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 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 commission income is generally recognised 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.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Revenue recognition (continued)

(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.

(b) Financial assets and financial liabilities

(i) Classification

Financial assets

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 and those designated as held for trading. 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.

- *Held-to-maturity investments* – These are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. Were the Bank to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale. These include treasury bills and treasury bonds.

- *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 and corporate bonds.

Financial Liabilities

The bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or fair value through profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

(ii) Recognition

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

Loans and receivables are recognised when cash is advanced to the borrowers.

(iii) Measurement

Financial instruments are initially recognised at fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue thereof.

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 profit or loss' 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 in other comprehensive income (OCI), until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in other comprehensive income 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.

(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.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the bank is recognised as a separate asset or liability.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

(iv) Derecognition (continued)

The bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all of the 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.

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

(v) Fair value measurement principles

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

(v) Fair value measurement principles (continued)

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

(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.

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 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.

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

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

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

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.

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 from 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.

(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.

(c) 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.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) 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 measured 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 profit or 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.

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.

(e) Transactions in foreign currencies

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

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Employee benefits

(i) 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 recognised in 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 recognised in profit or loss in the year to which they relate.

(ii) 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 profit or loss, with a corresponding entry to the equity compensation reserve, 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.

(iii) 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 in respect of short term cash bonuses to be paid.

(iv) 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 deferred tax. Current tax is the expected tax payable on the taxable income for the year, and any adjustment to tax payable in respect of the previous year. It is measured using tax rates enacted or substantively enacted at the reporting date.

Deferred tax is recognised on 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.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Taxation (continued)

Deferred tax is calculated using rates that are expected to be applied on temporary differences when they are reversed, using tax rates currently enacted or substantively enacted at the reporting date. 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 property and equipment are measured 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 and improvements	2% per annum.
• 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 profit or loss in the year in which they arise.

(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 recognised in profit or loss 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.

Assets held under operating leases are classified as operating leases and are not recognised in the statement of financial position.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are accounted for as contingent liabilities. Estimates of the outcome and the financial effect of contingent liabilities are 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 recognised in profit or loss.

(l) Related parties

In the normal course of business the Bank has entered into transactions with related parties. The related party transactions are at arm's 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, it is probable that an outflow of economic benefits will be required to settle the obligation and the amount can be estimated reliably.

(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 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.

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 are largely independent from other assets and groups. Impairment losses are recognised in profit or loss.

(o) New standards, amendments, and interpretations

(i) New standards, amendments and interpretations effective and adopted during the year beginning 1 January 2015

- ***Defined benefit plans – Employee contributions (Amendments to IAS 19)***

  The amendments introduced reliefs that reduce the complexity and burden of accounting for certain contributions from employees or third parties. Such contributions are eligible for practical expedience if they are:

  - set out in the formal terms of the plan;
  - linked to service; and
  - independent of the number of years of service.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) New standards, amendments and interpretations (continued)

(i) New standards, amendments and interpretations effective and adopted during the year (continued)

- ***Defined benefit plans – Employee contributions (Amendments to IAS 19) - continued***

- When contributions are eligible for practical expedience, a company is permitted (but not required) to recognise them as a reduction of the service cost in the period in which the related service is rendered.

- The amendments apply retrospectively for annual periods beginning on or after 1 July 2014.

- *The adoption of these changes did not affect the amounts and disclosures of the Bank's defined benefits obligations.*

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2015

New standard or amendments	**Effective for annual periods beginning on or after**
• Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)	1 January 2016
• Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)	1 January 2016
• Amendments to IAS 41 - Bearer Plants (Amendments to IAS 16 and IAS 41)	1 January 2016
• Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciations and Amortisation	1 January 2016
• Equity Method in Separate Financial Statements (Amendments to IAS 27)	1 January 2016
• IFRS 14 Regulatory Deferral Accounts	1 January 2016
• Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)	1 January 2016
• Disclosure Initiative (Amendments to IAS 1)	1 January 2016
• IFRS 15 Revenue from Contracts with Customers	1 January 2018
• IFRS 9 Financial Instruments (2014)	1 January 2018
• IFRS 16 Leases	1 January 2019

- All Standards and Interpretations will be adopted at their effective date (except for those Standards and Interpretations that are not applicable to the entity).

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2015 - continued

- ***Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)***

  The amendments require the full gain to be recognised when assets transferred between an investor and its associate or joint venture meet the definition of a 'business' under IFRS 3 *Business Combinations*. Where the assets transferred do not meet the definition of a business, a partial gain to the extent of unrelated investors' interests in the associate or joint venture is recognised. The definition of a business is key to determining the extent of the gain to be recognised

  The amendments will be effective from annual periods commencing on or after 1 January 2016.

  The amendment will not have a significant impact on the Bank's financial statements, as the Bank does not have associates and joint ventures.

- ***Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)***

  The amendments require business combination accounting to be applied to acquisitions of interests in a joint operation that constitutes a business.
  Business combination accounting also applies to the acquisition of additional interests in a joint operation while the joint operator retains joint control. The additional interest acquired will be measured at fair value. The previously held interest in the joint operation will not be remeasured.

  The amendments apply prospectively for annual periods beginning on or after 1 January 2016 and early adoption is permitted.

  The amendment will only have an effect on the financial statements if such an interest is acquired. Management will assess the impact if and when that occurs.

- ***Amendments to IAS 41- Bearer Plants (Amendments to IAS 16 and IAS 41)***

  The amendments to IAS 16 *Property, Plant and Equipment* and IAS 41 *Agriculture* require a bearer plant (which is a living plant used solely to grow produce over several periods) to be accounted for as property, plant and equipment in accordance with IAS 16 *Property, Plant and Equipment* instead of IAS 41 *Agriculture*. The produce growing on bearer plants will remain within the scope of IAS 41.
  The new requirements are effective from 1 January 2016, with earlier adoption permitted.

  The amendment will not have a significant impact on the Bank's financial statements as the Bank does not have bearer plants.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2015 - continued

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

  The amendments to IAS 16 *Property, Plant and Equipment* explicitly state that revenue-based methods of depreciation cannot be used for property, plant and equipment.

  The amendments to IAS 38 *Intangible Assets* introduce a rebuttable presumption that the use of revenue-based amortisation methods for intangible assets is inappropriate. The presumption can be overcome only when revenue and the consumption of the economic benefits of the intangible asset are 'highly correlated', or when the intangible asset is expressed as a measure of revenue.
  The amendments apply prospectively for annual periods beginning on or after 1 January 2016 and early adoption is permitted.

  The adoption of these changes will not affect the amounts and disclosures of the Bank's property, plant and equipment and intangible assets.

- ***Equity Method in Separate Financial Statements (Amendments to IAS 27)***

  The amendments allow the use of the equity method in separate financial statements, and apply to the accounting not only for associates and joint ventures but also for subsidiaries

  The amendments apply retrospectively for annual periods beginning on or after 1 January 2016 with early adoption permitted.

  The Bank does not have any subsidiaries, joint ventures, and associates; therefore, the adoption of these changes will not affect the amounts and disclosures of the Bank's financial statements.

- **IFRS 14 *Regulatory Deferral Accounts***

  IFRS 14 provides guidance on accounting for regulatory deferral account balances by first-time adopters of IFRS. To apply this standard, the entity has to be rate-regulated i.e. the establishment of prices that can be charged to its customers for goods and services is subject to oversight and/or approval by an authorised body.
  The standard is effective for financial reporting years beginning on or after 1 January 2016 with early adoption is permitted.

  The adoption of this standard is not expected to have an impact the financial statements of the Bank's given that it is not a first time adopter of IFRS.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2015 - continued

- **Investment Entities:** ***Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)***

  The amendment to IFRS 10 *Consolidated Financial Statements* clarifies which subsidiaries of an investment entity are consolidated instead of being measured at fair value through profit and loss. The amendment also modifies the condition in the general consolidation exemption that requires an entity's parent or ultimate parent to prepare consolidated financial statements. The amendment clarifies that this condition is also met where the ultimate parent or any intermediary parent of a parent entity measures subsidiaries at fair value through profit or loss in accordance with IFRS 10 and not only where the ultimate parent or intermediate parent consolidates its subsidiaries.

  The amendment to IFRS 12 *Disclosure of Interests in Other Entities* requires an entity that prepares financial statements in which all its subsidiaries are measured at fair value through profit or loss in accordance with IFRS 10 to make disclosures required by IFRS 12 relating to investment entities.

  The amendment to IAS 28 *Investments in Associates and Joint Ventures* modifies the conditions where an entity need not apply the equity method to its investments in associates or joint ventures to align these to the amended IFRS 10 conditions for not presenting consolidated financial statements. The amendments introduce relief when applying the equity method which permits a non-investment entity investor in an associate or joint venture that is an investment entity to retain the fair value through profit or loss measurement applied by the associate or joint venture to its subsidiaries.

  The amendments apply retrospectively for annual periods beginning on or after 1 January 2016, with early application permitted.

  The Bank does not have any subsidiaries, joint ventures, and associates; therefore, the adoption of these changes will not affect the amounts and disclosures of the Bank's financial statements.

- ***Disclosure Initiative*** **(Amendments to IAS 1)**

  The amendments provide additional guidance on the application of materiality and aggregation when preparing financial statements.

  The amendments apply for annual periods beginning on or after 1 January 2016 and early application is permitted.

  The Bank is assessing the potential impact on its financial statements resulting from the application.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2015 - continued

- ***IFRS 15 Revenue from Contracts with Customers***

  This standard replaces IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfer of Assets from Customers* and SIC-31 *Revenue – Barter of Transactions Involving Advertising Services*.

  The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The standard specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers in recognising revenue being: Identify the contract(s) with a customer; Identify the performance obligations in the contract; Determine the transaction price; Allocate the transaction price to the performance obligations in the contract; and recognise revenue when (or as) the entity satisfies a performance obligation.

  IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption is permitted.

  The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 15.

- ***IFRS 9: Financial Instruments (2014)***

  On 24 July 2014 the IASB issued the final IFRS 9 *Financial Instruments* Standard, which replaces earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*.

  This standard introduces changes in the measurement bases of the financial assets to amortised cost, fair value through other comprehensive income or fair value through profit or loss. Even though these measurement categories are similar to IAS 39, the criteria for classification into these categories are significantly different. In addition, the IFRS 9 impairment model has been changed from an "incurred loss" model from IAS 39 to an "expected credit loss" model.

  The standard is effective for annual periods beginning on or after 1 January 2018 with retrospective application, early adoption is permitted.

  The Bank has started the process of evaluating the full impact of this standard but the assessment has not been completed. Given the nature of the Bank's operations this standard is expected to have a pervasive impact on the Bank's financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2015 - continued

- ***IFRS 16: Leases***

On 13 January 2016 the IASB issued IFRS 16 Leases, completing the IASB's project to improve the financial reporting of leases. IFRS 16 replaces the previous leases standard, IAS 17 Leases, and related interpretations.

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The standard defines a lease as a contract that conveys to the customer ('lessee') the right to use an asset for a period of time in exchange for consideration. A Bank assesses whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time.

The standard eliminates the classification of leases as either operating leases or finance leases for a lessee and introduces a single lessee accounting model. All leases are treated in a similar way to finance leases. Applying that model significantly affects the accounting and presentation of leases and consequently, the lessee is required to recognise:

(a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A company recognises the present value of the unavoidable lease payments and shows them either as lease assets (right-of-use assets) or together with property, plant and equipment. If lease payments are made over time, a company also recognises a financial liability representing its obligation to make future lease payments.
(b) depreciation of lease assets and interest on lease liabilities in profit or loss over the lease term; and
(c) separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (typically presented within either operating or financing activities) in the statement of cash flows

IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. However, compared to IAS 17, IFRS 16 requires a lessor to disclose additional information about how it manages the risks related to its residual interest in assets subject to leases.

The standard does not require a company to recognise assets and liabilities for:

(a) short-term leases (i.e. leases of 12 months or less) and;
(b) leases of low-value assets

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2015 - continued

- ***IFRS 16: Leases - continued***

  The new Standard is effective for annual periods beginning on or after 1 January 2019. Early application is permitted insofar as the recently issued revenue Standard, IFRS 15 Revenue from Contracts with Customers is also applied).

  The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 16.

4. 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), Branch Credit Committee (BCC) and the Business Risk Compliance 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 of financial loss 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:

4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

- 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.

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:

4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

	Balances due from foreign banks	Placement with other banks	Available for sale securities	Loans and advances
2016	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**
Individually impaired assets	-	-	-	1,541,218
Allowance for impairment	-	-	-	(734,390)
				806,828
Performing assets	4,245,609	0	43,260,107	27,222,630
Portfolio impairment provision	-	-	-	(7,694)
	4,245,609	0	43,260,107	27,214,936
Total	**4,245,609**	**0**	**43,260,107**	**28,021,764**
2015	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**
Individually impaired assets	-	-	-	1,511,839
Allowance for impairment	-	-	-	(479,813)
				1,032,026
Performing assets	17,321,472	6	28,321,802	28,474,082
Portfolio impairment provision	-	-	-	(7,694)
	17,321,472	6	28,321,802	28,466,388
Total	**17,321,472**	**6**	**28,321,802**	**29,498,414**

The bank held Government securities worth KShs 192,650,000 (2015 - KShs 203,150,000) as collateral against some of its loans and advances.

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.

4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(b) Liquidity risk (continued)

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, 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:

	2016	**2015**
At 31 March/December	78.7%	76.2%
Average for the period	79.4%	85.4%
Highest for the period	82.8%	93.4%
Lowest for the period	76.6%	76.2%

4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(b) Liquidity risk (continued)

Residual contractual maturities of financial liabilities:

31-Mar-16

	On Demand	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Financial liabilities						
Deposits from banks	4,772,601	3,015,000	10,000	-		**7,797,601**
Derivative instruments	360,073	-	-	-		**360,073**
Due to customers	56,182,866	-	1,334,946	178,947		**57,696,758**
Other liabilities-items in transit and bills payable		506,445				**506,445**
	61,315,540	**3,521,445**	**1,344,946**	**178,947**		**66,360,877**

31-Dec-15

	On Demand	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Financial liabilities						
Deposits from banks	3,175,678	-	10,000	-		**3,185,678**
Derivative instruments	365,141	-	-	-		**365,141**
Due to customers	58,843,559	-	3,463,203	170,564		**62,477,326**
Other liabilities-items in transit and bills payable		589,014				**589,014**
	62,384,378	**589,014**	**3,473,203**	**170,564**		**66,617,159**

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.

4. 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 March2016, 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 639,318,455 (2015 – KShs 1,208,292).

4. FINANCIAL RISK MANAGEMENT (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-Mar-16	**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**
Cash and balances with Central Bank	-	-	-	-	12,186,948	12,186,948
Other Assets-Items in transit		465,718				465,718
Available for sale securities	12.67%	15,384,230	25,322,849	2,553,028	-	43,260,107
Due from foreign branches	1.83%	4,038,846	-	-	-	4,038,846
Due from other banks	3.53%	-	-	-	-	-
Derivative instruments		-	-		295,081	295,081
Loans and advances to customers (net)	9.05%	23,260,727	1,474,200	2,480,009	-	27,214,936
Total financial assets		**43,149,521**	**26,797,049**	**5,033,036**	**12,482,029**	**87,461,636**
Financial liabilities and equity						
Deposits from banking institutions	2.44%	7,787,601	10,000	-	-	7,797,601
Derivative instruments					360,073	360,073
Customer deposits	3.07%	56,182,866	1,334,946	178,947	-	57,696,758
Other Liabilities-Items in transit and bills payable			506,445			506,445
Total financial liabilities		**63,970,468**	**1,851,390**	**178,947**	**360,073**	**66,360,877**
Interest rate sensitivity gap		**(20,820,946)**	**24,945,659**	**4,854,090**	**12,121,956**	**21,100,759**

4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market risk (continued)

(i) Interest rate risk (continued)

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-Dec-15	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
Cash and balances with Central Bank	-	1,500,472	0	0	8,280,040	9,780,512
Other Assets-Items in transit		941,345				941,345
Available for sale securities	17.29%	19,991,089	5,775,163	2,555,550	0	28,321,802
Due from foreign branches	2.64%	17,321,472	0	0	0	17,321,472
Due from other banks	14.71%	6	0	0	0	6
Derivative instruments			-	-	299,744	299,744
Loans and advances to customers (net)	9.91%	22,362,943	4,482,045	2,653,426	0	29,498,414
Total financial assets		**62,117,327**	**10,257,208**	**5,208,976**	**8,579,784**	**86,163,295**
Financial liabilities and equity						
Deposits from banking institutions	1.23%	3,175,678	10,000.00	0	0	3,185,678
Derivative instruments					365,141	365,141
Customer deposits	2.85%	58,843,559	3,463,203	170,564	0	62,477,326
Other Liabilities-Items in transit and bills payable			589,015			589,014
Total financial liabilities		**62,019,236**	**4,062,218**	**170,564**	**365,141**	**66,617,159**
Interest rate sensitivity gap		**98,090**	**6,194,990**	**5,038,412**	**8,214,643**	**19,546,136**

4. FINANCIAL RISK MANAGEMENT (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 Mar 2016 are summarised below:

31-Mar-16

	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	3,555,637	648,016	6,940,879	130,776	963,017	**12,238,325**
Loans and advances	9,503,163	-	361,251	448,261	29,001	**10,341,677**
Other foreign assets	1,171,749	335	10,697	976,770	12,203	**2,171,754**
Off balance sheet items						
Undelivered spot purchases	1,473,777	-	462,903	233	321,891	**2,258,804**
Forward purchases	16,862,246	174,029	600,282	439,564	-	**18,076,122**
Total financial foreign assets	**32,566,573**	**822,381**	**8,376,012**	**1,995,604**	**1,326,111**	**45,086,682**
Financial liabilities						
Balance Sheet Items						
Deposits	25,151,946	651,299	7,515,003	56,522	373,218	**33,747,989**
Balances due to banks abroad	-	-	-	-	-	-
Other Foreign Liabilities	1,171,624	3,000	22,799	976,868	2,041	**2,176,332**
Foreign Loans and Advances	36,612	-	-	-	-	**36,612**
Inter-Company/Group Balances	-	-	-	-	-	-
Off Balance Sheet Items						-
Undelivered Spot Sales	1,504,189	-	231,834	-	114,530	**1,850,553**
Forward Sales	5,621,324	163,843	601,273	962,502	265,019	**7,613,961**
Other off balance sheet Items	-	-	-	-	-	-
Total Foreign liabilities	**33,485,695**	**818,142**	**8,370,910**	**1,995,893**	**754,808**	**45,425,447**
Net Open Position	**(919,122)**	**4,239**	**5,103**	**(289)**	**571,303**	**(338,765)**
Long/(short)position	**(919,122)**	**4,239**	**5,103**	**(289)**	**571,303**	**(338,765)**

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4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market risk (continued)

(ii) Currency rate risk (continued)

31-Dec-15

Financial assets	**USD KShs '000**	**GBP KShs '000**	**EURO KShs '000**	**JPY KShs '000**	**Others KShs '000**	**TOTAL KShs '000**
Balance sheet items						
Cash and balances with banks abroad	14,155,538	890,645	6,021,441	50,410	558,173	**21,676,207**
Loans and advances	13,802,409	13,720	435,017	186,952	12,264	**14,450,362**
Other foreign assets	1,792,011	207	3,374	1,312,868	-	**3,108,460**
Off balance sheet items						
Undelivered spot purchases	747,468	-	375,780	83	-	**1,123,331**
Forward purchases	10,866,620	174,805	537,479	442,757	23,428	**12,045,089**
Total financial foreign assets	**41,364,046**	**1,079,377**	**7,373,091**	**1,993,070**	**593,865**	**52,403,449**
Financial liabilities						
Balance Sheet Items						
Deposits	31,475,827	904,217	6,441,492	61,394	511,324	**39,394,254**
Balances due to banks abroad	-	-	-	-	-	**-**
Other Foreign Liabilities	1,580,426	2,986	17,318	1,312,908	1,991	**2,915,629**
Foreign Loans and Advances	31,764	-	-	-	-	**31,764**
Inter-Company/Group Balances	-	-	-	-	-	**-**
Off Balance Sheet Items						**-**
Undelivered Spot Sales	745,580	-	373,595	-	6,919	**1,126,094**
Forward Sales	7,032,031	164,573	534,354	614,387	55,087	**8,400,432**
Other off balance sheet Items	-	-	-	-	-	**-**
Total Foreign liabilities	**40,865,628**	**1,071,776**	**7,366,759**	**1,988,689**	**575,321**	**51,868,173**
Net Open Position	**498,418**	**7,601**	**6,332**	**4,381**	**18,544**	**535,276**
Long/(short)position	**498,418**	**7,601**	**6,332**	**4,381**	**18,544**	**535,276**

4. FINANCIAL RISK MANAGEMENT (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:

	2015 KShs'000	2014 KShs'000
USD	1,1169,17.72	351.46
EURO	30,852.56	47.36
GBP	14,105.15	8.68
JPY	(2,645.68)	1.55

The following significant exchange rates were applied during the year:

	Closing		Average	
	2016 KShs'000	2015 KShs'000	2016 KShs'000	2015 KShs'000
GBP	146.12	151.58	145.82	150.3675
JPY	90.29	84.96	88.40	81.4595
EUR	115.42	111.43	112.41	108.7425
USD	101.45	102.3	101.83	98.61

(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 Compliance 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 Manager Controls Assessment Process that assesses the effectiveness of controls over the risks identified.

4. FINANCIAL RISK MANAGEMENT (Continued)

(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; and
- promotes public confidence in the bank.

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:

- a core capital of not less than 8% of total risk weighted assets, plus risk weighted off -balance sheet items;
- a core capital of not less than 8% of its total deposit liabilities;
- a total capital of not less than 12% of its total risk weighted assets, plus risk weighted off-balance sheet items; and
- a capital conservation buffer of 2.5% over and above the above minimum ratios.

  This brings the minimum core capital to risk weighted assets and total capital to risk weighted assets to 10.5% and 14.5% respectively. The capital conservation buffer requirements are effective 1 January 2015.

Central Bank of Kenya required the Bank to maintain a minimum core capital of KShs 1 billion as at 31 December 2015. The bank is already compliant with this requirement.

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.

4. FINANCIAL RISK MANAGEMENT (Continued)

(e) Capital management (continued)

The Bank's regulatory capital position at 31 March/December was as follows:

	2016 KShs '000	2015 KShs '000
Core capital (Tier 1)		
Assigned capital	4,582,975	4,582,975
Retained earnings	14,419,705	14,060,819
Deferred tax assets	(77,399)	(195,714)
	18,925,279	**18,448,080**
Supplementary capital (Tier 2)		
Statutory reserve	610,623	652,723
Total capital	**19,535,902**	**19,100,803**
Risk weighted assets		
On-balance sheet	28,202,607	32,457,589
Off-balance sheet	21,571,517	16,951,056
Market risk qualifying assets	(36,942)	(44,066)
Total market risk qualifying assets	4,636,371	2,782,381
Operational risk equivalent assets	14,795,203	15,288,138
Total risk weighted assets	**69,168,755**	**67,435,098**
Deposits from customers	**65,494,359**	**65,662,004**

	CBK minimum		Capital ratios	
	2016	**2015**	**2015**	**2014**
Core capital/total deposit liabilities	8%	8%	28%	30%
Core capital /total risk weighted assets	10.5%	10.5%	27%	27%
Total capital /total risk weighted assets	14.5%	12%	28%	27%

5. USE OF ESTIMATES AND JUDGEMENTS

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Banks' accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

(a) Useful life of assets

Property and equipment

Critical estimates are made by management in determining the useful life of property and equipment.

5. USE OF ESTIMATES AND JUDGEMENTS (Continued)

(b) Fair value of financial instruments

Where the fair values of the financial assets and liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable market data where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

(c) Taxation

Judgment is required in determining the provision for income taxes due to the complexity of legislation. There are many transactions and calculations for which ultimate tax determination is uncertain during the ordinary course of business. The Bank recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

The Bank recognises the net future tax benefit that relates to deferred income tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred income tax assets requires the Bank to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Bank to realise the net deferred tax assets recorded at the reporting date could be impacted.

(d) Impairment of loans and receivables

The bank’s loan loss provisions are established to recognise incurred impairment losses either on specific loan assets or within a portfolio of loans and receivables.

Impairment losses for specific loan assets are assessed on an individual basis. Individual impairment losses are determined as the difference between the carrying value and the present value of estimated future cash flows, discounted at the loans’ original effective interest rate.

Estimating the amount and timing of future recoveries involves significant judgement, and considers the level of arrears as well as the assessment of matters such as future economic conditions and the value of collateral, for which there may not be a readily accessible market.

Loan losses that have been incurred but have not been separately identified at the reporting date are determined on a portfolio basis, which takes into account past loss experience and defaults based on portfolio trends. Actual losses identified could differ significantly from the impairment provisions reported as a result of uncertainties arising from the economic environment.

Critical accounting judgements in applying the Bank’s accounting policies

Critical accounting judgements made in applying the Branch’s accounting policies include financial asset and liability classification. The Branch’s accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances.

In classifying financial assets as held-to-maturity, the Branch has determined that it has both positive intention and ability to hold the assets until their maturity date.

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6. FINANCIAL ASSETS AND LIABILITIES

Accounting classifications and fair values

31-Mar-16	**Held for trading**	**Available for sale**	**Loans and receivables**	**Others at amortised cost**	**Fair value**
	KShs'000	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**
Financial assets					
Cash and balances with Central Bank of Kenya	-	-	-	12,186,948	12,186,948
Other assets-items in transit				465,718	465,718
Available for sale securities	-	43,260,107	-	-	43,260,107
Derivative financial instruments	295,081	-	-	-	295,081
Placements with other banks	-	-	-	-	-
Balances due from foreign branches	-	-	-	4,038,846	4,038,846
Loans and advances to customers	-	-	27,214,936	-	27,214,936
	295,081	**43,260,107**	**27,214,936**	**16,691,512**	**87,461,635**
Financial liabilities					
Deposits from banks	-	-	-	7,797,601	7,797,601
Deposits from customers	-	-	-	57,696,758	57,696,758
Derivative financial instruments	360,073	-	-	-	360,073
Other liabilities-items in transit				506,445	506,445
	360,073	**-**	**-**	**66,000,804**	**66,360,877**

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Financial assets					
Cash and balances with Central Bank of Kenya	-	-	9,780,512	-	9,780,512
Other assets-items in transit			941,345	-	941,345
Available for sale securities	-	28,321,802	-	-	28,321,802
Derivative financial instruments	299,744	-	-	-	299,744
Placements with other banks	-	-	6	-	6
Balances due from foreign branches	-	-	17,321,472	-	17,321,472
Loans and advances to customers	-	-	29,498,414	-	29,498,414
	299,744	**28,321,802**	**57,541,749**	**-**	**86,163,295**
Financial liabilities					
Deposits from banks	-	-	-	3,185,677	3,185,677
Deposits from customers	-	-	-	62,477,326	62,477,326
Derivative financial instruments	365,141	-	-	-	365,141
Other liabilities-items in transit				589,015	589,014
	365,141	**-**	**-**	**66,252,017**	**66,617,158**

6. FINANCIAL ASSETS AND LIABILITIES (Continued)

(a) Accounting classifications and fair values

The following sets out the branch's basis of establishing fair value of the financial instruments:

Derivative financial instruments

Derivative financial instruments are measured at fair value as set out in Note 15.

Cash and balances with Central Bank of Kenya

The fair value of cash and bank balances with the Central Bank of Kenya is their carrying amount.

Deposits and advances to banks

The fair value of floating rate placements and overnight deposits is their carrying amounts.

Loans and advances to customers

Loans and advances to customers are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates. Expected cash flows are discounted at current market rates to determine fair value. A substantial proportion of loans and advances reprice within 12 months and hence the carrying amount is a good proxy of the fair value.

Available for sale securities

Available for sale securities with observable market prices are fair valued using that information. The fair value is determined by discounting the securities using prevailing market rates.

Deposits from banks and customers

The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits without quoted market prices is based on discounting cash flows using the prevailing market.

A substantial proportion of deposits are within 6 months and hence the carrying amount is a good proxy of the fair value.

(b) Valuation hierarchy

The valuation hierarchy, and types of instruments classified into each level within that hierarchy, is set out below:

6. FINANCIAL ASSETS AND LIABILITIES (Continued)

	Level 1	**Level 2**	**Level 3**
Fair value determined using:	Unadjusted quoted prices in an active market for identical assets and liabilities	Valuation models with directly or indirectly market observable inputs	Valuation models using significant non-market observable inputs

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The table below shows the classification of financial instruments held at fair value by the level in the fair value hierarchy as at 31 March 2016:

	Level 1	**Level 2**	**Level 3**	**Total**
31-Mar-16	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**
Assets				
Available for sale securities	-	43,260,107	-	**43,260,107**
Derivative financial instruments	-	295,081	-	**295,081**
Total assets	**-**	**43,555,188**	**-**	**43,555,188**
Liabilities				
Derivative financial instruments	-	360,073	-	**360,073**
Total liabilities	**-**	**360,073**	**-**	**360,073**
31-Dec-15				
Assets				
Available for sale securities	-	28,321,802	-	**28,321,802**
Derivative financial instruments	-	299,744	-	**299,744**
Total assets	**-**	**28,621,546**	**-**	**28,621,546**
Liabilities				
Derivative financial instruments	-	365,141	-	**365,141**
Total liabilities	**-**	**365,141**	**-**	**365,141**

7. ASSETS PLEDGED AS SECURITY

As at 31 Mar 2016 (2015 - Nil), there were no assets pledged by the bank to secure liabilities and there were no secured bank liabilities.

8. RELATED PARTY TRANSACTIONS

(a) Transactions with other Citibank branches and subsidiaries

In the normal course of business, transactions are entered into with other Citibank N.A branches and subsidiaries of Citigroup Inc., the parent company. During the year, the bank paid head office expenses amounting to KShs 246,61644 (2015 - KShs 156,168,790) to other Citibank branches and subsidiaries. These transactions were carried out at arm's length.

(b) Transaction with key management personnel

The Bank has entered into transactions with its key management personnel:

	2016 KShs '000	2015 KShs '000
Staff loans to key management personnel	248,433	249,899

Interest earned on these staff loans amounted to KShs 2,100,845 (2015 – KShs 11,447,899).

8. RELATED PARTY TRANSACTIONS (Continued)

(b) Transaction with key management personnel (continued)

Interest rates charged on balances outstanding from employees are determined by the Senior Human Resource Committee and are granted at a discounted market interest rate. The mortgages and secured loans granted are secured over property and other assets of the respective borrowers.

No impairment losses have been recorded against balances outstanding during the period with key management personnel, and no specific allowance has been made for impairment losses on balances with key management personnel at the reporting date.

(c) Key management compensation

Compensation of the Bank's key management personnel includes salaries, bonuses, non-cash benefits, cash benefits and contributions for retirement benefits under a defined contribution plan. Some bank officers also participate in the Parent's share option programme.

	2016 KShs '000	2015 KShs '000
Short term benefits	67,157	304,784
Other long term benefits	3,879	18,765
Share based payments	304	10,344
	71,340	**333,893**

9. PARENT COMPANY

The Bank is a branch of Citibank N.A, a national banking association formed under the laws of the United States of America. The ultimate holding company of the parent is Citigroup Inc.