HABIB BANK LIMITED (KENYA BRANCH)

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2016

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COUNTRY EXECUTIVE KENYA REPORT

The banking industry in Kenya went through a turbulent period which started in the fourth quarter of 2015 with increased cost of funds that resulted in higher interest rates. The volatility continued into 2016 with liquidity constraints and rising non-performing loans weighing on the credit market. As much as the interest rates capping took effect in September 2016, the impending controls was a market risk that Kenyan banks had anticipated earlier in the year. The new legislation resulted in a “wait and see” approach to loan approvals especially during the third quarter.

Despite the challenging operating environment, financial year 2016 was a stable year for HBL Kenya, with consistent growth and profitability. Total assets increased by 22% to Kshs.12.50 Billion from the previous year and customer deposits grew by 20% to close at Kshs.8.22 Billion. Loans and advances rationalized by 3% to Kshs.3.81 Billion during the year. Our core capital stood at Kshs.2.14 Billion representing 15% growth from preceding year.

In line with the strategy to further consolidate market position, the two new branches opened in previous year continued to track largely for new deposits and advances. HBL Kenya fully complied with the Banking Amendment Law on interest capping introduced last year from September. Like other players in the industry the new law implementation led to condensed income in the third quarter due to increased interest expense and reduced interest income.

Looking forward, a stable and healthy banking sector is critical for Kenya’s economic success, as it stands interest rates capping threatens that stability. Financial year 2017 will indeed be a challenging year in terms of funding cost and interest rates. Our strategy remains to focus on our defined customer segments, with particular emphasis on trade and related financing opportunities.
HBL Kenya has initiated additional innovative products such as SMS alerts and E-statements in order to fulfil our commitment to our customers in offering premium service. We are also using technology to enhance efficiency and reduce costs for customers; improving customer support and service standards; and educating customers to make sound financial choices. HBL Kenya strives to continue expanding its business by serving the target market which is mid-sized local companies and SMEs. HBL Kenya remains committed to listening to our customers, and ensuring that our products and services are tailored with the customer in mind.

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:

COUNTRY EXECUTIVE KENYA REPORT (CONTINUED)

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.

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

...31......March 2017

STATEMENT OF 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.

Local Management Committee (LMC)

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 meeting attendance requirement of 75% for the year as below:

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

STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)

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 Marketing
Rukiya Abduljabbar	Branch Manager
John Kasuvu	Financial Controller
Grace Mbogo	Branch Manager
Sohaib Umer	Head of Risk

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

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St Ellis House
Wabera Street
P. O. Box 45100
00100 Nairobi, Kenya

Karingu & Company Advocates
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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

PricewaterhouseCoopers
Certified Public Accountants
Delta Towers, Westlands
Off Waiyaki Way
P. O. Box 30161
00100 Nairobi, Kenya

…………March 2017

Management is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Branch as at the end of the financial year and of the Branch's financial performance for the year then ended. Management are responsible for ensuring that the Branch keeps proper accounting records that are sufficient to show and explain the transactions of the Branch; disclose with reasonable accuracy at any time the financial position of the Branch; and that enables them to prepare financial statements of the Branch that comply with prescribed financial reporting standards. They are also responsible for safeguarding the assets of the Branch and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Management accept responsibility for the preparation and presentation of these financial statements in accordance with International Financial Reporting Standards. They also accept responsibility for:

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

In preparing the financial statements, management have assessed the Branch's ability to continue as a going concern and disclosed, as applicable, matters relating to the use of going concern basis of preparation of the financial statements. Subsequent to year end, Habib Bank Limited has entered into an agreement with Diamond Trust Bank (DTB) dated 21 March 2017, for the disposal of the business, assets and liabilities of Habib Bank Limited (Kenya Branch) to DTB. The business of the Branch will therefore be transferred as a going concern to Diamond Trust Bank on completion of the sale and the Branch will cease to operate. It is therefore still appropriate to use the going concern basis of preparation of financial statements.

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

....

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

...31.... March 2017

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REPORT OF THE INDEPENDENT AUDITOR TO THE DIRECTORS OF HABIB BANK LIMITED IN RESPECT OF THE KENYA BRANCH

Report on the audit of the financial statements

Our opinion

We have audited the accompanying financial statements of Habib Bank Limited (Kenya Branch) (the Branch) set out on pages 9 to 63 which comprise the statement of financial position at 31 December 2016 and the statements of comprehensive income, changes in equity and cash flows for the year then ended and the notes to the financial statements, which include a summary of a significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of Habib Bank Limited (Kenya Branch) at 31 December 2016, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

We draw attention to Note 31 to these financial statements, which explains that subsequent to year end, Habib Bank Limited has entered into an agreement with Diamond Trust Bank Kenya Limited (DTB) dated 21 March 2017 for the disposal of the business, assets and liabilities of Habib Bank Limited (Kenya Branch) to DTB. The business of the Branch will be transferred as a going concern to DTB. Our opinion is not qualified in respect of this matter.

Basis for opinion

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

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

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

Other information

Management is responsible for the other information. The other information comprises the information included in the annual report but does not include the financial statements and our auditor's report thereon.

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

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REPORT OF THE INDEPENDENT AUDITOR TO THE DIRECTORS OF HABIB BANK LIMITED IN RESPECT OF THE KENYA BRANCH (CONTINUED)

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

Responsibilities of management for the financial statements

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

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

Management is responsible for overseeing the Branch's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF HABIB BANK LIMITED IN RESPECT OF THE KENYA BRANCH (CONTINUED)

- Conclude on the appropriateness of managements' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Branch to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

PricewaterhouseCoopers

Certified Public Accountants ..31....March 2017

Nairobi

Statement of comprehensive income

	Notes	2016 Shs'000	2015 Shs'000
Interest income	5	1,211,109	1,060,674
Interest expense	6	(468,814)	(341,300)
Net interest income		742,295	719,374
Net fee and commission income	7	47,085	60,176
Other operating income	8	44,571	51,267
Net operating income		833,951	830,817
Impairment loss on loans and advances	15	(2,508)	(52,095)
Other operating expenses	9	(338,473)	(294,203)
Operating expenses		(340,981)	(346,298)
Profit before tax		492,970	484,519
Income tax expense	11	(186,805)	(185,935)
Profit after tax		306,165	298,584
Items that may be subsequently reclassified to profit or loss			
Net fair value movements on available-for-sale financial assets, net of tax		-	-
Total comprehensive profit for the year		306,165	298,584

The notes on pages 13 to 63 are an integral part of these financial statements.

Statement of financial position

	Notes	2016 Shs'000	2015 Shs'000
Assets			
Cash and balances with Central Bank of Kenya	12	837,492	538,163
Investment in Commercial Paper	13	68,446	170,534
Financial assets held-to-maturity	13	6,820,723	5,045,334
Deposits and balances due from banking institutions	14	649,901	322,735
Loans and advances to customers	15	3,812,504	3,946,146
Other assets and prepaid expenses	16	95,820	45,639
Property and equipment	17	78,074	86,159
Deferred income tax	18	86,234	75,269
Tax Recoverable	11	58,831	-
Total assets		12,508,025	10,229,979
Liabilities			
Deposits and balances due to banking institutions	20	1,736,272	1,004,447
Customer deposits	19	8,215,360	6,861,254
Other liabilities	21	102,775	135,988
Tax Payable	11	-	80,837
Total liabilities		10,054,407	8,082,526
Equity			
Assigned capital	23	1,044,226	1,044,226
Regulatory reserve		315,090	291,340
Retained earnings		1,094,302	811,887
Equity		2,453,618	2,147,453
Total equity and liabilities		12,508,025	10,229,979

The financial statements on pages 9 to 63 were approved for issue by the Local Management Committee on ...31..... March 2017 and signed on its behalf by:

Statement of changes in equity

	Assigned capital Shs'000	**Retained earnings Shs'000**	**Regulatory reserve Shs'000**	**Total Shs'000**
At 1 January 2015	1,044,226	801,351	95,952	1,941,529
Total comprehensive income for the year				
Profit for the year	-	298,584	-	298,584
Other comprehensive income, net of tax	-	-	-	-
Total comprehensive income for the year	-	298,584	-	298,584
Transfer from retained earnings	-	(195,388)	195,388	-
Transactions with owners				
Distribution to head office		(92,660)		(92,660)
At 31 December 2015	1,044,226	811,887	291,340	2,147,453
At 1 January 2016	1,044,226	811,887	291,340	2,147,453
Total comprehensive income for the year				
Profit for the year		306,165		306,165
Other comprehensive income, net of tax	-	-	-	-
Total comprehensive income for the year		306,165	-	306,165
Transfer to regulatory reserves		(23,750)	23,750	-
At 31 December 2016	1,044,226	1,094,302	315,090	2,453,618

The notes on pages 13 to 63 are an integral part of these financial statements.

Statement of cash flows

	Notes	**2016 Shs '000**	**2,015 Shs '000**
Profit before tax		**492,970**	**484,519**
Adjustments for:			
Depreciation on property and equipment	17	25,464	17,366
Provision for gratuity	22.2	1,260	13,204
Profit on sale of equipment	8	(332)	-
Adjusted Profit before tax		519,362	515,089
Changes in operating assets			
Loans and advances to customers	15	133,642	93,855
Government securities	13	(1,640,907)	108,497
Other assets	16	(50,181)	3,831
Balance with Central Bank of Kenya: (CRR)	12	(71,909)	(25,287)
Changes in operating liabilities			
Customers deposits	19	1,354,106	462,311
Payments of gratuity	22.2	-	(2,119)
Other liabilities	21	(34,472)	7,369
Net cash used in operating activities		209,641	1,163,546
Income tax paid	11.2	(337,437)	(148,168)
Net cash used in operating activities		**(127,796)**	**1,015,378**
Investing activities			
Distribution to head office		-	(92,659)
Proceeds on sale on equipment	17	714	-
Purchase of equipment	17	(17,763)	(73,061)
Cash flows used in investing activities		(17,049)	(165,720)
Net decrease in cash and cash equivalents		**(144,845)**	**849,658**
Cash and cash equivalents at the beginning of the year		1,752,010	902,352
Cash and cash equivalents at the end of the year	24	**1,607,165**	**1,752,010**

The notes on pages 13 to 63 are an integral part of these financial statements.

Notes

1 General information

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 5. The Branch is primarily involved in commercial banking and related services.

2 Summary of significant accounting policies

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

Basis of preparation

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

(a) Basis of measurement

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

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

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

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(b) Use of 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 management's 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

Subsequent to year end, Habib Bank Limited has entered into an agreement with Diamond Trust Bank Kenya Limited (DTB) dated 21 March 2017 for the disposal of the business, assets and liabilities of Habib Bank Limited (Kenya Branch) to DTB. This transaction is subject to shareholders' and regulatory approvals. The Bank is being sold off as a going concern and therefore, the financial statements continue to be prepared on the going concern basis.

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,

2 Summary of significant accounting policies (continued)

(b) Use of estimates, judgements and assumptions (continued)

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

(c) Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

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

The amendment to IAS 1 clarifies that materiality applies to the whole set of financial statements and that the inclusion of immaterial information can inhibit the usefulness of financial disclosures. The amendment further explains that professional judgement should be used in determining where and in what order information should be presented in the financial statements. During the year the Bank reviewed its financial statements to identify disclosures that were considered to be immaterial as well as to consider ways of better presenting financial information. The revised standards did not have any effect on the Bank's reported earnings or financial statement position and had no impact on the accounting policies.

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2016 and have not been applied in preparing these financial statements. The following standards and amendments set out below, are expected to have a significant effect on the financial statements of the Bank;

Amendment to IAS 12 – Income taxes, the amendments were issued to clarify the requirements for recognising deferred tax assets on unrealised losses. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. The amendments clarify the existing guidance under IAS 12. They do not change the underlying principles for the recognition of deferred tax assets. The standard is effective for accounting periods beginning on or after 1 January 2017. Early adoption is permitted. The Bank is in the process of determining IAS 12 full impact.

Amendment to IAS 7 – Cash flow statements, in January 2016, the International Accounting Standards Board (IASB) issued an amendment to IAS 7 introducing an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment responds to requests from investors for information that helps them better understand changes in an entity's debt. The amendment will affect every entity preparing IFRS financial statements. However, the information required should be readily available. Preparers should consider how best to present the additional information to explain the changes in liabilities arising from financing activities. The standard is effective for accounting periods beginning on or after 1 January 2017. Early adoption is permitted. The Bank is in the process of determining IAS 7 full impact.

Notes (continued)

2 Summary of significant accounting policies (continued)

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

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank (continued)

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through other comprehensive income (OCI) and fair value through profit or loss (P/L). The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Bank is in the process of determining IFRS 9's full impact.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The IASB has amended IFRS 15 to clarify the guidance, but there were no major changes to the standard itself. The amendments comprise clarifications of the guidance on identifying performance obligations, accounting for licences of intellectual property and the principal versus agent assessment (gross versus net revenue presentation). The IASB has also included additional practical expedients related to transition to the new revenue standard. The standard is effective for annual periods beginning on or after 1 January 2018 and earlier application is permitted. The Bank is assessing the impact of IFRS 15.

IFRS 16 – Leases, IASB and FASB they decided that lessees should be required to recognise assets and liabilities arising from all leases (with limited exceptions) on the balance sheet. Lessor accounting has not substantially changed in the new standard. The model reflects that, at the start of a lease, the lessee obtains the right to use an asset for a period of time and has an obligation to pay for that right. The application of the standard is however exempt for short-term leases (less than 12 months), and leases for which the underlying asset is of low value (such as laptops and office furniture). A lessee measures lease liabilities at the present value of future lease payments. A lessee measures lease assets, initially at the same amount as lease liabilities, and also includes costs directly related to entering into the lease. Lease assets are amortised in a similar way to other assets such as property, plant and equipment. This approach will result in a more faithful representation of a lessee's assets and liabilities and, together with enhanced disclosures, will provide greater transparency of a lessee's financial leverage and capital employed. The Bank is yet to assess the impact of the Standard.

Notes (continued)

2 Summary of significant accounting policies (continued)

(d) Foreign currency translation

(i) Functional and presentation currency

Items included in the Bank's financial statements are measured using the currency of the primary economic environment in which the Bank operates (the "Functional Currency"). The financial statements are presented in Kenya shillings (Shs), which is the Bank's presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the Functional Currency using the exchange rates prevailing at the dates of the transactions.

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. If several exchange rates are available, the forward rate is used at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss.

Changes in the fair value of monetary assets denominated in foreign currency classified as at-fair-value are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount, are recognised in other comprehensive income.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) 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 income and expense

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 commissions are generally recognised on an accrual basis when the service has been provided. Loan appraisal fees for loans that have been or are likely to be drawn down are deferred and recognised over the period of the loan using the effective interest method. Fees and commission expense are deferred and recognised on an accrual basis when incurred.

Notes (continued)

2 Summary of significant accounting policies (continued)

(f) 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.

(g) 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.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) 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 re-measurements 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.

(h) Income tax expense

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 income 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.

Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Income tax expense (continued)

Deferred income 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.

(i) 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, 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.

(j) 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

Notes (continued)

2 Summary of significant accounting policies (continued)

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

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

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	Held to maturity investments
Investment in commercial paper	Held to maturity investments
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.

Notes (continued)

2 Summary of significant accounting policies (continued)

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

(ii) Subsequent measurement (continued)

Liabilities 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.

ii. 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.

Notes (continued)

2 Summary of significant accounting policies (continued)

(j) 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.

(k) Identification and measurement of impairment of financial asset

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.

Notes (continued)

2 Summary of significant accounting policies (continued)

(l) 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.

(m) 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.

(n) 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.

Notes (continued)

2 Summary of significant accounting policies (continued)

(o) 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.

Notes (continued)

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.

Notes (continued)

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:

	2016 Shs'000	**2015 Shs'000**
Items recognised in the statement of financial position		
Cash and balances with Central Bank of Kenya	686,139	408,225
Investments in Government securities	6,820,723	5,045,334
Investment in commercial paper	68,446	170,534
Balances with banks and branches	649,901	322,735
Loans and advances to customers	3,812,504	3,946,146
Other assets	95,820	45,639
	12,133,533	9,938,613
Items not recognised in the statement of financial position:		
Irrevocable letters of credit	197,685	356,680
Guarantees	566,787	557,162
	764,472	913,842
Total	12,898,005	10,852,455

Notes (continued)

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 2016 and 31 December 2015 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:

As at 31-Dec-16	**Gross amount Shs '000**	**Impairment Shs '000**	**Net carrying amount Shs '000**
Grade 1- Normal	3,173,415	(32,288)	3,141,127
Grade 2- Watch	-	-	-
Grade 3- Substandard	-	-	-
Grade 4- Doubtful	815,986	(144,609)	671,377
Grade 5- Loss	-	-	-
	3,989,401	(176,896)	3,812,504
As at 31-Dec-15			
Grade 1- Normal	3,348,901	(22,303)	3,326,598
Grade 2- Watch	337,381	-	337,381
Grade 3- Substandard	-	-	-
Grade 4- Doubtful	434,252	(152,085)	282,167
Grade 5- Loss	-	-	-
	4,120,534	(174,388)	3,946,146

Notes (continued)

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	Watch	Sub standard	Doubtful	Loss	
	> 30 Days	31-90 days	91-180 days	181-360 days	> 360 days	
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
At 31 December 2016						
Gross	3,173,415	-	-	815,986	-	3,989,401
Impairment	(32,288)	-	-	(144,609)	-	(176,897)
Net carrying amount	3,141,127	-	-	671,377	-	3,812,504
At 31 December 2015						
Gross	3,686,283	-	-	434,252	-	4,120,535
Impairment	(22,303)	-	-	(152,086)	-	(174,389)
Net carrying amount	3,663,980	-	-	282,166	-	3,946,146

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.

Notes (continued)

3 Financial risk management (continued)

(a) **Credit risk (continued)**

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. During the year ended 31 December 2016, the total restructured loans amounted to Shs 368,861,000.

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 2016 or 2015.

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

	2016	**2015**
	Shs '000	**Shs '000**
Individually impaired		
Property	1,019,000	562,500
Cash collateral	42,417	14,390
Collectively impaired		
Property	1,011,066	1,831,425
Cash collateral	492,575	455,392
Total	2,565,058	2,863,707

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

Notes (continued)

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

	2016 Shs '000	2015 Shs'000
Carrying amount		
Manufacturing sector	361,310	365,831
Wholesale, retail trade	2,202,099	1,915,986
Building construction	105,756	145,694
Mining and quarrying	-	20,606
Transport	651,946	733,617
Real estate	142,300	310,554
Finance and insurance	228,804	154,667
Foreign trade	-	146,816
Individuals	296,420	289,469
Others	766	37,295
	3,989,401	4,120,535

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.

Notes (continued)

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%.

	2016	**2015**
At 31 December	80.0%	71.4%
Average for the period	71.3%	69.5%
Maximum for the period	79.0%	73.5%
Minimum for the period	66.2%	59.5%

Notes (continued)

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 2016. 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.

At 31 December 2016	Up to 1 month Shs '000	1 to 3 months Shs '000	3 to 12 months Shs '000	1 to 5 years Shs '000	Total Shs '000
FINANCIAL ASSETS					
Cash and balances with Central Bank of Kenya	837,492	-	-	-	837,492
Balances with banks and branches	649,901	-	-	-	649,901
Investment in government securities	-	2,211,393	3,743,736	865,594	6,820,723
Investment in commercial paper	-	68,446	-	-	68,446
Loans and advances	2,880,131	261,303	352,061	319,009	3,812,504
Total financial assets	4,367,524	2,541,142	4,095,797	1,184,603	12,189,066
FINANCIAL LIABILITIES					
Amounts due to foreign and local banks	1,736,272	-	-	-	1,736,272
Customers deposits	5,341,396	1,507,042	1,365,772	1,150	8,215,360
Other liabilities	-	-	102,776	-	102,776
Total financial liabilities	7,077,668	1,507,042	1,468,548	1,150	10,054,408
Net liquidity gap	(2,710,144)	1,034,100	2,627,249	1,183,453	2,134,658

Notes (continued)

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 2015 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 Shs'000	1 to 3 months Shs'000	3 to 12 months Shs'000	1 to 5 years Shs'000	Total Shs'000
At 31 December 2015					
FINANCIAL ASSETS					
Cash and balances with Central Bank of Kenya	538,163	-	-	-	538,163
Balances with banks and branches	322,735	-	-	-	322,735
Investment in government securities	650,000	1,233,104	2,524,343	637,887	5,045,334
Investment in commercial paper	-	170,534	-	-	170,534
Loans and advances	2,274,792	917,715	753,640		3,946,146
Total financial assets	3,785,690	2,321,353	3,277,983	637,887	10,022,912
FINANCIAL LIABILITIES					
Amounts due to foreign and local banks	1,004,447	-	-	-	1,004,447
Customers deposits	5,697,742	12,417	1,151,096	-	6,861,255
Other liabilities	-	-	135,988	-	135,988
Total financial liabilities	6,702,189	12,417	1,287,084	-	8,001,790
Net liquidity gap	(2,916,499)	2,308,936	1,990,899	637,887	2,021,222

Notes (continued)

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:

Notes (continued)

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:

At 31 December 2016	Effective interest rate	3 months or less	Between 3 months and 1 year	Between 1 year and 5 years	Non-interest bearing	Total
	%	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000
Financial assets						
Cash and balances with the Central Bank of Kenya	-	-	-	-	837,492	837,492
Investments in government securities	11.51%	2,211,393	3,743,736	865,594	-	6,820,723
Investment in commercial paper	15.40%	68,446	-	-	-	68,446
Balances with banks and branches	0.00%	-	-	-	649,901	649,901
Loans and advances to customers	10.56%	3,812,504	-	-	-	3,812,504
Total financial assets		6,092,343	3,743,736	865,594	1,487,393	12,189,066
Financial liabilities						
Customers deposits	7.47%	4,836,803	1,365,772	1,150	2,011,635	8,215,360
Due to foreign and local banks	4.4%	1,736,272	-	-	-	1,736,272
Other liabilities	0.00%	-	-	-	102,776	102,776
Total financial liabilities		6,573,075	1,365,772	1,150	2,114,411	10,054,408
Interest sensitivity gap		(480,732)	2,377,964	864,444	(627,018)	2,134,658

Notes (continued)

3 Financial risk management (continued)

(c) Market risk (continued)

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

Interest rate gap analysis (continued)

At 31 December 2015	Effective interest rate	3 months or less	Between 3 months and 1 year	Between 1 year and 5 years	Non-interest bearing	Total
		Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
Financial assets						
Cash and balances with the Central Bank of Kenya	-	-	-	-	538,163	538,163
Investments in government securities	13.91%	2,076,911	2,368,423	600,000	-	5,045,334
Investment in commercial paper	17.49%	170,534	-	-	-	170,534
Balances with banks and branches	0.00%	-	-	-	322,735	322,735
Loans and advances to customers	15.38%	3,946,147	-	-	-	3,946,147
Total financial assets		6,193,592	2,368,423	600,000	860,898	10,022,913
Financial liabilities						
Customers deposits	10.59%	2,182,886	1,163,513	-	3,514,856	6,861,255
Due to foreign and local banks	3.23%	1,004,447	-	-	-	1,004,447
Other liabilities	0.00%	-	-	-	135,988	135,988
Total financial liabilities		3,187,333	1,163,513	-	3,650,844	8,001,690
Interest sensitivity gap		3,006,259	1,204,910	600,000	(2,789,946)	2,021,223

Notes (continued)

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 2016

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**	**5**	**9**	**-**
	Shs '000	**shs '000**	**Shs '000**	**Shs '000**	**Shs '000**
GAP (RSA - RSL)	(52,620)	(1,099,182)	2,730,025	1,183,453	2,761,676
Earnings at Risk @ 25 bp Parallel Rate shift	(11)	(458)	2,559	2,219	4,309
Earnings at Risk @ 50 bp Parallel Rate shift	(22)	(916)	5,119	4,438	8,619
Earnings at Risk @ 100 bp Parallel Rate shift	(44)	(1,832)	10,238	8,876	17,238
Earnings at Risk @ 200 bp Parallel Rate shift	(88)	(3,664)	20,475	17,752	34,475

As a result of a 100 bp +ve/-ve Interest Rate Movement, the Bank's Net Interest Income is likely to change by Shs (1,362,477)

Notes (continued)

3 Financial risk management (continued)

(c) Market risk (continued)

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

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**	**-**
	Shs '000	**Shs '000**	**Shs '000**	**Shs '000**	**Shs '000**
GAP (RSA - RSL)	486,346	848,558	1,660,936	461,689	3,457,529
Earnings at Risk @ 25 bp Parallel Rate shift	101	177	346	96	720
Earnings at Risk @ 50 bp Parallel Rate shift	203	354	692	192	1,441
Earnings at Risk @ 100 bp Parallel Rate shift	405	707	1,384	385	2,881
Earnings at Risk @ 200 bp Parallel Rate shift	811	1,414	2,768	769	5,763

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).

Notes (continued)

3 Financial risk management (continued)

(c) Market risk (continued)

i) 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 2016 was limited to $ 400,000.

Currency risk

The following exchange rates were applied during the year:

	Closing		**Average**	
	2016 Shs	**2015 Shs**	**2016 Shs**	**2015 Shs**
USD	102.49	102.31	101.50	98.70
EUR	107.06	111.78	112.36	108.91
GBP	125.42	151.8	119.57	150.64

The various currencies to which the Bank is exposed at 31 December 2016 are summarised in the table below (all amounts expressed in Shs '000').

Notes (continued)

3 Financial risk management (continued)

(c) Market risk (continued)

Foreign exchange risk (continued)

At 31 December 2016	USD	GBP	EURO	OTHER	Total
Assets					
Cash and balances with Central Bank of Kenya	117,991	2,175	700	-	120,866
Balances due from banking institutions	574,998	50,065	18,281	6,557	649,901
Foreign currency notes and coins	41,921	290	3,403	-	45,614
Foreign currency advances	1,168,350	-	-	-	1,168,350
Other foreign Assets	32,252	-	-	-	32,252
Total assets	1,935,512	52,530	22,384	6,557	2,016,983
Liabilities					
Balances due to banking institutions	1,486,273	-	-	-	1,486,273
Foreign currency deposits	460,557	55,570	22,607	12	538,746
Other foreign liabilities	11,584			-	11,584
Total liabilities	1,958,414	55,570	22,607	12	2,036,603
Net financial position 2016	(22,902)	(3,040)	(223)	6,545	(19,620)
Off balance sheet position	41,060	3,773	1080	-	45,913
Overall net position	18,158	733	857	6,545	26,293

Notes (continued)

3 Financial risk management (continued)

(c) Market risk (continued)

Foreign exchange risk (continued)

At 31 December 2015	**USD**	**GBP**	**EURO**	**OTHER**	**Total**
Assets					
Cash and balances with Central Bank of Kenya	70,305	1,278	984	-	72,568
Balances due from banking institutions	293,105	25,674	2,632	1,321	322,734
Foreign currency notes and coins	16,406	4,847	2,074	-	23,328
Foreign currency advances	1,180,338	-	-	-	1,180,338
Other foreign Assets	10,879	-	-	-	10,879
Total assets	1,571,033	31,799	5,690	1,321	1,609,847
Liabilities					
Balances due to banking institutions	654,314	-	-	-	654,314
Foreign currency deposits	944,192	31,960	5,426	12	981,592
Other foreign liabilities	25,904	331	28	-	26,264
Total liabilities	1,624,411	32,292	5,455	12	1,662,172
Net financial position 2015	(53,378)	(493)	235	1,309	(52,325)
Off balance sheet position	61,386	1,517	-	-	62,904
Overall net position	8,008	1,024	235	1,309	10,579

Notes (continued)

3 Financial risk management (continued)

(c) Market risk (continued)

i. 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 2015.

	Profit or loss before tax		**Equity**	
	2016	**2015**	**2016**	**2015**
	Shs '000	**Shs '000**	**Shs '000**	**Shs '000**
USD	1,816	801	1,135	501
GBP	73	102	46	64
Euro	86	24	54	15
Other	655	131	409	82

(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.

Notes (continued)

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:

	2016	**2015**
	Shs '000	**Shs '000**
Tier 1 capital		
Assigned capital	1,044,226	1,044,226
Retained earnings and reserves	1,094,302	811,887
Total regulatory capital	2,138,528	1,856,113
Risk-weighted assets		
Retail bank, corporate bank and central treasury	5,467,513	5,776,330
Total risk-weighted asset	5,467,513	5,776,330
Capital ratios		
Total regulatory capital expressed		
as a percentage of total risk-weighted assets	38.91%	32.10%
Total tier 1 (core) capital expressed as		
a percentage of risk-weighted assets	38.91%	32.10%

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%.

Notes (continued)

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 value (excluding accrued interest):

At 31 DECEMBER 2016	Held to maturity	Loans and receivables	Other liabilities at amortized cost	Total fair value	Carrying amount
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
Assets					
Cash and balances with Central Bank of Kenya	-	837,492	-	837,492	837,492
Balances with banks and branches	-	649,901	-	649,901	649,901
Investments in government securities	6,555,129	-	-	6,555,129	6,820,723
Investments in commercial paper	68,446	-	-	68,446	68,446
Loans and advances to customers	-	3,812,504	-	3,812,504	3,812,504
Total assets	6,623,575	5,299,897	-	11,923,472	12,189,066
Liabilities					
Other liabilities-bills payable and items in transit	-	-	102,775	102,775	102,775
Deposits and balances due to banking institutions	-	-	1,736,272	1,736,272	1,736,272
Customers' deposits	-	-	8,215,360	8,215,360	8,215,360
Total liabilities	-	-	10,054,407	10,054,407	10,054,407

Notes (continued)

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)

At 31 DECEMBER 2015:	Held to maturity	Loans and receivables	Other liabilities at amortized cost	Total fair value	Carrying amount
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
Assets					
Cash and balances with Central Bank of Kenya	-	538,163	-	538,163	538,163
Balances with banks and branches	-	322,735	-	322,735	322,735
Investments in government securities	4,927,350	-	-	4,927,350	5,045,334
Investments in commercial paper	170,534	-	-	170,534	170,534
Loans and advances to customers	-	3,946,146	-	3,946,146	3,946,146
Total assets	5,097,884	4,807,045	-	9,904,928	10,022,912
Other liabilities-bills payable and items in transit	-	-	73,547	73,547	73,547
Deposits and balances due to banking institutions	-	-	1,004,447	1,004,447	1,004,447
Customers' deposits	-	-	6,861,254	6,861,254	6,861,254
Total liabilities	-	-	7,939,249	7,939,249	7,939,249

Notes (continued)

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 2016, 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 2016, the carrying amounts of these deposits were not materially different from their calculated fair values.

b) Fair value hierarchy

In 2016, the Bank had no assets and liabilities that are measured at fair value in its statement of financial position (2015-nil).

Notes (continued)

4 Financial assets and liabilities and their fair values (continued)

		2016	2015
		Shs '000	**Shs '000**
5	**Interest income**		
	Cash and cash equivalents	12,280	14,484
	Investment securities	662,141	503,660
	Loans and advances to customers	536,688	542,530
	Total interest income	1,211,109	1,060,674
6	**Interest expense**		
	Deposits from customers	446,252	318,152
	Deposits from banks	22,562	23,148
	Total interest expense	468,814	341,300
7	**Fees and commissions**		
	Total Fees and commissions	47,085	60,176
8	**Other operating income**		
	Foreign exchange gain	24,033	32,391
	Incidental charges	7,295	6,731
	Miscellaneous income	4,951	4,098
	Swift charges recovered	5,793	5,540
	Profit on disposal of property and equipment	332	-
	Others	2,167	2,507
		44,571	51,267
9	**Other operating expenses**		
	Personnel expenses	183,233	165,680
	Operating lease rentals (Note 29)	42,507	35,779
	Depreciation on property and equipment (Note 17)	25,464	17,366
	Establishment operating expenses	21,040	13,901
	Regional office expenses	-	4,402
	Travelling expenses	4,621	4,768
	Deposit Protection Fund	9,257	9,857
	Maintenance of office equipment	4,083	7
	Auditors' remuneration	3,350	3,340
	Security charges	7,090	6,135
	Printing and stationery	2,871	4,448
	Outsourced services	4,160	4,439
	Subscriptions and donations	5,008	3,701
	Other expenses	25,789	20,380
		338,473	294,203

Notes (continued)

10 Profit before tax

	2016 Shs '000	2015 Shs '000
Profit before tax is arrived at after charging:		
Personnel expenses	183,233	165,680
Depreciation on property and equipment (Note 17)	25,464	17,366
Auditors' remuneration	3,350	3,340
And after crediting		
Foreign exchange gain	24,033	32,391
Profit on disposal of property and equipment	332	-

11 Income Tax

11.1 Profit or loss

	2016 Shs '000	2015 Shs '000
Current income tax	197,770	233,271
Adjustment in current income tax of previous year	-	1,170
Deferred income tax charge (Note 18)	(10,965)	(48,506)
	186,805	185,935

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

	2016 Shs '000	2015 Shs '000
Accounting profit before tax	492,970	484,519
Computed tax using the applicable corporation tax rate (37.5%)	184,863	181,694
Non –deductible expenses	1,942	4,241
Income tax expense	186,805	185,935

11.2 Statement of financial position

	2016 Shs '000	2015 Shs '000
Balance brought forward	80,837	(5,436)
Tax charge for the year (Note 11.1)	197,770	234,441
Tax paid in the year	(337,438)	(148,168)
Closing balance as at 31 December	(58,831)	80,837

12 Cash and balances with the Central Bank of Kenya

	2016 Shs '000	2015 Shs '000
Cash in hand	151,353	129,938
Balances with Central Bank of Kenya:		
- Cash reserve ratio (CRR)	423,795	351,886
- Clearing balances	262,344	56,339
	837,492	538,163

Notes (continued)

(12) Cash and balances with the 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 2016, the cash reserve requirement was 5.25% (2015 – 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

	2016	2015
	Shs '000	**Shs '000**
(a) Investments in Government securities		
Treasury bills		
Maturing within 90 days	2,211,393	2,076,911
Maturing after 90 days but within 180 days	2,296,776	193,604
Maturing after 180 days but within one year	1,446,960	1,274,819
Treasury bonds – Held to maturity		
Maturing within 90 days	-	-
Maturing after 90 days but within 3 years	865,594	1,500,000
	6,820,723	5,045,334

The weighted average effective interest rate on Government securities at 31 December 2016 was 11.51% (2015:13.91%).

(b) Investments in commercial paper

Commercial paper	**2016** **Shs '000**	**2015** **Shs '000**
Maturing within 90 days	68,446	170,534

The weighted average effective interest rate on commercial paper at 31 December 2016 was 15.4% (2015: 17.49%).

14 Balances with banks and branches

	2016	2015
	Shs '000	**Shs '000**
Balances with local banks	-	153,467
Balances with foreign banks	1,392	444
Balances with Habib Bank branches	648,509	168,824
	649,901	322,735

Notes (continued)

15 Loans and advances to customers

		2016	2015
		Shs '000	Shs '000
(a)	Overdrafts	681,204	800,242
	Loans	2,709,219	2,540,648
	Bills purchased	-	176,180
	Bills discounted	598,978	603,465
	Gross loans and advances	3,989,401	4,120,535
	Impairment loss reserve (Note 15b)	(135,011)	(132,504)
	Interest in suspense	(41,885)	(41,885)
	Net loans and advances	3,812,504	3,946,146

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 2016 was 10.56% (2015: 15.38%).

(b) Impairment loss reserve

	2016	2015
	Shs '000	Shs '000
At 1 January	132,503	80,409
Provisions made in the year (Note 15 c)	2,508	52,095
At 31 December	135,011	132,504
Suspended interest	41,885	41,885
Total	176,896	174,389

Notes (continued)

(15) Loans and advances (continued)

Movement in provisions for impairment of loans and advances are as follows

	Identified Impairment Shs '000	Unidentified Impairment Shs '000	Total Shs'000
Year ended 31 December 2016			
At start of year	112,871	19,632	132,503
Provisions for impairment	(10,148)	12,656	2,508
At end of year	102,723	32,288	132,011
Year ended 31 December 2015			
At start of year	61,874	18,534	80,408
Provisions for impairment	50,997	1,098	52,095
At end of year	112,871	19,632	132,503

(c) Impaired loans and advances

	2016 Shs '000	2015 Shs '000
Impaired gross loans and advances	815,986	434,253
Impairment loss reserve	(102,723)	(112,871)
Net non-performing loans	713,263	312,382

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

The estimated realizable value of the securities held against these amounts is Shs 429,325,000 (2015: Shs 369,075,000). The gross impaired loans and advances exclude interest not received (suspended) as at year end of Shs 41,885,531 (2015: Shs 41,885,531).

16 Other assets

	2016 Shs '000	2015 Shs '000
Deposits and prepayments	5,820	45,639
	95,820	45,639

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

Notes (Continued)

17 Property Plant and equipment

Year ended 31 December 2016	Office equipment & Computers Shs '000	Motor vehicles Shs '000	Furniture fixtures and equipment Shs '000	Leasehold improvements Shs '000	Total Shs '000
Cost					
At 1 January 2016	71,880	18,389	20,040	84,078	194,387
Additions	8,923	1,726	951	6,163	17,763
Disposals	(1,635)		(1,234)		(2,869)
At 31 December 2016	79,168	20,115	19,757	90,241	209,281
Depreciation					
At 1 January 2016	48,925	6,613	15,378	37,312	108,228
Charge for the year	7,405	3,560	2,271	12,228	25,464
Disposals-Accumulated depreciation	(1,251)		(1,234)	-	(2,485)
At 31 December 2016	55,079	10,173	16,415	49,540	131,207
Closing Net book Value	24,089	9,942	3,342	40,701	78,074

Notes (Continued)

17 Property Plant and equipment

Year ended 31 December 2015	Office equipment Shs' 000	Motor vehicles Shs' 000	Furniture, fixtures and equipment Shs '000	Leasehold improvements Shs '000	Total Shs '000
Cost					
At 1 January 2015	52,640	13,917	17,002	37,767	121,326
Additions	19,240	4,472	3,038	46,311	73,061
At 31 December 2015	71,880	18,389	20,040	84,078	194,387
Depreciation					
At 1 January 2015	42,436	2,994	13,716	31,716	90,862
Charge for the year	6,489	3,619	1,662	5,596	17,366
At 31 December 2015	48,925	6,613	15,378	37,312	108,228
Net carrying amounts	22,955	11,776	4,662	46,766	86,159

Notes (continued)

(18) Deferred tax asset

The deferred tax asset is attributable to the following

Year ended 31 December 2016

Deferred income tax asset	**Balance at 01.01.2016 Shs '000**	**Recognized in profit or loss Shs '000**	**Balance at 31.12.2016 Shs '000**
Arising from:			
Equipment and motor vehicles	5,766	2,029	7,795
Provision for honorarium, gratuity, bonus and staff leave	46,566	(18,756)	27,810
General provision on loans and advances	22,937	27,692	50,629
	75,269	10,965	86,234

Year ended 31 December 2015

Deferred income tax asset	**Balance at 01.01.2015 Shs '000**	**Recognized in profit or loss Shs'000**	**Balance at 31.12.2015 Shs'000**
Arising from:			
Equipment and motor vehicles	6,284	(518)	5,766
Provision for honorarium, gratuity, Bonus and staff leave	3,828	42,738	46,566
General provision on loans and advances	16,651	6,286	22,937
	26,763	48,506	75,269

Notes (continued)

19 Customer deposits

	2016 Shs '000	2015 Shs '000
Term deposits	4,079,176	3,334,343
Current deposits	2,729,222	2,253,135
Savings deposits	1,259,955	1,107,640
Other	147,007	166,136
	8,215,360	6,861,254

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 2016 was 7.47 %(2015:8.58%).

20 Amounts due to foreign and local banks

	2016 Shs '000	2015 Shs '000
Due within one year		
Amounts due to head office	-	142,890
Amounts due to foreign and local banks	1,736,272	861,557
	1,736,272	1,004,447

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 2016 was 4.4% (2015: 3.23%)

21 Other liabilities

	2016 Shs '000	2015 Shs '000
Bills payable	34,375	50,911
Gratuity - Note 22.2	39,360	38,100
Other accounts payable	20,515	22,617
Items in transit	7,485	23,262
Unclaimed bills	1,040	1,098
	102,775	135,988

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

Notes (continued)

22. Retirement benefit obligation

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.

	2016 Shs '000	2015 Shs'000
National Social Security Fund	17	13
Provident fund	3,771	3,414
	3,788	3,427

22.2 Provision for gratuity

At 1 January	38,100	27,015
Charge for the year	1260	13,204
Payments	-	(2,119)
At 31 December	39,360	38,100

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 & reserves

	2016 Shs '000	2015 Shs '000
Assigned capital		
1 January and 31 December 2016	1,044,226	1,044,226

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.

(a) 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.

Notes (continued)

24 Analysis of the balance of cash and cash equivalents

	2016 Shs '000	2015 Shs '000	Charge Shs '000
Year Ended 31 December 2016			
Cash and balances with Central Bank of Kenya - excluding CRR (Note 12)	413,697	186,277	227,420
Balances due from banking Institutions (Note 14)	649,901	322,735	327,166
Balances due to banking institutions (Note 20)	(1,736,272)	(1,004,447)	(731,825)
Investment in Government securities due within 90 days (Note 13a)	2,211,393	2,076,911	134,482
Investment in commercial paper due within 90 days (Note 13b)	68,446	170,534	(102,088)
	1,607,165	1,752,010	(144,845)
Year Ended 31 December 2015			
Cash and balances with Central Bank of Kenya - excluding CRR (Note 12)	186,277	129,659	56,619
Balances due from banking Institutions (Note 14)	22,735	210,267	112,468
Balances due to banking institutions (Note 20)	(1,004,447)	(991,360)	(13,087)
Investment in Government securities due within 90 days (Note 13a)	2,076,911	987,712	1,089,199
Investment in commercial paper due within 90 days (Note 13b)	170,534	566,075	(395,541)
	1,752,010	902,352	849,658

25 Maturity analysis of assets and liabilities

At 31 December 2016	Within 12 months Shs '000	After 12 months Shs '000	Total Shs '000
Assets			
Cash and balances with Central Bank of Kenya	837,492	-	837,492
Investments in government securities	5,955,129	865,594	6,820,723
Investment in commercial paper	68,446	-	68,446
Balances with banks and branches	649,901	-	649,901
Loans and advances to customers	3,493,495	319,009	3,812,504
Other assets	95,820	58830	154,650
Property and equipment	-	78,074	78,074
Deferred tax asset	-	75,269	75,269
Total Assets	11,100,283	1,396,776	12,497,059
Liabilities			
Customers deposits	8,214,210	1,150	8,215,360
Amounts due to foreign and local banks	1,736,272	-	1,736,272
Other liabilities	102,775	-	102,775
Total Liabilities	10,053,257	1,150	10,054,407
Net assets	1,047,026	1,395,626	2,442,652

Notes (continued)

25 Maturity analysis of assets and liabilities (continued)

At 31 December 2015	Within 12 months	After 12 months	Total
Assets	**Shs '000**	**Shs '000**	**Shs '000**
Cash and balances with Central Bank of Kenya	538,163	-	538,163
Investments in government securities	4,445,334	600,000	5,045,334
Investment in commercial paper	170,534	-	170,534
Balances with banks and branches	322,735	-	322,735
Loans and advances to customers	3,192,506	753,640	3,946,146
Other assets	45,639	-	45,639
Property and equipment	-	86,159	86,159
Deferred tax asset	-	75,269	75,269
Total Assets	8,714,911	1,515,068	10,229,979
Liabilities			
Customers deposits	6,861,254	-	6,861,254
Amounts due to foreign and local banks	1,004,447	-	1,004,447
Other liabilities	135,988	-	135,988
Tax payable	80,837	-	80,837
Total liabilities	8,082,526	-	8,082,526
Net	632,385	1,515,068	2,147,453

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:

	2016	2015
	Shs '000	**Shs 000**
Commitments with respect to:		
Irrevocable letters of credit	197,685	356,680
Guarantees	566,787	557,162
Bills for collection	28,925	498,898
Spot exchange contracts	45,912	62,929
	839,309	1,475,669

Notes (continued)

26 Contingent Liabilities and Commitments

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

	2016 Shs'000	2015 Shs' 000
Balance as at 1 January	39,406	
Loans advances during the year	25,055	
Loan repayments received	(30,971)	
Balance at 31 December	33,490	

The related interest income in 2016 was Shs 1,740,400 (2015: Shs 1,421,750). The value of collateral held is Shs 58,200,000 (2015: Shs 58,200,000). The effective interest rate was 8.06% (2015: 8.06%). The loans' tenors stretch to a maximum of 15 years.

(b) Transactions with key management personnel

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

	2016 Shs' 000	2015 Shs '000
Mortgage lending and other secured loans	2780	3,194
Other loans	876	2,346
	3,656	5,540

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 in 2016 was Shs 63,273,000 (2015: Shs 58,200,000). 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.

Notes (continued)

27 Related party balances and transactions (continued)

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

	2016 Shs 000	2015 Shs 000
Short-term employee benefits	32,274	28,624
Post-employment benefits	-	597
	32,274	29,221

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, all staff members retire at age 60 and are entitled to their full benefits at retirement.

	2016 Shs '000	2015 Shs'000
(d) Amounts due to other Habib Bank's branches	1,486,044	654,447

The related interest paid in 2016 was Shs 12,259,545 (2015: Shs 12,676,696). The effective interest rate was 4.4% (2015: 3.23%).

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 2016 there were no assets pledged to secure liabilities.

29. Operating leases

Operating lease rentals are payable as follows:	2016 Shs '000	2015 Shs '000
Less than one year	138	32,924
Between one and five years	130,869	96,576
	131,007	129,500

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 2016, Shs 42,506,990 (2015: Shs 35,779,165) 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 (2015: Nil).

Notes (continued)

31. Events after the reporting date

Subsequent to year end, Habib Bank Limited has entered into an agreement with Diamond Trust Bank Kenya Limited (DTB), dated 21 March 2017, for the disposal of the business, assets and liabilities of Habib Bank Limited (Kenya Branch) to DTB. The business of the Branch will therefore be transferred as a going concern to DTB on completion of the sale and the Branch will cease to operate. This transaction is subject to shareholders' and regulatory approvals.

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