Annual Report
& Financial Statements
2012

Family Bank
With you, for life

Vision

To be the financial institution that leads in the positive transformation of peoples' lives in Africa.

Mission

We positively transform peoples lives by providing quality financial services through innovative, efficient and reputable practices.

Our Core Values

Winning Together
within ourselves and with our customers, we work together and we win together

Self Belief
in ours and our customers' ability to change the world

Transparency
our customers will trust and reward us for it

Humility
it's not about us, it's about our customers

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CORPORATE INFORMATION

DIRECTORS

Non Executive

Mr. Wilfred D Kiboro - Chairman
Dr. Kabiru Kinyanjui - Vice Chairman
Mr. Titus K. Muya
Prof. David Kimutai arap Some
Mr. David Kimani
Mrs. Ruth Waweru
Mr. Lerionka S. Tiampati
Mr. Brian Muyah Kiondo - Alternate to Titus K. Muya

Executive

Mr. Peter Munyiri - Managing Director and CEO
Mr. Njung'e Kamau – Director Finance and Strategy
Mr. Mark Keriri – Director Operations and Technology

COMPANY SECRETARY

Jackie Oyuyo Githinji

REGISTERED OFFICE

Family Bank Limited
6th Floor, Family Bank Towers, Muindi Mbingu Street
P.O. Box 74145- 00200, Nairobi
Tel: 254-2-318173/318940/2/7/0720 098 300
Fax: 254-2-318174
Email: info@familybank.co.ke
Website: www.familybank.co.ke

AUDITORS

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

LEGAL ADVISORS

Walker Kontos Advocates
Hakika House, Bishops Road
P. O. Box 60680 - 00200 Nairobi
Tel: 020 2713023/020
www.walkerkontos.com

CORRESPONDENT BANKS

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6 Bishopsgate
London
EC2P 2AT
United Kingdom

DZ Bank AG
60265 Frankfurt am Main
Internet: www.dzbank.de
Email: mail@dzbank.de

Deutsche Bank Trust Company Americas
P O Box 318, Church Street Station
New York, New York 10008 – 0318

BOARD COMMITTEES

Credit Committee

Prof. David Kimutai arap Some - Chairman
Dr Kabiru Kinyanjui
Mr. T. K. Muya
Mr. Wilfred D. Kiboro
Mr. Peter Munyiri
Mr. Mark Keriri

Audit Committee

Mr. David Kimani - Chairman
Mrs. Ruth Waweru
Mr. Lerionka S. Tiampati

Risk Management Committee

Mr. David Kimani - Chairman
Mrs. Ruth Waweru
Mr. Mark Keriri

Human Resource Committee

Dr. Kabiru Kinyanjui - Chairman
Prof. David Kimutai arap Some
Mr. T. K. Muya
Mr. Wilfred D. Kiboro
Mr. Peter Munyiri

Strategy Committee

Ms. Ruth Waweru - Chairman
Mr. T. K. Muya
Mr. Wilfred D. Kiboro
Mr. Lerionka S. Tiampati
Mr. Peter Munyiri
Mr. Mark Keriri
Mr. Njung'e Kamau

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the 6th ANNUAL GENERAL MEETING of the Shareholders will be held at the Kenyatta International Conference Centre on Friday 3rd May, 2013 at 10:00 a.m. to transact the following business:

ORDINARY BUSINESS:

1. To consider and, if thought fit, to adopt the Audited Accounts for the year ended 31st December, 2012, the Report of the Directors and the Report of the Auditors thereon.
2. To approve the payment of a final dividend of Kshs. 0.40 per share, subject to withholding tax where applicable, on the issued and paid-up share capital of the Company on or about 7th May, 2013 to the Shareholders registered as at 3rd May, 2013. To facilitate payment of the dividend, the register of members will be closed on 3rd May, 2013.
3. To elect the following Directors who retire by rotation and, being eligible, offer themselves for re-election:
   (a) Mr. W. D. Kiboro
   (b) Mr. L. S. Tiampati
4. To approve the Directors' remuneration.
5. To note that the auditors, Deloitte and Touche, will continue in office in accordance with Section 159 (2) of the Companies Act and to authorise the Directors to fix the Auditors' remuneration.

SPECIAL BUSINESS:

To consider and, if thought fit, to pass the following resolutions as Ordinary Resolutions:

6. **Increase of Authorised Share Capital**

   "RESOLVED that the authorised share capital of the Company be and is hereby increased from the current Kshs. 1,000,000,000 divided into 500,000,000 ordinary shares of par value Kshs. 2 per share to Kshs1,500,000,000 divided into 750,000,000 ordinary shares of par value Kshs. 2 per share ranking pari passu in all respects with the existing ordinary shares in the capital of the Company"

7. **Bonus Issue**

   "RESOLVED that, pursuant to Article 149 of the Articles of Association, and subject to the passing of Resolution 6 above, the revenue reserves amounting to Kshs. 556,996,000 be capitalised and the Directors be and are hereby authorised and directed to utilise such sums to the holders of ordinary shares as at 3rd May, 2013 and to apply such sum on behalf of such holders in paying up in full at par value 278,498,000 ordinary unissued shares in the capital of the Company, such shares to be allocated and credited as fully paid up to and amongst such holders in the proportion of 1 New Ordinary Share for every 1 Ordinary share as held on May, 3rd 2013 upon the terms that such new shares when issued shall not rank for dividend in respect of the year ended 31st December, 2012 but shall rank, in all other respects, pari passu with the existing ordinary shares of the Company and the Directors be and are hereby authorised to do all acts required to give effect to this resolution and deal with fractions in such manner as they think fit subject always to the Articles of Association of the Company"

8. **Special Notice under Section 142 of the Companies Act**

   Special Notice has been received by the Company pursuant to section 142 of the Companies Act (Cap. 486 of the Laws of Kenya) that the following Resolution be proposed in accordance with section 186 (5) of the Act for consideration by the Shareholders:

   "RESOLVED that Mr. T. K. Muya who, having attained the age of seventy years, be and is hereby re-elected as a Director until he comes up for retirement by rotation under the Company's Memorandum and Articles of Association".

9. **Allotment of New Shares to the Chairman Amounting to 1% of the bank's shareholding as per his terms of engagement:**

   "RESOLVED that the Shareholders do hereby approve the allotment of the equivalent of 1% of the issued share capital in the Bank from the already existing and unissued ordinary shares in the Bank to the Chairman Mr. W. D. Kiboro at a price of KShs. 22 per share per the terms of his engagement'.

By Order of the Board
J L Oyuyo Githinji
Company Secretary
Nairobi
20th March, 2013

Note: A member entitled to attend and vote at this Meeting may appoint a proxy to attend and vote on his/ her behalf and such proxy need not be a member of the Company. The proxy form is available on the Com pany's website www.familybank.co.ke

Board of Directors

2. 3. 5.

Mr. Wilfred David Kiboro, EBS, Chairman of the Board

Mr. Kiboro holds a Bachelor of Science (Civil Engineering) from the University of Nairobi. He started his engineering career with Shell and Esso where he rose through the ranks to head the Sales and Marketing functions. Later he was appointed the Managing Director for Rank Xerox. He is the immediate former Chief Executive Officer of the Nation Media Group.

He sits on the boards of several top blue chip organizations both locally and internationally. Currently he is the Chairman of the Nation Media Group where he sits on the boards of its subsidiaries. He also serves on the board of Air Uganda and is the Chancellor of Riara University.

He has served on the Board of East African Breweries amongst other organizations. Until his appointment, Mr. Kiboro was the Chairman of the board of the Standard Chartered Bank Group. Mr. Kiboro is married with children. He is a golfer and a renowned philanthropist.

Dr. Kabiru Kinyanjui, Vice Chairman and Chair, Board Human Resource Committee

Dr. Kinyanjui is the chairman of the Kenya National Examination Council and a former chairman of the Public Universities Inspection Board and also an international development consultant. He holds a Masters and Doctorate degree from Harvard University. Dr. Kinyanjui has authored distinguished publications, and is the chairman of the K-Rep Advisory Services Limited.

2. 3.

2. 3. 5.

Mr. Titus K Muya, E.B.S Director

Mr. Muya is a career banker having founded Family Bank as a building society in 1984. Prior to founding the Bank, he held various senior positions in the ministries of Home Affairs and Tourism. Mr. Muya also served as the institution's Chief Executive Officer from 1984 to June 2006 when he resigned to take on the role of Chairman, a position he held until December 2012. TK was awarded Elder of Burning Spear for his enterpreneurship in banking and his contribution to the growth of the industry.

Mrs. Ruth Waweru, Chair, Board Strategy Committee

Mrs. Waweru is a professional in various facets of organisational development including business strategy development, corporate governance, capacity building, human resource development, customer service training and gender mainstreaming. She holds a Bachelor of Education degree from Kenyatta University, an MBA (Human Resource Management and Marketing) from University of Nairobi, and is currently completing her PhD studies in strategic management at the Nelson Mandela Metropolitan University in South Africa. Ruth's experience has seen her transition from managerial roles at the Kenya Institute of Management to heading Liaison Consulting Limited where she is the Chief Executive Officer. She also sits on the Boards of OIKO Credit, All Africa Conference of Churches, and Groots Kenya.

1. 4. 5.

2. 3.

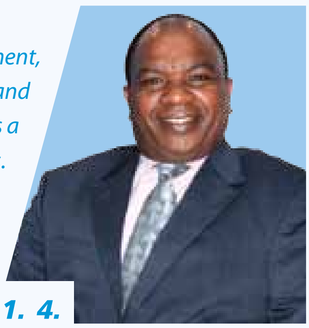
Prof. David Kimutai, Chair, Board Credit Committee

Prof Some is the former Vice Chancellor of Moi University, Eldoret. He holds a Doctorate in Agricultural Engineering from the University of Newcastle-upon Tyne in the UK. He has a wealth of experience in leadership and management. Prof. Some serves on several boards and advisory committees, and he is currently the Chief Executive Officer of the Commission for University Education.

Mr. David Kimani, Chair Board Audit Committee and Chair, Board Risk Management Committee

Mr. Kimani has served in senior positions for over 20 years and has a wealth of experience in auditing, financial management, treasury and general management. He served as Finance Director of Kenya Tea Development Agency (KTDA) for 5 years and thereafter as Managing Director of Chai Trading Company Ltd for almost three years. He also served for a short period as a consulting Director of KTDA. He is currently a lead consultant / Director with Superior Concepts Management Consultants. He is also a director of Kenya Orient Insurance Ltd.

David holds a B.Sc. Degree in International Business from USIU-A and an MBA in Finance from Maastricht School of Management. He is also a Certified Public Accountant (CPA-K) ,a Certified Public Secretary (CPS) and holder of Higher Diploma in HR from the Institute of Human Resource Management.



1. 4.

Mr. Lerionka S. Tiampati

Mr. Tiampati holds a postgraduate degree (MSc.) in Marketing and Product Management from the Cranfield Institute of Technology (Cranfield University) in the United Kingdom, a diploma of the Chartered Institute of Marketing (DIPM) from the United Kingdom and undergraduate degree in Business Administration (B.Com) from the University of Nairobi. Before taking up his current assignment as the Managing Director & Chief Executive Officer of Kenya Tea Development Agency Holdings Ltd., he was Chief Executive of the Kenya Tea Packers (KETEPA). He also worked as the Head of Marketing at the Standard Chartered Bank, Marketing Development Manager at Magadi Soda Company and Head of Marketing at the Agricultural Development Corporation. He sits on the board of the East Africa Tea Trade Association, The Standard Newspapers group and KTDA subsidiary companies.

2. 3.

Mr. Brian M. Kiondo, Alternate to Mr. T K Muya

Mr. Kiondo holds a Bachelor's Degree in Economics from Syracuse University, New York, and is a seasoned marketer with over 15 years experience in both the Unites States and Kenya. He has extensive knowledge in business development, service delivery management, product development, strategy implementation and staff training, development and motivation.

Mr. Kiondo headed the sales and marketing department during the conversion of Family Finance Building Society into a commercial bank during which time he spearheaded the development of new products and services. He is also the Chairman of Kenya Orient Insurance Ltd and Daykio Plantations Group, a real estate company, and is the founder Director of Ingenious Concepts Group an outdoor advertising and marketing firm in Kenya.

2. 3. 5.

Mr Peter Munyiri, Chief Executive Officer & Managing Director

Mr. Munyiri holds a BA honours degree in Economics from the University of Nairobi, an EMBA from Jomo Kenyatta University College of Agriculture and Technology. Mr. Munyiri is an Associate Member of the Chartered Institute of Banking UK (ACIB) , a Fellow of the Kenyan Institute of Banking(FKIB) as well as Council Member- Pan African Christian University. He has a wealth of experience in banking spanning over 21 years having previously worked at executive levels with Kenya Commercial Bank, Cooperative Bank of Kenya, Standard Chartered Bank and Barclays Bank of Kenya. He had also worked for the Kenya Government as an Economist. His last appointment was the Deputy Chief Executive Officer with Kenya Commercial Bank. .He holds a Head of State Commendations (HSC) for his contributions to the growth of Kenyan banking industry and transformation of small business in East Africa through financial intermediation.

2. 3. 5.

Mr. Njung'e Kamau, Finance & Strategy Director

Njung'e Kamau is the Finance & Strategy Director of the Bank. He joined the Bank as a Finance Manager. He has over 19 years professional working experience in Audit, Business Risk Assurance, Strategy, Risk and Financial Management. He commenced his career with Ernst & Young and also worked with Lonrho Africa Plc as a Senior Auditor covering 14 countries. He has also worked with East African Breweries Limited as Manager, Business Risk Assurance. Prior to joining Family Bank, Njung'e was the Finance Manager at Equity Bank. He holds an MBA in Finance & Banking from Moi University, a B.Com degree (Accounting Option) from the University of Nairobi. He is also a Certified Public Accountant (CPA-K), Certified Public Secretary (CPS-K) & a member of ICPAK and ICPSK. He is also a Certified Financial Modeller (CFM). He has also attended several banking courses locally and in the USA and Australia.

5.

Mr. Mark Keriri , Operations and Technology Director

Mr. Keriri is the Operations & Technology Director of Family Bank. He is responsible for the introduction of WAN Connectivity which facilitates easy accessibility of inter Branch transactions by the Bank's Account Holders. Mr. Keriri previously worked for PNC Bank in Pittsburg, Pennsylvania and holds a Bachelor of Science Degree (Major Information Technology; Minor Finance) from the Duquesne University in Pennsylvania USA.

2. 4. 5.

Key

- **1. Board Audit Committee**
- **2. Board Credit Committee**
- **3. Board Human Resource Committee**
- **4. Board Risk Management Committee**
- **5. Board Strategy Committee**

PASSING THE BATON: Family Bank Founder Chairman Mr. T.K. Muya hands over the mantle to the new Chairman Mr. Wilfred Kiboro as Mr. Peter Munyiri the Chief Executive Officer and Managing Director looks on.

Director T. K. Muya (Right) with Mr. Peter Kanyago Chairman KTDA signs the KTDA -Family Bank shareholding agreements.

Director T. K. Muya (Left) exchanges signed LAP Trust-Family Bank shareholding documents with Mr. Hosea Kili CEO Laptrust

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Your Payment is REAL-TIME

...when you pay your electricity bill at any Family Bank branch, ATM or through Pesa Pap!

For more information call: +254 712 606 363 • +254 738 228 881

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* Terms and Conditions Apply

Kenya Power

Family Bank
With you, for life

Chairman's Statement

Dear Shareholders,

It gives me great pleasure to present to you Family Bank's annual report and financial statements for the year ended 31st December, 2012. This has been a great year with very commendable performance against the backdrop of a very challenging operating environment. This is a clear testimony that the vision of a 'big bank' and our realigned business strategy of a Universal Bank is beginning to bear fruits. As you may already know, Family Bank's strategic intent is to become a Tier 1 bank within the next five years. From the growth delivered in the 2012 financial results I am confident we are firmly on track towards realising this goal.

The Operating Environment

In the year under review, the Kenyan economy continued to experience some significant challenges in most of our macroeconomic indices spilling over from 2011. The year started with a very high inflation regime which was hovering at about 25.5%. This was being fuelled by a number of economic factors from both domestic and foreign fronts. The economic instability in the Eurozone countries and slow growth in the US economy was one major contributor to this. The Euro came under huge pressure and the demand for dollar rose considerably. Our tourism industry was affected as were our horticultural exports thus impacting the Kenya shilling adversely.

This set off a spiral effect which resulted in very high inflationary pressure from all sectors of the economy resulting in prices increase in virtually every commodity. The Central Bank's Monetary Policy Committee responded swiftly by aggressively raising the Central Bank Rate (CBR) in order to contain the burgeoning money supply and stringent measures were put in place by CBK to control forex trading in the banking sector.

The Central Bank rate went as high as 24.5% with the resultant interbank's rates that peaked at 30%. This affected the uptake of credit by customers due to the high cost of borrowing. The cost of money went up considerably which impacted adversely on most banks interest expense. The CBR eased off towards the last quarter of the year to end the year at around 11%.

GDP growth

Domestically the GDP slowed as the country drew closer to the general elections and a number of investors and customers chose to slow down on their investments/ borrowings and adopt a 'wait and see' attitude. Hence there was a noticeable economic slowdown towards the final quarter of the year. The latest estimates indicate that the country's GDP grew at about 4.3% compared to 4.5 % the previous year.

Banking Sector

The Kenyan Banking sector registered improved growth in assets in 2012 driven by growth in deposits, injection of capital and retention of profits. The sector registered improved performance in earnings and capital and the level of non-performing loans reduced compared with a similar period in 2011.

Our Performance

This been described in greater detail by the Managing Director in his report as he underpins the universal banking business strategy and how it is influencing this growth you are beginning to see. But let me highlight a few salient changes taking place on our balance sheet. The shareholders funds have gone up from 3.3 billion in 2011 to 4.9 billion in 2012 thanks to the rights issue at the back end of the year. When I joined the bank's board, I promised that this will be a key area of focus for the board. We want to grow into a big bank and this is not possible without a robust balance sheet.

The profits before tax have grown by 66.2% from Ksh 522 million to Ksh 868 million in the year under review. This performance is coming against the economic backdrop I have just painted above. Every key growth parameter is looking up from deposits to the loan book to interest income which clearly show that the business model the business has adopted is working.

Corporate Governance

In the course of the year under review we saw some changes in the board. Our founder Chairman Mr. Titus K. Muya, EBS indicated his desire to step down from his role as the chairman of the bank effective from the 1st of January 2013. I joined the Board as Chairman-designate in October 2012 and assumed the role of Chairman of the Board from 1st January, 2013.

Following changes to our institutional shareholding structure, Mr. Skander Oueslati and his alternate Mr. George Odo who

Dr. Kabiru Kinyanjui (Vice Chairman Family Bank, Mr. Wilfred D. Kiboro (Chairman Family Bank), Peter Munyiri (MD & CEO Family Bank), Mr. Jimnah Mbaru (Chairman Dyer & Blair) at the launch of the Rights Issue in 2012

represented the Africinvest consortium resigned from the Board, whilst Mr. Lerionka S. Tiampati was nominated to the Board by KTDA and his nomination was subsequently approved by the Board and the Central Bank of Kenya.

The current non-executive Directors are thus Mr. Wilfred D. Kiboro, the Vice Chairman, Dr. Kabiru Kinyanjui, Mr. TK Muya, Prof. David Kimutai arap Some, Mr. David Kimani, Mrs. Ruth Waweru and Mr. Lerionka Tiampati . Mr. Brian Muyah Kiondo is an Alternate Director to Mr. TK Muya.

The three Executive Directors are; Mr. Peter Munyiri (Managing Director & Chief Executive Officer), Mr. Mark Keriri (Operations & Technology Director) and Mr. Njung'e Kamau (Finance & Strategy Director).

Dividend and Bonus Share

The bank takes into cognisance the need to optimise the shareholder value as well plough back funds into the company for much rapid growth. The board therefore recommends a dividend of Kshs. 0.40 per share (20% per share based on a par value of Kes. 2.00). This is similar to the dividend payout for the previous year.

In addition, your Board recommends a Bonus Share issue of 1 New Ordinary Share for every 1 Ordinary share held as at May 3rd 2013 provided that such new shares when issued shall not rank for dividend in respect of the year ended 31st December 2012 but shall rank, in all other respects, equal to the existing ordinary shares of the Company.

Outlook for 2013

According to global forecasts, the world economy is expected to be fairly flat given the persistent difficulties in the Eurozone and the slow American economy. However, we expect good growth in the emerging markets and in particular the African continent. The Kenya economy is expected to grow significantly given the fairly smooth change of government following the peaceful general elections and peaceful transition of power which has seen investors warming to investing in the country. We therefore expect good inflows of foreign direct investment into the country and a growth in the economy of above 5.5 %.

All the indications from the IMF & World Bank are pointing to a very promising year for all sectors of the economy. The banking sector is certainly poised to do well and most certainly your bank.

Conclusion

In conclusion, I want to register my appreciation to the Board, Management and staff of the Bank for driving the Bank's growth in the right direction. I also salute you our Shareholders and all our customers for continuing to believe in us, entrusting us with your investments and walking this journey with us. We promise to do all we can to maximise our shareholder value.

Thank You

Mr. Wilfred D. Kiboro
Chairman

Managing Director's Statement

Dear Shareholders,

It gives me great pleasure to present to you Family Bank's annual report and financial statements for the year 2012. The year began with our economy continuing to experience serious headwinds which had adversely affected the banking industry from the middle of 2011. This was further compounded by the pre- election anxiety in the second half of 2012 which kept the market fairly depressed for most of the year. Nevertheless, we have been able to return the commendable financial results I present to you in this report.

Financial Performance

The year under review was the first full year in which we have been able to execute our re-engineered universal banking model through which the Bank was able to defy the harsh macroeconomic environment and register growth in all the key parameters of its financial performance for the year 2012.

Total assets grew by Kes 5 billion, representing a 19% increase, from Kes 26.1 billion as at December 2011 to Kes 31 billion as at December 2012. This increase in assets was mainly attributable to the growth in loans and investments. Net loans and advances stood at Kes 17.8 billion as at December 2012 compared to Kes 16.3 billion as at December 2011, representing a growth of 9%. This has been achieved through a selective acquisition and the loan book is well diversified. Deposits grew by Kes 3.17 billion, recording a growth of 15% increase, from Kes 21.4 billion as at December 2011 to Kes 24.6 billion as at December 2012. The Central Bank maintained a monetary policy that was meant to cause credit squeeze which they had adopted in the second half of 2011 to fight inflation. This resulted in very high cost of funds and our interest expense grew from Kes 490 million in 2011 to Kes 1.484 million in 2012. Our operating cost base also grew reflecting the increase in our distribution footprint, staff numbers, and continued investment in our ICT infrastructure. Our operating costs grew by 10% to reach Kes 3.2B from Kes 2.9B in 2011.

As a result we delivered a profit before tax for the group of Kes 868 million (2011: Kes 522m). This represents a 66.2% growth. The total shareholders' funds grew by Kes 1.6 billion from Kes 3.3 billion as at December 2011 to Kes 4.9 billion as at December 2012 owing to an increase in core capital arising from the rights issue and retained earnings. This performance has been achieved amidst an ongoing investment in the expansion of our geographic footprint, our ICT infrastructure and our talent pool as we strengthen the key drivers of our business model. We are confident of making even better returns to the shareholders into the future as the macroeconomic environment improves and we begin to benefit fully from our revamped business model. The ongoing business 'renewal cum transformation' of our business model is meant to embed a very strong retail oriented business with strong and competitive offerings across all the key segments in the market. In the year under review we have continued to widen our outreach by expanding our distribution channels in some of the key strategic geographic areas as we prepare ourselves for the devolved county government. We have opened additional seven new branches and grown our account numbers to 1.2 million.

Operating Environment

As mentioned earlier , the country's macroeconomic environment became volatile from the second half of 2011 when the inflation hit the 18% mark and continued

Eng. Rosemary K Gitonga (Chief Manager, Commercial Services Kenya Power), Eng. Joseph Njoroge (CEO & MD Kenya Power) and Peter Munyiri (CEO & MD Family Bank) during the launch of Easy Pay Bill Payment Services by Family Bank for the better part of 2012. This caused the Central Bank to raise the Central Bank Rate(CBR) to an all time high of 19% and treasury Bill rates followed suit . Interbank rates sky rocketed to as high as 30%. Whereas this was done in order to stem the money supply into the economy and contain the rising inflation it had dire effects on the banking business. There was a knee jerk reaction to this with the escalation of interest rates to levels not seen in the last 10 years. The cost of borrowing and the cost of funds went up simultaneously. As a result the market has witnessed a very high interest rate regime throughout the year. We haven't been spared of these effects. We had to pay higher interest rates for the additional deposits we mobilized from the market. As a result our interest expenses increased steeply. To mitigate such knocks on our income statement we are building sufficient long-term muscle in our balance sheet. Due to the high cost of borrowing and some pre-election anxieties, some of our customers reduced or deferred their borrowings pending the lowering of interest rates while others waited for the conclusion of the general election.

Our operating costs increased in the year as the cost of goods and services continued to rise whilst the Kenya shilling weakened. We embarked on measures to contain costs while driving growth. Gradually these measures continue to lower the cost to income ratio. We have also embarked on an aggressive business growth campaign to bring in as many customers into our branches as possible, activate the dormant accounts and continue to mobilize more deposits. Our focus is therefore to grow our non interest income as well as our customer base and introduce new products that respond to our customers' needs.

Operational Excellence

In the year under review we have started to reap the benefits of the new universal business model. Our teams are aggressively driving more value into the business and embedding a culture that drives return on investment. We have started unlocking efficiencies from our ICT investments and we are now offering our customers better service with much faster transaction speeds.

We are beginning to see early signs of success of our business model as we address more customer needs across various market segments. This is enabling us tap into key value chains in the market where we have been absent in the past. A good example of this is the business partnership we have established with Kenya Tea Development Authority (KTDA) which is beginning to unlock value across the entire tea sector value chain. We thus continue to add more value to the existing customer base as well as go for other new players who were not banking with FBL.

Growing our outreach

As the bank continues to strengthen its universal banking model we have developed a 5 year corporate strategy that will propel us into a BIG BANK player in the next five years :

Branch Expansion and Agency Banking

We have rolled out an additional seven branches in the last 12 months and another seven are in the pipeline to enable us widen our footprint in the market and reach more customers. In addition, we are expanding the bank into the counties in which we are currently not represented to enable us position ourselves in the devolved government structures and to reach all our customers and simultaneously broaden our customer base. This is in full realisation that the county economy will become a key driver for our business going forward.

In order to expand our Automated Teller Machines (ATMS) usage we entered into a partnership with the Pesa Point network which has given our customers access to 1800ATM's within the Pesa Point network and has also opened up our ATMs for use by all the Pesa Point network customers. In addition, our customers are now able to withdraw MPESA on all our ATMs thus increasing the number of transactions to our business.

We have also rolled out our agency banking channels 'Family Pap Agents!' which is a critical strategy in growing our customer base and increasing our transaction incomes. We now have 500 agents in the market serving customers. This additional distribution channel will continue to enable us enter new markets in a more cost-efficient manner, serve more customers, mobilize deposits from these markets whilst providing the much desired convenience to our customers.

Product Launches

We have continued to roll out new products in the market to help us address the increasingly sophisticated needs of our customer. These products include:

- Utility bill payment service with Kenya Power that enables customers to make real time power bill payments at our branches, ATM's and Mobile Phones.
- Growing Business Account to support the SME'S businesses.
- Agri -Business Loans to support the large scale wheat and barley farmers in Rift Valley.
- Internet banking to provide a platform to enable our customers to do banking wherever they are.
- Trade Finance products, Letters of Credit, Guarantees, Bid Bonds, Performance Bonds.
- Mkenya Daima Diaspora Account -to take care of our Diaspora community.
- Banc assurance products.

Key Partnerships

In the course of 2012, we forged several strategic partnerships including the following:

- Kenya Power: to provide electricity bill payments to our customers through all our outlets, our ATM's channels and Mobile banking platform.
- KTDA: to help unlock value in the Kenya shilling multi-billion tea sector value chain.
- Lap Trust: to tap into the local government employees

Peter Munyiri (MD & CEO Family Bank) and Bernard Mathewman (Chairman Paynet Group) signs partnership agreement to provide VISA platform and open the PESA POINT ATM's network to Family Bank customers and vice versa.

market.
- Pan Africa Life: to tap into the insurance industry while we partner on the expanding the Banc assurance sector.
- Nzoia Sugar Company: mobile banking bulk wage payments to tap on cane farmers.
- Paynet Group: to provide VISA platform and open the PESA POINT ATM's network to Family Bank customers and vice versa.

In addition, we are in partnership with institutions and companies to deploy our mobile banking platform for collection business. This is part of our strategy to increase our fee based revenue sources.

Business Growth

The Business growth opportunities will also be largely driven by our technology driven transactions and our agency banking and we are working to unlock these opportunities. Thus, we are intensifying and will continue to innovate and rollout additional value added services such as e- Banking.
With the entry of the bank into the new business areas, we foresee more revenues from treasury trading and investment activities, SME sector, corporate banking and Trade finance, as well as the Consumer Banking.
With the continued growth of account numbers we see more transaction income coming through our different Channels.

Regional Expansion

We had more focus on the domestic market in 2012 and chose to strengthen the local business. We have however done a lot of market research in the regional markets and the entry into these markets is still on the right track.

Future Outlook

The outlook for 2013 looks positive and the Bank expects a very robust growth in its market share through deepening our business relationship with both the existing and the new customers. The devolved government presents a great opportunity to drive business growth across the entire country. All factors point to very promising business environment following the peaceful elections in the country. This is expected to reflect positively on the banking business. We intend to drive our business model even harder in order to exploit these emerging business opportunities. We will continue to identify new gaps in the business segments, offer superior and responsive service delivery, and to diversify our product range. Our Strategic intent will remain to grow the business to become a BIG BANK playing the Tier One league within the next 5 years.

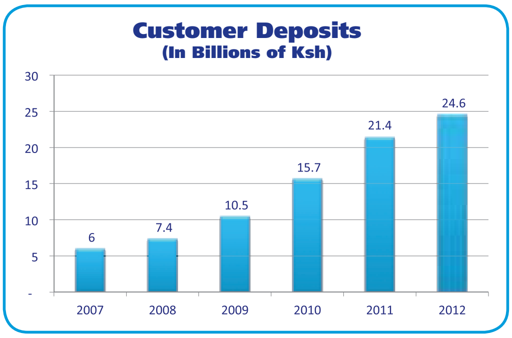
Conclusion

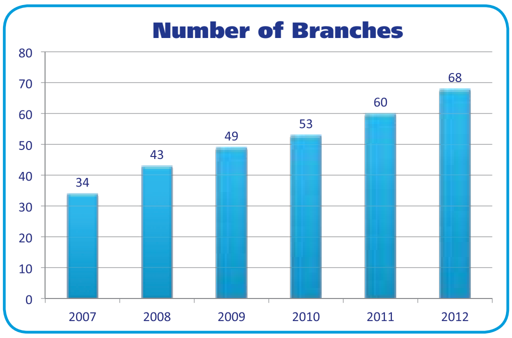
The Bank's management and staff are cognisant of the challenges that lie before us but we are nevertheless excited about the growth prospects this presents to our business. We know that the road to our success is an enormous task which will take our total determination and commitment. Our commitment to you is to drive this bank's growth and gain more market share. We will also continue to pursue excellence in customer service in the industry as we grow our customer base.
We thank you, our shareholders, for being a part of this journey and we look forward to celebrating more success with you. My sincere gratitude to our customers for all the support they have given our bank over the years. I also most sincerely thank the management and the staff for their selfless effort and determination in this journey. Lastly, my sincere thanks to the Board of Directors for taking a leading role in giving guidance, good governance and strategic insight that continue to steer the business to greater heights.

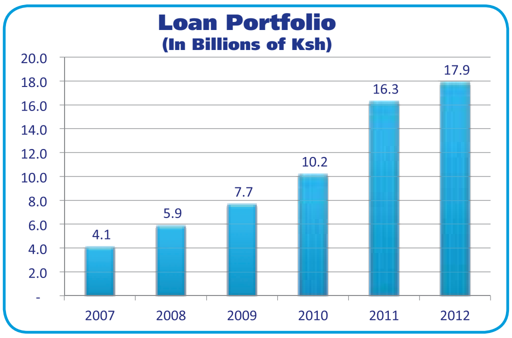
Thank you and God Bless.
Peter Munyiri
Managing Director& Chief Executive Officer

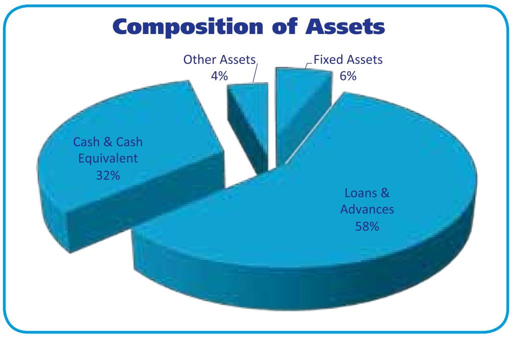
Peter Munyiri (MD & CEO Family Bank) with our coporate clients at one of our branches

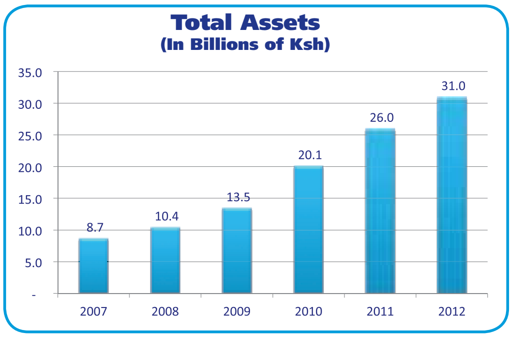
Financial Highlights

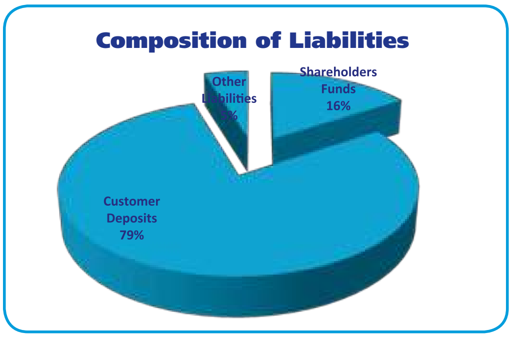


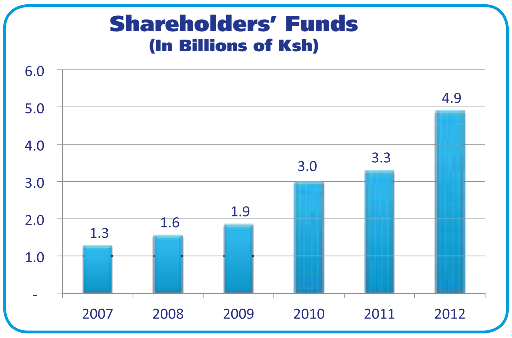


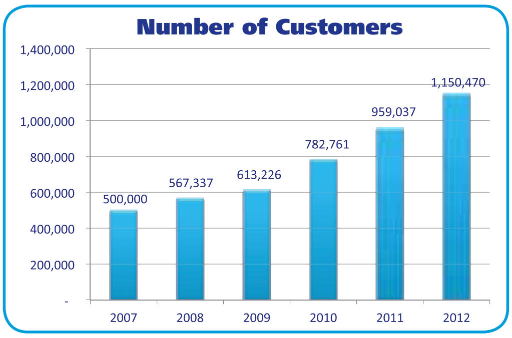












Key financial performance highlights for the Bank

- Total assets grew by 19% from Ksh 26 Billion in 2011 to Ksh 31 Billion in 2012
- Deposits grew by 15% from Ksh 21.4 Billion in 2011 to Ksh 24.6 Billion in 2012
- Loans grew by 9% from Ksh 16.3 Billion in 2011 to Ksh 17.9 Billion in 2012
- Profit before tax grew by 61% from Ksh 522.6 Million in 2011 to Ksh 843.2 Million in 2012
- Total Shareholders' funds grew by 46% from Ksh 3.3 Billion in 2011 to Ksh 4.9 Billion in 2012
- The Bank has 68 branches
- The bank has over 1.1 Million customers

REPORT OF THE DIRECTORS

The directors have pleasure in presenting their report together with the audited financial statements of Family Bank limited ("the bank") and its subsidiary (together, "the group") for the year ended 31 December 2012, which show the state of affairs of the group and the bank.

INCORPORATION

The bank and its subsidiary (Dhamana Insurance Agency Limited) are both incorporated in the Republic of Kenya under the Companies Act and are domiciled in Kenya.

ACTIVITIES

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

GROUP RESULTS

The following is the summary of the results for the year ended 31st December 2012:

	Sh'000
Profit before taxation	868,274
Taxation charge	(306,815)
Profit for the year	561,459

DIVIDEND

The directors recommend a first and final dividend of Sh 0.40 (2011: Sh 0.40) per share for the year amounting to Sh 111,399,054 (2011: Sh 96,837,977) subject to shareholders' approval at the Annual General Meeting.

DIRECTORS

The present members of the board of directors are shown on page 2. During the year to the date of this report, Mr. Wilfred D kiboro and Mr. Lerionka Tiampati were appointed as directors to the bank, on 2 November 2012 and 16 January 2013 respectively. Further, Mr. Wilfred D Kiboro was nominated to replace Mr T K Muya as board chairman effective 1 January 2013. Mr T K Muya continues to serve as a non executive director. Mr. Skander Oueslati resigned as a director and Mr. George Odo also resigned as his alternate with effect from 17 December 2012.

AUDITORS

Deloitte & Touche, have expressed their willingness to continue in office in accordance with the provisions of section 159 (2) of the Companies Act (Cap 486) and subject to approval by the Central Bank of Kenya in accordance with section 24 of the Banking Act.

BY ORDER OF THE BOARD
Secretary
Nairobi
20 March 2013

CORPORATE GOVERNANCE STATEMENT

Preamble

The Board of Directors, duly cognisant of its role in safeguarding shareholders' assets and ensuring a decent return on investment, reaffirms its commitment to upholding policies and strategies that enhance transparency and accountability.

Accordingly, the Board of Directors of Family Bank promotes the best practice of corporate governance as encoded in the prudential guidelines developed by Central Bank of Kenya for the banking industry. The Board recognizes corporate governance as a fundamental part of enhancing value in the culture and business practices that are undertaken with due regard to the entire Bank's stakeholders and its role in the community and the economy at large.

Family Bank has adequate policies and procedures in place that are reviewed regularly and which include:
a) clearly defined responsibilities and authority of directors, the Managing Director and management
b) set corporate objectives and strategies;
c) recognition of the interests of various stakeholders;
d) alignment of corporate activities and behaviour in compliance with applicable laws and regulations; and
e) protection of the interests of depositors and other creditors

Shareholders

The shareholders' responsibility is to appoint the Board of Directors, appoint the external auditors and ensure that the Board is held responsible and accountable for the efficient and effective governance of the institution. There is no shareholder acting as an executive director or in management with more than 5% shareholding.

The Bank publishes the quarterly and audited annual accounts in the daily newspaper(s) in line with the Central Bank of Kenya requirements and the same is also updated on our website.

All shareholders are entitled to attend the Annual General Meeting and any special / extraordinary meetings of the shareholders of the Bank.

Board of Directors

The Board of Directors is responsible for providing effective leadership based on an ethical foundation. This involves responsible leadership characterized by the ethical values of responsibility, accountability, fairness and transparency. The Board Charter sets out the objectives which include, among others, the provision of strategic guidance and effective oversight of management and maximization of the Banks' financial performance and shareholder value within the framework of appropriate risk assessment. These underlying values are:

a) responsibility: for the assets and actions of the group and the willingness to take corrective actions to keep the group on a strategic path that is ethical and sustainable.
b) accountability: ability to justify its decisions and actions to shareholders and other stakeholders.
c) fairness: giving fair consideration to the legitimate interests and expectations of all stakeholders of the institution.
d) transparency: disclosure of information in a manner that enables stakeholders to make an informed analysis of the bank's performance and sustainability.

Board Composition

Family Bank has a competent Board of Directors with diverse backgrounds and expertise. The Board comprises of seven non-executive Directors, three Executive Directors and one Alternate Director.

There were changes in the composition of the Board during the year. Mr. WD Kiboro was appointed to the Board, while Mr. Skander Oueslati and his alternate Mr. George Odo resigned from the Board. Mr. Lerionka S. Tiampati was nominated to the Board on 16th January 2013 and his nomination subsequently approved by the Central Bank of Kenya.

The current non-executive Directors are the Chairman, Mr. Wilfred D. Kiboro, the Vice Chairman, Dr. Kabiru Kinyanjui, Mr. TK Muya, Prof. David Kimutai arap Some, Mr. David Kimani, Mrs. Ruth Waweru and Mr. Lerionka Tiampati. Mr. Brian Muyah Kiondo is an Alternate Director to Mr. TK Muya.

The three Executive Directors are; Mr. Peter Munyiri (Managing Director & Chief Executive Officer), Mr. Mark Keriri (Operations & Technology Director) and Mr. Njung'e Kamau (Finance & Strategy Director).

Responsibility of the Board

The Board provides strategic guidance to the Bank and assumes primary responsibility of fostering the sustainability of the Bank's business and growth. The Board is responsible for providing the overall direction, governance and promoting proper standards of conduct and sound banking practices which enhance internal controls and shareholder value.

The directors are also responsible for the formulation and implementation of sound policies and procedures which enhance effective controls to safeguard the Bank against fraud and wastage, compliance with regulatory requirements, as well as ensuring that systems are in place to facilitate the effective management of all risks that may affect the Bank.

In addition to the Executive Directors, members of senior management of the Company attend Board Meetings by invitation to ensure informed and efficient decision-making by the Board of Directors. In addition, the Board invites third party professionals to attend Meetings and provide opinions and advice as necessary to enable the Board discharge its fiduciary mandate.

Cognisant of its responsibility for defining appropriate governance practices for its own work and to have in place the means to ensure that such practices are followed and periodically reviewed for improvement, the Board meets at regular intervals to, amongst others things:

a) Agree on the Company's strategic objectives, and its roadmap to achieving the agreed objectives
b) Review and approve the Company's annual budget
c) Review the Company's performance against agreed goals and strategies
d) Review the Company's policies and procedures
e) Consider and approve the annual and interim financial statements
f) Recommend dividends to the shareholders;
g) Evaluate the performance of the Managing Director; and
h) Approve other matters of fundamental significance

Board Independence

The Board has set a structure and standards to ensure the Directors' independence. The fundamental premise of the standards is that any Director is independent of management and free of any business or other relationship that could materially interfere with exercising their independent judgement.

The roles of the Chairman and the Managing Director are separate. The Chairman is a non-executive Director who provides leadership to the board and is responsible for the board's effective overall functioning. The Chair also ensures that board decisions are taken on a sound and well-informed basis, and encourages and promotes critical discussion to ensure that dissenting views can be expressed and discussed within the decision-making process, all the while upholding the principle of collective responsibility for Board decisions.

In order to ensure that the non-executive Directors maintain independence of thought and judgment, the non-executive Directors meet informally from time to time without the Executive Directors and other members of management being present.

Committees of the Board

The Board retains the overall accountability and has established various committees to increase efficiency and allow deeper focus in specific areas. The Managing Director holds the delegated authority to implement Board decisions and provide a clear flow of information between management and the Board. The Board committees, their composition and responsibilities are as follows:

Board Audit Committee

The committee is comprised of three non-executive directors, and the Head of Internal Audit attends all Committee meetings. The committee meets quarterly and is charged with the responsibility of reviewing the financial condition of the Bank, its internal controls, and to recommend appropriate remedial action where necessary. The committee also ensures that appropriate action has been taken on the recommendations of the internal auditors and that the same are implemented The Committee may invite the Managing Director or any other Director to attend the meetings occasionally for consultation as and when necessary. However, the committee meets at least twice in a year with the external and internal auditors without management being present, either in separate meetings or meetings held before or after a scheduled audit committee meeting. The Bank's external auditors are invited to attend the Meetings from time to time, but are required to attend once a year when the audited financial statements are being reviewed by the Committee and the Board.

Board Credit Committee

This committee is made up of four non-executive directors, the Managing Director and the Operations and Technology Director and meets at least once quarterly to review the Bank's overall lending policy. It also meets at least once a month to consider and approve loan applications beyond the credit management committee approval limits, to review and consider all issues that may materially impact on the present and future quality of the institution's risk management and to ensure that the credit policy and risk lending limits of the institution are reviewed where appropriate. It also regularly reviews the credit policy of the Bank. The Head of Credit attends all Committee meetings, whilst other members of management attend Committee meetings on a needs basis.

Board Risk Management Committee

The Board Risk Management Committee comprises of two non-executive directors, the Operations and Technology Director, and the Head of Risk and Compliance attends all Committee meetings. The committee meets quarterly and is responsible for ensuring quality, integrity and reliability of the institution's risk management. The committee assists the board in the discharge of its duties relating to the corporate accountability and associated risks, namely strategic risk, liquidity risk, foreign exchange risk, interest rate risk, price risk, operational risk, credit risk, regulatory risk, and reputational risk; in terms of identification, mitigation and overall management of risks.

Board Human Resource Committee

The Board Human Resource Committee is comprised of four non-executive directors of the board and the Managing Director. The Head of Human Resources attends all the Committee meetings. The committee acts as the link between the board and management and is responsible for the review of the human resources policies and practices, particularly in relation to the operations of the various business units. The Committee also assists the Managing Director to guide and control the overall direction of the business of the institution and act as a medium of key management staff and new Board members' recruitment, communication and co-ordination between the business units and the board.

Board Strategy Committee

The Board Strategy Committee is comprised of four non-executive directors, the Managing Director, the Finance and Strategy Director, and the Operations and Technology Director. The Strategy Committee's roles and responsibilities include an analysis of the strategy of the Bank and specifically the following:

a) Oversight of the implementation of the strategy approved by the Board and review of progress on a regular basis.

b) Review of the budget and strategic plan of the Bank prior to submission to the Board.

c) Design of action plans per business unit to ensure that objectives are met while factoring in organizational, human, technical and financial aspects.

d) Consider the analysis of any investment/CAPEX programme prior to its submission to the Board.

e) Design and submission to the Board of the main strategic orientations of the Bank.

f) Review any updated policy and environmental changes (e.g. Basel, CBK guidelines, IFRS/IAS, etc) and weigh the impact on the Bank and make recommendations for implementation.

g) Design and implementation of an environmental and social policy

h) Review Branch expansion plans of the Bank

Directors' Attendance of Board and Committee Meetings

The Board convened and held a total of five Board meetings in the course of year and the attendance was 100% by all the directors with exception of three directors whose attendance was 80%. The individual directors therefore attended more than 75% of the meetings convened during the year in compliance with the CBK prudential guidelines.
The Board Committees held four meetings each with an attendance rate of over 75% by the members. Overall, the Board's performance was effective which led to the excellent performance of the Bank in all parameters during the year.
All the Board and Committee meetings held had sufficient quorum.

Board Performance and Effectiveness

The Board discharged its duties ably and effectively in the course of the year including strategic planning and review of the Group's strategy, review of the Group's financial performance, regulatory compliance, capital enhancement, review and implementation of internal and external audit findings and recommendations, review of Corporate Governance structures and authority limits, attendance to Human Resource matters, and general timely and appropriate advice to management.

With the assistance of external facilitators, the Board carried out peer, self and overall evaluation of the Board, its committees and the contribution of each and every director, including the Chairman in March 2012 pursuant to which a Corporate Governance Seminar was convened in November 2012 to enable the Board discuss the outcomes of the Evaluation and agree on next steps.

Chairman

20 March 2013

CORPORATE SOCIAL RESPONSIBILITY STATEMENT

Giving back to society

The corporate citizenship profile of our Bank was raised higher in 2012 as we continued the implementation of social programs responsive to the needs of the society. A list of well thought out corporate social responsibility (CSR) programs being run by the Bank are helping communities meet needs in the area of education for bright-but-needy children, development of sports and talent, support for orphaned & vulnerable children and healthcare among other programs. We consider being part of the community in which we do business our obligation. In this regard, the Bank has a deliberate policy to be closely involved with the immediate societies particularly where we have our operations. Where we can, we have helped as shall be clear in the following review of some of these programs. The success of our bank is attributed to the support we have continually received from our society over the years.

Support for Education

Family Bank has identified education as the bedrock for a good future of our society. We hold the opinion that with good education the less fortunate children can gain economic wealth, social prosperity and eventually transform the lives of their families and the local communities. The bank thus launched in 2012 the Family Bank Education Scholarship Fund, to help the bright but needy children get scholarships for secondary school education. This fund is

uniquely designed to support students not just financially, but also through constantly mentoring and inspiring them towards excellence through-out the secondary school education and life thereafter. The bank has a panel that closely monitors academic performance of all the students' in the program and has a separate program for mentoring and counseling them.

In 2012, the Family Bank Scholarship Fund supported 40 students picked from across the country. Some of these students had been invited to study in National and Provincial secondary schools but were unable to report to the schools to start their study because of a lack of funds. This year, the program grew two-fold and is now supporting a total of 80 bright, need (some of them are orphaned) children to access quality education. We hope this will help them get a chance to realize their dreams. Family has funded the program in the two intakes?to the tune of about Ksh10 million, which has mostly gone into school fees payment.

Starehe Girls Centre - education for the girl child

Peter Munyiri (MD & CEO Family Bank) presents a cheque to Starehe Girls Centre

Alongside the Family Bank Education Scholarship Fund, the Bank last year closely worked with the Starehe Girls Centre to promote access of education to the girl child. We, for instance, supported the school's annual walk, an initiative that mobilizes resources to support bright girls from disadvantaged families' access education. Starehe girl Centre was founded 8 years ago and is sister school for the Starehe Boys Centre. The school gives scholarships nationally to top performing girls who come from disadvantaged set-ups. During the year, senior members of staff led by the Managing Director, Peter Munyiri visited Starehe Girls centre to give inspiration through talks to motivate the girls.

The Family Bank Eldoret Half Marathon- growing talent in Sports

Eldoret is home to many athletes in Kenya. It is also one town where Family Bank has a long established history of business and integration with its customers. As way to giving back to this society, we developed a social program to support the budding sports talents from the region and help spur more interest by the youth in athletics. This program is now the Family Bank Eldoret Half Marathon; an annual athletic

2012 Eldoret Marathon Winners receiving their cash prizes

event that is wholly funded and organized by the Bank in collaboration with the Kenya Athletics Association.

Year on year, the marathon has grown to attract over 2,000 athletes, and attracts over 10,000 spectators. The marathon is a significant even in the North Rift Athletics circuit and regional sports calendar and is attracting attention from interest groups including established athletes, talent scouts, and Athletics Kenya officials, among others. Since its launch in September 2008, the Family Bank Eldoret Half marathon has received an investment of about Ksh15 million and has produced talented marathoners now playing on the global arena.

In other activities promoting development of sports talent, the Bank donated uniform kits to football club members in a number of counties in 2012 in order to support the young upcoming talents in areas where we operate.

Music & Young Artists development

The Bank has spent Ksh 500,000 in a period of three years towards assisting various talented artistes launch their albums. The musicians include Ben Githae, Isaac Kahura, and Elijah Miller who are local upcoming gospel musicians. We endeavor to continue with support for young people with similar talents to become accomplished artistes.

Support for Wellness & Healthy Living

Family Bank Sponsored youth football

In the year 2012, the Bank spent Ksh 500,000 supporting initiatives that promote health, healthy practices and other good causes supporting the well being of society.

Family Bank was proud to support and be associated with the Diabetes Walk through a charity Golf Tournament. The Diabetes Walk is organized by the Kenya Diabetes Management and Information Centre to support the young people living with the disease to access medication and education.

Family Bank and the Heart to Heart Run

We also proudly supported and participated in the 2012 Heart to Heart Run. The bank sponsored fifteen staff members from various branches and departments to take part in the 2012 edition of the annual event organized by the Karen Hospital. The Heart Run is a major fundraiser for the Heart to Heart Foundation. We are happy to report that more than 50 children with heart diseases from disadvantaged families benefited from money collected in the 2012 run. The bank also supported another medical case involving Loreto Msongari School accident survivors, providing some funds towards offsetting the cost of the reconstructive surgery the children needed.

Director T K Muya presents cheque to SOS Children home in Meru

Support for Orphan and vulnerable Children

The plight of the poor and destitute children continues to be a major challenge for society. Through our Machakos branch, Family Bank donated food stuff to Kasinga Orphans Centre in Machakos. Teule Children Home in Oloitokok also benefitted as the Bank in 2012 provided some resources to support food provision to the underprivileged children.

Support for Environment Conservation

The well being of our environment is our collective responsibility. At Family Bank we believe in conducting our business in a manner that is environmentally responsible. In the year under review we took part in a number of environmental conservation activities in areas where our branches are located. Our teams across the country held tree planting effors. At the same time, through our Nairobi branches, we participated in and supported the UAP Ndakaini Half Marathon that has the objective of raising funds for the rehabilitating of the Ndakaini Dam water catchment area.

As the Bank continues to grow in assets and expand its branch network, its social programs continues to be felt and grow in impact. We remain committed to making social impact in areas and regions where we operate.

Ndakaini Dam water catchment area.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

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

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

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Chairman **Managing Director**

20 March 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF FAMILY BANK LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of Family Bank Limited and its subsidiary, set out on pages 12 to 65, which comprise the consolidated and bank statements of financial position as at 31 December 2012, and the consolidated and bank statements of comprehensive income, consolidated and bank statements of changes in equity and consolidated statements of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of financial affairs of the bank and its subsidiary as at 31 December 2012 and of their profits and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.

Report on Other Legal Requirements

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

1. 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;
2. in our opinion proper books of account have been kept by the bank, so far as appears from our examination of those books; and
3. the bank's statement of financial position (balance sheet) and statement of comprehensive income (profit and loss account) are in agreement with the books of account.

Deloitte & Touche

Certified Public Accountants (Kenya)

20 March 2013

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31ST DECEMBER 2012

	Note	Group 2012 Sh'000	Group 2011 Sh'000	Bank 2012 Sh'000	Bank 2011 Sh'000
INTEREST INCOME	6	4,775,721	2,844,462	4,775,721	2,844,462
INTEREST EXPENSE	7	(1,484,762)	(490,080)	(1,485,375)	(490,080)
NET INTEREST INCOME		3,290,959	2,354,382	3,290,346	2,354,382
Foreign exchange gain		51,147	30,623	51,147	30,623
Fee and commission income	8	1,309,072	1,331,918	1,309,072	1,331,918
Other income		78,024	49,118	40,383	49,118
OPERATING INCOME		4,729,202	3,766,041	4,690,948	3,766,041
Operating expenses	9	(3,215,656)	(2,906,303)	(3,202,436)	(2,906,303)
Impairment charge on loans and advances	17	(645,272)	(337,173)	(645,272)	(337,173)
PROFIT BEFORE TAXATION		868,274	522,565	843,240	522,565
TAXATION	11	(306,815)	(167,961)	(302,522)	(167,961)
PROFIT FOR THE YEAR		561,459	354,604	540,718	354,604
OTHER COMPREHENSIVE INCOME					
Gain on revaluation of properties		-	80,856	-	80,856
Deferred tax on revaluation surplus		-	(24,257)	-	(24,257)
Fair value gain/(loss) on available for sale financial assets	19	12	(286)	12	(286)
OTHER COMPREHENSIVE INCOME		12	56,313	12	56,313
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		561,471	410,917	540,730	410,917
EARNINGS PER SHARE		Sh	Sh	Sh	Sh
Basic and diluted	12	2.29	1.46	2.21	1.46

STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31ST DECEMBER 2012

	Note	Group 2012 Sh'000	Group 2011 Sh'000	Bank 2012 Sh'000	Bank 2011 Sh'000
ASSETS					
Cash and balances with Central Bank of Kenya	13	4,320,688	1,835,028	4,320,688	1,835,028
Balances due from banking institutions	14(a)	666,980	88,008	666,980	88,008
Government securities	15	4,343,973	4,485,023	4,343,973	4,485,023
Loans and advances to customers	16	17,868,745	16,332,359	17,868,745	16,332,359
Corporate bonds	18	681,452	705,990	681,452	705,990
Quoted investment	19	295	283	295	283
Other assets	20	928,621	436,316	924,294	436,316
Investment in subsidiary	21	-	-	1,000	-
Investment properties	22	94,000	71,400	94,000	71,400
Property and equipment	23	1,566,887	1,516,039	1,565,973	1,516,039
Intangible assets	24	345,896	354,897	345,896	354,897
Prepaid operating lease rentals	25	171,800	176,410	171,800	176,410
TOTAL ASSETS		30,989,337	26,001,753	30,985,096	26,001,753
LIABILITIES AND SHAREHOLDERS' FUNDS					
LIABILITIES					
Balances due to banking institutions	14(b)	-	150,000	-	150,000
Customer deposits	26	24,613,302	21,443,927	24,630,278	21,443,927
Taxation payable	11(c)	93,943	16,851	94,388	16,851
Borrowings	27	892,145	527,264	892,145	527,264
Other liabilities	28	483,687	513,135	482,766	513,135
Unclaimed dividends	29	1,475	983	1,475	983
Deferred tax liability	30	24,115	25,875	24,115	25,875
TOTAL LIABILITIES		26,108,667	22,678,035	26,125,167	22,678,035
SHAREHOLDERS' FUNDS					
Share capital	31	556,995	484,185	556,995	484,185
Share premium		2,663,938	1,644,429	2,663,938	1,644,429

STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31ST DECEMBER 2012 (CONTINUED)

	Group		Bank	
	2012	2011	2012	2011
	Sh'000	Sh'000	Sh'000	Sh'000
Revaluation surplus	83,222	85,314	83,222	85,314
Retained earnings	1,418,962	965,131	1,398,221	965,131
Statutory reserve	157,553	144,659	157,553	144,659
TOTAL SHAREHOLDERS' FUNDS	4,880,670	3,323,718	4,859,929	3,323,718
TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS	30,989,337	26,001,753	30,985,096	26,001,753

The financial statements on pages 12 to 65 were approved and authorised for issue by the Board of Directors on 20 March 2013 and were signed on its behalf by:

Chairman

Managing Director

Director

Company Secretary

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER 2012

	Share capital Sh'000	Share premium Sh'000	Revaluation surplus Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Total Sh'000
At 1 January 2011	484,185	1,644,429	30,304	760,065	90,655	3,009,638
Profit for the year	-	-	-	354,604	-	354,604
Other comprehensive income	-	-	56,313	-	-	56,313
Total comprehensive income	-	-	56,313	354,604	-	410,917
Dividend paid - 2010	-	-		(96,837)	-	(96,837)
Transfer to statutory reserve	-	-	-	(54,004)	54,004	
Transfer of excess depreciation	-	-	(1,861)	1,861	-	-
Deferred tax on excess depreciation			558	(558)	-	-
At 31 December 2011	484,185	1,644,429	85,314	965,131	144,659	3,323,718
At 1 January 2012	484,185	1,644,429	85,314	965,131	144,659	3,323,718
Profit for the year	-	-	-	561,459	-	561,459
Other comprehensive income	-	-	12	-	-	12
Total comprehensive income	-	-	12	561,459	-	561,471
Rights issue proceeds	72,810	1,019,509	-	-	-	1,092,319
Dividend paid - 2011	-	-	-	(96,838)	-	(96,838)
Transfer to statutory reserve	-	-	-	(12,894)	12,894	-
Transfer of excess depreciation	-	-	(3,005)	3,005	-	-
Deferred tax on excess depreciation			901	(901)	-	-
At 31 December 2012	556,995	2,663,938	83,222	1,418,962	157,553	4,880,670

BANK'S STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER 2012

	Share capital Sh'000	Share premium Sh'000	Revaluation surplus Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Total Sh'000
At 1 January 2011	484,185	1,644,429	30,304	760,065	90,655	3,009,638
Profit for the year	-	-	-	354,604	-	354,604
Other comprehensive income	-	-	56,313	-	-	56,313
Total comprehensive income	-	-	56,313	354,604	-	410,917
Dividend paid – 2010	-	-	-	(96,837)	-	(96,837)
Transfer to statutory reserve	-	-	-	(54,004)	54,004	-
Transfer of excess depreciation	-	-	(1,861)	1,861	-	-
Deferred tax on excess depreciation	-	-	558	(558)	-	-
At 31 December 2011	484,185	1,644,429	85,314	965,131	144,659	3,323,718
At 1 January 2012	484,185	1,644,429	85,314	965,131	144,659	3,323,718
Profit for the year	-	-	-	540,718	-	540,718
Other comprehensive income	-	-	12	-	-	12
Total comprehensive income	-	-	12	540,718	-	540,730
Rights issue proceeds	72,810	1,019,509	-	-	-	1,092,319
Dividend paid – 2011	-	-	-	(96,838)	-	(96,838)
Transfer to statutory reserve	-	-	-	(12,894)	12,894	-
Transfer of excess depreciation	-	-	(3,005)	3,005	-	-
Deferred tax on excess depreciation	-	-	901	(901)	-	-
At 31 December 2012	556,995	2,663,938	83,222	1,398,221	157,553	4,859,929

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31ST DECEMBER 2012

	Note	2012 Sh'000	2011 Sh'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash generated from operations	32(a)	1,950,237	1,001,898
Taxation paid	11(c)	(231,483)	(188,801)
Net cash generated from operating activities		1,718,754	813,097
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment	23	(348,162)	(713,731)
Proceeds on sale of property and equipment		12,217	1,578
Purchase of intangible assets	24	(95,907)	(272,062)
Purchase leasehold land	25	-	(138,515)
Net cash used in investing activities		(431,852)	(1,122,730)
CASH FLOWS FROM FINANCING ACTIVITIES			
Borrowings received	27	645,748	198,944
Repayment of borrowings	27	(280,868)	(144,652)
Dividends paid	29	(96,766)	(97,988)
Proceeds from issue of shares	31	1,092,319	-
Net cash generated from/(used in) financing activities		1,360,433	(43,696)
NET INCREASE IN CASH AND CASH EQUIVALENTS DURING THE YEAR		2,647,335	(353,329)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR		1,047,244	1,400,573
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	32(b)	3,694,579	1,047,244
		=======	=======

1. REPORTING ENTITY

Family Bank Limited (The "bank") together with its subsidiary ("the group") provides commercial banking services. Family bank Limited and its subsidiary Dhamana Insurance Agency Limited are both incorporated in Kenya under the Companies Act and is domiciled in Kenya.

The address of its registered office is as follows:
Family Bank Limited
Family Bank Towers, 6th Floor, Muindi Mbingu Street
P O Box 74145, 00200 Nairobi

2. ACCOUNTING POLICIES

Statement of compliance

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

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

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

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

(i) New standards and amendments to published standards effective for the year ended 31 December 2012

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

Amendments to IFRS 7 Disclosures – Transfers of Financial Assets	The amendments to IFRS 7 increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures of transactions where a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The application of the amendment had no effect on the group's financial statements as the group did not transfer any such financial assets during the year.

IAS 12 Deferred Tax: Recovery of Underlying Assets	The amendments to IAS 12 provide an exception to the general principle set out in IAS 12 Income Taxes that the measurement of deferred tax should reflect the manner in which an entity expects to recover the carrying amount of an asset. Specifically, the amendments establish a rebuttable presumption that the carrying amount of an investment property measured using the fair value model in IAS 40 Investment Property will be recovered entirely through sale. The amendments were issued in response to concerns that application of IAS 12's general approach can be difficult or subjective for investment property measured at fair value because it may be that the entity intends to hold the asset for an indefinite or indeterminate period of time, during which it anticipates both rental income and capital appreciation. The application of the amendments has had the effect of reversing deferred tax previously charged on fair value gains on the group's investment properties.

2 ACCOUNTING POLICIES (Continued)

Standards and interpretations affecting the reported result or financial position

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

(i) New standards and amendments to published standards effective for the year ended 31 December 2012 (Continued)

Amendments to IFRS 1 Severe Hyperinflation	The amendments regarding severe hyperinflation provide guidance for entities emerging from severe hyperinflation either to resume presenting IFRS financial statements or to present IFRS financial statements for the first time The amendments had not effect on the group's financial statements as the group did not trade in such hyperinflation environment.

(ii) New and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2012

	Effective for annual periods beginning on or after
IFRS 7, Amendments-Disclosure: offsetting financial assets and financial liabilities	1 January 2013
IFRS 9 Financial Instruments (as revised in 2010)	1 January 2015
IFRS 10 Consolidated Financial Statements	1 January 2013
IFRS 11, Joint Arrangements	1 January 2013
IFRS 12, Disclosure of Interests in Other Entities	1 January 2013
IFRS 13, Fair Value Measurement	1 January 2013
IAS 19, Employee Benefits (2011) - Revised requirements for pensions and other post retirement benefits, termination benefits and other changes.	1 January 2013
IAS 27, Separate Financial Statements (as revised in 2011)	1 January 2013
IAS 28, Investments in Associates and Joint Ventures	1 January 2013
IAS 32, Financial Instruments: Presentation – Amendments to application guidance on the offsetting of financial assets and financial liabilities	1 January 2014
IFRIC 20, Stripping costs in the production phase of a surface mine	1 January 2013

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2012 and future annual periods

- **IFRS 9, Financial Instruments**

IFRS 9 Financial Instruments issued in November 2010 and amended in October 2010 and December 2011 introduces new requirements for the classification and measurement of financial assets.

IFRS 9 requires all recognised financial assets that are within the scope of IAS 39 Financial Instruments Recognition and Measurement to be subsequently measured at amortised cost or fair value. Specifically debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods.

2 ACCOUNTING POLICIES (Continued)

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

iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2012 and future annual periods (Continued)

- **IFRS 9, Financial Instruments (Continued)**

The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was recognised in profit or loss.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015, with earlier application permitted.

The directors anticipate that IFRS 9 will be adopted in the group's financial statements for the annual period beginning 1 January 2015 and that the application of IFRS 9 may have a significant impact on amounts reported in respect of the group's financial assets and financial liabilities (e.g the group will classify financial assets as subsequently measured at either amortised cost or fair value). However, it is not practicable to provide a reasonable estimate of that effect until a detailed review is done.

- **IFRS 10, Consolidated Financial Statements**

IFRS 10 requires a parent to present consolidated financial statements as those of a single economic entity, replacing the requirements previously contained in IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation - Special Purpose Entities'.

The standard identifies the principles of control, determines how to identify whether an investor controls an investee and therefore must consolidate the investee, and sets out the principles for the preparation of consolidated financial statements. The Standard introduces a single consolidation model for all entities based on control, irrespective of the nature of the investee (i.e. whether an entity is controlled through voting rights of investors or through other contractual arrangements as is common in 'special purpose entities'). Under IFRS 10, control is based on whether an investor has:

- power over the investee
- exposure, or rights, to variable returns from its involvement with the investee, and
- the ability to use its power over the investee to affect the amount of the returns.

The standard is effective for annual periods beginning on or after 1 January 2013. The group will apply this amendment prospectively. The directors anticipate no material impact to the group's financial statements.

- **IFRS 11, Joint Arrangements**

IFRS 11 replaces IAS 31 'Interests in Joint Ventures'. It requires a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and then account for those rights and obligations in accordance with that type of joint arrangement.

2 ACCOUNTING POLICIES (Continued)

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

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2012 and future annual periods (Continued)

• IFRS 11, Joint Arrangements (Continued)

Joint arrangements are either joint operations or joint ventures:

- A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint operators recognise their assets, liabilities, revenue and expenses in relation to its interest in a joint operation (including their share of any such items arising jointly)
- A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (joint venturers) have rights to the net assets of the arrangement. A joint venturer applies the equity method of accounting for its investment in a joint venture in accordance with IAS 28 'Investments in Associates and Joint Ventures (2012)'. Unlike IAS 31, the use of 'proportionate consolidation' to account for joint ventures is not permitted.

The standard is effective for annual periods beginning on or after 1 January 2013. The group will apply this amendment prospectively. The directors anticipate no material impact to the group's financial statements currently. However, the group would have to apply this standard to any such arrangements entered in the course of its expansion strategy.

• IFRS 12, Disclosure of Interests in Other Entities

IFRS 12 requires the extensive disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.

In high-level terms, the required disclosures are grouped into the following broad categories:

- Significant judgements and assumptions - such as how control, joint control, significant influence has been determined

- Interests in subsidiaries - including details of the structure of the group, risks associated with structured entities, changes in control, and so on

- Interests in joint arrangements and associates - the nature, extent and financial effects of interests in joint arrangements and associates (including names, details and summarised financial information)
- Interests in unconsolidated structured entities - information to allow an understanding of the nature and extent of interests in unconsolidated structured entities and to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities

- IFRS 12 lists specific examples and additional disclosures which further expand upon each of these disclosure objectives, and includes other guidance on the extensive disclosures required.

The adoption of IFRS 12 in the group's financial statements for the annual period beginning 1 January 2013 and that the application of the new standard would result in more extensive disclosures in the financial statements.

2 ACCOUNTING POLICIES (Continued)

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

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 30 December 2012 and future annual periods (Continued)

- **IFRS 13, Fair Value Measurements**

IFRS 13 replaces the guidance on fair value measurement in existing IFRS accounting literature with a single standard. The IFRS is the result of joint efforts by the IASB and FASB to develop a converged fair value framework. The IFRS defines fair value, provides guidance on how to determine fair value and requires disclosures about fair value measurements. However, IFRS 13 does not change the requirements regarding which items should be measured or disclosed at fair value.

IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements).

With some exceptions, the standard requires entities to classify these measurements into a 'fair value hierarchy' based on the nature of the inputs:

- Level 1 - quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 - inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly;
- Level 3 - unobservable inputs for the asset or liability.

The scope of IFRS 13 is broad; it applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except in specified circumstances. In general, the disclosure requirements in IFRS 13 are more extensive than those required in the current standards. For example, quantitative and qualitative disclosures based on the three-level fair value hierarchy currently required for financial instruments only under IFRS 7 Financial Instruments: Disclosures will be extended by IFRS 13 to cover all assets and liabilities within its scope.

The directors anticipate that the application of the new Standard may affect the amounts reported in the financial statements and result in more extensive disclosures in the financial statements, however, the group is yet to assess IFRS 13's full impact and intends to adopt the standard no later than the accounting period beginning on or after 1 January 2013.

- **Disclosures — Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)**

Amends the disclosure requirements in IFRS 7 Financial Instruments: Disclosure to require information about all recognised financial instruments that are set off in accordance with paragraph 42 of IAS 32 Financial Instruments: Presentation.

The amendments also require disclosure of information about recognised financial instruments subject to enforceable master netting arrangements and similar agreements even if they are not set off under IAS 32. The IASB believes that these disclosures will allow financial statement users to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position.

The amendments to IFRS 7 are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The director's anticipate that the application of these amendments to IFRS 7 may result in more disclosures being made with regard to offsetting financial assets and financial liabilities in the future.

2 ACCOUNTING POLICIES (Continued)

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

(iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 30 December 2012 and future annual periods (Continued)

• Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)

The amendments to IAS 1 introduce new terminology for the statement of comprehensive income and income statement. Under the amendments to IAS 1, the statement of comprehensive income is renamed as a statement of profit or loss and other comprehensive income and the income statement is renamed as a statement of profit or loss. The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require additional disclosures to be made in the other comprehensive income section such that items of other comprehensive income are grouped into two categories: (a) items that will not be reclassified subsequently to profit or loss; and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis – the amendments do not change the option to present items of other comprehensive income either before tax or net of tax.

The above amendments are generally effective for annual periods beginning on or after 1 July 2012. The group will apply the amendments prospectively. Other than presentation, the directors anticipate no material impact to the group's financial statements.

• Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)

Amends IAS 32 Financial Instruments: Presentation to clarify certain aspects because of diversity in application of the requirements on offsetting, focused on four main areas:

- the meaning of 'currently has a legally enforceable right of set-off'
- the application of simultaneous realisation and settlement
- the offsetting of collateral amounts
- the unit of account for applying the offsetting requirements.

The amendments to IAS 32 are not effective until annual periods beginning on or after 1 January 2014, with retrospective application required. The directors anticipate that the application of this amendment may result in more disclosures being made with regard to offsetting of financial assets and financial liabilities in the future. The group will apply the amendments prospectively.

• IAS 19, Employee Benefits (as revised in 2012)

The amendments to IAS 19 change the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets. The amendments require the recognition of changes in defined benefit obligations and in fair value of plan assets when they occur, and hence eliminate the 'corridor approach' permitted under the previous version of IAS 19 and accelerate the recognition of past service costs. The amendments require all actuarial gains and losses to be recognised immediately through other comprehensive income in order for the net pension asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus.

2 ACCOUNTING POLICIES (Continued)

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

Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 30 December 2012 and future annual periods (Continued)

- **IAS 19, Employee Benefits (as revised in 2012) (Continued)**

The amendments to IAS 19 are effective for annual periods beginning on or after 1 January 2013 and require retrospective application with certain exceptions.

The directors anticipate that the amendments to IAS 19 will have no effect on the group's financial statements for the annual period beginning 1 January 2013 since the group currently does not have a defined benefits plan for its employees.

- **IAS 27, Separate Financial Statements (2012)**

Amended version of IAS 27 which now only deals with the requirements for separate financial statements, which have been carried over largely unamended from IAS 27 Consolidated and Separate Financial Statements. Requirements for consolidated financial statements are now contained in IFRS 10 Consolidated Financial Statements.

The Standard requires that when an entity prepares separate financial statements, investments in subsidiaries, associates, and jointly controlled entities are accounted for either at cost, or in accordance with IFRS 9 Financial Instruments.

The Standard also deals with the recognition of dividends, certain group reorganisations and includes a number of disclosure requirements.

The standard is effective for annual periods beginning on or after 1 January 2013. The group will apply this amendment prospectively. The directors anticipate no material impact to the group's financial statements.

- **IAS 28, Investments in Associates and Joint Ventures (2012)**

This Standard supersedes IAS 28 Investments in Associates and prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

The Standard defines 'significant influence' and provides guidance on how the equity method of accounting is to be applied (including exemptions from applying the equity method in some cases). It also prescribes how investments in associates and joint ventures should be tested for impairment.

The standard is effective for annual periods beginning on or after 1 January 2013. The group will apply this amendment prospectively. The directors, however, anticipate no material impact to the group's financial statements.

(IV) Early adoption of standards

The group did not early-adopt new or amended standards in 2012.

2 ACCOUNTING POLICIES (Continued)

Basis of preparation

The financial statements have been prepared on the historical cost basis of accounting as modified to include the valuation of property and certain financial assets.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the bank and its subsidiary for the year ended 31 December, 2012. The bank's subsidiary is shown in note 21. Control is achieved where the company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Subsidiaries are those entities in which the group has power to exercise control over their operations. Subsidiaries are included in the consolidated financial statements from the date the group gains effective control. The acquisition method of accounting is used when subsidiaries are acquired by the group. The cost of an acquisition in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the consideration transferred by the group, liabilities incurred by the group to the former owners of the acquiree and the equity interests issued by the group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred. Entities controlled by the group are consolidated until the date that control ceases.

The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the group.

Intra-group balances and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

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 in the profit or loss 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 year. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability or when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

The calculation of the effective interest rate includes all fees and commissions paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Once a financial asset or 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 ACCOUNTING POLICIES (Continued)

Fees and commission income

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

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

Fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

Property and equipment

Property and equipment are stated at cost or as professionally revalued from time to time less accumulated depreciation and any accumulated impairment losses.

Any surplus arising on the revaluation is recognised in other comprehensive income and accumulated in the revaluation surplus. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and charged against the revaluation surplus; all other decreases are charged to profit or loss.

The group's policy is to professionally revalue property at least once every five years. The last valuation was done on 31 December 2011. The basis of valuation is as follows:

(a). Buildings – open market value
(b). Other assets – depreciated replacement cost

Depreciation

Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of each asset or the revalued amounts, to its residual values over its estimated useful life as follows:

Buildings	2.5%
Fixtures, fittings and equipment	12.5%
ATM Machines	16.7%
Motor vehicles	20%
Computers	20%

Freehold land is not depreciated as it is deemed to have an indefinite life.

The depreciation charge to profit and loss is based on the carrying amounts of the property and equipment. The excess of this charge over that based on the historical cost of the property and equipment is released each year from the revaluation surplus to retained earnings.

Leasehold land

Payments to acquire interests in leasehold land are treated as prepaid operating rentals. They are stated at historical cost and are amortised over the term of the related lease. When a lease includes land and buildings elements, the group assesses the classification of each element as either a finance lease or an operating lease. In determining classification of the land element, an important consideration is that land normally has an indefinite economic life. Therefore the finance lease or operating lease classification of the land is considered a critical area of judgment. See note 5 to these financial statements.

2 ACCOUNTING POLICIES (Continued)

Intangible assets - computer software costs

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

Expenditure which enhances and extends computer software programmes beyond their original specifications and lives is recognised as a capital improvement and added to the original costs of the software.

Computer software development costs recognised as assets are stated at cost less amortisation. Amortisation is calculated on a straight line basis over the estimated useful lives not exceeding a period of 3 years.

Impairment of non-financial assets

At the end of each reporting period, the group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated and an impairment loss is recognized in profit or loss whenever the carrying amount of the asset exceeds its recoverable amount. Previously recognised impairment losses may be reversed to the extent of the assets carrying amount.

Investment properties

Investment properties comprise land and buildings and parts of buildings held to earn rentals and/or for capital appreciation. They are carried at fair value, determined annually by external independent valuers. Fair value is based on active market prices as adjusted, if necessary, for any difference in the nature, condition or location of the specific asset.

Investment properties are not subject to depreciation. Gains and losses arising from changes in the fair value of investment property are included in profit or loss in the year in which they arise.

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

Foreign currencies

(i) Functional and presentation currency
The financial statements of the group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in Kenya Shillings, which is the group's functional and presentational currency. Except as indicated, financial information presented in Kenya Shillings has been rounded to the nearest thousand.

(ii) Transactions and balances
Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.

Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

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 through profit or loss.

2 ACCOUNTING POLICIES (Continued)

Taxation

Income tax expense represents the sum of the current tax payable and the deferred taxation.
Current taxation is provided on the basis of the results for the year, as shown in the financial statements, adjusted in accordance with tax legislation. Deferred taxation is provided 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. Currently enacted tax rates are used to determine deferred taxation.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the unused tax credits can be utilised.

Financial instruments

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

Financial assets

a) Classification and measurement

The group classifies its financial assets into the following IAS 39 categories: Financial assets at fair value through profit or loss; loans and receivables; held- to- maturity investments; and available-for-sale financial assets. Management determines the appropriate classification of its financial instruments at initial recognition, depending on the purpose and intention for which the financial instrument was acquired and their characteristics.

i) Due from banks and loans and advances to customers

Due from banks and loans, advances and receivables include non–derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are recognised when cash is advanced to borrowers.

After initial recognition, amounts 'Due from banks' and 'Loans to customers' are subsequently measured at amortised cost using the effective interest rates, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in 'Interest and similar income' in the profit and loss. The losses arising from impairment are recognised in profit or loss.

ii) Held-to-maturity financial assets

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the group has the positive intention and ability to hold to maturity.

Held to maturity financial assets are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost using the effective interest method less any impairment, with revenue recognised on an effective yield basis. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate and recognised in the profit or loss.

Where a sale occurs other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and classified as available for sale. Furthermore, the group would be prohibited from classifying any financial asset as held to maturity during the following two years.

2 ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

a) Classification and measurement (Continued)

iii) Available-for-sale financial assets

Available for sale investments are those 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 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 investments are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets which are recognised in profit or loss.

Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

Dividends on available for sale equity instruments are recognised in profit and loss when the group's right to receive the dividends is established.

b) Derecognition of financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired.
- the group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement; and either:
- the group has transferred substantially all the risks and rewards of the asset, or
- the group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the group has transferred its rights to receive cash flows from an asset or has entered into a pass–through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the group's continuing involvement in the asset. In that case, the group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the group could be required to repay.

2 ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

c) *Impairment and uncollectability of financial assets*

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

- Delinquency in contractual payments of principal and interest;
- Cash flow difficulties experienced by the borrower (for example, equity ratio, net income percentage of sales);
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Downgrading below investment grade level.

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

i) *Assets carried at amortised cost*

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

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 group's grading process that considers asset type, industry, geographical location, collateral types, 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.

2 ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

c) Impairment and uncollectability of financial assets (Continued)

i) Assets carried at amortised cost (continued)

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 exist currently.

When a loan is uncollectible it is written off against the related provisions for loan impairment. Such loans are written off after all the necessary recovery procedures have been completed and the amount of loan has been determined. Subsequent recoveries of amounts previously written off are recognised as gains in the profit and loss.

ii) Renegotiated loans

Where possible, the group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Financial liabilities and equity instruments issued by the group

a) Classification and measurement

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the group are recorded at the proceeds received, net of direct issue costs.

Financial liabilities

Financial liabilities are classified as either financial liabilities at fair value through profit or loss or other financial liabilities.

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

Financial liabilities are classified as at fair value through profit or loss when the financial liability is either held for trading or it is designated as at fair value through profit or loss.

Financial liabilities at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability.

2 ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial liabilities and equity instruments issued by the group (continued)

a) Classification and measurement (continued)

(ii) Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for the future premiums is recognised. Subsequent to initial recognition, the group's liabilities under such guarantees are measured at the higher of the initial amount, less amortisation of fees recognised in accordance with IAS 18, and the best estimate of the amount required to settle the guarantee. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of management. The fee income earned is recognised on a straight line basis over the life of the guarantee.

b) Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.The group derecognises financial liabilities when, and only when, the group's obligations are discharged, cancelled or they expire.

Offsetting

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

Provisions

A provision is recognised if, as a result of a past event, the group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

2 ACCOUNTING POLICIES (Continued)

Statutory reserve

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

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The group as lessor

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

The group as lessee

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Cash and cash equivalents

Cash and cash equivalents include cash in hand, unrestricted balances held with the Central Bank of Kenya and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the group in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Contingent liabilities

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

Fiduciary activities

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

Employee benefit costs

The group operates a defined contribution retirement benefit scheme for all its employees. The scheme is administered by an independent investment management company and is funded by contributions from both the group and employees.

The group also contributes to the statutory National Social Security Fund. This is a defined contribution scheme registered under the National Social Security Fund Act. The obligations under the scheme are limited to specific contributions legislated from time to time. These are presently a maximum of Sh 200 per month for each employee.

The group's contributions in respect of retirement benefit costs are charged to the profit and loss in the period to which they relate.

Employee entitlement to leave not taken is charged to profit or loss as it accrues.

2 ACCOUNTING POLICIES (Continued)

Sale and repurchase agreements

Securities sold to the Central Bank of Kenya subject to repurchase agreements ('repos') are retained in the financial statements under government securities and the counterparty liability is included in advances from Central bank of Kenya. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Comparatives

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

3 CRITICAL JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the group's accounting policies, which are described in note 1, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

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

(i) Critical judgements in applying the group's accounting policies

The following are the critical judgements, apart from those involving estimations (see (ii) overleaf), that management have made in the process of applying the group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Impairment losses on loans and receivables

The group reviews its loan portfolios to assess impairment regularly. In determining whether an impairment loss should be recorded in the profit and loss, the group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio.

This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a 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.

Impairment of available-for-sale investments

The group reviews its debt securities classified as available–for–sale investments at each reporting date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances.

3 CRITICAL JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (Continued)

(i) Critical judgements in applying the group's accounting policies (continued)

Impairment of available-for-sale investments (continued)

The group also records impairment charges on available–for–sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgment. In making this judgment, the group evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Held -to-maturity investments

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

Classification of leases of land and buildings as finance or operating leases

At the inception of each lease of land or building, the group considers the substance rather than the form of the lease contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- The lease transfers ownership of the asset to the lessee by the end of the lease term;
- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- The leased assets are of such a specialised nature that only the lessee can use them without major modifications.

The group also considers indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease. Examples of such indicators include:

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

(ii) Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period.

Property, equipment and intangible assets

Critical estimates are made by management in determining depreciation rates for property, equipment and intangible assets.

4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The group defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors. The group aims to achieve an appropriate balance between risk and return and minimise the potential adverse effects of the group's financial performance.

The most important type of risks to which the group is exposed to are financial risks which include:

- Credit risk
- Liquidity risk
- Market risks

Risk management framework

The board of directors has overall responsibility for the establishment and oversight of the group's risk management framework. The board has established a risk management committee comprising of two non-executive directors to assist in the discharge of this responsibility. The board has also established the group Asset and Liability (ALCO), Credit Committee and Risk and Compliance Committees, which are responsible for developing and monitoring risk management policies in their specified areas. With the exception of the ALCO which is a Management Committee, these committees comprise of both non-executive and executive members and report regularly to the board of directors on their activities.

The board provides written principles for overall risk management as well as written policies covering specific risk areas. The group's risk management policies are established to identify and analyse the risks faced by the group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and best market practices. The group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Risk and Compliance Committee is responsible for monitoring compliance with the group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the group. This committee is assisted in these functions by the Assurance Function. The Assurance Function undertakes reviews of risk management controls and procedures, the results of which are reported to the committee.

(a) Credit risk

Credit risk is the risk of financial loss to the group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the group's loans and advances to customers and other banks and investment securities but can also arise from credit enhancement provided such as financial guarantees, letters of credit and acceptances. The group is also exposed to other credit risks arising from its trading activities including derivatives.

Credit risk is the single largest risk for the group's business and management carefully manages its exposure to credit risk. For risk management reporting purposes, the group considers and consolidates all elements of credit risk exposure.

For risk management purposes, credit risk arising on trading securities is managed independently, but reported as a component of market risk exposure.

Management of credit risk

The board of directors has delegated responsibility for the oversight of credit risk to its credit committee comprising of three. non-executive directors and two executive directors. The implementation of the credit risk policies and monitoring of the credit portfolio to ensure that risks are managed within acceptable standards is the responsibility of the credit committee comprising of executive management.

4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(a) Credit risk (Continued)

The committee assisted by the credit department is responsible for the management of the group's credit risk including:

Management of credit risk (Continued)

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are delegated to the head of credit and the credit committee while larger facilities require approval by the board of directors.
- Limiting concentrations of exposure to counterparties, geographies and industries for loans and advances.
- Developing and maintaining the group's risk gradings in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of eight grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Risk grades are subject to regular reviews by credit department.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to the group credit committee on the credit quality of local portfolios and appropriate corrective action is taken.
- Providing advice, guidance and specialist skills to branches to promote best practice throughout the group in the management of credit risk.

Credit risk measurement

In measuring credit risk of loans and advances to customers, the group takes into account the following factors:

- The probability of default: this is the possibility of the customer failure to pay over the stipulated period in the contract.
- Current exposure on the borrower and the likely future development from which the group derives the exposure at default
- Estimated recovery ratio should default occur; this is the amount that can be recovered through sale of collateral

The group assesses the probability of default of individual borrowers using internal rating methods tailored to the various categories of the borrower. In assessing the credit quality of the customer the group takes into account the customers financial position, past experience and other industry specific factors. The credit risk measurements are embedded in the group's daily operational management and closely aligned to the Central Bank of Kenya loan classifications. The impairment allowances on loans and advances computed through the group's internal measures and the Central Bank of Kenya prudential guidelines are contrasted with the measurement of impairment under the IAS 39.

Risk limit control and mitigation policies

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

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing limits where appropriate.

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(a) Credit risk (Continued)
Risk limit control and mitigation policies (Continued)

The group takes security for funds advances and implements guidelines on the acceptability of specific classes of collateral. To minimise credit loss the group will seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances. Collateral held for other financial assets other than loans and advances depends on the nature of the instrument.

The primary purpose of acceptances, letters of credit and guarantees is to ensure funds are available to a customer as required. Guarantees and standby letters of credit carry the same risk as loans. Documentary and commercial letters of credit which are written undertakings by the group on behalf of a customer authorising a third party to draw drafts on the group up to a stipulated amount under specific terms and conditions are collateralised by the underlying goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorisation to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the group 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 group has no significant concentration of credit risk, with exposure spread over a diversity of personal and commercial customers.

Maximum exposure to credit risk before collateral held

	2012 Sh'000	%	2011 Sh'000	%
Credit Exposures				
On – balance sheet items				
Balances with Central Bank of Kenya	2,555,566	10	725,792	3
Balances due from other banking institutions	666,980	2	88,008	<1
Government securities	4,343,973	16	4,485,023	20
Loans and advances to customers	17,868,745	67	16,332,359	72
Corporate bonds	681,452	3	705,990	3
	26,116,716	98	22,337,172	98
Off-balance sheet items				
Guarantees	648,659	2	419,719	2
	26,765,375	100	22,756,891	100

The above represents the worst case scenario of credit exposure for 31 December 2012 and 31 December 2011, without taking into account any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures, set out above are based on net carrying amount as reported on the statement of financial position.

Loans and advances to customers comprise of 67 % (2011 - 72 %) of the total maximum exposure.

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(a) Credit risk (Continued)

Maximum exposure to credit risk before collateral held (Continued)

While collateral is an important mitigant to credit risk, the group's policy is to establish that loans are within the capacity of the customer to repay, as the primary way out. The group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

The group is confident that its policies and procedures provide sufficient safeguards against exposure on credit risk as shown on the table overleaf.

Classification of loans and advances

Loans and advances to customers

	2012 Sh'000	2011 Sh'000
Carrying amount		
Individually impaired		
Grade 6: Impaired (substandard)	570,573	610,566
Grade 7: Impaired (doubtful)	848,017	353,361
Grade 8: Impaired (loss)	1,027,301	860,665
Gross amount	2,445,891	1,824,592
Allowance for impairment	(1,558,250)	(1,095,508)
Carrying amount	887,642	729,083
Collectively impaired (Past due but not impaired)		
Grade 4-5: Watch list	1,263,733	1,172,558
Allowance for impairment	(37,912)	(35,177)
Carrying amount	1,225,821	1,137,381
Neither past due nor impaired		
Grade 1-3: Normal	15,755,282	14,465,894
Total carrying amount	17,868,745	16,332,359

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

Loans and advances neither past due nor impaired

The group classifies loans and advances under this category for those exposures that are up to date and in line with contractual agreements. These exposures will normally be maintained within approved product programs and with no signs of impairment or distress. These exposures are categorised internally as grade 1-3, that is, normal accounts in line with CBK prudential guidelines and a provision of 1 % is made and appropriated from revenue reserves to statutory reserves.

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(a) Credit risk (Continued)

Loans and advances past due but not impaired loans

Loans where the contractual interest or principal payments are past due but the group believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the group are classified as past due but not impaired. These exposures are graded internally as category 4-5 that is watch accounts in the group's internal credit risk grading system, in line with CBK guidelines.

Allowances for impairment

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

The internal credit risk grading system which is in line with CBK prudential guidelines focus on expected credit losses – that is taking into account the risk of future events giving rise to losses. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the date of the statement of financial position based on objective evidence of impairment. Due to the different methodologies applied, the amount of incurred credit losses provided for in the statement of comprehensive income is usually lower than the amount determined from the expected loss model that is used for internal operational management and banking regulation purposes.

Write-off policy

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

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

Settlement risk

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

Settlement limits form part of the credit approval/limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from bank Risk.

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(a) Credit risk (Continued)

Concentration of risk

Details of significant concentrations of the group's assets, liabilities and off balance sheet items by industry groups are as detailed below:

	2012 Sh'000	%	2011 Sh'000	%
(i) Advances to customers				
Manufacturing	161,755	1	309,106	2
Wholesale and retail	5,959,926	30	5,549,327	32
Transport and communication	1,045,503	5	925,540	5
Agricultural	527,379	3	397,079	2
Business services	739,206	4	254,650	1
Other	11,210,122	57	9,959,758	57
	19,643,891	100	17,395,460	100
(ii) Customer deposits				
Central and local Government	119,252	<1	99,486	1
Co-operative societies	181,122	1	142,066	1
Insurance companies	95,720	<1	76,514	-
Private enterprises & individuals	24,172,932	98	21,079,528	98
Non-profit institutions	61,252	<1	46,333	-
	24,630,278	100	21,443,927	100
(iii) Off balance sheet items (letters of credit and guarantees)				
Trading	648,659	100	419,719	100%

(b) Liquidity risk

Liquidity risk is the risk that the group will encounter difficulty in meeting obligations from its financial liabilities when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments or other cash outflows.

Management of liquidity risk

The group's liquidity risk management is carried out within the group and monitored by the Asset Liability committee (ALCO).

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

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(b) Liquidity risk (continued)

Management of liquidity risk (continued)

Liquidity risk is addressed through the following measures:

- The treasury department monitors liquidity ratios on a daily basis against internal and regulatory requirements
- Day to day funding is managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers.
- The group invests in short term liquid instruments which can easily be sold in the market when the need arises.
- The group enters into lending contracts subject to availability of funds.
- The group has an aggressive strategy aimed at increasing the customer deposit base.
- The group borrows from the market through inter bank transactions with other banks and The Central Bank of Kenya for short term liquidity requirements.
- Investments in property and equipment are properly budgeted for and done when the group has sufficient cash flows.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by the board. Daily reports covering the liquidity position of the group are regularly submitted to Asset and Liability Committee.

Exposure to liquidity risk

The key measure used by the group for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. The Central Bank of Kenya minimum liquidity ratio is 20%. Details of the reported group ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2012	2011
At 31 December	39%	28%
Average for the year	34%	34%
Maximum for the year	40%	43%
Minimum for the year	28%	26%
	===	===

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(b) Liquidity risk (continued)

Liquidity risk based on undiscounted cash flows

The table below analyses the cash flows payable by the group under non-derivative financial liabilities by remaining contractual maturities and non-derivative financial assets by expected maturity dates as at the date of the statement of financial position.

31 December 2012	Up to 1 month Sh'000	1 – 3 months Sh'000	4 - 12 months Sh'000	1 – 5 years Sh'000	Over 5 years Sh'000	Total Sh'000
Financial assets						
Cash in hand	1,765,122	-	-	-	-	1,765,122
Balances with Central Bank of						
Kenya – cash rato	881,624	167,128	162,583	81,754	-	1,293,089
- other	1,262,477	-	-	-	-	1,262,477
Balances due from banking institutions	666,980	-	-	-	-	666,980
Government securities	-	30,667	45,050	486,612	4,305,432	4,867,761
Loans and advances to customers	2,744,476	559,023	3,091,000	9,565,188	5,676,214	21,635,901
Corporate bonds	-	-	22,221	560,000	181,006	763,227
Other assets	280,253	-	-	-	-	280,253
Total financial assets	7,600,932	756,818	3,320,854	10,693,554	10,162,651	32,534,810
Financial liabilities						
Customer deposits	17,968,337	3,406,238	3,313,601	1,666,221	-	26,354,397
Borrowings	-	28,928	161,412	614,648	122,842	927,831
Other payables	-	-	139,622	-	-	139,622
Total financial liabilities	17,968,337	3,435,166	3,614,635	2,280,869	122,842	27,421,850
Net liquidity gap	(10,367,405)	(2,678,348)	(293,781)	8,412,685	10,039,809	5,112,960
As at 31 December 2011						
Total financial assets	2,976,590	566,344	2,127,177	15,453,103	7,224,162	28,347,376
Total financial liabilities	15,778,382	1,649,666	3,886,838	1,210,853	120,008	22,645,747
Net liquidity gap	(12,801,792)	(1,083,322)	(1,759,661)	14,242,250	7,104,154	5,701,629

The above table shows the undiscounted cash flows on the group's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The group's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognised loan commitments are not all expected to be drawn down immediately.

(c) Market risks

Market risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk arise from open positions in interest rates, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, equity prices, foreign exchange rates and credit spreads. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(c) Market risks (continued)

The group separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market-making transactions where the group acts as principal with clients or with the market. Non-trading portfolios mainly arise from the interest rate management of the entity's retail and commercial banking assets and liabilities.

Management of market risks

Overall responsibility of managing market risk rests with the Asset and Liability 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 review of their implementation. The board of directors sets limits on the level of mismatch of interest rate repricing that may be undertaken which is monitored daily.

(i) Interest rate risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. The ALCO is the monitoring body for compliance with these limits and is assisted by Treasury Department in its day-to-day monitoring activities.

The table below summarises the group's exposures to interest rate risks. Included in the table are the group's assets and liabilities at carrying amounts, categorised by the earlier of the contractual repricing or maturity dates. The group does not bear an interest rate risk on off balance sheet items.

31 December 2012	Up to 1 month Sh'000	1 – 3 months Sh'000	4 – 12 months Sh'000	1-5 years Sh'000	Over 5 years Sh'000	Non-interest bearing Sh'000	Total Sh'000
Financial assets							
Cash in hand	-	-	-	-	-	1,765,122	1,765,122
Balances with Central Bank of Kenya	-	-	-	-	-	2,555,566	2,555,566
Balances due from banking institutions	-	-	27,660	-	-	639,320	666,980
Government securities	-	-	-	438,034	3,875,625	-	4,313,659
Loans and advances to customers	2,268,162	462,003	2,554,546	7,905,114	4,691,086	-	17,880,910
Corporate bonds	-	-	-	500,000	161,613	-	661,613
	2,268,162	462,003	2,582,206	8,843,148	8,728,323	4,960,008	27,843,849
Financial liabilities							
Customer deposits	-	3,183,400	3,096,824	1,557,216	-	16,792,838	24,630,278
Borrowings	-	27,815	155,204	591,008	118,118	-	892,145
	-	3,211,215	3,252,028	2,148,224	118,118	16,792,838	25,522,423
Interest sensitivity gap	2,268,162	(2,749,212)	(669,822)	6,694,924	8,610,206	(11,832,830)	2,321,427

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(c) Market risks (continued)

(i) Interest rate risk (Continued)

	Up to 1 month Sh'000	1 – 3 months Sh'000	4 - 12 months Sh'000	1 - 5 years Sh'000	Over 5 years Sh'000	Non interest bearing Sh'000	Total Sh'000
31 December 2011							
Total financial assets	608,510	461,169	1,703,104	12,445,203	6,307,154	1,921,268	23,446,408
Total financial liabilities	150,448	57,815	7,503,467	766,477	114,655	13,528,329	22,121,191
Interest rate sensitivity gap	458,062	403,354	(5,800,363)	11,678,726	6,192,499	(11,607,061)	1,325,217

(ii) Currency Risk

The group 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.

As at 31 December 2012	KSH Sh'000	USD Sh'000	GBP Sh'000	EURO Sh'000	TOTAL Sh'000
Financial assets					
Deposits and balances due from banking institutions	580,158	21,893	38,952	25,977	666,980
Financial liabilities	-	-	-	-	-
Sensitivity gap	580,158	21,893	38,952	25,977	666,980
As at 31 December 2011					
Financial assets					
Deposits and balances due from banking institutions	778,129	555	5,698	29,417	813,799
Financial liabilities	-	-	-	-	-
Sensitivity gap	778,129	555	5,698	29,417	813,799

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(c) Market risks (continued)

Market Risks - Sensitivity Analysis

A principal part of the group's management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling) and the sensitivity of future earnings and capital to varying foreign exchange rates. Stress tests provide an indication of the potential size of losses that could arise in extreme conditions. The group aims, through its management of market risk, to mitigate the impact of prospective interest rate movements and foreign exchange fluctuations which could reduce future earnings and capital.

For simulation modelling, the group uses a combination of scenarios relevant to local businesses and local markets. These scenarios are used to illustrate the effect on the group's earnings and capital.

Interest Rate Risks – Increase / Decrease of 10% in Net Interest Margin

The Interest Rate Risks sensitivity analysis is based on the following assumptions.

- Changes in the market interest rates affect the interest income or expenses of variable interest financial instruments.
- Changes in Market interest rates only affect interest income or expenses in relation to financial instruments with fixed interest rates if these are recognized at their fair value.
- The interest rate changes will have a significant effect on interest sensitive assets and liabilities and hence simulation modelling is applied to Net interest margins.
- The interest rates of all maturities move by the same amount and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged.
- The projections make other assumptions including that all positions run to maturity.

The table below sets out the impact on future net interest income of an incremental 10% parallel fall or rise in all yield curves at the beginning of each quarter during the 12 months from 1 January 2012.

	31 December 2012	Scenario 1 10% appreciation	Scenario 2 10% Depreciation
	Sh'000	Sh'000	Sh'000
Profit Before Tax	843,240	927,563	758,916
Adjusted Core Capital	4,860,657	5,346,723	4,374,592
Adjusted Total Capital	5,027,042	5,529,747	4,524,338
Risk Weighted Assets (RWA)	21,363,243	21,363,243	21,363,243
Adjusted Core Capital to RWA	23%	25%	20%
Adjusted total Capital to RWA	24%	26%	21%

Assuming no management actions, a series of such appreciation would increase net interest income by Sh 329,096,000 (2011 - Sh 235,438,000), while a series of such falls would decrease net interest income by Sh 329,096,000 (2011 - Sh 235,438,000).

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(c) Market risks (continued)

Foreign Exchange Risks – Appreciation/Depreciation of Kshs against other currencies by 10%

The Foreign Exchange Risks sensitivity analysis is based on the following assumptions;

- Foreign exchange exposures represent net currency positions of all currencies other than Kenya Shillings.
- The Currency Risk sensitivity analysis is based on the assumption that all net currency positions are highly effective.
- The Base currency in which the group's business is transacted is Kenya Shillings.

The table below sets out the impact on future earnings of an incremental 10% parallel fall or rise in all foreign currencies at the beginning of each quarter during the 12 months from 1 January 2012.

Assuming no management actions, a series of such rise and fall would impact the future earnings and capital as illustrated in the table below;

	31 December 2012 Sh'000	Scenario 1 10% appreciation Sh'000	Scenario 2 10% Depreciation Sh'000
Profit Before Tax	843,240	927,563	758,916
Adjusted Core Capital	4,860,657	5,346,723	4,374,592
Adjusted Total Capital	5,027,042	5,529,747	4,524,338
Risk Weighted Assets (RWA)	21,363,243	21,363,243	21,363,243
Adjusted Core Capital to RWA	23%	25%	20%
Adjusted total Capital to RWA	24%	26%	21%

Assuming no management actions, a series of such appreciation would increase earnings by Sh 5,114,700 (2011 - Sh 3,062,300), while a series of such falls would decrease net interest income by Sh 5,114,700 (2011 - Sh 3,062,300)

(d) Fair value of financial assets and liabilities

(i) Financial instruments not measured at fair value

Disclosures of fair value of financial instruments not measured at fair value have not been made because the financial instruments carrying amounts is a reasonable approximation of their fair values.

(ii) Fair Value hierarchy

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

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as a price) or indirectly (i.e. derived from prices);and
- 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).

4 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

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

(ii) Fair Value hierarchy (Continued)

	Note	Level 1 Shs'000	Level 2 Shs'000	Level 3 Shs'000	Total Shs'000
31 December 2012					
Available for sale financial assets					
Investment in quoted shares		295	-	-	295
		=====	======	======	======
31 December 2011					
Available for sale financial assets					
Investment in quoted shares		283	-	-	283
		======	======	======	======

There were no transfers between levels 1, 2 and 3 in the year.

5 CAPITAL MANAGEMENT

Regulatory capital

The group's objectives when managing capital are:

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

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

The Central Bank of Kenya requires each bank to:

a) Hold the minimum level of regulatory capital of Shs 1 billion.
b) Maintain a ratio of total regulatory capital; to risk weighted assets plus risk weighted off balance assets at above the required minimum of 8%;
c) Maintain a core capital of not less than 8% of total deposit liabilities and
d) Maintain total capital of not less than 12% of risk weighted assets plus risk weighted off balance sheet items.

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

The group and its individually regulated operations have complied with all externally imposed capital requirements throughout the year.

5 CAPITAL MANAGEMENT (Continued)

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

- Tier 1 capital, which includes ordinary share capital, non cumulative irredeemable non convertible preference shares, disclosed reserves such as share premiums, retained earnings, and 50% un-audited after tax profit less investment in subsidiaries conducting banking business, investments in equity of other institutions, intangible assets (excluding computer software) and goodwill.
- Tier 2 capital, which includes 25% revaluation surplus which have received prior CBK approval, subordinated debt, hybrid capital instruments or any other capital instruments approved by CBK.

The group's regulatory capital position at 31 December 2012 was as follows:

	2012 Sh'000	2011 Sh'000
Tier 1 capital		
Share capital	566,995	484,185
Share premium	2,663,938	1,644,429
Retained earnings	1,418,962	965,131
Total	4,649,895	3,093,745
Tier 2 capital		
Revaluation reserves (25%)	21,332	21,329
General loan loss provision (statutory reserve)	157,553	144,659
Total	178,885	165,988
Total regulatory capital	**4,828,780**	**3,259,733**
Risk-weighted assets	21,363,243	18,621,841

Capital ratios

	2012	2011
Totalregulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum 12%)	22.60%	17.50%
Total tier 1 capital expressed as a percentage of risk-weighted assets (CBK minimum 8%)	21.77%	16.61%

		Group 2012 Sh'000	2011 Sh'000	Bank 2012 Sh'000	2011 Sh'000
6	***INTEREST INCOME***				
	Interest on loans and advances	4,213,735	2,366,232	4,213,735	2,366,232
	Interest on bank placements	65,473	6,181	65,473	6,181
	Interest on held to maturity assets:				
	- Government securities	413,885	391,846	413,885	391,846
	- Corporate bonds	82,628	80,203	82,628	80,203
		4,775,721	2,844,462	4,775,721	2,844,462
7	***INTEREST EXPENSE***				
	Interest on customer deposits	1,336,647	377,907	1,337,260	377,907
	Interest on balances due to banks	77,691	80,411	77,691	80,411
	Interest on borrowings	70,424	31,762	70,424	31,762
		1,484,762	490,080	1,485,375	490,080
8	***FEE AND COMMISSION INCOME***				
	Transaction related fees	893,315	791,730	893,322	791,730
	Credit related fees and commissions	342,125	484,445	342,125	484,445
	Ledger related fees and commissions	73,625	55,743	73,625	55,743
		1,309,072	1,331,918	1,309,072	1,331,918
9	***OPERATING EXPENSES***				
	Staff costs (note 10)	1,357,854	1,112,935	1,346,083	1,112,935
	Directors' emoluments - Fees	22,250	21,198	22,250	21,198
	- Other	66,500	59,519	66,500	59,519
	Depreciation – property, plant and equipment	284,339	282,453	284,130	282,453
	Amortisation of intangible assets	104,908	74,793	104,908	74,793
	Contribution to Deposit Protection Fund	27,531	19,181	27,531	19,181
	Auditors' remuneration - current year	2,790	2,500	2,750	2,500
	Amortisation of operating lease	4,610	1,509	4,610	1,509
	Marketing expenses	105,653	146,828	105,563	146,828
	Occupancy expenses	496,312	462,651	495,971	462,651
	Other operating expenses	742,909	722,736	742,140	722,736
		3,215,656	2,906,303	3,202,436	2,906,303

	Group 2012 Sh'000	Group 2011 Sh'000	Bank 2012 Sh'000	Bank 2011 Sh'000
10 STAFF COSTS				
Salaries and wages	1,172,003	955,895	1,160,788	955,895
Training, recruitment and staff welfare costs	59,166	51,939	58,609	51,939
Contributions to defined contribution pension scheme	47,340	40,638	47,340	40,638
Medical expenses	80,104	61,847	80,104	61,847
Leave pay provision	(3,574)	-	(3,574)	-
NSSF contributions	2,816	2,616	2,816	2,616
	1,357,854	1,112,935	1,346,083	1,112,935
11 TAXATION				
(a) Taxation charge				
Current tax based on the taxable profit at 30%	308,575	187,736	304,282	187,736
Deferred tax credit	(1,760)	(19,775)	(1,760)	(19,775)
	306,815	167,961	302,522	167,961
(b) Reconciliation of expected tax based on accounting profit to tax charge				
Profit before taxation	868,274	522,565	843,240	522,565
Tax calculated at a tax rate of 30%	260,482	156,770	252,972	156,770
Tax effect of expenses not deductible for tax purposes	101,429	64,196	97,135	64,196
Tax effect of income not taxable	(55,096)	(53,005)	(47,585)	(53,005)
	306,815	167,961	302,522	167,961
(c) Taxation payable				
At beginning of the year	16,851	17,916	16,851	17,916
Charge for the year	308,575	187,736	304,282	187,736
Tax paid during the year	(231,483)	(188,801)	(226,745)	(188,801)
At end of the year	93,943	16,851	94,388	16,851

12 EARNINGS PER SHARE – Group & Bank

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

	Group 2012 Sh'000	2011 Sh'000	Bank 2012 Sh'000	2011 Sh'000
Profit (Sh'000)	561,459	354,604	540,718	354,604
	=========	=========	=========	========
Weighted average number of shares during the year (Sh'000)	245,126	242,092	245,126	242,092
	=========	=========	=========	========
Earnings per share Basic and diluted (Sh)	2.29	1.46	2.21	1.46
	=========	========	=========	========

There were no potential dilutive shares outstanding at 31 December 2012 and 31 December 2011.

13 CASH AND BALANCES WITH CENTRAL BANK OF KENYA – Group & Bank

	2012 Sh'000	2011 Sh'000
Cash in hand	1,765,122	1,109,236
Balances with Central Bank of Kenya - cash ratio reserve	1,293,089	725,792
- other balances	1,262,477	-
	4,320,688	1,835,028
	========	========

The cash ratio reserve is based on the value of customer deposits as adjusted by the Central Bank of Kenya requirements. As at 31 December 2012 the cash ratio reserve requirement was 5.25 % (2011 – 5.25%) of all customer deposits held by the group. These funds are not available to finance the group's day to day operations.

14 BALANCES DUE FROM BANKING INSTITUTIONS – Group & Bank

	2012 Sh'000	2011 Sh'000
(a) Balances due from banking institutions maturing within 90 days:		
Overnight lending and placement with other banks	27,660	1,768
Balances due from local banking institutions	4,346	64,108
Balances due from foreign banking institutions	634,974	22,132
	666,980	88,008
	=======	========
(b) Balances due to banking institutions maturing within 90 days:		
Balances with local banks	-	150,000
	========	========

Deposits with/from local banks as at 31 December 2011 represent overnight lending. The effective interest rate on deposits due from local banking institutions at 31 December 2012 was 4.75% (2011 – 2.3%). The effective interest rate on deposits due to local banking institutions at 31 December 2012 was Nil (2011 – 26%).

15 GOVERNMENT SECURITIES - HELD TO MATURITY - Group & Bank

	2012 Sh'000	2011 Sh'000
Treasury bonds –at amortised cost	4,343,973	4,485,023
	========	========
The maturity profile of government securities is as follows:		
Maturing within one year	68,159	65,063
Maturing between 2 to 5 years	189,739	177,826
Maturing after 5 years	4,086,075	4,242,134
	4,343,973	4,485,023
	========	========

The weighted average effective interest rate on treasury bonds at 31 December 2012 was 11.09% (2011 – 10.06%). As of 31 December 2012, treasury bonds with a carrying amount of Sh 760,000,000 (2011 – Sh 760,000,000) were pledged as collateral under repurchase agreements with the Central Bank of Kenya.

16 LOANS AND ADVANCES TO CUSTOMERS - Group & Bank

	2012 Sh'000	2011 Sh'000
(a) Commercial loans	15,806,080	14,121,525
Overdrafts	1,318,542	1,512,774
Asset finance loans	1,266,918	1,165,843
Staff loans	1,252,351	595,318
Gross loans and advances to customers	19,643,891	17,395,460
Less: Impairment losses (note 17)	(1,775,146)	(1,063,101)
Net loans and advances to customers	17,868,745	16,332,359
	========	========
(b) Analysis of gross loans and advances by maturity		
Maturing:		
Within 1 year	5,720,879	2,895,173
Between 1 and 3 years	5,804,395	6,528,276
After 3 years	8,118,617	7,972,011
Loans and advances to customers	19,643,891	17,395,460
	========	========

The related party transactions and balances are covered under note 33 and concentration of advances to customers is covered under note 4.

The weighted average effective interest rate on advances to customers at 31 December 2012 was 21% (2011 – 17%). Included in gross advances of Sh 19,791,908,090 (2011 – Sh 17,463,044,000) are loans and advances amounting to Sh 899,806,686 (2011 – Sh 733,191,000), net of specific provisions, which have been classified as non-performing (impaired).

17 IMPAIRMENT LOSSES ON LOANS AND ADVANCES – Group & Bank

	2012 Sh'000	2011 Sh'000
At 1 January	1,130,685	725,970
Increase in impairment allowances	645,272	337,173
Amounts written off during the year as uncollectible	(811)	(42)
	1,775,146	1,063,101

18 CORPORATE BONDS - HELD TO MATURITY – Group & Bank

	2012 Sh'000	2011 Sh'000
At amortised cost:		
Safaricom Limited	305,940	305,957
Kenya Electricity Generating Company Limited	164,989	188,632
Shelter Afrique	210,523	211,401
	681,452	705,990
The maturity profile of corporate bonds is as follows:		
Maturing 1 to 5 years	519,840	517,358
Maturing after 5 years	161,612	188,632
	681,452	705,990

The weighted average effective interest rate on corporate bonds at 31 December 2012 was 12.42% (2011 – 12%).

19 QUOTED INVESTMENT – AVAILABLE FOR SALE – Group & Bank

	2012 Sh'000	2011 Sh'000
At fair value:		
At 1 January	283	569
Fair value (loss)/gain	12	(286)
At 31 December	295	283

The investment consists of 33,466 shares of Kenya Electricity Generating Company Limited which are traded at the Nairobi Securities Exchange.

20 OTHER ASSETS

	Group 2012 Sh'000	2011 Sh'000	Bank 2012 Sh'000	2011 Sh'000
Un-cleared items in the course of collection	280,253	293,310	280,253	293,310
Prepayments	111,677	61,878	111,677	61,878
Deposits for services	58,027	43,904	54,120	43,904
Other	478,664	37,224	478,244	37,224
	928,621	436,316	924,294	436,316

21 INVESTMENT IN SUBSIDIARY - Bank

	2012	2011
	Sh'000	Sh'000
Dhamana Insurance Agency Limited	1,000	-
	=======	======

The subsidiary is wholly owned Limited Liability Company incorporated and domiciled in Kenya.

The principal activity of the subsidiary is the provision of insurance agency services.

22 INVESTMENT PROPERTIES – Group & Bank

	2012	2011
	Sh'000	Sh'000
COST		
At start of year	71,400	27,670
Gain on revaluation	22,600	43,730
	————	————
At end of year	94,000	71,400
	=======	=======

Investment properties relate to; leasehold land acquired at a cost of Shs 24,500,000 was previously meant for the group's expansion plans and lease hold land acquired at a cost of Shs 3,170,000 for national customer promotion raffle. The two properties are now held for capital appreciation.

The properties were re-valued as at 31 December 2012 by Ebony Estate Valuers Limited, Registered valuers. Valuations for the properties were made on the basis of the open market value. The book values of the re-valued items were adjusted to the re-valued amounts and the resultant surplus was credited to profit and loss.

23 PROPERTY AND EQUIPMENT – GROUP

COST/VALUATION	Freehold land Sh'000	Buildings Sh'000	Leasehold improvements Sh'000	Computer Sh'000	Motor vehicles Sh'000	Fixtures, fittings and equipment Sh'000	Total Sh'000
At 1 January 2011	2,400	146,158	852,253	554,470	36,155	326,902	1,918,338
Additions	-	156,982	192,468	271,377	32,664	60,240	713,731
Disposal	-	-	-	-	(3,330)	-	(3,330)
Gain on revaluation	2,600	55,080	-	-	-	-	57,680
Transfer to operating lease rentals	-	(33,220)	-	-	-	-	(33,220)
At 31 December 2011	5,000	325,000	1,044,721	825,847	65,489	387,142	2,653,199
At 1 January 2012	5,000	325,000	1,044,721	825,847	65,489	387,142	2,653,199
Additions	-	-	223,462	76,543	-	48,157	348,162
Disposal	-	-	-	-	(1,608)	-	(1,608)
Write offs	-	-	(8,906)	(774)	-	(3,268)	(12,948)
At 31 December 2012	5,000	325,000	1,259,277	901,616	63,881	432,031	2,986,805
Comprising:							
At cost	-	-	1,259,277	901,616	63,881	432,031	2,656,805
At valuation	5,000	325,000	-	-	-	-	330,000
At 31 December 2012	5,000	325,000	1,259,277	901,616	63,881	432,,031	2,986,805
DEPRECIATION							
At 1 January 2011	-	25,776	310,564	403,266	25,786	118,421	883,813
Charge for the year	-	-	121,323	109,641	7,032	44,457	282,453
Write-back on revaluation	-	(25,776)	-	-	-	-	(25,776)
Eliminated on disposals	-	-	-	-	(3,330)	-	(3,330)

23 PROPERTY AND EQUIPMENT – GROUP (CONTINUED)

COST/VALUATION	Freehold land Sh'000	Buildings Sh'000	Leasehold improvements Sh'000	Computer Sh'000	Motor vehicles Sh'000	Fixtures, fittings and equipment Sh'000	Total Sh'000
At 31 December 2011	-	-	431,887	512,907	29,488	162,878	1,137,160
At 1 January 2012	-	-	431,887	512,907	29,488	162,878	1,137,160
Charge for the year	-	8,125	125,359	96,408	9,421	45,026	284,339
Eliminated on disposals	-	-	-	-	(1,581)	-	(1,581)
At 31 December 2012	-	8,125	557,246	609,315	37,328	207,904	1,419,918
NET BOOK VALUE – VALUATION BASIS							
At 31 December 2012	5,000	316,875	702,031	292,301	26,553	224,127	1,566,887
	=====	======	=====	=====	=====	======	======
At 31 December 2011	5,000	325,000	612,834	312,940	36,001	224,264	1,516,039
	=====	======	=====	=====	=====	======	======
NET BOOK VALUE – COST BASIS							
At 31 December 2012	2,400	199,687	702,031	292,301	26,553	224,127	1,447,094
	=====	=====	=====	=====	=====	=====	=====
At 31 December 2011	2,400	204,807	612,834	312,940	36,001	224,264	1,393,246
	====	=====	=====	=====	====	=====	=====

23 PROPERTY AND EQUIPMENT - BANK

COST/VALUATION	Freehold land Sh'000	Buildings Sh'000	Leasehold improvements Sh'000	Computer Sh'000	Motor vehicles Sh'000	Fixtures, fittings and equipment Sh'000	Total Sh'000
At 1 January 2011	2,400	146,158	852,253	554,470	36,155	326,902	1,918,338
Additions	-	156,982	192,468	271,377	32,664	60,240	713,731
Disposal	-	-	-	-	(3,330)	-	(3,330)
Gain on revaluation	2,600	55,080	-	-	-	-	57,680
Transfer to operating lease rentals	-	(33,220)	-	-	-	-	(33,220)
At 31 December 2011	5,000	325,000	1,044,721	825,847	65,489	387,142	2,653,199
At 1 January 2012	5,000	325,000	1,044,721	825,847	65,489	387,142	2,653,199
Additions	-	-	223,462	75,624	-	47,953	347,039
Disposal	-	-	-	-	(1,608)	-	(1,608)
Write offs	-	-	(8,906)	(774)	-	(3,268)	(12,948)
At 31 December 2012	5,000	325,000	1,259,277	900,697	63,881	431,827	2,655,682
Comprising:							
At cost	-	-	1,259,277	900,697	63,881	431,827	2,325,682
At valuation	5,000	325,000	-	-	-	-	330,000
At 31 December 2012	5,000	325,000	1,259,277	900,697	63,881	431,827	2,655,682
DEPRECIATION							
At 1 January 2011	-	25,776	310,564	403,266	25,786	118,421	883,813
Charge for the year	-	-	121,323	109,641	7,032	44,457	282,453
Write-back on revaluation	-	(25,776)	-	-	-	-	(25,776)
Eliminated on disposals	-	-	-	-	(3,330)	-	(3,330)
At 31 December 2011	-	-	431,887	512,907	29,488	162,878	1,137,160
At 1 January 2012	-	-	431,887	512,907	29,488	162,878	1,137,160
Charge for the year	-	8,125	125,359	96,224	9,421	45,001	284,130
Eliminated on disposals	-	-	-	-	(1,581)	-	(1,581)
At 31 December 2012	-	8,125	557,246	609,131	37,328	207,879	1,419,709

23 PROPERTY AND EQUIPMENT – BANK (CONTINUED)

	Freehold land Sh'000	Buildings Sh'000	Leasehold improvements Sh'000	Computer Sh'000	Motor vehicles Sh'000	Fixtures, fittings and equipment Sh'000	Total Sh'000
NET BOOK VALUE – VALUATION BASIS							
At 31 December 2012	5,000	316,875	702,031	291,566	26,553	223,948	1,565,973
At 31 December 2011	5,000	325,000	612,834	312,940	36,001	224,264	1,516,039
NET BOOK VALUE – COST BASIS							
At 31 December 2012	2,400	199,687	702,031	292,301	26,553	224,127	1,447,094
At 31 December 2011	2,400	204,807	612,834	312,940	36,001	224,264	1,393,246

The properties were re-valued as at 31 December 2011 by Ebony Estate Valuers Limited, Registered valuers. Valuations for the properties were made on the basis of the open market value.

24 INTANGIBLE ASSETS – COMPUTER SOFTWARE – Group & Bank

	2012 Sh'000	2011 Sh'000
COST		
At 1 January	483,184	211,122
Additions	95,907	272,062
At 31 December	579,091	483,184
AMORTISATION		
At 1 January	128,287	53,494
Charge for the year	104,908	74,793
At 31 December	233,195	128,287
NET BOOK VALUE		
At 31 December	345,896	354,897

25 PREPAID OPERATING LEASE RENTALS – Group & Bank Leasehold land:

	2012 Sh'000	2011 Sh'000
COST		
At beginning of the year	180,335	8,600
Additions	-	138,515
Transfer from property and equipment	-	33,220
	180,335	180,335
AMORTISATION		
At 1 January	3,925	2,416
Charge for the year	4,610	1,509
At 31 December	8,535	3,925
NET BOOK VALUE		
At 31 December	171,800	176,410

26 CUSTOMER DEPOSITS

	Group 2012 Sh'000	Group 2011 Sh'000	Bank 2012 Sh'000	Bank 2011 Sh'000
Current and demand accounts	16,783,388	13,528,329	16,792,838	13,528,329
Savings accounts	1,154,502	529,576	1,154,502	529,576
Fixed deposit accounts	6,675,412	7,386,022	6,682,938	7,386,022
	24,613,302	21,443,927	24,630,278	21,443,927
MATURITY ANALYSIS OF CUSTOMER DEPOSITS				
Repayable:				
On demand	16,783,388	13,528,329	16,792,838	13,528,329
Within one year	7,829,914	7,915,598	7,837,440	7,915,598
	24,613,302	21,443,927	24,630,278	21,443,927

The weighted average effective interest rate on interest bearing customer deposits at 31 December 2012 was 17.06% (2011 – 4.77%). The related party transactions and balances are covered under note 33 and concentration of customers' deposits is covered under note 4.

27 BORROWINGS – Group & Bank

	2012 Sh'000	2011 Sh'000
(a) Analysis		
Youth Fund	60,000	120,317
PTA Loan 1	64,902	176,161
PTA Loan 2	590,588	-
Women Fund	62,000	116,131
Practical Action Fund	6,159	6,159
KICTB – Pasha loan	108,496	108,496
	892,145	527,264
(b) Movement:		
At beginning of the year	527,264	472,972
Received in the year	645,748	198,944
Repaid in the year	(280,868)	(144,652)
	892,145	527,264

Facilities:

The Youth fund is a Government granted facility for onward lending to the youth. The fund is a revolving fund disbursed in tranches. The principal is repayable after three years and interest of 1% is charged and repayable on quarterly basis.

PTA loan 1 is a long term facility, repayable within 5 years inclusive of 1 year grace period. The interest rate charged is the prevailing Treasury bill rate plus 3.5% margin repayable on monthly basis. The loan is secured by an all asset debenture in favour of PTA Bank. The loan was received in August 2007 and matures in July 2013.

Facilities:

PTA loan 1 is a long term facility, repayable within 5 years. The interest rate charged is based on margin of 5% plus market risk premium plus 6 month libor repayable on half yearly basis. The loan was received in March 2012 and matures in September 2017.

The Women Fund is a Government granted facility for onward lending to women. The fund is a revolving fund disbursed in tranches. The principal is repayable after three years and interest of 1% is charged and repayable on quarterly basis.

The Practical Action Fund is a revolving fund to onward lending to customers who are undertaking waste management initiatives. The loan is interest free and all the customers are referred directly by Practical Action Fund.

The KICTB Pasha loan is a credit from the International Development Authority advanced to the Kenya Information and Communication Technology for the purposes of developing the digital villages program. Family Bank is charged with managing the disbursements of the loans.

The effective interest rates for the various loans are as follows:

	2012 Sh'000	2011 Sh'000
Youth Fund	2	2.5
PTA Loan 1	17	11
PTA Loan 2	7.7	-
Women Fund	1	1
Practical Action Fund	-	-
KICTB – Pasha loan	4	1
	========	=========

28 OTHER LIABILITIES

	Group 2012 Sh'000	2011 Sh'000	Bank 2012 Sh'000	2011 Sh'000
Provisions and accruals	160,520	23,510	160,520	23,510
Leave pay provision	14,223	17,796	14,223	17,796
Cheques for collection	139,622	253,728	139,622	253,728
Other payables	169,322	218,101	168,401	218,101
	483,687	513,135	482,766	513,135
	========	=========	=======	========

29 UNCLAIMED DIVIDENDS – Group & Bank

	2012 Sh'000	2011 Sh'000
At 1 January	983	2,134
Declared	97,258	96,837
Paid during the year	(96,766)	(97,988)
At 31 December	1,475	983
	======	=======

	2012 Sh'000	2011 Sh'000
30 DEFERRED TAX ASSET		
The deferred tax asset computed at the enacted rate of 30% is attributed to the following items:		
Deferred tax assets:		
General bad debts provision	(12,393)	(11,786)
Excess depreciation over capital allowances	(58)	-
	(12,451)	(11,786)
Deferred tax liabilities:		
Accelerated capital allowances	-	182
Revaluation surplus	36,566	37,479
	36,566	37,661
Net deferred tax liability	24,115	25,875
Movement in deferred tax asset is as follows:		
At 1 January – as restated	25,875	21,393
Charge/(credit) to profit or loss	(1,760)	(19,775)
Other comprehensive income charge	-	24,257
At 31 December	24,115	25,875
31 SHARE CAPITAL		
Authorised:		
500,000,000 ordinary shares of Sh 2 each	1,000,000	1,000,000
Issued and fully paid:		
278,497,634 (2011: 242,092,716) ordinary shares of Sh 2 each	556,995	484,185

Movement in issued and fully paid shares

	Number of shares	Share Capital Sh '000	Share Premium Sh '000	Total Sh'000
At 1 January 2011	242,092,442	484,185	1,644,429	2,128,614
Issued in the year	-	-	-	-
At 31 December 2011	242,092,442	484,185	1,644,429	2,128,614
At 1 January 2012	242,092,442	484,185	1,644,429	2,128,614
Issued in the year	36,405,192	72,810	1,019,509	1,092,319
At 31 December 2012	278,497,634	556,995	2,663,938	3,220,933

In 2012, the group increased its capital by Sh 1,092,319 through the issue 36,405,192 ordinary shares of Sh 2 each at a premium of Sh 28.16 per share. The amounts received from the rights issue were capitalised after deducting the rights issue costs of Sh 14,453,442.

32 NOTES TO THE STATEMENT OF CASH FLOWS

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

	2012 Sh'000	2011 Sh'000
Profit before taxation	868,274	522,565
Adjustments for:		
Depreciation of property and equipment	284,339	282,453
Amortisation of intangible assets	104,908	74,793
Amortisation of leasehold land	4,610	1,509
Gain disposal of equipment	(850)	(1,578)
Surplus on revaluation of investment property	(22,600)	(43,730)
Profit before working capital changes	1,238,681	836,012
Changes in working capital items:		
Cash ratio balance	(567,297)	(33,546)
Loans and advances to customers	(1,536,386)	(6,033,568)
Other assets	(492,305)	414,425
Customer deposits	3,169,375	5,712,680
Other liabilities	(29,448)	(323,685)
Government securities	143,079	632,745
Corporate bonds	24,538	(206,665)
Cash generated from operations	1,950,237	1,001,898

(b) Analysis of the balances of cash and cash equivalents as shown in the statement of financial position and notes

	2012 Sh'000	2011 Sh'000
Cash in hand	1,765,122	1,109,236
Balances with the Central Bank of Kenya	1,262,477	-
Balances with other banking institutions	666,980	88,008
Balances due to other banking institutions	-	(150,000)
	3,694,579	1,047,244

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short term highly liquid investments with original maturities of three months or below, less advances from banks repayable within three months from the dates of the advances.

33 CONTINGENCIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS

a) Contingent liabilities

In common with other financial institutions, the group 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.

	2012 Sh'000	2011 Sh'000
Acceptances and letters of credit		
Guarantees	648,659	419,719
	=====	=====
Litigations against the group	280,542	299,065
	=====	=====

Nature of contingent liabilities:

An acceptance is an undertaking by a bank to pay a bill of exchange drawn on a customer. The group expects most acceptances to be presented, but reimbursement by the customer is normally immediate.

Letters of credit commit the group 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 customers to third parties. The group will only be required to meet these obligations in the event of the customer's default.

Concentrations of contingent liabilities are covered under note 5.

Litigations against the bank relate to civil suits lodged against the group by customers and employees in the normal course of business. The likely outcome of these suits cannot be determined as at the date of signing these financial statements. The directors, however, do not anticipate that any liability will accrue from the pending suits.

	2012 Sh'000	2011 Sh'000
b) Commitments to extend credit		
Undrawn formal stand-by facilities, credit lines and other commitments to lend	1,100,691	1,739,392
	======	=======

Commitments to extend credit are agreements to lend to a customer in future subject to certain conditions. Such commitments are normally made for a fixed period. The group may withdraw from its contractual obligation to extend credit by giving reasonable notice to the customer.

	2012 Sh'000	2011 Sh'000
(c) Capital commitments		
Authorised and contracted for	111,827	108,921
Authorised but not contracted for	39,750	176,000
	=======	======

34 RELATED PARTY TRANSACTIONS

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

Placings are made in the group by directors, their associates and companies associated to directors. Advances to customers at 31 December 2012 include advances and loans to companies associated with the directors. Contingent liabilities at 31 December 2012 include guarantees and letters of credit for companies associated with the directors.

Movement in related party balances was as follows:	2012 Sh'000	2011 Sh'000
Loans and advances:		
At 1 January	570,593	479,025
Advanced during the year	1,073,686	547,854
Interest earned	55,336	23,007
Repaid during the year	(200,929)	(479,293)
At 31 December	1,498,687	570,593
	======	======

As at 31 December 2012 loans and advances to staff amounted to Sh1,258,764,000 (2011 – Sh 526,650,000). The loans and advances to related parties are performing and adequately secured.

Included in other assets ia a balance of Sh 31 million due from a related party (Kenya Orient Insurance Limited) in respect of the rights issue. The outstanding amount was received after the year end.

Key management compensation The remuneration of directors and other members of key management during the year were as follows:	2012 Sh'000	2011 Sh'000
Salaries and other benefits	60,511	25,108
Directors' emoluments	88,750	80,717
	149,261	105,825
	======	=======

35 INCORPORATION

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

36 CURRENCY

These financial statements are prepared in Kenya shillings thousands (Sh'000) which is the group's functional and presentation currency.

Branch Details

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Fax: 318174
Family Bank Towers - Corporate
3rd Floor
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Fax: 2250507

Sonalux
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Fax: 318845

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Fax: 241559

Cargen House
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Fax: 2213918

KTDA Retail
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Fax: 2242267

KTDA Corporate
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(Corporate Wing)
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