Annual Report and Financial Statements 2009

CELEBRATING 25 YEARS SINCE 1985

TRANS NATIONAL BANK LIMITED

Innovative & Responsive

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CORPORATE INFORMATION

DIRECTORS	M Cherwon D K Rana* P Kemei J K Kenduiwo A DeSimone** H Tororey * Indian ** American	Chairman Managing Director
AUDIT COMMITTEE	H Tororey P Kemei J K Kenduiwo F Mayodi	Chairman
CREDIT COMMITTEE	P Kemei D K Rana H Tororey S Tanui	Chairman
STRATEGY COMMITTEE	J K Kenduiwo M Cherwon P Kemei D K Rana F Sheikh	Chairman
RISK COMMITTEE	A DeSimone P Kemei F Sheikh	Chairman
ASSETS AND LIABILITY MANAGEMENT COMMITTEE	K Rana F Sheikh S Tanui P Gitau W Ruto	Chairman
HUMAN RESOURCES COMMITTEE	J K Kenduiwo H Tororey A DeSimone D K Rana D Namwendwa	Chairman
SECRETARY	L Kariuki Certified Public Secretary (Kenya) P O Box 72133 00200 - Nairobi	
REGISTERED OFFICE	Trans-National Plaza City Hall Way P O Box 75840 00200 - Nairobi	
AUDITORS	Deloitte & Touche “Kirungii”, Ring Road, Westlands Certified Public Accountant (Kenya) P O Box 40092 00100 - Nairobi	
ADVOCATES	Karimbux - Effendy & Company P O Box 43356 00100 - Nairobi Mukite Musangi & Co Advocates P O Box 149Nakuru Kalya & Company P O Box 235 Eldoret	

CORPORATE GOVERNANCE STATEMENT

Trans National Bank Limited is fully committed to the principles of transparency, integrity and accountability. The Directors of the bank are ultimately accountable to all stakeholders for ensuring that the bank's business is conducted in accordance with high standards of corporate governance. Of particular importance to the bank are the observance of shareholders' interest, efficient practices and open corporate communication systems.

1. BOARD OF DIRECTORS

The names of the Directors who held office in the year and to the date of this report are set out on page 2.

The Board is responsible for formulating bank policies and strategies and ensuring that business objectives, aimed at promoting and protecting shareholder value, are achieved. The Board also retains the overall responsibility for effective control of the bank and implements corporate governance policies of the bank.

The Board comprises five non-executive Directors and the Managing Director. The Directors have diverse skills and are drawn from various sectors of the economy. The Chairman, Vice-Chairman and Chairmen of Board committees are non-executive Directors.

A timetable of calendar dates for Board meetings to be held in the following year is fixed in advance by the Board. The notice of Board meetings is given in advance in accordance with the Bank's Articles of Association and is distributed together with the agenda and board papers to all the Directors before hand. The Board meets regularly and at least eight times annually. In accordance with the bank's practice, one Board meeting is normally scheduled to coincide with the occasion of the Annual General Meeting.

The Bank Secretary is always available to the Board of Directors.

a) Directors' Emoluments and Loans

The aggregate amount of emoluments paid to Directors for services rendered during the financial year is disclosed in Note 32 (d) to the financial statements for the year ended 31 December 2009. The bank advances loans to Directors and their associated companies as disclosed in Note 32 (d).

b) Related Party Transactions

There have been no materially significant related party transactions, pecuniary transactions or relationships between the bank and its Directors or Management except those disclosed in Note 32 to the financial statements for the year ended 31 December 2009.

2. BOARD COMMITTEES

The Board has in place five main committees, namely the Risk Management, Credit, Human Resources, Audit, Strategy & Business development. These committees assist the Board in ensuring that proper policies, strategies, internal controls, and organizational structure are in place to achieve the Bank's objectives and obligations to its stakeholders.

All the committees have detailed terms of reference and hold meetings as necessary. The Board may delegate some of its powers to any committee and may appoint any other committee, including ad hoc task forces, as and when it is deemed necessary.

a) Risk Management Committee

The committee assists the Board in establishing and implementing overall risk management system and policies. The committee periodically reviews existing levels of risks for various identified and unidentified risks through analysis of scenarios showing impact on capital and determine risk appetite for such risks through setting risk limits. The identified risks monitored by the committee include size of overall credit risk on balance sheet, liquidity risk, market risk, exchange risk, interest rate risk, operations risk, regulatory risk and reputational risk etc. The committee studies risks associated with new and existing products and established mitigations on the risks

2. BOARD OF DIRECTORS(Continued)

b) Credit Committee

The committee assists the Board in providing policy guidelines on credit business of the bank. The committee is responsible for review of overall performance of credit portfolio into various asset classes, review of significant exposures in normal and watch portfolios, recommending appetite levels through risk and return balance in credit business to Risk Management Committee, review slippages and debt recovery, ensuring adequacy of bad and doubtful debt provisions. The committee reviews quality of monitoring of credit portfolio across the bank. The committee periodically reviews credit policy.

c) Human Resources Committee

The committee is responsible for providing policy guidelines on HR practices of recruitment, training, remuneration and compensations, disciplinary actions and manpower quality across the bank, review system of performance management, job gradation, skills gaps, principles of rationalisation etc. The committee is responsible for study of productivity levels across the bank and address anomaly in staff productivity. The committee assists the Board in providing efficient, productive and quality organisation structure for the bank. The committee periodically reviews HR policy.

d) Audit Committee

The Audit Committee is chaired by a non-executive Director. The other members are non-executive appointees of the Board with the Chief Executive Officer in attendance. The Committee meets on a quarterly basis and is responsible for ensuring that the systems, procedures and policies of the Bank are properly established, monitored and reported on. The Committee receives reports from both external and internal auditors, and also monitors implementation of audit recommendations, on behalf of the Board. The Audit committee is also responsible for monitoring and providing effective supervision of the management's financial reporting process to ensure accurate and timely financial reporting. Additionally, the Committee is responsible for ensuring entrenchment of good corporate governance practices in the Bank

e) Strategy and Business development Committee

The committee assists the Board in formulation of overall strategic direction of the bank. This includes identifying strengths and weaknesses and opportunities and threats and identifying strategic objectives to realise full potential of the bank. The committee reviews growth strategy of the bank, marketing plans, product offering, client segment review, identification of business opportunities and analysis of business strategies of competition. The committee assists the Board in periodically aligning the strategy direction to changes in market direction.

3. RISK MANAGEMENT AND INTERNAL CONTROL

Management, in consultation with the Board Committees, is responsible for the Bank's day-to-day overall risk management to minimize potential adverse effects on its financial performance while the Board is responsible for the Bank's system of internal control and for reviewing its effectiveness. The Bank has an ongoing process of identifying, evaluating and managing significant risks inherent in its business, by the Risk Management department. This process is also reviewed by the Internal Auditor. The Bank has in place a chain of controls which include, but are not limited to, an annual strategic planning and budgeting process, a regular review of strategic initiatives, a well defined organizational structure which is kept under regular review by the Board, clearly laid down authority levels, and a review of quarterly financial and operating information by Management and the Board.

4. BUSINESS ETHICS

The Bank conducts its business in compliance with high ethical standards of business practice. In this respect, transactions with its clients, intermediaries, insiders, employees and other stakeholders are conducted at arm's length, with integrity and transparency. The business is conducted with high levels of transparency and accountability.

5. RESPONSIBILITY FOR STAFF WELFARE AND TRAINING

As part of its policy, the Bank recognizes the need for diversity, equal opportunities, gender sensitivity and provision of a safe and conducive work environment for all its staff. The Bank assists its staff to undertake continuous professional and development training programmes to fulfil their potential. This process is appropriately managed to align staff development with the Bank's strategic and business goals and objectives, and is reinforced with appropriate remuneration and incentive systems.

6. SHAREHOLDERS

The list of the shareholders and their individual holdings at the year end was as follows:

	2009 Holding No. of Shares	%	2008 Holding No. of Shares	%
Archers and Wilcock Limited	7,295,169	25.00%	7,295,169	25.00%
Sovereign Trust Limited	7,074,694	24.24%	7,074,694	24.24%
Duggan Limited	4,736,598	16.23%	4,736,598	16.23%
Pyramid Trustee Limited	4,644,725	15.91%	4,644,725	15.91%
November Nominees Limited	2,235,392	7.66%	2,235,392	7.66%
Simbi Investors	1,262,205	4.32%	1,262,205	4.32%
Losupuk Limited	857,108	2.94%	857,108	2.94%
Kenyerere Limited	659,190	2.26%	659,190	2.26%
Samkolit (k) Limited	127,821	0.44%	127,821	0.44%
Toiyoi investments Limited	64,117	0.22%	64,117	0.22%
Mwakai Kikonde Sio	35,867	0.12%	35,867	0.12%
Dhirendra Rana	35,857	0.12%	35,857	0.12%
Charles Field Marsham	35,857	0.12%	35,857	0.12%
Peter Kemei	35,857	0.12%	35,857	0.12%
Benjamin Chepkoit	35,857	0.12%	35,857	0.12%
John Kenduiwo	35,856	0.12%	35,856	0.12%
Lesmat Limited	13,930	0.05%	13,930	0.05%
TOTAL	29,186,100	100%	29,186,100	100%

7. BOARD AND COMMITTEE MEETINGS ATTENDANCE

During the year, attendances at meetings of the Board and its committees, namely Audit Committee and Credit Committee, were as follows:

a) Board Meetings

Name	Number of attendance	Percentage attendance
Mr. Michael Cherwon	12 out of 12	100%
Mr. Dhirendra Rana	12 out of 12	100%
Mr. Peter Kemei	12 out of 12	100%
Mr. Andre DeSimone	10 out of 12	80%
Mr. John Kenduiwo	12 out of 12	100%
Mr. Hilary Tororey	10 out of 12	80%

Audit Committee Meetings

Name	Number of attendance	Percentage attendance
Mr. Hilary Tororey	4 out of 4	100%
Mr. Peter Kemei	4 out of 4	100%
Mr. John Kenduiwo	4 out of 4	100%
Mr. Fred Mayodi	4 out of 4	100%

b) Credit Committee Meetings

Name	Number of attendance	Percentage attendance
Mr. Peter Kemei	4 out of 4	100%
Mr. Dhirendra Rana	4 out of 4	100%
Mr. Hilary Tororey	4 out of 4	100%
Mr. S Tanui	4 out of 4	100%

8. COMPLIANCE

The Bank operates within the requirements of the Banking Act, among other Acts, and adopts certain universally accepted principles in the areas of human rights, labour standards in its commitment to best practice. Additionally, the Bank complies with International Financial Reporting Standards (IFRS).

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Director Director

11 March 2010

CHAIRMAN'S REPORT

I wish to welcome all members to this 25th Annual General Meeting of the Shareholders. The year 2009 was a year of mixed fortunes for Kenyan economy. The early part of the year was badly affected due to drought, rise in electricity prices and low levels of economic activity. The latter part of the year had a big improvement with good rains, good agriculture, improved prices for Kenya's main exports etc.

National Events & Economic Environment

Political landscape showed improved stability all through the year. Progress continued on new draft constitution. The year ahead too shows hope for sustained progress and peace.

The early part of 2009 recorded high inflation rate of 9.4% which came down to 6.8% by September 2009 and continued to reduce with a boost of the economic activity and increased credit facilities to private sector. The Kenya Shilling Exchange rate marginally weakened providing Kenyan exports with a life line after some very trying time earlier in the year. The liquidity in the market remained strong and interest rates kept on declining giving positive outlook to business and economy.

Persistent impetus provided through monetary policy helped Kenya largely overcome negative impact of global financial crisis of 2008 and early 2009. The outlook now appears very good led by strong growth.

Banking Industry in Kenya

Banking was somewhat affected in 2009 due to high incidence of Non performing loans in small and micro segments as well as corporate segment. The effects appear to have been largely overcome with strong growth of credit to private sector in the first quarter of 2010.

The results for banking industry were mixed with some players showing declined profit while others showed improvement. Level of NPAs increased for banks in Kenya while fresh lending slowed. This appears to have been reversed now.

The pace of branch expansion appears to have slowed down considerably with players preferring to consolidate.

Recent Changes in Banking

Credit Reference Bureau Regulation came into force. Banks are required to mandatorily share information on all NPA accounts. The bank has already listed information on all NPA accounts as at 31st December 2009 on Credit Reference Bureau database.

Guidelines on Agency banking are awaited from Central Bank of Kenya. Plans are already underway to roll out appropriate business model enrolling services of agents. Extensive work has been done in this area through market survey in various locations. This delivery channel will make our services accessible to all Kenyan in course of time. Agency Banking will cater to retail banking service needs and will be delivered through value added products as well as highly user friendly technology of SMS banking. We will put in place guidelines to manage risks associated with this line of business. Our shareholders will benefit through improved profitability.

Trans National Bank's performance

The performance of the bank was impressive during the year. The bank moved forward in the direction of growth with setting up of three new branches namely Kericho, Nandi Hills and EPZ. The bank also took steps towards sustained growth of branch network. The bank is therefore poised towards taking its rightful place as a niche player.

Your bank is planning to open two or three new branches in the year 2010 in line with Retail banking focus.

The profit declined from Ksh.121 Million in 2008 to Ksh.90 Million due largely to start up overheads of new branches. The asset size remained at the level of 2008 which has since showed growth in the first quarter of 2010. The customer deposits were also similar to the year 2008 which too have showed good growth in the first quarter of 2010. The new braches meanwhile have started building new customers in large numbers.

The core capital of the bank remained strong. The liquidity levels remained strong. The NPA levels remain high due to long outstanding cases that are still in litigation. The management is working towards speedy recovery of such loans.

The SME and Agriculture lending taken up at new branches has significantly contributed towards strategy driven retail focus. The bank will continue with its expansion strategy to enhance its footage in retail banking segment. At the same time the bank has taken steps to aggressively recover NPAs aggressively.

The shareholders approved an issue of Private Placement of Shares to make shareholding structure broad based and further strengthen corporate governance and market niche. The issue is closing in June 2010 and it will further bolster retail strategy of the bank.

Corporate Social responsibility

The bank has been supporting Education and Children's Homes as part of its CSR work. The bank gave full study scholarships to two indigent promising students for four years degree program at Kabarak University one of whom is a female student. The earlier beneficiaries of TNB scholarships graduated this year and have entered professional careers. Branches of the bank continued supporting Children's Homes. The year 2008-9 had seen one of the worst droughts. TNB supported food distribution to the needy in worst affected areas of Kabarnet, Baringo and Marigat Districts. The staff of the bank enthusiastically participated in the distribution exercise to ensure that help reached the neediest ones within the communities.

Concluding remarks

The bank will keenly focus on high standards of corporate governance, strong Board leadership, and appropriate focus on recovery of NPAs, deposits and of customer numbers. The sustained direction would not have been possible without strong support from our shareholders and I wish to thank them for the same. I also wish to thank my colleagues on the Board who have committed a lot of their time and focus on the progress of the direction of this bank. I wish to thank the management and all staff for sustaining momentum for retail banking growth. The success cannot come without support from customers. I wish to thank them also and assure them the bank will continue to provide them with good service.

Michael Cherwon
Chairman

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2009

The directors have the pleasure to submit their report together with the audited financial statements for the year ended 31 December 2009, in accordance with Section 22 of the Banking Act and Section 157 of the Companies Act, which disclose the state of affairs of the bank.

PRINCIPAL ACTIVITIES

The principal activities of the bank are the provision of banking, financial and related services.

BANK RESULTS

	Sh'000
Profit before taxation	87,577
Taxation credit	2,579
Profit for the year	90,156

DIVIDENDS

The directors do not recommend the payment of dividend for the year ended 31 December 2009 (2008: nil).

DIRECTORS

The current directors are listed on page 2.

SECRETARY

Peter Kemei resigned as Company Secretary on 27 March 2009 and Lucy Kariuki was appointed as Company Secretary on the same date.

AUDITORS

The auditors, Deloitte & Touche, having indicated their willingness, continue in office in accordance with Section 159 (2) of the Companies Act and subject to Section 24(1) of the Banking Act.

BY ORDER OF THE BOARD

SECRETARY

Nairobi
11 March 2010

CORPORATE RESPONSIBILITY & GOVERNANCE

One of the strategic objectives of Transnational Bank is to improve on its good governance, the main objective being to achieve accountability, fairness and openness in every aspect of its day to day operations. The Board of Directors and the management of TNB are committed to corporate citizenship through support to education, the environment, the community and staff welfare.

- COMMUNITY

The Internally Displaced Persons and those affected by the 2008-9 drought received a boost from a food donation drive that was engineered by Transnational Bank in partnership with another institution. This was a welcome gesture in the face of strife and scarcity. Through the help of the local chiefs and authorities, the bank staff were able to distribute bags of food to over 1,300 families through out Kericho and Baringo district.

TNB also gives support to various Children's Homes at each of the locations where our branches are. Where there is no Children's Home near the TNB Branch, then a suitable activity in support of the needy is identified for support.

- EDUCATION

The bank recognizes the need for our youth to be educated to the highest level, more so, the girl child. Mentorship and post university training is of high importance. TNB provides two scholarships at Kabarak University, to needy bright students coming from the local community. The earlier beneficiaries of Transnational Bank scholarships graduated this year and have entered professional careers. Interested parties are expected to apply through the university. TNBL also offers internship to University students across its branches, giving them an opportunity to realize their potential as they prepare themselves for the corporate world.

- ENVIRONMENT

To recognize the role played by the society in the wild-life conservation, TNB maintains corporate membership of East African Wild Life Society and is on call whenever an environmental activity has arisen.

- EMPLOYEE WELFARE

Staff training and development takes priority at TNBL, with both on- the- job, in-house and external training sessions taking place all year round. To ensure that all members of staff are motivated, careful planning is done so that no body misses out on the training. The selections process ensures that specific skill versus knowledge requirements are met. These courses boost employees' morale and confidence.

TNBL acknowledges the importance of good communication and interaction amongst the staff. This has been fostered through vibrant and interactive team building activities where all staff participate and have a chance to get to know each other out of the formal setting. TNBL staff maintain high ethical standards to which every employee commits themselves at the time of employment. The core values which define the staff conduct are: innovativeness, responsiveness, integrity, professionalism, accountability, fairness and openness.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

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

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

………………………………………………	………………………………......…………
Director	Director

11 March 2010

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF TRANS-NATIONAL BANK LIMITED

Report on financial statements

We have audited the accompanying financial statements of Trans-national bank Limited set out on pages 13 to 52 which comprise the statement of financial position as at 31 December 2009, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the accompanying financial statements give a true and fair view of the state of financial affairs of the bank as at 31 December 2009 and of its profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.

Report on Other Legal Requirements

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

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

Certified Public Accountants (Kenya)
11 March 2010
Nairobi

STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED 31 DECEMBER 2009

	Note	2009 Sh'000	2008 Sh'000
INTEREST INCOME	5	414,694	385,376
INTEREST EXPENSE	6	(80,314)	(82,231)
NET INTEREST INCOME		334,380	303,145
Fees and commission income	7	101,509	94,978
Gains on foreign exchange dealings	8	36,400	42,874
Bad debts recovered		11,412	27,604
Other income	9	101	773
OPERATING INCOME		483,802	469,374
OTHER OPERATING EXPENSES	10	(362,625)	(311,606)
IMPAIRMENT LOSSES ON LOANS AND ADVANCES	19	(33,600)	(36,600)
PROFIT BEFORE TAXATION		87,577	121,168
TAXATION CREDIT	12	2,579	11,245
PROFIT FOR THE YEAR		90,156	132,413
OTHER COMPREHENSIVE INCOME		-	-
TOTAL COMPREHENSIVE INCOME		90,156	132,413
		Sh	Sh
EARNINGS PER SHARE			
- Basic and diluted	13	3.09	4.5

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2009

	Note	2009 Sh'000	2008 Sh'000
ASSETS			
Cash and balances with Central Bank of Kenya	14	244,764	217,803
Deposits and balances due from banking institutions	15	173,493	309,397
Corporate bonds held at fair value	16	47,514	-
Government securities	17	926,097	1,230,977
Loans and advances to customers	18	1,688,664	1,440,702
Taxation recoverable	12(c)	-	116
Other assets	20	119,241	85,331
Equipment	21	79,744	51,098
Intangible assets	22	16,029	12,732
Deferred tax asset	23	68,912	66,333
TOTAL ASSETS		3,364,458	3,414,489
LIABILITIES			
Customer deposits	24	1,844,938	1,890,623
Deposits due to banking institutions	25	25,000	16,445
Other liabilities	26	168,932	271,925
Financial liability - derivatives	27	148	212
TOTAL LIABILITIES		2,039,018	2,179,205
SHAREHOLDERS' FUNDS			
Share capital	28	583,722	583,722
Retained earnings		720,899	632,028
Statutory reserve	29	20,819	19,534
TOTAL SHAREHOLDERS' FUNDS		1,325,440	1,235,284
TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS		3,364,458	3,414,489

The financial statements on pages 13 to 52 were approved by the board of directors on 11 March 2010 and were signed on its behalf by:

Directors

Secretary

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

	Note	Share capital Sh'000	Statutory reserve Sh'000	Revenue reserve Sh'000	Total Sh'000
Balance at 1 January 2008		583,722	21,188	497,961	1,102,871
Transfer from statutory reserve	29	-	(1,654)	1,654	-
Profit for the year	-	-	132,413	132,413	
Balance at 31 December 2008		583,722	19,534	632,028	1,235,284
Balance at 1 January 2009		583,722	19,534	632,028	1,235,284
Transfer to statutory reserve	29	-	1,285	(1,285)	-
Profit for the year		-	-	90,156	90,156
Balance at 31 December 2009		583,722	20,819	720,899	1,325,440

STATEMENT OF CASH FLOWS
FOR THE PERIOD ENDED 31 DECEMBER 2009

	Note	2009 Sh'000	2008 Sh'000
Cash flows from operating activities			
Cash (used in)/generated from operations	30(a)	(584,305)	42,617
Compensating tax paid		-	(61,059)
Cash (used in)/generated from operating activities		(584,305)	(18,442)
Cash flows from investing activities			
Additions to equipment	21	(53,907)	(24,842)
Additions to intangible assets	22	(12,757)	(624)
Proceeds from disposal of equipment		587	1,306
Net cash used in investing activities		(66,077)	(24,160)
Decrease in cash and cash equivalents		(650,382)	(42,602)
Cash and cash equivalents at 1 January		995,662	1,038,264
Cash and cash equivalents at 31 December	30(b)	345,280	995,662

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

1 ACCOUNTING POLICIES

Statement of compliance

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

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

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

(a) Standards, amendments and interpretations effective on or after 1 January 2009

The following standards, amendments and interpretations, which became effective in 2009 are relevant to the bank:

IFRS 7 Improving disclosures about financial instruments

The IASB published amendments to IFRS 7 in March 2009. The amendment requires enhanced disclosures about fair value measurements and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy. The adoption of the amendment results in additional disclosures but does not have an impact on the financial position or the comprehensive income of the bank.

IAS 1 Presentation of financial statements

A revised version of IAS 1 was issued in September 2007. It prohibits the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity in a statement of comprehensive income. As a result, the bank presents in the statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the statement of comprehensive income. According to the amendment of IAS 1 in January 2008, each component of equity, including each item of other comprehensive income, should be reconciled between carrying amount at the beginning and the end of the period. The adoption does not have any impact on retained earnings.

(b) Standards and interpretations issued but not yet effective

At the date of authorisation of these financial statements, the following revised standards and interpretations were in issue but not yet effective:

- IFRS 9 Financial instruments part 1: Classification and measurement
- IAS 39, Financial Instruments: Recognition and Measurement: Amendments resulting from May 2009 Annual Improvements to IFRSs (effective for accounting periods beginning on or after 1 January 2009)
- IAS 39, Financial Instruments: Recognition and Measurement: Amendments for eligible hedged items (effective for accounting periods beginning on or after 1 July 2009); amendments for embedded derivatives when reclassifying financial instruments (effective for accounting periods ending on or after 30 June 2009).

The adoption of these standards and interpretations, when effective, will have no material impact on the financial statements of the bank.

(c) Early adoption of standards

The bank did not early-adopt new or amended standards in 2009.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

Basis of preparation

The bank prepares its financial statements under the historical cost convention, modified to include the revaluation of certain properties and financial instruments.

Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised within the statement of comprehensive income on accrual basis 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 the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

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

Fair value changes on other derivatives held for risk management purposes, and other financial assets and liabilities carried at fair value through profit or loss, are presented in net income on other financial instruments carried at fair value in the statement of comprehensive income.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest that was used to discount the future cash flows for purposes of measuring the allowance for impairment.

Fees and commission income

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

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

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

Equipment

Equipment is stated at cost less accumulated depreciation and accumulated impairment losses where applicable.

Depreciation

Depreciation is calculated on a straight line basis at annual rates estimated to write off the cost of the equipment over their expected useful lives. The rates generally in use are:

Leasehold improvements	20%
Motor vehicles	25%
Computer hardware and software	30%
Equipment, furniture, fixtures and fittings	12.5%

Intangible assets

Computer software costs are stated at cost less amortisation and impairment losses where applicable. The costs are amortised over their expected useful lives on a straight line basis. Currently, software costs are amortised over three years.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

Impairment

At each balance sheet date, the bank reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the asset's recoverable amount is estimated and an impairment loss is recognized in the statement of comprehensive income whenever the carrying amount of the asset exceeds its recoverable amount.

Offsetting

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

Taxation

Income tax expense represents the sum of the current tax payable and the deferred taxation.

Current taxation is provided on the basis of the results for the year, as shown in the financial statements, adjusted in accordance with tax legislation.

Deferred taxation is provided using the liability method for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used to determine deferred taxation.

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

Foreign currencies

Assets and liabilities in foreign currencies are expressed in Kenya Shillings at the rates of exchange ruling at the balance sheet date. Transactions in foreign currencies during the year are translated at the rates ruling at the dates of the transactions. The resulting gains or losses are dealt within the statement of comprehensive income.

Retirement benefits

The bank operates a defined contribution retirement benefit scheme for its employees. The assets of this scheme are held in a separate trustee administered fund. The scheme is funded by payments from both the employees and the bank.

The bank also contributes to a statutory defined contribution pension scheme, the National Social Security Fund (NSSF). Contributions are determined by local statute and are limited to Sh 200 per month per employee.

The bank's contributions in respect of retirement benefit costs are charged to the statement of comprehensive income in the year to which they relate.

Financial instruments

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

Financial assets

The bank classifies its financial assets into the following categories: Financial assets at fair value through profit or loss; loans, advances and receivables; held - to - maturity investments; and available-for-sale assets. Management determines the appropriate classification of its investments at initial recognition.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading.

Loans, advances and receivables

Loans, advances and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the bank provides money, goods or services directly to a debtor with no intention of trading the receivable.

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.

Available-for-sale financial assets

Financial assets that are not (a) financial assets at fair value through profit or loss, (b) loans, advances and receivables, or (c) financial assets held to maturity are classified as available-for-sale.

Recognition of financial assets

Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the bank has transferred substantially all risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans, advances and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Available for sale financial assets and financial assets at fair value through profit or loss are initially recognised at fair value and measured subsequently at fair value. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investment revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in the profit or loss when the bank's right to receive payment is established.

Fair values of quoted investments in active markets are based on quoted bid prices. Equity securities for which fair values cannot be measured reliably are measured at cost less impairment.

Impairment and uncollectability of financial assets

At each balance sheet date, all financial assets are subject to review for impairment. If it is probable that the bank will not be able to collect all amounts due (principal and interest) according to the contractual terms of loans, receivables, or held-to-maturity investments carried at amortised cost, an impairment or bad debt loss has occurred. The amount of the loss is the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate (recoverable amount). The carrying amount of the asset is reduced to its estimated recoverable amount through use of the provision for impaired loans and advances account. The amount of the loss incurred is included in statement of comprehensive income for the period. A financial asset is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after initial recognition of the asset and that the loss event has an impact on the estimated future cash flows of the financial asset than can be reliably estimated.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

Impairment and uncollectability of financial assets (Continued)

Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the bank about the following loss events

- A breach of contract, such as default or delinquency in interest or principal repayments
- A significant financial difficulty of the borrower
- The bank granting to the borrower, for economy or legal reasons relating to the borrowers financial difficulty a concession that the bank would not otherwise consider.
- It becoming probable that the borrower will enter bankruptcy or other financial reorganisation
- The disappearance if an active market for that financial asset because of financial difficulties or
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including adverse changes in the payment status of the borrowers in the group: or national or local economic conditions that correlate with defaults on the assets in that particular group.

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

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

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

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

Write off

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the statement of comprehensive income.

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

Renegotiated loans

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans. In subsequent years, the renegotiated terms apply in determining whether the asset is considered to be past due.

Financial Liabilities

After initial recognition, the bank measures all financial liabilities including customer deposits other than liabilities held for trading at amortised cost. Liabilities held for trading (financial liabilities acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin) are subsequently measured at their fair values.

Measurement of financial instruments

Financial instruments are initially recognised at fair value plus transaction costs.

Financials assets at 'fair value through profit and loss' are subsequently carried at fair value. Gains and loss arising from changes in the fair value in those assets are recognised in the profit or loss in the period in which they arise.

Gains and losses arising from changes in the fair value of 'available-for-sale financial assets' are recognised in other comprehensive income in the period in which they arise and accumulated in the revaluation surplus.

Loans and advances and held to maturity investments are carried at amortised cost using the effective interest rate method.

Financial liabilities are subsequently measured at amortised cost.

Statutory reserve

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

Leasing

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

The bank as lessee

Assets held under finance leases are recognised as assets of the bank at their fair value at the date of acquisition. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the fair value of the assets acquired, are charged to the statement of comprehensive income over the term of the relevant lease so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are generally written by the 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. These obligations are accounted for as off balance sheet transactions and disclosed as contingent liabilities.

Comparatives

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE BANK'S ACCOUNTING POLICIES

In the process of applying the entity's accounting policies, management has made estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are dealt with below:

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

The company makes estimates and assumptions concerning the future. The resulting accounting estimates will by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year as discussed below:

Impairment losses on loans and advances

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

Held -to-maturity investments

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

(ii) Key sources of estimation uncertainty

Equipment and intangible assets

Critical estimates are made by the directors in determining depreciation/amortisation rates for equipment and intangible assets.

3 RISK MANAGEMENT OBJECTIVES AND POLICIES

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

- credit risk
- liquidity risk
- market risks

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the bank's risk management framework. The board has established the Asset and Liability Committee (ALCO), Credit and Operational Risk committees, which are responsible for developing and monitoring the bank's risk management policies in their specified

NOTES TO THE FINANCIAL STATEMENTS (Continued)

areas. All board committees have both executive and non-executive members and report regularly to the Board of Directors on their activities. The board has set up an independent compliance function reporting to the Board.

The bank's risk management policies are established to identify and analyse the risks faced by the bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The audit committee is responsible for monitoring compliance with the bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the bank. The audit committee is assisted in these functions by internal audit. Internal audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the audit committee.

The bank's overall financial risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on financial performance.

a) Credit risk

Credit risk is the risk of financial loss to the bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the bank's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure.

i) Management of credit risk

The Board of Directors has delegated responsibility for the management of credit risk to the credit committee. A separate credit department, reporting to the credit committee, is responsible for oversight of the bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to business unit Managers. Larger facilities require approval by head office credit committee or the Board of Directors as appropriate.
- Reviewing and assessing credit risk. Credit risk function assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of loans and advances to counterparties, geographies and business sectors and by issuer, credit rating band, market liquidity and country (for investment securities).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

a) Credit risk (Continued)

i) Management of credit risk (Continued)

- Developing and maintaining the bank's risk gradings in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of five grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive/committee as appropriate. Risk grades are subject to regular reviews by credit risk management department.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to credit committee on the credit quality of local portfolios and appropriate corrective action is taken.
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the bank in the management of credit risk.

The bank monitors concentration of risk by economic sector in line with set limits per the sector. An analysis of concentrations within the loan and advances to customers, customer deposits and off balance sheet items is as follows:

(a) Loans and advances to customers - Gross

	2009 Sh'000	%	2008 Sh'000	%
Agriculture	86,432	4	44,030	3
Manufacturing	42,838	2	66,818	4
Wholesale and retail	170,584	9	94,029	6
Transport and communication	205,485	11	115,774	7
Real estate	228,533	12	51,813	3
Social community and personal services	375,680	19	527,783	31
Business services	39,017	2	435,609	26
Other	790,799	41	345,608	20
	1,939,368	100	1,681,464	100

(b) Customer deposits

	2009 Sh'000	%	2008 Sh'000	%
Building societies	11	-	12	-
Co-operative societies	3,319	-	3,375	-
Insurance companies	4,586	-	4,663	-
Private enterprises	1,070,442	58	1,088,970	58
Non profit institutions and individuals	766,580	42	793,603	42
	1,844,938	100	1,890,623	100

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

a) Credit risk (Continued)

(i) Management of credit risk (Continued)

(c) Off balance sheet items (letters of credit and guarantees)

	2009 Sh'000	%	2008 Sh'000	%
Agriculture	8,933	3	9,076	3
Manufacturing	9,292	3	9,440	3
Wholesale and retail	4,027	1	4,091	1
Transport and communication	73,283	25	74,453	25
Real estate	8,039	3	8,167	3
Social community and personal services	11,763	4	11,951	4
Business services	74,234	25	75,419	25
Other	107,267	36	108,980	36
	296,838	100	301,577	100

(ii) Maximum exposure to credit riskbefore collateral held

	2009 Sh'000	%	2008 Sh'000	%
Credit exposures:				
On balance sheet items:				
Deposits and balances due from banking institutions	173,493	6	309,397	9
Loans and advances to customers	1,688,664	54	1,440,702	44
Government securities held to maturity	704,604	22	1,230,977	38
Goverment securities at fair value	221,493	7	-	-
Corporate bonds at fair value	47,514	2	-	-
	2,835,768	91	2,981,076	91
Off balance sheet items:				
Letters of credit	23,266	1	73,864	2
Letters of guarantees and performance bonds	262,666	8	216,756	7
Foreign exchange forward contracts	10,906	-	10,764	-
	296,838	9	301,577	9
	3,132,606	100	3,282,653	100

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

a) Credit risk (Continued)

(iii) Classification of loans and advances

	2009 Sh'000	2008 Sh'000
Individually impaired		
Grade 5: Impaired (loss)	187,337	233,612
Grade 3 & 4: Impaired (doubtful)	316,959	245,727
Gross amount	504,296	479,339
Suspended interest	(90,196)	(81,580)
Allowance for impairment	(250,704)	(240,762)
Carrying amount	163,396	156,997
Past due but not impaired		
Watch (30-90 days)	257,781	338,749
Neither past due nor impaired		
Grade 1 : Normal	1,267,487	944,956
Total carrying amount	1,688,664	1,440,702

Impaired loans and advances

Impaired loans and securities are loans and advances for which the bank determines that it is probable that it will be unable to collect a part/whole of principal and interest due according to the contractual terms of the loan/securities agreement(s). These loans are graded 3, 4 and 5 in the bank's internal credit risk grading system.

Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the 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. These exposures are categorised as watch accounts in line with Central Bank of Kenya prudential guidelines and a provision at 3 % is made and appropriated under statutory reserves.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

a) Credit risk (Continued)

(iii) Classification of loans and advances

Loans and advances that are neither past due nor impaired

The bank classifies loans and advances under this category for those exposures that are upto date & in line with contractual agreements. Such loans would have demonstrated financial conditions, risk factors and capacity to repay that are acceptable. These exposures will normally be maintained largely within approved product programs and with no signs of impairment or distress. These exposures are categorised as normal accounts in line with Central Bank of Kenya (CBK) prudential guidelines and a provision at 1 % is made and appropriated under statutory reserves.

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.

	2009 Sh'000	2008 Sh'000
Renegotiated loans 1-90 days	13,091	16,432

(iv) Allowances for impairment

The bank sets aside from its income an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to each defaulting borrower, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

(v) Write-off policy

The bank writes off a loan / security balance (and any related allowances for impairment losses) when the credit committee determines that the loans / securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardised loans, charge off decisions generally are based on a product specific past due status.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

a) Credit risk (Continued)

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of individually impaired assets by risk grade.

In thousands of Kenya Shillings	Loans and advances to customers Gross	Net
31 December 2009		
Grade 5: Individually impaired	161,528	-
Grade 3&4: Individually impaired	254,159	164,983
Total	415,687	164,983
31 December 2008		
Grade 5: Individually impaired	173,879	-
Grade 3&4: Individually impaired	223,880	156,997
Total	397,759	156,997

(vi) Collateral held

The bank holds collateral against loans and advances to customers, non-insiders as well as insiders in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2009.

An estimate of the fair value of collateral and other security enhancements held against past due and impaired loans and advances is shown below:

	2009 Sh'000	2008 Sh'000
Against individually impaired		
Property	229,314	117,377
Equities	288	20,016
Other	72,961	30,648
	302,563	168,041
Against past due but not impaired		
Property	121,922	265,020
Equities	1,680	143,439
Other	156,368	224,178
	279,970	632,637
Total	582,533	800,678

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

a) Credit risk (Continued)

(vii) 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 bank 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 bank's board of directors.

b) Liquidity risk

The bank is exposed to the risk that it will encounter difficulty in raising funds to meet commitments associated with customer requirements. Liquidity risk is addressed through the following measures:

(i) 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 Asset and Liability Committee(ALCO), a management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when due and that no difficulties in meeting financial liabilities as they fall due are encountered.

Treasury department maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the bank as a whole.

(ii) Source of funding

The bank has an aggressive strategy aimed at increasing the customer base and maintains a diversified and stable base comprising retail and corporate customers. The bank also borrows from the interbank market through transactions with other banks and from the wholesale market through transactions with pension funds and insurance companies for short term liquidity requirements.

(iii) 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 investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

b) Liquidity risk (Continued)

(iii) Exposure to liquidity risk (Continued)

Details of the reported bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2009	2008
At 31 December	65.50%	81.90%
Average for the period	73.31%	74.12%
Maximum for the period	78.20%	90.50%
Minimum for the period	65.50%	24.70%
Statutory Minimum requirement	20.00%	20.00%

Liquidity risk based on undiscounted cash flows

The table below represents the cash flows payable by the bank under non- derivative financial liabilities by remaining contractual maturities at the balance sheet date. The amounts disclosed in the table are the contractual undiscounted cash flows, whereas the bank manages the inherent liquidity risk based on expected undiscounted cash inflows.

AT 31 December 2009 FINANCIAL LIABILITIES	Upto 3 months Sh'000	3-6 months Sh'000	6-12 months Sh'000	1-3 years Sh'000	3-5 years Sh'000	Over 5 years Sh'000	Total Sh'000
Deposits due to banking institutions	25,011	-	-	-	-	-	25,011
Customer deposits	1,373,245	120,657	109,787	144,519	98,621	-	1,846,829
Financial liability - derivatives	148	-	-	-	-	-	148
Contractual maturity dates	1,398,404	120,657	109,787	144,519	98,621	-	1,871,988
FINANCIAL ASSETS							
Cash and bank balances with The Central Bank of Kenya	187,934	14,521	13,174	17,642	12,016	-	245,287
Deposits and balances due from banking institutions	236,238	-	-	-	-	-	236,238
Loans and advances to customers	996,519	116,615	186,726	243,677	124,700	61,633	1,729,870
Corporate bond at fair value	47,634	-	-	-	-	-	47,634
Government securities	42,296	465,679	-	114,514	75,781	230,601	928,871
Expected maturity dates	1,510,621	596,815	199,900	375,833	212,497	292,234	3,187,900
Net liquidity gap	(112,217)	(476,158)	(90,113)	(231,314)	(113,876)	(292,234)	(1,315,912)
At 31 December 2008							
Total financial liabilities	1,792,818	28,973	263,904	101,206	-	-	2,186,901
Total financial assets	1,470,100	264,711	485,548	824,968	224,544	44,783	3,314,654
Net liquidity gap	322,718	(235,738)	(221,644)	(723,762)	(224,544)	(44,783)	(1,127,753

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (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) 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.

Management of market risks

The bank's open Foreign Exchange Position is the net investment in its foreign operations. The amount of market risk on the net foreign exchange position is estimated at 7% of the amount of net exchange position.
Overall authority for market risk is vested in ALCO. The senior management is responsible for the development of detailed risk management policies (subject to review and approval by the Board) and for the day-to-day review of their implementation.

Exposure to interest rate risk – non-trading portfolios

The bank is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on financial position and cash flows. The assets and liability committee closely monitors the interest rates trends to minimize the potential adverse impact of interest rate changes. The table overleaf summarizes the exposure of interest rate risk at the balance sheet date. The bank maintains an appropriate mix of fixed and floating rates deposit base. Interest rates on advances to customers and other risk assets are either pegged to the bank's base lending rate or Treasury bill rate. The base rate is adjusted from time to time to reflect the cost of deposits.

Interest rates on customer deposits are negotiated between the bank and the customer with the bank retaining the discretion to adjust the rates in line with changes in market trends. The interest rates, therefore, fluctuate depending on the movement in the market interest rates. The bank also invests in fixed interest rate instruments issued by the Government of Kenya through the Central Bank of Kenya.

The matching and controlled mismatching of the maturities and interest rate of assets and liabilities is fundamental to the management of the bank. It is unusual for a bank's assets and liabilities to be completely matched due to the nature of business terms and types.

The bank is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

c) Market risks (Continued)

Interest rate risks

The Assets and Liability Committee closely monitors the interest rate trends to minimize the potential adverse impact of interest rate changes. The table below summarises the exposure to interest rate risk at the balance sheet date whereby financial assets and liabilities at carrying amounts are categorized by the earlier of contractual repricing or maturity dates.

AT 31 December 2009 FINANCIAL ASSETS	Upto 3 months Sh'000	3-6 months Sh'000	6-12 Months Sh'000	1-3 years Sh'000	Over 3 years Sh'000	Non -interest bearing Sh'000	Total Sh'000
Cash and bank balances with The Central Bank of Kenya	-	-	-	-	-	244,764	244,764
Deposits and balances due from banking institutions	22,770	-	-	-	-	150,723	173,493
Loans and advances to customers	972,782	113,837	182,278	237,873	181,894	-	1,688,664
Corporate bond at fair value	47,514	-	-	-	-	-	47,514
Government securities	42,281	463,097	-	114,415	306,304	-	926,097
Total financial assets	1,085,347	576,934	182,278	352,288	488,198	395,487	3,080,532
FINANCIAL LIABILITIES							
Deposits due to banking institutions	25,011	-	-	-	-	-	25,011
Customer deposits	1,371,354	120,657	109,787	144,519	98,621	-	1,844,938
Financial liabilities – derivaties	148	-	-	-	-	-	148
Total financial liabilities	1,396,513	120,657	109,787	144,519	98,621	-	1,870,097
On balance sheet interest sensitivity gap	(311,166)	456,277	72,491	207,769	389,577	395,487	1,210,435
At 31 December 2008							
Total assets	976,852	260,097	467,561	813,929	265,026	500,745	3,284,210
Total liabilities	1,161,103	28,670	260,241	98,435	-	630,756	2,179,205
On balance sheet interest sensitivity gap	(184,251)	231,427	207,320	715,494	265,026	(130,011)	1,105,005

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

c) Market risks (Continued)

Interest rate risk stress test-Increase/decrease of 8% in Net Interest Margin
Interest rate risk sensitivity analysis is based on the following assumptions

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

The table below sets out the impact on the future net interest income of an incremental 8% parallel fall or rise in net interest margin for the twelve months from 1 January 2010.

31 December 2009	Amount Sh'000	Scenario 1 8% increase in net interest margin Sh'000	Scenario 2 8% decrease in net interest margin Sh'000
Profit before tax	87,577	114,327	60,827
Adjusted core capital	1,288,592	1,315,342	1,261,842
Adjusted total capital	1,309,411	1,336,161	1,282,661
Risk weighted assets (RWA)	1,847,897	1,847,897	1,847,897
Adjusted core capital to RWA	69.73%	71.18%	68.29%
Adjusted total capital to RWA	70.86%	72.31%	69.41%

Overall non-trading interest rate risk positions are managed by treasury, which uses investment securities, advances to banks, deposits from banks and derivative instruments to manage the overall position arising from the bank's non-trading activities.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

c) Market risks (Continued)

Currency risk

The bank operates wholly in Kenya and its assets and liabilities are reported in the local currency. The bank's currency risk is managed within Central Bank of Kenya exposure guideline of 20% of core capital. The bank's management monitors foreign currency exposure on a daily basis.

The table below summarises the bank's exposure to foreign currency exchange rate risk at 31December. Included in the table are the bank's financial instruments at carrying amounts categorised by currency.

AT 31 December 2009 FINANCIAL ASSETS	KSH Sh'000	USD Sh'000	GBP Sh'000	EURO Sh'000	OTHERS Sh'000	TOTAL Sh'000
Cash and balances with Central Bank of Kenya	203,993	25,269	3,854	5,089	6,559	244,764
Deposits and balances due from banking institutions	1,785	135,572	9,769	21,488	4,879	173,493
Loans and advances	1,665,641	23,023	-	-	-	1,688,664
Corporate bond at fair value	47,514	-	-	-	-	47,514
Government securities	926,097	-	-	-	-	926,097
Total financial assets	2,845,030	183,864	13,623	26,577	11,438	3,080,532
FINANCIAL LIABILITIES						
Deposits due to banking institutions	25,000	-	-	-	-	25,000
Customer deposits	1,701,528	125,506	8,785	5,856	3,263	1,844,938
Financial liability - derivatives	-	-	-	148	-	148
Total financial liabilities	1,726,528	125,506	8,785	6,004	3,263	1,870,086
Net on balance sheet position	1,118,502	58,358	4,838	20,573	8,175	1,210,446
Off balance sheet position	(152,585)	(31,989)	(180)	(40,237)	(71,847)	(296,838)
At 31 December 2008						
Total financial assets	3,039,932	168,714	9,018	42,599	23,947	3,284,210
Total financial liabilities	2,004,055	150,503	5,185	19,462	-	2,179,205
Net on balance sheet position	1,035,877	18,211	3,833	23,137	23,947	1,105,005
Off balance sheet position	(116,156)	(70,648)	(169)	(41,882)	(72,722)	(301,577)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

c) Market risks (Continued)

Foreign currency risk stress test-appreciation/depreciation of Kenya shilling by 10%
The foreign exchange risks sensitivity analysis is based on the following assumptions

- Foreign exchange exposures represent net currency positions of all currencies other than the Kenya shilling
- The currency risk sensitivity analysis is based on the assumption that all net currency positions are highly effective.
- The base currency in which Transnational bank's business is transacted is Kenya shilling.

The table below summarises the estimated impact of a 10 % decline/appreciation of the Kenya Shilling.

31 December 2009	Amount Sh'000	Scenario 1 10% appreciation of Kenya shilling Sh'000	Scenario 2 10% depreciation of Kenya shilling Sh'000
Profit before tax	87,577	87,664	87,403
Adjusted core capital	1,288,592	1,288,679	1,288,505
Adjusted total capital	1,309,411	1,309,498	1,309,324
Risk weighted assets(RWA)	1,847,897	1,847,897	1,847,897
Adjusted core capital to RWA	69.73%	69.74%	69.73%
Adjusted total capital to RWA	70.86%	70.86%	70.85%

Exposure to other market risks – non-trading portfolios

Credit spread risk (not relating to changes in the obligor / issuer's credit standing) on debt securities held by treasury and equity price risk is subject to regular monitoring by ALCO but is not currently significant in relation to the overall results and financial position of the bank.

d) Fair value of financial assets and liabilities

(i) Financial instruments not measured at fair value

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

(ii) Fair value hierachy

The bank specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices in active markets for identical assets or liabilities. This level includes equity securities and debt instruments listed on the Nairobi stock exchange.

- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly as prices or indirectly as derived from prices.

- Level 3 – inputs for the assets or liabilities that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

This hierarchy requires the use of observable market data when available. The bank considers relevant and observable market prices in its valuations where possible.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

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

(ii) Fair value hierachy (Continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy.

31 December 2009	Note	Level 1 Kshs'000	Level 2 Kshs'000	Level 3 Kshs'000	Total Kshs'000
Fair value through profit or loss					
- Corporate bonds	16	47,514	-	-	47,514
- Goverment securities	17	221,493	-	-	221,493
Financial asset		269,007	-	-	269,007
Fair value					
- Financial derivative	27	148	-	-	148
Financial liability		148	-	-	148

4 CAPITAL MANAGEMENT

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the bank as a whole.

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 calculates requirements for operations risk and market risk for internal monitoring purpose.

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

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings and translation reserve after deductions for intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 percent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of banks and certain other regulatory items.
Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures. The bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the bank 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4 CAPITAL MANAGEMENT (Continued)

Regulatory capital (Continued)

In implementing current capital requirements, the Central Bank of Kenya requires each bank to maintain;

- A minimum level of regulatory capital of Shs 250m. This minimum level will be increased gradually to Sh 1billion by end of 2012.
- A ratio of core capital to the risk–weighted assets plus risk-weighted off-balance sheet assets at or above the required minimum of 8%.
- Core capital of not less than 8% of total deposit liabilities.
- Supplementary capital of not less than 12% of risk-weighted assets plus risk-weighted off-balance sheet items.

The bank has complied with all externally imposed capital requirements throughout the year.

There have been no material changes in the bank's management of capital during the year.
The bank's regulatory capital position at 31 December was as follows:

	2009 Sh'000	2008 Sh'000
Tier 1 capital		
Total share capital	583,722	583,722
Retained earnings	720,899	632,028
Less intangible assets	(16,029)	(12,732)
Total	1,288,592	1,203,018
Tier 2 capital		
Statutory reserve	20,819	19,534
Total regulatory capital	1,309,411	1,222,552
Risk-weighted assets		
Retail bank, corporate bank and central treasury	1,847,897	1,853,467
Total risk weighted assets	1,847,897	1,853,467
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets	70.8%	65.9%
Total tier 1 capital expressed as a percentage of total risk-weighted assets	69.7%	64.9%

NOTES TO THE FINANCIAL STATEMENTS (Continued)

		2009 Sh'000	2008 Sh'000
5	INTEREST INCOME		
	Interest on loans and advances	306,509	272,189
	Interest on Government securities held to maturity	92,711	83,703
	Interest on deposits and balances due from banking institutions	9,239	29,484
	Interest on Goverment securities held at fair value	5,519	-
	Interest on corporate bonds held at fair value	716	-
		414,694	385,376
6	INTEREST EXPENSE		
	Interest on customer deposits	79,877	76,343
	Interest on deposits due to banking institutions	437	5,888
		80,314	82,231
7	FEES AND COMMISSION INCOME		
	Commissions	87,777	84,051
	Ledger related fees	13,732	10,927
		101,509	94,978

8 GAINS ON FOREIGN EXCHANGE DEALINGS

Gains on foreign currency dealings arose from trading in foreign currency transactions and also on the translation of foreign currency assets and liabilities.

		2009 Sh'000	2008 Sh'000
9	OTHER INCOME		
	Gain on disposal of equipment	-	385
	Miscellaneous income	101	388
		101	773
10	OTHER OPERATING EXPENSES		
	Staff costs (note 11)	202,370	178,040
	Other expenses	26,650	31,983
	Rent and parking	24,020	19,668
	Depreciation (note 21)	21,130	16,204
	Computer expenses	5,402	8,018
	Security services	14,243	11,085
	Amortisation (note 22)	9,460	7,509
	Telephone, telex and postage	8,425	8,405
	Insurance	8,083	8,753
	Advertising and marketing	5,119	3,595
	Stationery and supplies	4,923	4,429
	Directors' emoluments - fees	3,771	3,086
	other emoluments	7,384	5,824
	Loss on disposal of equipment	3,544	-
	Auditors' remuneration	3,420	2,803
	Contribution to Deposit Protection Fund	2,680	2,204
	Fair value loss on goverment security held at fair value	1,350	-
	Fair value loss on corporate bond held at fair value	602	-
	Travel and accommodation	49	-
		362,625	311,606

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2009 Sh'000	2008 Sh'000
11 STAFF COSTS		
Salaries and wages	173,113	150,657
Pension costs - defined contribution plan	9,957	8,364
Other staff costs	7,052	5,466
Provision for leave pay	6,960	8,814
Medical expenses	4,982	4,461
National Social Security Fund contributions	306	278
	202,370	178,040
12 TAXATION		
(a) TAX CREDIT		
Current taxation based on the taxable profit for the year at 30%	-	-
Deferred taxation credit (note 23) - current year	(2,194)	(5,955)
- prior year overprovision	(385)	(5,290)
Tax credit	(2,579)	(11,245)
(b) RECONCILIATION OF TAX CHARGE/(CREDIT) TO THE EXPECTED TAX BASED ON ACCOUNTING PROFIT		
Accounting profit before taxation	87,577	121,168
Tax at the applicable rate of 30%	26,273	36,350
Tax effect of expenses not deductible for tax purposes	4,012	1,824
Tax effect of revenues that are not taxable	(215)	(71)
Prior years deferred tax credit not recognised	(32,264)	(44,058)
Prior year deferred tax overprovision	(385)	(5,290)
Tax credit	(2,579)	(11,245)
(c) TAX RECOVERABLE MOVEMENT		
At the beginning of the year	116	116
Prior year overprovision	(116)	-
At the end of the year	-	116

13 EARNINGS PER SHARE

Earnings per share is calculated by dividing the net profit attributable to shareholders amounting to Sh 90,156,000 (2008 - Sh 132,413,000) by the number of ordinary shares outstanding during the year which were 29,186,100 (2008 –29,186,100). The basic earnings per share is the same as the diluted earnings per share as there were no potentially dilutive shares as at 31 December 2009 and 31 December 2008.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

14 CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2009 Sh'000	2008 Sh'000
Cash on hand	110,986	97,401
Balances with Central Bank of Kenya:		
- Cash ratio requirement	81,909	89,209
- Cash held under lien	8,349	-
- Other (available for use by the bank)	43,520	31,193
	244,764	217,803

The cash ratio requirement balance is non-interest earning and is based on the value of customer deposits as adjusted by the Central Bank of Kenya requirements. As at 31 December 2009, the cash ratio requirement was 4.5% (2008 - 5%) of all customer deposits. These funds are not available to finance the bank's day to day operations.

15 DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	2009 Sh'000	2008 Sh'000
Held to maturity: At amortised cost		
Deposits due within 90 days	1,874	51,785
Current accounts due on demand	171,619	257,612
	173,493	309,397

The weighted average effective interest rate on deposits with banking institutions as at 31 December 2009 was 4.6% (2008 - 4.8%) and nil for current account balances.

16 CORPORATE BONDS HELD AT FAIR VALUE THROUGH PROFIT AND LOSS

	2009 Sh'000	2008 Sh'000
Face value	47,400	-
Interest receivable	716	-
Fair value loss	(602)	-
	47,514	-

The effective interest rate on corporate bonds held at fair value was 12.5 % (2008 – nil)

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2009 Sh'000	2008 Sh'000
17 GOVERNMENT SECURITIES		
Treasury bills - at amortised cost		
Face value - maturing within 90 days	45,000	319,000
Less: unearned discount	(2,719)	(5,754)
	42,281	313,246
Treasury bonds - at fair value through profit and loss		
Face value	225,000	-
Interest and premiums receivable	(2,157)	-
Fair value loss	(1,350)	-
	221,493	-
Treasury bonds - at amortised cost		
- maturing within 90 days	-	260,870
- maturing between 90 days to 1 year	463,097	112,245
- maturing between 1 - 2 years	114,415	458,405
- maturing after 2 years but within 5 years	75,781	77,181
- maturing after 5 years	9,030	9,030
	662,323	917,731
	926,097	1,230,977
The weighted average effective interest rates as at year end were:		
Treasury bills held to maturity	8.25%	7.51%
Treasury bonds held to maturity	11.25%	10.17%
18 LOANS AND ADVANCES TO CUSTOMERS		
(a) Loans and advances to customers	1,740,180	1,564,783
Staff loans	89,856	66,478
Finance lease receivables (note 18b)	146,127	54,572
	1,976,163	1,685,833
Less: unearned finance charges (note 18b)	(36,795)	(4,369)
	1,939,368	1,681,464
Impairment loss on loans and advances (note 19)	(250,704)	(240,762)
	1,688,66	41,440,702

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18 LOANS AND ADVANCES TO CUSTOMERS (Continued)

(b) Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2009 Sh'000	2008 Sh'000	2009 Sh'000	2008 Sh'000
Amounts receivable under finance leases:				
Within one year	68,756	18,964	51,443	17,446
In the second to fifth year inclusive	77,371	35,408	57,889	32,557
	146,127	54,372	109,332	50,003
Less: unearned finance income	(36,795)	(4,369)	-	-
Present value of minimum lease payments receivable	109,332	50,003	109,332	50,003

The bank enters into finance leasing arrangements for certain equipment and motor vehicles. The average term of finance leases entered into is 3 years.

Unguaranteed residual values of assets leased under finance leases are estimated at nil (2008: Nil).

The interest rate inherent in the leases is variable at the contract date for all of the lease term.

The weighted average effective interest rate on loans and advances as at 31 December 2009 was 17.5 % (2008 - 15.78%).

The weighted average effective interest rate on finance lease receivables at 31 December 2009 was 15% (2008 - 15%).

NON PERFORMING LOANS AND ADVANCES TO CUSTOMERS

Included in net advances of Sh 1,688,664,000 (2008 - Sh 1,440,702,000) are loans and advances amounting to Sh 253,591,324 (2008 - Sh 252,900,338), net of specific provisions, which have been classified as non-performing.

	2009 Sh'000	2008 Sh'000
MATURITY OF GROSS LOANS AND ADVANCES (NET OF FINANCE CHARGES)		
Maturing:		
Up to one month	390,339	505,477
1-3 months	231,758	182,338
3-6 months		132,090
103,923		
6-12 months	451,619	355,316
1-3 years	352,067	344,950
3-5 years	199,886	145,194
Over 5 years	181,609	44,266
Loans and advances to customers (gross)	1,939,368	1,681,464

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18 LOANS AND ADVANCES TO CUSTOMERS (Continued)

GROSS LOANS AND ADVANCES TO CUSTOMERS BY TYPE (NET OF FINANCE CHARGES)	2009 Sh'000	2008 Sh'000
Overdrafts	869,705	699,853
Term loans	1,069,663	981,611
Loans and advances to customers (gross)	1,939,368	1,681,464

The related party transactions and balances are covered under note 32 and concentration of advances to customers is covered under note (2) (1) on financial risk management objectives and policies.

19 IMPAIRMENT LOSS ON LOANS AND ADVANCES

	2009 Sh'000	2008 Sh'000
At 1 January	240,762	237,124
Provisions in the year	33,600	36,600
Written off in the year	(23,658)	(32,962)
At 31 December	250,704	240,762

20 OTHER ASSETS

	2009 Sh'000	2008 Sh'000
Clearing and transit items	26,775	35,715
Deposits and prepayments	5,893	2,911
Other assets	86,573	46,705
	119,241	85,331

NOTES TO THE FINANCIAL STATEMENTS (Continued)

21 EQUIPMENT

	improvements Sh'000	Furniture, fittings and equipment, Leasehold hardware Sh'000	computer, vehicles Sh'000	Motor Total Sh'000
COST				
At 1 January 2008	42,430	105,206	10,223	157,859
Additions	14,996	9,846	-	24,842
Writeoff	-	(236)	-	(236)
Disposals	-	(217)	(2,600)	(2,817)
At 31 December 2008	57,426	114,599	7,623	179,648
At 1 January 2009	57,426	114,599	7,623	179,648
Additions	24,620	29,287	-	53,907
Disposals	(32)	(5,712)	(775)	(6,519)
At 31 December 2009	82,014	138,174	6,848	227,036
DEPRECIATION				
At 1 January 2008	31,970	75,809	6,699	114,478
Charge for the year	4,159	10,186	1,859	16,204
Eliminated on writeoff	-	(236)	-	(236)
Eliminated on disposals	-	(217)	(1,679)	(1,896)
At 31 December 2008	36,129	85,542	6,879	128,550
At 1 January 2009	36,129	85,542	6,879	128,550
Charge for the year	8,218	12,645	267	21,130
Eliminated on disposals	(32)	(1,872)	(484)	(2,388)
At 31 December 2009	44,315	96,315	6,662	147,292
NET BOOK VALUE				
At 31 December 2009	37,699	41,859	186	79,744
At 31 December 2008	21,297	29,057	744	51,098

Equipment with a cost of Sh 103,633,000 (2008 - Sh 87,036,000) were fully depreciated as at 31 December 2009. The nominal annual depreciation charge on these assets would have been Sh 23,234,000 (2008 - Sh 19,513,000).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

22 INTANGIBLE ASSETS (Computer Software)

	2009 Sh'000	2008 Sh'000
COST		
At 1 January	32,960	32,336
Additions	12,757	624
At 31 December	45,717	32,960
AMORTISATION		
At 1 January	20,228	12,719
Charge for the year	9,460	7,509
At 31 December	29,688	20,228
NET BOOK VALUE		
At 31 December	16,029	12,732

Intangible assets with a cost of Sh 7,526,000 (2008 - Sh 7,526,000) were fully amortised as at 31 December 2009. The nominal annual amortisation charge on these assets would have been Sh 2,258,000 (2008 - Sh 2,258,000).

23 DEFERRED TAX ASSET

The deferred tax asset is attributable to the following items:

	2009 Sh'000	2008 Sh'000
Accelerated capital allowances	3,573	1,610
Provisions		
-Leave pay	1,603	1,986
-Legal fee	4,578	1,163
-Gratuity and union salary increment	4,642	8,170
-Bonus and other staff costs	11,617	10,504
Tax losses	82,251	113,789
	108,264	137,222
Tax asset not recognised	(39,352)	(70,889)
	68,912	66,333

Movement in deferred tax asset is as follows:

	2009 Sh'000	2008 Sh'000
At 1 January	66,333	55,088
Income statement credit:		
- Current year	2,194	5,955
- Prior year under provision	385	5,290
Income statement credit - Note 12 (a)	2,579	11,245
At 31 December	68,912	66,333

NOTES TO THE FINANCIAL STATEMENTS (Continued)

23 DEFERRED TAX ASSET (Continued)

Deferred tax on tax losses has been provided based on management's projection of profits for the next 3 years. As a result, deferred tax asset amounting to Sh 32,264,098 (2008 - Sh 44,057,726) relating to part of the tax losses has not been recognised.

As at 31 December 2009,the bank had taxable losses amounting to Sh 271,513,917 (2008 – Sh 379,060,910) available for future relief.

24 CUSTOMER DEPOSITS

	2009 Sh'000	2008 Sh'000
Current and demand accounts	598,847	729,049
Savings accounts	347,723	308,966
Fixed and call deposit accounts	898,368	852,608
	1,844,938	1,890,623

MATURITY ANALYSIS OF CUSTOMER DEPOSITS

	2009 Sh'000	2008 Sh'000
Repayable:		
Within one month	1,260,211	1,291,417
Within 1 - 3 months	206,741	211,860
Within 3 - 6 months	27,977	28,670
Within 6-12 months	253,953	260,241
Within 1-3 years	96,056	98,435
	1,844,938	1,890,623

The weighted effective interest rate on interest bearing customer deposits at 31 December 2009 was 4.35% (2008 – 4.14%).
The related party transactions and balances are covered under note 32 and concentration of customer deposits is covered under note (2) (1) on financial risk management objectives and policies.

25 DEPOSITS AND BALANCES DUE TO BANKING INSTITUTIONS

	2009 Sh'000	2008 Sh'000
Demand accounts	25,000	16,445

The effective interest rate on deposits and balances due to banking institutions was 4.0% (2008 – 5.3%).

26 OTHER LIABILITIES

	2009 Sh'000	2008 Sh'000
Bankers cheques outstanding	34,814	148,229
Deposits for letters of credit and letters of guarantee	11,883	23,605
Provision for leave pay	4,936	6,619
Other liabilities and accruals	117,299	93,472
	168,932	271,925

NOTES TO THE FINANCIAL STATEMENTS (Continued)

27 FINANCIAL LIABILTY DERIVATIVE

Maturing within 3 months	Contract exchange rate 2009	Contract exchange rate 2008	Foreign currency 2009 '000	Foreign currency 2008 '000	Contract value 2009 Sh'000	Contract value 2008 Sh'000	Fair value liability 2009 Sh'000	Fair value liability 2008 Sh'000
Sell Euros	107.58	107.52	100	100	10,758	10,752	(148)	(212)
							(148)	(212)

The bank enters into forward foreign exchange contracts to cover specific exposure generated from payments and receipts of foreign currency. The fair value is the difference between the contract value and the foreign currency at the closing rate Sh 109.06 (2008 - Sh 109.64) for Euros.

	2009 Sh'000	2008 Sh'000
28 SHARE CAPITAL		
Authorised:		
31,250,000 ordinary shares of Sh 20 each	625,000	625,000
Issued and fully paid:		
29,186,100 ordinary shares of Sh 20 each	583,722	583,722
29 STATUTORY RESERVE		
At 1 January	19,534	21,188
Transfer from/(to) retained earnings	1,285	(1,654)
At 31 December	20,819	19,534

The statutory reserve represents an appropriation from retained earnings to comply with Central Bank of Kenya's prudential guidelines on impairment of loans and advances. It represents the excess of loan provision as computed in accordance with the Central Bank of Kenya prudential guidelines over impairment of loans and advances computed per IAS 39. The statutory reserve is not distributable.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

30 NOTE TO THE CASH FLOW STATEMENT

	2009 Sh'000	2008 Sh'000
(a) Reconciliation of profit before taxation to cash generated from operating activities		
Profit before taxation	87,577	121,168
Depreciation	21,130	16,204
Amortisation of intangible assets	9,460	7,509
Loss/(profit) on disposal of equipment	3,544	(385)
Profit before working capital changes	121,711	144,496
Balances with Central Bank of Kenya		
- Decrease in cash ratio requirement	7,300	29,900
- (Increase)/decrease in cash held under lien-clearing	(8,349)	7,227
Increase in governments securities maturing after 90 days	(5,462)	(32,921)
Increase in goverment securities held at fair value	(221,493)	-
Increase in corporate bonds held at fair value	(47,514)	-
Increase in loans and advances to customers	(247,962)	(232,564)
(Increase)/decrease in other assets	(33,910)	4,310
(Decrease)/increase in customer deposits	(45,685)	90,718
(Decrease)/increase in other liabilities	(102,993)	36,957
Decrease in financial liability – derivatives	(64)	(5,506)
Tax recoverable overprovision writeoff	116	-
Cash (used in)/generated from operating activities	(584,305)	42,617
(b) Analysis of the balances of cash and cash equivalents		
Cash on hand	110,986	97,401
Balances with Central Bank of Kenya - other	43,520	31,193
Placements and balances due from banking institutions	173,493	309,397
Government securities maturing within 90 days	42,281	574,116
Deposits due to banking institutions	(25,000)	(16,445)
	345,280	995,662

For the purposes of the cash flow statement, cash equivalents include short term liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the date of the advance.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

31 CONTINGENCIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS

(a) Contingent liabilities

	2009 Sh'000	2008 Sh'000
Letters of credit	23,266	73,864
Letters of guarantee and performance bonds	262,666	216,749
Forward exchange contracts	10,906	10,964
	296,838	301,577

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

Letters of guarantee and performance bonds are issued by the bank, on behalf of customers, to guarantee performance by customers to third parties. The bank will only be required to meet these obligations in the event of default by the customers.

The bank enters into forward foreign exchange contracts to cover specific exposure generated from payments and receipts of foreign currency.

The related party transactions and balances are covered under note 32 and concentration of contingent liabilities is covered under note (2) (1) on financial risk management objectives and policies.

(b) Capital commitments

	2009 Sh'000	2008 Sh'000
Authorised but not contracted for	20,572	43,037
Authorised and contracted for	10,032	8,311
	30,604	51,348

(c) Operating lease arrangements

The bank as a lessee
At the balance sheet date, the bank had outstanding commitments under operating leases which fall due as follows:

	2009 Sh'000	2008 Sh'000
Within one year	18,822	10,609
In the second to fifth year inclusive	41,877	27,239
After five years	5,032	4,763
	65,731	42,611

Operating lease payments represent rentals payable by the bank for its office premises. Leases are negotiated for an average term of 6 years.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

32 RELATED PARTY TRANSACTIONS

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

Placings are made in the bank by directors, their associates and companies associated to directors. Advances to customers at 31 December 2009 include advances and loans to companies associated to directors. Contingent liabilities at 31 December 2009 include guarantees and letters of credit for companies associated to directors.

(a) The bank leases office and parking space from Autosilo (Queensway) Ltd, a company with common directorship and former shareholding. Payments during the year amounted to Sh 8,780,488 (2008 - Sh 8,584,656).

(b) Loans and advances:

	Directors' associated companies		Employees	
	2009	2008	2009	2008
	Sh'000	Sh'000	Sh'000	Sh'000
At 1 January	407,575	370,801	66,478	47,162
Net movement during the year	77,265	36,774	23,378	19,316
At 31 December	484,840	407,575	89,856	66,478

These loans and advances are performing and are adequately secured, except for loans amounting to Sh 38,073,000 which are classified as non-performing.

Interest earned on advances to directors and associated companies amounted to Sh 22,466,270 (2008 - Sh 18,886,000) and Sh 6,840,269 (2008 - Sh 4,589,132) on staff advances.

(c) Deposits:

	Directors' associated companies		Employees	
	2009	2008	2009	2008
	Sh'000	Sh'000	Sh'000	Sh'000
At 1 January	249,957	188,290	13,944	11,470
Net movement during the year	196,402	61,667	5,656	2,474
At 31 December	446,359	249,957	19,600	13,944

Interest paid on deposits from directors and associated companies amounted to Sh 25,907,841 (2008 - 8,002,686) and Sh 1,372,000 (2008 - Sh 492,896) on staff deposits.

	2009	2008
	Sh'000	Sh'000
(d) Guarantees and letters of credit to companies associated to directors	52,536	54,345

NOTES TO THE FINANCIAL STATEMENTS (Continued)

32 RELATED PARTY TRANSACTIONS (Continued)

(d) Key management compensation

The remuneration of directors and other members of key management during the year were as follows:

	2009 Sh'000	2008 Sh'000
Salaries and other benefits	61,808	49,560
Directors' remuneration:		
Fees for services as directors	3,771	3,086
Allowances	7,384	5,824
	11,155	8,910

33 ASSET PLEDGED AS SECURITY

As at 31 December 2009, assets pledged as security were balances with Central Bank of Kenya under lien for the Domestic Foreign Currency clearing amounting to USD 110,000 (2008: USD 110,000).

34 POST BALANCE SHEET EVENTS

The Shareholders of the bank adopted a resolution to convert the bank from a private limited company to a public limited company on 4 November 2009. The resolution was registered with the registrar of companies on 25 January 2010. The shareholders also approved a private placement issue of ordinary shares in the amount of Ksh 1 billion to provide capital for growth of the bank in small and medium enterprises and the agriculture segments and to broaden shareholder base.

35 COUNTRY OF INCORPORATION

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

36 CURRENCY

The financial statements are presented in Kenya shillings thousands (Sh'000)

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