



“

I am grateful to Faulu,
it has really boosted
my business.

Chelangat
Faulu Customer

”

2015 Annual Report and Financial Statements

Faulu Microfinance Bank

Our Vision

Giving Kenyans hope and a future

Our Mission

To listen and empower Kenyans by providing relevant financial solutions

Our Values

The Lordship of Jesus Christ

Teamwork, love, caring, compassion, commitment

Listening

To God, to each other and to our clients

Learning

Open to ideas and innovation

Excellence

Professionalism and commitment to improvement

Integrity

Accountability, transparency, fairness, honesty

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Corporate Information

Board of Directors

Dr. Peter W. Muthoka	Non-Executive Chairman	
Charles K. Njuguna	Managing Director	
Kevin Terry*	Non-Executive Director	
Tavaziva Madzinga*	Non-Executive Director	
Peter J. Mogan**	Non-Executive Director	
George A. Maina	Non-Executive Director	
Beverley Nuthu	Non-Executive Director	
Mwikali Muthiani	Non-Executive Director	
Sospeter Joshua Muiru	Non-Executive Director	Appointed on 30 March 2015
Peter Gachuba	Non-Executive Director	Appointed on 16 March 2015
Catherine Musakali	Non-Executive Director	Appointed on 2 April 2015
Peter K. Mwangi	Non-Executive Director	Appointed on 11 March 2015

*Zimbabwean, **Canadian

Audit Committee

Joshua Muiru
Beverley Nuthu
Kevin Terry
Paul Kahoro*

Strategy Committee

Mwikali Muthiani
George A. Maina
Charles K. Njuguna
Bernard Githinji*

Risk & Compliance Committee

George A. Maina
Joshua Muiru
Catherine Musakali
Charles K. Njuguna
Amos Mwangi*
Bernard Githinji*
Raphael Lekolool*

Remuneration and Nominating Committee

Dr. Peter W. Muthoka
George A. Maina
Charles Njuguna
William Wambugu*

Credit committee

Peter Gachuba
George A. Maina
Mwikali Muthiani
Peter Onsongo*

*Senior management

Corporate Information. cont.

Registered office

Ngong Lane
Off Ngong Road
P.O. Box 60240
00200 - Nairobi
Kenya

Company Secretary

Pauline Ngonyo
Corner of Mara Road and
Hospital Road, Upper Hill
P.O. Box 30059
Nairobi
Kenya

Principal Bankers

Standard Chartered Bank Kenya Limited
Yaya Centre Branch
P.O. Box 40310
00100 - Nairobi
Kenya

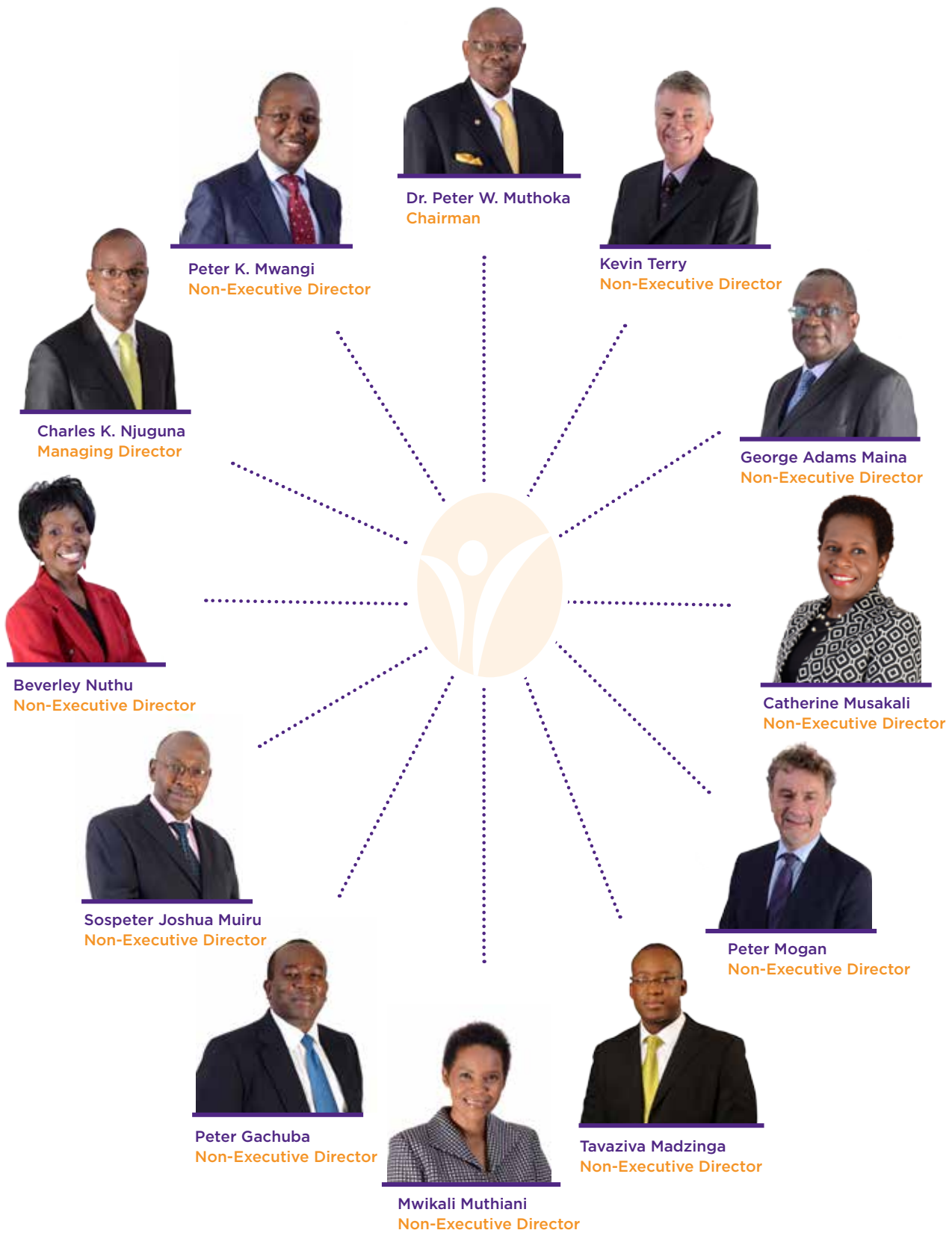
Auditors

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

Principal Lawyers

Daly & Figgis Advocates
6th Floor, ABC Towers, ABC
Place, Waiyaki Way
P.O. Box 40034
00100 - Nairobi
Kenya

Board of Directors



Senior Management



Charles K. Njuguna
Managing Director



Bernard Githinji
General Manager, Finance

Raphael Lekoolool
Head of Risk and Compliance



Tom V. Juma
General Manager, Technology and Operations



William Wambugu
Head of HR and Business Integration



Amos Mwangi
General Manager, Business Development

Paul Kahoro
Head of Internal Audit



Purity Raaria
Head of Legal



Carol Kipsanai
Head of Marketing



Peter Onsongo
Head of Credit

Chairman's Statement



“ Faulu will continue to offer diversified products, in credit facilities, savings and bancassurance innovatively and affordably. ”

It is a great honour for me to present to you the Faulu Microfinance Bank's ("Faulu") annual report and financial statements for the year ended 31st December 2015.

This is the first full financial year since Old Mutual Holdings Limited acquired controlling stake in Faulu. During the year significant effort was directed towards business consolidation, geographical expansion, enhancing governance and derisking the business as the first steps of establishing a strong foundation for sustainable growth and delivery of stakeholders' expectations. This has enabled Faulu to expand banking services and insurance products to more Kenyans who are financially excluded in the micro, small and medium enterprise space.

Economic environment

On the global front, economic growth slowed down to 2.4% from 2.6% in 2014. According to the World Bank, the slowdown was mainly due to a continued deceleration of economic activity in emerging and developing economies amid weakening commodity prices, global trade, and capital flows. Many emerging and developing economies experienced depreciation of their currencies against the United States Dollar (USD). This was on the back of a strengthening United States of America (USA) economy and the announcement of the increase in interest rates by Federal Reserve Bank which was eventually raised in December 2015.

According to Kenya National bureau of statistics (KNBS), the domestic market experienced relative stability in key macroeconomics indicators. The economic performance improved by 5.8% during last quarter of 2015. The growth was mainly supported by strong expansions in Agriculture; Construction; Financial and Insurance. During the year, most of the

macroeconomic indicators remained relatively stable. The World Bank has however revised the GDP growth outlook from 6.0% to 5.4% while International Monetary Fund (IMF) revised the GDP growth to 6%. Overall the rate of inflation averaged 6.58% in 2015 compared to 6.88% in 2014. This was mainly due to favourable weather conditions which have prevailed during the year and declines in prices of oil and several food items.

Central Bank of Kenya (CBK) increased Central Bank Rate (CBR) from 8.5% in May 2015 to 11.5% in December 2015 to tighten the liquidity in the market. Interest rates increased following surging interbank rates and depreciating local currency. High interbank rates were experienced, recording 25.8% in September 2015 while local currency depreciated to close the year at 102.3 to the USD compared to 90.60 in 2014. The market also witnessed the Imperial Bank (IB) put under receivership with CBK appointing Kenya Deposit Insurance Corporation to manage IB for a period of 12 months from 13th October over what the Regulator indicated was 'unsafe banking practices'. This resulted in considerable interest rates volatility, liquidity constraints among medium and small sized banks especially those perceived as family owned and of "Asian" extraction.

The Federal Reserve (Fed) raised its key interest rate in December 2015 from a range of 0% to 0.25% to a range of 0.25% to 0.5%. This has had an impact on local currency weakening against the USD and subsequent increase in interest rates to attract foreign currency inflows thereby cushioning the local currency against further depreciation.

Financial Performance

Faulu posted profit before tax of Shs 183 million down from Shs 432 million in 2014. This was mainly driven by high interest expenses on deposits and borrowed funds following the escalation of local currency interest rates mainly driven by heavy government domestic borrowing to finance expenditure as well cushioning the local

currency against the strengthening dollar. Fee and commissions were depressed by low transactional activity while at the same time Faulu exited non-core/low potential branches resulting in write off of establishment costs.

The quality of the loan book improved in the year as compared to 2014. Portfolio at Risk (PAR) closed at 3.63% compared to 4.06% in 2014. The credit loss provisions increased from Shs 132 million in 2014 to Shs 165 million in the year 2015. This was due to adoption of more conservative credit provisioning model.

The statement of financial position grew impressively by Shs 5.0 billion or 24.63% to Shs 25.3 billion up from Shs 20.3 billion in 2014 driven by the growth in the outstanding loans balances and deposit liabilities.

Completion of Divestiture

The final tranche of capital injection by Old Mutual of Shs 397m was paid in May 2015 following the completion of post transaction valuation. The first tranche of Shs 2.7 billion was injected in April 2014. Through this transaction Old Mutual acquired 67% controlling stake in Faulu Microfinance Bank Limited. The divestiture was in line with the Central Bank of Kenya regulations on shareholding and adequate capitalization of the financial institutions. The process also involved appointment of new directors who are highly qualified, experienced and technically capable, adding value to Faulu.

As part of governance enhancement process additional directors Sospeter Joshua Muiru, Peter Gachuba, Catherine Musakali and Peter Mwangi were appointed to the Board. The new appointees bring valuable skills and expertise to the Board. Further, Risk Management Committee was split into Risk and Compliance Committee and Credit Committee to enhance Risk management and governance in the Credit Processes. This is in line with regulatory requirements and implementation of Faulu strategy.

Looking forward

World Bank and IFC forecasts that the country's economy will grow by about 5.5%- 6% per cent in 2016 powered by increased investment in infrastructure and growth of agriculture and service sectors. This is expected to provide a robust environment for business growth.

Faulu will continue to expand its infrastructure with a view to enhancing distribution of banking and bancassurance products. Our focus will remain acquiring entry level customers as well as offering transformative products to the Retail and Micro Small Medium enterprises.

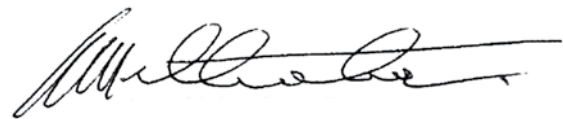
Acknowledgement

I take this opportunity to express my gratitude to all who have enabled Faulu to achieve these results. I thank the clients for taking Faulu as their Bank of choice thereby consuming our products and services. I thank the development partners and lenders who not only provided affordable funding but also supported the institution with Technical Assistance programs that have created significant leadership bandwidth for growth.

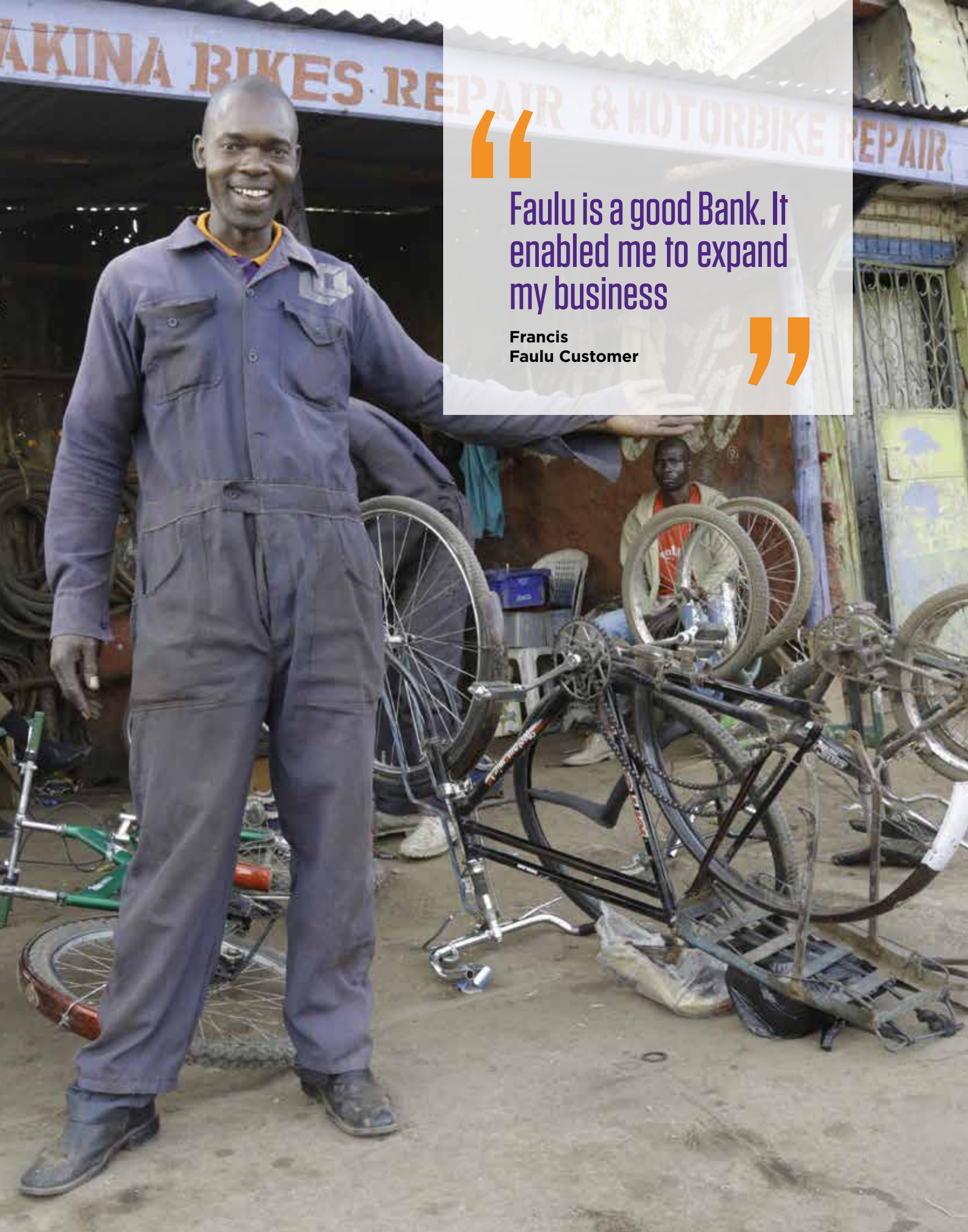
Finally, I acknowledge the staff for their great passion, commitment and enthusiasm in delivering value to our customers and shareholders. I also thank my fellow board members for the invaluable guidance they have extended to the institution's leadership. In addition, I thank the Governor and the Central Bank of Kenya for enabling a business friendly economic and monetary environment in which the banks and the financial institutions have continued to thrive in offering their products and services to the Republic.

We remain confident that Faulu will continue to grow and prosper as it pursues the vision of giving Kenyans Hope and a Future.

Thank you and God Bless You.



Dr. Peter W. Muthoka EBS, MBS



“

Faulu is a good Bank. It enabled me to expand my business

Francis
Faulu Customer

”

Managing Director's Statement



“ Faulu’s total assets grew impressively by 24.63% to Sh. 25.3 billion up from Shs 20.3 billion in 2014. ”

I am delighted to present to you the Annual Report and Financial Statements of Faulu Kenya Microfinance Bank for the year ended 31st December 2015.

Although 2015 was a challenging year for the industry due to a number of both external and internal factors, the company’s overall performance continued to align well with our vision. We have continued to grow as a business and as a brand.

Economic Environment

According to the World Bank, the Kenyan economy in 2015 experienced substantial growth. The country’s GDP grew by 5.6% in 2015 compared to 5.3% growth in 2014. The positive growth was attributed to:

- Low oil prices
- Good agricultural performance
- Supportive monetary policy
- Ongoing Infrastructural Investments such as the standard gauge railway

The country’s GDP is expected to expand by 5.9% and 6% in 2016 and 2017 respectively.

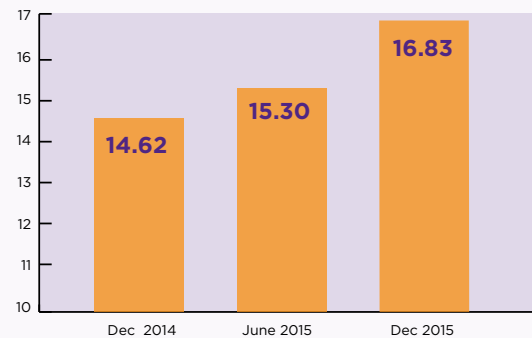
The political environment was relatively stable throughout the year with few isolated cases such as the Garissa University College Terrorist attack in April. Security threat both locally and globally undermined foreign investment in the country especially in the tourism industry. Nevertheless, there were positive political occurrences such as visit by the Pope and the President of the United States which increased investor confidence in the country.

Financial performance

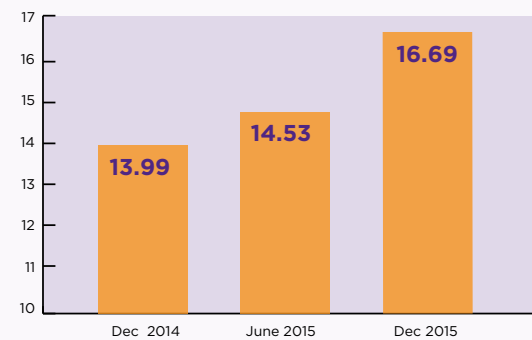
The Faulu 2015 performance was as follows:

- The profit before tax declined to Sh. 183 million from Sh. 432 million in 2014. This was mainly driven by high interest expenses on deposits and borrowed funds following the escalation of local currency interest rates mainly driven by heavy government deposit borrowing to finance expenditure as well cushioning the local currency against strengthening dollar.
- The quality of the loan book improved, with the portfolio at risk (PAR) decreasing from 4.06% in 2014 to 3.63% in 2015. The credit loss provisions increased from Sh. 132 million to Sh. 165 million in 2015 due to adoption of a more conservative credit provisioning model.
- The customer deposits increased by 19.3% to Shs 16.69 billion up from Shs 13.98 in 2014 due to focused deposit sales and increased customer confidence as a result of synergy between Old Mutual –UAP strong brand.
- Loans and advances to customers increased by 14.95% to Shs 16.82 billion in 2015 compared to Shs 14.62 in 2014. This was driven by enhanced sales force.
- The total assets grew impressively by 24.63% to Sh. 25.3 billion up from Shs 20.3 billion in 2014 driven by the growth in outstanding loans balances and deposit liabilities.

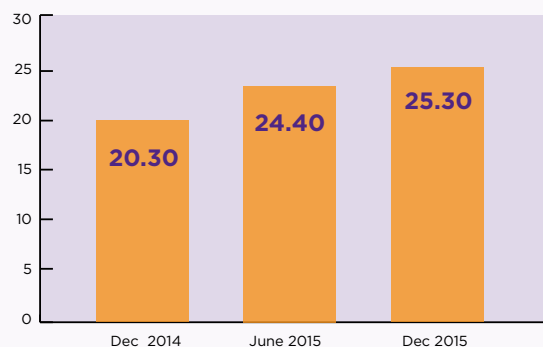
Loan and advances to customers (Kshs 'Billions)



Deposits (Kshs 'Billions)



Total Assets (Kshs 'Billions)



Infrastructure and Customer Service

Faulu Microfinance Bank has continued to invest in infrastructure upgrading the core banking system, increasing the number of branches and service outlets across the country. In addition, the company has adopted mobile banking services to ease customer access to loans, such as Chap Chap, and other banking services.

Faulu partnered with European Investment Bank, where the latter lent Sh.1 billion. This new credit line facilitated the financing of SMEs and bolstered our mission of financial inclusion and transformation in the communities we serve in Kenya at large.

Outlook

Backed by our reputable brand, excellent team, salient client relationships and core financial strength, I am optimistic that Faulu will continue to grow steadily.

Our focus will be on ensuring financial inclusion, enhanced customer experience, and business efficiency through continued investment in technology and innovation as well as new opportunities.

Acknowledgement

I take this opportunity to extend my sincere appreciation to the Board of Directors for having

provided invaluable guidance to the institution and to all our staff for their diligent effort. In this endeavor, I shall continue to solicit your ongoing support.

Thank you and God Bless You



Charles Njuguna



“

Faulu listens. That's how they've helped me to expand my business

**Daniel
Faulu Customer**

”

Our Vision of Community (VOC)

The Vision of Community is strongly entrenched in the Faulu staff culture. The Faulu Kenya fraternity is committed to giving hope and improving the lives of Kenyans through sustainable community partnerships and development. Throughout the year, Faulu Kenya participated in numerous projects around the country, which included:

- Run for the Bibleless in partnership with Bible Translation and Literacy (BTL)
- Ndeka Tree Planting with the UAP-Old Mutual
- Ndakaini Half Marathon with UAP-Old Mutual
- Ngong Road Branch staff intervened in

the Mt. Longonot hike with the Kenya Society of the Blind

- Meru branch staff participated in the Meru Marathon in support of underprivileged children in the region
- Nyahururu branch also intervened in the Laikipia University Marathon in support of forest conservation
- Kisumu and Mumias branches extended educational support to individual students within the region, and
- The Audit Department provided support to the Bethel Children's home

BTL run for the Bibleless

The annual run is dedicated towards the translation of the Bible into minority language groups in Kenya and facilitates basic financial literacy programmes for these communities.



Tree planting at Ndeka near Ndakaini Dam

on 18 May 2015



Ndakaini Half Marathon

The Faulu team actively participated in the Ndakaini half marathon on 12th September 2015.



Ngong Road Branch joins the Kenya Society for the Blind in the Mt. Longonot hike
on 19th September 2015

For the past three years, Ngong Road has actively participated in the Mt. Longonot hike, and 2015 was no exception. Everyone is ready for the journey up the mountain.



Nothing could deter them as they continued up the mountain

At the peak of the mountain

Meru Marathon

Meru Branch also could not be left behind in the support of the underprivileged children in the region



Laikipia University Marathon

Nyahururu branch staff dedicated their efforts toward forest conservation through participation in the Laikipia University Marathon



The Audit Department was overjoyed to spend a day with kids at Bethel Children's home in Limuru

The audit team provided financial and emotional support to the lovely angels.



Report of the Directors

The directors present their report together with the audited financial statements of Faulu Microfinance Bank Limited (the “company”) for the year ended 31 December 2015 which disclose its state of affairs.

Principal Activities

The principal activity of the company is the transformation of lives through the provision of loans to micro and small entrepreneurs and deposit taking from the public.

OPERATING RESULTS FOR THE YEAR

	2015 Shs '000	2014 Shs '000
Profit before taxation	182,689	431,571
Taxation	(67,356)	(132,625)
Profit for the year transferred to retained earnings	115,333	298,946

DIVIDEND

The directors do not recommend the payment of a dividend in respect of the year (2014: Shs nil).

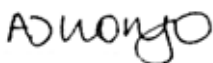
DIRECTORS

The current board of directors is as shown on page 2.

AUDITORS

The auditors, Deloitte & Touche, having expressed their willingness, continue in office in accordance with section 159(2) of the Companies Act and subject to approval by the Central Bank of Kenya under section 29(1) of the Kenyan Microfinance Act (2006).

BY ORDER OF THE BOARD



SECRETARY

Nairobi
23rd March 2016

Corporate Governance Statement

Faulu Microfinance Bank Limited (formerly Faulu Kenya Deposit Taking Microfinance Limited) received its Deposit Taking License from the Central Bank of Kenya on 21 May 2009, becoming the first institution in Kenya to be licensed to receive deposits from the public under the Micro Finance Act (2006). The Board of Directors of the institution is responsible for ensuring that the institution complies with the Laws of Kenya and the prudential guidelines issued by the Central Bank of Kenya.

The Board of Directors of Faulu Microfinance Bank Limited is also responsible for ensuring that the company complies with the highest standards of corporate governance and universally accepted business ethics. The Board has developed, adopted and benchmarked a framework of internationally recognized principles of good corporate governance, which it endeavors to adhere to in the pursuit and maintenance of the highest possible standards.

The Board of Faulu upholds the values of uncompromised integrity, while conforming to the highest standards of ethics, honesty, trust, fairness, quality and pursuit for excellence.

Board size, composition and appointments

The Board comprises a balanced mix of proficient individuals. This takes into account a balance of executive, non executive and independent Directors, various skills and competencies, differing experiences and team roles, balance gender and age factors. This ensures ability to add value while ensuring that there is an appropriate balance of power on the Board such that no individuals/ interests has unfettered power or can dominate the Board decision making process.

There is a formal and transparent process for all appointments to the Board. On an annual basis, the Board reviews and assesses the composition and performance of the Board to ensure that:

(a) The mix of membership is appropriate and

compatible with the requirements of both the Board and the company;

(b) Non-executive Directors commit adequate time and contribute effectively to the Board.

The Board is directly involved in the sourcing and appointment of new Directors and appointments are based on merit and against objective criteria.

Board responsibilities

The Board is responsible for setting the direction of the company, corporate values and standards, and ensures that its obligations to shareholders are understood and met. In particular, their responsibilities include the following:

- Providing entrepreneurial leadership to the company within a framework of prudent and effective controls which enable risk to be assessed and managed;
- Strategy formulation (including company vision, mission and values) and ensuring that there are adequate policies systems and structures to successfully implement the company's strategies;
- Elaborating duty of care and confidentiality, including establishing responsibility and obligations of individual Board members;
- Reviewing and approving the strategic plans and annual budgets, financial statements; and
- Monitoring the company's performance against strategic plans and objectives on an ongoing basis, as well as through mandatory quarterly meetings.

Chairman and Managing Director

The roles and responsibilities of the Chairman of the Board and the Managing Director remain distinct and separate. The Chairman provides overall leadership to the Board without limiting the principles of collective responsibility for Board

CORPORATE GOVERNANCE STATEMENT (Continued)

decisions. The Managing Director is responsible to the Board and takes responsibility for the effective and efficient running of the institution on a day-to-day basis.

Board Committees

The committees of the Board consist of a balanced mix of non-executive and executive Directors. The Board has constituted the following 5 main Board committees:

1. The Strategy Committee
2. The Audit Committee
3. The Risk and Compliance Committee

4. Credit Committee
5. The Remuneration and Nominating Committee

Other ad hoc committees are set up as and when the need arises. The committees regularly reports to the Board on their activities and decisions.

Board and Board Committee Meetings

The Board and its committees meet regularly in accordance with business requirements. Adequate notice was given for each meeting and directors received in good time detailed papers on the issues to be discussed. The Board and Board committees attendance during the year was as follows:

Board of Directors attendance

Dr. Peter W. Muthoka	100%
Charles K. Njuguna	100%
Joshua Muiru	100%
George A. Maina	100%
Beverley Nuthu	60%
Kevin Terry	100%
Catherine Musakali	100%
Mwikali Muthiani	100%
Peter Mogan	80%
Tavaziva Madzinga	60%
Peter Mwangi	100%
Peter Gachuba	100%

Risk and Compliance Committee

George A. Maina	100%
Mwikali Muthiani	100%
Peter Mwangi	50%
Joshua Muiru	100%
Catherine Musakali	100%
Charles Njuguna	100%
Amos Mwangi*	100%
Bernard Githinji*	100%
Raphael Lekoolool*	100%

Audit Committee

Joshua Muiru	100%
Beverley Nuthu	25%
Kevin Terry	100%
Paul Kahoro*	100%

Strategy Committee

Mwikali Muthiani	100%
George A. Maina	100%
Charles Njuguna	100%
Bernard Githinji*	100%

CORPORATE GOVERNANCE STATEMENT (Continued)

Remuneration and Nominating Committee

Dr. Peter W. Muthoka	100%
George A. Maina	100%
Charles Njuguna	100%
William Wambugu	100%

*Senior Management

In light of the changing business and risk environment and to better offer business oversight, Faulu Board reconstituted all the Board committees in May 2015 and established a dedicated committee to offer oversight on credit risk. (The credit Committee).

The Audit Committee

The Audit Committee has been established by the Board to assist in raising the standards of corporate governance and internal controls in the following areas:-

- Assisting the board in oversight of preparation and presentation of Financial Statements;
- Recommending and reviewing adherences to accounting policies and internal controls;
- Assisting the Board in ensuring the company's compliance with applicable laws and regulations as well as the company's charter, by laws and other internal regulations;
- Acting as Board's central coordination point for investigation of complaints relating to financial statements, compliance, and internal controls and
- Oversee independence of external auditors.

The Strategy Committee

The Strategy Committee has been established by the Board to assist in executing the following responsibilities:

- Providing leadership on strategic issues and direction within the Board and alignment with Group strategies;
- Ensuring there are adequate policies, systems, processes and structures to successfully implement the Bank's strategies;

Credit Committee

Peter Gachuba	100%
Mwikali Muthiani	100%
George A. Maina	100%
Peter Onsongo*	100%

- Monitoring the institution's performance against strategic plans and objectives on an ongoing basis;
- Providing direction and guidance to the Management on strategy execution;
- Review strategic plans and corporate objectives and budgets;
- Review effectiveness of the bank strategies;
- Ensure that capital is fully optimized / capital management and the need for additional capital or restructuring of the balance sheet; and
- Review, approve and monitor capital expenditure, investments, mergers & acquisitions.

The Risk & Compliance Committee

The committee comprises of three Board members and has been established by the board to assist in the following Responsibilities:

- Establishing the company's risk policies, including risk tolerances, consistent with the Risk Management Program and ensuring that senior management takes steps necessary to identify, measure, monitor and control risk;
- Reviewing the adequacy of the company's capital and allocations to various business units considering the types and sizes of risks at those business units; and
- Establishing an enterprise-wide risk management framework for all functions in the company and at all levels. The Credit Committee

The Committee is a Board Committee established by and among the Board of Directors to assist in discharging their corporate governance duties by:

CORPORATE GOVERNANCE STATEMENT (Continued)

The Credit Committee (Continued)

- a) Reviewing and recommending for approval of the Board policies with respect to credit risk of the Bank's operations;
- b) Reviewing and monitoring the application and effectiveness of such policies;
- c) Review lending practices and quality of loan portfolio;
- d) Ensure that there are effective procedures and adequate resources to identify and mitigate credit risk;
- e) Monitor and evaluate all issues that may materially impact on the present and future quality of the loan portfolio and credit risk management;
- f) Delegate and review lending limits to the sanctioning arms of the institution; and
- g) Ensure adequate provisions for loans and advances, bad and doubtful debts and write off policy.

The Remuneration and Nominating Committee
The committee has been established to assist the board with the following responsibilities;

- (a) Guiding and directing the implementation of remuneration strategy, policies, group-wide remuneration principles, related proposals and structure, whilst taking into consideration local conditions;
- (b) Monitoring and controlling the remuneration and benefit structures and their costs.

Management Committees

i) The Assets and Liabilities Management Committee (ALCO)

This committee meets every month or more frequently when necessary. ALCO, a risk management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposit withdrawals can be met as and when they fall due, and the

company does not encounter difficulties in meeting its obligations or financial liabilities as they fall due. This includes management of operational risks, interest rate, market and exchange rate risks and ensuring compliance with statutory requirements governing liquidity.

ii) The Management Credit Risk Committee

This committee meets regularly to approve new credit applications and renewals within the delegated limits set by the Board. The committee also regularly makes recommendations to the Board Credit Committee on the revision of limits. All approvals are independent of the originating business unit.

Monitoring and Evaluation

The Board assesses its own performance and that of the management in the discharge of their duties and responsibilities and develops and submits to the Central Bank an annual self-assessment of the Board performance.

Reckless and Fraudulent Activities

The Board of Directors ensures that the institution and the Management do not;

- (a) Allow a credit facility or guarantee to remain outstanding;
- (b) Incur any liability; or
- (c) Enter into any contract or transaction; or
- (d) Conduct its business or part thereof in a fraudulent or reckless manner detrimental to the institution's interest or the interest of depositors or the general public, as directed in the Microfinance Act 2006 (s.32).

Scheme of Arrangement

The Board of Directors ensures that the institution does not enter into any scheme of arrangement with its creditors.

CORPORATE GOVERNANCE STATEMENT (Continued)

Restriction on Trading and Investment

The Board of Directors certifies that Faulu Microfinance Bank Limited

Restriction on Trading and Investment (Continued)

- (a) Has not Acquired or held, directly or indirectly, any part of the share capital of; or
- (b) Have a beneficial interest in any financial, commercial, agricultural, industrial or other undertaking, where the value of the institution's interest exceeds 25% in the aggregate of the institution's core capital, except in an undertaking in fulfillment of a debt due to the institution.

Single Borrower Limit

The institution did not extend loans exceeding 5% of its core capital to any single end-user borrower. The Board of Directors ensures that loans or credit facilities equivalent to the maximum limit

are extended only to those borrowers who have the capacity or have an established track record of satisfactory repayment. Faulu Microfinance Bank Limited has well-defined credit policies and procedures covering the maximum lending limits and approval levels, rate to be charged, repayment period, loan tracking and collateral. The institution granted a microfinance loan to a single end user that exceeded 2% of its core capital (Disney Insurance Shs 102 million). The aggregate amount of loans was not more than 70% of the institution's total loan portfolio.

KYC Requirements

The Board of Directors ensures that Management obtains and maintains proper identification of customers wishing to open accounts or make transactions or enter into an engagement with the institution whether directly or indirectly through proxy; and maintains adequate and accurate records for a minimum of seven years regarding its customers, sources of funds and transactions, as required by the Microfinance Act 2006.



Director
23rd March 2016



Director
23rd March 2016

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments 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 company 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 company will not remain a going concern for at least the next twelve months from the date of this statement.



.....

Director
23rd March 2016



.....

Director
23rd March 2016



“

I am grateful to Faulu, it has really boosted my business. I am now self-reliant and can provide for my family and my community.

Chelangat
Faulu Customer

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INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF FAULU MICROFINANCE BANK LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of Faulu Microfinance Bank Limited, (the "company") set out on pages 14 to 56 which comprise the statement of financial position as at 31 December 2015, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, 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 company's preparation of the financial statements that give a true and fair view in order to design audit procedures that were appropriate in the circumstances, but not for the purpose of expressing an opinion on the company's internal controls. An audit also includes evaluating

the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of financial affairs of the company as at 31 December 2015 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.

Report on Other Legal Requirements

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

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

The engagement partner responsible for the audit resulting in this independent auditors' report is CPA F OAloo -P/No 1537.

**Certified Public Accountants (Kenya) Nairobi,
30 March 2016**

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2015

	Note	2015 Shs '000	2014 Shs '000
Interest income	5	3,847,572	3,184,005
Interest expense	6	(1,651,727)	(1,223,222)
Net interest income		2,195,845	1,960,783
Fees and commissions	7	277,060	517,101
Foreign exchange losses		4,461	(284)
Other operating income	8	5,053	1,259
Operating income		2,482,419	2,478,859
Administration and operating expenses	9	(2,135,720)	(1,919,556)
Impairment losses on loans and receivables	16	(165,146)	(132,451)
		(2,300,866)	(2,052,007)
Operating profit		181,553	426,852
Share of associate company's profit	19	1,136	4,719
Profit before tax		182,689	431,571
Taxation charge	11	(67,356)	(132,625)
Profit for the year		115,333	298,946
Other comprehensive income:			
<i>Items that will not be reclassified subsequently to profit or loss</i>			
Surplus on revaluation of buildings		-	145,297
Deferred tax liability arising on revaluation surplus		-	(43,589)
Other comprehensive income		-	101,708
Total comprehensive income for the year		115,333	400,654
Earnings per share (basic and diluted)	12	2.40	7.53

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2015


	Note	2015 Shs '000	2014 Shs '000
ASSETS			
Cash and bank balances		495,807	297,155
Short term deposits with banks	13(a)	3,779,033	2,446,770
Commercial papers	13(b)	-	97,237
Government securities	14	721,328	779,999
Loans to customers	15	16,583,682	14,488,387
Other assets	17	757,241	-
Tax recoverable	18	981,658	634,413
Other investment	11(c)	171,200	12,594
Investment in associate companies	19(a)	-	46
Deferred tax asset	19(b)	42,881	42,086
Property and equipment	21	1,524,194	1,365,638
Intangible assets	22	266,642	155,633
TOTAL ASSETS		25,323,666	20,319,958
LIABILITIES AND EQUITY			
LIABILITIES			
Cash collaterals	23	1,224,587	1,341,181
Customer deposits	24	15,465,559	12,646,278
Borrowings	25	2,670,527	1,339,477
Other liabilities	26	1,605,279	1,136,187
Due to related companies	29(a)	179	-
Deferred tax liability	20	58,119	69,452
		21,024,250	16,532,575
CAPITAL RESOURCES			
Share capital	27	480,000	480,000
Share premium		2,899,759	2,503,059
Retained earnings		236,882	257,337
Revaluation surplus		212,756	205,472
Statutory reserve		470,019	341,515
		4,299,416	3,787,3835
TOTAL LIABILITY AND EQUITY		25,323,666	20,319,958

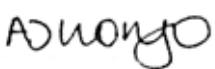
The financial statements on pages 14 to 56 were approved and authorised for issue by the board of directors on 23 March 2016 and were signed on its behalf by:



 Director


 Managing Director



 Director


 Company Secretary

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2015

	Share capital Shs'000	Share premium Shs'000	Retained earnings Shs'000	Revaluation surplus Shs'000	Statutory reserve Shs'000	Total Shs'000
At 1 January 2014	120,000	274,125	58,408	103,589	241,673	797,795
Profit for the year	-	-	298,946	-	-	298,946
Other comprehensive income	-	-	-	101,708	-	101,708
Total comprehensive income for the year	-	-	298,946	101,708	-	400,654
Share capital issued (note 27)	360,000	2,346,698	-	-	-	2,706,698
Share issue costs	-	(117,764)	-	-	-	(117,764)
Transfer to statutory reserve	-	-	(99,842)	-	99,842	-
Transfer of excess depreciation	-	-	(250)	250	-	-
Deferred tax on excess depreciation	-	-	75	(75)	-	-
At 31 December 2014	480,000	2,503,059	257,337	205,472	341,515	3,787,383
At 1 January 2015	480,000	2,503,059	257,337	205,472	341,515	3,787,383
Profit and total comprehensive income for the year	-	-	115,333	-	-	115,333
Share capital issued (note 27)	-	396,700	-	-	-	396,700
Share issue costs	-	-	-	-	-	-
Transfer to statutory reserve	-	-	(128,504)	-	128,504	-
Transfer of excess depreciation	-	-	(10,406)	10,406	-	-
Deferred tax on excess depreciation	-	-	3,122	(3,122)	-	-
At 31 December 2015	480,000	2,899,759	236,882	212,756	470,019	4,299,416

The statutory reserve relate to the excess provisions for impairment of loans and advances as computed per the Kenyan Microfinance Act (2006) over the loans and advances impairment provisions as computed in accordance with IAS 39 on financial instruments. The statutory reserve is not distributable.

Premiums from the issue of shares are reported as share premiums. In 2014, a portion of this amount was utilised to cater for the equity or divestiture transaction cost.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2015

	2015	2014
Note	Shs'000	Shs'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash generated from operations	28(a) (180,491)	270,517
Taxation paid	11(c) (236,954)	(141,705)
Net cash generated from operating activities	(417,445)	128,812
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of intangible assets	22 (31,675)	(55)
Purchase of property and equipment	21 (424,786)	(571,695)
Net cash used in investing activities	(456,461)	(571,750)
CASH FLOWS FROM FINANCING ACTIVITIES		
Loan received	28(c) 2,196,261	-
Loan repaid	28(c) (947,520)	(741,075)
Proceed from issue of shares	27 396,700	2,706,698
Share issue costs paid	-	(117,764)
Net cash generated from financing activities	1,645,441	1,847,859
INCREASE IN CASH AND CASH EQUIVALENTS	771,535	1,404,921
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	3,401,504	1,996,583
CASH AND CASH EQUIVALENTS AT END OF YEAR	28(b) 4,173,039	3,401,504

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

Statement of compliance

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

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

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

(i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2015

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

IAS 19 Defined Benefit Plans: Employee Contributions	<p>The amendments to IAS 19 clarify the accounting treatment for contributions from employees or third parties to a defined benefit plan.</p> <p>According to the amendments, discretionary contributions made by employees or third parties reduce service cost upon payment of these contributions to the plan. When the formal terms of the plan specify contributions from employees or third parties, the accounting depends on whether the contributions are linked to service, as follows:</p> <ul style="list-style-type: none"> • If the contributions are not linked to services (e.g. contributions are required to reduce a deficit arising from losses on plan assets or from actuarial losses), they affect the remeasurement of the net defined benefit liability (asset). • If contributions are linked to services, they reduce service costs. If the amount of contribution is dependent on the number of years of service, the entity should reduce service cost by attributing it to the contributions to periods of service using the attribution method required by IAS 19 paragraph 70 (for the gross benefits). If the amount of contribution is independent of the number of years of service, the entity is permitted to either reduce service cost in the period in which the related service is rendered, or reduce service cost by attributing the contributions to the employees' periods of service in accordance with IAS 19 paragraph 70. The amendment requires retrospective application. • The directors anticipate that the application of the standard will not have an impact on the company's financial statements since the company doesn't have a defined benefit plan.
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NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

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

(i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2015 (Continued).

<p>Annual Improvements 2010-2012 Cycle</p>	<p>The Annual Improvements to IFRSs 2010-2012 Cycle include a number of amendments to various IFRSs, which are summarised below:</p> <p>The amendment to IFRS 2 is to clarify the definition of vesting condition and market condition to ensure the consistent classification of conditions attached to a share-based payment. It also adds definition for 'performance condition' and 'service condition' which were previously included as -part of the definition of 'vesting condition'. The amendment requires prospective application.</p> <p>The amendment to IFRS 3 clarifies that contingent consideration should be measured at fair value at each reporting date, irrespective of whether or not the contingent consideration falls within the scope of IFRS 9 or IAS 39. Changes in fair value (other than measurement period adjustments as defined in IFRS 3) should be recognised in profit and loss. The amendment to IFRS 3 requires prospective application</p> <p>The amendment to IFRS 8(i) requires an entity to disclose the judgements made by management in applying the aggregation criteria to operating segments, including a brief description of the operating segments aggregated and the economic indicators assessed in determining whether the operating segments share similar economic characteristics; and (ii) clarifies that a reconciliation of the total of the reportable segments' assets to the entity's assets should only be provided if information about the amount of segment assets are regularly provided to the chief operating decision-maker.</p> <p>The amendment to IFRS 13 clarifies that the issuance of IFRS 13 and consequential amendments to IAS 39 and IFRS 9 did not remove the ability to measure short- term receivables and payables with no stated interest rate at their invoice amounts without discounting, if the effect of discounting is immaterial. This amendment does not include any effective date because this is just to clarify the intended meaning in the basis for conclusions.</p> <p>The amendment to IAS 16 and IAS 38 remove perceived inconsistencies in the accounting for accumulated depreciation/amortisation when an item of property, plant and equipment or an intangible asset is revalued. The amended standards clarify that the gross carrying amount is adjusted in a manner consistent with the revaluation of the carrying amount of the asset and that accumulated depreciation! amortisation is the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses.</p> <p>The amendment to IAS 24 clarifies that a management entity providing key management personnel services to the reporting entity or to the parent of the reporting entity is a related party of the reporting entity. Consequently, the reporting entity should disclose as related party transactions the amounts incurred for the service paid or payable to the management entity for the provision of key management personnel services. However, disclosure of the components of compensation to key management personnel that is paid by the management entity to the management entity's employees or directors is not required.</p>
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NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

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

(i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2015 (Continued).

Annual Improvements 2011-2013 Cycle	<p>The Annual Improvements to IFRSs 2011-2013 Cycle include a number of amendments to various IFRSs, which are summarised below:</p> <p>The amendments to IFRS 3 clarify that the standard does not apply to the accounting for the formation of all types of joint arrangement in the financial statements of the joint arrangement itself.</p> <p>The amendments to IFRS 13 clarify that the scope of the portfolio exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis includes all contracts that are within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, even if those contracts do not meet the definitions of financial assets or financial liabilities within IAS 32.</p> <p>The amendments to IAS 40 clarify that IAS 40 and IFRS 3 are not mutually exclusive and application of both standards may be required. Consequently, an entity acquiring investment property must determine whether:</p> <ul style="list-style-type: none"> (a) the property meets the definition of investment property in terms of IAS 40; and (b) the transaction meets the definition of a business combination under IFRS 3. <p>The directors of the company do not anticipate that the application of these amendments will have a significant impact on the company's financial statements.</p>
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(ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2015

	Effective for annual periods beginning on or after
<i>New and Amendments to standards</i>	
IFRS 9	1 January 2018
IFRS 15	1 January 2017
Amendments to IFRS 11	1 January 2016
Amendments to IAS 16 and IAS 38	1 January 2016

IFRS 9 Financial Instruments

IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

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

iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2015 and future annual periods

IFRS 9 Financial Instruments (Continued) Key requirements of IFRS 9:

- All recognised financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement are required to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognised in profit or loss.
- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value

through profit or loss is presented in profit or loss.

The directors of the company anticipate that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed by the company.

IFRS 15 Revenue from Contracts with Customers

In May 2015, IFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related Interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until a detailed review has been completed.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

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

iii) Impact of relevant new and amended standards and interpretations on the financial statements for the year ended 31 December 2015 and future annual periods. (Continued).

Amendments to IAS 16 and IAS 38 *Clarification of Acceptable Methods of Depreciation and Amortisation*

The amendments to IAS 16 prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortisation of an intangible asset. This presumption can only be rebutted in the following two limited circumstances :

- a) when the intangible asset is expressed as a measure of revenue; or
- b) when it can be demonstrated that revenue and consumption of the economic benefits of the intangible asset are highly correlated.

The amendments apply prospectively for annual periods beginning on or after 1 January 2016. Currently, the company uses the straight-line method for depreciation and amortisation for its property and equipment, and intangible assets respectively. The directors of the company do not anticipate that the application of the standard will have a significant impact on the company's financial statements.

Annual Improvements 2012-2014 Cycle

The amendments to IFRS 5 adds specific guidance in IFRS 5 for cases in which an entity reclassifies an asset from held for sale to held for distribution or vice versa and cases in which held-for-distribution accounting is discontinued .

The amendments to IFRS 7 add additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset for the purpose of determining the disclosures required. Clarifies the applicability of the amendments to IFRS 7 on offsetting disclosures to condensed interim financial statements.

The amendments to IAS 19 clarifies that the high quality corporate bonds used in estimating the discount rate for post-employment benefits should be denominated in the same currency as the benefits to be paid (thus, the depth of the market for high quality corporate bonds should be assessed at currency level).

The amendment to IAS 34 clarifies the meaning of 'elsewhere in the interim report' and requires a cross reference.

The directors of the company do not anticipate that the application of these amendments will have a significant impact on the company's financial statements.

iv) Early adoption of standards

The company did not early-adopt any new or amended standards in 2015.

(a) Basis of preparation

The financial statements are prepared under the historical cost convention, as modified to include revaluation of certain assets at fair value.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(b) Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised within the profit or loss 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 points 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 profit or loss.

Once a financial asset or a portfolio 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.

(c) Investment in associate company

An associate is an entity over which the company has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Under the equity method, investments in associates

are carried in the statement of financial position at cost as adjusted for post-acquisition changes in the company's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the company's interest in that associate are recognised only to the extent that the company has incurred legal or constructive obligations or made payments on behalf of the associate.

(d) Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

(i) Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

(ii) Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(d) Taxation (Continued)

(ii) Deferred tax (Continued)

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in associates, except where the company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

(iii) Current and deferred tax for the year

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

(e) Fees, commission and grant income

In the normal course of business, the company 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, are recognised as the related services are performed.

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

(f) Property and equipment

Property and equipment are stated at cost or as professionally revalued less accumulated depreciation and any impairment charge. Professional valuations are carried out in accordance with the company's policy of revaluing certain items of property and equipment from time to time. The basis of valuation is the open market value for the existing use.

Any revaluation increase arising on revaluation of such property, plant and equipment is recognised in other comprehensive income, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously expensed. A decrease in the carrying amount arising on revaluation of such property, plant and equipment is recognised in profit or loss to the extent that it exceeds the balance, if any, held in the revaluation surplus reserve relating to a previous revaluation of that asset.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(g) Depreciation

Depreciation on property and equipment is calculated on the reducing balance at the following annual rates:

Motor vehicles	25.0%
Computers and equipment	30.0%
Electronic office equipment	25.0%
Durable non-electrical equipment	12.5%
Buildings on freehold land	2.5%
Freehold land	nil

Depreciation on revalued assets is recognised in profit or loss. On subsequent sale or retirement of a revalued property and equipment, the revaluation surplus remaining in the revaluation reserve is transferred directly to equity. Each year, the difference between depreciation based on the revalued carrying amount of an asset (the depreciation charged to the profit or loss) and the depreciation based on the assets' original cost is transferred from the revaluation surplus to revenue reserves, net of related deferred taxation.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

(h) Work in progress

Work in progress relates to construction of the banking halls for the branches. Cost includes materials, direct labour and any other direct expenses incurred in respect of the project. The amounts are transferred to property and equipment once is completed and commissioned. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

(i) Intangible assets - computer software development costs

Costs incurred on computer software are initially accounted for at cost as intangible assets and subsequently at cost less any accumulated amortisation and accumulated impairment losses. Amortisation is calculated on a straight line basis over the estimated useful lives.

j) Impairment of tangible and intangible assets other than goodwill

At the end of each reporting period, the company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

j) Impairment of tangible and intangible assets other than goodwill (Continued)

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(k) Leases

The company's leases are classified as finance leases whenever the terms of the lease substantially transfer all risks and rewards of ownership to the company as a lessee. All other leases are classified as operating leases.

Rentals payable under operating leases are amortised on the straight line basis over the term of the relevant lease.

(l) Loans and provision for loan impairments

Loans and receivables are recognised when cash is advanced to borrowers. They are categorised as originated loans and carried at amortised cost.

Provisions for loan impairment are established if there is objective evidence that the company will not be able to collect all amounts due according to the original contractual terms of loans. The objective evidence of impairment of the receivables is when there is a significant financial difficulty of the counter party or when there is a default or delinquency in the interest or principal payments. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate computed at initial recognition.

Identified provisions are recognised for loans and advances that are individually significant. Unidentified provision is measured and recognised on a portfolio basis where there is objective evidence that probable losses are present in components of the loan portfolio at the end of each reporting date. This is estimated based upon historical patterns of losses in each component, the credit ratings allocated to the borrowers and reflecting the current economic climate in which the borrowers operate.

When a loan is deemed uncollectible, it is written off against the related provision for impairment losses. Subsequent recoveries are credited to the provision for impairment losses in the profit and loss account. If the amount of the impairment subsequently decreases due to an event occurring after the write-down, the release of the provision is credited to the provision for impairment losses in the profit or loss.

(m) Retirement benefit obligations

i) *Company's defined contribution pension scheme*

The company operates a defined contribution pension scheme for its permanent employees. The assets of the scheme are held and administered independently of the company's assets. The scheme is funded by contributions from both the company and employees. The company's contribution to the scheme is limited to 10 per cent of the employees' basic salary while employees contribute 5 per cent of their basic salary. The company's contribution is charged to the profit or loss in the year to which it relates.

ii) *Statutory defined contribution pension scheme*

The company also contributes to the statutory National Social Security Fund. This is a defined contribution scheme to which the company's obligation is limited to a specified contribution per employee per month and is charged to the profit or loss in the year to which it relates.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(m) Retirement benefit obligations (Continued)

iii) Other employee entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. An accrual is made for the liability for annual leave outstanding at the end of each reporting period.

(n) Foreign currencies

Transactions in foreign currencies are translated at the rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Kenya Shillings at the rates of exchange ruling at the end of each reporting period. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Gains and losses on exchange of monetary items are dealt with in the profit or loss in the period in which they arise.

(o) Financial instruments

i) Recognition

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

ii) Classification and measurement

Financial assets

The company classifies its financial assets into the following categories: Financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale investments.

Management determines the appropriate classification of its investments at initial recognition.

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. Financial assets at fair value through profit or loss are stated at fair value, with any gains or losses arising on measurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned

on the financial asset and is included in the 'other operating income' line item in the profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the company provides money, goods or services directly to a borrower with no intention of trading the receivable. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Held to maturity investments

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. Held-to-maturity investments are measured at amortised cost using the effective interest method less any impairment, with revenue recognised on an effective yield basis.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(o) Financial instruments (Continued)

ii) Classification and measurement (Continued)

Available-for-sale financial assets

Financial assets that are not (a) financial assets at fair value through profit or loss, (b) loans and receivables, or (c) financial assets held to maturity, and are measured at fair values. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve, with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognised in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss. Dividends on available-for-sale equity instruments are recognised in the profit or loss when the company'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 the end of each reporting period, all financial assets are subject to review for impairment. If it is probable that the company will not be able to collect all amounts due (principal and interest) according to the contractual terms of loans and 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 financial asset is reduced to its estimated recoverable amount through use of the provision for bad and doubtful debts account. The amount of the loss incurred is included in the profit or loss for the period.

The company reviews its loan portfolios to assess impairment regularly. In determining whether an impairment loss should be recorded in the profit or loss, the company makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or national or local economic conditions that correlate with defaults on assets in the company.

If a loss on a financial asset carried at fair value (recoverable amount is below original acquisition cost) has been recognised directly in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative net loss that had been recognised directly in other comprehensive income is removed from equity and recognised in profit or loss for the period even though the financial asset has not been derecognised.

Where a loan is deemed uncollectible, it is written off against the related provision for impairment losses. Subsequent recoveries are credited to the profit or loss for the year.

Derecognition of financial assets

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the company has transferred substantially all risks and rewards of ownership.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(o) Financial instruments (Continued)

ii) Classification and measurement (Continued)

Financial liabilities

After initial recognition, the company 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.

Derecognition of financial liabilities

Financial liabilities are derecognised when and only when the company obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

Borrowings

Borrowings are recorded at the proceeds received. Finance charges, including premiums payable on settlement or redemption, are accounted for on the accruals basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

(p) Derivative financial instruments

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

(q) Offsetting financial instruments

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

(r) Cash and cash equivalents

For the purposes of the statement of cash flows, 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 dates of the advances.

(s) Statutory reserve

Where impairment losses required by the microfinance (Deposit Taking Institutions) Regulation 2008 issued by the Central Bank of Kenya exceed those computed under International Financial Reporting Standards (IFRS), the excess is recognised as a statutory reserve and accounted for as an appropriation from revenue reserves. The reserve is not available for distribution.

(t) Revaluation reserve

This arises on revaluation of land and buildings and is not distributable. When revalued land or buildings are sold, the portion of the properties revaluation reserve that relates to that asset is transferred directly to retained earnings. Items of other comprehensive income included in the properties revaluation reserve will not be reclassified subsequently to profit or loss.

(u) 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 JUDGMENTS IN APPLYING THE ENTITY'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 judgments 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 accounting judgments in applying the company's policies

Impairment losses on loans and receivables

The entity reviews its loan portfolios to assess impairment regularly. In determining whether an impairment loss should be recorded in the profit or loss, the company makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash

flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a company, or national or local economic conditions that correlate with defaults on assets in the entity. 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 entity 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 judgment. In making this judgment, the company evaluates its intention and ability to hold such investments to maturity. If the company 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 and not amortised cost.

ii) Key sources of estimation uncertainty

Property and equipment

Critical estimates are made by the directors in determining depreciation rates for property and equipment.

Fair value measurement mid valuation

Some of the company's assets and liabilities are measured at fair value for financial reporting process. In estimating the fair value of an asset or liabilities, the company uses market-observable data to the extent it is available. Where level 1 inputs are not available, the company engages third party qualified valuers to perform the valuation.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT

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

- credit risk
- liquidity risk
- market risks

a) Credit risk

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

The Risk Compliance and Credit Committee manages and oversees the overall lending policy of the company. Measures to minimize credit risk include the following among others;

- Establishing the authorization structure for the approval and renewal of credit facilities.
- Establishment of IT controls to avoid

unauthorized lending and to generate exception reports on new advance accounts.

- Placing limits on the amounts of risk accepted in relation to one borrower, or group of borrower, and to industry segments.
- Regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations.
- Obtaining collateral and corporate/ personal guarantees.
- Reviewing compliance with agreed exposure limits. Regular reports are provided to the Risk Committee on the credit quality of portfolios and appropriate corrective action is taken.

(i) Management of credit risk

Concentrations of assets and off balance sheet items:

Details of significant concentrations of the company's financial assets by industry groups are as detailed below:

a) Loans to customers

	2015 Shs '000	%	2014 Shs '000	%
Agriculture	16,584	0.1%	23,230	0.2%
Business services	5,223,860	31.5%	3,775,383	26.1%
Consumer	11,343,238	68.4%	10,689,774	73.7%
	16,583,682	100%	14,488,387	100%

Cash collaterals

	2015	%	2014	%
Agriculture	161,066	13%	164,472	12%
Business services	169,448	14%	209,131	16%
Consumer	894,073	73%	967,578	72%
	1,224,587	100%	1,341,181	100%

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

(ii) Maximum exposure to credit risk before collateral held

	2015 Shs '000	%	2014 Shs '000	%
Credit exposures:				
On balance sheet items:				
Short term deposits with banks	3,779,033	18%	2,446,770	14%
Loans to customers	16,832,716	79%	14,642,997	81%
Government securities	721,328	3%	779,999	4%
Commercial papers			97,237	1%
	21,333,077	100%	17,967,003	100%

(iii) Classification of loans and receivables

	2015 Shs '000	2014 Shs '000
Neither past due nor impaired	16,221,035	14,036,775
Past due but not impaired	97,122	185,036
Impaired	514,559	421,186
Gross	16,832,716	14,642,997
Less: allowances for impairment (note16)	(249,034)	(154,610)
Net loans and receivables	16,583,682	14,488,387

Loans and receivables that are neither past due nor impaired

The company classifies loans and receivables under this category for those exposures that are up to date and 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 guidelines issued by banking regulators and a provision of 1% is made and appropriated from revenue reserves to statutory reserves.

Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the company 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 company. A collective allowance for impairment of 5% is made to cover losses which have been incurred but have not yet been identified. These exposures are categorised as watch per the microfinance regulations.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (Continued)

Impaired loans

Impaired loans are loans for which the company determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan/securities agreement(s). These accounts under guidelines issued by company's regulators are termed as non-performing loans. The company establishes a specific allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. These exposures are categorised as classes 3 - 5 per the microfinance regulations.

Allowances for impairment

The company establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant

exposures, and a collective loan loss allowance in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-off policy

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

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of individually impaired assets based on age:

Loans to customers

31 December 2015

Neither past due nor impaired
Past due but not impaired
Impaired

	Gross Shs '000	Net Shs '000
Neither past due nor impaired	16,221,035	16,221,035
Past due but not impaired	97,122	97,122
Impaired	514,559	265,525
	16,832,716	16,583,682

31 December 2014

Neither past due nor impaired
Past due but not impaired
Impaired

Neither past due nor impaired	14,036,775	14,036,775
Past due but not impaired	185,036	185,036
Impaired	421,186	266,576
	14,642,997	14,488,387

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (Continued)

Collateral held

The company's collateral mainly consists of cash collateral held against loans and receivables to customers (note 23). The fair value of collateral is Shs 1,224,587 (2014: Shs 1,341,181).

b) Liquidity risk

The company 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 company'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 company's reputation. The Risk Compliance and Credit 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 meeting financial liabilities as they fall due is encountered.

A portfolio of short-term liquid assets largely made up of short-term liquid investment securities and bank facilities ensure that sufficient liquidity is

maintained within the company as a whole.

(ii) Source of funding

The company has an aggressive strategy aimed at increasing the customer base and maintains a diversified and stable base of customers. The company also borrows from the banks for short term liquidity requirements.

(iii) Exposure to liquidity risk

The key measure used by the company 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 in securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. The company regulators require that the company maintains a liquidity ratio of 20% effective May 2009. The company complied with the liquidity requirements during the year. The average liquidity ratio for the year was 30.6% (2014- 23.5%).

The table below represents the cash flows payable by the company under non- derivative financial liabilities by remaining contractual maturities at the end of the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows. The company manages the inherent liquidity risk based on expected undiscounted cash inflows.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

	Maturing in less than 1 month Shs '000	1 month less than 3 month Shs '000	3 month less than 6 month Shs '000	6 month less than 1 year Shs '000	1 year less than 3 year Shs '000	3 year less than 5 year Shs '000	Over 5 years Shs '000	Total Shs '000
FINANCIAL LIABILITIES								
Cash collateral held	120,855	68,501	167,735	447,669	370,486	44,364	4,977	1,224,587
Borrowings	180,844	134,693	147,994	222,133	1,030,484	991,579	66,733	2,774,461
Customer deposits	4,081,247	6,718,756	2,919,439	1,957,862	53,255	-	-	15,730,559
Total liabilities (contractual maturity dates)	4,382,946	6,921,950	3,235,168	2,627,664	1,454,225	1,035,943	71,710	19,729,606
FINANCIAL ASSETS								
Cash and bank balances	495,807	-	-	-	-	-	-	495,807
Short term deposits	316,126	3,462,907	-	-	-	-	-	3,779,033
Cash reserve ratio- CBK	757,24	-	-	-	-	-	-	757,241
Government securities	-	-	-	-	-	-	721,328	721,328
Loans to customers (net)	270,327	158,484	344,855	853,376	3,372,866	6,949,475	4,634,299	16,583,682
Total assets (expected maturity dates)	1,839,501	3,621,391	344,855	853,376	3,372,866	6,949,475	5,355,627	22,337,091
NET LIQUIDITY GAP	(2,543,445)	(3,300,559)	(2,890,313)	(1,774,288)	1,918,641	5,913,532	5,283,917	2,607,485
As at 31 December 2014								
Total liabilities (contractual maturity dates)	2,160,374	6,149,916	2,435,553	3,027,285	653,694	535,220	742,537	15,704,579
Total assets (expected maturity dates)	1,665,202	1,462,597	357,755	631,087	2,155,681	5,983,363	5,853,863	18,109,548
NET LIQUIDITY GAP	(495,172)	(4,687,319)	(2,077,798)	(2,396,198)	1,501,987	5,448,143	5,111,326	2,404,969

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

c) Market Risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads will affect the company'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

Overall authority for market risk is vested in the Risk Compliance and Credit Committee which is responsible for the development of detailed risk management policies. The policies are subject to review and approval by the board.

Exposure to interest rate risk

The company 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 risk 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 end of reporting period. The company

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 company's lending rate or the company's rates are adjusted from time to time to reflect the cost of deposits.

Interest rates on cash collateral held are determined by the company with the company retaining the discretion to adjust the rates in line with changes in market trends. The interest rates, therefore, may fluctuate depending on the movement in the market interest rates. The company 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 company. It is unusual for a company's assets and liabilities to be completely matched due to the nature of business terms and types.

Included in the table overleaf are financial assets and liabilities at carrying amounts categorized by the earlier of contractual repricing or maturity dates.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks (continued)

The table below summarises the exposure to interest rate risks. Included in the table are the company's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The company does not bear an interest rate risk on off statement of financial position items. (All figures are in Kenya Shillings).

	Less than 1 month Shs '000	1 month less than 3 month Shs '000	3 month less than 6 month Shs '000	6 month less than 1 year Shs '000	1 year less than 3 year Shs '000	3 year less than 5 year Shs '000	Over 5 years Shs '000	Non-interest bearing Shs '000	Total Shs '000
A. FINANCIAL ASSETS									
Cash and bank balances	-	-	-	-	-	-	-	495,807	495,807
Cash reserve ratio- CBK	-	-	-	-	-	-	-	757,241	757,241
Short term deposits	300,000	3,479,033	-	-	-	-	-	-	3,779,033
Government securities	-	-	-	-	-	-	700,000	21,328	721,328
Loans to customers (net)	270,237	158,484	344,855	853,556	3,372,776	6,949,475	4,634,299	-	16,583,682
Total financial assets	570,237	3,637,517	344,855	853,556	3,372,776	6,949,475	5,334,299	1,274,376	22,337,091
B. FINANCIAL LIABILITIES									
Borrowings	116,866	134,693	143,197	215,990	1,001,469	991,579	66,733	-	2,670,527
Customer deposits	3,696,701	6,614,100	2,800,644	1,884,827	49,173	-	-	420,114	15,465,559
Cash collateral held	-	-	-	-	-	-	-	1,224,587	1,224,587
Total financial liabilities	3,813,567	6,748,793	2,943,841	2,100,817	1,050,642	991,579	66,733	1,644,701	19,360,673
C. On statement of financial position-interest sensitivity gap	(3,243,330)	(3,111,276)	(2,598,986)	(1,247,261)	2,322,134	5,957,896	5,267,566	(370,325)	2,976,418
D. As at 31 December 2014									
Total financial assets	1,398,330	1,423,204	357,374	642,279	2,155,681	5,981,827	5,853,698	297,155	18,109,548
Total financial liabilities	2,131,620	5,834,788	2,424,716	2,951,338	443,093	-	200,200	1,341,181	15,326,936
E. On statement of financial position- interest sensitivity gap	(733,290)	(4,411,584)	(2,067,342)	(2,309,059)	1,712,588	5,981,827	5,653,498	(1,044,026)	2,782,612

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks (Continued)

Interest rate risk stress test

The impact that an immediate hypothetical increase or decrease in interest rates of 3% applied at the beginning of the year would have on the profit for the year assuming a growing balance sheet and current interest rate risk profile would be as follows:

	2015 Shs'000		2014 Shs'000	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
3% increase in interest rates	114,624	80,236	69,594	92,515
3% decrease in interest rates	(114,624)	(80,236)	(69,594)	(92,515)

The model does not take into account any corrective action in response to interest rate movements, particularly in adverse situations.

Currency risk

The company operates wholly within Kenya and its assets and liabilities are reported in the local currency. The company's currency position is as follows:

	Shs '000	USD	Euro	Total
A. ASSETS				
Cash and bank balances	483,433	545	11,469	495,807
Short term deposits with banks	3,716,827	-	-	3,716,827
Government securities	721,328	-	-	721,328
Loans to customers (net)	16,583,682	-	-	16,583,682
Total financial assets	21,505,270	545	11,469	21,517,284
B. LIABILITIES				
Cash collateral held	1,224,587	-	-	1,224,587
Borrowings	2,774,461	-	-	2,774,461
Customer deposits	15,465,559	-	-	15,465,559
Total financial liabilities	19,464,607	-	-	19,464,607
C NET BALANCE SHEET POSITION	2,040,843	545	11,469	2,053,037
As at 31 December 2013				
A Total financial assets	18,088,419	11,407	9,722	18,109,548
B Total financial liabilities	15,326,936	-	-	15,326,936
NET BALANCE SHEET POSITION	2,761,483	11,407	9,722	2,782,612

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks (Continued)

The table below summarizes the estimated impact of a 10% decline/appreciation of the Kenya Shilling against the two major currencies traded by the company i.e. the US Dollar and the Euro.

	2015 Shs'000		2014 Shs'000	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
Currency - Euro				
+ 10% Shs movement	(1,147)	(803)	(972)	(680)
- 10% Shs movement	1,147	803	972	680
Currency - US dollars				
+ 10% Shs movement	(55)	(38)	(1,141)	(799)
- 10% Shs movement	55	38	1,141	799

4 CAPITAL RISK MANAGEMENT

The Central Bank of Kenya sets and monitors capital requirements for Microfinance banks as a whole. The Microfinance bank 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 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. Qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50% 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 Microfinance bank and certain other regulatory items.

Risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-statement of financial position exposures.

The institution's aim is to build 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 Microfinance 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 RISK MANAGEMENT (continued)

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

- A minimum level of regulatory capital of Shs 60 million.
- A ratio of core capital to the risk-weighted assets plus risk-weighted off-statement of financial position assets at or above the required minimum of 10%.
- 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-statement of financial position items.

Faulu Microfinance bank has complied with all externally imposed capital requirements throughout the period.

The capital position at 31 December was as follows;

	2015 Shs '000	2014 Shs '000
Tier 1 capital		
Share capital	480,000	480,000
Share premium	2,899,759	2,503,059
Retained earnings	236,882	257,337
	3,616,641	3,240,396
Tier 2 capital		
Subordinated debt	-	-
Collective allowances for impairment	228,509	194,081
Revaluation reserve	51,368	51,368
	279,877	245,449
Regulatory capital	3,896,518	3,485,845
Total risk-weighted assets	18,280,723	15,526,505
Borrowings	2,670,527	1,339,477
Gearing	62%	41%
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum -12%)	21%	23%
Total tier 1 capital expressed as a percentage of total risk-weighted assets (CBK minimum -10%)	19.5%	21%

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4 CAPITAL RISK MANAGEMENT (continued)

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Risk and Compliance and

Credit, and is subject to review by the Board Credit Committee or ALCO as appropriate.

Although maximization of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Microfinance bank to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with Microfinance Bank's longer term strategic objectives. The Microfinance bank's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

5 INTEREST INCOME

	2015 Shs '000	2014 Shs '000
Loans and receivables	3,226,542	2,753,204
Short term bank deposits	535,767	363,903
Held to maturity investments-treasury bonds	85,263	66,898
	3,847,572	3,184,005

6 INTEREST EXPENSE

Savings accounts	1,387,376	919,074
Bank overdrafts/borrowed funds	264,351	304,148
	1,651,727	1,223,222

7 FEES AND COMMISSIONS

Registration fees	916	1,896
Loan set up fees	169,615	380,629
Commission (net)	77,131	100,467
Chattels mortgage fees	29,398	34,109
	277,060	517,101

NOTES TO THE FINANCIAL STATEMENTS (Continued)

8 OTHER OPERATING INCOME

	2015 Shs '000	2014 Shs '000
Bad debts recovered	434	-
Other income	4,619	1,259
	5,053	1,259

9 ADMINISTRATION AND OPERATING EXPENSES

Staff costs (note 10)	1,060,240	1,056,592
Office operations and supplies	648,235	545,302
Training and evaluation	37,675	37,741
Office rent and repairs	171,404	119,539
Travelling expenses	45,454	40,669
Depreciation of property and equipment	125,354	81,180
Audit fees	3,969	3,675
Amortisation of intangible assets	25,473	22,228
Directors' fees	12,275	8,387
Other expenses	5,641	4,243
	2,135,720	1,919,556

10 STAFF COSTS

Staff salaries and wages	779,441	753,231
Medical expenses	89,494	61,127
Company contributions to defined contribution pension scheme	55,070	36,788
Temporary labour	4,991	40,389
Provision for accumulated leave	5,161	6,538
Staff awards	1,619	1,760
Staff uniforms	127	44
Statutory pension contributions (NSSF)	2,130	2,862
Staff incentives-permanent	-	144,342
Recruitment	4,786	7,705
Health & safety	64	16
Staff welfare & entertainment	13,070	1,790
Staff bonus*	104,287	-
	1,060,240	1,056,592

*This relates to provisions made for staff bonuses as part of the group business plan.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

11 TAXATION

	2015 Shs '000	2014 Shs '000
(a) TAXATION CHARGE		
Current tax expense		
Based on the adjusted profit for the year at 30%	75,385	138,380
Share of associate company taxation (note 19)	341	1,416
Prior year under/(over) provision for current tax	2,963	(34,837)
	<u>78,689</u>	<u>104,959</u>
Deferred taxation (note 20)		
Current year credit	(18,356)	(7,266)
Prior year under provision of deferred tax	7,023	34,932
	<u>(11,333)</u>	<u>27,666</u>
	<u>67,356</u>	<u>132,625</u>
(b) RECONCILIATION OF EXPECTED TAX BASED ON ACCOUNTING PROFIT TO TAX CHARGE		
Accounting profit before taxation	182,689	431,571
Tax at the applicable rate of 30%	54,807	129,471
Tax effect of income not taxable	(341)	1,416
Tax effect of expenses not deductible for tax purposes	3,245	3,059
Prior year under provision- deferred tax	7,023	34,932
Prior year under/(over) provision- current tax	2,963	(34,837)
	<u>67,697</u>	<u>134,041</u>
Share of associate company taxation (note 19)	(341)	(1,416)
	<u>67,356</u>	<u>132,625</u>
(c) TAX (RECOVERABLE)/PAYABLE		
Balance at 1 January	(12,594)	25,568
Charge for the year	75,385	138,380
Paid in the year	(236,954)	(141,705)
Prior year under/(over) provision- current tax	2,963	(34,837)
Balance at 31 December	<u>(171,200)</u>	<u>(12,594)</u>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

12 EARNINGS PER SHARE

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

	2015	2014
Profit for the year attributable to ordinary shareholders (Shs '000)	115,333	298,946
Weighted average number of ordinary shares in issue ('000)	48,000	39,692
Earnings per share- basic & diluted (Shs)	2.40	7.53

There were no potentially dilutive shares outstanding at 31 December 2015 (2014: Nil).

2015	2014
Shs '000	Shs '000

13 (a) SHORT TERM DEPOSITS WITH BANKS

Chase Bank (K) Limited	745,600	427,734
Family Bank Limited	737,045	-
The Co-operative Bank of Kenya Limited	651,442	-
Jamii Bora Bank Limited	621,497	218,186
The Kenya Commercial Bank Limited	552,029	1,111,089
Commercial Bank of Africa	316,126	-
Consolidated Bank Limited	155,294	-
Eco Bank (K) Limited	-	259,597
Bank of Africa Limited	-	412,740
Century DTM Limited	-	17,424
	3,779,033	2,446,770

Effective interest rate average 14% in 2015 and 11.8% in 2014. All the deposits mature within 90 days from the balance sheet date.

(b) COMMERCIAL PAPERS

Held to maturity

	Maturity Date	Interest rate	2015 Shs '000	2014 Shs '000
Car & General (K) Limited	January 2015	13%	-	45,688
ARM Cement Limited	October 2015	13%	-	51,549
			-	97,237

NOTES TO THE FINANCIAL STATEMENTS (Continued)

14 GOVERNMENT SECURITIES

	2015 Shs '000	2014 Shs '000
Treasury bonds - held to maturity		
Maturing within 1 year	-	239,834
Maturing between 1 and 3 years	-	200,165
Maturing over 3 years	721,328	-
	721,328	439,999
Treasury bills - held to maturity	-	340,000
	721,328	779,999
For cash flow purposes		
Treasury bonds maturing within 1 year	-	239,834
Treasury bills- maturing within 1 year	-	340,000
Government securities included in the cash flow (note 29(b))	-	579,834

The effective interest rate on treasury bonds at 31 December 2015 was 11.8% (2014 - 9.7 %). The effective interest rate on treasury bills at 31 December 2015 was nil (2014 - 12 %)

Treasury bonds with a value of Shs 245 million (2014: Shs 277million) and treasury bills valued at Shs 300m are held under lien against Standard Chartered Bank Kenya Limited and Eco Bank loan respectively (note 26)

15 LOANS TO CUSTOMERS

	2015 Shs '000	2014 Shs '000
Gross loans to customers (secured)	16,832,716	14,642,997
Accumulated impairment losses (note 16)	(249,034)	(154,610)
	16,583,682	14,488,387

The effective interest rate on customer advances at 31 December 2015 was 21% (2014- 24%). Advances to customers are secured by cash collaterals (note 24) and chattels mortgages. The net non-performing loans and advances amounted to Shs 593,483,000 (2014: Shs 451,612,000).

16 IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	2015 Shs '000	2014 Shs '000
At 1 January	154,610	141,483
Additional provision during the year	165,146	132,451
Amounts written off	(70,722)	(119,324)
At 31 December	249,034	154,610

NOTES TO THE FINANCIAL STATEMENTS (Continued)

17 CASH BALANCES WITH CENTRAL BANK OF KENYA

	2015 Shs '000	2014 Shs '000
- Cash ratio requirement	757,241	-

The cash ratio requirement is based on the customer deposits with the bank as adjusted by the Central Bank of Kenya requirements. As at 31 December 2015 the cash reserve ratio requirement was 5.25% of all customer deposits.

18 OTHER ASSETS

	2015 Shs '000	2014 Shs '000
Staff receivables	3,441	5,843
Prepaid expenses	69,076	58,428
Deposits and sundry receivables	909,141	570,142
	981,658	634,413

19 INVESTMENTS

(a) Other investments

	2015 Shs '000	2014 Shs '000
Faulu Tanzania Limited:		
Investment at cost - 10% shareholding	46	46
Less write off	(46)	46
	-	46

(b) Investment in associate company

	2015 Shs '000	2014 Shs '000
Faulu Advisory Services Limited:		
At 1 January	42,086	38,783
Share of profit for the year	1,136	4,719
Share of taxation (note 11(a))	(341)	(1,416)
	42,881	42,086

The reporting date of Faulu Advisory Services Limited is 31 December. The company is incorporated in Kenya which is also its principal place of business. The company holds 25% ownership interest in the associate company. Its principal activity is guaranteeing loans advanced by Faulu Microfinance Bank Limited and training beneficiaries of microfinance loans on business related courses.

The associate company is a private company and there are no quoted market prices available for its shares. There were no contingent liabilities relating to the company's interest in the associate.

Summarised financial information below represents amounts shown in the associates unaudited financial statements (adjusted by the company for equity accounting purposes) as of 31 December 2015:

NOTES TO THE FINANCIAL STATEMENTS (Continued)

19 INVESTMENTS (Continued)

Faulu Advisory Services Limited (continued)

	2015	2014
	Shs '000	Shs '000
Non-current assets	3,196	23,565
Current assets	244,198	101,557
Total assets	247,394	125,122
Current liabilities	(83,587)	(28,069)
Revenue	87,955	79,612
Profit from continuing operations before tax	4,545	18,876
Other comprehensive income	-	-

Faulu Advisory Services Limited:

Reconciliation of summarises financial information to the carrying amount of the interest in associate company and the net results recognised:

	2015	2014
	Shs '000	Shs '000
Total assets	247,394	125,122
Total liabilities	(107,622)	(28,069)
Net assets	139,772	97,053
Company's share of net assets of associate @ 25%	34,943	24,263
Profit of associate before taxation	4,545	18,876
Company's share @ 25%	1,136	4,719
Company share of associate's taxation	(341)	(1,416)
Net result of associate recognised	795	3,303

NOTES TO THE FINANCIAL STATEMENTS (Continued)

20 DEFERRED TAX (ASSET)/LIABILITY

	2015 Shs '000	2014 Shs '000
The net deferred tax asset is attributable to the following items:		
Excess depreciation of capital allowances	13,476	(11,886)
Deferred tax on revaluation surplus	87,541	90,089
Bonus provision	(31,286)	-
General provision	-	(3,000)
Provision for staff leave pay	(7,299)	(5,751)
Other provisions	(4,313)	-
	58,119	69,452

The movements in the deferred tax account during the year were as follows:

At 1 January	69,452	(1,803)
Credit to profit or loss (note 11(a))	(18,356)	(7,266)
Prior year under provision of deferred tax (note 11(a))	7,023	34,932
Surplus dealt with through equity	-	43,589
At 31 December	58,119	69,452

NOTES TO THE FINANCIAL STATEMENTS (Continued)

21 PROPERTY AND EQUIPMENT

	Freehold land and buildings	Motor vehicles	Computers and equipment	Electronic office equipment	Durable non-electrical equipment	Work in progress (WIP)	Total
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
COST/VALUATION							
At 1 January 2014	210,000	18,366	101,312	51,137	724,762	32,633	1,138,210
Additions		9,462	17,523	9,724	21,716	513,270	571,695
Revaluation surplus	145,297	-	-	-	-	-	145,297
Transfer to/(from) WIP	-	-	-	737	32,218	(32,955)	-
At 31 December 2014	355,297	27,828	118,835	61,598	778,696	512,948	1,855,202
At 1 January 2015	355,297	27,828	118,835	61,598	778,696	512,948	1,855,202
Additions	-	-	14,979	24,752	24,085	360,970	424,786
Transfer to/(from) WIP	-	-	25,283	40,428	568,557	(739,075)	(104,807)
Assets written off*	-	(2,180)	(952)	(172)	(2,364)	(34,574)	(40,242)
At 31 December 2015	355,297	25,648	158,145	126,606	1,368,974	100,269	2,134,939
DEPRECIATION							
At 1 January 2014	4,023	9,679	70,054	32,039	292,589	-	408,384
Charge for the year	1,274	2,504	11,910	6,492	59,000	-	81,180
At 31 December 2014	5,297	12,183	81,964	38,531	351,589	-	489,564
At 1 January 2015	5,297	12,183	81,964	38,531	351,589	-	489,564
Charge for the year	1,250	3,866	19,243	8,476	92,519	-	125,354
Eliminated on write off	-	(1,932)	(849)	(139)	(1,253)	-	(4,173)
At 31 December 2015	6,547	14,117	100,358	46,868	442,855	-	610,745
NET BOOK VALUE							
At 31 December 2015	348,750	11,531	57,787	79,738	926,119	100,269	1,524,194
At 31 December 2014	350,000	15,645	36,871	23,067	427,107	512,948	1,365,638

Land and buildings were last revalued at Shs 350,000,000 as at 31 December 2014 by Gimco Limited, registered valuers, on an open market value basis by reference to market evidence of recent transactions for similar properties.

At 31 December 2015, the net book value of the freehold land and building based on original cost was Shs 44,812,503 (2014: Shs 49,702,834).

*Write offs of Shs 34,574,000 relate to the cost of branches exited branches during the year. The branches were considered unfavourable.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

21 PROPERTY AND EQUIPMENT (Continued)

Fair value measurement of the company's freehold land and buildings

The company's land and buildings are stated at their revalued amounts, being the fair values at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The fair value measurements of the company's leasehold land and buildings as at 31 December 2014 were performed by Gimco Limited, registered and independent valuers (i.e. not related to the company). Gimco Limited are members of the Institute of Surveyors of Kenya and they have appropriate qualifications and relevant and

recent experience in the fair value measurement of properties in the various locations in Kenya. The fair value of land and buildings was determined by reference to market evidence of recent transactions for similar properties. There has been no change to the valuation technique during the year.

Details of the company's freehold land and buildings and information about fair value hierarchy as at 31 December 2015 are as follows:

	Level 1 Shs'000	Level 2 Shs'000	Level 3 Shs'000	Fair value as at 31 December Shs'000
31 December 2015	-	348,750	-	348,750
31 December 2014	-	350,000	-	350,000
Land and buildings	-	350,000	-	350,000

There were no transfers between level 1 and level 2 during the year.

22 INTANGIBLE ASSETS - COMPUTER SOFTWARE

	2015 Shs '000	2014 Shs '000
COST		
At 1 January	328,665	328,610
Additions	31,675	55
Transfer from work in progress (note 21)	104,807	-
At 31 December	465,147	328,665
AMORTISATION		
At 1 January	173,032	150,804
Charge for the year	25,473	22,228
At 31 December	198,505	173,032
NET BOOK VALUE		
At 31 December	266,642	155,633

NOTES TO THE FINANCIAL STATEMENTS (Continued)

23 CASH COLLATERALS HELD

Cash collaterals represent payments made by loanees as security for loans taken. In accordance with the loan agreements, the amounts are refundable upon the successful repayment of loans

by loanees and at the time a loanee leaves the loan scheme. The amounts are utilised to cover loans in the event of default.

	2015	2014
	Shs '000	Shs '000
0 - 30 days	80,001	85,039
31-90 days	52,422	48,599
91- 180 days	48,123	50,524
Over 180 days	1,044,041	1,157,019
	1,224,587	1,341,181

The effective interest rate on the cash collaterals held at 31 December 2015 was nil (2014: nil).

24 CUSTOMER DEPOSITS

	2015	2014
	Shs '000	Shs '000
Savings account	2,332,496	2,224,857
Fixed account	13,133,063	10,421,421
	15,465,559	12,646,278

The effective interest rate on customer deposits as at 31 December 2015 is 9% (2014: 7%).

25 BORROWINGS

	2015	2014
	Shs '000	Shs '000
Loans from Bank of Africa	434,921	-
Loans from Symbiotics fund	513,261	170,097
Loan from Eco Bank Limited	-	550,000
Loan from European Investment Bank	1,270,344	174,688
Loan from Oiko	150,000	225,000
Loan from IFAD	200,200	200,200
Bank overdrafts	101,801	19,492
	2,670,527	1,339,477

The borrowings are repayable as follows:

	2015	2014
	Shs '000	Shs '000
Within 1 year	610,745	901,920
After 1 year within 3 years	1,001,469	237,357
After 3 years and within 5 years	991,579	-
Over 5 years	66,734	200,200
	2,670,527	1,339,477

NOTES TO THE FINANCIAL STATEMENTS (Continued)

25 BORROWINGS (Continued)

The USD 2 million from Symbiotic SA (fully hedged) fully settled. However, additional debts were acquired from Symbiotic as follows. a). USD 4M from Symbiotic Microfinance Fund III at the rate of 11.5% bullet repayment of principal on May 15, 2020. b). USD 1M from Symbiotic Microfinance Fund at the rate of 13.5% bullet repayment of principal on June, 15 2018. Interest for both debts is semi-annual.

The loan from European Investment Bank of EURO 4M was advanced at 11.57% has only two installments to be repaid in April and October 2016. Additional debt of EUR 10M was acquired on September, 10.2015 at the rate of 9.196% for 5 years.

The bank overdrafts are held at Standard Chartered Bank Kenya Limited and Eco bank Limited for working capital requirements. They are secured by government securities (note 14). The interest rates are pegged to the Kenya Bankers reference Rates (KBRR) plus a margin of 2.1% and 3.78% respectively.

The Bank of Africa loan of Shs 500M was acquired in 2015 for 5 years .The interest rate is pegged to the Kenya Bankers Reference Rate (KBRR) plus a margin of 12.13%.

IFAD (International Fund for Agricultural Development) loan of Shs 200.2 million was granted by the Government of Kenya through Profit Fund in February 2012. It is aimed at promoting financial deepening in rural financial sector by availing access to credit for agricultural related projects. The loan period is 10 years with four year grace period all-inclusive at an interest rate of 5% on reducing balance.

Oiko loan is a 4 year loan priced at T-Bill rate 182 days + 2.5% per annum, thereafter being reviewed semi annually but never lower than 10.00% per annum and capping of 16% for the first year. For the first 6 months, the net interest rate is fixed at 12.27%.

26 OTHER LIABILITIES

Accrued expenses
Staff leave provision
Bonus provision
Suspended interest
Sundry liabilities

	2015	2014
	Shs '000	Shs '000
Accrued expenses	400,772	225,071
Staff leave provision	24,332	19,171
Bonus provision	104,287	-
Suspended interest	108,760	115,994
Sundry liabilities	967,128	775,951
	1,605,279	1,136,187

27 SHARE CAPITAL

Authorised:
60,000,000 ordinary shares of Shs 10 each

Authorised, issued and fully paid:
48,000,000 (2014: 12,000,000) ordinary shares of Shs 10 each

On 26th March 2014, additional 36, 000,000 shares of Shs 10 each were fully paid for and allotted to Old Mutual Holdings Limited 32,160,000 shares and Micsha Capital Limited 3,840,000 shares.

The bank received Shs 2.7 billion comprising of Shs

360 million as share capital and She 2.3 billion as share premium. On 5th May 2015, the bank received an additional She 397 million as share premium. The movement in the number of shares is analysed as follows

1 January
Issue of additional shares
At end of period/year

	2015	2014
	No of shares	No of shares
	Shs '000	Shs '000
1 January	48,000	12,000
Issue of additional shares	-	36,000
At end of period/year	48,000	48,000

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28 NOTES TO THE STATEMENT OF CASH FLOWS

	2015 Shs '000	2014 Shs '000
(a) RECONCILIATION OF PROFIT BEFORE TAXATION TO CASH GENERATED FROM OPERATIONS		
Profit before taxation	182,689	431,571
Adjustment for:		
Depreciation	125,354	81,180
Amortisation of computer software	25,473	22,228
Write off of assets	36,069	-
Write off of investment in associate	46	-
Share of associate company's profit	(1,136)	(4,719)
	368,495	530,260
Working capital changes:		
Increase in loans to customers	(2,095,295)	(5,763,472)
Movement in related party balances	179	(1,162)
Increase in other assets	(347,245)	(77,849)
Decrease in cash collaterals held	(116,594)	(144,469)
Increase in customer deposits	2,819,281	5,448,094
Increase in other liabilities	469,092	431,429
Decrease/(increase) in government securities maturing after one year	(521,163)	(36,190)
Increase in cash reserve ratio- CBK	(757,241)	(116,124)
Decrease in derivative financial liability	-	(116,124)
Cash generated from operations	(180,491)	270,517
(b) ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS		
Cash and bank balances	495,807	297,155
Short term deposits with banks (note 13(a))	3,779,033	2,446,770
Commercial papers (note 13(b))	-	97,237
Government securities (note 14)	-	579,834
Bank overdraft (note 25)	(101,801)	(19,492)
	4,173,039	3,401,504

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash in hand, deposits held at call with banks, and short-term investments in money market instruments, net of bank overdrafts.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28 NOTES TO THE STATEMENT OF CASH FLOWS (Continued)

	2015 Shs '000	2014 Shs '000
(c) Movement in borrowings		
At 1 January	1,319,985	2,061,060
Received in the year	2,196,261	-
Paid in the year	(947,520)	(741,075)
At 31 December	2,568,726	1,319,985
Bank overdraft	101,801	19,492
At 31 December (note 26)	2,670,527	1,339,477

29 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.

Old Mutual Holdings Limited is the principal shareholder of Faulu Microfinance Bank Limited. Old Mutual Holdings Limited, Faulu Kenya Trust and Food for the Hungry Association (FH) are shareholders in Faulu Microfinance Bank Limited.

Faulu Microfinance Bank Limited, Faulu Advisory Services Limited and Faulu Kenya Trust are also related by virtue of common directorship.

All transactions with related parties are at arm's length in the normal course of business, and on terms and conditions similar to those applicable to other customers. Amounts not settled as at the end of each reporting period in respect of transactions with related parties are disclosed under note 30 (a).

Deposits are made in the bank by directors and companies associated to directors. Advances to customers at 31 December 2015 include advances and loans to staff and directors as indicated below:

	2015 Shs '000	2014 Shs '000
(a) Due to related parties:		
Old Mutual Holdings Limited	179	-
(b) Advances to customers:		
- Directors	39,716	-
- Employees	381,246	263,391
	420,962	263,391
(c) Customer deposits:		
- Directors	48,287	66,523
- Employees	28,967	45,595
- Companies associated with directors	1,110,000	1,355,000
	1,187,254	1,467,118

NOTES TO THE FINANCIAL STATEMENTS (Continued)

29 RELATED PARTY TRANSACTIONS (Continued)

Key management compensation

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

	2015 Shs '000	2014 Shs '000
Salaries and other benefits	101,672	103,371
Directors' remuneration		
Fees for services as directors	12,275	8,387

30 CONTINGENT LIABILITIES

The company is a defendant in various legal suits with an estimated liability of Shs 556 million (2014- Shs 600 million). In the opinion of the directors, after obtaining appropriate legal advice, the outcome of such actions will not give rise to any significant loss.

31 CAPITAL COMMITMENTS

The company had capital commitments worth Shs 333 million relating to IT Capex and software infrastructure upgrade (2014: Shs 22 million for IT hardware infrastructure upgrade).

32 FUTURE RENTAL COMMITMENTS UNDER OPERATING LEASES

The future lease payments in respect of obligations under operating leases are as follows:

	2015 Shs '000	2014 Shs '000
Within one year	47,828	8,572
Between one and five years	185,342	305,890
Over 5 years	480,773	616,709
	713,943	931,171

The lease rental expense incurred during the year in respect of company offices rental amounted to Shs 165,358,437(2014- Shs 113,139,238).

33 DIVESTITURE

As at 26th March 2014, Faulu received Shs 2.7 billion in pursuit of the divestiture process. Through this capitalisation, Old Mutual Holdings acquired a controlling stake at 67% while Micsha limited acquired 8%. This resulted to a dilution of Faulu Kenya Trust and Food for the Hungry International stake from 60% and 40% to 15% and 10% stake respectively.

The shareholding structure after the divestiture process is analysed as follows:

	No of Shares	% of Holding
Old Mutual Holdings Limited	32,160,000	67%
Micsha Capital Limited	3,840,000	8%
Food for the Hungry Association	4,800,000	10%
The Faulu Kenya Trust	7,200,000	15%
	48,000,000	100%

Upon conclusion, Sh 3.1 billion was raised as additional capital.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

34 OPERATING SEGMENTS INFORMATION

The entity's business is not organised on the basis of differences in related products and services or differences in geographical areas of operation.

35 ULTIMATE AND IMMEDIATE HOLDING COMPANY

The immediate holding and parent company is Old Mutual Holdings Limited, a company incorporated and domiciled in Kenya under the Companies Act. The ultimate holding company is Old Mutual Plc. which is incorporated in United Kingdom.

36 INCORPORATION

Faulu Kenya Microfinance Bank Limited is domiciled and incorporated in Kenya under the Companies Act.

37 EVENTS SUBSEQUENT TO YEAR END

There are no significant events after reporting period which have been reported in these financial statements

38 CURRENCY

These financial statements are presented in Kenya Shillings thousands (Shs'000).



“

Faulu is a listening and friendly bank. It has enabled us earn extra business income through their loans.

Hiram and Hellen
Faulu Customers

”



“

I can access loans faster at Faulu Bank. This has really boosted my business.

Isaac
Faulu Customer

”

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