112.49 |
| Euros | 107.95 | 102.21 | 108.96 | 109.65 |

**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 2008.

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risk (continued)

**Effect in Kenya shillings thousands**

| | Profit or loss | |
|---|---|---|
| **As at 31 December** | **2009** | **2008** |
| US Dollar | (8,733) | (3,753) |
| Sterling pound | 997 | 466 |
| Euros | 1,403 | (1,137) |

A 10 percent decrease in the rate of the Kenya Shilling against the above currencies at 31 December 2009 and 2008 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.

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (f) Capital management (continued)

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, collective impairment allowances 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 collective impairment allowances 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.

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 up recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

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

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

## 4. FINANCIAL RISK MANAGEMENT (Continued)

### (f) Capital management (continued)

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

| | 2009 | 2008 |
|---|---|---|
| | KShs'000 | KShs'000 |
| **Tier 1 capital** | | |
| Ordinary share capital | 600,000 | 600,000 |
| Retained earnings | 88,545 | 48,272 |
| | 688,545 | 648,272 |
| **Tier 2 capital** | 41,100 | 27,674 |
| **Total regulatory capital** | **729,645** | **675,946** |
| **Risk-weighted assets** | | |
| On balance sheet risk weighted assets | 2,871,841 | 2,787,201 |
| Off balance sheet risk weighted assets | 641,583 | 420,364 |
| **Total risk-weighted assets** | **3,513,424** | **3,207,565** |
| **Capital ratios** | | |
| Percentage of total regulatory capital to risk-weighted assets | 20.76% | 21.07% |
| Minimum requirement | 12.00% | 12.00% |
| Percentage of core capital to risk weighted assets | 19.59% | 20.21% |
| Minimum requirement | 8.00% | 8.00% |
| Percentage of core capital to deposits | 19.55% | 17.65% |
| Minimum requirement | 8.00% | 8.00 |

### 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 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.

## 5. USE OF ESTIMATES AND JUDGEMENTS

### (a) Loan loss provisioning

The Group'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 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 balance sheet 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.

### (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 Group's financial instruments are carried at fair value, with changes in fair value either reported within the income statement or within equity until the instrument is sold or becomes impaired. Details of the type and classification of the Group's financial instruments are set out in Note 6 to the financial statements.

### (c) Impairment of property and equipment

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

### (c) 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

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 KShs'000 | Held to maturity KShs'000 | Loans and Receivables KShs'000 | Available for-sale KShs'000 | Other amortised cost KShs'000 | Total carrying amount KShs'000 |
|---|---|---|---|---|---|---|
| **As at 31 December 2009** | | | | | | |
| **Assets** | | | | | | |
| Cash and cash equivalents | - | - | 201,541 | - | - | 201,541 |
| Deposits and balances due from other Banks | - | - | 558,365 | - | - | 558,365 |
| Investments in corporate bond | - | 95,115 | - | - | | 95,115 |
| Investments in Government securities | - | 699,764 | - | - | | 699,764 |
| Loans and advances to customers | - | - | 2,749,529 | - | | 2,749,529 |
| **Total assets** | **-** | **794,879** | **3,509,453** | **-** | **-** | **4,304,314** |
| **Liabilities and shareholders' funds** | | | | | | |
| Deposits and balances due to Banking institutions | | | | | | |
| Customers' deposits | - | - | - | - | 179,852 | 179,852 |
| Loan capital | - | - | - | - | 3,522,174 | 3,522,174 |
| **Total liabilities** | **-** | **-** | **-** | **-** | **3,702,026** | **3,702,026** |

## 6. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES (Continued)

| | Held for trading KShs'000 | Held to maturity KShs'000 | Loans and Receivables KShs'000 | Available for-sale KShs'000 | Other amortised cost KShs'000 | Total carrying amount KShs'000 |
|---|---|---|---|---|---|---|
| **As at 31 December 2008** | | | | | | |
| **Assets** | | | | | | |
| Cash and cash equivalents | - | - | 282,058 | - | - | 282,058 |
| Deposits and balances due from other banks | - | - | 914,353 | | - | 914,353 |
| Investments in Government securities | - | 406,063 | - | - | - | 406,063 |
| Loans and advances to customers | - | - | 2,306,663 | - | - | 2,306,663 |
| Investment in commercial paper and loan notes | - | 258,819 | - | - | - | 258,819 |
| **Total assets** | **-** | **664,882** | **3,503,074** | | **-** | **4,167,956** |
| **Liabilities and shareholders' funds** | | | | | | |
| Deposits and balances due to Banking institutions | | | | | 5,000 | 5,000 |
| Customers' deposits | - | - | - | - | 3,667,533 | 3,667,533 |
| Loan capital | - | - | - | - | - | - |
| **Total liabilities** | **-** | **-** | **-** | **-** | **3,672,533** | **3,672,533** |

The standard requires disclosure of fair values of all financial instruments. Other than governments securities held for trading, that are actively traded in the market, the other financial instruments have been disclosed at amortised cost. The market has not developed a standard yield curve that can be used to fair value securities held to maturity (HTM), that are not actively traded in the market. The total HTM portfolio is therefore reflected at amortised cost. Loans and advances are not actively traded in the market, rendering fair valuation impractical. Consequently, these have been disclosed at amortised cost.

| | Group 2009 KShs'000 | Group 2008 KShs'000 |
|---|---|---|
| **7. INTEREST INCOME** | | |
| Loans and advances to customers | 380,467 | 343,860 |
| Government securities | 49,130 | 35,552 |
| Investment in commercial paper and loan notes | 2,120 | 50,002 |
| Placements with other Banks | 9,034 | 37,795 |
| Corporate Bonds | 1,942 | - |
| | **442,693** | **467,209** |

## 8. INTEREST EXPENSE

| | | |
|---|---|---|
| Customer deposits | 153,892 | 194,384 |
| Deposits from other Banks and Banking institutions | 3,156 | 2,422 |
| | **157,048** | **196,806** |

## 9. OTHER INCOME

| | | |
|---|---|---|
| Profit on sale of property and equipment | 400 | 340 |
| Other income | 990 | - |
| | **1,390** | **340** |

## 10. IMPAIRMENT LOSSES ON FINANCIAL ASSETS

| | | |
|---|---|---|
| Loans and advances (Note 21(b)) | 8,296 | 1,762 |
| Commercial paper and loan notes (Note 19) | - | 100,230 |
| | **8,296** | **101,992** |

## 11. OPERATING EXPENSES

| | | |
|---|---|---|
| Salaries and employee benefits | 124,409 | 115,449 |
| Occupancy expenses | 51,005 | 51,891 |
| Deposit Protection Fund contribution | 5,697 | 5,315 |
| Other expenses | 87,570 | 82,015 |
| | **268,682** | **254,670** |

Included in other expenses are support services payable to a related company. During the year the Bank incurred costs of KShs 32,169,405 (2008 – KShs 32,192,974) for these services.

| | | Group 2009 | Group 2008 |
|---|---|---|---|
| **12.** | **STAFF COSTS** | **KShs'000** | **KShs'000** |
| | Salaries and wages | 110,084 | 99,128 |
| | Contributions to defined contribution scheme | 4,853 | 3,277 |
| | Social security contributions | 168 | 160 |
| | Staff welfare | 9,304 | 12,884 |
| | | **124,409** | **115,449** |

The average numbers of employees engaged during the year were:

| | 2009 | 2008 |
|---|---|---|
| Management Staff | 60 | 57 |
| Unionisable | 13 | 13 |
| | **73** | **70** |

## 13. PROFIT/(LOSS) BEFORE TAXATION

| Profit before taxation is arrived at after charging/ (crediting): | | |
|---|---|---|
| Depreciation expense | 13,082 | 10,979 |
| Amortisation of intangible assets | 2,567 | 1,813 |
| Directors' emoluments: | | |
| Non-executives – Fees | 525 | 470 |
| Executives – Remuneration | 13,980 | 7,375 |
| Auditors' remuneration: | | |
| – Current year | 2,200 | 1,900 |
| Gains on sale of property and equipment | (400) | (341) |

## 14. TAXATION

| | | |
|---|---|---|
| Current tax at 30% on adjusted profit for tax purposes | 18,312 | - |
| Deferred tax credit (Note 25) | 5,323 | (1,180) |
| | 23,635 | (1,180) |
| Current tax overprovision in prior year | (734) | 4,038 |
| Prior year understatement of deferred tax asset | 53 | (16,479) |
| | **22,953** | **(13,621)** |

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

| | Group 2009 KShs'000 | Group 2008 KShs'000 |
|---|---|---|
| Accounting profit before tax | 74,259 | (9,646) |
| Computed tax using the applicable tax rate of 30% | 22,278 | (2,894) |
| Non-deductible expenses and non-taxable income | 1,357 | 1,714 |
| | 23,635 | (1,180) |
| Overprovision in prior year income and deferred tax | (681) | (12,441) |
| **Income tax expense** | **22,953** | **(13,621)** |

## 15. BASIC AND DILUTED EARNINGS PER SHARE

| The calculation of basic and diluted earnings per share is based on: | Group 2009 | Group 2008 |
|---|---|---|
| Net profit for the year attributable to shareholders – KShs'000 | **51,306** | **3,975** |
| Number of ordinary shares in issue at 31 December | 6,000,000 | **6,000,000** |
| Basic and diluted earnings per share | **8.55** | **0.66** |

## 16. DIVIDENDS PER SHARE

No dividends were declared in 2009 (2008 – Nil).

## 17. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

| | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| Cash on hand | 37,055 | 52,451 |
| Balances with Central Bank of Kenya: | | |
| - Cash reserve ratio | 133,152 | 177,000 |
| - Other | 31,334 | 52,607 |
| | **201,541** | **282,058** |

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 2009, the cash reserve ratio requirement was 4.5% of eligible deposits (2008 – 5%). The funds are not available to finance the Bank's day-to-day operations.

## 18. INVESTMENTS HELD TO MATURITY

| | Group and Company 2009 | Group and Company 2008 |
|---|---|---|
| **Government Securities** | **KShs'000** | **KShs'000** |
| Treasury bills – due within 90 days | - | - |
| Treasury bills – due after 90 days | 73,046 | 59,943 |
| Treasury Bonds | 626,717 | 346,120 |
| | **699,764** | **406,063** |
| Corporate Bonds | 95,115 | - |
| Total Investments | **794,879** | **406,063** |

The weighted average effective interest rate on government securities for the year 2009 was 9.58% (2008 – 8.50%).

## 19. COMMERCIAL PAPER AND LOAN NOTES

| | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| Due after 90 days (gross) | - | 359,049 |
| Due within 90 days | 100,230 | - |
| Impairment loss | (100,230) | (100,230) |
| | **-** | **258,819** |

The weighted average effective rate on loan notes for the year 2009 was nil (2008 – 10.53%).

## 20. PLACEMENTS WITH OTHER BANKS

| | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| Due within 90 days | **558,365** | **914,353** |

The weighted average effective interest rate on placements with other banks for the year 2009 was 4.62% (2008 – 5.30%).

## 21. LOANS AND ADVANCES TO CUSTOMERS

| | | Group and Company 2009 | Group and Company 2008 |
|---|---|---|---|
| | | KShs'000 | KShs'000 |
| (a) | Overdrafts | 1,347,669 | 1,340,987 |
| | Loans | 1,465,053 | 824,240 |
| | Bills discounted | 4,541 | 5,872 |
| | Others | - | 206,853 |
| | Gross loans and advances | 2,817,263 | 2,377,952 |
| | Less: Provisions for impairment losses on loans and advances | (67,734) | (71,289) |
| | **Net loans and advances** | **2,749,529** | **2,306,663** |

### (b) Impairment losses on financial assets

| **Year ended 31 December 2009:** | Specific impairment losses | Portfolio impairment losses | Total |
|---|---|---|---|
| | KShs'000 | KShs'000 | KShs'000 |
| At 1 January 2009 | 66,831 | 4,458 | 71,289 |
| Amounts written off during the year | (11,851) | | (11,851) |
| | 54,980 | 4,458 | 59,438 |
| Provisions made during the year | 7,965 | 331 | 8,296 |
| **At 31 December 2009** | **62,945** | **4,789** | **67,734** |

| **Year ended 31 December 2008:** | Specific impairment losses | Portfolio impairment losses | Total |
|---|---|---|---|
| | KShs'000 | KShs'000 | KShs'000 |
| At 1 January 2008 | 54,255 | 25,055 | 79,310 |
| Amounts written off during the year | (9,783) | - | (9,783) |
| | 44,472 | 25,055 | 69,527 |
| Provisions made during the year | 22,359 | (20,597) | 1,762 |
| **At 31 December 2008** | **66,831** | **4,458** | **71,289** |

## 21. LOANS AND ADVANCES TO CUSTOMERS (Continued)

### (b) Impairment losses on financial assets (continued)

The weighted average effective interest rate on loans and advances to customers for the year 2009 was 13.02% (2008 – 13.63%).

### (c) Non performing loans and advances

Loans and advances include an amount of KShs 404,554,330.24 (2008 – KShs 215,162,000) which has been classified as impaired. These loans have been written down to their recoverable amount.

## 22. PROPERTY AND EQUIPMENT

**Group and company**

| 2009: | Leasehold improvements KShs'000 | Motor vehicles KShs'000 | Furniture fixtures & fittings KShs'000 | Computer equipment KShs'000 | Office equipment KShs'000 | Total KShs'000 |
|---|---|---|---|---|---|---|
| **Cost:** | | | | | | |
| At 1 January 2009 | 32,699 | 11,144 | 18,592 | 35,646 | 17,658 | 115,739 |
| Additions | 104 | - | 5,846 | 3,279 | 2,686 | 11,915 |
| Disposals | - | (2,328) | - | | | (2,328) |
| At 31 December 2009 | 32,803 | 8,816 | 24,438 | 38,925 | 20,344 | 125,326 |
| **Depreciation:** | | | | | | |
| At 1 January 2009 | 18,542 | 7,229 | 13,401 | 23,095 | 12,521 | 74,788 |
| Charge for the year | 2,409 | 1,484 | 1,665 | 5,600 | 1,924 | 13,082 |
| Disposals | | (2,328) | | | | (2,328) |
| At 31 December 2009 | 20,951 | 6,385 | 15,066 | 28,695 | 14,445 | 85,541 |
| **Net book value:** | | | | | | |
| **At 31 December 2009** | **11,852** | **2,431** | **9,372** | **10,230** | **5,899** | **39,785** |
| **2008:** | | | | | | |
| **Cost:** | | | | | | |
| At 1 January 2008 | 24,178 | 9,292 | 23,258 | 37,396 | 15,499 | 109,623 |
| Additions | 2,481 | 3,037 | 3,269 | 2,408 | 1,724 | 12,919 |
| Reclassifications/ write offs | 6,040 | (476) | (7,935) | (4,158) | 590 | (5,939) |
| Disposals | - | (709) | - | - | (155) | (864) |
| At 31 December 2008 | 32,699 | 11,144 | 18,592 | 35,646 | 17,658 | 115,739 |

| | Leasehold improvements KShs'000 | Motor vehicles KShs'000 | Furniture fixtures & fittings KShs'000 | Computer equipment KShs'000 | Office equipment KShs'000 | Total KShs'000 |
|---|---|---|---|---|---|---|
| **Depreciation:** | | | | | | |
| At 1 January 2008 | 14,846 | 6,465 | 14,889 | 24,801 | 10,413 | 71,414 |
| Charge for the year | 2,303 | 1,494 | 1,318 | 3,908 | 1,956 | 10,979 |
| Reclassifications/ write back | 1,393 | (21) | (2,806) | (5,614) | 307 | (6,741) |
| Disposals | - | (709) | - | - | (155) | (864) |
| At 31 December 2008 | 18,542 | 7,229 | 13,401 | 23,095 | 12,521 | 74,788 |
| **Net book value:** | | | | | | |
| **At 31 December 2008** | **14,157** | **3,915** | **5,191** | **12,551** | **5,137** | **40,951** |

## 23. INTANGIBLE ASSETS

| | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| **Cost** | | |
| At 1 January | 21,415 | 24,569 |
| Reclassification/write offs | - | (5,641) |
| Additions in the year | 1,517 | 2,487 |
| **At 31 December** | **22,932** | **21,415** |
| **Amortisation** | | |
| At 1 January | 10,171 | 13,197 |
| Reclassification/write back | | (4,839) |
| Charge for the year | 2,566 | 1,813 |
| **At 31 December** | **12,737** | **10,171** |
| **Net book value** | **10,195** | **11,244** |

## 24. INVESTMENT IN ASSOCIATE

The bank's share of loss in its equity accounted investee for the year was Ksh 2,392,973 (2008 – Kshs 1,731,063).

The following is the movement in the bank's investment in the associate;

| | 2009 KShs'000 | 2008 KShs'000 |
|---|---|---|
| Balance as at 1 January | 28,269 | 30,000 |
| Prior year understatement of loss from associate | (103) | |
| Share of loss from associate | (2,290) | (1,731) |
| **Net investment in associate** | **25,876** | **28,269** |

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

| | Ownership | Current Assets | Non-Current asset | Total assets | Current Liabilities | Non-Current liabilities | Total liabilities | Revenues | Expenses | Profit/(loss) |
|---|---|---|---|---|---|---|---|---|---|---|
| 2009 | | | | | | | | | | |
| Equatorial investment bank | 20% | 114,381 | 16,335 | 130,716 | 1,362 | 129,354 | 130,716 | 9,087 | 20,537 | (11,450) |
| | | 114,381 | 16,335 | 130,716 | 1,362 | 129,354 | 130,716 | 9,087 | 20,537 | (11,450) |
| 2008 | | | | | | | | | | |
| Equatorial investment bank | 20% | 134,728 | 6,727 | 141,455 | 651 | 140,804 | 141,455 | 8,270 | 17,441 | (9,170) |
| | | 134,728 | 6,727 | 141,455 | 651 | 140,804 | 141,455 | 8,270 | 17,441 | (9,170) |

## 25. DEFERRED TAX

Deferred tax assets at 31 December 2009 and 2008 are attributable to movements in temporary differences between calculations of certain items for accounting and for taxation purposes as specified below:

| Group and Company 2009: | Balance at 01/01/2009 KShs'000 | Under/(over)provision in prior year KShs'000 | Movement during the year KShs'000 | Balance at 31/12/2009 KShs'000 |
|---|---|---|---|---|
| **Arising from:** | | | | |
| Plant and equipment | 2,706 | 645 | 160 | 3,511 |
| Less: Carried forward | 394 | (394) | - | - |
| General provisions for | | | | |
| loans and advances | 21,387 | | (1,066) | 20,321 |
| Other provisions | 6,802 | (304) | (4,417) | 2,081 |
| | **31,289** | **(53)** | **(5,323** | **25,913** |

| Group and Company 2008: | Balance at 01/01/2008 KShs'000 | Under provision in prior year KShs'000 | Movement during the year KShs'000 | Balance at 31/12/2008 KShs'000 |
|---|---|---|---|---|
| Arising from: | | | | |
| Plant and equipment | 4,621 | (1,020) | (895) | 2,706 |
| Less: Carried forward | - | - | 394 | 394 |
| General provisions for | | | | |
| loans and advances | 7,517 | 16,276 | (2,406) | 21,387 |
| Other provisions | 1,492 | 1,223 | 4,087 | 6,802 |
| | **13,630** | **16,479** | **1,180** | **31,289** |

## 26. (a) OTHER ASSETS

| | Group 2009 | Group 2008 |
|---|---|---|
| Deposits and prepayments | 13,338 | 40,731 |
| Items in transit | 22,202 | 48,147 |
| Other assets | 13,931 | 16,687 |
| | **49,471** | **105,565** |

### 26. (b) OTHER ASSETS

| | Company 2009 | Company 2008 |
|---|---|---|
| Deposits and prepayments | 13,338 | 40,731 |
| Items in transit | 22,202 | 48,147 |
| Other assets | 13,913 | 16,672 |
| | **49,453** | **105,550** |

### 27. CUSTOMER DEPOSITS

| **From private sector & individuals** | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| Non-profit institutions and individuals | 1,010,697 | 1,027,491 |
| Private enterprises | 1,717,556 | 1,667,223 |
| Foreign currency accounts | 793,921 | 972,819 |
| | **3,522,174** | **3,667,533** |

Included in customers' deposits is KShs 910,985,279.45 (2008 – KShs 947,653,038) due to related companies. Interest paid on such deposits during the year amounted to KShs 41,046,005 (2008 – KShs 29,903,054)

### 28. OTHER LIABILITIES

| | Group and Company 2009 | Group and Company 2008 |
|---|---|---|
| Bills payable | 16,286 | 30,119 |
| Sundry creditors | 17,571 | 31,837 |
| | **33,857** | **61,956** |

### 29. SHARE CAPITAL AND RESERVES

| **(a) Share capital** | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| Authorised | | |
| 6,000,000 Ordinary shares of KShs.100 each | **600,000** | **600,000** |
| Issued and fully paid | | |
| 6,000,000 Ordinary shares of KShs 100 each | **600,000** | **600,000** |

**(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.

## 30. NOTES TO THE CASH FLOW STATEMENT

| **(a) Reconciliation of profit before taxation to cash flows from operating activities** | **2009 KShs'000** | **2008 KShs'000** |
|---|---|---|
| Profit before taxation | 74,259 | (9,646) |
| Loss In Associate | 2,393 | 1,731 |
| Depreciation | 13,082 | 10,979 |
| Amortisation of intangible assets | 2,567 | 1,813 |
| Impairment loss on leasehold improvements | - | - |
| Profit on sale of property and equipment | (400) | (341) |
| **Net cash inflow from trading activities** | **91,901** | **4,536** |
| **(Decrease)/increase in operating assets** | | |
| Central Bank of Kenya cash reserve | 43,848 | 43,773 |
| Investment in government securities maturing | | |
| after 90 days | (293,701) | (15,119) |
| Loans and advances to customers | (442,866) | (1,347) |
| Investment in commercial paper and loan notes | 258,819 | (258,819) |
| Investment in corporate bonds | (95,115) | - |
| Investment in associate (previously treated | | |
| as subsidiary) | - | (30,000) |
| Other assets | 56,094 | (32,298) |
| | (472,922) | (293,810) |
| Increase/(decrease) in operating liabilities | | |
| Customers deposits | (145,359) | (447,709) |
| Other liabilities | (28,097) | (31,127) |
| | **(173,456)** | **(478,836)** |
| Net cash outflow from operations | **(554,477)** | **(768,110)** |
| Tax paid | - | (21,484) |
| Net cash flow from operating activities | **(554,477)** | **(789,594)** |

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

| | Group 2009 KShs'000 | Group 2008 KShs'000 | Change in the year KShs'000 |
|---|---|---|---|
| Cash and balances with Central Bank of Kenya | 68,389 | 105,058 | (36,669) |
| Balances due from Banking institutions | 558,365 | 914,353 | (355,988) |
| Deposits and Balances due to Banking institutions | (179,852) | (5,000) | (174,852) |
| | **446,902** | **1,014,411** | **(567,509)** |

## 31. 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% of the employee's basic salary. During the year, the Bank incurred costs of KShs 4,852,590 as contributions payable (2008 – KShs 2,238,718).

## 32. 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

## 33. CONTINGENT LIABILITIES

| | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| Commitments with respect to: | | |
| Irrevocable letters of credit | 29,667 | 18,048 |
| Guarantees | 450,234 | 409,867 |
| Acceptances | 12,424 | - |
| Inward foreign documentary bills | 149,336 | 142,321 |
| Stock of travellers' cheques | - | - |
| Forward deals outstanding | 191,349 | 1,724 |
| | **833,010** | **571,960** |

**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 a Bank to support performance by a customer to third parties. The Bank will only be required to meet these obligations in the event of the 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.

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.

| **34. ASSETS PLEDGED AS SECURITY** | **Group and Company 2009 KShs'000** | **Group and Company 2008 KShs'000** |
|---|---|---|
| Cash pledged to Central Bank Domestic Foreign Currency Clearing | **USD 287,000** | **USD 456,000** |

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

## 35. RELATED PARTY TRANSACTIONS

The Bank has entered into transactions with its Directors, affiliates and employees:

| The aggregate amount of loans: | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| Directors and affiliates | | |
| Balance at the beginning of the year | 89,927 | 158,127 |
| Loans advanced during the year | 16,654 | 31,336 |
| Loans repayments received | (86,260) | (99,536) |
| | **20,321** | **89,927** |
| Guarantees | **33,913** | **12,373** |
| Import letters of credit | **1,421** | **9,850** |

The loans to related parties were given on commercial terms and conditions. The related interest income in the year was KShs 1,809,261 (2008 – KShs 10,507,400).

| | Group and Company 2009 KShs'000 | Group and Company 2008 KShs'000 |
|---|---|---|
| *Employees:* | | |
| Balance at the beginning of the year | 7,540 | 4,505 |
| Loans advanced during the year | 14,569 | 5,909 |
| Loans repayments received | (4,244) | (2,874) |
| | **17,865** | **7,540** |
| Guarantees | 100 | - |

The related interest income in the year was KShs 1,155,937 (2008 – KShs 474,678). Senior management compensation was Ksh 31,353,727 (2008 – KShs 39, 684,121).

## 36. OPERATING LEASE

Operating lease rentals are payable as follows:

| | 2009<br>KShs'000 | 2008<br>KShs'000 |
|---|---|---|
| *Tenancy:* | | |
| Less than one year | 29,547 | 26,956 |
| Between one and five years | 27,966 | 88,297 |
| Due after five years | - | 8,013 |
| | **57,513** | **123,266** |

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 includes contingent rentals. During the year ended 31 December 2009, KShs 30,411,860 (2008 – KShs 26,956,340) was recognised as an expense in the income statement 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 21,339,560 (2008 – KShs 18,451,240).

## 36. CAPITAL COMMITMENTS

There are no authorised capital commitments that are outstanding at the year end.

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