

Empowering you to Succeed
2014 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	Appointed on 26 March 2014
Charles K. Njuguna	Managing Director	Appointed as a director on 26 March 2014 and as Managing Director on 8 August 2014
John K. Mwara	Managing Director	Resigned as Director and Managing Director on 8 August 2014
Kevin Terry*	Non-Executive Director	Appointed on 26 March 2014
Tavaziva Madzinga*	Non-Executive Director	Appointed on 26 March 2014
Peter J. Mogan***	Non-Executive Director	Appointed on 4 July 2014
George A. Maina	Non-Executive Director	
Beverley Nuthu	Non-Executive Director	
Mwikali Muthiani	Non-Executive Director	
Ken Wathome	Non-Executive Director	Resigned on 4 December 2014
Keith Wright**	Non-Executive Director	Resigned on 26 March 2014
Rueben T. Java*	Non-Executive Director	Appointed on 5 May 2014 and resigned 30 September 2014

*Zimbabwean, ** American, ***Canadian

Audit Committee

Beverley Nuthu
Kevin Terry
Mwikali Muthiani
Paul Kahoro*

Strategy Committee (formerly Executive Committee)

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

Risk, Compliance & Credit Committee (formerly Risk Management Committee)

George A. Maina
Mwikali Muthiani
Charles K. Njuguna
Amos Mwangi*
Bernard Githinji *
Raphael Lekoolool*

Remuneration and Nominating Committee

Dr. Peter W. Muthoka
George A. Maina
Charles K. Njuguna

*Senior management

Corporate Information. cont.

Registered Office

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

Company Secretary

John L G Maonga
Maonga Ndonye Associates
Jadala Place, 3rd Floor
Ngong Lane, Ngong Road
P. O. Box 73248
00200 - Nairobi

Auditors

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

Principal Lawyers

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

Principal Bankers

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

Board of Directors



Dr. Peter W. Muthoka
Chairman



Charles K. Njuguna
Managing Director



Beverley Nuthu
Non-Executive Director



George Adams Maina
Non-Executive Director



Mwikali Muthiani
Non-Executive Director



Kevin Terry
Non-Executive Director



Peter Mogan
Non-Executive Director



Tavaziva Madzinga
Non-Executive Director

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



Peter Iha
Acting Head of
Human Resources



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



I am pleased to present to you the Faulu Microfinance Bank annual report and financial statements for the year ended 31 December, 2014.

The year in review saw remarkable growth in the bank and is a testament of commitment by the Board of Directors, the management and the wider Faulu fraternity in ensuring that the bank not only delivers to stakeholder expectations, but also meets the customer at their point of need with relevant financial solutions.

2014 marked a great milestone in the history of Faulu, from its humble beginnings in Mathare Slums in 1992 to a successful financial services institution that has partnered with a global financial services group – The Old Mutual Group. The partnership has strengthened the Faulu Mission 'To listen and empower Kenyans by providing relevant financial solutions' as we can now offer our customers a full array of financial services that include Investment, Savings, Insurance and Banking.

2014 was also a year of transformation for the top leadership of the bank. The Faulu Board was revitalized via appointment of new Board members

with a wealth of experience. In addition, a Shared Services Model at Group level was established to allow for cost efficiencies, knowledge sharing and service excellence.

Economic Environment

The macro economic factors have continually stabilized over the year providing a good business environment. Demand for credit generally increased in most economic sectors, with availability of investment opportunities, affordable credit, introduction of the Kenya Banks Reference Rate (KBRR) at 9.13% (base rate used by banks and mortgage finance companies to price flexible interest loans) and retention of Central Bank Rate at 8.5% were cited as the main driving factors.

The economic growth was estimated to have expanded by 5.3% in 2014 compared a growth of 5.7% in 2013. This was achieved amidst the security concerns and delayed rainfall. Inflation eased in September and has been on downward trend to stand at 6.02% in December as compared to 7.15% in 2013. This has been attributed to food, electricity and gas prices slowing down.

Faulu posted an impressive 82% growth in profitability before tax to close at Shs 432 million up from Shs 238 million in 2013.

Financial Performance

Faulu posted an impressive 82% growth in profitability before tax to close at Shs 432 million up from Shs 238 million in 2013. This performance was driven by growth in operating income from Shs 1.7 billion to Shs 2.5 billion supported by growth in loans and advances, increased transaction volumes and improved operational efficiencies.

The quality of the loan book improved in the year as compared to 2013. Portfolio at Risk (PAR) closed at 4.1% compared to 5.28% in 2013. The credit loss provisions increased from Shs 69.5 million in 2013 to Shs 132.5 million in the year 2014. This was due to growth in loan book from Shs 8.7 billion to Shs 14.5 billion.

The balance sheet grew impressively by Shs 8 billion or 64% to Shs 20.3 billion up from Shs 12.4 billion in 2013 driven by the growth in the outstanding loans balances and deposit liabilities.

Divestiture & Integration

The divestiture program that started in 2011 was successfully concluded in the first quarter of

2014, resulting in a capital injection of Shs 2.7 billion by Old Mutual. Through this transaction Old Mutual acquired 67% controlling stake in Faulu Microfinance Bank. The divestiture was in line with the Central Bank of Kenya regulations on shareholding and adequate capitalisation of the financial institutions.

The capital injection has enabled Faulu Bank to expand banking services and insurance products to more Kenyans who are financially excluded in the micro, small and medium enterprises space.

Governance and Board changes

After the successful conclusion of the divestiture and integration with Old Mutual in March 2014, there were changes to the board of directors. Six new members were added to the board and Dr. Peter W. Muthoka was appointed chairman to take over from Mr. Kenneth Wathome as the incoming chairman. In August, 2014, the new Managing Director, Mr. Charles K. Njuguna was appointed to succeed Mr. John K. Mwara.

Looking Forward

International Monetary Fund forecasts that the country's economy will advance by about 6.2 per cent in 2015 powered by increased investment in infrastructure and growth of agriculture and service sectors. This is expected to provide a good environment for growth in Faulu's market niche.

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


Acknowledgement

Finally, I take this opportunity to thank the management and staff for their passion and commitment that has enabled Faulu achieve tremendous growth in 2014. I also thank my fellow board members for the invaluable guidance they have extended to the institution's leadership. Further, I express my gratitude to 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 offer products and services to the Republic and for approval of the Old Mutual - Faulu Kenya acquisition transaction that has created a bigger financial services group.

Thank you and God Bless You.

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



Dr. Peter W. Muthoka EBS, MBS
Chairman



Now that's Faida

The more you invest in a Faida Fixed Deposit with Faulu Bank the greater your returns.



Managing Director's Statement



INTRODUCTION

It is my pleasure to present to you the Annual Report and Financial Statements of Faulu Kenya Microfinance Bank for the year ended 31 December, 2014. In the year under review, we are pleased with our overall business performance which aligns well with our vision. The bank is endowed with a competitive strategy, a unique culture and a very strong brand.

ECONOMIC ENVIRONMENT

According to World Bank, Kenyan economy in 2014 experienced a stable macroeconomic environment with single-digit inflation.

The country's GDP is estimated to have expanded by 5.3% in 2014 compared to a growth of 5.7 % in 2013. The performance was supported by:

- increased government and private final consumption.
- Low oil prices.
- Increase in exports of goods and services.
- Stability of the Kenya Shilling against major currencies (despite slight depreciation against the US dollar).

According to the central bank's economic monthly review of December 2014, growth was largely supported by expansion in construction,

manufacturing, finance & insurance, information, communications & technology, wholesale & retail trade. The economy slowed in the third quarter of 2014, partly due to a sharp drop in tourism following terrorist attacks in the country.

Overall GDP growth is expected to amount to 6.5% and 6.3% in 2015 and 2016, respectively.

Political activity in 2014 centered mostly on the call by both the opposition party, Coalition for Reforms and Democracy (CORD), and county governments - the latter mainly seeking amendments of the constitution - to raise national government financial transfers to county governments from 15% to 45% with county governments spearheading Pesa Mashinani initiative.

The trials at International Criminal Court (ICC) facing President Republic of Kenya, his Deputy and a journalist raised political debates and temperatures throughout the year. However, in December 2014, the President's case was terminated by ICC Trial Chamber. This improved the political stability and confidence levels at international arena.

The overall inflation decreased to 6.02% in 2014 compared to 7.15% in 2014. This was mainly driven by low food prices, reduction in oil and energy products prices. Inflation rate remained relatively low throughout the year due to strong monetary policy and was within the government's preferred range of 5 to 7%.

Total assets grew impressively by Shs 7.9 billion to Shs 20.32 billion compared to Shs 12.42 billion in the corresponding period in 2013.

The Kenya shilling depreciated by 5.47% against USD in 2014 to trade at 90.59 compared to 85.89 in 2013. However, the shilling appreciated against the Euro to trade at 110.17 in December 2014 as compared to 117.91 in 2013.

Interest rates remained stable throughout the year. This was supported by the Central Bank Rate which remained at 8.5% in 2014 similar to that of prior year. 91 days Treasury bill rate decreased to 8.57% in December 2014 as compared to 9.4% in December 2013.

FINANCIAL PERFORMANCE

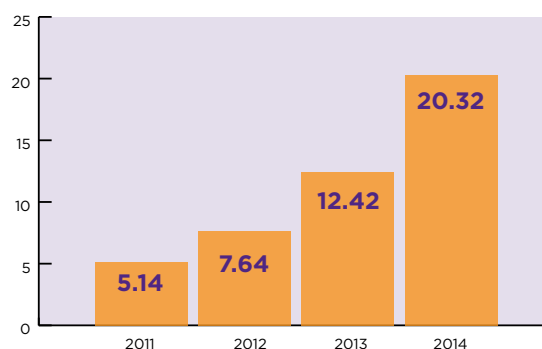
I am delighted to report that Faulu Bank continued to maintain positive growth trends. Profit before tax for the year ended 31st December 2014 rose by Shs 194 million to Shs 432 million compared to a profit of Shs 238 million in the corresponding period in 2013. This is a growth of 82 %.

Total assets grew impressively by Shs 7.9 billion to Shs. 20.32 billion compared to Shs 12.42 billion in the corresponding period in 2013 supported by growth in loans, balances with banks and short term investments.

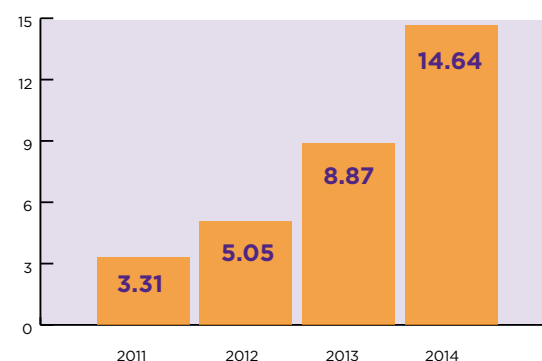
Loans and advances to customers increased by Shs 5.78 billion to Shs 14.64 billion in 2014 compared to Shs 8.87 billion in 2013. This was driven by an

aggressive product advertising “Chini Kwa Chini” Campaign and enhanced sales force.

Total Assets (Kshs ‘Billions)

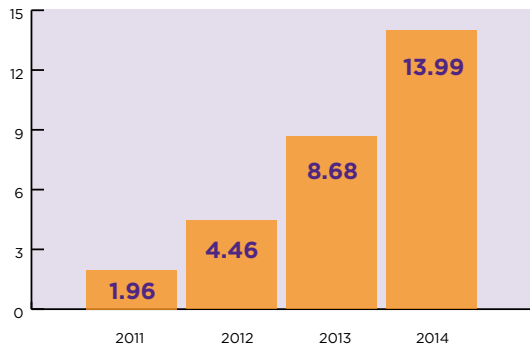


Loans and Advances to Customers (Kshs ‘Billions)



Customer deposits stood at Shs 13.99 billion from Shs 8.68 billion in 2013 due to increased customer acquisition attracted by high brand awareness and focused deposit sales.

Growth in Customer Deposits (Kshs 'Billions)



INFRASTRUCTURE AND CUSTOMER SERVICE

In the year 2014, Faulu continued to upgrade its core banking system, with an objective to give Faulu Bank a robust platform that would provide outstanding customer service and enhanced capacity to offer technology-driven products. Faulu has embraced geographical expansion and market penetration through use of technology, mobile platform and partnerships.

We are focused on customer transformation through holistic approach to product & service development and entrenchment of customer education in delivery of services.

OUR VISION OF COMMUNITY (VOC)

The Vision of Community is the vision embraced by Faulu Kenya staff to give Kenyans hope and a future through sustainable community partnership and development.

The staff have participated in Vision of Community through the following ways;

- Meeting real needs; projects focused on food & water, youth & education, health and disaster intervention restoring dignity to the community.
- Involving the community; projects that are community based from conception to commissioning while ensuring relevance and sustainability

- Involving all the staff; projects that go beyond hand-outs to heart-outs. Staying with the community until we see change!
- Involving God; recognizing Him as the true need of all communities and giving him the glory for what we are able to do.

We have intervened in various projects around the county in the year, which included;

- Cancer awareness support.
- Children's homes visit.
- Street children feeding and clothing programs.
- Run for the bible less.
- Kenya society for the blind visit.

Ngong Road Branch Supports Kenya Society for the Blind through Mt. Longonot Climbing event held on 29th Sept 2014.

Ngong Road Branch has been participating in this event for the last two years and 2014 was no exception.



Before embarking on the journey up the mountain.



At the peek of the mountain.

Ngong Road Visits Tunza Children's Centre at Kibera



Faulu staff issuing mattresses to the children

Faulu Participated in Run for the Bibleless in March



Faulu staff join participants at the run for the bibleless.

Operations Department, visited Excellent Care Centre and School in Mathare Slum.

They donated food staff, clothing and had fun with the little angels.



OUTLOOK

Looking ahead, I am very optimistic that the business will continue to grow steadily.

Faulu has the right strategy, a powerful brand, distinctive culture and fantastic people to deliver

the targeted objectives for the coming year.

Lastly, the focus will be on Technology& Innovation, business efficiency, sustainable growth, and new opportunities while ensuring sustained profitability.

A handwritten signature in black ink, appearing to be 'Charles Njuguna'.

Charles Njuguna
Faulu MD



Personal Accounts

A selection of interest earning accounts that allow you to transact conveniently via mobile banking. You can access personal loans, asset finance and much more.

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 2014 which discloses 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

	2014 Shs '000	2013 Shs '000
Profit before taxation	431,571	237,605
Taxation	(132,625)	(71,922)
Profit for the year transferred to retained earnings	298,946	165,683

DIVIDEND

The Directors do not recommend the payment of a dividend in respect of the year (2013: Shs nil).

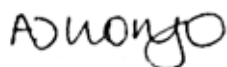
DIRECTORS

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

5th March 2015

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 endeavours 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 the pursuit of 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 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.

CORPORATE GOVERNANCE STATEMENT (CONTINUED)

Board Committees

The committees of the Board consist of a balanced mix of non-executive and executive Directors. The Board has constituted the following 4 main Board committees:

1. The Strategy Committee (formerly the Executive Committee)
2. The Audit Committee
3. The Risk, Compliance & Credit Committee (formerly the Risk Management Committee and Credit Committee)
4. 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%
Ken Wathome	83%
George A. Maina	100%
Beverley Nuthu	50%
Kevin Terry	100%
Rueben Java	50%
Mwikali Muthiani	100%
Peter Mogan	50%
Tavaziva Madzinga	25%
John Mwara	100%

Board of Directors attendance

Audit Committee		Risk, Compliance & Credit Committee		Strategy Committee		Remuneration and Nominating Committee	
Ken Wathome	75%	George A Maina	100%	Mwikali Muthiani	100%	Dr. Peter W. Muthoka	100%
Beverley Nuthu	75%	Mwikali Muthiani	100%	George A Maina	100%	George Maina	100%
Kevin Terry	100%	Reuben Java	50%	Charles Njuguna	100%	Rueben Java	50%
Paul Kahoro*	100%	Charles Njuguna	100%	Bernard Githinji*	100%	Charles Njuguna	100%
		Amos Mwangi*	100%				
		Bernard Githinji *	100%				
		Raphael Lekoolool*	100%				

*Senior Management

CORPORATE GOVERNANCE STATEMENT (CONTINUED)

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:-

- (a) Assisting the board in oversight of preparation and presentation of Financial Statements;
- (b) Recommending and reviewing adherences to accounting policies and internal controls;
- (c) 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;
- (d) Acting as Board's central coordination point for investigation of complaints relating to financial statements, compliance, and internal controls and
- (e) Oversee independence of external auditors.

The Strategy Committee (formerly Executive Committee)

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

- (a) Providing leadership on strategic issues and direction within the Board and alignment with Group strategies.
- (b) Ensuring there are adequate policies, systems, processes and structures to successfully implement the Bank's strategies.
- (c) Monitoring the institution's performance against strategic plans and objectives on an ongoing basis.
- (d) Providing direction and guidance to the Management on strategy execution.
- (e) Review strategic plans and corporate objectives and budgets.
- (f) Review effectiveness of the bank strategies.
- (g) Ensure that capital is fully optimized /capital management and the need for additional capital or restructuring of the balance sheet.
- (h) Review, approve and monitor capital expenditure, investments, mergers & acquisitions.

The Risk, Compliance & Credit Committee

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

- (a) 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;
- (b) Reviewing the adequacy of the company's capital and allocations to various business units considering the types and sizes of risks in those business units; and
- (c) Establishing an enterprise-wide risk management framework for all functions in the company and at all levels.
- (d) Review and oversee the overall lending policy of the company;
- (e) Deliberate and consider loan applications beyond the discretionary limits of the Credit Risk Management committee;
- (f) Review lending by the Credit Risk Management committee.

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

CORPORATE GOVERNANCE STATEMENT (CONTINUED)

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.

Restriction on Trading and Investment

The Board of Directors certifies that Faulu Microfinance Bank Limited

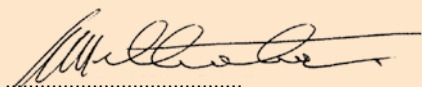
- (a) Has not acquired or held, directly or indirectly, any part of the share capital of; or
- (b) Have a beneficial interest in any financial, commercial, agricultural, industrial or other undertaking, where the value of the institution's interest exceeds 25% in the aggregate of the institution's core capital, except in an undertaking in fulfilment 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 did not grant a microfinance loan to any single end user or his associate that exceeds 2% of its core capital and that the aggregate amount of loans were 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
5th March 2015



Director
5th March 2015

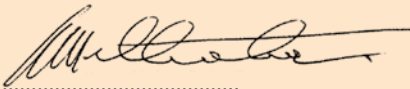
Statement of Directors' Responsibilities

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 Acts of 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 judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the 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
5th March 2015



Director
5th March 2015



Chama Accounts

Savings accounts for formal and informal groups with the aim of securing and preparing for investment opportunities. Has competitive interests rates on your chama money of up to 5% p.a.



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 24 to 67 which comprise the statement of financial position as at 31 December 2014, 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 judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we considered the internal controls relevant to the 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 2014 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 O Aloo -P/No 1537.



Certified Public Accountants (Kenya)

Nairobi, Kenya

13th March 2015

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

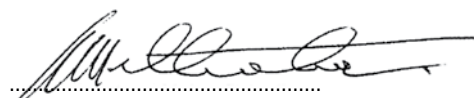
FOR THE YEAR ENDED 31 DECEMBER 2014

	Note	2014 Shs '000	2013 Shs '000
Interest income	5	3,184,005	1,770,784
Interest expense	6	(1,223,222)	(586,126)
Net interest income		1,960,783	1,184,658
Fees and commissions	7	517,101	459,650
Foreign exchange losses		(284)	(148)
Other operating income	8	1,259	13,057
Operating income		2,478,859	1,657,217
Administration and operating expenses	9	(1,919,556)	(1,357,840)
Impairment losses on loans and receivables	16	(132,451)	(69,508)
		(2,052,007)	(1,427,348)
Operating profit		426,852	229,869
Share of associate company's profit	19	4,719	7,736
Profit before tax		431,571	237,605
Taxation charge	11	(132,625)	(71,922)
Profit for the year		298,946	165,683
Other comprehensive income:			
<i>Items that will not be reclassified subsequently to profit or loss</i>			
Share of associate company's other comprehensive income	19	-	12
Surplus on revaluation of buildings		145,297	25,000
Deferred tax liability arising on revaluation surplus		(43,589)	(7,500)
		101,708	17,500
Other comprehensive income		101,708	17,512
Total comprehensive income for the year		400,654	183,195
Earnings per share (basic and diluted)	12	7.53	13.81

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2014

	Note	2014 Shs '000	2013 Shs '000
ASSETS			
Cash and bank balances		297,155	480,173
Short term deposits with banks	13(a)	2,446,770	860,226
Commercial papers	13(b)	97,237	111,187
Government securities	14	779,999	737,887
Loans to customers	15	14,488,387	8,724,915
Other assets	18	634,413	556,564
Tax recoverable	11(c)	12,594	-
Other investment	19(a)	46	46
Investment in associate companies	19(b)	42,086	38,783
Deferred tax asset	20	-	1,803
Property and equipment	21	1,365,638	729,826
Intangible assets	22	155,633	177,806
TOTAL ASSETS		20,319,958	12,419,216
LIABILITIES AND EQUITY			
LIABILITIES			
Cash collaterals	23	1,341,181	1,485,650
Customer deposits	24	12,646,278	7,198,184
Derivative financial liability	25	-	116,124
Borrowings	26	1,339,477	2,089,975
Deferred tax liability	20	69,452	-
Due to related companies	17	-	1,162
Other liabilities	27	1,136,187	704,758
Tax payable	11(c)	-	25,568
		16,532,575	11,621,421
CAPITAL RESOURCES			
Share capital	28	480,000	120,000
Share premium		2,503,059	274,125
Retained earnings		257,337	58,408
Revaluation surplus		205,472	103,589
Statutory reserve		341,515	241,673
		3,787,383	797,795
TOTAL LIABILITY AND EQUITY		20,319,958	12,419,216

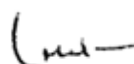
The financial statements on pages 24 to 67 were approved and authorised for issue by the board of directors on 2015 and were signed on its behalf by:



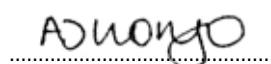
Director



Managing Director



Director



Company Secretary

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2014

	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 2013	120,000	274,125	3,938	88,323	128,214	614,600
Profit for the year	-	-	165,683	-	-	165,683
Other comprehensive income	-	-	12	17,500	-	17,512
Total comprehensive income for the year	-	-	165,695	17,500	-	183,195
Transfer of excess depreciation	-	-	3,192	(3,192)	-	-
Deferred tax on excess depreciation	-	-	(958)	958	-	-
Transfer to statutory reserve	-	-	(113,459)	-	113,459	-
At 31 December 2013	120,000	274,125	58,408	103,589	241,673	797,795
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 28)	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

The statutory reserve relates 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 IAS39 on financial instruments. The statutory reserve is not distributable.

Revaluation surplus arises on revaluation of land and buildings and its not distributable.

Premiums from the issue of shares are reported as share premiums. During the year, 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 2014

	2014	2013
Note	Shs'000	Shs'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash generated from operations	29(a) 270,517	827,773
Taxation paid	11(c) (141,705)	(25,924)
Net cash generated from operating activities	128,812	801,849
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of intangible assets	22 (55)	(5,567)
Purchase of property and equipment	21 (571,695)	(143,951)
Net cash used in investing activities	(571,750)	(149,518)
CASH FLOWS FROM FINANCING ACTIVITIES		
Loan received	29(c) -	1,050,200
Loan repaid	29(c) (741,075)	(752,598)
Proceed from issue of shares	28 2,706,698	-
Share issue costs paid	(117,764)	-
Net cash generated from financing activities	1,847,859	297,602
INCREASE IN CASH AND CASH EQUIVALENTS	1,404,921	949,933
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,996,583	1,046,650
CASH AND CASH EQUIVALENTS AT END OF YEAR	29(b) 3,401,504	1,996,583

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2014

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 2014

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.

<p>Amendments to IFRS 10, IFRS 12 and IAS 27 Investment Entities</p>	<p>The amendments to IFRS 10 define an investment entity and require a reporting entity that meets the definition of an investment entity not to consolidate its subsidiaries but instead to measure its subsidiaries at fair value through profit or loss in its consolidated and separate financial statements.</p> <p>To qualify as an investment entity, a reporting entity is required to:</p> <ul style="list-style-type: none"> • obtain funds from one or more investors for the purpose of providing them with investment management services; • commit to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and • measure and evaluate performance of substantially all of its investments on a fair value basis. <p>Consequential amendments have been made to IFRS 12 and IAS 27 to introduce new disclosure requirements for investment entities.</p> <p>Application of these standards has not had any impact on the disclosures or the amounts recognised in these financial statements as the company is not an investment entity (assessed based on the criteria set out in IFRS 10 as at 1 January 2014).</p>
<p>Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities</p>	<p>The amendments to IAS 32 clarify the requirements relating to the offset of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and 'simultaneous realisation and settlement'. The amendments have been applied retrospectively.</p> <p>As the company does not have any financial assets and financial liabilities that qualify for offset, the application of the amendments has had no impact on the disclosures or on the amounts recognised in the company's financial statements.</p>

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 2014 (Continued).

Amendments to IAS 36 Recoverable Amount Disclosures for Non-Financial Assets	The amendments to IAS 36 remove the requirement to disclose the recoverable amount of a cash-generating unit (CGU) to which goodwill or other intangible assets with indefinite useful lives had been allocated when there has been no impairment or reversal of impairment of the related CGU. Furthermore, the amendments introduce additional disclosure requirements applicable to when the recoverable amount of an asset or a CGU is measured at fair value less costs of disposal. These new disclosures include the fair value hierarchy, key assumptions and valuation techniques used which are in line with the disclosure required by IFRS 13 <i>Fair Value Measurements</i> . As the company does not have any cash-generating units (CGU) to which goodwill or other intangible assets with indefinite useful lives had been allocated, the application of the amendments has had no impact on the disclosures or on the amounts recognised in the company's financial statements.
IFRIC 21 Levies	<p>IFRIC 21 addresses the issue as to when to recognise a liability to pay a levy imposed by a government. The Interpretation defines a levy, and specifies that the obligating event that gives rise to the liability is the activity that triggers the payment of the levy, as identified by legislation. The Interpretation provides guidance on how different levy arrangements should be accounted for, in particular, it clarifies that neither economic compulsion nor the going concern basis of financial statements preparation implies that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.</p> <p>The application of this Interpretation has had no material impact on the disclosures or on the amounts recognised in the company's financial statements.</p>

(ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2014.

	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
Amendments to IFRS's Annual improvements	1 July 2014

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 2014 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 not 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 2014, 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 new and amended standards and interpretations on the financial statements for the year ended 31 December 2014 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. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until a detailed review has been completed.

Annual Improvements 2010-2012 Cycle

The Annual Improvements to IFRSs 2011-2013 Cycle include a number of amendments to various IFRSs, which are summarised below:

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.

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

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:

- (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

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 2014.

(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.

(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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(b) Interest income and expense (continued)

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.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(d) Taxation (Continued)

(ii) Deferred tax (Continued)

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.

(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 attributable 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(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 at an annual rate of 12.5%.

(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.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(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. Currently, the company's contribution is limited to Shs 200 per employee per month and is charged to the profit or loss in the year to which it relates.

(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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(o) Financial instruments (Continued)

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.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(o) Financial instruments (Continued)

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 judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, 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.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(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.



Business Accounts

A transactional account that allows you to borrow for working capital, business expansion or asset acquisition. You can access construction Loans, LPO Financing and Invoice Discounting.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS 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 judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are dealt with below:

i) Critical accounting judgements 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 judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a 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 judgement. In making this judgement, 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 and 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.

3 FINANCIAL RISK MANAGEMENT

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

- Credit risk
- Liquidity risk
- Market risks

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3 FINANCIAL RISK MANAGEMENT

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

	2014	%	2013	%
	Shs '000		Shs '000	
Agriculture	23,230	0.2%	68,035	1%
Business services	3,775,383	26.1%	3,053,110	35%
Consumer	10,689,774	73.7%	5,603,770	64%
	14,488,387	100%	8,724,915	100%

Cash collaterals

Agriculture	164,472	12%	25,786	1%
Business services	209,131	16%	1,111,687	76%
Consumer	967,578	72%	348,177	23%
	1,341,181	100%	1,485,650	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

	2014 Shs '000	%	2013 Shs '000	%
Credit exposures:				
On balance sheet items:				
Short term deposits with banks	2,446,770	14%	860,226	8%
Loans to customers	14,642,997	81%	8,866,398	84%
Government securities	779,999	4%	737,887	7%
Commercial papers	97,237	1%	111,187	1%
	17,967,003	100%	10,575,698	100%

(iii) Classification of loans and receivables

	2014 Shs '000	2013 Shs '000
Neither past due nor impaired	14,036,775	8,399,550
Past due but not impaired	185,036	112,109
Impaired	421,186	354,739
Gross	14,642,997	8,866,398
Less: allowances for impairment (note16)	(154,610)	(141,483)
Net	14,488,387	8,724,915

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 2014

Neither past due nor impaired
Past due but not impaired
Impaired

	Gross Shs '000	Net Shs '000
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

31 December 2013

Neither past due nor impaired
Past due but not impaired
Impaired

Neither past due nor impaired	8,399,550	8,399,550
Past due but not impaired	112,109	112,109
Impaired	354,739	213,256
	8,866,398	8,724,915

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 1,341,180 (2013: Sh 1,485,650).

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 23.5% (2013 - 26.65 %).

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	28,754	8,604	5,311	40,383	199,550	535,220	523,359	1,341,181
Borrowings	19,492	-	124,198	799,321	248,409	-	219,178	1,410,598
Customer deposits	2,112,128	6,141,512	2,306,044	2,187,581	205,735	-	-	12,952,800
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
FINANCIAL ASSETS								
Cash and bank balances	297,155	-	-	-	-	-	-	297,155
Short term deposits & commercial papers	1,057,426	1,369,656	100,381	16,544	-	-	-	2,544,007
Government securities	-	-	200,000	178,298	-	201,536	200,165	779,999
Loans to customers (net)	310,621	92,941	57,374	436,245	2,155,681	5,781,827	5,653,698	14,488,387
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
As at 31 December 2013								
Total liabilities (contractual maturity dates)	2,936,393	2,034,830	1,577,876	2,747,080	798,368	958,332	200,200	11,253,079
Total assets (expected maturity dates)	996,796	810,514	731,773	1,509,352	1,747,388	5,133,750	-	10,929,573
NET LIQUIDITY GAP	(1,939,597)	(1,224,316)	(846,103)	(1,237,728)	949,020	4,175,418	(200,200)	(323,506)

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	-	-	-	-	-	-	-	297,155	297,155
Short term deposits & commercial papers	1,087,709	1,330,263	100,000	26,035	-	-	-	-	2,544,007
Government securities	-	-	200,000	179,999	-	200,000	200,000	-	779,999
Loans to customers (net)	310,621	92,941	57,374	436,245	2,155,681	5,781,827	5,653,698	-	14,488,387
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
B. FINANCIAL LIABILITIES									
Borrowings	19,492	-	118,672	763,756	237,357	-	200,200	-	1,339,477
Customer deposits	2,112,128	5,834,788	2,306,044	2,187,582	205,736	-	-	-	12,646,278
Cash collateral held	-	-	-	-	-	-	-	1,341,181	1,341,181
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
C. 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
D. As at 31 December 2013									
Total financial assets	516,623	810,514	731,773	1,509,352	1,747,388	5,133,750	-	480,173	10,929,573
Total financial liabilities	2,889,598	1,988,960	1,455,870	2,269,900	524,108	91,683	183,517	1,485,650	10,889,286
E. On statement of financial position- interest sensitivity gap	(2,372,975)	(1,178,446)	(724,097)	(760,548)	1,223,280	5,042,067	(183,517)	(1,005,477)	40,287

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:

	2014 Shs'000		2013 Shs'000	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
3% increase in interest rates	69,594	92,515	53,331	28,843
3% decrease in interest rates	(69,594)	(92,515)	(53,331)	(28,843)

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	276,026	11,407	9,722	297,155
Short term deposits with banks and commercial papers	2,544,007	-	-	2,544,007
Government securities	779,999	-	-	779,999
Loans to customers (net)	14,488,387	-	-	14,488,387
Total financial assets	18,088,419	11,407	9,722	18,109,548
B. LIABILITIES				
Cash collateral held	1,341,181	-	-	1,341,181
Borrowings	1,339,477	-	-	1,339,477
Customer deposits	12,646,278	-	-	12,646,278
Total financial liabilities	15,326,936	-	-	15,326,936
C NET BALANCE SHEET POSITION	2,761,483	11,407	9,722	2,782,612
As at 31 December 2013				
A Total financial assets	10,928,171	468	934	10,929,573
B Total financial liabilities	10,773,809	-	-	10,773,809
NET BALANCE SHEET POSITION	154,362	468	934	155,764



Asset Financing

Loan for purchase of personal cars, commercial vehicles or machinery among other assets at an interest rate as low as 9.5%. Long repayment term to a maximum of 60 months.



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.

	2014 Shs'000		2013 Shs'000	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
Currency - Euro				
+ 10% Shs movement	(972)		(93)	-
- 10% Shs movement	972		93	-
Currency - US dollars				
+ 10% Shs movement	(1,141)		(58,349)	-
- 10% Shs movement	1,141		58,349	-

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;

	2014 Shs '000	2013 Shs '000
Tier 1 capital		
Share capital	480,000	120,000
Share premium	2,503,059	274,125
Retained earnings	257,337	58,408
	3,240,396	452,533
Tier 2 capital		
Subordinated debt	-	245,843
Collective allowances for impairment	194,081	106,766
Revaluation reserve	51,368	25,897
	245,449	378,506
Regulatory capital	3,485,845	827,223
Total risk-weighted assets	15,526,505	8,541,268
Borrowings	1,339,477	2,089,328
Gearing	41%	462%
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum -12%)	23%	10%
Total tier 1 capital expressed as a percentage of total risk-weighted assets (CBK minimum -10%)	21%	5%

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 maximisation 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

Loans and receivables
Short term bank deposits
Held to maturity investments-treasury bonds

2014	2013
Shs '000	Shs '000
2,753,204	1,623,854
363,903	101,516
66,898	45,414
3,184,005	1,770,784

6 INTEREST EXPENSE

Savings accounts
Bank overdrafts/borrowed funds

919,074	377,754
304,148	208,372
1,223,222	586,126

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

7 FEES AND COMMISSIONS

	2014	2013
	Shs '000	Shs '000
Registration fees	1,896	2,274
Loan set up fees	380,629	275,600
Commission (net)	100,467	141,772
Chattels mortgage fees	34,109	40,004
	517,101	459,650

8 OTHER OPERATING INCOME

Bad debts recovered	-	4
Other income	1,259	13,053
	1,259	13,057

9 ADMINISTRATION AND OPERATING EXPENSES

Staff costs (note 10)	1,056,592	603,082
Office operations and supplies	545,302	388,742
Training and evaluation	37,741	29,296
Office rent and repairs	119,539	96,622
Loss on revaluation of derivative	-	116,124
Travelling expenses	40,669	13,672
Depreciation of property and equipment	81,180	80,486
Audit fees	3,675	3,100
Amortisation of intangible assets	22,228	16,242
Directors' fees	8,387	7,930
Assets write off	-	385
Reversal of WIP capitalized erroneously	-	106
Other expenses	4,243	2,053
	1,919,556	1,357,840

10 STAFF COSTS

Staff salaries and wages	753,231	468,694
Medical expenses	61,127	44,398
Company contributions to defined contribution pension scheme	36,788	26,582
Temporary labour	40,389	26,166
Provision for accumulated leave	6,538	2,321
Staff awards	1,760	681
Staff uniforms	44	54
Statutory pension contributions (NSSF)	2,862	1,806
Staff incentives-permanent	144,342	26,416
Recruitment	7,705	3,227
Health & safety	16	42
Staff welfare & entertainment	1,790	2,695
	1,056,592	603,082

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

11 TAXATION

	2014 Shs '000	2013 Shs '000
(a) TAXATION CHARGE		
Current tax expense		
Based on the adjusted profit for the year at 30%	138,380	108,913
Share of associate company taxation (note 19)	1,416	2,321
Prior year overprovision for current tax	(34,837)	-
	<u>104,959</u>	<u>111,234</u>
Deferred taxation (note 20)		
Current year credit	(7,266)	(39,312)
Prior year under provision of deferred tax	34,932	-
	<u>27,666</u>	<u>(39,312)</u>
	<u>132,625</u>	<u>71,922</u>
(b) RECONCILIATION OF EXPECTED TAX BASED ON ACCOUNTING PROFIT TO TAX CHARGE		
Accounting profit before taxation	431,571	237,605
Tax at the applicable rate of 30%	129,471	71,282
Tax effect of income not taxable	1,416	(5,824)
Tax effect of expenses not deductible for tax purposes	3,059	4,143
Prior year under provision- deferred tax	34,932	-
Prior year over provision- current tax	(34,837)	-
	<u>134,041</u>	<u>69,601</u>
Share of associate company taxation (note 19)	(1,416)	2,321
	<u>132,625</u>	<u>71,922</u>
(c) TAX (RECOVERABLE)/PAYABLE		
Balance at 1 January	25,568	(57,421)
Charge for the year	138,380	108,913
Paid in the year	(141,705)	(25,924)
Prior year over provision- current tax	(34,837)	-
Balance at 31 December	<u>(12,594)</u>	<u>25,568</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.

	2014	2013
Profit for the year attributable to ordinary shareholders (Shs '000)	298,946	165,683
Weighted average number of ordinary shares in issue ('000')	39,692	12,000
Earnings per share - basic & diluted (Shs)	7.53	13.81

There were no potentially dilutive shares outstanding at 31 December 2014 (2013: nil).

13 (a) SHORT TERM DEPOSITS WITH BANKS

	2014 Shs '000	2013 Shs '000
Bank of Africa Limited	412,740	255,609
Eco Bank (K) Limited	259,597	213,897
Chase Bank (K) Limited	427,734	260,058
Jamii Bora Bank Limited	218,186	100,079
The Kenya Commercial Bank Limited	1,111,089	-
Century DTM Limited	17,424	21,258
Sumac DTM Limited	-	9,325
	2,446,770	860,226

Effective interest rate average 11.8% in 2014 and 10.8% in 2013. All the deposits mature in 2015.

(b) COMMERCIAL PAPERS

Held to maturity

	Maturity Date	Interest rate	2014 Shs '000	2013 Shs '000
Car & General (K) Limited	January 2015	13%	45,688	70,000
ARM Cement Limited	January 2015	13%	51,549	41,187
			97,237	111,187

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

14 GOVERNMENT SECURITIES

	2014 Shs '000	2013 Shs '000
Treasury bonds - held to maturity		
Maturing within 1 year	239,834	233,912
Maturing between 1 and 3 years	200,165	163,975
	439,999	397,887
Treasury bills - held to maturity	340,000	340,000
	779,999	737,887
For cash flow purposes		
Treasury bonds maturing within 1 year	239,834	233,912
Treasury bills- maturing within 1 year	340,000	340,000
Government securities included in the cash flow (note 30(b))	579,834	573,912

The effective interest rate on treasury bonds at 31 December 2014 was 9.7% (2013 - 9.50%). The effective interest rate on treasury bills at 31 December 2014 was 12% (2013 - 11.90%).

Government securities (treasury bonds) with a value of Shs 277 million (2013: Shs 252 million) are held under a lien against Standard Chartered. Treasury bonds and bills worth Shs 100 million and Shs 200 million respectively are held under lien to secure the Eco Bank Facility.

15 LOANS TO CUSTOMERS

	2014 Shs '000	2013 Shs '000
Gross loans to customers (secured)	14,642,997	8,866,398
Accumulated impairment losses (note 16)	(154,610)	(141,483)
	14,488,387	8,724,915

The effective interest rate on customer advances at 31 December 2014 was 24% (2013 - 25%). Advances to customers are secured by cash collaterals (note 24) and chattels mortgages. The net non-performing loans and advances amounted to Shs 451,612,000 (2013: Shs 325,365,000).

16 IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	2014 Shs '000	2013 Shs '000
At 1 January	141,483	103,242
Additional provision during the year	132,451	69,508
Amounts written off	(119,324)	(31,267)
At 31 December	154,610	141,483

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

17 RELATED PARTY BALANCES

	2014 Shs '000	2013 Shs '000
Due to related organisations		
Faulu Advisory Services Limited	-	1,162

18 OTHER ASSETS

	2014 Shs '000	2013 Shs '000
Staff receivables	5,843	28,924
Prepaid expenses	58,428	46,186
Deposits and sundry receivables	570,142	481,454
	634,413	556,564

19 INVESTMENTS

(a) Other investments

	2014 Shs '000	2013 Shs '000
Faulu Tanzania Limited		
Investment at cost - 10% shareholding	46	46

(b) Investment in associate company

	2014 Shs '000	2013 Shs '000
Faulu Advisory Services Limited:		
At 1 January	38,783	33,356
Share of profit for the year	4,719	7,736
Share of taxation (note 11(a))	(1,416)	(2,321)
Share of other comprehensive income	-	12
	42,086	38,783

The reporting date of Faulu Advisory Services Limited is 31 December. The company is incorporated in Kenya which is also its 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 is 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 2014:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

19 INVESTMENTS (Continued)

Faulu Advisory Services Limited (continued)

	2014	2013
	Shs '000	Shs '000
Non-current assets	23,565	39,599
Current assets	101,557	94,109
Total assets	125,122	133,708
Current liabilities	(28,069)	(50,083)
Revenue	79,612	150,817
Profit from continuing operations before tax	18,876	38,504
Other comprehensive income	-	49

Faulu Advisory Services Limited:

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

	2014	2013
	Shs '000	Shs '000
Total assets	125,122	133,736
Total liabilities	(28,069)	(50,083)
Net assets	97,053	83,653
Company's share of net assets of associate @ 25%	24,263	20,913
Profit of associate before taxation	18,876	38,504
Company's share @ 25%	4,719	9,626
Prior year adjustment*	-	(1,890)
Company share of associate's taxation	(1,416)	(2,321)
Company share of other comprehensive income	-	12
Net result of associate recognised	3,303	5,427

*The prior year adjustment relates to adjustments to recognise prior period's associate's income. The amounts involved were not significant to warrant prior period reclassifications as per the requirements of IAS 8.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

20 DEFERRED TAX (ASSET)/LIABILITY

	2014 Shs '000	2013 Shs '000
The net deferred tax asset is attributable to the following items:		
Excess depreciation of capital allowances	(11,886)	(10,540)
Deferred tax on revaluation surplus	90,089	47,458
Unrealised exchange loss	-	(34,932)
General provision	(3,000)	-
Provision for staff leave pay & other provisions	(5,751)	(3,789)
	69,452	(1,803)
The movements in the deferred tax account during the year were as follows:		
At 1 January	(1,803)	30,009
Credit to profit or loss (note 11(a))	(7,266)	(39,312)
Prior year under provision of deferred tax (note 11(a))	34,932	-
Surplus dealt with through equity	43,589	7,500
At 31 December	69,452	(1,803)

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 2013	185,000	13,540	84,035	47,541	679,892	60,381	1,070,389
Additions	-	5,210	17,277	2,778	18,420	100,266	143,951
Revaluation surplus	25,000	-	-	-	-	-	25,000
Transfer to/(from)	-	-	-	818	26,450	(127,907)	(100,639)
Reversal of WIP erroneously capitalised	-	-	-	-	-	(106)	(106)
Asset write off	-	(384)	-	-	-	-	(385)
At 31 December 2013	210,000	18,366	101,312	51,137	724,762	32,633	1,138,210
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
DEPRECIATION							
At 1 January 2013	2,716	6,946	60,132	25,916	232,188	-	327,898
Charge for the year	1,307	2,733	9,922	6,123	60,401	-	80,486
At 31 December 2013	4,023	9,679	70,054	32,039	292,589	-	408,384
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
NET BOOK VALUE							
At 31 December 2014	350,000	15,645	36,871	23,067	427,107	512,948	1,365,638
At 31 December 2013	205,977	8,687	31,258	19,098	432,173	32,633	729,826

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 2014, the net book value of the freehold land and building at original cost was Shs 49,702,834 (2013: Shs 54,593,165).

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 2014 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 2014				
Land and buildings	-	350,000	-	350,000
31 December 2013				
Land and buildings	-	205,977	-	205,977

22 INTANGIBLE ASSETS - COMPUTER SOFTWARE

	2014 Shs '000	2013 Shs '000
COST		
At 1 January	328,610	222,404
Additions	55	5,567
Transfer from WIP	0	100,639
At 31 December	328,665	328,610
AMORTISATION		
At 1 January	150,804	134,562
Charge for the year	22,228	16,242
At 31 December	173,032	150,804
NET BOOK VALUE		
At 31 December	155,633	177,806

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.

	2014	2013
	Shs '000	Shs '000
0 - 30 days	85,039	46,325
31 - 90 days	48,599	24,329
91 - 180 days	50,524	59,927
Over 180 days	1,157,019	1,355,069
	1,341,181	1,485,650

The effective interest rate on the cash collaterals held at 31 December 2014 was nil (2013: nil).

24 CUSTOMER DEPOSITS

	2014	2013
	Shs '000	Shs '000
Savings account	2,224,857	1,753,280
Fixed account	10,421,421	5,444,904
	12,646,278	7,198,184

The effective interest rate on customer deposits as at 31 December 2014 is 11% (2013: 10.57%).

25 DERIVATIVE FINANCIAL LIABILITY - HELD FOR RISK MANAGEMENT

At fair value through profit and loss

The entity uses the derivative for non-hedging purposes. The company held currency forwards which represent commitments to purchase foreign currency.

The derivative instruments held become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which the instruments are favourable or unfavourable, and thus the aggregate fair values

of derivative financial assets or liabilities, can fluctuate significantly from time to time. The derivatives held by the entity are classified at fair value through profit or loss.

During the year 2013, the company had entered into an arrangement with the Standard Chartered Bank (SCB) for a hedge for its Deutsche Bank Euro loan of Euro 5 million. Under the arrangement, Faulu Kenya borrowed US dollars of equivalent amount from SCB and placed a deposit of the Euros.

At 31 December 2014, the fair value of the derivative financial instrument is set out below;

	2014	2013
	Shs '000	Shs '000
Derivative financial liability	-	116,124

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

26 BORROWINGS

	2014 Shs '000	2013 Shs '000
Loan from Deutsche Bank (Euro 5,000,000)	-	466,250
Loan from Standard Chartered Bank Limited	-	75,000
Loans from Symbiotics Fund	170,097	207,578
Loan from Eco Bank Limited	550,000	550,000
Loan from European Investment Bank	174,688	262,032
Loan from Oiko	225,000	300,000
Loan from IFAD	200,200	200,200
Bank overdrafts	19,492	28,915
	1,339,477	2,089,975

The borrowings are repayable as follows:

	2014 Shs '000	2013 Shs '000
Within 1 year	901,920	1,320,003
After 1 year within 3 years	237,357	494,772
After 3 years and within 5 years	-	91,683
Over 5 years	200,200	183,517
	1,339,477	2,089,975

The USD 2 million from Symbiotic SA (fully hedged) was obtained at 10.5% interest rate for a period of 2 years from October 2012.

The loan from Deutsche Bank was unsecured and the interest rate on the loan was 6.5% per annum. The facility was fully settled in December 2014.

The loan from European Investment Bank of EURO 4M was advanced at 11.57% repayable semi-annually till 15 October 2016 with first repayment date 15 April 2014.

The bank overdraft is held with Standard Chartered Bank Kenya Limited for working capital requirements and is secured by government securities (note 15). The effective interest rate for the year ended 31 December 2014 was 11.2 % (91 Day Tbill plus 2.5%) (2013 - 12.8%).

The loan from Eco Bank is secured by treasury

bond and treasury bills. The interest rate on the loan is 4.87% above KBRR rate (9.13%).

IFAD (International Fund for Agricultural Development) loan of Shs 200.2 million was granted by the Government of Kenya through Profit Fund in February 2013. 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%.

27 OTHER LIABILITIES

	2014 Shs '000	2013 Shs '000
Accrued expenses	225,071	32,427
Staff leave provision	19,171	12,632
Sundry liabilities	891,945	659,699
	1,136,187	704,758

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

28 SHARE CAPITAL

Authorised:

60,000,000 ordinary shares of Shs 10 each

Authorised, issued and fully paid:

48,000,000 (2013: 12,000,000) ordinary shares of Shs 10 each

	2014	2013
	Shs '000	Shs '000
Authorised:		
60,000,000 ordinary shares of Shs 10 each	600,000	600,000
Authorised, issued and fully paid:		
48,000,000 (2013: 12,000,000) ordinary shares of Shs 10 each	480,000	120,000

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 Shs 2.3 billion 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

	2014	2013
	No of shares Shs '000	No of shares Shs '000
1 January	12,000	12,000
Issue of additional shares	36,000	-
At end of period/year	48,000	12,000

29 NOTES TO THE STATEMENT OF CASH FLOWS

(a) RECONCILIATION OF PROFIT BEFORE TAXATION TO CASH GENERATED FROM OPERATIONS

Profit before taxation

Adjustment for:

Depreciation

Amortisation of computer software

Write off of assets

Reversal of WIP erroneously capitalised

Share of associate company's profit

Working capital changes:

Increase in loans to customers

Movement in related party balances

Increase in other assets

Decrease in cash collaterals held

Increase in customer deposits

Increase in other liabilities

Increase in government securities

(Decrease)/increase in derivative financial liability

Cash generated from operations

	2014	2013
	Shs '000	Shs '000
(a) RECONCILIATION OF PROFIT BEFORE TAXATION TO CASH GENERATED FROM OPERATIONS		
Profit before taxation	431,571	237,605
Adjustment for:		
Depreciation	81,180	80,486
Amortisation of computer software	22,228	16,242
Write off of assets	-	385
Reversal of WIP erroneously capitalised	-	106
Share of associate company's profit	(4,719)	(7,736)
	530,260	327,088
Working capital changes:		
Increase in loans to customers	(5,763,472)	(3,775,717)
Movement in related party balances	(1,162)	(270)
Increase in other assets	(77,849)	(234,425)
Decrease in cash collaterals held	(144,469)	(29,937)
Increase in customer deposits	5,448,094	4,249,270
Increase in other liabilities	431,429	339,615
Increase in government securities	(36,190)	(163,975)
(Decrease)/increase in derivative financial liability	(116,124)	116,124
Cash generated from operations	270,517	827,773

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

29 NOTES TO THE STATEMENT OF CASH FLOWS (continued)

	2014 Shs '000	2013 Shs '000
(b) ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS		
Cash and bank balances	297,155	480,173
Short term deposits with banks (note 13(a))	2,446,770	860,226
Commercial papers (note 13(b))	97,237	111,187
Government securities (note 14)	579,834	573,912
Bank overdraft (note 26)	(19,492)	(28,915)
	<u>3,401,504</u>	<u>1,996,583</u>

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.

	2014 Shs '000	2013 Shs '000
(c) Movement in borrowings		
At 1 January	2,061,060	1,763,458
Received in the year	-	1,050,200
Paid in the year	(741,075)	(752,598)
At 31 December	1,319,985	2,061,060
Bank overdraft	19,492	28,915
At 31 December (note 26)	<u>1,339,477</u>	<u>2,089,975</u>

30 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 in note 17.

Placings are made in the bank by directors and companies associated to directors. Advances to customers at 31 December 2014 include advances and loans to staff and directors as indicated below:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

30 RELATED PARTY TRANSACTIONS

	2014 Shs '000	2013 Shs '000
Advances to customers:		
- Directors	-	4,549
- Employees	263,391	114,992
	263,391	119,541
Customer deposits:		
- Directors	66,523	28,012
- Employees	45,595	18,115
- Companies associated with directors	1,355,000	-
	1,467,118	46,127

Key management compensation

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

	2014 Shs '000	2013 Shs '000
Salaries and other benefits	103,371	95,029
Directors' remuneration		
Fees for services as directors	8,387	7,930

31 CONTINGENT LIABILITIES

The company is a defendant in various legal suits with an estimated liability of Shs 600 million (2013 - Shs 10 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.

32 CAPITAL COMMITMENTS

The company had capital commitments worth Shs 22 million relating to IT hardware infrastructure upgrade which has been authorised and contracted for at end of the year (2013: Shs 300 million).

33 FUTURE RENTAL COMMITMENTS UNDER OPERATING LEASES

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

	2014 Shs '000	2013 Shs '000
Within one year	8,572	6,046
Between one and five years	305,890	309,854
Over 5 years	616,709	158,173
	931,171	474,073

The lease rental expense incurred during the year in respect of company offices rental amounted to Shs 113,139,238 (2013 - Shs 89,091,558).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

34 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 Mischa

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%

35 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.

36 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.

37 INCORPORATION

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

38 EVENTS SUBSEQUENT TO YEAR END

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

39 CURRENCY

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



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