HABIB BANK LIMITED
(KENYA BRANCH)

ANNUAL REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2015

HABIB BANK LIMITED
(KENYA BRANCH)

MISSION AND VALUES

Our brand

Our brand identity is the outward expression of what we stand for as an organization. This is summarized in our vision, mission and is supported by our values.

Vision

"Enabling people to advance with confidence and success."

Mission

"To make our customers prosper, our staff excel and create value for shareholders."

Values

Our values are the main principles that define our culture and are brought to life in our attitudes and behaviour. Our values make us unique and unmistakable. Our values are defined below:

Excellence

This is at the core of everything we do. In an increasingly competitive environment, we strive to provide quality services, products and premises. Only by being the very best, we can become successful.

Integrity

Habib Bank Limited (HBL), the head office of Habib Bank Limited (Kenya Branch), is the leading bank in Pakistan. Our success depends upon building trust at every level. Our customers - and society in general - expect us to possess and steadfastly adhere to high moral principles and professional standards.

Customer focus

We strive to fully understand our customers' needs while adapting our products and services to meet their requirements. We always endeavour for customer satisfaction as our primary goal.

Meritocracy

We believe in providing opportunities to our employees on the basis of their performance and ability. We reward achievements and provide enriching careers for all.

Progressiveness

We believe in the advancement of society through the adoption of enlightened working practices, innovative products and processes, and a spirit of enterprise.

HABIB BANK LIMITED
(KENYA BRANCH)
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015

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HABIB BANK LIMITED
(KENYA BRANCH)

COUNTRY EXECUTIVE KENYA REPORT

Financial year 2015 was another steady year for Habib Bank Limited (Kenya Branch) (HBL Kenya) with consistent growth and profitability. Total assets increased by 8% to KShs 10.2 billion from the previous year and customer deposits grew by 7% to close at KShs 6.9 billion. Loans and advances decreased by 2% to KShs 3.9 billion during the year. Core capital stood at KShs 1.9 billion, growth of 1% over prior year.

During the year, the franchise was able to increase customer base which facilitated international trade through enhanced traction with HBL worldwide network.

In line with the strategy to further consolidate market position, two new branches were successfully opened in Nairobi. The Industrial Area branch was opened in March 2015 and Westlands branch in July 2015. Market response to the increased geographic coverage has been positive and over time, is expected to enhance HBL's presence with mid-sized local companies and SMEs.

In financial year 2015, HBL Kenya was designated as Africa Regional office. The new structure is intended to develop new prospects within the Region and more importantly cross sell HBL's international presence in 29 countries.

Looking forward, financial year 2016 will be a challenging year in terms of credit management and interest rates. The strategy remains to focus on our defined customer segments, with particular emphasis on trade and related financing opportunities. In addition, new branches are expected to contribute on the liability side to boost overall profitability.

....
Salman Malik
Regional General Manager
and Country Executive Kenya

Date 30-03-2016

CORPORATE GOVERNANCE

Corporate governance provides structures through which the goals of the Bank are set, and the means of attaining those objectives and monitoring performance are determined. It works for the benefit of everyone concerned by ensuring that the Bank adheres to accepted standards and best practices as well as to formal laws.

The Local Management Committee (LMC) of HBL Kenya confirms its commitment to implementation of proper standards of corporate governance as required by the country regulations of the Central Bank of Kenya and its head office. The LMC is responsible for the overall supervision of the Branch. The board approves and monitors the actual implementation of the policy and strategy to be followed by the Bank in pursuit of its business goals in line with the overall strategy of HBL. The Regional General Manager Africa and Country Executive Kenya and the other members of the LMC have the responsibility of day-to-day-operations and implementing policy and operational decisions taken by the board of HBL. The LMC meets every quarter at regular intervals. Each member of the LMC has met the minimum attendance requirement of 75% for the year as below:

Name	Position	Percentage of meetings attended
Salman Malik	Regional General Manager Africa and Country Executive Kenya	100%
Aurangzeb Quadri	Country Operations Manager	100%
Patrick Maina Mwangi	Head of Risk	100%
Rukiya Abduljabbar	Branch Manager	100%
John Kasuvu	Financial Controller	100%
Grace Mbogo	Head of Credit	100%

The Local Management Committee has set up various committees to complement its functions:

Assets and Liability Committee (ALCO)

The ALCO reports to the LMC. It is chaired by the Regional General Manager Africa and Country Executive Kenya and has four other members drawn from the Branch senior management staff. The ALCO meets regularly and manages the Branch's assets and liabilities and is responsible for monitoring liquidity, interest rate and currency risks.

Credit Committee

The Credit Committee reports to the LMC and is chaired by the Regional General Manager Africa and Country Executive Kenya and comprises the credit team. It meets regularly to review and approve the Branch's credit applications within specified country approval limits. Credit applications beyond the country approval limits applied for are forwarded to the head office.

Risk Management Committee (RMC)

The RMC reports to the LMC and consists of the risk manager and other senior staff members drawn from the internal control/compliance, credit administration, financial control and business development. The RMC meets once every quarter and is tasked with identifying key risk factors affecting the business and recommending policies and guidelines within the overall bank policy to the LMC.

Human Resource Committee (HRC)

The HRC reports to the LMC and consists of the Regional General Manager Africa and Country Executive Kenya, Country Operations Manager and the Head of Human Resources. The HRC meets once every quarter and is tasked with overseeing all human resource issues locally and ensuring compliance with the overall bank HR policy.

HABIB BANK LIMITED
(KENYA BRANCH)

OFFICERS AND ADMINISTRATION

LOCAL MANAGEMENT COMMITTEE

Name	Position
Salman Malik	Regional General Manager Africa and Country Executive Kenya
Aurangzeb Quadri	Country Operations Manager
Patrick Maina Mwangi	Head of Risk
Rukiya Abduljabbar	Branch Manager
John Kasuvu	Financial Controller
Grace Mbogo	Head of Credit

REGISTERED OFFICE

17 - Koinange Street
P. O. Box 43157
00100 Nairobi, Kenya

BRANCHES

Koinange Street Branch	15 - Koinange Street, Nairobi
Mombasa Branch	Fort Mansion - Nkrumah Road, Mombasa
Malindi Branch	Jamhuri Road, Malindi
Industrial Area Branch	Funzi Road, Nairobi
Westlands Branch	Peponi Road Westlands, Nairobi

ADVOCATES

M A Khan Advocates
St Ellis House
Wabera Street
P. O. Box 45100
00100 Nairobi, Kenya

Karingu & Company Advocates
Cotts House
Wabera Street
P. O. Box 44980
00100 Nairobi, Kenya

MAJOR CORRESPONDENT BANKS

Habib Bank Ltd New York
Habib UK PLC London
Habib Bank Ltd Brussels
Habib Bank, Dubai
United Bank Ltd A.G. Zurich
Union Bank of India, Mumbai
Standard Bank of South Africa
National Bank of Pakistan Tokyo

AUDITORS

Ernst & Young LLP
Kenya-Re Towers, Upper hill
Off Ragati Road
P. O. Box 44286
00100 Nairobi, Kenya

HABIB BANK LIMITED
(KENYA BRANCH)
REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2015

The directors have pleasure in presenting their annual report and the audited financial statements for the year ended 31 December 2015 which show the state of affairs of Habib Bank Limited (Kenya Branch) "the Branch" or "the Bank".

1. PRINCIPAL ACTIVITIES

The principal activity of the Branch, which is licensed under the Kenyan Banking Act, is the provision of banking and related services.

2. RESULTS

The results for the year are set out on page 8.

3. DIRECTORS

The directors who served during the year and to the date of this report are set out below:

Sultan Ali Allana*	Chairman
Nauman K Dar*	President and CEO
Moez Ahamed Jamal**	
Sajid Zahid*	
Agha Sher Shah*	
Dr. Najeeb Samie	
Shaffiq Dharamshi***	Appointed on 27 March 2015
R. Zakir Mahmood*	Resigned on 26 March 2015

* Pakistani
** UK
***Kenyan

4. AUDITORS

The auditors, Ernst & Young LLP, have expressed their willingness to continue in office in accordance with Section 159(2) of the Kenyan Companies Act and subject to section 24(1) of the Banking Act.

By Order of the Board

Regional General Manager and Country Executive Kenya
Signed under Limited Power of Attorney issued by
the Board of Directors of Habib Bank Limited on 02 March 2016
Nairobi

30-03-2016

HABIB BANK LIMITED
(KENYA BRANCH)
STATEMENT OF DIRECTORS' RESPONSIBILITIES
ON THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

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 the financial affairs of the Branch as at the end of the financial year and of the operating results of the Branch for that year. It also requires the directors to ensure that the Branch keeps proper accounting records which disclose with reasonable accuracy, the financial position of the Branch. They are also responsible for safeguarding the assets of the Branch.

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 annual financial statements give a true and fair view of the state of the financial affairs of the Branch and of its operating results. The directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

Nothing has come to the attention of the directors to indicate that the Branch will not remain a going concern for at least the next twelve months from the date of this statement.

....
Regional General Manager and Country Executive Kenya
Signed under Limited Power of Attorney issued by
the Board of Directors of Habib Bank Limited on 02 March 2016

........30 - 03 - 2016

EY
Building a better working world

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Kenya Re Towers
Upper Hill
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PO Box 44286 - 00100
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Email: info@ke.ey.com
www.ey.com

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF HABIB BANK LIMITED (KENYA BRANCH)

REPORT ON THE FINANCIAL STATEMENTS

We have audited the financial statements of Habib Bank Limited (Kenya Branch) set out on pages 8 to 60, which comprise the statement of financial position as at 31 December 2015, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material 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 the auditor's 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, the auditor considers internal control relevant to the Branch's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the Branch's internal control. 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 present fairly, in all material respects, the financial position of Habib Bank Limited (Kenya Branch) as at 31 December 2015, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.

REPORT ON OTHER LEGAL REQUIREMENTS

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

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

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

(iii) the statement of financial position and statement of profit or loss and other comprehensive income of the Branch are in agreement with the books of account.

The engagement partner responsible for the audit resulting in this independent report is CPA Herbert Chiveli Wasike - P.1485.

Nairobi, Kenya

31/3/ 2016

HABIB BANK LIMITED
(KENYA BRANCH)
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2015

	Notes	2015 KShs	2014 KShs
INTEREST INCOME	5	1,060,673,656	946,479,580
INTEREST EXPENSE	6	(341,300,139)	(292,472,567)
NET INTEREST INCOME		719,373,517	654,007,013
NET FEES AND COMMISSION INCOME	7	60,176,388	64,336,549
OTHER OPERATING INCOME	8	51,267,320	67,595,971
NET OPERATING INCOME		830,817,225	785,939,533
IMPAIRMENT LOSS ON LOANS AND ADVANCES	15 (c)	(52,094,862)	(17,728,967)
OTHER OPERATING EXPENSES	9	(294,202,935)	(236,448,537)
PROFIT BEFORE TAX	10	484,519,428	531,762,029
INCOME TAX EXPENSE	11.1	(185,935,852)	(213,235,974)
PROFIT AFTER TAX		298,583,576	318,526,055
OTHER COMPREHENSIVE INCOME, NET OF TAX		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		298,583,576	318,526,055

HABIB BANK LIMITED
(KENYA BRANCH)
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2015

	Notes	2015 KShs	2014 KShs
ASSETS			
Cash and balances with Central Bank of Kenya	12	538,163,268	456,257,145
Investments in Government securities	13(a)	5,045,333,528	4,064,631,465
Investments in commercial paper	13(b)	170,533,922	566,074,672
Balances with banks and branches	14	322,734,959	210,267,262
Loans and advances to customers	15(a)	3,946,146,310	4,040,001,370
Other assets	16	45,638,974	49,470,429
Property and equipment	17	86,158,974	30,463,780
Tax recoverable	11.2	-	5,436,941
Deferred tax asset	18	75,268,964	26,762,615
TOTAL ASSETS		10,229,978,899	9,449,365,679
LIABILITIES AND EQUITY			
LIABILITIES			
Customers deposits	19	6,861,254,352	6,398,943,695
Amounts due to foreign banks and branches	20	1,004,447,231	991,359,909
Other liabilities	21	135,987,797	117,534,097
Tax payable	11.2	80,837,481	-
TOTAL LIABILITIES		8,082,526,861	7,507,837,701
EQUITY			
Assigned capital	23(a)	1,044,226,302	1,044,226,302
Retained earnings		811,887,165	801,351,157
Statutory credit risk reserve	23(b)	291,338,571	95,950,519
TOTAL EQUITY		2,147,452,038	1,941,527,978
TOTAL LIABILITIES AND EQUITY		10,229,978,899	9,449,365,679

The financial statements were approved by the directors on 30-03-2016
and were signed on its behalf by:

....

Regional General Manager and Country Executive Kenya
Signed under Limited Power of Attorney issued by
the Board of Directors of Habib Bank Limited on 02 March 2016

HABIB BANK LIMITED
(KENYA BRANCH)
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2015

	Assigned capital KShs	Statutory credit risk reserve KShs	Retained earnings KShs	Total KShs
	Note 23 (a)	Note 23 (b)		
As at 1 January 2014	1,044,226,302	57,174,032	565,501,589	1,666,901,923
Profit for the year	-	-	318,526,055	318,526,055
Other comprehensive income for the year	-	-	-	-
Total comprehensive income	-	-	318,526,055	318,526,055
Dividend paid to head office	-	-	(43,900,000)	(43,900,000)
Transfer to statutory credit risk reserve	-	38,776,487	(38,776,487)	-
As at 31 December 2014	1,044,226,302	95,950,519	801,351,157	1,941,527,978
As at 1 January 2015	1,044,226,302	95,950,519	801,351,157	1,941,527,978
Profit for the year	-	-	298,583,576	298,583,576
Other comprehensive income for the year	-	-	-	-
Total comprehensive income	-	-	298,583,576	298,583,576
Dividend paid to head office	-	-	(92,659,516)	(92,659,516)
Transfer to statutory credit risk reserve	-	195,388,052	(195,388,052)	-
As at 31 December 2015	1,044,226,302	291,338,571	811,887,165	2,147,452,038

HABIB BANK LIMITED
(KENYA BRANCH)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2015

	Notes	2015 KShs	2014 KShs
Operating activities			
Profit before tax		484,519,428	531,762,029
Adjustments for:			
Depreciation on property and equipment	17	17,365,850	13,956,079
Provision for gratuity	22.2	13,203,959	5,826,705
Profit on sale of equipment	8	-	(955,000)
		515,089,237	550,589,813
Changes in operating assets			
Loans and advances to customers		93,855,060	(653,920,960)
Government securities		108,497,369	(699,513,990)
Other assets		3,831,455	(32,003,185)
Balance with Central Bank of Kenya - Cash Reserve Ratio		(25,287,623)	(65,436,735)
Changes in operating liabilities			
Customers deposits		462,310,657	799,559,390
Payments of gratuity	22.2	(2,118,962)	(2,207,281)
Other liabilities		7,368,703	37,650,355
Cash generated from/ (used in) operating activities		1,163,545,896	(65,282,593)
Income tax paid	11.2	(148,167,779)	(222,436,148)
Net cash generated from/ (used in) operating activities		1,015,378,117	(287,718,741)
Investing activities			
Dividend paid to head office		(92,659,516)	(43,900,000)
Proceeds on sale on equipment		-	955,000
Purchase of equipment	17	(73,061,044)	(13,330,408)
Net cash used in investing activities		(165,720,560)	(56,275,408)
Net increase/ (decrease) in cash and cash equivalents		849,657,557	(343,994,149)
Cash and cash equivalents at the beginning of the year		902,352,228	1,246,346,377
Cash and cash equivalents at the end of the year	24	1,752,009,785	902,352,228
The operational cash flows include interest received and paid as follows:			
Interest paid		725,993,991	622,910,800
Interest received		1,445,367,507	1,276,917,813

1. REPORTING ENTITY

Habib Bank Limited (Kenya Branch) (the “Bank” or “Branch” or ‘’HBL Kenya’’) is a branch of Habib Bank Limited, which is incorporated in Pakistan (the head office). Habib Bank Limited (Kenya Branch) is licensed to operate as a bank under the Kenyan Banking Act, and is domiciled in Kenya. The address of its registered office is shown on Page 3. The Branch is primarily involved in commercial banking and related services.

2. SIGNIFICANT ACCOUNTING POLICIES

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

2.1 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and as required by the Kenyan Companies Act (cap 486).

The financial statements have been prepared on the historical cost basis, except where stated otherwise in the accounting policies below.

These financial statements are presented in Kenya Shillings (Kshs), which is the Bank’s functional currency.

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

2.2 Significant accounting estimates, judgements and assumptions

The preparation of financial statements in accordance with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities at the date of the financial statements and the income and expenses during the reporting period, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Although these estimates are based on the directors’ best knowledge of current events and actions, actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are accounted for prospectively.

Judgements

In the process of applying the Bank’s accounting policies, management has made the following judgements, which have the most significant effect on the amounts recognised in the financial statements:

Going concern
The Bank’s management has made an assessment of the Bank’s ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Bank’s ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting estimates, judgements and assumptions (continued)

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Bank based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances beyond the control of the Bank. Such changes are reflected in the assumptions when they occur.

Impairment losses on loans and advances

The Bank reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in profit or loss. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Bank makes judgments about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risks and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups). The impairment loss on loans and advances is disclosed in more detail in Note 15.

2.3 Changes in accounting policies and disclosures

New and amended standards and interpretations

The Bank applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2015. The Bank has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The nature and the effect of these changes are disclosed below. Although these new standards and amendments applied for the first time in 2015, they did not have a material impact on the annual financial statements of the Bank.

- Amendments to IAS 19 Defined Benefit Plans: Employee Contributions
- Annual Improvements 2010-2012 Cycle
  - IFRS 2: Share-based Payment
  - IFRS 3: Business Combinations
  - IFRS 8: Operating Segments
  - IAS 16: Property, Plant and Equipment and IAS 38 Intangible Assets
  - IAS 24: Related Party Disclosures
- Annual Improvements 2011-2013 Cycle
  - IFRS 3: Business Combinations
  - IFRS 13: Fair Value Measurement
  - IAS 40: Investment Property

2. ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures (continued)

New and amended standards and interpretations (continued)

The nature and the impact of the relevant standards or amendments to the Bank are described below:

Amendments to IAS 19 Defined Benefit Plans: Employee Contributions
IAS 19 requires an entity to consider contributions from employees or third parties when accounting for defined benefit plans. Where the contributions are linked to service, they should be attributed to periods of service as a negative benefit. These amendments clarify that, if the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to the periods of service. This amendment is effective for annual periods beginning on or after 1 July 2014. This amendment is not relevant to the Bank, since the Bank does not have a defined benefit plan.

Annual Improvements 2010-2012 Cycle
With the exception of the improvement relating to IFRS 2 Share-based Payment applied to share-based payment transactions with a grant date on or after 1 July 2014, all other improvements are effective for accounting periods beginning on or after 1 July 2014. The Bank has applied these improvements for the first time in these financial statements.

They include:

IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets
The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data by either adjusting the gross carrying amount of the asset to market value or by determining the market value of the carrying value and adjusting the gross carrying amount proportionately so that the resulting carrying amount equals the market value. In addition, the accumulated depreciation or amortisation is the difference between the gross and carrying amounts of the asset. This amendment did not have any impact on the Bank since its assets are carried at cost.

IAS 24 Related Party Disclosures
The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services. This amendment is not relevant for the Bank as it does not receive any management services from other entities.

Annual Improvements 2011-2013 Cycle
These improvements are effective from 1 July 2014 and the Bank has applied these amendments for the first time in these financial statements. The amendment that is relevant for the Bank is as shown below:

IFRS 13 Fair Value Measurement
The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IAS 39. The Bank does not apply the portfolio exception in IFRS 13.

2. ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures (continued)

New and amended standards and interpretations (continued)

Standards issued but not effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments
In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions. The adoption of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, and the Bank is in the process of determining the impact of the change on the classification and measurement of the Bank's financial liabilities.

a) Classification and measurement
The Bank does not expect a significant impact on its statement of financial position or equity on applying the classification and measurement requirements of IFRS 9. The Bank currently has no financial instruments measured at fair value. Debt securities are expected to be measured at fair value through OCI under IFRS 9 as the Bank expects not only to hold the assets to collect contractual cash flows but also to sell a significant amount on a relatively frequent basis. Loans as well as trade receivables are held to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest. Thus, the Bank expects that these will continue to be measured at amortised cost under IFRS 9. However, the Bank will analyse the contractual cash flow characteristics of those instruments in more detail before concluding whether all those instruments meet the criteria for amortised cost measurement under IFRS 9.

b) *Impairment*
IFRS 9 requires the Bank to record expected credit losses on all of its debt securities, loans and advances to customers and trade receivables, either on a 12-month or lifetime basis. The Bank's main financial assets affected by impairment are loans and advances to customers. The Bank expects to apply the simplified approach and record lifetime expected losses on the loans and advances to customers. The Bank does not expect a significant impact on its equity due to the secured nature of its loans and advances to customers, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

c) Hedge accounting
The Bank does not have hedge relationships.

2. ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures (continued)

Standards issued but not effective (continued)

IFRS 15 Revenue from Contracts with Customers
IFRS 15 was issued in May 2014 and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted. The Bank plans to adopt the new standard on the required effective date using the full retrospective method. During 2015, the Bank performed a preliminary assessment of IFRS 15, which is subject to changes arising from a more detailed ongoing analysis. Furthermore, the Bank is considering the clarifications issued by the IASB in an exposure draft in July 2015 and will monitor any further developments.

Amendments to IAS 1 Disclosure Initiative
The amendments to IAS 1 Presentation of Financial Statements clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated
- That entities have flexibility as to the order in which they present the notes to financial statements
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact on the Bank.

Annual Improvements 2012-2014 Cycle
These improvements are effective for annual periods beginning on or after 1 January 2016. These amendments are not expected to have any impact on the Bank.

They include:

IFRS 7 Financial Instruments: Disclosures

a) Servicing contracts
The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

2. ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures (continued)

Standards issued but not effective (continued)

IFRS 7 Financial Instruments: Disclosures (continued)

b) *Servicing contracts*
The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

c) *Applicability of the amendments to IFRS 7 to condensed interim financial statements*
The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. This amendment must be applied retrospectively.

IAS 19 Employee Benefits
The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. This amendment must be applied prospectively.

IFRS 16 Leases
The IASB issued IFRS 16 Leases on 13 January 2016. The scope of the new standard includes leases of all assets, with certain exceptions. A lease is defined as a contract, or part of a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Key features

- The new standard requires lessees to account for all leases under a single on-balance sheet model (subject to certain exemptions) in a similar way to finance leases under IAS 17.
- Lessees recognise a liability to pay rentals with a corresponding asset, and recognise interest expense and depreciation separately.
- The new standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computer) and short-term leases (i.e., leases with a lease term of 12 months or less).
- Reassessment of certain key considerations (e.g., lease term, variable rents based on an index or rate, discount rate) by the lessee is required upon certain events.
- Lessor accounting is substantially the same as today's lessor accounting, using IAS 17's dual classification approach.

The new standard is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. The new standard permits a lessee to choose either a full retrospective or a modified retrospective transition approach.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies

(a) Recognition of income and expenses, and fees and commissions

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. Interest income and expense are recognised in profit or loss on the accrual basis.

(i) Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of a financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability.

The calculation of the effective interest rate includes all fees 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.

Interest income and expense presented in profit or loss include:

- Interest on financial assets and liabilities at amortised cost on an effective interest rate basis
- Interest income and expense on all trading assets and liabilities are considered to be incidental to the Bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

(ii) Fees and commission income

Fees and commission income that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, are recognised as the related services are performed.

(b) Foreign currency translations

Transactions in foreign currencies during the year are converted to Kenya Shillings at the exchange rates ruling at the date of the transaction. Foreign currency monetary assets and liabilities at the reporting date are retranslated into the functional currency at the spot exchange rate at that date. Resulting exchange differences are recognised in profit or loss under other operating income or expenses. Non-monetary assets and liabilities denominated in foreign currency are recorded at the exchange rate ruling at the date of transaction.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

(c) Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of replacing part of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

The estimated useful lives for the current and comparative periods are as follows:

Leasehold improvements	5 years
Motor vehicles and cycles	5 years
Furniture and fixtures	5 years
Office equipment	5 years
Personal computers	3 years

The assets' residual values, useful lives and methods of depreciation are reviewed at each reporting date and adjusted prospectively, as a change in an estimate, if appropriate.

Derecognition of property and equipment

Property and equipment is derecognised on disposal or when no future economic benefits are expected from its use.

Gains and losses on disposal of property and equipment are determined by reference to the carrying amount and proceeds received on disposal and are recognised net within other operating income/expenses in profit or loss.

(d) Employee benefits

(i) Retirement benefits schemes

The majority of the Bank's employees are eligible for retirement benefits under a defined contribution plan. Obligations for contributions to the defined contribution plan are recognised as an expense in profit or loss as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

The employees of the Bank also contribute to the National Social Security Fund. Contributions are determined by local statute and the Bank's contributions are charged to profit or loss under operating expenses in the year to which they relate.

(ii) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis due to the short term nature of the balances and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus if the Bank has a present legal and constructive obligation to pay this amount as a result of past service provided by the employee, the obligation can be estimated reliably and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

(d) Employee benefits (continued)

(iii) Gratuity

In addition, the Bank has a gratuity arrangement in which the benefits provided is a cash lump sum of one month's basic pay for each completed year of service with the Bank provided a minimum of fifteen year service has been completed.

The benefit is payable on normal retirement age (55 years), on early retirement, on ill health, on death in service, on withdrawal or on redundancy. Employees who have not completed fifteen years of service or are dismissed from service due to misconduct are not entitled to any benefit under the arrangement.

The Bank classifies the gratuity provision as "other long-term employee benefits". The Bank recognises the net total of the service costs, net interest on the long-service benefit and remeasurements of the long-service benefit, if any, in the profit or loss under operating expenses.

The gratuity arrangement is unfunded but a provision is made in the Bank's books of account to meet the cost accrued benefits.

The Bank's gratuity arrangement is subjected to valuation by independent actuaries after every two years. The gratuity was revalued as at 31 December 2015 by Alexander Forbes Financial Services (East Africa) Limited. The actuarial method used to determine the unfunded accrued liability and the notional Bank contribution for future accrual of gratuity benefit is projected unit method.

(iv) Provision for leave pay

Employee benefits in the form of annual leave entitlements are provided for when they accrue to employees with reference to services rendered up to the reporting date. Employees are entitled to carry forward a maximum of 15 leave working days per annum which should be fully utilised by end of March the following year.

(e) Tax

Current income tax
Income tax expense comprises current tax and change in deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or other comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the reporting date and any adjustment to tax payable in respect of previous years.

Deferred tax
Deferred tax 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, except for:-

- Where the deferred tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and,
- ☐In respect of temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

(e) Tax (continued)

Deferred tax (continued)
Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilised.

The carrying amount of deferred tax assets is reviewed at reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it is probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Current tax and deferred tax relating to items recognised directly in other comprehensive income or equity are also recognised in other comprehensive income or equity and not in profit or loss.

Value Added Tax (VAT)

Bank services are VAT exempt and expenses and assets are recognised gross of the amount of VAT.

(f) Cash and cash equivalents

For the purpose of the statement of cash flows in the financial statements, cash and cash equivalents include cash and balances with Central Bank of Kenya excluding the cash ratio reserve, net balances from banking institutions, uncleared effects and investment in government securities and commercial paper with a maturity of three months or less from the date of acquisition.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(g) Recognition and measurement of financial instruments

(i) Date of recognition and initial measurement of financial instruments

A financial instrument is a contract that gives rise to both a financial asset of one enterprise and a financial liability of another enterprise.

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

The classification of financial instruments at initial recognition depends on their purpose and characteristics and the management’s intention in acquiring them. Financial instruments are initially recognised at fair value including transaction costs except for financial instruments measured at fair value through profit or loss which are recognised excluding transaction costs.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

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

(i) Date of recognition and initial measurement of financial instruments (continued)

The Bank's classification of financial assets and financial liabilities is as follows:

Description of asset/liability	*Classification*
Investments in government securities-Treasury bonds	Held to maturity investments
Investments in government securities-Treasury bills	Loans and receivables
Investment in commercial paper	Loans and receivables
Cash and cash equivalents-cash and bank balances	Loans and receivables
Loans and advances to customers	Loans and receivables
Customers deposits	Other liabilities at amortised cost
Amounts due to foreign banks and branches	Other liabilities at amortised cost
Other Liabilities	Other liabilities at amortised cost

(ii) Subsequent measurement

The subsequent measurement of financial assets depends on their classification as follows:

Held-to-maturity
Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. 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. The assets are carried at amortised cost. Amortised cost is calculated using the EIR method and takes into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortisation is included in 'interest income' in profit or loss. The losses arising from impairment of such investments are recognised in profit or loss under finance costs.

Included in this category are treasury bonds, which are debt securities issued by the Government of Kenya.
Loans and advances to customers and receivables
Loans and advances to customers and receivables include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:
- Those that the Bank intends to sell immediately or in the near term and those that the Bank, upon initial recognition, designates as at fair value through profit or loss
- Those that the Bank, upon initial recognition, designates as available-for-sale
- Those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration

After initial measurement, amounts due from foreign banks and branches, loans and advances to customers and receivables are subsequently measured at amortised cost using the effective interest rate (EIR), less allowance for impairment, if any. 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 EIR. The amortisation is included in Interest income in profit or loss. The losses arising from impairment of loans and advances to customers are recognised as a separate line item in the statement of profit or loss and other comprehensive income whereas those arising from other receivables are recognised in profit and loss under other operating expenses.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

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

(ii) Subsequent measurement (continued)

Loans and payables at amortised cost
After initial recognition, these are subsequently measured at amortized cost using the EIR method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. This category generally applies to customer deposits, deposits due to other banks and branches, and other liabilities.

a) *Customer deposits*
Customer deposits include call, fixed, current account and savings deposits.

b) Amounts due to foreign banks and branches
Amounts due to foreign banks and branches include inter-bank placements and deposits from HBL branches

c) *Other liabilities*
Financial liabilities under other liabilities include bills payables and other payables.

For all financial instruments measured at amortised cost, interest income or expense is recorded using the EIR.

(iii) Derecognition

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 Bank has transferred its rights to receive cash flows from the asset but retains the contractual rights to receive the cash flows of the financial asset, but 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 Bank has transferred substantially all the risks and rewards of the asset; or
  - ☐The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank 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 of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. In that case, the Bank 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 Bank 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 Bank could be required to repay.

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 amount of the original financial liability and the consideration paid is recognised in profit or loss.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

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

Offsetting of financial assets and liabilities

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

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activities.

(h) Identification and measurement of impairment of financial assets

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

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

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

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

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

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

Where impairment losses required by regulation exceed those computed under IFRS, the excess is recognised as statutory credit risk reserve and is accounted for as an appropriation of retained earnings. The statutory credit risk reserve is non-distributable.

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

(i) Impairment for non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount.

An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less costs of disposal and its value in use. The CGU is used when assessing for impairment. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs of disposal, an appropriate valuation model is used. Impairment losses are recognised in profit or loss in those expense categories consistent with the function of the impaired asset.

For all assets, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Bank estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised.

The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, or the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss.

(j) Contingent liabilities

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

(k) Related parties

In the normal course of business, transactions have been entered with certain related parties.

(l) Provisions

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

2. ACCOUNTING POLICIES (continued)

2.4 Significant accounting policies (continued)

(m) Leasing

(i) Determination

The determination of whether an arrangement is a lease, or contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

(ii) Bank as a lessee

Leases where a significant portion of the risks and rewards of ownership is retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease. Contingent rentals payable are recognised as expenses in the period in which they are incurred.

Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

3. FINANCIAL RISK MANAGEMENT

Introduction and overview

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

- credit risk
- liquidity risk
- market risks

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

Risk management framework

The Risk Management function of the Bank is centralized at the Risk Management Division (RMD) in head office, Karachi. All the organs of the Risk Management e.g. the Board Risk Management Committee, the Management Risk Committee and the Chief Risk Officer are based in our head office. Being a branch office of Habib Bank Ltd, Pakistan, the overall responsibility for implementing the Risk Management framework and the associated Risk Management policies lies with the Local Risk Management Committee (RMC) which reports to the Local Management Committee (LMC).

The Bank's Internal Audit undertakes both regular and adhoc reviews of risk management controls and procedures, the results of which are reported to the Board's Audit committee.

(a) Credit risk

Credit Risk is the risk of financial loss to the Bank if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and balances with other banks and investment securities.

Management of credit risk

Credit risk makes up the largest part of Bank's risk exposure. The Bank's credit process is guided by centrally established credit policies, rules and guidelines with an aim to maintaining a well-diversified portfolio of credit risk which produces a reliable and consistent return. The Bank has a system of checks and balances in place around the extension of credit that are:

- an independent risk management function
- multiple credit approvers (Minimum three initials)
- an independent audit and risk review function.

3. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

Management of credit risk (continued)

Salient features of risk approval process are outlined below:

- Every extension of credit to any counter party requires approval by the pre-defined level of authority.
- Every material change to a credit facility requires approval at the appropriate / pre-defined level.
- Credit approval authority is assigned to individuals at the Branch, regional office and head office level according to their qualifications and experience. Credit facilities are approved by competent credit authorities at each level based on the content, limit and the proposed facility.
- Certain groups of exposures / facilities are managed under product programmes which are approved by various levels of approving authorities as defined in the credit policy manual. Each product programme contains detailed credit criteria, regulatory compliance and documentation requirement.
- The Bank uses risk rating system to supplement the credit risk measurement procedure for exposures exceeding a certain threshold. Risk rating of counterparties is an essential requirement of credit approval process.
- The disbursement, administration and monitoring of credit facilities are managed by Credit Administration Department (CAD) which operates under the Risk Management Group. CAD is also responsible for collateral/documents management.

Credit risk related to commitments and guarantees

The Bank makes available to its customers guarantees that may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Such commitments expose the Bank to similar risks as loans and are mitigated by the same control processes and policies. The Bank's maximum credit risk exposure for commitments and guarantees is disclosed in Note 26. The maximum exposure to credit risk relating to a financial guarantee is the maximum amount the Bank could have to pay if the guarantee is called upon. The maximum exposure to credit risk relating to a loan commitment is the full amount of the commitment.

Maximum exposure to credit risk before collateral held is as follows:

	2015	2014
	KShs	KShs
Items recognised in the statement of financial position		
Cash and balances with Central Bank of Kenya	538,163,268	456,257,145
Investments in Government securities	5,045,333,528	4,064,631,465
Investment in commercial paper	170,533,922	566,074,672
Balances with banks and branches	322,734,959	210,267,262
Loans and advances to customers	4,120,534,965	4,159,080,836
	10,197,300,642	9,456,311,380
Items not recognised in the statement of financial position:		
Irrevocable letters of credit	356,679,912	343,894,832
Guarantees	557,162,258	355,384,599
	913,842,170	699,279,431
Total	11,111,142,812	10,155,590,811

3. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

Credit risk related to commitments and guarantees (continued)

Maximum exposure to credit risk before collateral held (continued)

The above table represents a worst-case scenario of credit risk exposure to the Bank at 31 December 2015 and 31 December 2014 without taking account of any collateral held or other credit enhancement attached. For assets recognised in the statement of financial position, the exposures set out above are based on the carrying amount.

Loans and advances to customers are secured by collateral in the form of charges over cash, land and buildings and/or plant and machinery or corporate guarantees. Management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the Bank resulting from both its loans and advances portfolio and debt securities.

The Bank's internal risk rating scale for credit risk which is in line with Central Bank of Kenya's prudential guidelines is as follows:

Grade 1 - Normal risk
Grade 2 - Watch risk
Grade 3 - Substandard risk
Grade 4 - Doubtful risk
Grade 5 - Loss

Impairment and provisioning policies

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loans and advances portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures. The second component is in respect of losses that have been incurred but have not been identified in relation to the loans and advances portfolio that is not specifically impaired.

The impairment provision shown in the statement of financial position at year-end is derived from each of the five internal rating grades. However, the impairment provision is composed largely of the bottom two grades.

The table below summarises the Bank's loans and advances for each internal rating category and the associated impairment provision:

31 December 2015	Gross amount	Impairment	Net carrying amount
Grade 1- Normal	3,348,901,188	(22,303,217)	3,326,597,971
Grade 2- Watch	337,381,100	-	337,381,100
Grade 3- Substandard	-	-	-
Grade 4- Doubtful	434,252,677	(152,085,438)	282,167,239
Grade 5- Loss	-	-	-
	4,120,534,965	(174,388,655)	3,946,146,310
31 December 2014			
Grade 1- Normal	3,817,020,000	(18,534,433)	3,798,485,567
Grade 2- Watch	-	-	-
Grade 3- Substandard	-	-	-
Grade 4- Doubtful	342,060,836	(100,545,033)	241,515,803
Grade 5- Loss	-	-	-
	4,159,080,836	(119,079,466)	4,040,001,370

3. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

Impairment and provisioning policies (continued)

Grade 1-Normal
All loans are performing in accordance with the contractual terms and are expected to continue doing so. Loans in this category are fully protected by the current sound net worth and paying capacity of the borrower.

Grade 2-Watch
Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary.

Grade 3, 4 and 5-Substandard, doubtful risk and loss
Impaired loans are loans for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan agreements. These loans are graded 4 to 5 in the Bank's internal credit risk grading system.

The aging analysis of the loans and advances is as follows

	Collectively impaired		Individually impaired		Total
	Neither past due nor impaired	Past due but not impaired	Past due and Impaired		
	Normal	Substandard	Doubtful	Loss	
	> 30 Days	91-180 days	181-360 days	> 360 days	
31-Dec-15					
Gross	3,686,282,288	-	434,252,677	-	4,120,534,965
Impairment	(22,303,217)	-	(152,085,438)	-	(174,388,655)
Net carrying amount	3,663,979,071	-	282,167,239	-	3,946,146,310
31-Dec-14					
Gross	3,817,020,000	-	342,060,836	-	4,159,080,836
Impairment	(18,534,433)	-	(100,545,033)	-	(119,079,466)
Net carrying amount	3,798,485,567	-	241,515,803	-	4,040,001,370

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

Impaired loans and securities

Impaired loans and securities are loans and securities for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan/securities agreement(s).

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

3. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

Write-off policy

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

Collateral on loans and advances

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral is usually not held against investment securities, and no such collateral was held at 31 December 2015 or 2014.

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

Fair value of collateral held against loans and advances to customers

	2015	2014
	KShs	KShs
Individually impaired property	91,000,000	175,000,000
Cash collateral	14,390,116	4,500,000
Collectively impaired		
Property	2,302,925,000	3,229,171,753
Cash collateral	455,392,453	374,540,009
Total	2,863,707,569	3,783,211,762

There is no collateral held against cash and cash equivalents and investments.

3. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

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

Gross loans and advances to customers

	2015	2014
	KShs	KShs
Carrying amount		
Manufacturing sector	365,831,456	317,897,473
Wholesale, retail trade	1,915,986,158	1,858,360,897
Building construction	145,694,147	316,074,755
Mining and quarrying	20,606,123	19,753,292
Transport	733,617,165	649,073,527
Real estate	310,554,100	384,487,366
Finance and insurance	154,666,891	160,823,268
Foreign trade	146,815,580	68,437,735
Individuals	289,468,510	255,997,057
Others	37,294,835	128,175,466
	4,120,534,965	4,159,080,836

Settlement risk

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

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

(b) Liquidity risk

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

Management of liquidity risk

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

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of the Bank.

3. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Exposure to liquidity risk

The key measure used by the Bank 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 government securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period are shown below. The statutory prescribed minimum liquidity requirement is 20%.

	2015	2014
At 31 December	71.40%	60.60%
Average for the period	69.51%	59.75%
Maximum for the period	73.50%	74.20%
Minimum for the period	59.50%	51.30%

3. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Residual contractual maturities of financial assets and liabilities

The table below summarises the maturity profile of the undiscounted cash flows of the Bank's financial assets and liabilities as at 31 December. Repayments which are subject to notice are treated as if the notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date it could require to pay and the table does not reflect the expected cash flows indicated by its deposit retention history.

	Up to 1 month KShs	1 to 3 months KShs	3 to 12 months KShs	1 to 5 years KShs	Total KShs
At 31 December 2015:					
FINANCIAL ASSETS					
Cash and balances with Central Bank of Kenya	538,163,268	-	-	-	538,163,268
Balances with banks and branches	322,734,959	-	-	-	322,734,959
Investment in government securities	650,000,000	1,802,451,293	2,524,342,500	637,887,000	5,614,680,793
Investment in commercial paper	-	170,533,922	-	-	170,533,922
Total financial assets	1,510,898,227	1,972,985,215	2,524,342,500	637,887,000	6,646,112,942
FINANCIAL LIABILITIES					
Amounts due to foreign and local banks	1,004,447,231	-	-	-	1,004,447,231
Customers deposits	5,697,741,539	12,417,063	1,151,095,750	-	6,861,254,352
Other liabilities	-	-	73,547,227	-	73,547,227
Total financial liabilities	6,702,188,770	12,417,063	1,224,642,977	-	7,939,248,810
Net liquidity gap -	(5,191,290,543)	1,960,568,152	1,299,699,523	637,887,000	(1,293,135,868)
Cumulative gap	(5,191,290,543)	(3,230,722,391)	(1,931,022,868)	(1,293,135,868)	(1,293,135,868)

3. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Residual contractual maturities of financial assets and liabilities (continued)

	Up to 1 month KShs	1 to 3 months KShs	3 to 12 months KShs	1 to 5 Years KShs	Total KShs
At 31 December 2014:					
FINANCIAL ASSETS					
Cash and balances with Central Bank of Kenya	456,257,145	-	-	-	456,257,145
Balances with banks and branches	210,267,262	-	-	-	210,267,262
Investment in government securities	200,000,000	936,129,474	2,423,015,000	948,568,500	4,507,712,974
Investment in commercial paper	-	566,074,672	-	-	566,074,672
Total financial assets	866,524,407	1,502,204,146	2,423,015,000	948,568,500	5,740,312,053
FINANCIAL LIABILITIES					
Amounts due to foreign and local banks	991,359,909	-	-	-	991,359,909
Customers deposits	3,552,023,104	1,741,753,193	1,105,167,398	-	6,398,943,695
Other liabilities	-	-	69,498,517	-	69,498,517
Total financial liabilities	4,543,383,013	1,741,753,193	1,174,665,915	-	7,459,802,121
Net liquidity gap -	(3,676,858,606)	(239,549,047)	1,248,349,085	948,568,500	(1,719,490,068)
Cumulative gap	(3,676,858,606)	(3,916,407,653)	(2,668,058,568)	(1,719,490,068)	(1,719,490,068)

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) that will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Overall management for market risk is vested in ALCO. ALCO is responsible for the development of detailed risk management policies and for the day-to-day review of their implementation.

i) Exposure to interest rate risk-non-trading portfolios

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. Interest rate risk is managed principally through monitoring interest rate gaps. The ALCO is the monitoring body and is assisted by Risk Management in its day-to-day monitoring activities. A summary of the Bank's interest rate gap position on non-trading portfolios is as follows:

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

i) Exposure to interest rate risk – non-trading portfolios (continued)

Interest rate gap analysis

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The table below summarises the exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates:

2015	Effective interest rate %	3 months or less KShs	Between 3 months and 1 year KShs	Between 1 year and 5 years KShs	Non interest bearing KShs	Total KShs
Financial assets						
Cash and balances with the Central Bank of Kenya	-	-	-	-	538,163,268	538,163,268
Investments in government securities	13.91%	2,076,911,000	2,368,422,528	600,000,000	-	5,045,333,528
Investment in commercial paper	17.49%	170,533,922	-	-	-	170,533,922
Balances with banks and branches	0.00%	-	-	-	322,734,959	322,734,959
Loans and advances to customers	15.38%	2,274,791,704	917,715,073	753,639,533	-	3,946,146,310
Total at 31 December 2015		4,522,236,626	3,286,137,601	1,353,639,533	860,898,227	10,022,911,987
Financial liabilities						
Customers deposits	10.59%	2,182,885,934	1,163,512,813	-	3,514,855,605	6,861,254,352
Due to foreign and local banks	0.35%	1,004,447,231	-	-	-	1,004,447,231
Other liabilities	0.00%	-	-	-	73,547,227	73,547,227
Total at 31 December 2015		3,187,333,165	1,163,512,813	-	3,588,402,832	7,939,248,810
Interest sensitivity gap		1,334,903,461	2,122,624,788	1,353,639,533	(2,727,504,605)	2,083,663,177

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

i) Exposure to interest rate risk – non-trading portfolios (Continued)

Interest rate gap analysis (Continued)

2014	Effective interest rate	3 months or less	Between 3 months and 1 year	Between 1 year and 5 years	Non interest bearing	Total
	%	KShs	KShs	KShs	KShs	KShs
Financial assets						
Cash and balances with the Central Bank of Kenya	-	-	-	-	456,257,145	456,257,145
Investments in government securities	11.15%	987,711,568	2,176,919,897	900,000,000	-	4,064,631,465
Investment in commercial paper	13.00%	566,074,672	-	-	-	566,074,672
Balances with banks and branches	0.00%	-	-	-	210,267,262	210,267,262
Loans and advances to customers	13.97%	2,260,740,545	950,658,599	828,602,226	-	4,040,001,370
Total at 31 December 2014		3,814,526,785	3,127,578,496	1,728,602,226	666,524,407	9,337,231,914
Financial liabilities						
Customers deposits	8.58%	3,425,872,491	654,691,056	-	2,318,380,148	6,398,943,695
Due to foreign and local banks	3.23%	991,359,909	-	-	-	991,359,909
Other liabilities	0.00%	-	-	-	69,498,517	69,498,517
Total at 31 December 2014		4,417,232,400	654,691,056	-	2,387,878,665	7,459,802,121
Interest sensitivity gap		(602,705,615)	2,472,887,440	1,728,602,226	(1,721,354,258)	1,877,429,793

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

i) Exposure to interest rate risk – non-trading portfolios (continued)

Interest rate risk exposures on banking book arise on account of mismatches in maturity or repricing of assets and liabilities. Rate sensitive gap is the tool used to judge the Bank's earnings exposure to interest rate movements. The Bank's interest rate gap over a given period of time is the difference between the value of its assets that mature or reprice during that period and the value of its liabilities that mature or reprice during that period. If this difference is large (in either a positive or negative direction) then interest rate changes will have a larger impact on the net interest income. To monitor and control exposures taken on account of rate sensitive assets and liabilities, the Sensitivity Analysis of Earnings At Risk approach is used. An analysis of the Bank's sensitivity to parallel rate shift with different scenarios is shown below:

EARNINGS AT RISK - December 2015

Earnings at Risk	Up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	Total
Time to Maturity/ Repricing (in months)	1	2	4.5	9	-
	Kshs '000	Kshs '000	Kshs '000	Kshs '000	Kshs '000
GAP (RSA - RSL)	(486,346)	(1,332,518)	(1,704,872)	(461,689)	(3,985,425)
Earnings at Risk @ 25 bp Parallel Rate shift	(101)	(555)	(1,598)	(866)	(3,121)
Earnings at Risk @ 50 bp Parallel Rate shift	(203)	(1,110)	(3,197)	(1,731)	(6,241)
Earnings at Risk @ 100 bp Parallel Rate shift	(405)	(2,221)	(6,393)	(3,463)	(12,482)
Earnings at Risk @ 200 bp Parallel Rate shift	(811)	(4,442)	(12,787)	(6,925)	(24,964)

Interpretation

As a result of a 100 bp +ve/-ve Interest Rate Movement, the Bank's Net Interest Income is likely to change by KShs (12,482,091) and equity by KShs (7,801,307).

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

i) Exposure to interest rate risk – non-trading portfolios (continued)

EARNINGS AT RISK - December 2014

Earnings at Risk	Up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	Total
Time to Maturity/ Repricing (in months)	1	2	4.5	9	-
	Kshs '000	Kshs '000	Kshs '000	Kshs '000	Kshs '000
GAP (RSA - RSL)	(480,173)	(10,331)	(2,274,835)	1,705,850	(1,059,489)
Earnings at Risk @ 25 bp Parallel Rate shift	(100)	(4)	(2,133)	3,198	961
Earnings at Risk @ 50 bp Parallel Rate shift	(200)	(9)	(4,265)	6,397	1,923
Earnings at Risk @ 100 bp Parallel Rate shift	(400)	(17)	(8,531)	12,794	3,846
Earnings at Risk @ 200 bp Parallel Rate shift	(800)	(34)	(17,061)	25,588	7,693

Interpretation

As a result of a 100 bp +ve/-ve Interest Rate Movement, the Bank's Net Interest Income is likely to change by KShs 3,845,884 and equity by KShs 2,403,678.

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

ii) Foreign exchange risk

The Bank's assets are typically funded in the same currency as that of the business transacted to eliminate foreign exchange exposure. However, at times the Bank has net sum open positions in various currencies due to its trade related transactions handled by it. The Bank strives to minimize the potential impact of movements in exchange rates on its risk bearing capacity by having currency open position and stop loss limits. Also developed are the key risk indicators which are used to pro-actively manage and monitor foreign exchange risk. The open position is monitored through foreign exchange exposure limit. The maximum foreign exchange exposure at any given time in 2015 was limited to $ 400,000.

Currency risk
The following exchange rates were applied during the year:

	Closing		Average	
	2015	2014	2015	2014
	KShs	KShs	KShs	KShs
USD	102.3114	90.5978	98.6968	87.9235
EUR	111.7833	110.1708	108.9130	116.8235
GBP	151.7978	140.9472	150.6436	144.8911

The various currencies to which the Bank is exposed at 31 December 2015 are summarised in the table below (all amounts expressed in KShs):

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

ii) Foreign exchange risk (continued)

2015	USD	GBP	EURO	OTHER	Total
Assets					
Cash and balances with Central Bank of Kenya	70,305,355	1,278,500	984,440	-	72,568,295
Balances due from banking institutions	293,105,753	25,674,888	2,632,804	1,321,513	322,734,958
Foreign currency notes and coins	16,406,349	4,847,663	2,074,139	-	23,328,151
Foreign currency advances	1,180,338,215	-	-	-	1,180,338,215
Other foreign Assets	10,879,775	-	-	-	10,879,775
Spot purchases	61,386,840	1,517,978	-	-	62,904,818
Total assets	1,632,422,287	33,319,029	5,691,383	1,321,513	1,672,754,212
Liabilities					
Balances due to banking institutions	654,314,494	-	-	-	654,314,494
Foreign currency deposits	944,192,945	31,960,884	5,426,809	12,074	981,592,712
Other foreign liabilities	25,904,411	331,901	28,516	-	26,264,828
Total liabilities	1,624,411,850	32,292,785	5,455,325	12,074	1,662,172,034
Net financial position 2015	8,010,437	1,026,244	236,058	1,309,439	10,582,178

2014	USD	GBP	EURO	OTHER	Total
Assets					
Cash and balances with Central Bank of Kenya	56,964,041	1,224,871	1,048,957	-	59,237,869
Balances due from banking institutions	124,037,108	55,423,729	29,950,509	855,916	210,267,262
Foreign currency notes and coins	8,072,626	367,167	640,643	-	9,080,436
Foreign currency advances	1,505,500,682	-	-	-	1,505,500,682
Spot purchases	70,151,000	-	-	-	70,151,000
Total assets	1,764,725,457	57,015,767	31,640,109	855,916	1,854,237,249
Liabilities					
Balances due to banking institutions	991,359,910	-	-	-	991,359,910
Foreign currency deposits	800,350,385	55,992,244	33,273,694	-	889,616,323
Other foreign liabilities	9,518,998	308,107	28,104	-	9,855,209
Total liabilities	1,801,229,293	56,300,351	33,301,798	-	1,890,831,442
Net financial position 2014	(36,503,836)	715,416	(1,661,689)	855,916	(36,594,193)

3. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

ii) Foreign exchange risk (continued)

Sensitivity analysis

A 10 percent strengthening of the Kenya shillings against the following currencies would have increased profit or loss before tax and equity by amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2014.

	Profit or loss before tax		Equity	
	2015	2014	2015	2014
	KShs	KShs	KShs	KShs
USD	801,044	(3,650,384)	500,652	(2,281,490)
GBP	102,624	71,542	64,140	44,714
Euro	23,606	(166,169)	14,754	(103,856)
Other	130,944	85,592	81,840	53,495

(d) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Bank's operations and are faced by all business entities.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Bank standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective.

Compliance with Bank standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee of the parent company and senior management of the Bank.

3. FINANCIAL RISK MANAGEMENT (continued)

(e) Capital management

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the Bank. In implementing current capital requirements The Central Bank of Kenya requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets.

The Bank's regulatory capital is held in the form of Tier 1 capital.

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

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

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

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

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

	2015 KShs	2014 KShs
Tier 1 capital		
Ordinary share capital	1,044,226,302	1,044,226,302
Retained earnings and reserves	811,887,165	801,351,157
Total regulatory capital	1,856,113,467	1, 845,577,459
Risk-weighted assets		
Retail bank, corporate bank and central treasury	5,776,330,225	5,802,947,850
Total risk-weighted asset	5,776,330,225	5,802,947,850
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets	32.10%	31.80%
Total tier 1 (core) capital expressed as a percentage of risk-weighted assets	32.10%	31.80%

The Central Bank of Kenya requires a minimum statutory ratio for core capital to total risk weighted assets to be above 10.5%.

The Central Bank of Kenya requires a minimum statutory ratio for total capital to total risk weighted assets to be above 14.5%.

4. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES

a) Comparison by class of the carrying amount and fair values of the financial instruments:

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

AS AT 31 DECEMBER 2015:	Held to maturity	Loans and receivables	Other liabilities at amortized cost	Total fair value	Carrying amount
	KShs	KShs	KShs	KShs	KShs
Assets					
Cash and balances with Central Bank of Kenya	-	538,163,268	-	538,163,268	538,163,268
Balances with banks and branches	-	322,734,959	-	322,734,959	322,734,959
Investments in government securities	4,927,349,810	-	-	4,927,349,810	5,045,333,528
Investments in commercial paper	170,533,922	-	-	170,533,922	170,533,922
Loans and advances to customers	-	3,946,146,310	-	3,946,146,310	3,946,146,310
Total assets	5,097,883,732	4,807,044,537	-	9,904,928,269	10,022,911,987
Other liabilities-bills payable and items in transit	-	-	73,547,227	73,547,227	73,547,227
Deposits and balances due to banking institutions	-	-	1,004,447,231	1,004,447,231	1,004,447,231
Customers' deposits	-	-	6,861,254,352	6,861,254,352	6,861,254,352
Total liabilities	-	-	7,939,248,810	7,939,248,810	7,939,248,810

AS AT 31 DECEMBER 2014:	Held to maturity	Loans and receivables	Other liabilities at amortized cost	Total fair value	Carrying amount
	KShs	KShs	KShs	KShs	KShs
Assets					
Cash and balances with Central Bank of Kenya	-	456,257,145	-	456,257,145	456,257,145
Balances with banks and branches	-	210,267,262	-	210,267,262	210,267,262
Investments in government securities	3,926,120,459	-	-	3,926,120,459	4,064,631,465
Investments in commercial paper	566,074,672	-	-	566,074,672	566,074,672
Loans and advances to customers	-	4,040,001,370	-	4,040,001,370	4,040,001,370
Total assets	4,492,195,131	4,706,525,777	-	9,198,720,908	9,337,231,914
Other liabilities-bills payable and items in transit	-	-	69,498,517	69,498,517	69,498,517
Deposits and balances due to banking institutions	-	-	991,359,909	991,359,909	991,359,909
Customers' deposits	-	-	6,398,943,695	6,398,943,695	6,398,943,695
Total liabilities	-	-	7,459,802,121	7,459,802,121	7,459,802,121

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

a) Comparison by class of the carrying amount and fair values of the financial instruments (continued)

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- ☐ In the principal market for the asset or liability, or
- ☐In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to by the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

Fair value of financial assets
Management assessed that cash and balances with Central Bank of Kenya, balances with foreign banks and branches and commercial papers approximate their carrying amounts largely due to the short-term maturities of these instruments.

Loans and advances to customers are evaluated by the Bank based on parameters such as interest rates, individual creditworthiness of the customer and the risk characteristics of the collateral held. Based on this evaluation, impairment losses are taken into account for the expected losses of these loans and advances. As at 31 December 2015, the carrying amounts of such loans and advances, net of impairment allowances, were not materially different from their calculated fair values.

Fair values of investments in government securities and investment in commercial papers are derived from quoted market prices in active markets.

Fair value of financial liabilities
Bills payable and amounts due to foreign banks and branches are financial liabilities that have a short term maturity (less than three months). Their carrying amounts approximate their fair value.

Customers' deposits that include demand deposits, savings accounts and current accounts without a specific maturity. Their carrying amounts also approximate their fair value. The fair value of term deposits carried is estimated by comparing market interest rates when they were first recognised with current market interest rates for similar financial instruments. The estimated fair value of term deposits is based on discounted cash flows using prevailing current market deposit interest rates. As at 31 December 2015, the carrying amounts of these deposits were not materially different from their calculated fair values.

b) Fair Value Hierarchy

The Bank groups its financial instruments into levels 1 to 3 based on the degree to which the fair value is observable, as follows:

- Level 1 – use quoted prices in active markets for identical assets or liabilities
- Level 2 – use inputs for the asset or liability other than quoted prices, that are observable either directly or indirectly
- Level 3 – use inputs for the asset or liability that are not based on observable market data such as internal models or other valuation methods.

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

In 2015, the Bank had no assets and liabilities that are measured at fair value in its statement of financial position (2014-nil). The Bank, however, had assets for which fair values are disclosed in the financial statements.

The table below shows an analysis of all assets and liabilities for which fair values are disclosed in the financial statements by level of the fair value hierarchy. These are grouped into levels 1 to 3 based on the degree to which the fair value is observable.

	Level 1 KShs	Level 2 KShs	Level 3 KShs
31 December 2015			
Investments in government securities	4,927,349,810	-	-
31 December 2014			
Investments in government securities	3,926,120,459	-	-

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NOTES TO THE FINANCIAL STATEMENTS (continued)
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5. INTEREST INCOME

	2015 KShs	2014 KShs
Interest income		
Cash and cash equivalents	14,483,486	9,527,833
Investment securities	503,659,975	399,629,573
Loans and advances to customers	542,530,195	537,322,174
Total interest income	1,060,673,656	946,479,580

6. INTEREST EXPENSE

	2015 KShs	2014 KShs
Deposits from customers	318,151,688	271,977,757
Deposits from banks	23,148,451	20,494,810
Total interest expense	341,300,139	292,472,567

7. FEES AND COMMISSIONS

	2015 KShs	2014 KShs
Fees and commissions	60,176,388	64,336,549

8. OTHER OPERATING INCOME

	2015 KShs	2014 KShs
Foreign exchange gain	32,391,139	25,742,019
Incidental charges	6,731,149	7,225,348
Miscellaneous income	4,097,982	5,053,490
Swift charges recovered	5,540,325	5,341,400
Profit on disposal of property and equipment	-	955,000
Recovery of bad debts (Note 15 (b))	-	21,003,520
Others	2,506,725	2,275,194
	51,267,320	67,595,971

9. OTHER OPERATING EXPENSES

	2015 KShs	2014 KShs
Personnel expenses	161,954,417	126,736,682
Operating lease rentals (Note 29)	35,779,165	20,153,602
Depreciation on property and equipment (Note 17)	17,365,850	13,956,079
Establishment operating expenses	13,902,980	11,607,418
Regional office expenses	4,401,738	9,772,358
Travelling expenses	4,767,772	3,464,511
Deposit Protection Fund	9,857,433	7,708,022
Maintenance of office equipment	6.568,465	6,259,140
Auditors' remuneration	3,340,000	3,210,000
Security charges	6,136,048	4,043,621
Printing and stationery	4,447,950	2,706,614
Outsourced services	4,438,534	2,853,567
Increase in provision for gratuity	3,727,521	5,826,705
Subscriptions and donations	3,702,379	2,172,880
Other expenses	20,381,148	15,977,338
	294,202,935	236,448,537

10. PROFIT BEFORE TAX

	2015 KShs	2014 KShs
Profit before tax is arrived at after charging:		
Personnel expenses	161,954,417	126,736,682
Depreciation on property and equipment (Note 17)	17,365,850	13,956,079
Auditors' remuneration	3,340,000	3,210,000
And after crediting		
Foreign exchange gain	32,391,139	25,742,019
Profit on disposal of property and equipment	-	955,000

11. INCOME TAX

11.1 PROFIT OR LOSS

	2015	2014
Current income tax charge	233,271,817	207,990,386
Adjustment in respect of current income tax of previous year	1,170,384	9,354,831
	234,442,201	217,345,217
Relating to origination and reversal of temporary differences (Note 18)	(48,506,349)	(4,109,243)
	185,935,852	213,235,974
The accounting profit on the Bank's profit differs from the theoretical amount using the basic tax rate as follows:		
Accounting profit before tax	484,519,428	531,762,029
Computed tax using the applicable corporation tax rate (37.5%)	181,694,786	199,410,761
Adjustment in respect of current income tax of previous year	1,170,384	9,354,831
Disallowable excess pension	685,751	454,178
Disallowable staff benefits	861,769	243,638
Adjustments in respect of head office expenses	1,650,652	3,298,171
Disallowable items related to property and equipment	764,520	315,122
Other disallowable expenses	(892,010)	159,273
Income tax expense	185,935,852	213,235,974

11.2 STATEMENT OF FINANCIAL POSITION

INCOME TAX PAYABLE/ (RECOVERABLE

	2015	2014
Balance brought forward	(5,436,941)	(346,010)
Tax charge for the year (Note 11.1)	234,442,201	217,345,217
Tax paid in the year	(148,167,779)	(222,436,148)
Closing balance as at 31 December	80,837,481	(5,436,941)

12. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2015	2014
Cash in hand	129,937,773	76,925,290
Balances with Central Bank of Kenya:		
- Cash reserve ratio (CRR)	351,886,133	326,598,510
- Clearing balances	56,339,362	52,733,345
	538,163,268	456,257,145

12. CASH AND BALANCES WITH CENTRAL BANK OF KENYA (continued)

The cash reserve ratio is non-interest bearing and is based on the value of deposits as adjusted for Central Bank of Kenya requirements. At 31 December 2015, the cash reserve requirement was 5.25% (2014 – 5.25%). Banks are required to maintain their CRR based on monthly average basis, free to deviate from the 5.25% on any given day but not to fall below 3%, provided that the overall average for the month will be at least 5.25%. These funds are not available to finance the Bank's day to day operations.

13. INVESTMENTS

	2015 KShs	2014 KShs
(a) Investments in Government securities		
Treasury bills		
Maturing within 90 days	2,076,911,000	987,711,568
Maturing after 90 days but within 180 days	193,603,528	286,956,989
Maturing after 180 days but within one year	1,274,819,000	1,669,891,062
Treasury bonds – Held to maturity		
Maturing within 90 days	-	-
Maturing after 90 days but within 3 years	1,500,000,000	1,120,071,846
	5,045,333,528	4,064,631,465

The weighted average effective interest rate on Government securities at 31 December 2015 was 13.91% (2014 – 10.61%).

(b) Investments in commercial paper

Commercial paper	2015 KShs	2014 KShs
Maturing within 90 days	170,533,922	566,074,672

The weighted average effective interest rate on commercial paper at 31 December 2015 was 17.49% (2014– 13.07%).

14. BALANCES WITH BANKS AND BRANCHES

	2015 KShs	2014 KShs
Balances with local banks	153,467,100	-
Balances with foreign banks	444,082	325,362
Balances with Habib Bank branches	168,823,777	209,941,900
	322,734,959	210,267,262

15. LOANS AND ADVANCES TO CUSTOMERS

		2015	2014
		KShs	KShs
(a)	Overdrafts	800,241,606	917,130,457
	Loans	2,540,648,288	2,542,219,283
	Bills purchased	176,180,231	244,354,003
	Bills discounted	603,464,840	455,377,093
	Gross loans and advances	4,120,534,965	4,159,080,836
	Less: impairment loss reserve [Note 15(b)]	(174,388,655)	(119,079,466)
	Net loans and advances	3,946,146,310	4,040,001,370

Overdrafts: These are short term financing facilities under which the branch extends credit up to a maximum amount against which, a current account customer can write cheques or make withdrawals. Tenors range up to a maximum of one year.

Loans: These are financing facilities that extend beyond one year but are limited to five years except for housing finance where the tenors are up to 15 years. These consist of short term loans, bridging loans and asset financing at competitive pricing subject to customers' requirements and collateral held.

Bills purchased: In relation to trade finance allows a seller to obtain financing and receive immediate funds in exchange for a sales document not drawn under a letter of credit. The Bank will send the sales documents to the buyer's bank on behalf of the seller at competitive pricing subject to customers' requirements and collateral held.

Bills discounted: These are short term financing facilities which allow traders to obtain an advance from the branch pending receipt of their sale proceeds. The advance is based on the face value of the bills drawn by the seller. While discounting a bill, the Bank buys the bill (i.e. post dated cheques) before it is due and credits the value of the bill after a discount charge to the customer's account at competitive pricing subject to customers' requirements and collateral held.

The weighted average effective interest rate on loans and advances at 31 December 2015 was 15.38% (2014 – 13.07%).

(b) Impairment loss reserve

	2015	2014
	KShs	KShs
At 1 January	119,079,466	140,404,926
Provisions made in the year [Note 15 (c)]	52,094,862	17,728,967
Interest suspended in the year	3,214,327	-
Recoveries made in the year [Note (8)]	-	(21,003,520)
Amounts written off during the year	-	(18,050,907)
At 31 December	174,388,655	119,079,466

15. LOANS AND ADVANCES TO CUSTOMERS (continued)

(c) Impairment losses	2015 KShs	2014 KShs
Impairment charge as per CBK prudential guidelines	247,482,914	56,505,453
IAS 39 adjustment	(195,388,052)	(38,776,486)
Impairment charge as per IAS 39 requirements	52,094,862	17,728,967

The IAS 39 adjustment relates to excess provision for impairment of loans and advances determined in accordance with the Central Bank of Kenya's prudential guidelines compared with the requirements of IAS 39. The adjustment is recognised as a statutory reserve and accounted for as an appropriation of retained earnings in the statement of changes in equity.

(d) Impaired loans and advances	2015 KShs	2014 KShs
Impaired loans and advances (gross) [Note 3 (a)]	434,252,677	342,060,836
Impairment loss reserve [Note 3 (a)]	(152,085,438)	(100,545,033)
Net non-performing loans	282,167,239	241,515,803

The above loans have been written down to their recoverable amount.

The estimated realisable value of the securities held against these amounts is KShs 369,075,000 (2014 – KShs 388,500,000). Included in the gross impaired loans and advances is interest not received (suspended) as at year end of KShs 41,885,531 (2014 – KShs 38,671,203).

16. OTHER ASSETS

	2015 KShs	2014 KShs
Stock of stationery	-	769,245
Deposits and prepayments	45,638,974	48,701,184
	45,638,974	49,470,429

Other assets are settled no more than 12 months after reporting date apart from deposits and prepayments which are more than 12 months.

17. PROPERTY AND EQUIPMENT

2015	Office equipment KShs	Motor vehicles KShs	Furniture, fixtures and equipment KShs	Leasehold improvements KShs	Total KShs
Cost					
At 1 January 2015	52,640,713	13,916,575	17,001,851	37,766,601	121,325,740
Additions	19,239,549	4,472,041	3,038,539	46,310,915	73,061,044
At 31 December 2015	71,880,262	18,388,616	20,040,390	84,077,516	194,386,784
Depreciation					
At 1 January 2015	42,436,203	2,993,817	13,716,422	31,715,518	90,861,960
Charge for the year	6,489,455	3,619,474	1,661,174	5,595,747	17,365,850
At 31 December 2015	48,925,658	6,613,291	15,377,596	37,311,265	108,227,810
Net carrying amount					
At 31 December 2015	22,954,604	11,775,325	4,662,794	46,766,251	86,158,974

2014	Office equipment KShs	Motor vehicles KShs	Furniture, fixtures and equipment KShs	Leasehold improvements KShs	Total KShs
Cost					
At 1 January 2014	57,846,554	7,006,168	17,542,253	37,766,601	120,161,576
Additions	561,750	12,751,575	17,083	-	13,330,408
Disposals	(5,767,591)	(5,841,168)	(557,485)	-	(12,166,244)
At 31 December 2014	52,640,713	13,916,575	17,001,851	37,766,601	121,325,740
Depreciation					
At 1 January 2014	41,647,969	6,598,415	13,277,076	27,548,665	89,072,125
Charge for the year	6,555,825	2,236,570	996,831	4,166,853	13,956,079
Disposal	(5,767,591)	(5,841,168)	(557,485)	-	(12,166,244)
At 31 December 2014	42,436,203	2,993,817	13,716,422	31,715,518	90,861,960
Net carrying amount					
At 31 December 2014	10,204,510	10,922,758	3,285,429	6,051,083	30,463,780

18. DEFERRED TAX ASSET

The deferred tax asset is attributable to the following:

2015

Deferred tax asset	Balance at 01.01.2015	Recognized in profit or loss	Balance at 31.12.2015
	KShs	KShs	KShs
Arising from:			
Equipment and motor vehicles	6,283,956	(518,002)	5,765,954
Provision for honorarium, gratuity, Bonus and staff leave	3,828,146	42,738,259	46,566,405
General provision on loans and advances	16,650,513	6,286,092	22,936,605
Deferred tax asset	26,762,615	48,506,349	75,268,964

2014

Deferred tax asset	Balance at 01.01.2014	Recognized in profit or loss	Balance at 31.12.2014
	KShs	KShs	KShs
Arising from:			
Equipment and motor vehicles	4,682,639	1,601,317	6,283,956
Provision for honorarium, gratuity, Bonus and staff leave	3,183,990	644,156	3,828,146
General provision on loans and advances	14,786,743	1,863,770	16,650,513
Deferred tax asset	22,653,372	4,109,243	26,762,615

19. CUSTOMER DEPOSITS

	2015 KShs	2014 KShs
Term deposits	3,334,344,301	2,895,086,768
Current deposits	2,253,134,991	2,108,495,118
Savings deposits	1,107,639,546	1,169,511,811
Other	166,135,514	225,849,998
	6,861,254,352	6,398,943,695

Term deposits - These are interest-bearing accounts that are opened for a specific period of time at a fixed rate of interest. Funds are fixed on the account for specified term periods of time. Interest is calculated daily and paid only on maturity of the deposits. Interest rates are offered at competitive and attractive rates.

Current accounts – These are non-interest bearing accounts that are due on demand. They are operated by both individuals and institutions with the use of a cheque book. They are subject to monthly fees.

Savings accounts – These are deposit accounts that enable customers to save funds and earn interest and are generally due on demand. Interest is graduated on the level of balance held in the account and paid on a minimum monthly balance. The interest is paid into the account bi-annually.

The weighted average effective interest rate paid on the customer deposits at 31 December 2015 was 8.58% (2014 – 4.36%).

20. AMOUNTS DUE TO FOREIGN AND LOCAL BANKS

	2015 KShs	2014 KShs
Due within one year		
Amounts due to head office	142,890,231	125,979,709
Amounts due to foreign and local banks	861,557,000	865,380,200
	1,004,447,231	991,359,909

Amounts due to head office are current account and due on demand whereas Amounts due to foreign and local banks include inter-bank placements with other local banks and deposits from HBL branches. The effective interest rate as at 31 December 2015 was 3.23% (2014: 0.35%)

21. OTHER LIABILITIES

	2015 KShs	2015 KShs
Bills payable	50,911,261	56,512,121
Gratuity - Note 22.2	38,100,000	27,015,003
Other accounts payable	22,617,386	19,804,804
Items in transit	23,261,364	13,562,103
Unclaimed bills	1,097,786	640,066
	135,987,797	117,534,097

Other liabilities are non-interest bearing and have an average term period of no more than 12 months after reporting date apart from gratuity.

22. RETIREMENT BENEFIT OBLIGATIONS

22.1 Defined contribution plan

The Bank contributes to a statutory defined contribution pension scheme, the National Social Security Fund (NSSF).

The Bank contributes to a provident fund established for the benefit of the employees. The Bank matches the contributions made by employees up to 5% of the employee's basic salary. The contributions are charged to profit or loss in the period in which they relate.

	2015 KShs	2014 KShs
National Social Security Fund	12,800	9,600
Provident fund	3,414,274	3,208,638
	3,427,074	3,218,238

22.2 Provision for gratuity

	2015 KShs	2014 KShs
At 1 January	27,015,003	23,395,579
Charge for the year	13,203,959	5,826,705
Payments	(2,118,962)	(2,207,281)
At 31 December	38,100,000	27,015,003

22. RETIREMENT BENEFIT OBLIGATIONS (continued)

22.2 Provision for gratuity (continued)

The Bank's gratuity arrangement is subjected to valuation by independent actuaries. The gratuity was revalued as at 31 December 2015 by Alexander Forbes Financial Services (East Africa) Limited.
The principal features of the actuarial valuation were as follows:

- Actuarial method : Projected Unit Method
- Rate of interest : 14% per annum
- Rate of salary escalation : 10%p.a. in the first year; 6%p.a. thereafter;
- Pre-retirement mortality : A1949/52 Ultimate

23. SHARE CAPITAL AND RESERVES

	2015 KShs	2014 KShs
(a) Assigned capital		
1 January and 31 December	1,044,226,302	1,044,226,302

This relates to paid-up capital that the head office, Habib Bank Limited, has invested in the Branch. The Branch is wholly owned by the head office.

(b) Statutory credit risk reserve

IAS 39 requires the Bank to recognise impairment losses when there is objective evidence that loans and advances are impaired. Central Bank of Kenya prudential guidelines, on the other hand, requires the Bank to recognise impairment losses on loans and advances based on a prescribed formula. Where impairment losses required by Central Bank of Kenya prudential guidelines exceed those computed under IAS 39, the excess is recognised as a statutory credit risk reserve and accounted for as an appropriation of retained earnings and not expense in determining profit or loss. This reserve is not distributable.

24. NOTES TO THE STATEMENT OF CASH FLOWS

Analysis of the balance of cash and cash equivalents

	2015 KShs	2014 KShs	Change during the year KShs
Cash and balances with Central Bank of Kenya – excluding CRR (note 12)	186,277,135	129,658,635	56,618,500
Balances due from banking Institutions (note 14)	322,734,959	210,267,262	112,467,697
Balances due to banking institutions (note 20)	(1,004,447,231)	(991,359,909)	(13,087,322)
Investment in Government securities due within 90 days (note 13(a))	2,076,911,000	987,711,568	1,089,199,432
Investment in commercial paper due within 90 days (note 13(b))	170,533,922	566,074,672	(395,540,750)
	1,752,009,785	902,352,228	849,657,557

The cash reserve ratio is not available to finance the Bank's day-to-day operations and, therefore, it has not been included as part of the Bank's cash and cash equivalents.

25. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled

31-Dec-15	KShs Within 12 months	KShs After 12 months	KShs Total
ASSETS			
Cash and balances with Central Bank of Kenya	538,163,268	-	538,163,268
Investments in government securities	4,445,333,528	600,000,000	5,045,333,528
Investment in commercial paper	170,533,922	-	170,533,922
Balances with banks and branches	322,734,959	-	322,734,959
Loans and advances to customers	3,192,506,777	753,639,533	3,946,146,310
Other assets	45,638,974	-	45,638,974
Property and equipment	-	86,158,974	86,158,974
Deferred tax asset	-	75,268,964	75,268,964
TOTAL ASSETS	8,714,911,428	1,515,067,471	10,229,978,899
LIABILITIES			
Customers deposits	6,861,254,352	-	6,861,254,352
Amounts due to foreign and local banks	1,004,447,231	-	1,004,447,231
Other liabilities	135,987,797	-	135,987,797
Tax payable	80,837,481	-	80,837,481
TOTAL LIABILITIES	8,082,526,861	-	8,082,526,861
NET	632,384,567	1,515,067,471	2,147,452,038

31-Dec-14	KShs Within 12 months	KShs After 12 months	KShs Total
ASSETS			
Cash and balances with Central Bank of Kenya	456,257,145	-	456,257,145
Investments in government securities	3,164,631,465	900,000,000	4,064,631,465
Investment in commercial paper	566,074,672	-	566,074,672
Balances with banks and branches	210,267,262	-	210,267,262
Loans and advances to customers	3,211,399,144	828,602,226	4,040,001,370
Other assets	49,470,429	-	49,470,429
Property and equipment	-	30,463,780	30,463,780
Tax recoverable	5,436,941	-	5,436,941
Deferred tax asset	-	26,762,615	26,762,615
TOTAL ASSETS	7,663,537,058	1,785,828,621	9,449,365,679
LIABILITIES			
Customers deposits	6,398,943,695	-	6,398,943,695
Amounts due to foreign and local banks	991,359,909	-	991,359,909
Other liabilities	117,534,097	-	117,534,097
TOTAL LIABILITIES	7,507,837,701	-	7,507,837,701
NET	155,699,357	1,785,828,621	1,941,527,978

26. CONTINGENT LIABILITIES AND COMMITMENTS

In the ordinary course of business, the Bank conducts business involving guarantees, irrevocable letters of credit, bills of collections and forward exchange contracts. These facilities are offset by corresponding obligations of third parties. At the year end, the contingencies were as follows:

	2015 KShs	2014 KShs
Commitments with respect to:		
Irrevocable letters of credit	356,679,912	343,894,832
Guarantees	557,162,258	355,384,599
Bills for collection	498,897,774	314,255,703
Spot exchange contracts	62,928,500	70,151,000
	1,475,668,444	1,083,686,134

Nature of contingent liabilities and commitments

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

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

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

Spot exchange contracts are either purchases or sales of designated foreign exchange currency at a specified date awaiting transfer at a specified price.

27. RELATED PARTY BALANCES AND TRANSACTIONS

Related party transactions/balances in the year are as detailed below:

(a) Loans and advances to employees

	2015 KShs	2014 KShs
Balance as at 1 January	32,398,067	48,692,598
Loans advances during the year	11,501,364	2,997,634
Loan repayments received	(4,493,687)	(19,292,165)
Balance at 31 December	39,405,744	32,398,067

The related interest income in 2015 was KShs 1,421,750 (2014 – KShs 1,586,582). The value of collateral held is KShs 58,200,000 (2014: KShs 48,040,000). The effective interest rate was 8.06% (2014: 6.11%). The loans' tenors stretch to a maximum of 15 years.

27. RELATED PARTY BALANCES AND TRANSACTIONS (continued)

(b) Transactions with key management personnel

Key management personnel and their immediate relatives have transacted with the Bank during the period as follows:

	2015 Maximum balance KShs	2014 Maximum balance KShs
Mortgage lending and other secured loans	3,194,058	36,730,361
Other loans	2,345,588	12,011,480
	5,539,646	48,741,841

No impairment losses have been recorded against outstanding loan balances with the employees during the year.

The value of collateral held for mortgage lending and other secured loans is KShs 58,200,000 (2014: KShs 15,000,000). The loans tenor stretch to a maximum of 15 years. The interest rates vary according to the credit policy on specific type of loan taken.

(c) Key management personnel compensation for the year comprised:

	2015 KShs	2014 KShs
Short-term employee benefits	28,623,566	26,818,314
Post-employment benefits	596,718	2,207,281
	29,220,284	29,025,595

In addition to their salaries, the Bank also provides non-cash benefits to its executive officers and contributes to a post-employment defined contribution plan on their behalf. In accordance with the terms of the plan, the local officers retire at age 55, expatriate officers at 60 and are entitled to their full benefits at retirement.

		2015 KShs	2014 KShs
(d)	Current account balances with Habib Bank's branches	168,823,777	209,941,900

The current accounts are non-interest earning. Transactions entered with other Habib Bank branches are in the normal course of business.

27 RELATED PARTY TRANSACTIONS (continued)

		2015 KShs	2014 KShs
(e)	Amounts due to other Habib Bank's branches	654,447,231	941,359,909

The related interest paid in 2015 was KShs 12,676,696 (2014 – KShs 3,539,804). The effective interest rate was 3.23% (2014: 0.35%).

Amounts due to other Habib Bank's branches are borrowings that are generally due within 90 days.

28. ASSETS PLEDGED AS SECURITY

As at 31 December 2015 there were no assets pledged to secure liabilities.

29. OPERATING LEASES

Operating lease rentals are payable as follows:

	2015 KShs	2014 KShs
Less than one year	32,923,569	18,707,036
Between one and five years	96,576,777	56,121,108
	129,500,346	74,828,144

The Bank pays rent for its premises under operating leases. The leases typically run for an initial period of between three and five years with an option to renew the lease after that date. None of the leases includes contingent rentals. During the year ended 31 December 2015, KShs 35,779,165 (2014 – KShs 20,153,602) was recognised as an expense in profit or loss, under other operating expense in respect of operating leases.

30. CAPITAL COMMITMENTS

There are no authorised capital commitments that are outstanding (2014: Nil).

31. EVENTS AFTER THE REPORTING DATE

No material events or circumstances have arisen between the reporting date and the date of this report.