



VICTORIA
COMMERCIAL BANK
Elevating Relationships

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ANNUAL REPORT
& FINANCIAL STATEMENTS

REGISTERED OFFICE

Mezzanine Floor, Victoria Towers,
Kilimanjaro Avenue, Upper Hill
PO Box 41114- 00100, Nairobi

AUDITOR

PricewaterhouseCoopers, Certified Public Accountants
PwC Tower,
Waiyaki Way/Chiromo Road, Westlands
Nairobi, Kenya
PO Box 43963-00100 Nairobi

PRINCIPAL CORRESPONDENTS

Standard Chartered Bank	NEW YORK
Standard Chartered Bank	LONDON
Standard Chartered Bank	FRANKFURT
Standard Chartered Bank	TOKYO
Standard Chartered Bank	JOHANNESBURG
Mashreq Bank Psc	NEW YORK
Mashreq Bank Psc	LONDON
Mashreq Bank Plc	DUBAI

MAIN LAWYERS

Taibjee and Bhalla Advocates
Ashitiva and Company Advocates
Raffman, Dhanji, Elms and Virdee Advocates
Njoroge Regeru & Company Advocates

BOARD OF DIRECTORS

Kanji D Pattni
CHAIRMAN

Yogesh K Pattni, Ph.D *
MANAGING DIRECTOR

Silvano O Kola

Rajan P Jani */ ALTERNATE Yadav Jani

Ketaki Sheth*
COMPANY SECRETARY

Mukesh S Shah

Zarqa N Ahmed (Retired 15 June 2016)

British*

PRINCIPLE OFFICERS

Yogesh K Pattni, Ph.D
MANAGING DIRECTOR

Manish L Parmar
GENERAL MANAGER

Nitin H Jethwa
GENERAL MANAGER

Dharmesh M Vaya
ASSISTANT GENERAL MANAGER

Azmina Pattni
BRANCH MANAGER

Mitesh Chouhan
CREDIT ADMIN. MANAGER

Hezron Kamau
FINANCE MANAGER

Alpesh C Parmar
TREASURY MANAGER

Varsha Lakhman
BRANCH MANAGER

Fiddelice Otwani
HUMAN RESOURCES MANAGER



VICTORIA
COMMERCIAL BANK

Elevating Relationships

VICTORIA COMMERCIAL BANK LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2016

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DIRECTORS' REPORT



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DIRECTORS' REPORT

The directors submit their report together with the audited financial statements of Victoria Commercial Bank (the "Bank") for the year ended 31 December 2016 in accordance with Section 22 of the Banking Act and Sections 147 to 163 of the repealed Companies Act - Cap 486, which remain in force under the transition rules contained in the Sixth Schedule, the Transitional and Saving Provisions of the Companies Act 2015.

PRINCIPAL ACTIVITIES

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

RESULTS AND DIVIDEND

Profit for the year of Shs 592,395,000 (2015: Shs 713,800,000) has been added to retained earnings. During the year, the Bank paid an interim dividend of Shs 91,125,000 (2015: Shs 91,125,000). The directors do not recommend payment of a final dividend.

STATEMENT ON CORPORATE GOVERNANCE

Corporate governance involves the manner in which the business and affairs of an institution are governed by its board and senior management and provides the structure through which the objectives of the institution are set, and the means of attaining those objectives and monitoring performance are determined.

These structures are aimed at maintaining and increasing shareholder value simultaneously with the satisfaction of other stakeholders in the context of the institution's corporate mission.

THE BOARD OF DIRECTORS

Kanji D. Pattni	Chairman
Yogesh K Pattni Ph.D	Managing Director
Rajan P Jani	Non-Executive Director
Sylvano O. Kola	Non-Executive Director
Ketaki Sheth	Non-Executive Director
Zarqa N Ahmed	Non-Executive Director (Retired 15 June 2016)
Mukesh S. Shah	Non-Executive Director

GOVERNANCE PRINCIPLES

The Board of Directors is composed of the Chairman, five non-executive directors and the Managing Director, all of whom have extensive business and banking experience applied in the management of the Bank. The Board meets regularly to review the Bank's performance against business plans in addition to formulating and implementing strategy as well as discharge its duties relating to the corporate accountability and associated risks in terms of management, assurance and reporting.

The Central Bank of Kenya Prudential Guidelines require that appointment of all directors must be approved by Central Bank, a requirement that the Bank has complied with.

The Board has delegated authority for the conduct of the day to day business to the Management. However, the Board retains responsibility for establishing and maintaining the Bank's overall internal control of financial, operational and compliance issues.

DIRECTORS' REPORT *(continued)*

The Board has four main functional committees (Audit, Credit, Nomination and Remuneration, and Risk Management) which meet at least on quarterly basis with the main functions outlined below. These are supported by Management committees charged with implementing various decisions of the Board.

All the Bank's Directors and employees adhere to the principles of the Code of Conduct in all of their dealings on behalf of the Bank. The code of conduct ensures that all actions are in the overall best interests of the Bank and reflects commitment to maintaining the highest standards of integrity, ethical behaviour and compliance with all applicable internal and external laws and regulations.

All the Directors are committed to act honestly and in the best interests of the Bank. The Board also ensures that the Directors' personal interests do not conflict with their duty to the Bank and to all the stakeholders.

The following are the board and management committees of Victoria Commercial Bank Limited with brief description of their key role, composition and membership as well as the frequency of the meetings.

BOARD AUDIT COMMITTEE (BAC)

This Committee provides independent oversight of the bank's financial reporting and internal control system, ensure checks and balances within the Bank are in place and recommends remedial actions regularly.

The committee comprises of three non- executive directors. In addition, the Chairperson of the Committee can invite members to attend meetings as may be necessary.

The external and internal auditors of the Bank shall have free access to the Audit Committee. The Auditors can request the Chairperson of the Committee to convene a meeting to consider any matter that the auditors believe should be brought to the attention of directors or shareholders.

The BAC is chaired by an independent non-executive director and meets once every quarter as per its terms of reference.

BOARD RISK MANAGEMENT COMMITTEE (BRMC)

This Committee assists the board of directors in the discharge of its duties relating to the corporate accountability and associated risks in terms of management, assurance and reporting. The responsibility to ensure quality, integrity and reliability of the bank's risk management is delegated to the BRMC.

The committee comprises of three non- executive directors. In addition, the Chairperson of the Committee can invite members to attend meetings as may be necessary.

The Risk and Compliance Function of the Bank has free access to the BRMC.

The BRMC is chaired by an independent non-executive director and meets once every quarter as per its terms of reference.

BOARD CREDIT COMMITTEE (BCC)

This Committee assists the board of directors in reviewing and overseeing the overall lending of the Bank. The committee also monitors and reviews the quality of the Banks' portfolio and ensures adequate levels of loan loss provisions are maintained. The BCC deliberates and considers loan applications beyond the discretionary limits of the Credit Risk Management Committee.

The Committee comprises of two non-executive directors and the Managing Director, who is an executive director.

The BCC is chaired by an independent non-executive director and meets once every quarter as per its terms of reference. In addition, the Chairperson of the Committee can invite members to attend meetings as may be necessary.

DIRECTORS' REPORT *(continued)*

BOARD NOMINATION AND REMUNERATION COMMITTEE (BNRC)

The objective of this Committee is to assist the Board undertake structured assessment of candidates for membership of the Board and senior executives as well as regular review of structure, size and composition of the board and make recommendations on any adjustments deemed necessary.

The Committee also oversees the compensation system's design and operation in line with clearly defined remuneration principles.

The Committee comprises of three non-executive directors and the Managing Director, who is an executive director.

The BNRC is chaired by an independent non-executive director and meets at least twice every year as per its terms of reference.

EXECUTIVE COMMITTEE (EXCO)

This committee is the link between the Board and the management of the Bank. It assists the Managing Director in implementing operational plans, the annual budget and periodic review of the Bank's overall strategies.

The Committee comprises of the senior management of the bank.

The Committee is chaired by the Managing Director of the Bank and meets at a minimum of twice per month unless otherwise notified by the Chairperson to the committee.

RISK MANAGEMENT AND COMPLIANCE COMMITTEE

This Committee assists the board risk management Committee in the discharge of its duties relating to the corporate accountability and associated risks in terms of management, assurance and reporting.

The Committee is chaired by the Risk Officer and members include all the line managers and a representative of the senior management team. In addition, the chair person can invite other members of the bank as may be necessary.

The Committee meets once every quarter as per its terms of reference.

ASSETS AND LIABILITIES COMMITTEE (ALCO)

ALCO is responsible for monitoring and managing the assets and liabilities of the Bank. This includes managing interest rate movements, liquidity, treasury risk management, cost of funds/margins, reviewing and monitoring bank deposit base, foreign exchange exposure and capital adequacy. The Committee also recommends appropriate steps with regards the areas above in line with the CBK/Risk Management guidelines.

The committee comprises mainly of the executive team and is chaired by the Head of Treasury.

The Committee meets at a minimum once a month as per its terms of reference.

CREDIT RISK MANAGEMENT COMMITTEE

The objectives of the Credit Risk Management Committee are to review, oversee, decline and approve the credit facilities in line with the lending policy set by the Board Credit Committee.

The committee also deals with the day to day management of loans and advances as well as off- balance sheet facilities in accordance with the Credit Policies of the Bank.

The committee is chaired by the General Manager in charge of credit. Other members are the senior management team, relationship managers, credit Manager, legal Officer and the committee secretary. The committee reports to the Board Credit Committee.

DIRECTORS' REPORT *(continued)*

The Committee meets on monthly basis as per its terms of reference.

ICT STEERING COMMITTEE

ICT Committee's responsibilities include directing the investigation and development of ICT requirements; developing long-term strategies and plans for ICT services; recommending and implementing approved systems, policies and strategies; recommending and approving hardware and software changes; ensuring accurate management information is available on a timely and reliable manner and that appropriate security arrangements are in place including information security.

The Committee is chaired by Managing Director and membership consists of representatives from senior management, the IT function, Credit Manager, Operations Officer as well as the Project Manager.

The Committee meets once every three months as per its terms of reference.

BOARD AND DIRECTORS EVALUATION

The Board, on an annual basis, carries out a self-assessment of its members. Each board member evaluates fellow board members as well as the Chairman of the Board. An evaluation of the performance of the Managing Director during the period under review is also carried out.

The assessment is broad based and encompasses all aspects of management of the business and particularly the contribution of each board member. Effectiveness, participation, attendance and co-operation amongst directors also form part of the basis of the assessment. Mix of skills and experiences of each director are taken into consideration. All directors and the Chairman will continue making these assessments on an annual basis.

ATTENDANCE AT BOARD MEETINGS

	Jan, 25, 2016	Feb, 24, 2016	Mar, 31, 2016	Apr, 18, 2016	Apr, 28, 2016	May, 25, 2016	June, 28, 2016	Jul, 26, 2016	Sept, 2, 2016	Sept, 20, 2016	Oct, 25, 2016	Nov, 15, 2016	Dec, 6, 2016
K D Pattni (Chairman)	P	P	P	P	P	P	P	P	P	P	P	P	P
Yogesh K Pattni Ph D (Managing)	P	P	P	P	P	P	P	P	P	P	P	P	P
S O Kola	P	P	P	P	P	P	P	P	P	P	P	P	P
Rajan P Jani	P	P	P	P	P	P	P	P	P	P	P	P	P
Ketaki Sheth	P	AP	P	P	P	P	P	P	P	P	P	P	P
Zarqa N Ahmed (rtd 15.06.2016)	P	P	AP	P	AP	P	-	-	-	-	-	-	-
Mukesh Shah	AP	P	P	P	P	P	P	P	P	P	P	P	AP

P - Present

A - Absent

AP - Apology

AUDITOR

The Bank's auditor, PricewaterhouseCoopers, continues in office in accordance with the provisions of the repealed Section 159(2) of the Companies Act and Section 24(1) of the Banking Act.

By order of the Board
KANJI D PATTNI
CHAIRMAN

07 March 2017

FIVE YEAR FINANCIAL REVIEW

BALANCE SHEET

Assets

	2012 Shs'000	2013 Shs'000	2014 Shs'000	2015 Shs'000	2016 Shs'000
Government securities	2,101,258	1,165,666	2,399,880	2,823,790	2,993,604
Loans and advances to customers	5,291,220	8,363,452	10,979,238	13,124,420	15,292,829
Property and equipment	142,547	137,418	185,373	235,466	192,350
Other assets	2,787,794	3,977,706	3,679,601	3,836,396	3,924,698
Total assets	10,322,819	13,644,242	17,244,092	20,020,072	22,403,481

Liabilities

Customer deposits	7,560,894	9,043,645	12,288,662	14,024,406	15,695,947
Long term borrowings	312,800	1,482,686	1,387,418	1,305,428	1,519,870
Other liabilities	413,119	589,767	692,464	1,178,729	127,627
Total liabilities	8,286,813	11,116,098	14,368,544	16,508,563	17,343,444

Shareholder's funds

Total equity and liabilities	10,322,819	13,644,242	17,244,092	20,020,072	22,403,481
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INCOME STATEMENT

Interest income	1,352,816	1,375,389	1,754,695	2,379,856	2,450,811
Interest expense	(693,018)	(604,255)	(902,899)	(1,325,394)	(1,302,865)
Net interest income	659,798	771,134	851,796	1,054,462	1,147,946
Non- funded income	146,475	189,534	204,929	196,042	268,070
Operating income	806,273	960,668	1,056,725	1,250,504	1,416,016
Credit impairment credit / (charge)	5,692	(7,505)	(10,982)	(20,026)	(12,032)
Other operating expenses	(321,081)	(366,781)	(410,858)	(553,537)	(607,571)
Profit before income tax and exceptional items	490,884	586,382	634,885	676,941	796,413
Exceptional items	-	-	-	242,161	-
Profit before tax after exceptional items	490,884	586,382	634,885	919,102	796,413
Income tax expense	(140,352)	(154,479)	(170,540)	(205,302)	(204,018)
Profit for the year	350,532	431,903	464,345	713,800	592,395

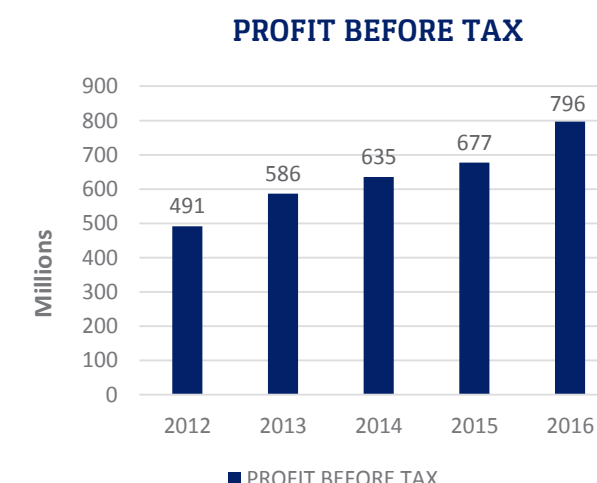
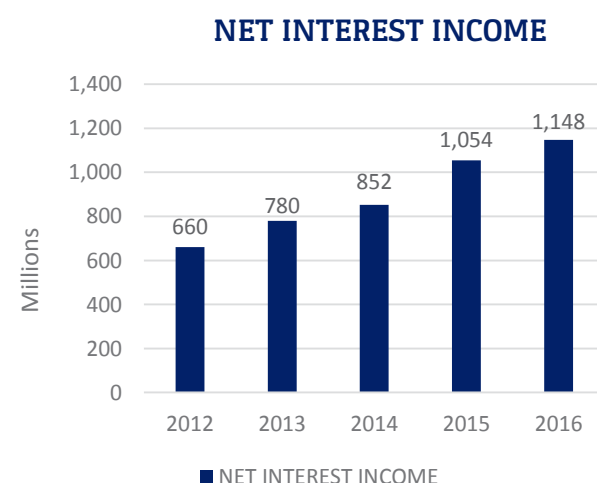
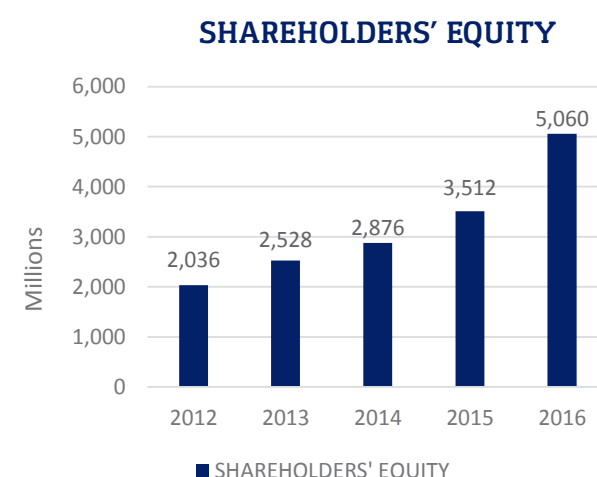
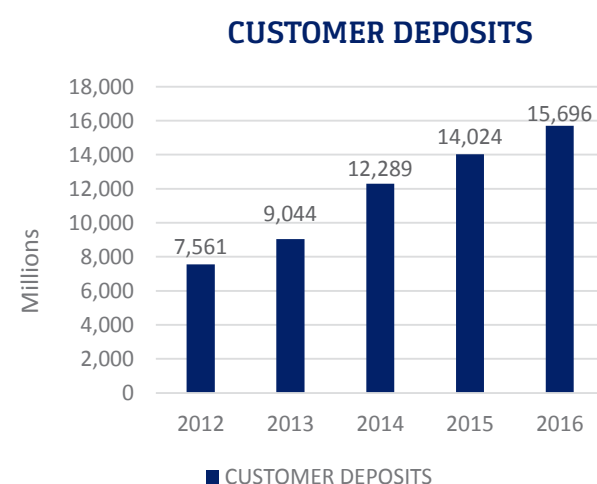
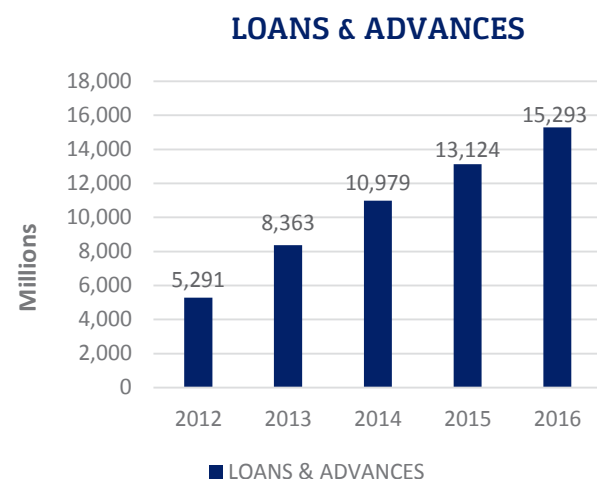
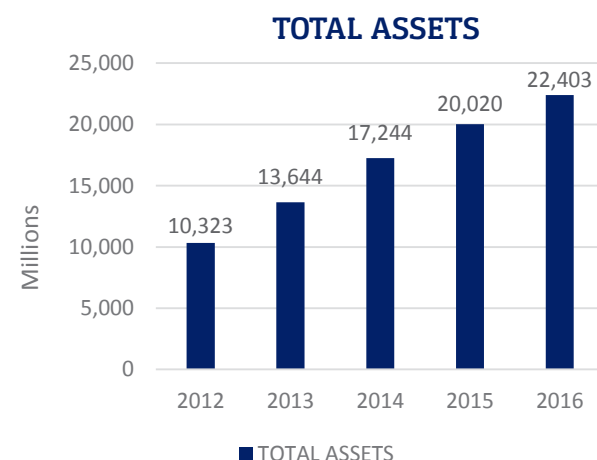
PERFORMANCE RATIOS

Earnings per share (Shs)	11.56	13.42	14.36	21.69	18.60
Dividend Per share (Shs)	3.50	4.50	5.00	3.00	3.00
Return on average shareholder's funds	29.85%	25.70%	23.70%	28.78%	20.84%
Return on average assets	5.46%	4.89%	4.11%	4.93%	3.75%
Non performing loans to total loans and advances	0%	0%	0%	0%	0%
Net advances to customer deposits (%)	70.00%	92.48%	89.34%	93.58%	97.43%

CAPITAL STRENGTH

Core capital to customer deposits	26.40 %	25.40%	21.30%	23.80%	30.90%
Core capital to total risk weighted assets	24.50%	19.80%	18.20%	18.60%	24.70%
Total capital to total risk weighted assets	25.10%	20.40%	19.20%	19.30%	25.50%

FIVE YEAR FINANCIAL REVIEW *(continued)*



*2015 PBT excludes gains on sale of associate

STATEMENT OF DIRECTOR'S RESPONSIBILITY

The Kenyan Companies Act 2015 requires the directors to prepare financial statements for each financial year which give a true and fair view of the financial position of the Bank at the end of the financial year and its financial performance for the year then ended. The directors are responsible for ensuring that the Bank keeps proper accounting records that are sufficient to show and explain the transactions of the Bank; disclose with reasonable accuracy at any time the financial position of the Bank; and that enables them to prepare financial statements of the Bank that comply with prescribed financial reporting standards and the requirements of the Kenyan Companies Act 2015. They are also responsible for safeguarding the assets of the Bank and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

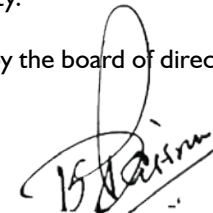
The directors accept responsibility for the preparation and presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act 2015. They also accept responsibility for:

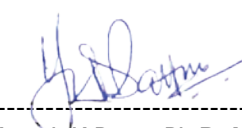
- Designing, implementing and maintaining internal control as they determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;
- selecting suitable accounting policies and then apply them consistently; and
- Making judgements and accounting estimates that are reasonable in the circumstances

In preparing the financial statements, the directors have assessed the Bank's ability to continue as a going concern and disclosed, as applicable, matters relating to the use of going concern basis of preparation of the financial statements. Nothing has come to the attention of the directors to indicate that the Bank will not remain a going concern for at least the next twelve months from the date of this statement.

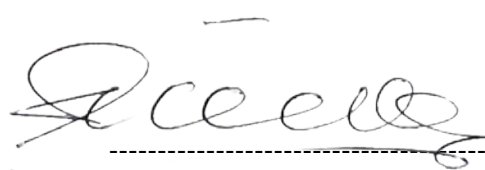
The directors acknowledge that the independent audit of the financial statements does not relieve them of their responsibility.

Approved by the board of directors on 07 March 2017 and signed on its behalf by:


Kanji D Pattni, **Chairman**


Yogesh K Pattni Ph.D, **Managing Director**


KETAKI SHETH
Director /Company Secretary


Sylvano O. Kola, **Director**



**REPORT OF THE INDEPENDENT AUDITOR TO THE
SHAREHOLDERS OF VICTORIA COMMERCIAL BANK LIMITED**





REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF VICTORIA COMMERCIAL BANK LIMITED

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Victoria Commercial Bank Limited (the “Bank”) set out on pages 12 to 61 which comprise the statement of financial position at 31 December 2016 and the statement of profit or loss, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended and the notes to the financial statements, which include a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of Victoria Commercial Bank Limited at 31 December 2016 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act 2015.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s responsibilities for the audit of the financial statements section of our report.

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA Code.

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

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report but does not include the financial statements and our auditor’s report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.



REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF VICTORIA COMMERCIAL BANK LIMITED Continued

Responsibilities of the directors for the financial statements

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act 2015, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Bank’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for overseeing the Bank’s financial reporting process.

Auditor’s responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank’s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors’ use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Bank to cease to continue as a going concern.



**REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS
OF VICTORIA COMMERCIAL BANK LIMITED** Continued

Auditor's responsibilities for the audit of the financial statements (continued)

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Bank to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Bank audit. We remain solely responsible for our audit opinion.

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

Report on other legal requirements

As required by the Kenyan Companies Act 2015 we report to you, based on our audit, that:

- i) we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;
- ii) in our opinion proper books of account have been kept by the Bank, so far as appears from our examination of those books;
- iii) the Bank's statement of financial position and statement of comprehensive income are in agreement with the books of account.

The engagement partner responsible for the audit resulting in this independent auditor's report is FCPA Richard Njoroge - P/No.1244.

Certified Public Accountants-
Nairobi

13 March 2017



FINANCIAL STATEMENTS



Statement of profit or loss

As at 31 December 2016	Notes	2016 Shs'000	2015 Shs'000
Interest income	5	2,450,811	2,379,856
Interest expense	6	(1,302,865)	(1,325,394)
Net interest income		1,147,946	1,054,462
Credit impairment charge	14	(12,032)	(20,026)
Net interest income after credit impairment charge		1,135,914	1,034,436
Fee and commission income		208,521	178,713
Fee and commission expense		(11,394)	(15,479)
Net fee and commission income		197,127	163,234
Foreign exchange income		26,246	27,741
Other (expense) /income		13,777	(4,633)
Non funded income		237,150	186,342
Net operating income		1,373,064	1,220,778
Operating expenses	7	(607,571)	(553,537)
Profit from operations		765,493	667,241
Share of profit from associates	9	30,920	9,700
Profit from ordinary operations		796,413	676,941
Gain on sale of associate		-	242,161
Profit before income tax		796,413	919,102
Income tax expense	10	(204,018)	(205,302)
Profit for the year		592,395	713,800
Earnings per share (Shs per share)			
Basic	11	18.60	21.69
Diluted	11	17.52	-

The notes on pages 17 to 61 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2016	Notes	2016 Shs'000	2015 Shs'000
Profit for the year		592,395	713,800
Other comprehensive income:			
<i>Items that may be subsequently reclassified to profit or loss</i>			
Fair value gain/loss on available for sale investments		49,996	(61,506)
Deferred tax on fair valuation of available for sale investments	18	(14,999)	18,452
Other comprehensive income for the year, net of tax		34,997	(43,054)
Total comprehensive income for the year		627,392	670,746

The notes on pages 17 to 61 are an integral part of these financial statements.

Statement of financial position

For the year ended 31 December 2016	Notes	2016 Shs'000	2015 Shs'000
ASSETS			
Cash and balances with Central Bank of Kenya	13	1,339,265	1,319,609
Investment securities:			
- available for sale	15	1,273,543	927,329
- held to maturity	15	2,084,701	2,420,562
Deposits and balances due from banking institutions	22	1,711,978	1,491,691
Loans and advances to customers	14	15,292,829	13,124,420
Investment in associates	9	284,031	253,111
Property and equipment	16(a)	192,350	195,466
Property and equipment held for sale	16(b)	-	40,000
Intangible assets	17	26,104	32,047
Deferred income tax	18	13,734	24,695
Other assets	19	184,946	191,142
Total assets		22,403,481	20,020,072
LIABILITIES			
Customer deposits	20	15,695,947	14,024,406
Deposits and balances due to banking institutions	21	-	1,076,937
Long term borrowings	23	1,519,870	1,305,428
Other liabilities	24	120,475	87,297
Current income tax		7,152	14,495
Total liabilities		17,343,444	16,508,563
EQUITY			
Share capital	25	829,162	607,501
Share premium	25	1,271,743	420,393
Fair value reserve		(30,774)	(65,771)
Revaluation reserve		137,000	137,000
Regulatory reserve	26	105,000	98,000
Retained earnings		2,747,906	2,314,386
Shareholders' equity		5,060,037	3,511,509
Total equity and liabilities		22,403,481	20,020,072

The financial statements on pages 12 to 61 were approved for issue by the Board of Directors on 07 March 2017 and signed on its behalf by

Kanji D Pattni, Chairman

Yogesh K Pattni Ph.D, Managing Director

KETAKI SHETH
Director/Company Secretary

Sylvano O. Kola, Director

Statement of changes in equity

	Notes	Share capital Shs'000	Share premium Shs'000	Fair value reserve Shs'000	Revaluation reserve Shs'000	Regulatory reserve Shs'000	Retained earnings Shs'000	Total Shs'000
Year ended 31 December 2015								
At 1 January 2015		588,721	382,833	(22,717)	189,900	93,000	1,643,811	2,875,548
Profit for the year		-	-	-	-	-	713,800	713,800
Other comprehensive income, net of tax		-	-	(43,054)	-	-	-	(43,054)
Total comprehensive income for the year		-	-	(43,054)	-	-	713,800	670,746
Transfer to regulatory reserve	26	-	-	-	-	5,000	(5,000)	-
Release of revaluation reserve on disposal of associate		-	-	-	(52,900)	-	52,900	-
Transactions with owners								
Issue of new shares	25	18,780	37,560	-	-	-	-	56,340
Interim dividend paid	12	-	-	-	-	-	(91,125)	(91,125)
At 31 December 2015		607,501	420,393	(65,771)	137,000	98,000	2,314,386	3,511,509
At 1 January 2016		607,501	420,393	(65,771)	137,000	98,000	2,314,386	3,511,509
Profit for the year		-	-	-	-	-	592,395	592,395
Other comprehensive income, net of tax		-	-	34,997	-	-	-	34,997
Total comprehensive income for the year		-	-	34,997	-	-	592,395	627,392
Transfer to regulatory reserve	26	-	-	-	-	7,000	(7,000)	-
Transactions with owners								
Bonus Shares		60,750	-	-	-	-	-	-
Issue of new shares	25	160,911	851,350	-	-	-	-	1,012,261
Interim dividend paid	12	-	-	-	-	-	(91,125)	(91,125)
At 31 December 2016		829,162	1,271,743	(30,774)	137,000	105,000	2,747,906	5,060,037

The notes on pages 17 to 61 are an integral part of these financial statements

Statement of cash flows

For the year ended 31 December 2016	Notes	2016 Shs'000	2015 Shs'000
Cash flows from operating activities			
Interest receipts		2,450,811	2,379,789
Interest payments		(1,361,075)	(1,234,600)
Net fee and commission receipts		202,255	168,654
Foreign exchange income receipts		26,246	27,741
Other Income received		2,485	-
Payments to employees and suppliers		(547,538)	(503,014)
Income tax paid		(215,399)	(191,117)
Cash flows from operating activities before changes in operating assets and liabilities		557,785	647,453
Changes in operating assets and liabilities:			
- loans and advances		(2,180,442)	(2,165,208)
- cash reserve requirement		(53,684)	(94,465)
- other assets		6,196	(36,977)
- customer deposits		1,729,751	1,644,950
- other liabilities		33,178	27,419
Net cash from operating activities		92,784	23,172
Cash flows from investing activities			
Purchase of property and equipment	16	(30,947)	(85,586)
Purchase of intangible assets	17	(18,428)	(8,895)
Purchase of investment securities		(222,711)	(605,771)
Proceeds from sale of investment securities		163,533	-
Proceeds from sale of property and equipment		36,036	910
Dividend received		7,500	-
Proceeds on sale of Investment in Associate		-	595,344
Net cash utilised in investing activities		(65,017)	(103,998)
Cash flows from financing activities			
Borrowings during the year		-	358,395
Repayments of Borrowings during the year		(862,495)	-
Interim dividend paid	12	(91,125)	(91,125)
Proceeds from issue of new shares	25	1,012,261	56,340
Net cash from financing activities		58,641	323,610
Net increase in cash and cash equivalents		86,408	242,784
Cash and cash equivalents at start of year		2,185,761	1,942,977
Cash and cash equivalents at end of year	28	2,272,169	2,185,761

The notes on pages 17 to 61 are an integral part of these financial statements



NOTES



Notes

I General information

Victoria Commercial Bank Limited (the “Bank”) is a company domiciled in Kenya. The registered address of the Bank is:

Mezzanine Floor, Victoria Towers
Kilimanjaro Avenue, Upper Hill
PO Box 41114
00100 Nairobi

For the Kenya Companies Act reporting purposes, the balance sheet is represented by the statement of financial position and profit or loss account by the statement of profit or loss in these financial statements.

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRIC) applicable to companies reporting under IFRS.

(a) Basis of measurement

The measurement basis used is the historical cost basis except where otherwise stated in the accounting policies below.

For those assets and liabilities measured at fair value, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When measuring the fair value of an asset or a liability, the Bank uses market observable data as far as possible. If the fair value of an asset or a liability is not directly observable, it is estimated by the Bank using valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs (e.g. by use of the market comparable approach that reflects recent transaction prices for similar items or discounted cash flow analysis). Inputs used are consistent with the characteristics of the asset / liability that market participants would take into account.

Fair values are categorised into three levels of fair value hierarchy based on the degree to which the inputs to the measurements are observable and the significance of the inputs to the fair value measurement in its entirety:

- Level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Transfers between levels of the fair value hierarchy are recognised by the Bank at the end of the reporting period during which the change occurred.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(b) Use of estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 4.

(c) Changes in accounting policies and disclosures

(i) New and amended standards adopted by the Bank

The following standards and amendments have been applied by the Bank for the first time for the financial year beginning 1 January 2016:

Amendments to IAS 1, 'Presentation of Financial Statements': The amendments are made in the context of the IASB's Disclosure Initiative, which explores how financial statement disclosures can be improved. The amendments, effective 1 January 2016, provide clarifications on a number of issues, including:

- Materiality – an entity should not aggregate or disaggregate information in a manner that obscures useful information. Where items are material, sufficient information must be provided to explain the impact on the financial position or performance.
- Disaggregation and subtotals – line items specified in IAS 1 may need to be disaggregated where this is relevant to an understanding of the entity's financial position or performance. There is also new guidance on the use of subtotals.
- Notes – confirmation that the notes do not need to be presented in a particular order.
- OCI arising from investments accounted for under the equity method – the share of OCI arising from equity-accounted investments is grouped based on whether the items will or will not subsequently be reclassified to profit or loss. Each group should then be presented as a single line item in the statement of other comprehensive income.

According to the transitional provisions, the disclosures in IAS 8 regarding the adoption of new standards/accounting policies are not required for these amendments.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(c) Changes in accounting policies and disclosures (continued)

(ii) New and revised standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2016, and have not been applied in preparing these financial statement. None of these is expected to have a significant effect on the financial statements of the Bank, except the following set out below

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L.

(iii) New and revised standards and interpretations not yet adopted (continued)

The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes.

Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Bank is yet to assess IFRS 9's full impact.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018 and earlier application is permitted. The Bank is assessing the impact of IFRS 15.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

(c) Changes in accounting policies and disclosures (continued)

IFRS 16, 'Leases' After ten years of joint drafting by the IASB and FASB they decided that lessees should be required to recognise assets and liabilities arising from all leases (with limited exceptions) on the balance sheet. Lessor accounting has not substantially changed in the new standard.

The model reflects that, at the start of a lease, the lessee obtains the right to use an asset for a period of time and has an obligation to pay for that right. In response to concerns expressed about the cost and complexity to apply the requirements to large volumes of small assets, the IASB decided not to require a lessee to recognise assets and liabilities for short-term leases (less than 12 months), and leases for which the underlying asset is of low value (such as laptops and office furniture).

A lessee measures lease liabilities at the present value of future lease payments. A lessee measures lease assets, initially at the same amount as lease liabilities, and also includes costs directly related to entering into the lease. Lease assets are amortised in a similar way to other assets such as property, plant and equipment.

This approach will result in a more faithful representation of a lessee's assets and liabilities and, together with enhanced disclosures, will provide greater transparency of a lessee's financial leverage and capital employed.

One of the implications of the new standard is that there will be a change to key financial ratios derived from a lessee's assets and liabilities (for example, leverage and performance ratios).

IFRS 16 supersedes IAS 17, 'Leases', IFRIC 4, 'Determining whether an Arrangement contains a Lease', SIC 15, 'Operating Leases – Incentives' and SIC 27, 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'. The standards is effective for annual periods beginning 1 January 2019. Early adoption is permitted only if IFRS 15 is adopted at the same time.

2.2 Foreign currency translation

(a) Functional and presentation currency

The accounting records are maintained in the currency of the primary economic environment in which the Bank operates (the "Functional Currency"). The financial statements are presented in Kenya Shillings, which is the Bank's presentation currency. The figures shown in the financial statements are stated in Kenya Shillings (Shs), rounded to the nearest thousand.

(b) Transactions and balances

Transactions in foreign currencies during the year are translated into the functional currency using the exchange rates prevailing at the dates of the transaction or valuation where items are re-measured.

Monetary items denominated in foreign currency are translated at the closing rate as at the reporting date.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non-monetary financial instruments, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary financial instruments, such as equities classified as available-for-sale financial assets, are included in other comprehensive income.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.3 Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are classified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in amounts due to Central Bank of Kenya, due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate.

Securities purchased from Central Bank of Kenya under agreements to resell ('reverse repos') are disclosed separately as they are purchased and are not negotiable/discounted during their tenure. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

2.4 Financial assets and liabilities

2.4.1 Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables, held to maturity and available for sale financial assets. The directors determine the classification of its financial assets at initial recognition. The Bank uses trade date accounting for regular way contracts and when recording financial asset transactions.

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

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis or
- the financial assets consists of debt host and an embedded derivatives that must be separated.

Financial assets at fair value through profit or loss are carried at fair value. Purchases and sales of financial assets at fair value through profit or loss are recognized on trade-date, the date on which the Bank commits to purchase or sell the asset. Fair value changes relating to financial assets designated at fair value through profit or loss are recognized in the statement of profit or loss in the year in which they arise.

The Bank did not have any financial assets in this class at 31 December 2016 (2015: Nil).

Notes *(continued)*

2 Summary of significant accounting policies (continued)

2.4 Financial assets and liabilities (continued)

2.4.1 Financial assets (continued)

(b) Loans and receivables

Loans and receivables are non – derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- (a) those that the Bank intends to sell immediately or in the short term, which are classified as held for trading, and those that the Bank upon initial recognition designates as at fair value through profit or loss;
- (b) those that the Bank upon initial recognition designates as available – for – sale; or
- (c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method.

(c) Held to maturity investments

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the directors may have positive intention and ability to hold to maturity, other than:

- (a) those that the Bank upon initial recognition designates as at fair value through profit or loss;
- (b) those that the Bank designates as available for sale; and
- (c) those that meet the definition of loans and receivables.

Held to maturity investments are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method.

(d) Available for sale financial assets

Available for sale financial assets are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Available for sale financial assets are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value with gains and losses being recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised. If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in other comprehensive income is recognised in the statement of profit or loss. However, interest is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the statement of profit or loss.

2.4.2 Financial liabilities

The Bank's holding in financial liabilities represents mainly deposits from banks and customers and other liabilities. Such financial liabilities are initially recognized at fair value and subsequently measured at amortised costs.

Notes *(continued)*

2 Summary of significant accounting policies (continued)

2.4 Financial assets and liabilities (continued)

2.4.3 Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial assets is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg and Reuters.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indicators that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

The Bank uses widely recognised valuation models for determining fair values of government securities. For these financial instruments, inputs into models are generally market-observable.

The fair values of the Bank's financial assets and liabilities approximate the respective carrying amounts, due to the generally short periods to contractual re-pricing or maturity dates. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the Bank at the reporting date.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment.

The fair values of contingent liabilities correspond to their carrying amounts.

2.4.4 Derecognition

Financial assets are derecognized when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition).

Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.4 Financial assets and liabilities (continued)

2.4.5 Classes of financial instruments

The Bank classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table as follows:

Category(as defined by IAS 39)		Class (as determined by the Bank)		Subclasses
Financial assets and liabilities	Loans and receivables	Deposits and balances due from banking institutions		
		Loans and advances to customers	Loans to individuals (retail)	Overdrafts
				Term loans
			Loans to corporate customers	Mortgages
				Large corporate customers
		Others		
		Items in the course of collection		
	Available for sale investments	Investment securities	Debt securities	Listed
			Other securities	Not listed
	Held to maturity investments	Investment securities	Government securities	Treasury bills
				Treasury bonds
			Other securities	Overseas investments
			Local investments	
Financial liabilities at amortised cost	Deposits and balances due to banking institutions			
	Deposits from customers	Individual (retail) customers		
		Corporate customers		
		Items in the course of collection		
Off-balance sheet financial Instruments	Loan commitments			
	Guarantees, acceptances and other financial facilities			

Notes (continued)

2 Summary of significant accounting policies (continued)

2.5 Impairment of financial assets

(a) Assets carried at amortised cost

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

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
 - adverse changes in the payment status of borrowers in the portfolio; and
 - national or local economic conditions that correlate with defaults on the assets in the portfolio.

The estimated period between a loss occurring and its identification is determined by local management for each identified portfolio. In general, the periods used vary between 1 and 6 months; in exceptional cases, longer periods are warranted.

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

If there is objective evidence that an impairment loss on loans carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instrument's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of profit or loss. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.5 Impairment of financial assets (continued)

(a) Assets carried at amortised cost (continued)

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the Bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Impairment charges relating to loans and advances to customers are included in credit impairment charges. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the statement of profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the statement of profit or loss.

(b) Assets classified as available for sale

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the statement of profit or loss. Impairment losses recognised in the statement of profit or loss on equity instruments are not reversed through the statement of profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the statement of profit or loss.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.6 Offsetting of financial instruments

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

2.7 Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less, including: cash and non-restricted balances with the Central Bank of Kenya, Treasury and other eligible bills, and amounts due from other banks. Cash and cash equivalents excludes the cash reserve requirement held with the Central Bank of Kenya.

2.8 Property and equipment

Property and equipment are stated at historical cost less depreciation.

Depreciation is calculated on the straight line basis to allocate their cost less their residual values over their estimated useful lives, as follows:

• Office premises	50 years
• Office improvements	8 years
• Furniture, fittings and equipment	8 years
• Motor vehicles	4 years
• Computer equipment	3-4 years

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

The Bank assesses at each reporting date whether there is any indication that any item of property and equipment is impaired. If any such indication exists, the Bank estimates the recoverable amount of the relevant assets. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining profit.

2.9 Intangible assets - software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives of 5 years.

Costs associated with maintaining computer software programmes are recognised as an expense as incurred.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.10 Impairment of non – financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.11 Employee benefits

(a) Retirement benefit obligations

The Bank operates a defined contribution scheme for its employees. The assets of the scheme are held in separate trustee administered fund, which is funded from contributions from both the Bank and employees.

The Bank also contributes to the statutory National Social Security Fund. This is a defined contribution pension scheme registered under the National Social Security Act. The Bank's obligations under the scheme are limited to specific obligations legislated from time to time and are currently limited to a maximum of Shs 200 per month per employee. The Bank contributions in respect of retirement benefit schemes are charged to profit or loss in the year to which they relate.

The Bank's contribution to the defined contribution scheme is charged to the statement of profit or loss in the year in which it falls due. The Bank has no further obligations once the contribution is paid.

2.12 Income tax expense

Income tax expense is the aggregate of the charge to the income statement in respect of current income tax and deferred income tax. Tax is recognised in the income statement unless it relates to items recognised directly in equity, in which case it is also recognised directly in equity.

(a) Current income tax

Current income tax is the amount of income tax payable on the taxable profit for the year determined in accordance with the Kenyan Income Tax Act.

(b) Deferred income tax

Deferred income tax is recognised, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. However, the deferred income tax is not accounted for if it arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

2.13 Dividend payable

Dividends on ordinary shares are charged to equity in the period in which they are declared. Proposed dividends are shown as a separate component of equity until declared.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.14 Share capital

Ordinary shares are classified as 'share capital' in equity. Any premium received over and above the par value of the shares is classified as 'share premium' in equity.

2.15 Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, are recognised within 'interest income' or 'interest expense' in the income statement account using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

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 that was used to discount the future cash flows for the purpose of measuring the impairment loss.

2.16 Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for advances are credited to income upon first utilisation of the facility and are charged on an annual basis.

2.17 Dividend income

Dividends are recognised in profit or loss when the Bank's right to receive payment is established.

2.18 Acceptances and letters of credit

Acceptances and letters of credit are accounted for as off-balance sheet transactions and disclosed as contingent liabilities.

2.19 Investment in associates

The investment in the associates is accounted for using the equity method. It is initially recorded at cost and the carrying amount is increased or decreased to recognise the Bank's share of the profits or losses of the investee after the acquisition date. Distributions received from the investee reduce the carrying amount of the investment.

On disposal of the investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the profit or loss.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.20 Derivative financial instruments

Derivatives, which comprise solely forward foreign exchange contracts, are initially recognised at fair value on the date the derivative contract is entered into and are subsequently measured at fair value. The fair value is determined using forward exchange market rates at the balance sheet date or appropriate pricing models. The derivatives do not qualify for hedge accounting. Changes in the fair value of derivatives are recognised immediately in the statement of profit or loss.

3 Financial risk management

The Bank's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. Those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the Bank's business, and the financial risks are an inevitable consequence of being in business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on its financial performance.

Risk management is carried out by the risk and Compliance unit under policies approved by the Board Risk Management Committee (BRMC). Assets and Liability Committee (ALCO) identifies, evaluates and hedges financial risks in close cooperation with the operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas such as foreign exchange risk, interest rate risk, credit risk, use of derivative and non-derivative financial instruments.

3.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss to the Bank by failing to pay amounts in full when due. Credit risk is the most important risk for the Bank's business: management therefore carefully manages the exposure to credit risk. Credit exposures arise principally in lending and investment activities. There is also credit risk in off-balance sheet financial instruments, such as loan commitments. Credit risk management and control is centralised in the Credit Risk Management Committee, which reports regularly to the Board Credit Committee (BCC).

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and are subject to annual or more frequent review. Limits on the level of credit risk by industry sector are approved regularly by the BCC.

The exposure to any one borrower including banks is further restricted by sub-limits covering on- and off-balance sheet exposures and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral equal or above the loan advanced.

Notes (continued)

3 Financial risk management (continued)

3.1 Credit risk (continued)

Credit related commitments:

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

<u>Maximum exposure to credit risk before collateral held</u>	2016 Shs'000	2015 Shs'000
Balances with Central Bank of Kenya (Note 13)	1,271,638	1,237,465
Deposits and balances due from banking institutions (Note 22)	1,711,978	1,491,691
Loans and advances to customers (Note 14)	15,292,829	13,124,420
Government and other securities held to maturity (Note 15)	2,084,701	2,420,562
Available for sale investment securities (Note 15)	1,273,543	927,329
Other assets	145,610	148,674
Credit risk exposures relating to off-balance sheet items:		
- Acceptances and letters of credit	1,565,864	1,869,073
- Guarantee and performance bonds	641,452	963,428
- Commitments to lend	1,880,575	1,734,613
	25,868,190	23,917,255

The above table represents a worst case scenario of credit risk exposure to the Bank at 31 December 2016 and 2015, without taking account of any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on carrying amounts as reported in the balance sheet.

As shown above, 66% of the total maximum exposure is derived from loans and advances to banks and customers (2015: 61%). 14% represents investments in government and other investment securities (2015: 14%).

Loans and advances to customers and off-balance sheet items are secured by collateral in form of charges over land and buildings and/or plant and machinery or corporate guarantees and other collateral acceptable by the Kenyan law. However, there are loans and advances to corporate customers and individuals that are unsecured. Before disbursing any unsecured loan, the Bank undertakes stringent credit risk assessment.

Notes (continued)

3 Financial risk management (continued)

3.1 Credit risk (continued)

Management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the Bank resulting from both its loan and advances portfolio and debt securities based on the following:

- the Bank exercises stringent controls over the granting of new loans
- 99% of the loans and advances portfolio are neither past due nor impaired
- 95% of held to maturity investments securities are government securities.

Financial assets that are past due or impaired

The Bank aligns the classification of assets that are past due or impaired in line with the Central Bank of Kenya prudential guidelines. In determining the classification of an account, performance is the primary consideration. Classification of an account reflects judgement about the risk of default and loss associated with the credit facility.

Accounts are classified into five categories as follows:

- Normal
- Watch
- Sub-standard
- Doubtful
- Loss

Loans and advances less than 30 days past due date are not considered to be impaired unless other information is available to indicate otherwise.

Loans and advances are summarised as follows:

	2016 Shs'000	2015 Shs'000
Neither past due nor impaired	15,186,704	12,999,055
Past due but not impaired	163,125	170,365
Gross	15,349,829	13,169,420
Less: allowance for impairment (Note 14)	(57,000)	(45,000)
Net loans and advances	15,292,829	13,124,420

No other financial assets are either past due or impaired.

Notes (continued)

3 Financial risk management (continued)

3.2 Concentrations of risk

Economic sector risk concentrations within the customer loan and deposit portfolios were as follows:

At 31 December 2016

	Loans and advances %	Credit Commitments %
Manufacturing	26%	27%
Wholesale and retail trade	25%	45%
Transport and communication	1%	2%
Business services	2%	0%
Agricultural	5%	1%
Building and Construction	12%	12%
Real Estate	15%	3%
Other	14%	10%
	100%	100%

At 31 December 2015

	Loans and advances %	Credit commitments %
Manufacturing	30%	28%
Wholesale and retail trade	23%	36%
Transport and communication	1%	2%
Business services	2%	0%
Agricultural	4%	2%
Building and Construction	4%	15%
Real Estate	23%	10%
Other	13%	7%
	100%	100%

Customer deposits

	2016	2015
Insurance companies	1%	1%
Private enterprises	39%	37%
Commercial banks	0%	0%
Individuals and non- profit organisations	59%	60%
Non – residents	1%	2%
	100%	100%

Notes (continued)

3 Financial risk management (continued)

3.3 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities as they fall due and to replace funds when they are withdrawn.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, and calls on cash settled contingencies. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Central Bank of Kenya requires that the Bank maintain a cash reserve ratio computed as 5.25% of customer deposits of the preceding month. In addition, the Board and Assets and liabilities Committee (ALCO) closely monitors the limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The Treasury department monitors liquidity ratios on a daily basis. The table below details the reported ratios of net liquidity assets to deposits from customer during the year:

	2016 %	2015 %
At close of the year	31.40	27.10
Average for the period	33.08	29.52
Maximum for the period	38.60	33.50
Minimum for the period	25.80	23.70

The Bank at all times complies with the regulatory minimum liquidity ratio of 20%.

The table below presents the undiscounted cash flows payable by the Bank under financial liabilities by remaining contractual maturities at the balance sheet date. All figures are in Thousands of Kenya Shillings.

At 31 December 2016	Up to 1 month	1-3 months	3-6 months	6-12 months	Over 1 year	Total
Liabilities						
Customer deposits	5,432,317	9,820,378	544,393	118,401	-	15,915,489
Deposits and balances due to banking institutions	-	-	-	-	-	-
Long term borrowings	168,550	944,030	-	-	517,553	1,630,133
Other financial liabilities	127,627	-	-	-	-	127,627
Total financial liabilities (contractual maturity dates)	5,728,494	10,764,408	544,393	118,401	517,553	17,673,249

Notes (continued)

3 Financial risk management (continued)

3.3 Liquidity risk (continued)

At 31 December 2015	Up to 1 month	1-3 months	3-6 months	6-12 months	Over 1 year	Total
Liabilities						
Customer deposits	7,386,712	5,933,665	787,990	119,838	1,641	14,229,846
Deposits and balances due to banking institutions	390,515	618,504	70,450	-	-	1,079,469
Long term borrowings	147,882	1,174,910	-	-	-	1,322,792
Other financial liabilities	101,792	-	-	-	-	101,792
Total financial liabilities (contractual maturity dates)	8,026,901	7,727,079	858,440	119,838	1,641	16,733,899

3.4 Market risk

Market risk is the risk that changes in market prices, which include currency exchange rates and interest rates, will affect the fair value or future cash flows of a financial instrument. Market risk arises from open positions in interest rates and foreign currencies, both of which are exposed to general and specific market movements and changes in the level of volatility. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while optimising the return on risk. Overall responsibility for managing market risk rests with the Assets and Liabilities Committee (ALCO). The Treasury department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day to day implementation of those policies.

Currency risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December. Included in the table are the Bank's financial instruments, categorised by currency (all amounts expressed in thousands of Kenya Shillings):

Notes (continued)

3 Financial risk management (continued)

3.4 Market risk (continued)

Currency risk (continued)

At 31 December 2016	USD	GBP	Euro	Other	Total
Assets					
Cash and balances with Central Bank of Kenya	208,606	16,288	31,433	38	256,365
Deposits and balances due from banking institutions	936,717	76,673	38,758	1,484	1,053,632
Loans and advances to customers	1,091,049	395,750	654,798	-	2,141,597
Investment securities	310,297	-	21,412	-	331,709
Other assets	398	-	-	-	398
Total assets	2,547,067	488,711	746,401	1,522	3,783,701
Liabilities					
Customer deposits	1,890,760	182,515	83,319	-	2,156,594
Deposits and balances due to banking institutions	-	-	-	-	-
Long term borrowings	653,961	289,218	576,450	-	1,519,629
Other liabilities	2,007	2,092	309	6	4,414
Total liabilities	2,546,728	473,825	660,078	6	3,680,637
Net on-balance sheet position	339	14,886	86,323	1,516	103,064
Net off-balance sheet position	1,613,390	5,429	157,606	-	1,776,425
Overall open position	1,613,729	20,315	243,929	1,516	1,879,489
At 31 December 2015					
Total assets	2,955,444	583,242	683,724	1,038	4,223,448
Total liabilities	2,945,396	577,295	648,067	6	4,170,764
Net on-balance sheet position	10,048	5,947	35,657	1,032	52,684
Net off-balance sheet position	1,891,196	35,751	274,180	33,727	2,234,854
Overall open position	1,901,244	41,698	309,837	34,759	2,287,538

The net off-balance sheet position represents the off balance sheet facilities that were held by the Bank.

Notes (continued)

3 Financial risk management (continued)

3.4 Market risk (continued)

Currency risk (continued)

Currency risk sensitivity analysis

The table below shows the impact on post tax profit of 10% appreciation or depreciation of the shilling against other major currencies (all amounts expressed in thousands of Kenya Shillings):

	Currency carrying amount	Appreciation by 10%	Depreciation by 10%
At 31 December 2016			
Assets			
Cash and balances with Central Bank of Kenya	256,365	(25,637)	25,637
Deposits and balances due from banking institutions	1,053,632	(105,363)	105,363
Loans and advances to customers	2,141,597	(214,160)	214,160
Investment securities	331,709	(33,171)	33,171
Other assets	398	(40)	40
Total assets	3,783,701	(378,371)	378,371
Liabilities			
Customer deposits	2,156,594	215,659	(215,659)
Long term borrowings	1,519,629	151,963	(151,963)
Other liabilities	4,414	441	(441)
Total liabilities	3,680,637	368,063	(368,063)
Total (decrease) / increase		(10,308)	10,308
Tax charge 30%		3,092	(3,092)
Impact on profits		(7,216)	7,216

At 31 December 2016, if the Shilling had weakened/strengthened by 10% against the foreign currencies in which the Bank had exposures, with all other variables held constant, post tax profit for the year would have been higher/lower by Shs 7,216,000 (2015:Shs 3,687,000).

Notes (continued)

3 Financial risk management (continued)

3.4 Market risk (continued)

Interest rate risk

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Management sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored daily.

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates. The Bank does not bear an interest rate risk on off balance sheet items. All figures are in thousands of Kenya Shillings.

At 31 December 2016	Up to 1 Month	1-3 Months	3-6 Months	6-12 Months	Over 1 Year	Non-interest Bearing	Total
Assets							
Cash and balances with Central Bank of Kenya	-	-	-	-	-	1,339,265	1,339,265
Investment securities: available for sale	-	-	-	-	1,032,745	240,798	1,273,543
held to maturity	99,426	392,001	95,551	218,751	1,278,972	-	2,084,701
Deposits and balances due from banking institutions	650,321	-	-	-	-	1,061,657	1,711,978
Loans and advances to customers	2,333,550	1,480,427	1,627,700	2,636,634	7,214,518	-	15,292,829
Investments in associates	-	-	-	-	-	284,031	284,031
Property and equipment	-	-	-	-	-	192,350	192,350
Intangible assets	-	-	-	-	-	26,104	26,104
Deferred income tax asset	-	-	-	-	-	13,734	13,734
Other assets	-	-	-	-	-	184,946	184,946
Total assets	3,083,297	1,872,428	1,723,251	2,855,385	9,526,235	3,342,885	22,403,481
Liabilities & Shareholders' Funds							
Customer deposits	6,754,866	5,868,310	523,848	111,357	-	2,437,566	15,695,947
Long term borrowings	168,550	930,257	-	-	421,063	-	1,519,870
Current income tax	-	-	-	-	-	7,152	7,152
Other liabilities	-	-	-	-	-	120,475	120,475
Shareholders' funds	-	-	-	-	-	5,060,037	5,060,037
Total liabilities & shareholders' funds	6,923,416	6,798,567	523,848	111,357	421,063	7,625,230	22,403,481
Interest sensitivity gap	(3,840,119)	(4,926,139)	1,199,403	2,744,028	9,105,172	(4,282,345)	-
At 31 December 2015	Up to 1 Month	1-3 Months	3-6 Months	6-12 Months	Over 1 Year	Non-interest Bearing	Total
Total assets	2,651,538	1,574,177	1,651,810	2,753,754	8,243,875	3,144,918	20,020,072
Total liabilities	(6,089,764)	(7,549,468)	(820,189)	(110,491)	(1,514)	(5,448,646)	(20,020,072)
Interest sensitivity gap	(3,438,226)	(5,975,291)	831,621	2,643,263	8,242,361	(2,303,728)	-

Notes (continued)

3 Financial risk management (continued)

3.4 Market risk (continued)

Interest rates risk sensitivity analysis

The impact of 1% increase or decrease in interest rates on the Bank's financial assets and liabilities would be as follows:

	Carrying amounts	At 31 December 2016	
		1% increase	1% decrease
ASSETS			
Cash and balances with Central Bank of Kenya	1,339,265	-	-
Investment securities :			
-available for sale	1,032,745	-	-
-available for sale	240,798	-	-
-held to maturity	2,084,701	-	-
Deposits and balances due from banking institutions	1,061,657	-	-
Deposits and balances due from banking institutions	650,321	6,503	(6,503)
Loans and advances to customers	15,292,829	152,928	(152,928)
Investment in associate	284,031	-	-
Property and equipment	192,350	-	-
Intangible assets	26,104	-	-
Deferred income tax	13,734	-	-
Other assets	184,946	-	-
LIABILITIES & EQUITY			
Customer deposits	13,258,381	(132,584)	132,584
Customer deposits zero rate	2,437,566	-	-
Long term borrowings	1,519,870	-	-
Other liabilities	120,475	-	-
Current income tax	7,152	-	-
Shareholders' equity	5,060,037	-	-
Net interest income increase /(decrease)		26,847	(26,847)
Tax charge at 30 %		(8,054)	8,054
Impact on post tax profit		18,793	(18,793)

At 31 December 2016, assuming all other variables remain constant an increase/decrease of 100 basis point on interest rates would have resulted in an increase/decrease in post tax profit of Shs 18,793,000 (2015: Shs 11,130,000).

Notes (continued)

3 Financial risk management (continued)

3.4 Market risk (continued)

Interest rates risk sensitivity analysis (continued)

The effective interest rates by major currency for monetary financial instruments at 31 December 2016 and 2015 were in the following ranges:

	2016		2015	
	In Shs	In Other currencies	In Shs	In Other Currencies
Assets				
Government securities	11.47%	-	12.69%	-
Deposits and balances due from banking institutions	9.00%	-	11.30%	-
Loans and advances to customers	13.57%	7.62%	17.58%	7.78%
Other investment securities	-	5.00%	-	5.00%
Liabilities				
Customer deposits	7.28%	2.10%	12.67%	2.59%
Deposits and balances due to banking institutions	-	-	-	3.33%
Long term borrowings	-	5.78%	-	6.00%

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

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

3.5 Fair values of financial assets and liabilities

Effective 1 January 2009, the Bank adopted the amendment to IFRS 7 for financial instruments that are measured in the balance sheet at fair value, this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2); and
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

Notes (continued)

3 Financial risk management (continued)

3.5 Fair values of financial assets and liabilities (continued)

The following table presents the Bank's assets that are measured at fair value at 31 December 2016. There were no liabilities measured at fair value through profit and loss for the same period (2015: Nil)

As at 31 December 2016	Level 1 Shs'000	Level 2 Shs'000	Level 3 Shs'000	Total balance Shs'000
Assets				
Available for sale financial assets				
– Debt investments	1,022,138	-	251,405	1,273,543
Total assets	1,022,138	-	251,405	1,273,543
As at 31 December 2015				
Assets				
Available for sale financial assets				
– Debt investments	675,345	-	251,984	927,329
Total assets	675,345	-	251,984	927,329

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Bank is the current bid price. These instruments are included in level 1. Instruments included in level 1 comprise primarily foreign corporate bonds and Nairobi Securities Exchange ("NSE") equity investments classified as available for sale.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

The movement in level 3 during the year are in respect of forex gains.

Notes (continued)

3 Financial risk management (continued)

3.5 Fair values of financial assets and liabilities (continued)

The fair value of held-to-maturity investment securities listed at NSE as at 31 December 2016 is estimated at Shs 1,188,712,000 (2015: Shs 1,381,153,000) compared to their carrying value of Shs 1,230,000,000 (2015: Shs 1,453,700,000). The available for sale investment securities are carried at fair value in the Bank's books. The fair values of the Bank's other financial assets and liabilities approximate the respective carrying amounts, due to the generally short periods to contractual repricing or maturity dates as set out above. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the Bank at the balance sheet date.

3.6 Capital management

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

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

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

The Central Bank of Kenya requires each bank to: (a) hold the minimum level of regulatory capital of Shs1 billion; (b) maintain a ratio of total regulatory capital to the risk-weighted assets plus risk-weighted off-balance sheet assets (the 'Basel ratio') at or above the required minimum of 10.50%; (c) maintain core capital of not less than 8% of total deposit liabilities; and (d) maintain total capital of not less than 14.50% of risk-weighted assets plus risk-weighted off-balance sheet items.

The Bank's total regulatory capital is divided into two tiers:

- Tier 1 capital (core capital): share capital, share premium, plus retained earnings.
- Tier 2 capital (supplementary capital): 25% (subject to prior approval) of revaluation reserves, subordinated debt not exceeding 50% of Tier 1 capital and hybrid capital instruments. Qualifying Tier 2 capital is limited to 100% of Tier 1 capital.

The risk weighted assets are measured by means of a hierarchy of four risk weights classified according to the nature of – and reflecting an estimate of the credit risk associated with – each asset and counterparty. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

Notes (continued)

3 Financial risk management (continued)

3.6 Capital management (continued)

Introduction of Basel II principles in the measurement and assessment of Capital Adequacy Ratios (CARs)

Kenyan banks have been computing the CARs based on Basel I methodology i.e. restricted to credit risk measurement of assets only. In the revised guideline, some principles of Basel II measurement of capital adequacy have been introduced. This will require Kenyan banks to also take into account capital charges for:

- Operational risk –using the Basic Indicator Approach
- Market risk - both specific and general market risks to be calculated using the standardized management approach.

The table below summarises the composition of regulatory capital and the ratios of the Bank at 31 December

	2016 Shs'000	2015 Shs'000
Tier 1 capital	4,848,811	3,342,280
Tier 1 + Tier 2 capital	4,988,061	3,474,530
Risk-weighted assets		
Adjusted credit risk weighted assets	16,939,328	15,449,597
Total market risk weighted assets equivalent	465,468	358,308
Total risk weighted assets equivalent for operation risk	2,193,786	2,196,286
Total risk-weighted assets	19,598,582	18,004,191
Basel ratio		
Core capital to risk – weighted assets (CBK minimum –10.5%)	24.70%	18.60%
Total capital to risk– weighted assets (CBK minimum- 14.50%)	25.50%	19.30%
Core Capital to deposits (CBK minimum – 8 %)	30.90%	23.80%

Notes (continued)

4 Critical accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions concerning the future. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Impairment of available for sale equity investments

The Bank determines that an available for sale equity investment is impaired when there has been a significant or prolonged decline in its fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

(c) Held to maturity financial assets

The Bank follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturing as held to maturity. This classification requires significant judgement. In making this judgement, the Bank evaluates its intention and ability to hold such assets to maturity. If the Bank fails to keep these assets to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to classify the entire class as available-for-sale and measure the assets at fair value.

Notes (continued)

5 Interest income

	2016 Shs'000	2015 Shs'000
Loans and advances to customers	2,024,589	1,885,454
Government securities	355,834	296,816
Cash and short term funds	36,292	115,535
Other investments	34,096	82,051
	<u>2,450,811</u>	<u>2,379,856</u>

6 Interest expense

Fixed deposit accounts	982,259	1,009,898
Current and demand deposits	211,690	201,872
Deposits and balances due to banking institutions	7,382	6,151
Borrowings	101,534	107,473
	<u>1,302,865</u>	<u>1,325,394</u>

7 Expenses by nature

The following items are included within operating expenses

Employee benefits (Note 8):

Key management	109,965	115,405
Other employees	185,121	168,028
Depreciation of property and equipment (Note 16)	35,662	28,709
Amortisation of intangible assets (Note 17)	24,371	21,814
Auditor's remuneration (inclusive of value added tax)	4,110	3,877
	<u></u>	<u></u>

8 Employee benefits

The following items are included within employee benefits expense:

Retirement benefit costs

- National Social Security Fund	148	136
- Employer Pension Contribution	4,874	-
	<u></u>	<u></u>

Notes *(continued)*
9 Investment in associates

	2016 Shs'000	2015 Shs'000
At start of year	253,111	596,594
Share of profit for the year, net of tax	30,920	9,700
Disposal of associate – Brookhouse Schools Ltd	-	(353,183)
At end of year	284,031	253,111

The Bank owns 24.52% share capital of Victoria Towers Limited. Victoria Towers Limited's profit after tax for 2016 attributable to the owners of the parent was Shs 126,101,300 (2015: Shs 38,947,000). The Bank accounts for its share of associates profit equivalent to its shareholding.

The summarised financial information in respect of the associate is set out below;

	2016 Shs'000	2015 Shs'000
Total assets	1,855,210	1,415,685
Total liabilities	(693,186)	383,422
Net assets	1,162,024	1,032,263
Less: Non-controlling interest	(3,279)	-
Net Assets – Equity holders of the Parent	1,158,745	1,032,263
Bank's share of net assets of Victoria Towers Limited	284,031	253,111
Total revenue	101,932	86,060
Profit for the year	126,101	38,947
Bank's share of profit for the year	30,920	9,550
Under provision of prior year share of profit	-	150
Total Bank's share of profit	30,920	9,700

Notes *(continued)*
10 Income tax expense

	2016 Shs'000	2015 Shs'000
Current income tax	215,147	189,086
Deferred income tax (Note 18)	(4,038)	(3,652)
Capital gains tax	-	18,405
Under provision of deferred income tax asset in prior year	-	1,463
Over provision of current income tax in prior year	(7,091)	-
	204,018	205,302

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

	2016 Shs'000	2015 Shs'000
Profit before income tax	796,413	919,102
Tax calculated at the statutory income tax rate of 30% (2015: 30%)	238,924	275,731
Tax effect of:		
Income not subject to tax	(38,181)	(101,687)
Expenses not deductible for tax purposes	10,366	11,390
Under provision of deferred income tax asset in prior years	-	1,463
Capital gains tax	-	18,405
Over provision of current income tax in prior year	(7,091)	-
Income tax expense	204,018	205,302

11 Earnings per share

Basic earnings per share are calculated on the profit attributable to shareholders of Shs 592,395,000 (2015: Shs 713,800,000) and on the weighted average number of ordinary shares outstanding during the year.

	2016	2015
Net profit attributable to shareholders (Shs thousands)	592,395	713,800
Weighted average number of ordinary shares in issue (thousands)	31,844	29,906
Basic earnings per share (Shs)	18.60	21.69

The Bank issued a debt instrument that has an option to convert into equity (Note 23). The dilutive earnings per share is Shs17.52. (2015:Nil)

Notes (continued)

12 Dividends per share

During the year, the Bank paid an interim dividend of Shs 3.00 per share amounting to a total of Shs 91,125,000 (2015: Shs 91,125,000). Payment of dividends is subject to withholding tax at a rate of 5% for resident and 10% for non-resident shareholders.

13 Cash and balances with Central Bank of Kenya

	2016 Shs'000	2015 Shs'000
Cash in hand	67,627	82,144
Balances with Central Bank of Kenya	1,271,638	1,237,465
	<u>1,339,265</u>	<u>1,319,609</u>

14 Loans and advances to customers

Overdrafts	5,173,721	3,886,769
Loans	9,344,929	8,876,160
Advances under finance lease agreements	831,179	406,491
	<u>15,349,829</u>	<u>13,169,420</u>
Gross loans and advances		
Less: Provision for impairment of loans and advances		
- Collectively assessed	(57,000)	(45,000)
	<u>15,292,829</u>	<u>13,124,420</u>

Movements in provisions for impairment of loans and advances are as follows:

	Identified Shs'000	Unidentified Shs'000	Total Shs'000
Year ended 31 December 2015			
At 1 January 2015	-	25,000	25,000
Increase in impairment provision	-	20,000	20,000
At 31 December 2015	-	45,000	45,000
Charge/(credit) to profit or loss			
Increase in impairment provision (as above)	-	20,000	20,000
Direct write-off of debts	26	-	26
	<u>26</u>	<u>20,000</u>	<u>20,026</u>

Notes (continued)

14 Loans and advances to customers (continued)

	Identified Shs'000	Unidentified Shs'000	Total Shs'000
Year ended 31 December 2016			
At 1 January 2016	-	45,000	45,000
Increase in impairment provision	-	12,000	12,000
At 31 December 2016	-	57,000	57,000
Charge/(credit) to profit or loss			
Increase in impairment provision (as above)	-	12,000	12,000
Direct write-off of debts	32	-	32
	<u>32</u>	<u>12,000</u>	<u>12,032</u>

All impaired loans are written down to their estimated recoverable amount. The aggregate carrying amount of impaired loans at 31 December 2016 was nil (2015: Nil).

The loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2016 Shs'000	2015 Shs'000
Net investment in finance leases:		
Not later than 1 year	55,645	24,317
Later than 1 year and not later than 5 years	646,884	365,824
Later than 5 years	128,650	16,350
	<u>831,179</u>	<u>406,491</u>

There were no individually assessed provisions for finance lease receivable as at 31 December 2016 (2015: Nil).

Notes (continued)

15 Investment securities

	2016 Shs'000	2015 Shs'000
Available for sale		
Government securities	1,022,138	675,345
Foreign securities	189,914	190,597
Other local investments	61,491	61,387
Total securities available for sale	1,273,543	927,329
Held to maturity		
Government securities		
- Maturing within 91 days of the date of acquisition	-	99,851
- Maturing after 91 days of the date of acquisition	1,971,466	2,048,594
Local corporate bond and investments	18,146	181,782
Foreign investments	95,089	90,335
Total securities held to maturity	2,084,701	2,420,562
Total investment securities	3,358,244	3,347,891

The Bank invests in government securities, corporate infrastructure bonds, placements with financial and other institutions Banks as well as various offshore funds. These investments have been classified as either held to maturity or available for sale.

15 Investment securities (continued)

The movement in investments is shown below:

	Value at 01/01/2016 Shs'000	Purchases at cost Shs'000	Disposals /maturities Shs'000	Premium/ discount Shs'000	Unearned interest Shs'000	Interest receivable Shs'000	Forex gains/losses Shs'000	Gain in fair value Shs'000	Value at 31/12/2016 Shs'000
Available for sale									
Government securities	675,345	396,797	(100,000)	-	-	-	-	49,996	1,022,138
Foreign securities	190,597	-	-	-	-	-	(683)	-	189,914
Other local investments	61,387	-	-	-	-	-	104	-	61,491
	927,329	396,797	(100,000)	-	-	-	(579)	49,996	1,273,543
Held to maturity									
Government securities:									
- Maturing within 91 days of the date of acquisition	99,851	-	(99,851)	-	-	-	-	-	-
- Maturing after 91 days of the date of acquisition	2,048,594	1,299,161	(1,366,237)	32	(20,033)	9,949	-	-	1,971,466
Local corporate bond and investments	181,782	500,000	(664,007)	-	-	371	-	-	18,146
Foreign investments	90,335	-	-	-	-	4,603	151	-	95,089
	2,420,562	1,799,161	(2,130,095)	32	(20,033)	14,923	151	-	2,084,701
Total investment securities	3,347,891	2,195,958	(2,230,095)	32	(20,033)	14,923	(428)	49,996	3,358,244

Notes (continued)

16 (a) Property and equipment

	Office premises Shs'000	Office improvements Shs'000	Furniture, fittings & equipment Shs'000	Motor vehicles Shs'000	Total Shs'000
At 1 January 2015					
Cost	118,313	62,295	87,896	51,732	320,236
Accumulated depreciation	(23,219)	(30,547)	(63,348)	(17,749)	(134,863)
Net book amount	95,094	31,748	24,548	33,983	185,373
Year ended 31 December 2015					
Opening net book amount	95,094	31,748	24,548	33,983	185,373
Additions	-	29,520	55,156	910	85,586
Net book value of assets held for sale (Note 16(b))	(36,139)	(7,638)	(2,097)	-	(45,874)
Net book value of assets disposed	-	-	-	(910)	(910)
Depreciation charge	(2,366)	(5,919)	(8,291)	(12,133)	(28,709)
Closing net book amount	56,589	47,711	69,316	21,850	195,466
At 31 December 2015					
Cost	77,246	72,172	137,419	51,732	338,569
Accumulated depreciation	(20,657)	(24,461)	(68,103)	(29,882)	(143,103)
Net book amount	56,589	47,711	69,316	21,850	195,466
Year ended 31 December 2016					
Opening net book amount	56,589	47,711	69,316	21,850	195,466
Additions	-	461	15,486	31,000	46,947
Net book value of assets traded in	-	-	-	(14,307)	(14,307)
Transfer	-	-	(94)	-	(94)
Depreciation charge	(1,545)	(6,457)	(16,779)	(10,881)	(35,662)
Closing net book amount	55,044	41,715	67,929	27,662	192,350
At 31 December 2016					
Cost	77,246	72,633	152,905	62,532	365,316
Accumulated depreciation	(22,202)	(30,918)	(84,976)	(34,870)	(172,966)
Net book amount	55,044	41,715	67,929	27,662	192,350

Asset disposed during the year relate to motor vehicle that was traded in for Shs 16,000,000. The written down value of the said vehicle was Shs 14,307,000. Included in Office premises are costs related to the floor owned by the Bank at Victoria Towers and the parking bays at the premises. The remaining floors of Victoria Towers are owned by Victoria Towers Limited, an associate of the Bank (Note 9).

Notes (continued)

16 (b) Property and equipment held for sale

	Shs'000
At 31 December 2015	
Cost	66,344
Accumulated Depreciation	(20,470)
Net book amount	45,874
Expected sale proceeds as per sale agreement (fair value)	(40,000)
Expected loss on disposal charged to profit or loss	5,874

The property and equipment held for sale in the prior year relates to the premises of the former Riverside Branch, which was relocated to Fortis Tower in Westlands.

The sale process was concluded during the year.

17 Intangible assets

	2016 Shs'000	2015 Shs'000
Opening net book amount	32,047	44,966
Additions	18,428	8,895
Amortisation charge	(24,371)	(21,814)
Closing net book amount	26,104	32,047
Cost	133,943	115,515
Accumulated amortisation	(107,839)	(83,468)
Closing net book amount	26,104	32,047

Notes (continued)

18 Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 30% (2013: 30%).

The movement on the deferred income tax account is as follows:

	2016 Shs'000	2015 Shs'000
At start of year	24,695	4,054
Credit to profit or loss (Note 10)	4,038	3,652
Under provision of deferred income tax asset in prior years	-	(1,463)
	4,038	2,189
Credit /(charge) to other comprehensive income	(14,999)	18,452
At end of year	13,734	24,695

The deferred income tax asset, deferred income tax charge/(credit) in the income statement is attributable to the following items:

Year ended 31 December 2016	1.1.2016 Shs'000	(Charged)/ credited to P&L Shs'000	Charge to OCI Shs'000	31.12.2016 Shs'000
Provisions for impairment	13,500	3,600	-	17,100
Excess of accounting depreciation over tax allowance	(2,012)	438	-	(1,574)
Fair value gains on available for sale investments	13,207	-	(14,999)	(1,792)
Deferred income tax asset	24,695	4,038	(14,999)	13,734

Notes (continued)

18 Deferred income tax (continued)

Year ended 31 December 2015	1.1.2015 Shs'000	(Charged)/ credited to P&L Shs'000	Charge to OCI Shs'000	31.12.2015 Shs'000
Provisions for impairment	7,500	6,000	-	13,500
Excess of accounting depreciation over tax allowance	1,799	(3,811)	-	(2,012)
Fair value gains on available for sale investments	(5,245)	-	18,452	13,207
Deferred income tax asset	4,054	2,189	18,452	24,695

19 Other assets

	2016 Shs'000	2015 Shs'000
Local and upcountry cheques for clearing or collection	110,947	135,607
Other debtors	34,663	13,067
Prepayments	39,336	42,468
	184,946	191,142

20 Customer deposits

Current and demand deposits	2,437,566	1,633,938
Savings accounts	2,994,751	2,132,110
Fixed deposit accounts	10,263,630	10,258,358
	15,695,947	14,024,406

21 Deposits and balances due to banking institutions

Balances due to local banks	-	666,195
Balances due to foreign banks	-	410,742
	-	1,076,937

Notes *(continued)*
22 Deposits and balances due from banking institutions

	2016 Shs'000	2015 Shs'000
Placements maturing within 90 days	-	454,791
Overnight lending	650,321	200,037
Current account balances with other banks	1,061,657	836,863
	<u>1,711,978</u>	<u>1,491,691</u>

23 Long term borrowings

At start of year	1,305,428	1,387,418
Additions	409,943	70,528
Payments during the year	(213,390)	(160,367)
Accrued interest	17,889	7,849
	<u>1,519,870</u>	<u>1,305,428</u>

During the year, the Bank acquired a 5 year term loan amounting to USD 4 million. The facility attracts interest rate of 5.25% p.a and is repayable on 30 June 2021. As per the loan agreement, the lender has an option to covert either part, or the whole balance into equity at an agreed price-to-book multiple of 1.7 of the Bank's core capital and noncurrent assets valued at the market value as per the last unaudited financial statements of the Bank preceding the date of conversion.

The remaining balance of the long term borrowings were received from Symnex Limited and Cistenique Investment Fund B.V. in GBP to increase the Bank's capability for lending in foreign currencies. Symnex Limited availed a credit line of USD 15Million for a tenor of 6 years whereas C I F availed a USD 18million credit line for a period of 10years. Both facilities attract interest at a rate of 6 %p.a.

24 Other liabilities

	2016 Shs'000	2015 Shs'000
Bankers cheques	10,777	13,435
Unclaimed balances	3,480	3,928
Accrued expenses	21,530	45,736
Rights issue application money received	60,662	-
Other	24,026	24,198
	<u>120,475</u>	<u>87,297</u>

Notes *(continued)*
25 Share capital

	Number of Shares '000	Share Capital Shs'000	Share Premium Shs'000
Balance at 1 January 2015	29,436	588,721	382,833
Issue of new shares	939	18,780	37,560
	<u>30,375</u>	<u>607,501</u>	<u>420,393</u>
At 31 December 2015			
At 1 January 2016	30,375	607,501	420,393
Issue of new shares	11,083	221,661	851,350
	<u>41,458</u>	<u>829,162</u>	<u>1,271,743</u>
At 31 December 2016			

The analysis of the new shares issued during the year is as follows

	Number of shares '000'
Share capital movement	
Bonus Shares issued on 19.10.2016	3,038
Rights Issue shares allocated on 15.11.2016	6,958
ESOP shares vested on 30.12.2016	1,087
	<u>11,083</u>

The bank is holding proceeds for 466,632 rights issue shares amounting to Shs 60,662,000. These shares require Central Bank of Kenya approval before being allotted. The bank initiated an employee share ownership scheme (ESOP) during the year. The shares amounted to 1,087,000 and are held under a trust company incorporated by the Bank for ESOP purpose only known as Victoria SP limited.

Notes (continued)

26 Regulatory reserve

	2016 Shs'000	2015 Shs'000
At start of year	98,000	93,000
Transfer from retained earnings	7,000	5,000
At end of year	105,000	98,000

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

27 Off balance sheet financial instruments, contingent liabilities and commitments

In common with other banks, the Bank conducts business involving acceptances, letters of credit, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties. In addition, there are other off-balance sheet financial instruments including forward contracts for the purchase and sale of foreign currencies, the nominal amounts for which are not reflected in the balance sheet.

	2016 Shs'000	2015 Shs'000
Contingent liabilities		
Acceptances and letters of credit	1,565,864	1,869,073
Guarantees and performance bonds	641,452	963,428
	2,207,316	2,832,501

Nature of contingent liabilities

An acceptance is an undertaking by a bank to pay a bill of exchange drawn on a customer. The Bank expects most acceptances to be presented, and reimbursement by the customer is normally immediate. Letters of credit commit the Bank to make payments to third parties, on production of documents, which are subsequently reimbursed by 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 customer's default.

In addition, the Bank is a defendant in various legal actions. In the opinion of the Directors after taking appropriate legal advice, the outcome of such actions will not give rise to any significant liabilities.

Notes (continued)

27 Off balance sheet financial instruments, contingent liabilities and commitments

	2016 Shs'000	2015 Shs'000
Other commitments		
Undrawn formal stand-by facilities, credit lines and other commitments to lend	1,880,575	1,734,613
Foreign exchange forward contracts	83,520	36,233
	1,964,095	1,770,846

Nature of commitments

Commitments to lend are agreements to lend to a customer in future subject to certain conditions. Such commitments are normally made for a fixed period. The Bank may withdraw from its contractual obligation for the undrawn portion of agreed overdraft limits by giving reasonable notice to the customer.

28 Analysis of cash and cash equivalents as shown in the cash flow statement

	2016 Shs'000	2015 Shs'000
Cash and balances with Central Bank of Kenya (Note 13)	1,339,265	1,319,609
Less: Cash reserve requirement	(779,074)	(725,390)
Deposits and balances due from banking institutions (Note 22)	1,711,978	1,491,691
Government securities :		
- Maturing within 91 days of the date of acquisition (Note 15)	-	99,851
	2,272,169	2,185,761

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 91 days maturity from the date of acquisition including: cash and balances with central banks, treasury bills and other eligible bills, and amounts due from other banks. Cash and cash equivalents exclude the cash reserve requirement held with the Central Bank of Kenya.

Banks are required to maintain a prescribed minimum cash balance with the Central Bank of Kenya that is not available to finance the bank's day-to-day activities. The amount is determined as 5.25% (2015: 5.25%) of the average outstanding customer deposits over a cash reserve cycle period of one month.

Notes *(continued)*

29 Related party transactions

The Bank is owned by a diverse group of shareholders and none of them holds a controlling interest.

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and foreign currency transactions.

(i) Loans and advances to related parties

Advances to customers at 31 December 2016 include an amount of Sh 238,957,000 (2015: 151,488,000) relating to loans to companies controlled by directors or their families, and/ or shareholders of the Bank and Bank employees.

	2016 Shs'000	2015 Shs'000
At start of year	151,488	222,062
Additions	122,569	18,695
Payments during the year	(61,982)	(113,122)
Accrued interest	26,882	23,853
At end of year	238,957	151,488

Out of Sh 238,957,000 that relates to lending to related parties, Shs 92,213,000 (2015: Shs 50,368,000) relates to employee loans and are advanced at rates lower than commercial rates but equal or higher than the ruling fringe benefit tax rates.

Loans to all other related parties are advanced at commercial rates.

Loans and advances to related parties are 100 % performing and fully secured. No impairment provision has been recognised on loans and advances to related parties during the year

(ii) Related party deposits

At 31 December 2016, customer deposits include deposits due to staff, directors and shareholders or their associates amounting to Shs 572,291,000 (2015: Shs 628,801,000). These deposits attract rates of interest similar to all other deposits.

(iii) Purchase of goods and services

	2016 Shs'000	2015 Shs'000
Victoria Towers Limited - rent and service charge	8,246	6,574
Victoria Towers Limited – parking	278	292
	8,524	6,866

(iv) Key management compensation

	2016 Shs'000	2015 Shs'000
Salaries and other short-term employee benefits	109,965	115,405

(v) Directors' remuneration

Fees for services as a director	31,500	33,000
Salaries (included in key management compensation above)	53,135	61,585
	84,635	94,585

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VICTORIA



VICTORIA COMMERCIAL BANK

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