

2016

ANNUAL REPORT AND
FINANCIAL STATEMENTS



Celebrating 25 Years
of Transforming Lives

Our Vision

To Enable Kenyans to Realize their dreams.

Enable – Faulu has a rich heritage of transformation and empowerment. The current product portfolio help customers grow their investments and protect what they value.

Kenyans – The bank has a footprint in 32 counties across Kenya.

Realize their dreams – Everybody hopes for a better future. The future may include growing one’s business, saving for one’s children’s education, investing towards a home, etc. Faulu’s products and services are designed to meet these aspirations.

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.

CONTENTS

Corporate Information	02
Chairman's Statement	06
Managing Director's Statement	10
Report of the Directors	20
Corporate Governance Statement	21
Statement of Directors' Responsibilities	26
Independent Auditors' Report	27
Financial Statements:	
Statement of Profit or Loss and Other Comprehensive Income	30
Statement of Financial Position	31
Statement of Changes in Equity	32
Statement of Cash Flows	34
Notes to the Financial Statements	35

CORPORATE INFORMATION

Board of Directors

Dr. Peter W. Muthoka	Non- Executive Chairman	
Charles K. Njuguna	Managing Director	up to 18 December 2016
Apollo N. Njoroge	Managing Director	Appointed on 19 December 2016
Kevin Terry*	Non- Executive Director	
Peter J. Mogan**	Non- Executive Director	
George A. Maina	Non- Executive Director	
Beverley Nuthu	Non- Executive Director	
Mwikali Muthiani	Non- Executive Director	
Sospeter Joshua Muiru	Non- Executive Director	
Peter Gachuba	Non- Executive Director	
Catherine Musakali	Non- Executive Director	
Peter K. Mwangi	Non- Executive Director	
Tavaziva Madzinga	Non- Executive Director	Resigned August 2016
Werner Alberts	Non- Executive Director	Appointed in February 2016
Theunis Kruger	Non- Executive Director	Appointed in December 2016

*Zimbabwean, **Canadian

Audit Committee

Joshua Muiru
Beverley Nuthu
Kevin Terry
Catherine Musakali

Strategy Committee - disbanded May 2016

Mwikali Muthiani
George A. Maina
Charles K. Njuguna

Risk & Compliance Committee

George A. Maina
Joshua Muiru
Catherine Musakali
Peter K. Mwangi

Remuneration and Nominating Committee

Dr. Peter W. Muthoka
George A. Maina
Peter K. Mwangi

Credit Committee

Peter Gachuba
George A. Maina
Mwikali Muthiani

IT Committee - constituted in December 2015

George A. Maina
Peter Gachuba
Joshua Muiru
Charles K. Njuguna
Kevin Terry

CORPORATE INFORMATION cont.

Registered Office	Company Secretary	Principal Bankers
Faulu Head Office Ngong Lane Off Ngong Road P.O. Box 60240 00200 - Nairobi Kenya	Pauline Ngunyo Old Mutual Building Corner of Mara Road and Hospital Road, Upper Hill P.O. Box 30059 Nairobi Kenya	Standard Chartered Bank Kenya Limited Yaya Centre Branch P.O. Box 40310 00100 - Nairobi Kenya
Auditors	Principal Lawyers	
Deloitte & Touche Certified Public Accountants (Kenya) Deloitte Place, Waiyaki Way, Muthangari P.O. Box 40092 00100 - Nairobi Kenya	Daly & Figgis Advocates 6th Floor, ABC Towers, ABC Place, Waiyaki Way P.O. Box 40034 00100 - Nairobi Kenya	

BOARD OF DIRECTORS



Dr. Peter W. Muthoka
Chairman



Peter K. Mwangi
Non-Executive Director



George A. Maina
Non-Executive Director



Theunis Kruger
Non-Executive Director



Peter Gachuba
Non-Executive Director



Catherine Musakali
Non-Executive Director



Beverley Nuthu
Non-Executive Director



Werner Alberts
Non-Executive Director



Sospeter Joshua Muiru
Non-Executive Director



Peter Mogan
Non-Executive Director



Mwikali Muthiani
Non-Executive Director



Apollo N. Njoroge
Managing Director

2016 SENIOR MANAGEMENT

Apollo N. Njoroge
Managing Director

Tom V. Juma
Chief Operating Officer

Amos Mwangi
General Manager,
Business Development

Bernard Githinji
General Manager, Finance

Peter Onsongo
Head of Credit

Raphael Lekoolool
Head of Risk and Compliance

Maureen Mbori
Head of Treasury

Paul Kahoro
Head of Internal Audit

Carol Kipsanai
Head of Marketing
and Research

Purity Raaria (deceased)
Head of Legal

William Wambugu
Head of HR and Business
Intergration

CURRENT SENIOR MANAGEMENT



Apollo N. Njoroge
Managing Director



Tom V. Juma
Chief Operating Officer



Peter Iha
Head of Human Resources



Peter Onsongo
Head of Collections



Maureen Mbori
Head of Treasury



Paul Kahoro
Head of Internal Audit



Grace Thiongo
Head of Risk and Compliance



Julius Taliani
Head of Finance & Strategy



Nahashon Ojode
Head of Credit



Caroline Kipsanai
Head of Marketing



Michael Kalii
Head of Operations

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, 2016. In the year, the bank launched a number of strategic initiatives, in Distribution, Technology and People towards the development of a leading Retail and MSME Bank. This was aimed at putting up strong foundations while aligning to the business's overall objective of sustainable growth and maximizing returns to our shareholders, even with the money market turbulence in the banking sector.

Economic Environment

According to World Bank, global growth in 2016 was estimated at a post-crisis low of 2.3% and is projected to rise to 2.7% in 2017. Growth in Emerging Markets and Developing Economies (EMDEs) is expected to pick up in 2017, reflecting receding obstacles to activity in commodity exports and imports. Weak investment and productivity growth are, however, weighing on medium-term prospects across many EMDEs. Downside risks to global growth include increasing policy uncertainty in major advanced economies and some EMDEs, financial market disruptions, and weakening potential growth. However, fiscal stimulus in key major economies—in particular, the United States—could lead to stronger-than-expected activity in the near term and thus represent a substantial upside risk to the outlook. The Kenya National Bureau of Statistics (KNBS) estimated the economy to have expanded by 5.7% in 2016 compared to a growth of 6.0% in 2015. The key macroeconomic indicators remained largely stable throughout the year. Inflationary rate rose to 6.3% in 2016 from 6.1%. This was contained within the Central Bank's monetary policy target of 5% (with a margin of plus/minus 2.5%). The slight increase in inflation was primarily due to increases in prices of food and beverages during the period under review.

This rise was however countered by significant decreases in prices of utilities and transport. The country continues to benefit from low fuel prices, a stable macroeconomic environment, and stability in monetary policy actions, which has ensured inflation remained contained in 2016. However effects of controlled oil outputs by OPEC saw the cost of oil and related products edge upwards towards the end of 2016 piling more inflationary pressure. In the money market, the Kenyan Shilling strengthened against the US dollar, Euro, Sterling pound, South African Rand and the Tanzanian Shilling but weakened against the Yen and the Ugandan Shilling in comparison to 2015.

Legal and Regulatory developments

The year 2016 saw the enactment of a number of legislations and other regulations that affected the financial services sector. The key one was the Banking (Amendment) Act 2016, which established restrictions on the rates banks offer on loans and deposits. The amendment put a cap on lending rates at 4% above the Central Bank Rate (CBR) and a floor on the deposit rates at 70% of the CBR. There was also the Oversight of Collective Investment Scheme (CIS) funds regulation whereby the Capital Markets Authority now requires CIS's to disclose their distribution of fixed deposits across Tier 1, 2 and 3 banks, in a bid to protect investor funds on the backdrop of the collapse of 3 local banks. Other additional regulatory amendments included the Kenya Deposit Insurance Corporation Act (KDIC), where Treasury sought to be involved before a bank is placed under receivership, and the Internal Capital Adequacy Assessment Process (ICAAP) where all banks and mortgage finance institutions were required to formulate their own ICAAPs that ensure overall internal capital levels are adequate and consistent with their strategies, business plans, risk profiles and operating environments.

Developments in the Banking Sector

The year 2016 saw the placement of Chase Bank into receivership which resulted in erosion of consumer confidence in small and mid-sized banks. This closely followed the receivership of Dubai Bank and Imperial Bank in October 2015.

Money market and liquidity turbulence hit the banking sector with deposits flight from small players to Tier 1 banks. Large banks became more dominant, accounting for almost 80% of the banking deposits and creating liquidity pressure for the small players in market.

The Central Bank of Kenya continued to enforce compliance prudential guidelines and regulations, partly resulting in a noted significant increase in the provisioning for non-performing loans. During the year, the Central Bank of Kenya issued a notice requiring all banks to undertake an insider lending audit. This was partly in reaction to the findings from forensic investigations into the banks that had earlier been placed under receivership.

Although provisions of The Banking (Amendment) Act, 2016, legally affected Commercial banks as defined under the Banking Act, Microfinance banks continued to be pressured by customers to reduce interest rates on loans and also experienced some loans buyouts by Commercial Banks. The Amendment is expected to have a significant bearing to the profitability across the whole banking sector, and result in wide range restructuring measures as lenders pursue

sustainability and profitability. There also was a proposed consolidation of all state-owned banks and a general expectation that this would set the stage for a number of mergers and acquisition in the banking sector in the coming future.

Financial Performance

The Banking Sector developments resulted in a tough year for the non-Tier 1 players in the market. Faulu Microfinance Bank posted a 44% drop in profitability before tax to close at Shs 107 million down from Shs 190 million in 2015. The performance was mainly attributed to low net interest income and depressed loans disbursements. Due to the liquidity constraints in the banking sector triggered by the receivership of Chase Bank in April 2016, customers preferred placing funds with Tier 1 banks negatively affecting funding/deposits mobilisation for loans disbursements. A placement of Shs 451m was also locked in Chase Bank at interest moratorium.

The capping of interest rates on enactment of Banking (Amendment 2016) Act also triggered a push for lower interest rates even though the law did not directly legislate the rates applied by Microfinance Banks.

The quality of the loan book declined in the year as compared to 2015. Portfolio at Risk (PAR) closed at 7.98% compared to 3.63% in 2015. The credit loss expense increased from Shs 165 million in 2015 to Shs 188 million in the year 2016. The statement of financial position grew by Shs 2.2 billion or 9% to Shs 27.5 billion up from Shs 25.3 billion in 2015 driven by the growth in the outstanding loans balances and deposit liabilities.

Robust strategies have been put in place to improve the company's financial performance in 2017 and beyond. These will be driven mainly through aggressive customer acquisition and deposit mobilisation, a focus on transactional revenue growth, quality and prudent lending and implementation of robust cost management initiatives.

Future Outlook

The World Bank forecasts that the country's economy will grow by about 6 per cent 2017 powered by increased investment in infrastructure and growth of agriculture and service sectors. This is expected to provide a robust environment for business growth.

In spite of the daunting challenges inherent in the business operating environment for the general election year 2017, Faulu will seek to aggressively grow its market share through effective business partnerships and quality service delivery to

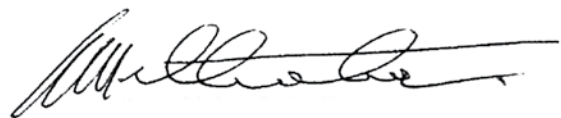
clients. This will be achieved by expanding our infrastructure with a view to enhancing distribution of Banking and Bancassurance products. The key focus areas will be business growth through deposit mobilisation and debt funding partnerships, efficient management of the non-performing loans portfolio, expanding our distribution through digital banking, Agency Banking and ATMs roll-out, and finally optimization of the staff compliment with special emphasis on performance and leadership development.

The upgrade of T24 core banking system is scheduled to be concluded within 2017. This is in line with the banks overall strategy of driving efficiencies and convenient offering of products and services to our esteemed customers. This advanced technology makes the Bank nimble in all its operations.

Acknowledgement

Finally, I take this opportunity to thank the management and staff for their passion and commitment. I also thank my fellow board members for the invaluable guidance they have extended to the institution's leadership.

Thank you and God Bless You.



**Dr. Peter W. Muthoka EBS, MBS, FKIB,FKIM
Chairman**



Mobile Banking



Faulu Visa Debit Card

ACCESS YOUR MONEY CONVENIENTLY TODAY



Faulu ATMs Countrywide



To enjoy these benefits, sms the word "Open" to 0708 000 111 or call 0711 074 074

Regulated by the Central Bank of Kenya
*Terms and conditions apply.



A Member of the  **OLDMUTUAL** Group

MANAGING DIRECTOR'S STATEMENT



I am delighted to present to you the Annual Report and Financial Statements of Faulu Microfinance Bank for the year ended 31st December 2016.

Despite 2016 being a relatively challenging year due to a number of both external and internal factors, the Bank has continued to grow. One of the main changes in the banking industry was The Banking (Amendment) Act, 2016, that came into force in September 2016 capping interest rates charged by Commercial Banks at 4% above the prevailing Central Bank Rate set by the CBK. The Act also set the minimum interest rate granted on a deposit held in an interest earning account in Kenya to at least 70% of the base rate.

Faulu was recognized as the Fastest Growing Microfinance Bank over the past three (3) years (2014 to 2016) during the 2017 Think Business Banking Awards. The Awards did not only focus on financial stability and growth, but also on how banks have embraced corporate best practices, product and system innovation, education as well as engaging in sustainable social projects

Economic Environment

According to World Bank, the Kenyan economy was solid in 2016, The GDP grew to 5.9% in 2016 as compared to 5.6% in 2015. This was supported by a stable macroeconomic environment, low oil prices, favourable harvest, rebound in tourism, strong remittance inflows and an ambitious public investment drive.

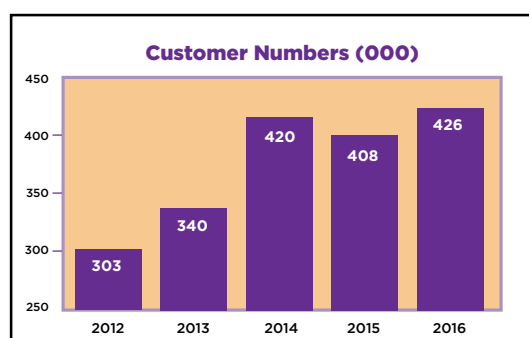
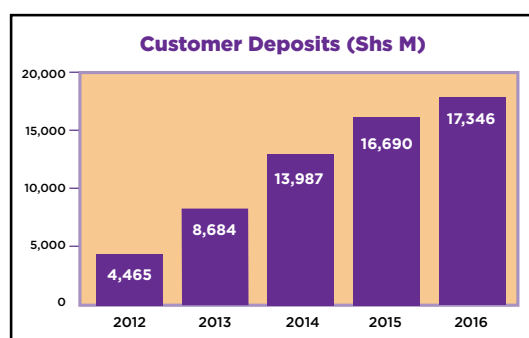
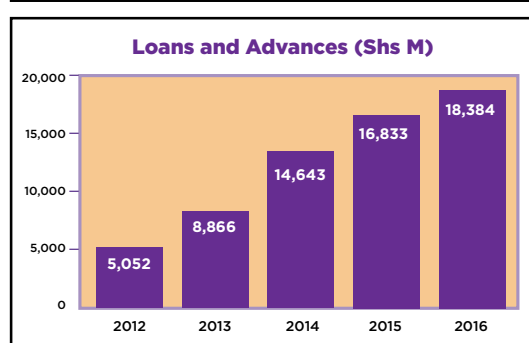
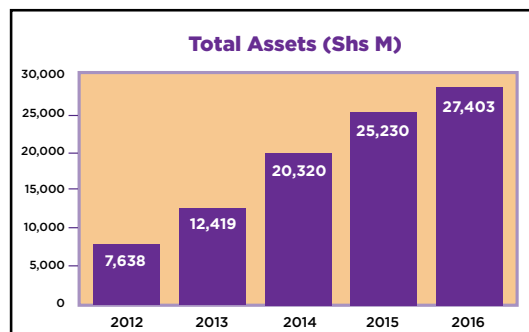
Kenya's GDP is expected to average 5.5%. The decelerating growth is attributed to sluggish credit growth due to August 2017 presidential elections, rising energy costs and crop failure both owing to poor rains.

Inflation averaged at 6.3% due to subdued oil prices, lower electricity tariffs – owing to increased reliance on geothermal power and low food prices due to improved rainfall. The political environment was also relatively stable throughout the year.

Financial performance

Faulu Microfinance Bank 2016 performance was as follows:

- The **Profit before tax** declined to Kshs. 107 Million from Kshs. 190 Million in 2015. This was mainly driven by high suspended interest as a result of an increase in the Non-performing loan book from weak economic environment and low net interest income following sluggish credit growth due to interest capping law implemented on commercial banks
- **Customer deposits** increased by 4% to Kshs. 17.3 Billion in 2016 from Kshs. 16.6 Billion in 2015 due superior products offered and the strong brand
- **Gross loans & advances** increased by 9% to Kshs.18.3 Billion in 2016 up from Kshs. 16.8 Billion in 2015, this was driven by our enhanced sales force
- **Total assets** grew by 9% to Kshs. 27.4 Billion in 2016 from Kshs. 25.2 Billion in 2015 driven by the growth in outstanding loan balances
- **Customer numbers grew.** The customer base was attributed to the Bank's revamped customer experience, innovations and a product portfolio that addresses customer needs
- The **quality of the loan book** declined, with the portfolio at risk (PAR) increasing to 7.97% from 3.63% in 2015. The credit loss provisions increased to Kshs. 188 Million from Kshs.165 Million in 2015 on account of weak economic environment



Infrastructure and Customer Service

Faulu Microfinance Bank has continued to invest in modern and state of the art IT platforms and systems including the rollout of 20 VISA enabled ATMs countrywide, the opening of an additional 10 banking branches, joining the Kenya Electronic Payment and Settlement System (KEPSS), direct KBA Cheque clearing enablement and a robust digital solution which includes a revamped mobile banking platform to accelerate customer growth and enhance service delivery to our customers.

Outlook

Backed by our reputable brand, excellent team, salient client relationships and core financial strength, I am optimistic that Faulu will continue to grow steadily. Our focus will be on ensuring financial inclusion, enhanced customer experience, and business efficiency through continued investment in technology and innovation as well as new opportunities.

Acknowledgement

I take this opportunity to extend my sincere appreciation to the Board of Directors for having provided invaluable guidance to the institution and to all our staff for their diligent effort. In this endeavor, I shall continue to solicit your ongoing support.

Thank you and God Bless You.

A handwritten signature in black ink, appearing to be 'AN', enclosed within a hand-drawn circle. A horizontal line extends from the right side of the circle.

Apollo N. Njoroge
Managing Director



Faulu Chairman, Dr Peter. W. Muthoka EBS, MBS, FKIM, FKIB together with Nyeri Senator, Mutahi Kagwe officially launch Faulu Visa Debit Cards and Faulu ATMs in Nyeri.

OUR CORPORATE SOCIAL RESPONSIBILITY

Faulu Corporate Social Responsibility is strongly ingrained in the culture of the bank. As a member of the Old Mutual Group and an integral part of the UAP Old Mutual Foundation, which is the social investment arm of the Group, Faulu is committed to enabling Kenyans realize their dreams with a focus on Healthcare, Environment, Education and Risk Awareness in order to form sustainable community partnerships and development.

Throughout the year, Faulu participated in numerous projects around the country in various categories as outlined below:

1. Education

- Faulu donated Kshs. 5 Million to support literacy development amongst small language groups in Kenya. This was through the partnership with Bible Translation and Literacy (BTL). Faulu was the title sponsor at the annual Run for the Bibleless which attracted over 10,000 participants.
- Donation of assistive devices which took place in five regions, Kisumu, Bomet, Kitui, Mombasa and Meru. Assistive devices donated included:
 - o 60 Books
 - o 16 Perkins Braille
 - o 85 Braille Kits
 - o 106 A4 Braille States
 - o 500 Braille papers
- Scholarship - Faulu has supported quality learning through our scholarship program offered to bright yet needy students. The beneficiaries have been Gatanga Girls, Starehe boys and Sunshine Secondary School. We also continue to interact with them through a mentorship program to impart life and leadership skills

2. Environment

- Ndeka Tree Planting to conserve the Ndakaini Dam which saw over 10,000 trees planted in 2016
- Ndakaini Half Marathon to raise money in order to sustain the Ndakaini Dam
- Rehabilitation of Aberdare National Park in partnership with the Kenya Wildlife Services to plant over 19,000 trees in 2016
- Faulu staff also participated in the Mt. Longonot hike with the Kenya Society of the Blind

3. Healthcare

- Renovation of the Accident and Emergency Unit (A&E) of Kenyatta National Hospital (KNH) to improve service delivery for over 500 patients received daily and the enhancement of work environment for over 100 staff at the unit.

4. Staff Engagement Programs

- Donation of furniture to Kipkabas Dawns School
- Prostate cancer screening with Africa Cancer Foundation in three counties with
- Provision of school uniforms to 100 pupils in Todonyang' Mission School Turkana

Bible Translation and Literacy Run for the Bibleless held on Saturday, March 05, 2016

The annual run is dedicated towards the translation of the Bible into minority language groups in

Kenya and facilitates basic financial literacy programs for these communities.



Warm up session during run for the bibleless



Run for the bibleless being flagged - off



Staff embark on the 10km run



A happy participant crosses the finishing line first after the 4Km walk

Faulu donates assistive devices in five regions, Kisumu, Bomet, Kitui, Mombasa and Meru



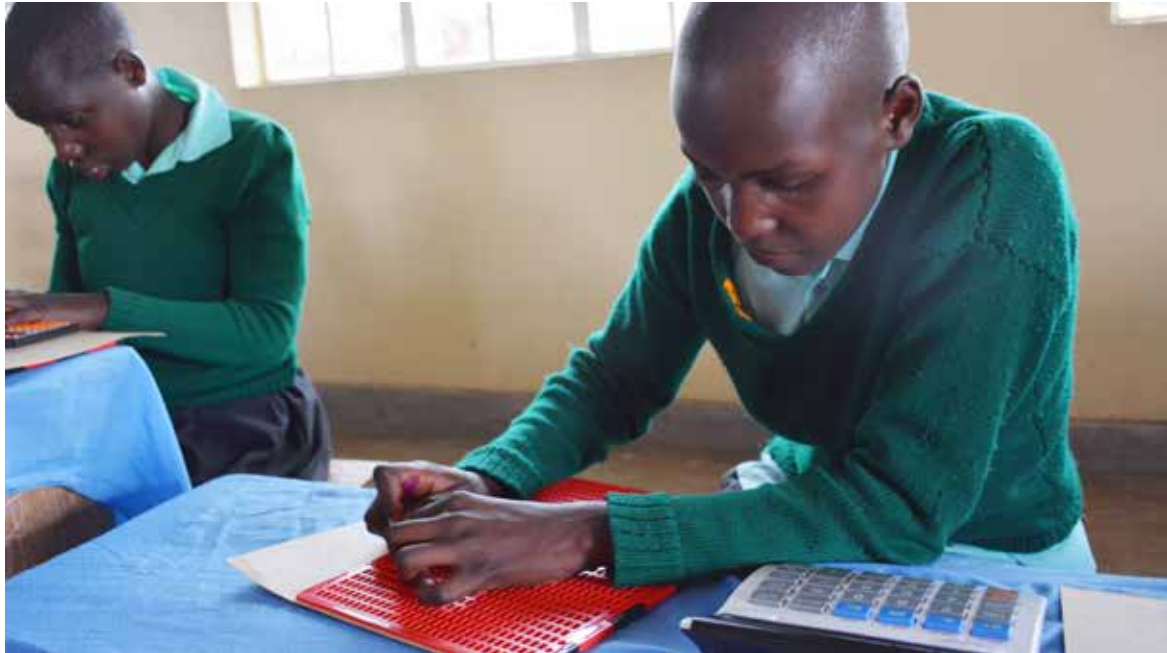
Faulu donates assistive devices to Kenya Society of the Blind



(Right - Left) Mr. Sitati Makhandia - Chairman, Kenya Society for the Blind Council, Dr. Peter W. Muthoka EBS, MBS, FKIM, FKIB - Chairman, Faulu and Peter Mwangi - Group CEO, UAP Old Mutual together with KSB staff pose for a photo.



Dr. Peter W. Muthoka EBS, MBS, FKIM, FKIB - Chairman, Faulu hands over a white cane to Mr. Sitati Makhandia - Chairman, Kenya Society for the Blind Council.



Renovation of the Accident and Emergency Unit of Kenyatta National Hospital

Before



The substandard floor of the accident and emergency section



Staff locker room area at the accident and emergency wing



The reconstruction work for the floor begins

After



The floor and sink area renovated



The floor redone and wall repainted



Staff locker room well done



Sink area well fitted



The casualty section completely renovated



The Staff working area completed

Rehabilitation of Aberdare National Park in partnership with the Kenya Wildlife Services



Staff taking part in the business of tree planting



Tree planting at Ndeka near Ndakaini Dam on Saturday, April 16, 2016



UAP Old Mutual Group CEO – Peter Mwangi plants a tree in Ndeka



Faulu Chairman - Dr Peter. W. Muthoka contributes in conserving the environment.



A group photo of all staff from the UAP Old Mutual group Kenya after tree planting at Ndeka



10,000 trees planted at Ndeka

Staff Engagement Programs



Staff visit Destiny shapers children's home and bond with the children

Ndakaini Half Marathon held on Saturday, September 10, 2016

The Faulu team actively participated in the Ndakaini half marathon on 10th September 2016.



Faulu Microfinance Bank joins Kenya Society for the Blind to hike Mt. Longonot on September 24, 2016

For the past four years, Faulu has actively participated in the Mt. Longonot hike to raise money for Kenya Society for the Blind, and 2016 was no exception.



Staff form groups in readiness for the hike



Faulu staff pose for a photo as they gear up for the hike



The hike is flagged off by Rosebell Maina - Relationship Manager Institutional Banking and Bernard Githinji - General Manager Finance & Strategy



Staff ready to embark on the hike

REPORT OF THE DIRECTORS

The directors present their report together with the audited financial statements (the “company” or Bank”) and its subsidiary (together, the “Group”) for the year ended 31 December 2016, which disclose its state of affairs. In accordance with Section 42 of the sixth schedule transitional and savings provisions of the Companies Act, 2015, this report has been prepared in accordance with section 157 of the repealed Companies Act, as if this repeal had not taken effect.

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

	Group		Bank	
	2016	2015	2016	2015
	Shs '000	Shs'000	Shs '000	Shs'000
Profit before tax	107,407	190,300	97,564	182,689
Taxation charge	(58,264)	(69,639)	(54,905)	(67,356)
Profit for the year transferred to retained earnings	49,143	120,661	42,659	115, 333

DIVIDEND

The directors do not recommend the payment of a dividend in respect of the year (2015: Shs nil).

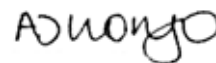
DIRECTORS

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
30th March 2017

CORPORATE GOVERNANCE STATEMENT

Faulu Microfinance Bank 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 pursuit for excellence.

Board Size, Composition and Appointments

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

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

and performance of the Board to ensure that:

- a. The mix of membership is appropriate and compatible with the requirements of both the Board and the company;
- b. Non-executive Directors commit adequate time and contribute effectively to the Board.

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

Board Responsibilities

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

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

CORPORATE GOVERNANCE STATEMENT (Continued)

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.

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 Audit Committee
2. The Risk and Compliance Committee
3. Credit Committee
4. The Remuneration and Nominating Committee
5. The Strategy Committee-was disbanded in May 2016

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

Board and Board Committee Meetings

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

Board of Directors attendance

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

Board Sub-committees

Risk and Compliance Committee

George A Maina	100%
Peter Mwangi	80%
Joshua Muiru	100%
Catherine Musakali	100%

Audit Committee

Joshua Muiru	100%
Beverley Nuthu	100%
Catherine Musakali	100%

Strategy Committee

Mwikali Muthiani	100%
George A Maina	100%
Peter K Mwangi	100%

Remuneration and Nominating Committee

Dr. Peter W. Muthoka	100%
George A Maina	100%
Peter K Mwangi	100%

CORPORATE GOVERNANCE STATEMENT (Continued)

Credit Committee

Peter Gachuba	100%
Mwikali Muthiani	100%
George A Maina	100%
Werner Alberts	100%

IT Committee

George A. Maina	100%
Joshua Muiru	100%
Peter Gachuba	100%
Charles Njuguna	100%
Kevin Terry	100%

The Audit Committee

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

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

The Strategy Committee

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

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

The Risk, Compliance & Credit Committee

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

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

CORPORATE GOVERNANCE STATEMENT (Continued)

The Credit Committee

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

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

The Remuneration and Nominating Committee

The committee has been established to assist the board with the following responsibilities;

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

The IT Committee

The ICT Board Committee was established by the Board of Faulu Microfinance Bank as part of its mandate to drive transformation, governance and business growth for the bank. The committees mandate include the following:

1. Develop and sustain the ICT plan for the Faulu Microfinance Bank and ensure approval by the Board. This include:
 - a. Responsibility of managing strategic IT-related projects like the core banking upgrade/replacement.
 - b. Coordinating the ICT components of the ICT plans from all units across the Faulu Microfinance bank within the wider Old Mutual, where Faulu Microfinance Bank is a member.
2. Develop and recommend Faulu Microfinance Bank policy with relation to ICT.
3. Review and recommend on ICT project development plans within the context of ICT strategic and transformation agenda.
4. Create ad hoc committees to address strategic ICT issues, as required.
5. Review, coordinate and arbitrate major ICT activities across the bank
6. Provide an update to the Faulu Board, Regulators and the relevant Old Mutual board on the progress made in the identified IT related strategic projects and transformation agenda.

Management Committees

i. The Assets and Liabilities Management Committee (ALCO)

This committee meets every month or more frequently when necessary. ALCO, a risk management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposit withdrawals can be met as and when they fall due, and the company does not encounter difficulties in meeting its obligations or financial liabilities as they fall due. This includes management of operational risks, interest rate, market and exchange rate risks and ensuring compliance with statutory requirements governing liquidity.

CORPORATE GOVERNANCE STATEMENT (Continued)

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;

- Allow a credit facility or guarantee to remain outstanding;
- Incur any liability; or
- Enter into any contract or transaction; or
- 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

- Has not Acquired or held, directly or indirectly, any part of the share capital of; or
- 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 granted a microfinance loan to 3 single end user that exceeded 2% of its core capital (Hardrock Holdings & Investment Co Shs 121 million, Bizack Limited Shs 90 million and Disney Insurance Brokers Shs 88 million). The aggregate amount of loans was not more than 70% of the institution's total loan portfolio.

KYC Requirements

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



.....

Director
30th March 2017



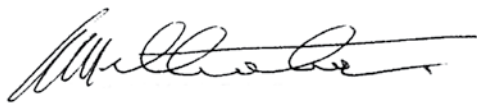
.....

Director
30th March 2017

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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



.....
Director
30th March 2017

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
30th March 2017

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

Report on the Audit of the Financial Statements

We have audited the accompanying consolidated financial statements of Faulu Microfinance Bank Limited, set out on pages 30 to 76, which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the company as at 31 December 2016 and of its consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs") and the requirements of the Kenyan Companies Act.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated and Separate Financial Statements section of our report. We are independent of the company in accordance with the Institute of Certified Public Accountants of Kenya Code of ethics (ICPAK Code of Ethics), which is consistent with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants, together with other

ethical requirements that are relevant to our audit of the consolidated and separate financial statements in Kenya, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Other Information

The directors are responsible for the other information, which comprises corporate information, Chairman's statement, Report of the directors, corporate governance statement and the Statement of director's responsibilities. The other information does not include the financial statements and our auditor's report thereon.

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

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

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

RESPONSIBILITIES OF THE DIRECTORS AND THOSE CHARGED WITH GOVERNANCE FOR THE FINANCIAL STATEMENTS

The Directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRSs, and for such internal controls as Directors determine are necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so. Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

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

taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.

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

If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the consolidated financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

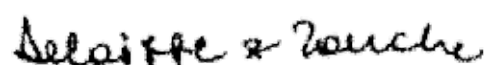
We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

As required by section 162 of the Kenyan Companies Act, we report to you, based on our audit, that:

- 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;
- in our opinion, proper books of account have been kept by the company, so far as appears from our examination of those books of account; and
- the company's statement of financial position is in agreement with the books of account.

The engagement partner responsible for the audit resulting in this independent auditors' report is CPA Anne Muraya - P/No 1697.



**Certified Public Accountants (Kenya) Nairobi,
Deloitte & Touche
31st March 2017**

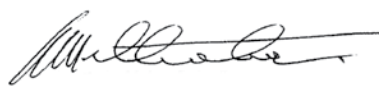
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	Group		Bank	
		2016	2015	2016	2015
		Shs '000	Shs '000	Shs '000	Shs '000
Interest income	5	4,220,811	3,847,572	4,220,811	3,847,572
Interest expense	6	(2,143,882)	(1,651,727)	(2,143,882)	(1,651,727)
Net interest income		2,076,929	2,195,845	2,076,929	2,195,845
Fees and commissions	7	393,680	293,517	382,030	277,060
Foreign exchange gain		15,189	4,461	15,189	4,461
Other operating income	8	3,232	5,079	404	5,053
Operating income		2,489,030	2,498,902	2,474,552	2,482,419
Administration and operating expenses	9	(2,196,914)	(2,144,593)	(2,192,279)	(2,135,720)
Impairment losses on loans and receivables	16	(188,362)	(165,146)	(188,362)	(165,146)
		(2,385,276)	(2,309,739)	(2,380,641)	(2,300,866)
Operating profit		103,754	189,163	93,911	181,553
Share of associate company's profit	19	3,653	1,136	3,653	1,136
Profit before tax		107,407	190,300	97,564	182,689
Taxation charge	11	(58,264)	(69,639)	(54,905)	(67,356)
Profit for the year		49,143	120,661	42,659	115,333
Total comprehensive income for the year		49,143	120,661	42,659	115,333
Earnings per share (basic and diluted)	12	1.02	2.51	0.89	2.40

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

	Note	Group		Bank	
		2016 Shs '000	2015 Shs '000	2016 Shs '000	2015 Shs '000
ASSETS					
Local currency cash		310,838	285,289	297,540	275,799
Balances due from banks and financial institutions		334,337	220,008	334,337	220,008
Short term deposits with banks	13	2,271,571	3,779,033	2,271,571	3,779,033
Cash Reserve Ratio-CBK	17	1,016,104	757,241	1,016,104	757,241
Government securities	14	1,750,000	721,328	1,750,000	721,328
Tax recoverable	11(c)	192,135	168,917	197,777	171,200
Loans to customers	15	17,954,979	16,583,682	17,954,979	16,583,682
Other assets	18	1,356,669	880,338	1,329,202	871,899
Investment in associate companies	19(a)	45,439	42,881	45,439	42,881
Investment in Faulu Insurance Agency	19(b)	-	-	1,000	1,000
Property and equipment	21	1,842,087	1,524,194	1,842,087	1,524,194
Intangible assets	22	328,873	266,642	328,873	266,642
TOTAL ASSETS		27,403,032	25,229,552	27,368,909	25,214,906
LIABILITIES AND EQUITY					
LIABILITIES					
Cash collaterals	23	980,802	1,224,587	980,802	1,224,587
Customer deposits	24	16,365,424	15,465,559	16,390,424	15,465,559
Borrowings	25	4,386,811	2,670,527	4,386,811	2,670,527
Deferred tax liability	20	72,647	58,119	72,647	58,119
Other Liabilities	26	1,195,246	1,496,972	1,177,737	1,496,519
Due to related companies	29	46,862	9,045	18,413	179
		23,047,792	20,924,809	23,026,834	20,915,490
CAPITAL RESOURCES					
Share capital	27	480,000	480,000	480,000	480,000
Share premium		2,899,759	2,899,759	2,899,759	2,899,759
Retained earnings		260,152	242,209	247,781	236,882
Revaluation surplus		212,756	212,756	211,962	212,756
Statutory reserve		502,573	470,019	502,573	470,019
		4,355,240	4,304,743	4,342,075	4,299,416
TOTAL LIABILITY AND EQUITY		27,403,032	25,229,552	27,368,909	25,214,906

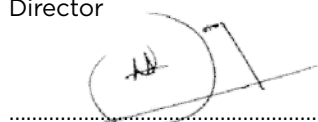
The financial statements on pages 30 to 76 were approved and authorised for issue by the board of directors on 30th March 2017 and were signed on its behalf by:



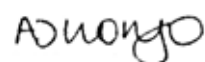
Director



Director



Managing Director



Company Secretary

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

GROUP	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 2015	480,000	2,503,059	258,690	205,472	341,515	3,788,736
Profit and total	-	-	120,661	-	-	120,661
Other comprehensive income	-	-	-	-	-	-
Total comprehensive income for the year	-	-	120,661	-	-	120,661
Share capital issued	-	396,700	-	-	-	396,700
Transfer to statutory reserve	-	-	(128,504)	-	128,504	-
Transfer of excess depreciation	-	-	(10,406)	10,406	-	-
Deferred tax on excess depreciation	-	-	3,122	(3,122)	-	-
At 31 December 2015	480,000	2,899,759	243,563	212,756	470,019	4,304,743
At 1 January 2016	480,000	2,899,759	243,563	212,756	470,019	4,304,743
Profit for the year	-	-	49,143	-	-	49,143
Other comprehensive income	-	-	-	-	-	-
Total comprehensive income for the year	-	-	49,143	-	-	49,143
Transfer to statutory reserve	-	-	(32,554)	-	32,554	-
At 31 December 2016	480,000	2,899,759	260,152	212,756	502,573	4,355,240

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

BANK	Share	Share	Retained	Revaluation	Statutory	Total
	capital	premium	earnings	surplus	reserve	
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
At 1 January 2015	480,000	2,503,059	257,337	205,472	341,515	3,787,383
Profit for the year	-	-	115,333	-	-	115,333
Other comprehensive income	-	-	-	-	-	-
Total comprehensive income for the year	-	-	115,333	-	-	115,333
Share capital issued	-	396,700	-	-	-	396,700
Transfer to statutory reserve	-	-	(128,504)	-	128,504	-
Transfer of excess depreciation	-	-	(10,406)	10,406	-	-
Deferred tax on excess depreciation	-	-	3,122	(3,122)	-	-
At 31 December 2015	480,000	2,899,759	236,882	212,756	470,019	4,299,416
At 1 January 2016	480,000	2,899,759	236,882	212,756	470,019	4,299,416
Profit for the year	-	-	42,659	-	-	42,659
Other comprehensive income	-	-	-	-	-	-
Total comprehensive income for the year	-	-	42,659	-	-	42,659
Transfer to statutory reserve	-	-	(32,554)	-	32,554	-
Transfer of excess depreciation	-	-	1,135	(1,135)	-	-
Deferred tax on excess depreciation	-	-	(341)	341	-	-
At 31 December 2016	480,000	2,899,759	247,781	211,962	502,573	4,342,075

The statutory reserve relate to the excess provisions for impairment of loans and advances as computed per the Kenyan Microfinance Act (2006) over the loans and advances impairment provisions as computed in accordance with International Accounting Standards 39 Financial Instruments: Recognition and Measurement. The statutory reserve is not distributable.

Premiums from the issue of shares are reported as share premiums.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	Group		Bank	
		2016 Shs'000	2015 Shs'000	2016 Shs'000	2015 Shs'000
CASH FLOWS FROM OPERATING ACTIVITIES					
Cash utilised in operations	28(a)	(2,401,380)	(172,001)	(2,430,187)	(180,491)
Taxation paid	11(c)	(62,984)	(236,954)	(62,984)	(236,954)
Net cash utilised in operating activities		(2,464,364)	(408,955)	(2,493,171)	(417,445)
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of intangible assets	22	(36,347)	(31,675)	(36,347)	(31,675)
Purchase of property and equipment	21	(558,157)	(424,786)	(558,157)	(424,786)
Proceed from issue of shares		-	397,700	-	396,700
Net cash used in investing activities		(594,504)	(58,761)	(594,504)	(59,761)
CASH FLOWS FROM FINANCING ACTIVITIES					
Borrowings received	28(c)	3,171,069	2,196,261	3,171,069	2,196,261
Borrowings repaid	28(c)	(1,386,922)	(947,520)	(1,386,922)	(947,520)
Net cash generated from financing activities		1,784,147	1,248,741	1,784,147	1,248,741
(DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(1,274,721)	781,025	(1,303,528)	771,535
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR					
		4,182,529	3,401,504	4,173,039	3,401,504
CASH AND CASH EQUIVALENTS AT END OF YEAR					
	28(b)	2,907,809	4,182,529	2,869,511	4,173,039

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1 ACCOUNTING POLICIES

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the Kenyan Companies Act.

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 2016***

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.

IFRS 14 - Regulatory Deferral Accounts	<p>The objective of IFRS 14 is to specify the financial reporting requirements for 'regulatory deferral account balances' that arise when an entity provides good or services to customers at a price or rate that is subject to rate regulation</p> <p>IFRS 14 permits an entity which is a first-time adopter of International Financial Reporting Standards to continue to account, with some limited changes, for 'regulatory deferral account balances' in accordance with its previous GAAP, both on initial adoption of IFRS and in subsequent financial statements. Regulatory deferral account balances, and movements in them, are presented separately in the statement of financial position and statement of profit or loss and other comprehensive income, and specific disclosures are required.</p> <p>IFRS 14 applies to an entity's first annual IFRS financial statements for a period beginning on or after 1 January 2016</p>
Amendments to IFRS 11 - Joint Arrangements	<p>This amendment to IFRS 11, requires an acquirer of an interest in a joint operation in which the activity constitutes a business (as defined in IFRS 3 <i>Business Combinations</i>) to:</p> <p>a) apply all of the business combinations accounting principles in IFRS 3 and other IFRSs, except for those principles that conflict with the guidance in IFRS 11; and</p> <p>b) disclose the information required by IFRS 3 and other IFRSs for business combinations.</p> <p>Applicable to annual periods beginning on or after 1 January 2016</p>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1 ACCOUNTING POLICIES (Continued)

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 2016 (Continued)*

<p>Amendments to IAS 16 <i>Property, Plant and Equipment</i> and IAS 41 <i>Agriculture</i></p>	<p>Amends IAS 16 <i>Property, Plant and Equipment</i> and IAS 41 <i>Agriculture</i> to:</p> <ul style="list-style-type: none"> a) include 'bearer plants' within the scope of IAS 16 rather than IAS 41, allowing such assets to be accounted for a property, plant and equipment and measured after initial recognition on a cost or revaluation basis in accordance with IAS 16; b) introduce a definition of 'bearer plants' as a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales; and c) clarify that produce growing on bearer plants remains within the scope of IAS 41. <p>Applicable to annual periods beginning on or after 1 January 2016</p>
<p>Amendments to IAS 27 <i>Separate Financial Statements</i></p>	<p>Amends IAS 27 <i>Separate Financial Statements</i> to permit investments in subsidiaries, joint ventures and associates to be optionally accounted for using the equity method in separate financial statements.</p> <p>Applicable to annual periods beginning on or after 1 January 2016.</p>
<p>Annual Improvements 2012-2014 Cycle</p>	<p>Makes amendments to the following standards:</p> <p>IFRS 5 — Adds specific guidance in IFRS 5 for cases in which an entity reclassifies an asset from held for sale to held for distribution or vice versa and cases in which held-for-distribution accounting is discontinued;</p> <p>IFRS 7 — Additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset, and clarification on offsetting disclosures in condensed interim financial statements;</p> <p>IAS 19 — Clarify that the high quality corporate bonds used in estimating the discount rate for post-employment benefits should be denominated in the same currency as the benefits to be paid; and</p> <p>IAS 34 — Clarify the meaning of 'elsewhere in the interim report' and require a cross-reference.</p> <p>Applicable to annual periods beginning on or after 1 January 2016.</p>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

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 2016 (Continued)**

<p>Amendments to IFRS 10 <i>Consolidated Financial Statements</i>, IFRS 12 <i>Disclosure of Interests in Other Entities</i> and IAS 28 <i>Investments in Associates and Joint Ventures (2011)</i></p>	<p>Amends IFRS 10 <i>Consolidated Financial Statements</i>, IFRS 12 <i>Disclosure of Interests in Other Entities</i> and IAS 28 <i>Investments in Associates and Joint Ventures (2011)</i> to address issues that have arisen in the context of applying the consolidation exception for investment entities by clarifying the following points:</p> <p>a) The exemption from preparing consolidated financial statements for an intermediate parent entity is available to a parent entity that is a subsidiary of an investment entity, even if the investment entity measures all of its subsidiaries at fair value;</p> <p>b) A subsidiary that provides services related to the parent's investment activities should not be consolidated if the subsidiary itself is an investment entity;</p> <p>c) When applying the equity method to an associate or a joint venture, a non-investment entity investor in an investment entity may retain the fair value measurement applied by the associate or joint venture to its interests in subsidiaries; and</p> <p>d) An investment entity measuring all of its subsidiaries at fair value provides the disclosures relating to investment entities required by IFRS 12.</p> <p>Applicable to annual periods beginning on or after 1 January 2016.</p>
---	--

(ii) **Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2015.**

	Effective for annual periods beginning on or after
<i>New and Amendments to standards</i>	
IFRS 9	1 January 2018
IFRS 15	1 January 2017
IFRS 16	1 January 2019

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 DE recognition.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2015 (Continued)

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

Key requirements of IFRS 9:

- **Classification and measurement.** Financial assets are classified by reference to the business model within which they are held and their contractual cash flow characteristics. The 2014 version of IFRS 9 introduces a 'fair value through other comprehensive income' category for certain debt instruments. Financial liabilities are classified in a similar manner to under IAS 39, however there are differences in the requirements applying to the measurement of an entity's own credit risk.
- **Impairment.** The 2014 version of IFRS 9 introduces an 'expected credit loss' model for the measurement of the impairment of financial assets, so it is no longer necessary for a credit event to have occurred before a credit loss is recognise
- **Hedge accounting.** Introduces a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.
- **Derecognition.** The requirements for the derecognition of financial assets and liabilities are carried forward from IAS 39. The directors of the company anticipate that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed by the company.

IFRS 15 Revenue from Contracts with Customers

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

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

Step 1: Identify the contract(s) with a customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. The directors of the company do not anticipate that the application of IFRS 15 in the future may have a significant impact on amounts reported

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2016 (Continued)

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

IFRS 16 Leases

IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

The directors of the company anticipate that the application of IFRS 16 in the future may have a significant impact on amounts reported in respect of the company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until a detailed review has been completed by the company.

(iii) Early adoption of standards

The company did not early-adopt any new or amended standards in 2016.

(a) Basis of preparation

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

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the bank and its subsidiary Faulu Insurance Agency Limited for

the year ended 31 December 2016. Subsidiaries are those companies in which the bank has power to exercise control over the operations of the entities. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the group. Intra-group balances and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

(b) Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised within the profit or loss on accrual basis using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(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.

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

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 and commission

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 freehold land and buildings.

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 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.

(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) 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.

(m) Retirement benefit obligations

(i) *Company's defined contribution pension scheme*

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

(ii) *Statutory defined contribution pension scheme*

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

(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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(n) Foreign currencies

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

(o) Financial instruments

(i) Recognition

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

(ii) Classification and measurement

Financial assets

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

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

Financial assets at fair value through profit or loss

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

stated at fair value, with any gains or losses arising on measurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the 'other operating income' line item in the profit or loss.

Loans and receivables

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

Held to maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. Where a sale occurs other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and classified as available for sale. Held-to-maturity investments are measured at amortised cost using the effective interest method less any impairment, with revenue recognised on an effective yield basis.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(o) Financial instruments (continued)

Available-for-sale financial assets (continued)

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.

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, cash collaterals other than liabilities held for trading at amortised cost. Liabilities held for trading (financial liabilities acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin) are subsequently measured at their fair values.

Derecognition of financial liabilities

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

Borrowings

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

(p) Derivative financial instruments

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

(q) Offsetting financial instruments

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

(r) Cash and cash equivalents

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

(s) Statutory reserve

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

(t) Revaluation reserve

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

(u) Comparatives

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

2 CRITICAL ACCOUNTING ESTIMATES AND 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT

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

- credit risk
- liquidity risk
- market risks

a) Credit risk

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

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

- a. Establishing the authorization structure for the approval and renewal of credit facilities.

- b. Establishment of IT controls to avoid unauthorized lending and to generate exception reports on new advance accounts.
- c. Placing limits on the amounts of risk accepted in relation to one borrower, or group of borrower, and to industry segments.
- d. Regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations.
- e. Obtaining collateral and corporate/personal guarantees.
- f. 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 and liabilities by industry groups are as detailed below:

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (Continued)**(i) Management of credit risk (Continued)**

Loans to customers	2016		2015	
	Shs '000	%	Shs '000	%
Agriculture	90,306	0.5%	16,584	0.1%
Trade	7,324,771	40.8%	5,223,860	31.5%
Consumer	10,539,901	58.7%	11,343,238	68.4%
	17,954,979	100%	16,583,682	100%

Cash Collaterals				
	2016	%	2015	%
	Shs '000		Shs '000	
Agriculture	164,472	17%	161,066	13%
Trade	119,036	12%	169,448	14%
Consumer	697,294	71%	894,073	73%
	980,802	100%	1,224,587	100%

(ii) Maximum exposure to credit risk before collateral held

	2016		2015	
	Shs '000	%	Shs '000	%
Credit exposure on balance sheet items:				
Short term deposits with banks	2,271,571	9%	3,779,033	17%
Loans to customers	18,384,042	76%	16,832,716	75%
Government securities	1,750,000	7%	721,328	3%
Bank balances	334,337	3%	387,065	2%
Chase bank balance*	438,915	2%	-	-
Cash reserve ratio	1,016,104	4%	757,240	3%
	24,053,595	100%	22,586,124	100%

* The Chase Bank amount included in the Other Assets balance on the statement of financial position, and was reclassified from Short Term Deposits with Banks due delay in maturity during the year.

(iii) Classification of loans and receivables

	2016	2015
	Shs '000	Shs '000
Neither past due nor impaired	16,726,657	16,221,035
Past due but not impaired	191,066	97,122
Impaired	1,466,319	514,559
Gross	18,384,042	16,832,716
Less: allowances for impairment (note16)	(429,064)	(249,034)
Net	17,954,979	16,583,682

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (Continued)

(iii) Classification of loans and receivables (Continued)

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 regulatory 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 regulatory 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.

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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (Continued)

a) Credit risk (Continued)

Loans to customers

	Gross Shs '000	Net Shs '000
31 DECEMBER 2016		
Neither past due nor impaired	12,958,354	12,958,354
Past due but not impaired	3,959,369	3,959,369
Impaired	1,466,319	1,037,256
	18,384,042	17,954,979
31 December 2015		
Neither past due nor impaired	12,714,725	12,714,725
Past due but not impaired	3,435,126	3,435,126
Impaired	593,843	433,832
	16,832,716	16,583,682

Cash Collateral held

The company's cash collateral consists of collateral held against loans and receivables to group customers (note 23). The fair value of cash collateral is Shs 980,802,069 (2015: Shs 1,224,587,340).

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. The liquidity ratio as at 31 December 2016 was 29.7% (2015:30.6%)

(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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (Continued)

(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 29.7% (2015 - 30.6%).

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)

As at December 2016	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	22,631	8,843	15,671	40,863	199,319	487,294	206,181	980,802
Borrowings	33,938	528,641	245,347	199,425	1,863,735	1,482,357	33,367	4,386,811
Customer deposits	4,811,775	6,774,424	2,175,846	2,601,628	26,751	-	-	16,390,424
Total liabilities (contractual maturity dates)	4,868,343	7,311,908	2,436,865	2,841,917	2,089,805	1,969,651	239,547	21,758,037
FINANCIAL ASSETS								
Cash and bank balances	297,541	-	-	-	-	-	-	297,541
Short term deposits	1,385,528	1,220,380	-	-	-	-	-	2,605,908
Cash reserve ratio (CBK)	-	-	-	-	-	-	1,016,104	1,016,104
Government securities	-	-	-	-	-	-	1,750,000	1,750,000
Loans to customers (net)	414,630	162,014	287,125	748,688	3,651,865	8,913,074	3,777,582	17,954,979
Total assets (expected maturity dates)	2,097,700	1,382,394	287,125	748,688	3,651,865	8,913,074	6,543,686	23,624,532
NET LIQUIDITY GAP	(2,770,644)	(5,929,515)	(2,149,740)	(2,093,229)	1,562,060	6,943,424	6,304,139	1,866,595
As at 31 December 2015								
Total liabilities (contractual maturity dates)	5,180,633	8,092,633	2,905,300	2,841,917	2,089,805	1,969,651	4,591,471	26,671,410
Total assets (expected maturity dates)	2,463,795	2,297,633	1,852,374	748,688	3,651,865	8,193,074	7,743,980	26,671,410
NET LIQUIDITY GAP	(2,716,838)	(5,795,000)	(1,052,926)	(2,093,229)	1,562,060	6,943,424	3,152,509	-

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.

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).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (Continued)

c) Market risks (continued)

	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-inter- est bearing Shs '000	Total Shs '000
A. FINANCIAL ASSETS									
Cash and bank balances	-	-	-	-	-	-	-	297,541	297,541
Short term deposits	1,385,528	1,220,380	-	-	-	-	-	-	2,605,908
Cash reserve ratio (CBK)	-	-	-	-	-	-	-	1,016,104	1,016,104
Government securities	-	-	-	-	-	-	1,750,000	-	1,750,000
Loans to customers (net)	414,630	162,014	287,125	748,688	3,651,865	8,913,074	3,777,582	-	17,954,979
Total financial assets	1,800,158	1,382,394	287,125	748,688	3,651,865	8,913,074	5,527,582	1,313,645	23,624,532
B. FINANCIAL LIABILITIES									
Borrowings	33,938	528,641	245,347	199,425	1,863,735	1,482,357	33,367	-	4,386,811
Customer deposits	1,060,350	6,425,383	3,302,568	4,626,654	699,054	203,012	73,404	-	16,390,424
Cash collateral held	-	-	-	-	-	-	-	980,802	980,802
Total financial liabilities	1,094,288	6,954,024	3,547,915	4,826,080	2,562,789	1,685,368	106,771	980,802	21,758,037
C. On statement of financial position-interest sensitivity gap									
	705,871	(5,571,631)	(3,260,790)	(4,077,392)	1,089,076	7,227,706	5,420,812	332,848	1,866,495
D. As at 31 December 2016									
Total financial assets	1,800,158	1,382,394	287,125	748,688	3,651,865	8,913,074	5,573,021	5,315,084	27,671,410
Total financial liabilities	1,094,288	6,954,024	3,547,915	4,826,080	2,562,789	1,685,368	106,771	1,486	20,778,720
E. On statement of financial position- interest sensitivity gap									
	705,871	(5,571,631)	(3,260,790)	(4,077,392)	1,089,076	7,227,706	5,466,250	5,313,599	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:

	2016 Shs'000		2015 Shs'000	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
3% increase in interest rates	72,760	50,932	114,624	80,236
3% decrease in interest rates	(72,760)	(50,932)	(114,624)	(80,236)

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 and all amounts are stated in kshs.

	Shs '000	USD	Euro	Total
A. ASSETS				
Cash and bank balances	276,026	169	100,972	297,155
Short term deposits with banks	2,605,908	5,110,808	-	2,605,908
Cash reserve ratio (CBK)	1,016,104	-	-	1,016,104
Government securities	1,750,000	-	-	1,750,000
Loans to customers (net)	17,954,979	-	-	17,954,979
Total financial assets	23,603,017	5,110,977	100,972	28,814,966
B. LIABILITIES				
Cash collateral held	980,802	-	-	980,802
Borrowings	4,386,811	-	-	4,386,811
Customer deposits	16,390,424	-	-	12,646,278
Total financial liabilities	21,758,037	-	-	21,758,037
C NET BALANCE SHEET POSITION	828,876	5,110,977	100,972	7,056,929
As at 31 December 2016				
A Total financial assets	22,586,913	5,110,977	100,972	27,798,862
B Total financial liabilities	21,758,037	-	-	21,758,037
NET BALANCE SHEET POSITION	828,876	5,110,977	100,972	6,040,826

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.

	2016 Shs'000		2015 Shs'000	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
Currency - Euro				
+ 10% Shs movement	(10,097)		(1,147)	(803)
- 10% Shs movement	10,097		1,147	803
Currency - US dollars				
+ 10% Shs movement	(511)		(55)	(38)
- 10% Shs movement	511		55	38

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;

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
Tier 1 capital		
Share capital	480,000	480,000
Share premium	2,899,759	2,899,759
Retained earnings	247,781	236,882
	3,627,540	3,616,641
Tier 2 capital		
Collective allowances for impairment	246,776	228,509
Revaluation reserve	53,189	51,368
	299,965	279,877
Regulatory capital	3,884,053	3,896,518
Total risk-weighted assets	19,742,082	18,280,723
Borrowings	4,386,811	2,607,527
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum -12%)	19.8%	21.0%
Total tier 1 capital expressed as a percentage of total risk-weighted assets (CBK minimum -10%)	18.3%	19.5%

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

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
Loans and receivables	3,753,040	3,226,542
Short term bank deposits	294,667	535,767
Held to maturity investments-treasury bonds	173,103	85,263
	4,220,811	3,847,572

6 INTEREST EXPENSE

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
Savings accounts	1,761,926	1,387,376
Bank overdrafts/borrowed funds	381,956	264,351
	2,143,882	1,651,727

NOTES TO THE FINANCIAL STATEMENTS (Continued)

7 FEES AND COMMISSIONS

	GROUP		BANK	
	2016	2015	2016	2015
	Shs '000	Shs '000	Shs '000	Shs '000
Registration fees	1,050	916	1,050	916
Loan set up fees	274,219	169,615	274,219	169,615
Commission (net)	101,046	93,588	89,396	77,131
Chattels mortgage fees	17,365	29,398	17,365	29,398
	393,680	293,517	382,030	277,060

8 OTHER OPERATING INCOME

Bad debts recovered	402	434	402	434
Other income	2,830	4,645	2	4,619
	3,232	5,079	404	5,053

9 ADMINISTRATION AND OPERATING EXPENSES

	GROUP		BANK	
	2016	2015	2016	2015
	Shs '000	Shs '000	Shs '000	Shs '000
Staff costs (note 10)	1,037,992	1,066,902	1,037,992	1,060,240
Office operations and supplies	651,303	648,271	651,303	648,235
Training and evaluation	24,292	37,675	24,292	37,675
Office rent and repairs	153,959	171,404	153,959	171,404
Travelling expenses	48,702	45,454	48,702	45,454
Depreciation of property and equipment	170,027	125,354	170,027	125,354
Audit fees	4,653	4,269	4,287	3,969
Amortisation of intangible assets	37,157	25,473	37,157	25,473
Directors' fees	18,427	12,275	18,427	12,275
Other expenses	50,402	7,516	46,133	5,641
	2,196,914	2,144,593	2,192,279	2,135,720

NOTES TO THE FINANCIAL STATEMENTS (Continued)

10 STAFF COSTS

	GROUP		BANK	
	2016	2015	2016	2015
	Shs '000	Shs '000	Shs '000	Shs '000
Staff salaries and wages	866,811	779,441	866,811	779,441
Medical expenses	82,458	89,494	82,458	89,494
Company contributions to defined Contribution pension scheme	75,942	55,070	75,942	55,070
Temporary labour	3,088	4,991	3,088	4,991
Provision for accumulated leave	(616)	5,161	(616)	5,161
Staff awards	1,852	1,619	1,852	1,619
Staff uniforms	232	127	232	127
Statutory pension contributions (NSSF)	1,915	2,130	1,915	2,130
Recruitment	4,195	4,786	4,195	4,786
Health & safety	2,292	64	2,292	64
Staff welfare & entertainment	1,458	13,070	1,458	13,070
Staff bonus	(11,981)	104,287	(11,981)	104,287
Medical awareness	876	-	876	-
Check-off commissions	9,034	-	9,034	-
Staff related surveys	436	-	436	-
	1,037,992	1,060,240	1,037,992	1,060,240

11 TAXATION

(a) TAXATION CHARGE

Current tax expense

Based on the adjusted profit for the year at 30%	27,789	77,668	24,430	75,385
Share of associate company taxation (note 19)	1,096	341	1,096	341
Prior year overprovision for current tax	14,852	2,963	14,852	2,963
	43,737	80,972	40,378	78,689

Deferred taxation (note 20)

Current year credit	26,528	(18,356)	26,528	(18,356)
Prior year (over)/under provision of deferred tax	(12,000)	7,023	(12,000)	7,023
	14,528	(11,333)	14,528	(11,333)
	58,264	69,639	54,905	67,356

NOTES TO THE FINANCIAL STATEMENTS (Continued)

11 TAXATION (Continued)**(b) RECONCILIATION OF EXPECTED TAX BASED ON ACCOUNTING PROFIT TO TAX CHARGE**

	GROUP		BANK	
	2016 Shs '000	2015 Shs '000	2016 Shs '000	2015 Shs '000
Accounting profit before taxation	107,407	190,300	97,565	182,689
Tax at the applicable rate of 30%	32,629	57,090	29,270	54,807
Tax effect of income not taxable	(1,096)	(341)	(1,096)	(341)
Tax effect of expenses not deductible for tax purposes	22,783	3,245	22,783	3,245
Prior year under provision- deferred tax	(12,000)	7,023	(12,000)	7,023
Prior year over provision- current tax	14,852	2,963	14,852	2,963
	57,168	69,980	53,809	67,697
Share of associate company taxation (note 19)	(1,096)	(341)	1,096	(341)
	56,072	69,639	54,906	67,356

(c) TAX (RECOVERABLE)/PAYABLE

Balance at 1 January	(168,917)	(12,594)	(171,200)	(12,594)
Charge for the year	27,789	77,668	24,430	75,385
Paid in the year	(62,984)	(236,954)	(62,984)	(236,954)
Prior year under provision- current tax	11,977	2,963	11,977	2,963
Balance at 31 December	(192,135)	(168,917)	(197,777)	(171,200)

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.

	GROUP		BANK	
	2016	2015	2016	2015
Profit for the year attributable to ordinary shareholders (Shs '000)	49,143	120,661	42,659	115,333
Weighted average number of ordinary shares in issue ('000')	48,000	48,000	48,000	48,000
Earnings per share – basic & diluted (Shs)	1.02	2.51	0.89	2.40

There were no potentially dilutive shares outstanding at 31 December 2016 (2015: nil).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

13 SHORT TERM DEPOSITS WITH BANKS

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
Chase Bank (K) Limited	-	745,600
Family Bank Limited	-	737,045
The Co-operative Bank of Kenya Limited	501,191	651,442
Jamii Bora Bank Limited	-	621,497
KCB Bank Limited	1,770,380	552,029
Commercial Bank of Africa	-	316,126
Consolidated Bank Limited	-	155,294
	2,271,571	3,779,033

Effective interest rate average 13% in 2016 and 14% in 2015. All the deposits mature within 90 days from the balance sheet date.

14 GOVERNMENT SECURITIES

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
Treasury bonds - held to maturity		
Maturing within 1 year	-	-
Maturing between 1 and 3 years	-	-
Maturing over 3 Years	1,750,000	721,328
	1,750,000	721,328
Treasury bills - held to maturity	-	-
	1,750,000	721,328

The effective interest rate on treasury bonds during the year ended 31 December 2016 was 14.7 % (2015 - 11.8%). Treasury Bonds of Shs 300 million and Shs 550 million have been used to secured the Credit Facilities in KCB Bank Limited and bank overdrafts are held at Standard Chartered Bank Kenya Limited respectively for working capital requirements.

15 LOANS TO CUSTOMERS

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
Gross loans to customers (secured)	18,384,042	16,832,716
Accumulated impairment losses (note 16)	(429,064)	(249,034)
	17,954,979	16,583,682

NOTES TO THE FINANCIAL STATEMENTS (Continued)

15 LOANS TO CUSTOMERS (Continued)

The effective interest rate on customer advances at 31 December 2016 was 21% (2015 – 24%). Advances to customers are secured by cash collaterals (note 24) and chattels mortgages. The net non-performing loans and advances amounted to Shs.1,466,319,305 (2015: Shs.593,483,000).

16 IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
At 1 January	249,034	154,610
Additional provision during the year	188,362	165,146
Amounts written off	(8,332)	(70,722)
At 31 December	429,064	249,034

17 CASH BALANCES WITH CENTRAL BANK OF KENYA

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
Cash Reserve Requirement	1,016,104	757,241

As at 31 December 2015, the cash ratio requirement was 5.25% (2015: 5.25%) of eligible deposits. These funds are not available for the day to day operations of the Bank and are non-interest bearing.

18 OTHER ASSETS

	GROUP		BANK	
	2016 Shs '000	2015 Shs '000	2016 Shs '000	2015 Shs '000
Staff receivables	-	3,441	-	3,441
Prepaid expenses	106,853	69,076	106,853	69,076
Deposits and sundry receivables	1,248,442	791,516	1,430,660	799,382
Commission receivable	6,642	16,305	-	-
	1,356,669	880,338	1,329,202	871,899

Part of the deposits & sundry receivables is Shs.438 million held in Chase Bank, following the bank's receivership.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

19 INVESTMENTS IN SUBSIDIARY AND ASSOCIATE COMPANY**19 (a) Investments in associate company**

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
Faulu Advisory Services Limited:		
At 1 January	42,881	42,086
Share of profit for the year	3,653	1,136
Share of taxation (note 11(a))	(1,096)	(341)
	45,439	42,881

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

The associate company is a private company and there are no quoted market prices available for its shares.

There were no contingent liabilities relating to the company's interest in the associate.

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

	2016 Shs '000	2015 Shs '000
Non-current assets	85,711	3,196
Current assets	167,220	244,198
Total assets	252,931	247,394
Current liabilities	(61,277)	(83,587)
Revenue	66,920	87,955
Profit from continuing operations before tax	14,613	4,545
Other comprehensive income	-	-

NOTES TO THE FINANCIAL STATEMENTS (Continued)

19 INVESTMENTS IN SUBSIDIARY AND ASSOCIATE COMPANY (Continued)

19 (a) Investments in associate company (continued):

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

	2016 Shs '000	2015 Shs '000
Total assets	252,931	247,394
Total liabilities	(116,734)	(107,622)
Net assets	136,197	139,722
Company's share of net assets of associate @ 25%	34,049	34,943
Profit of associate before taxation	14,613	4,545
Company's share @ 25%	3,653	1,136
Company share of associate's taxation	(1,096)	(341)
Net result of associate recognised	2,557	795

19 (b) Investments in Faulu Insurance Agency

The group financial statements include the results of a subsidiary of Faulu Microfinance Bank Limited, Faulu Insurance Agency Limited. The principal activity of the company is the provision of insurance agency services

The subsidiary company's financial year end is 31 December and are incorporated as limited liability companies. They are incorporated in Kenya under the Companies Act and domiciled in Kenya.

This subsidiary is 100% owned and fully controlled by the Bank. This investment is recognised at cost in the Bank's financial statements

The results and net assets of the consolidated subsidiary company are as outlined below:

Faulu Insurance Agency Limited

	2016 Sh'000	2015 Sh'000
Summarised statement of financial position		
Total assets	68,207	25,795
Total liabilities	14,165	19,468
Net assets	54,042	6,327
Summarised statement of profit and loss and other comprehensive income		
Revenue	26,587	16,483
Profit before income tax	11,197	7,611
Income tax expense	(3,359)	(2,283)
Total comprehensive income for the year	7,838	5,327

NOTES TO THE FINANCIAL STATEMENTS (Continued)

NATIONAL BANK OF KENYA LIMITED

19 INVESTMENT IN SUBSIDIARY AND ASSOCIATE COMPANIES (Continued)**19 (b) Investments in Faulu Insurance Agency (Continued)***Faulu Insurance Agency Limited (Continued)*

	2016 Sh'000	2015 Sh'000
Summarised statement of cash flows		
Net cash generated from operating activities	28,807	8,490
Net cash generated from /(used in) investing activities	25,000	-
Net cash generated from /(used in) financing activities	-	1,000
Net increase in cash and cash equivalents	3,807	9,490
Cash and cash equivalents at beginning of year	9,490	-
Cash and cash equivalents at end of year	13,298	9,490

20 DEFERRED TAX LIABILITY

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
The net deferred tax asset is attributable to the following items:		
Excess depreciation of capital allowances	24,638	13,476
Deferred tax on revaluation surplus	87,200	87,541
Bonus provision	(4,107)	(31,286)
Provision for staff leave pay	(7,115)	(7,299)
Other provisions	(27,970)	(4,313)
	72,647	58,119
The movements in the deferred tax account during the year were as follows:		
At 1 January	58,119	69,452
Credit to profit or loss (note 11(a))	14,528	(18,356)
Prior year (over)/under provision of deferred tax (note 11(a))	(12,000)	7,023
At 31 December	72,647	58,119

NOTES TO THE FINANCIAL STATEMENTS (Continued)

21 PROPERTY AND EQUIPMENT - GROUP AND BANK

	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 2015	355,297	27,827	118,834	61,598	778,698	512,948	1,855,202
Additions	-	-	14,979	24,752	24,085	360,971	424,786
Transfer to/(from) WIP	-	-	25,283	40,428	568,557	(739,075)	(104,807)
Assets Written Off	-	(2,180)	(952)	(172)	(2,365)	(34,573)	(40,241)
At 31 December 2015	355,297	25,647	158,144	126,606	1,368,974	100,271	2,134,940
At 1 January 2016	355,297	25,647	158,144	126,606	1,368,974	100,271	2,134,940
Additions	-	-	7,413	17,848	63,550	469,346	558,157
Transfer to/(from) WIP	-	-	1,663	7,685	77,859	(156,848)	(69,641)
Assets written off	-	(339)	(457)	-	(1,077)	-	(1,873)
At 31 December 2016	355,297	25,308	166,763	152,140	1,509,306	412,770	2,621,583
DEPRECIATION							
At 1 January 2015	5,297	12,183	81,964	38,531	351,589	-	489,564
Charge for the year	1,250	3,866	19,243	8,476	92,519	-	125,353
Eliminated on write off	-	(1,932)	(849)	(139)	(1,253)	-	(4,172)
At 31 December 2015	6,257	14,117	100,358	46,868	442,855	-	610,745
At 1 January 2016	6,257	14,117	100,358	46,868	442,855	-	610,745
Charge for the year	1,320	2,881	18,509	23,370	123,947	-	170,027
Eliminated on write off	-	(281)	(340)	-	(655)	-	(1,276)
At 31 December 2016	7,867	16,717	118,527	70,238	566,147	-	779,496
NET BOOK VALUE							
At 31 December 2016	347,430	8,591	48,326	81,902	943,159	412,770	1,842,087
At 31 December 2015	348,750	11,530	57,786	79,739	926,119	100,271	1,524,194

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 2016, the net book value of the freehold land and building based on original cost was Shs 48,565,484 (2015: Shs 48,750,000).

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 2016 are as follows:

	Level 1	Level 2	Level 3	Fair value As at 31 December
	Shs'000	Shs'000	Shs'000	Shs'000
31 December 2016	-	347,430	-	347,430
31 December 2015				
Land and buildings	-	348,750	-	348,750

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

22 INTANGIBLE ASSETS - COMPUTER SOFTWARE

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
COST		
At 1 January	465,147	325,665
Additions	36,347	31,675
Transfer from WIP	63,041	104,807
At 31 December	564,535	465,147
AMORTISATION		
At 1 January	198,505	173,032
Charge for the year	37,157	25,473
At 31 December	235,662	198,505
NET BOOK VALUE		
At 31 December	328,873	266,642

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.

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
0 - 30 days	22,631	80,001
31 - 90 days	24,514	52,422
91 - 180 days	40,863	48,123
Over 180 days	892,794	1,044,041
	980,802	1,224,587

The effective interest rate on the cash collaterals held at 31 December 2016 was nil (2015: nil).

24 CUSTOMER DEPOSITS

	GROUP		BANK	
	2016	2015	2016	2015
	Shs '000	Shs '000	Shs '000	Shs '000
Savings account	3,868,358	2,332,496	3,868,358	2,332,496
Fixed account	12,497,066	13,133,063	12,522,066	13,133,061
	16,365,424	15,465,559	16,390,424	15,465,557

The effective interest rate on customer deposits as at 31 December 2016 is 11% (2015: 9%).

25 BORROWINGS

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
Loan from Bank of Africa	-	434,921
Loan from Symbiotics fund	1,221,222	513,261
Loans from Old Mutual Emerging Markets	506,054	-
Loan from European Investment Bank	946,400	1,270,344
Loan from Oiko	525,000	150,000
Loan from IFAD	200,200	200,200
Bank Overdrafts	33,938	101,801
	4,386,811	2,670,527

NOTES TO THE FINANCIAL STATEMENTS (Continued)

25 BORROWINGS (Continued)

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
The borrowings are repayable as follows:		
Within 1 year	1,187,606	610,745
After 1 year within 3 years	2,032,340	1,001,469
After 3 years and within 5 years	1,133,497	991,579
Over 5 years	33,367	66,734
	4,386,811	2,670,527

During the year, additional debts were acquired from the following: -

Usd 1M from Symbiotic Microfinance Fund at the rate of 13% bullet repayment of principal on May, 15 2018.

Usd 6M from Symbiotic Microfinance Fund at the rate of 12.5% bullet repayment of principal on June, 15 2018. Interest for both debts is semi-annual.

Shs 1 Billion from KCB bank with interest rate pegged to the Kenya Bankers reference Rates (KBRR) plus a margin of 5.3% payable in 5 years (last instalment due on August 2021) repayment is through direct monthly debits from the account.

Shs 450 Million from Oiko with interest rate pegged on TB 91 Days +2% Minimum of 10% -14% capping for the 1st 12 Months)payable annually up to November 2019.

Usd 10 Million from Old Mutual Emerging Markets at interest rate of 1 M LIBOR + 3.5%. Usd 5 Million

was repaid in November 2016 and the other Usd 5 Million is due in February 2017.

The bank overdrafts are held at Standard Chartered Bank Kenya Limited and KCB Bank for working capital requirements. They are secured by government securities (note 14).

The interest rates are pegged to the Kenya Bankers reference Rates (KBRR) plus a margin of 2.1% and 5.13% respectively.

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

26 OTHER LIABILITIES

	GROUP		BANK	
	2016	2015	2016	2015
	Shs '000	Shs '000	Shs '000	Shs '000
Accrued expenses	306,547	400,772	306,547	400,772
Staff leave provision	23,715	24,332	23,715	24,332
Bonus provision	13,512	104,287	13,512	104,287
Sundry liabilities	851,472	976,447	833,963	967,128
	1,195,246	1,496,972	1,177,737	1,496,519

27 SHARE CAPITAL

	GROUP		BANK	
	2016	2015	2016	2015
	Shs '000	Shs '000	Shs '000	Shs '000
Authorised:				
60,000,000 ordinary shares of Shs 10 each	600,000	600,000	600,000	600,000
Authorised, issued and fully paid:				
48,000,000 (2013: 12,000,000) ordinary shares of Shs 10 each	480,000	480,000	480,000	480,000

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28 NOTES TO THE STATEMENT OF CASH FLOWS

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

	GROUP		BANK	
	2016 Shs '000	2015 Shs '000	2016 Shs '000	2015 Shs '000
Profit before taxation	107,407	190,300	97,565	182,689
Adjustment for:				
Depreciation	170,027	125,354	170,027	125,354
Amortisation of computer software	37,157	25,473	37,157	25,473
Write off of assets	597	36,069	597	36,069
Write off of investment in associate	-	46	-	46
Share of associate company's profit	(3,653)	(1,136)	(3,653)	(1,136)
	312,889	376,106	301,692	368,495
Working capital changes:				
Increase in loans to customers	(1,371,297)	(2,095,295)	(1,371,297)	(2,095,295)
Increase in amounts due to related party balances	18,234	(1,825)	18,234	179
Increase in other assets	(362,148)	(352,680)	(348,543)	(347,245)
Decrease in cash collaterals held	(243,785)	(116,594)	(243,785)	(116,594)
Increase in customer deposits	924,865	2,819,281	924,865	2,819,281
Decrease in other liabilities	(392,602)	477,411	(423,818)	469,092
Increase in government securities	(1,028,672)	(521,163)	(1,028,672)	(521,163)
Increase in cash reserve ratio-CBK	(258,863)	(757,241)	(258,863)	(757,241)
Cash utilised in operations	(2,401,380)	(172,001)	(2,430,187)	(180,491)

(b) ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS

Cash and bank balances	645,176	505,297	631,878	495,807
Short term deposits with banks (note 13)	2,296,571	3,779,033	2,271,571	3,779,033
Bank overdraft (note 25)	(33,938)	(101,801)	(33,938)	(101,801)
	2,907,809	4,182,529	2,869,511	4,173,039

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

28 NOTES TO THE STATEMENT OF CASH FLOWS (Continued)

(c) Movement in borrowings

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
At 1 January	2,670,527	1,319,985
Received in the year	3,171,069	2,196,261
Paid in the year	(1,488,723)	(947,520)
At 31 December	4,352,873	2,568,726
Bank overdraft	33,938	101,801
At 31 December	4,386,811	2,670,527

29 RELATED PARTY TRANSACTIONS

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

Old Mutual Holdings Limited is the principal shareholder of Faulu Microfinance Bank Limited.

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

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

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

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

(a) Due to related parties:

	GROUP AND BANK	
	2016 Shs '000	2015 Shs '000
Old Mutual Holdings Limited	18,413	179

(b) Advances to customers:

- Directors	44,232	39,716
- Employees	436,649	381,246
	480,881	420,962

NOTES TO THE FINANCIAL STATEMENTS (Continued)

29 RELATED PARTY TRANSACTIONS (Continued)

(c) Customer deposits:

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
- Directors	151,739	48,287
- Employees	250	28,967
- Companies associated with directors	2,420,287	1,110,000
	2,572,277	1,187,254

Key management compensation

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

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
Salaries and other benefits	124,615	101,672
Directors' remuneration		
Fees for services as directors	18,426	12,275

30 CONTINGENT LIABILITIES

The company is a defendant in various legal suits with an estimated liability of Shs 500 million (2015 - Shs 556 million). In the opinion of the directors, after obtaining appropriate legal advice, the outcome of such actions will not give rise to any significant loss.

31 CAPITAL COMMITMENTS

The company had capital commitments worth Shs 467 million relating to IT Capex and software

infrastructure upgrade (2015: Shs 333 million for IT hardware infrastructure upgrade).

32 FUTURE RENTAL COMMITMENTS UNDER OPERATING LEASES

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

	GROUP AND BANK	
	2016	2015
	Shs '000	Shs '000
Within one year	14,471	47,828
Between one and five years	370,819	185,342
Over 5 years	462,745	480,773
	848,036	713,943

The lease rental expense incurred during the year in respect of company offices rental amounted to Shs 147,617,208 (2015 - Shs 165,358,437).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

33 DIVESTITURE

The shareholding structure 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%

34 OPERATING SEGMENTS INFORMATION

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

35 ULTIMATE AND IMMEDIATE HOLDING COMPANY

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

36 INCORPORATION

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

37 EVENTS SUBSEQUENT TO YEAR END

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

38 CURRENCY

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



Faulu Finance Team displaying FIRE awards won in 2013, 2015 and 2016.



Telephone: +254 20 2388088

Mobile: +254 728 446 800, +254 738 170 451, +254 738 170 451

Email: customerservice@faulukenya.com

Website: www.faulukenya.com

Facebook and Twitter: [@faulukenya](https://www.facebook.com/faulukenya)