QUALITATIVE DISCLOSURES

1. FINANCIAL RISK MANAGEMENT DISCLOSURES

This section provides details of the bank's exposure to risk and describes the methods used by management to control risk in respect of financial instruments. The most important types of financial risk to which the bank is exposed to are credit risk, liquidity risk, operational risk and market risk. Market risk includes interest rate risk and currency risk.

Being a branch, the bank does not have a board of directors but a Management Committee which has overall responsibility for the establishment and oversight of the Bank's risk management framework.

Through its risk management structure, the bank seeks to manage efficiently the core risks; credit, liquidity and market risk, which arise directly through the bank's commercial activities. In addition compliance, regulatory risk and operational risk are normal consequences of any business undertaking.

The Management Committee has established the Asset and Liability Committee (ALCO), Credit Committee and the Business Risk and Controls Committee (BRCC), which are responsible for developing and monitoring the bank's risk management policies in their specified areas.

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

(a) Credit risk

Credit risk management

Credit risk is the risk to earnings or capital arising from an obligor's failure to meet the terms of any contract or to otherwise fail to perform as agreed.

The bank has well documented policies and procedures for managing credit risk. The policies are based on the principles of:

- Management responsibility
- Defined credit approval authorities
- Set standards for risk measurement
- Consistent approach to origination of credit, documentation and problem recognition
- Portfolio management strategies.

The risk that counterparties might default on their obligations is monitored on an ongoing basis.

To manage the level of credit risk, the bank deals with counterparties of good credit standing and for which in its assessment the transactions are appropriate and risks understood by the counterparty.

The bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments.

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

Allowances for impairment

Loans are designated as impaired and considered non-performing where recognised weakness indicates that full payment of either interest or principal becomes questionable or as soon as payment of interest or principal is 90 days or more overdue. Where any amount is considered uncollectible, an individual impairment provision is raised, being the difference between the loan carrying amount and the present value of estimated future cash flows. In any decision relating to the raising of provisions, the bank attempts to balance economic conditions, local knowledge and experience, and the results of independent asset reviews. Where it is considered that there is no realistic prospect of recovering an element of an account against which an impairment provision has been raised, then that amount will be written off.
A portfolio impairment provision is also held to cover the inherent risk of losses, which, although not identified, are known through experience to be present in the loan portfolio. The provision is estimated by using the historical loss rate, the emergence period and the loan's balance of the performing portfolio.

The portfolio impairment provision is set with reference to past experience using loss rates, and judgmental factors such as the economic environment and the trends in key portfolio indicators. The bank exposure to credit risk is analysed as follows:

MARCH 31, 2013:	**Balances due from foreign banks KShs '000**	**Placement with other banks KShs '000**	**Available for sale securities KShs '000**	**Loans and advances KShs '000**
Individually impaired assets	-	-	-	429,243
Allowance for impairment	-	-	-	(429,243)
	-	**-**	**-**	**-**
Performing assets	9,486.816	804,554	24,549,243	27,725,667
Portfolio impairment provision	-	-	-	(7,242)
	9,486,816	804,554	24,549,243	27,718,425
Total	**9,486,816**	**804,554**	**24,549,243**	**27,718,425**
DECEMBER 31, 2012:				
Individually impaired assets	-	-	-	428,402
Allowance for impairment	-	-	-	(428,402)
	-	**-**	**-**	**-**
Performing assets	12,229,319	214,220	24,825,557	23,161,293
Portfolio impairment provision	-	-	-	(7,242)
	12,229,319	214,220	24,825,557	23,154,051
Total	**12,229,319**	**214,220**	**24,825,557**	**23,154,051**

The bank held Government securities as at 31 March, 2013 worth KShs 1,591,550,000 (December 31,2012 - KShs 2,105,650,000) as collateral against some of its loans and advances.

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

Write-off policy

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

(b) Liquidity risk

Liquidity risk is the risk that the bank will encounter difficulty in meeting obligations from its financial liabilities. The bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the bank's reputation.

Liquidity risk arises in the general funding of the bank's activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate timeframe.

ALCO is responsible for ensuring that the bank manages its liquidity risk and is able to meet all its obligations to make payments as and when they fall due. It also has primary responsibility for compliance with regulations and bank policy and maintaining a liquidity crisis contingency plan.

The bank maintains a portfolio of short term liquid assets, largely made up of short term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained with daily liquidity positions being monitored.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of liquidity risk.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing liabilities as they mature are important factors in assessing the liquidity of the bank and its exposure to changes in interest rates and exchange rates.

A substantial portion of the bank's assets are funded by customer deposits made up of current and savings accounts and other deposits. These customer deposits, which are widely diversified by type and maturity, represent a stable source of funds. Lending is normally funded by liabilities in the same currency.

The bank also maintains significant levels of marketable securities either for compliance with statutory requirements or as prudential investments of surplus funds.

A key measure of liquidity risk is the ratio of net liquid assets to deposit liabilities. The Central Bank of Kenya requires banks to maintain a statutory minimum ratio of 20% of liquid assets to all its deposit liabilities.

For this purpose, liquid assets comprises cash and balances with Central Bank of Kenya,

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(b) Liquidity risk (continued)

net balances with financial institutions, treasury bonds and bills and net balances with banks abroad.

Deposit liabilities comprise deposits from customers, other liabilities that have matured or maturing within 91 days.

The liquidity ratios at the reporting date and during the reporting period (based on month end ratios) were as follows:

	31 MAR 2013	**31 DEC 2012**
	73.8%	82.2%
Average for the period	78.5%	70.8%
Highest for the period	82.3%	82.2%
Lowest for the period	73.8%	55.2%

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(b) Liquidity risk (continued)

Residual contractual maturities of financial liabilities:

31 March 2013

	On Demand KShs '000	Due within 3 months KShs '000	Due between 3 and 12 months KShs '000	Due between 1 and 5 years KShs '000	Due after 5 years KShs '000	Total KShs '000
Financial liabilities						
Deposits from banks	1,942,909	6,758,000	-	-	-	8,700,909
Derivative instruments	258,327	-	-	-	-	258,327
Due to customers	38,445,716	3,303,629	970,676	500	-	42,720,521
Other liabilities- Items in transit and bills payable	-	698,830	-	-		698,830
	40,646,952	**10,760,459**	**970,676**	**500**	**-**	**52,378,587**

31 December 2012

	On Demand KShs '000	Due within 3 months KShs '000	Due between 3 and 12 months KShs '000	Due between 1 and 5 years KShs '000	Due after 5 years KShs '000	Total KShs '000
Financial liabilities						
Deposits from banks	3,028,974	-	1,723,000	-	-	**4,751,974**
Derivative instruments	134,760	-	-	-	-	**134,760**
Due to customers	33,196,077	10,541,731	274,385	-	-	**44,012,193**
Other liabilities-Items in transit and bills payable		895,788				**895,788**
	36,359,811	**11,437,519**	**1,997,385**	**-**	**-**	**49,794,714**

Customer deposits up to three months represent current, savings and call deposit account balances, which past experience has shown to be stable and of a long term nature.

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(c) Market risk

Market risk is the risk that changes in market prices, such as interest rate and foreign exchange rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands.

The Bank is also exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Currency risk is managed principally through limits set on the level of exposure by currency and in total for both overnight and intra-day positions which are monitored daily.

Overall responsibility for market risk is vested in ALCO.

Sensitivity analysis interest rate risk

The sensitivity analysis on the accrual book is measured by the change in DV01(Dollar value of 01) that measures the change in value of the accrual portfolio due to a 1 basis point parallel move in the interest rates. At 31 March 2013, a 1 basis point parallel increase in the interest rates with all other variables held constant would have resulted to a pre-tax loss movement of KShs 2,536,429 (31 December, 2012 – KShs 2,026,214).

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(c) Market risk (continued)

(i) Interest rate risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The table below summarises the exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

31 March 2013	**Effective interest rate**	**Within 3 months**	**Between 3 and 12 months**	**Between 1 and 5 years**	**Non interest bearing**	**Total**
	%	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**
Financial assets						
Cash and balances with Central Bank	9.5%	3,000,000	-	-	5,616,987	8,616,987
Other assets-items in transit	-	658,034				658,034
Available for sale securities	12.10%	5,239,168	2,973,539	16,336,537	-	24,549,243
Due from foreign branches	0.10%	9,486,816	-	-	-	9,486,816
Due from other banks	8.80%	804,554	-	-	-	804,554
Derivative instruments	-	-	-	-	293,842	293.842
Loans and advances to customers (net)	8.80%	22,056,237	2,334,374	3,312,024	15,790	27,718,424
Total financial assets		**41,244,809**	**5,307,913**	**19,648,560**	**5,926,618**	**72,172,900**
Financial liabilities and equity						
Deposits from banking institutions	1.90%	8,700,909	-	-	-	8,700,909
Derivative instruments	-	-	-	-	258,327	258,327
Customer deposits	4.30%	41,749,345	970,676	500	-	42,720,521
Other liabilities-Items in transit and bills payable	-	-	698,830			698,830
Total financial liabilities		**50,450,254**	**1,669,506**	**500**	**258,327**	**52,378,587**

(i) Interest rate risk (continued)

31 December 2012	Effective interest rate	Within 3 months	Between 3 and 12 months	Between 1 and 5 years	Non interest bearing	Total
	%	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Financial assets						
Cash and balances with Central Bank	-	-	-	-	6,983,620	6,983,620
Other assets-items in transit	-	856,561	-	-	-	856,561
Available for sale securities	12.70%	7,761,259	7,762,007	9,302,291	-	24,825,557
Due from foreign branches	0.30%	12,229,319	-	-	-	12,229,319
Due from other banks	11.70%	214,220	-	-	-	214,220
Derivative instruments	-	-	-	-	248,455	248,455
Loans and advances to customers (net)	11.10%	18,658,371	332,901	4,162,779	-	23,154,051
Total financial assets		**39,719,730**	**8,094,908**	**13,465,070**	**7,232,075**	**68,511,783**
Financial liabilities and equity						
Deposits from banking institutions	1.90%	3,028,974	1,723,000	-	-	4,751,974
Derivative instruments	-	-	-	-	134,760	134,760
Customer deposits		43,737,808	274,385	-	-	44,012,193
Other liabilities-Items in transit and bills payable	5.40%	-	895,788	-	-	895,788
Total financial liabilities		**46,766,782**	**2,893,173**	**-**	**134,760**	**49,794,715**

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(c) Market risk (continued)

(ii) Currency rate risk

The Bank operates wholly within Kenya and its assets and liabilities are carried in the local currency. The various foreign currencies to which the Bank is exposed at 31 March 2013 and 31 December 2012 are summarised below:

31 March 2013	**USD**	**GBP**	**EURO**	**JPY**	**Others**	**TOTAL**
Financial assets	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**
Balance sheet items						
Cash and balances with banks abroad	5,137,727	524,829	2,243,573	4	333,115	**8,239,248**
Loans and advances	11,659,733	71,163	666,931	0	5,616	**12,403,444**
Other foreign assets	2,503,578	14,494	17,132	762,044	150,895	**3,448,142**
						0
Off balance sheet items						**0**
Undelivered spot purchases	112,482	299	110,679	94,033	2,223	**319,717**
Forward purchases	6,712,137	0	41,197	1,018,744	135,434	**7,907,512**
Total financial foreign assets	**26,125,658**	**610,785**	**3,079,512**	**1,874,825**	**627,283**	**32,318,062**
Financial liabilities						
Balance sheet items						
Deposits	19,593,656	300,065	2,692,250	20,983	426,576	**23,033,529**
Other foreign liabilities	2,271,705	2,751	22,481	759,971	18,729	**3,075,637**
Foreign loans and advances	66,752	-	-	-	-	**66,752**
Inter-company/group balances	0	0	0	33,856	-	**33,856**
Off balance sheet items						**0**
Undelivered spot sales	308,722	0	17,847	0	89	**326,659**
Forward sales	3,761,040	318,488	365,001	1,024,343	121,126	**5,589,997**
Total financial foreign liabilities	**26,001,874**	**621,303**	**3,097,580**	**1,839,152**	**566,520**	**32,126,430**
Net open position	**123,784**	**-10,518**	**-18,068**	**35,672**	**60,762**	**191,632**
Long/(short)position	**123,784**	**-10,518**	**-18,068**	**35,672**	**60,762**	**191,632**

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(c) Market risk (continued)

(ii) Currency rate risk (continued)

31 December 2012

	USD	GBP	EURO	JPY	Others	TOTAL
Financial assets	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**
Balance sheet items						
Cash and balances with banks abroad	5,294,073	422,621	7,614,484	192,792	460,891	**13,984,861**
Loans and advances	12,507,854	15,689	422,505	285,473	-	**13,231,521**
Other foreign assets	2,203,934	5,989	10,390	1,058,428	22,251	**3,300,992**
Off balance sheet items						
Undelivered spot purchases	-	-	-	-	-	**-**
Forward purchases	4,933,067	-	454,670	756,965	-	**6,144,702**
Total financial foreign assets	**24,938,928**	**444,299**	**8,502,049**	**2,293,658**	**483,142**	**36,662,076**
Financial liabilities						
Balance sheet items						
Deposits	16,445,217	452,147	8,154,521	33,815	453,282	**25,538,982**
Other foreign liabilities	2,000,919	2,968	23,689	1,034,686	2,713	**3,064,975**
Foreign loans and advances	88,349	-	-	-		**88,349**
Inter-company/group balances	1,722,538	-	-	-		**1,722,538**
Off balance sheet items						**-**
Undelivered spot sales	532,538	-	-	-		**532,538**
Forward sales	4,622,007	-	284,410	1,205,186	4,948	**6,116,551**
Total financial foreign liabilities	**25,411,568**	**455,115**	**8,462,620**	**2,273,687**	**460,943**	**37,063,933**
Net open position	**(472,640)**	**(10,816)**	**39,429**	**19,971**	**22,199**	**(401,857)**
Long/(short)position	**(472,640)**	**(10,816)**	**39,429**	**19,971**	**22,199**	**(401,857)**

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(c) Market risk (continued)

Sensitivity analysis foreign currency exchange risk

The bank's assets and liabilities held in foreign currency are bound to be affected by the fluctuations in the foreign exchange rate. The sensitivity analysis on the foreign currency position is measured by the trading DVO1 that measures the change in value of the position as a result of a 1 percentage point shift (appreciation) in exchange rates. The trading DVO1 for the KES and the USD positions that constitute the significant portion of the statement of financial position is as follows:

	31 MAR 2013 KShs'000	**31 DEC 2012 KShs'000**
USD	317,618	(532,188)
KES	(35,391)	573,930

(d) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes reputation and franchise risk associated with the Bank's business practices or market conduct; and the risk of failing to comply with applicable laws and regulations.

The Bank seeks to ensure that key operational risks are managed in a timely and effective manner through a framework of policies, procedures and tools to identify, assess, monitor, control and report such risks.

Compliance with operational risk policies and procedures is the responsibility of all business managers. The Business Risk and Controls Committee (BRCC) has the overall responsibility for ensuring that an appropriate and robust risk management framework is in place to monitor and manage operational risk.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This is supported by the Risk and Controls Self assessment process that assess the effectiveness of controls over the risks identified.

(e) Capital management

The Central Bank of Kenya sets and monitors capital requirements for all banks.

The objective of the Central Bank of Kenya is to ensure that a bank maintains a level of capital which:

- is adequate to protect its depositors and creditors;
- is commensurate with the risks associated with its activities and profile
- promotes public confidence in the bank.

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(e) Capital management (continued)

In implementing current capital requirements, the Central Bank of Kenya requires banks to maintain a prescribed ratio of total capital to total risk-weighted assets.

Capital adequacy and use of regulatory capital are monitored regularly by management employing techniques based on the guidelines developed by the Basel Committee, as implemented by the Central Bank of Kenya for supervisory purposes.

The Central Bank of Kenya requires a bank to maintain at all times:

- core capital of not less than 8% of total risk weighted assets, plus risk weighted off - balance sheet items
- core capital of not less than 8% of its total deposit liabilities
- total capital of not less than 12% of its total risk weighted assets, plus risk weighted off-balance sheet items

In addition to the above minimum capital adequacy ratios, institutions are required to hold a capital conservation buffer of 2.5% over and above these minimum ratios to enable the institutions withstand future periods of stress, with a view to meeting the conservation buffer by 1st January 2015.

However, the Banking Act requires banks to maintain the following minimum core capital of KShs 1,000 million

Capital is segregated into core capital (Tier 1) and supplementary capital (Tier 2).

Core capital includes assigned capital, irredeemable preference shares, share premium and retained earnings after deductions for goodwill and intangible assets.

Supplementary capital on the other hand includes 25% of revaluation reserves of property and equipment, subordinated debt not exceeding 50% of core capital and any other approved reserves.

Risk weighted assets are arrived at using a framework of four weights applied to both on-balance sheet and off-balance sheet items to reflect the relative risk of each asset and counterparty.

1. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(e) Capital management (continued)

The Bank's regulatory capital position at 31 March 2013 and 31 December 2012 was as follows:

	31 MAR 2013 KShs '000	31 DEC 2012 KShs '000
Core capital (Tier 1)		
Assigned capital	4,582,973	4,582,973
Retained earnings	12,347,585	12,347,585
50% Net after tax profits for current year	370,747	
	17,301,305	**16,930,558**
Supplementary capital (Tier 2)		
Statutory reserve	354,113	294,258
Total capital	**17,655,418**	**17,224,816**
Risk weighted assets		
On-balance sheet	30,988,313	26,615,045
Off-balance sheet	12,489,454	14,577,445
Total risk weighted assets	**43,477,767**	**41,192,490**
Deposits from customers	**51,421,430**	**48,764,166**

Capital ratios	**31 MAR 2013**	**31 DEC 2012**
Core capital/total deposit liabilities (CBK minimum 8%)	34%	35%
Core capital /total risk weighted assets (CBK minimum 8%)	40%	41%
Total capital /total risk weighted assets (CBK minimum 12.0%)	41%	42%

2. RELATED PARTY TRANSACTIONS

(a) Transactions with other Citibank branches and subsidiaries

In the normal course of business, transactions are entered into with other branches and subsidiaries of Citibank N.A, the parent company. During the quarter, the bank paid head office expenses amounting to KShs 24,909,990 (31 Dec 2012 - KShs 96,885,549) to other Citibank branches and subsidiaries. These transactions were carried out at arm's length.

(b) Transaction with employees

The Bank has entered into transactions with its employees:

	31 MAR 2013	31 DEC 2012
	KShs '000	KShs '000
Staff loans	1,230,232	1,174,803

Interest earned on the staff loans for the quarter amounted to KShs 16,122,002 (Full year 2012 – KShs 59,949,866).

(c) Key management compensation

	31 MAR 2013 KShs '000	31 DEC 2012 KShs '000
Salaries and other benefits	124,239	327,587

3. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements as set out below have been applied consistently to all periods presented in the financial statements.

(a) Revenue recognition

Revenue is derived substantially from banking business and related activities and comprises net interest income and non-interest income. Income is recognised on an accrual basis in the period in which it accrues.

(i) Net interest income

Interest income and expenses are recognised in the profit or loss for all interest-bearing instruments on an accrual basis using the effective interest method. The effective interest rate is the rate that exactly discounts the expected estimated future cash payments and receipts through the expected life of the financial asset or liability. Where financial assets have been impaired, interest income continues to be recognised on the impaired value, based on the original effective interest rate. External expenses incurred directly as a result of bringing margin-yielding assets on-balance sheet are amortised through interest income over the life of the asset.

(ii) Fees and commission income

Fees and commissions are generally recognised on an incurred basis when the related services are provided or on execution of a significant act. Fees charged for servicing a loan are recognised as revenue as the service is provided.

(iii) Net income from other financial instruments at fair value

Net income from other financial instruments at fair value relates to derivatives held for risk management purposes and includes all realised and unrealised fair value changes and foreign exchange differences.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Financial assets and liabilities

(i) Classification

Management determines the appropriate classification of financial instruments at the time of the purchase and revaluates its portfolio on a regular basis to ensure that all financial assets are appropriately classified. The bank's investments are categorized as:

- *Financial instruments at fair value through profit or loss* – These include financial instruments designated at fair value through profit or loss at inception. A financial instrument is classified in this category if acquired principally for the purpose of selling or repurchasing it in the short term or if so designated by management.

- *Loans and receivables* – These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the bank provides money directly to a debtor with no intention of trading the receivable. These include advances to customers and placements with other banks.

- *Available-for-sale* – These are investments intended to be held to maturity, which may be sold in response to needs for liquidity or changes in interest rates or exchange rates. These include treasury bills and bonds, corporate bonds and government stock.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and liabilities (continued)

(ii) Recognition

Purchases and sales of financial instruments at fair value through profit or loss, held to maturity assets and available for sale assets are recognised on the date they are transferred to the Bank.

Loans are recognised when cash is advanced to the borrowers.

(iii) Measurement

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

Available-for-sale financial assets and financial instruments at fair value through profit or loss are subsequently carried at fair value. Gains and losses arising from changes in the fair value of the ‘financial instruments at fair value through income statement’ category are included in the profit or loss in the period in which they arise.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity should be recognised in profit or loss. However, interest calculated using the effective interest method is recognised in the profit or loss.

Loans and receivables are carried at amortised cost using the effective interest method.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Financial assets and liabilities

(iv) Derecognition

The bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the bank is recognised as a separate asset or liability.

The bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include, for example, securities lending and repurchase transactions.

(v) Fair value measurement principles

The fair value of trading assets, financial assets held at fair value and available-for-sale assets are based on quoted bid prices, excluding transaction costs. If a quoted bid price is not available for dated financial assets, the fair value is estimated using pricing models or discounted cash flow techniques.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and liabilities (continued)

(v) Fair value measurement principles - continued

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate at the reporting date for a financial asset with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the reporting date.

If specific circumstances occur that disqualify a financial asset from continuing to be accounted for at amortised cost, the difference between amortised cost and fair value is accounted for in the period in which it arises in the profit or loss.

(vi) Identification and measurement of impairment of financial assets

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset than can be estimated reliably.

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortised cost) with similar risk characteristics.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by

(b) Financial assets and liabilities (continued)

the Bank on terms that the Bank would otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

In assessing collective impairment the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management’s judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rate, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets’ original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

(b) Financial assets and liabilities (continued)

(vi) Identification and measurement of impairment of financial assets - continued

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of equity to profit or loss. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

(vii) Statutory credit risk reserve

Where impairment losses required by regulations exceed those computed under IFRS, the excess is recognised as a statutory credit risk reserve and is accounted for as an appropriation of retained earnings. The statutory credit risk reserve is non-distributable.

(viii) Offsetting of financial assets and liabilities

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

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Derivative financial instruments

The bank enters into financial instruments for trading purposes with third parties to hedge their exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities.

Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions and valuation techniques. The gain or loss on re-measurement to fair value is recognised immediately in the profit and loss. The main derivative financial instruments in use by the bank are as follows:

Currency forwards

Foreign exchange forward contracts are agreements to buy and sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate. The fair value of forward exchange contracts is the present value of the mark to market adjustment at the reporting date.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Derivative financial instruments (continued)

Currency options

A currency option is an agreement between two counter-parties, giving the option buyer (option holder) the right, but not the obligation, either to buy or to sell a quantity of currency at a specified rate, on or before a specified date in the future. All currency options concluded with third parties are immediately offset by an opposite option transacted with another Citibank affiliate under exactly the same parameters (date, notional amount, currency and strike price). The bank receives a premium for the transaction. Thus no fair value of outstanding options is carried on the bank's statement of financial position.

(d) Transactions in foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at the exchange rate ruling at the date of the transaction monetary. Foreign currency monetary assets and liabilities are translated at the exchange rate ruling at the reporting date other than the forwards contracts which are carried at prevailing forward rates. Resulting exchange differences are recognised in the profit and loss for the year. Non-monetary assets and liabilities denominated in foreign currency are recorded at the exchange rate ruling at the transaction date.

(e) Cash and cash equivalents

For the purpose of presentation in the statement of cash flows, the cash and cash equivalents include balances with the Central Bank of Kenya which are available to finance the bank's day to day operations, net balances from banking institutions, and investments with maturities of three months or less from the date of acquisition.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Employee benefits

a. Retirement benefit schemes

The majority of the bank's employees are eligible for retirement benefits under a defined contribution plan. Contributions to the defined contribution plan are charged to the profit or loss as incurred.

The employees and the Bank also contribute to the NSSF, a national retirement scheme. Contributions are determined by local statutes and the Bank's contributions are charged to the profit or loss in the year to which they relate.

b. Share based payments

Certain categories of senior management are awarded ordinary shares in Citigroup Inc (the ultimate holding company) based on their performance. The shares vest over a period of four years. The stock awards are recognised in the profit or loss on the award date at the market value of the shares on the award date. As the awards are categorised as equity-settled, no adjustment is made for fair value changes until the settlement date. The expense is recognised in profit or loss as it vests, with a corresponding entry to the equity compensation reserve.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Employee benefits (continued)

c. Short term benefits

Short term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expensed to be paid under short term cash bonus.

d. Termination benefits

Termination benefits are recognised as an expense when the bank is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the bank has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

(g) Taxation

Income tax expense comprises current tax and change in deferred tax. Current tax is the expected tax payable on the taxable income for the year using tax rates enacted at the reporting date, and any adjustment to tax payable in respect of the previous year.

Deferred tax is recognised on all temporary differences between the carrying amounts for financial reporting purposes and the amounts used for taxation purposes, except differences relating to the initial recognition of assets or liabilities which affect neither accounting nor taxable profit.

Deferred tax is calculated on the basis of the tax rates currently enacted. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(h) Property and equipment

Items of buildings, equipment, furniture and fittings and motor vehicles are stated at cost, less accumulated depreciation and impairment losses. Depreciation is charged on the assets on a straight line basis to allocate the cost to their residual values over useful lives estimated as follows:

• Buildings	Over the period of the lease
• Computer equipment and computer software	20% to 33⅓% per annum.
• Furniture and equipment	10% to 20% per annum.
• Motor vehicles	25% to 29% per annum.

The residual values of the assets are reviewed, and adjusted if appropriate, at each reporting date. Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are recognised in the profit or loss in the year in which they arise.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Intangible assets

The costs incurred to acquire and bring to use specific computer software licences are capitalised. The costs are amortised on a straight line basis over the expected useful lives, from the date it is available for use, not exceeding three years.

Computer development costs that are directly associated with the production of identifiable and unique software products that will probably generate economic benefits in excess of its costs are capitalised. The costs are amortised on a straight line basis over the expected useful lives, from the date that it is available for use, not exceeding three years.

Costs associated with maintaining software are recognised as an expense as incurred.

(j) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

Prepaid operating lease rentals in respect of leasehold land is recognised as an asset and amortised over the lease period.

(k) Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are accounted for as off balance sheet transactions and disclosed as contingent liabilities. Estimates of the outcome and the financial effect of contingent liabilities is made by management based on the information available up to the date the financial statements are approved for issue by management. Any expected loss is charged to the profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Related parties

In the normal course of business the Bank has entered into transactions with related parties. The related party transactions are at arms length.

(m) Provisions

A provision is recognised in the statement of financial position when the Bank has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation.

(n) Impairment for non-financial assets

The carrying amounts of the Bank's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the assets' recoverable amount is estimated. The recoverable amount of goodwill is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro-rata basis.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) Impairment for non-financial assets (continued)

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. 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.

(p) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2012, and have not been applied in preparing these financial statements. None of these will have an effect on the financial statements of the bank, with the exception of:

- Amendments to IAS 1– *'Presentation of Items of Other Comprehensive Income'– effective 1 July 2012*. The amendments require that an entity present separately the items of other comprehensive income that would be reclassified to profit or loss in the future if certain conditions are met from those that would never be reclassified to profit or loss. It however does not change the existing option to present profit or loss and other comprehensive income in two statements but changes the title of the statement of comprehensive income to the statement of profit or loss and other comprehensive income. However, an entity is still allowed to use other titles.

- Amendments to IAS 12 –'*Deferred Tax: Recovery of Underlying Assets Statements' – effective 1 January 2012.* The amendments introduce an exception to the general measurement requirements of IAS 12 ' Income Taxes' in respect of investment properties measured at fair value. The measurement of deferred tax assets and liabilities, in this limited circumstance, is based on a rebuttable presumption that the carrying amount of the investment property will be recovered entirely through sale. The presumption can be rebutted only if the investment property is depreciable and held within a business model whose objective is to consume substantially all of the asset's economic benefits over the life of the asset.

- IAS 19 – '*Employee Benefits' – effective 1 January 2013*. The amended IAS 19 requires that actuarial gains and losses are recognised immediately in other comprehensive income; this change will remove the corridor method and eliminate the ability for entities to recognise all changes in the defined benefit obligation and in plan assets in profit or loss, which currently is allowed under IAS 19. It also requires that expected return on

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards and interpretations not yet adopted (continued)

plan assets recognised in profit or loss is calculated based on the rate used to discount the defined benefit obligation.

- IFRS 9 – *'Financial Instruments'– effective 1 January 2015*. This is a new standard on financial instruments that will eventually replace IAS 39. The published standard introduces changes to the current IAS 39 rules for classification and measurement of financial assets. Under IFRS 9 there will be two measurement bases for financial assets: amortised cost and fair value. Financial assets at fair value will be recorded at fair value through the profit and loss account with a limited opportunity to record changes in fair value of certain equity instruments through other comprehensive income. Financial liabilities are excluded from the scope of the standard.

  The standard also differs from existing requirements for accounting for financial assets in various other areas, such as embedded derivatives and the recognition of fair value adjustments in other comprehensive income.

  The standard will be applied retrospectively (subject to the standard's transitional provisions).

  The Bank is currently in the process of evaluating the potential effect of this standard. Given the nature of the Bank's operations, this standard is expected to have a pervasive impact on the Bank's financial statements.

- IFRS 10 – *'Financial statements'– effective 1 January 2013.* This standard replaces the requirements and guidance in IAS 27 relating to financial statements. The objective of this standard is to improve the usefulness of financial statements by developing a single basis for consolidation and robust guidance for applying that basis to situations where it has proved difficult to assess control in practice and divergence has evolved. The basis for consolidation is control and it is applied irrespective of the nature of the investee.
- IFRS 11 – '*Joint arrangements' – effective 1 January 2013*. IFRS 11 supersedes IAS 31 and SIC-13 relating to Jointly Controlled Entities. The objective of this IFRS is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly. It focuses on the rights and obligations of joint arrangements, rather than the legal form (as is currently the case). It further distinguishes joint arrangements between joint operations and joint ventures; and requires the equity method for jointly controlled entities that are now called joint ventures.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards and interpretations not yet adopted (continued)

- IFRS 12 – *'Disclosure of interests in other entities'* - *effective 1 January 2013*. The objective of this IFRS is to require an entity to disclose information that enables users of its financial statements to evaluate: the nature of, and risks associated with, its interests in other entities; and the effects of those interests on its financial position, financial performance and cash flows.

- IFRS 13 – *'Fair value measurement'* - *effective 1 January 2013*. IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other IFRSs. It does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards.

The Management Committee have assessed the relevance of these amendments and interpretations with respect to the Bank's operations and have concluded that they are unlikely to have a significant impact to the Bank.