COMPANY INFORMATION (continued)

BOARD & MANAGEMENT COMMITTEES

The Board & management committees as at the date of this report comprise:

Board Audit Committee	Credit Committee	Asset and Liability Committee	Board Risk Management Committee	Executive Committee
Composition				
Three Non-Executive Directors	Two Executive and Two Non-Executive Directors.	Two Executive Directors Head Credit Head Operations Head Treasury Head Treasury (Back Office) Head Risk / Compliance Head Finance	One Executive Director Three Non-Executive Director	Director Executive Head Operations Head Credit Head IT Head Treasury Head HR & Administration Head Finance
Main function				
Strengthening the control environment, financial reporting and auditing function.	Appraisal and approval of credit applications and reviewing credit portfolio.	Monitoring and management of the statement of financial position including liquidity risk, interest rate risk, foreign currency risk and compliance with all statutory requirements.	Ensuring quality, integrity and reliability of the Bank's risk management function.	To act as link between the Board and Management in implementing operational plans, annual budgets and periodic review of operations, strategic plans and identification of opportunities.
Frequency of meetings per Annum (minimum)				
Quarterly	Quarterly	Monthly	Quarterly	Three times a year
Chairperson				
Mr. Patrick K. Njoroge	Mr. Patrick K. Njoroge	Mr. Yatish C. Tewari	Mr. Patrick K. Njoroge	Mr. Philip Burh
Members				
Mr. Vikram C. Kanji Mr. Rajiv S. Abhyankar	Mr. Yatish C. Tewari Mr. Vikram C. Kanji Mr. Philip Burh Mr. Rajiv S. Abhyankar	Ms. Elizabeth Nyambutu Mr. Kumar Ajay Singh Mr. Sanjay Kumar Ray Ms. Maria Gorett Makokha Mr. Philip Burh Mr. Patrick Sila	Mr. Vikram C. Kanji Mr. Rajiv S. Abhyankar Mr. Yatish C. Tewari	Ms. Elizabeth Nyambutu Mr. Patrick Kombe Mr. Sanjay Kumar Ray Mr. Kennedy Machoka Mr. Patrick Sila Mr. Kumar Ajay Singh

SIGNIFICANT ACCOUNTING POLICIES

1. PRESENTATION OF FINANCIAL STATEMENTS

The financial statements have been prepared in accordance with International Financial Reporting Standards, the Kenyan Companies Act and the Banking Act. The financial statements have been prepared on the historical cost basis, as modified by the carrying of available for sale investments at fair value and impaired assets at their recoverable amount. They are presented in Kenya Shillings and rounded off to the nearest thousand.

These accounting policies are consistent with the previous period.

1.1 General information

Bank of Baroda (Kenya) Limited is incorporated in Kenya under the Companies Act as a private limited liability company and is domiciled in Kenya. The Bank is licensed under the Banking Act and provides banking, financial and related services.

The Bank operates 13 branches within Kenya.

1.2 Significant judgements and sources of estimation uncertainty

In preparing the financial statements, in conformity with International Financial Reporting Standards, management is required to make judgements, estimates and assumptions that affect the amounts represented in the financial statements and disclosure of contingent assets and liabilities at the date of the financial statements. Use of available information and the application of judgement are inherent in the formation of estimates. Actual results in the future could differ from these estimates which may be material to the financial statements. Significant judgements include:

Impairment of loans and advances

Critical estimates have been made by the management in arriving at the discounted values of securities in order to arrive at the impairment charges for non-performing loans and advances. The values of securities are discounted using both the International Financial Reporting Standards and the Prudential Guidelines issued by the Central Bank of Kenya. The Prudential Guidelines provide a specific basis of discounting securities whilst discounting according to International Accounting Standard 39 (IAS 39) on Financial Instruments: 'Recognition and Measurement' is based on historical experience and other relevant factors, discounted to net present values.

Impairment losses on loans and advances

The bank reviews its loan portfolio to assess the likelihood of impairment at least on a quarterly basis. In determining whether a loan or advance is impaired, the management makes judgement as to whether there is any evidence indicating that there is a measurable decrease in the estimated future cash flows expected from that loan or advance.

Management use judgement based on historical experience for such assets with credit risk characteristics and as to whether there are any conditions that would indicate potential impairment. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Impairment of available-for-sale financial assets

The bank determines that available-for-sale investments are impaired when there has been a significant, or prolonged, decline in the fair value below its cost. This determination of what is significant, or prolonged, requires significant judgement. In making this judgement, the bank evaluates among other factors, the normal volatility in share price and market prices for government securities. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.the financial statements are prepared on a going concern basis.

NOTES (continued)

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair value measurement and valuation process

In estimating the fair value of an asset or a liability, the Bank uses market-observable data to the extent it is available. Where level 1 inputs are not available, the Bank makes use of financial models or engages third party qualified valuers to perform the valuation techniques and inputs to the model.

Useful life and residual value of property, plant and equipment

The estimates of useful lives as translated into depreciation rates are detailed in property, plant and equipment policy on the annual financial statements. These rates and residual lives of the assets are reviewed annually taking cognizance of the forecasted commercial and economic realities and through benchmarking of accounting treatments in the country.

Held-to-maturity financial assets

The management have reviewed the Bank's held to maturity assets in light of its capital maintenance and liquidity requirements and have confirmed the Bank's positive intention and ability to hold those assets to maturity.

Non financial assets

The bank reviews its non financial assets to assess the likelihood of impairment on an annual basis. In determining whether such assets are impaired, management make judgements as to whether there are any conditions that indicate potential impairment of such assets.

1.3 Property and equipment

The cost of an item of property and equipment is recognised as an asset when:
- it is probable that future economic benefits associated with the item will flow to the company; and
- the cost of the item can be measured reliably.

Property and equipment is initially measured at cost. Buildings are subsequently shown at market value, based on the valuations performed by professional independent valuers, less subsequent accumulated depreciation and impairment losses. All other property and equipment are stated at historical cost less depreciation.

Property and equipment are depreciated on the straight line basis and reducing balance basis to write down the cost of assets, or the revalued amounts, to its residual value over its estimated useful life using the following annual rates:

Nature of assets	Rate % and Method of Depreciation
Buildings	Straight line basis over the remaining period of the lease
Furniture and fixtures	12.5 - Reducing balance basis
Motor vehicles	25 - Reducing balance basis
Computers and electronics	Straight line basis over a period of tjree years
Leasehold improvements	Straight line basis over a period of ten years

The residual value, useful life and depreciation method of each asset are reviewed at the end of each reporting period. If the expectations differ from previous estimates, the change is accounted for as a change in accounting estimate.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gain or losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.4 Intangible assets

Intangible assets costs which are clearly identifiable and controlled by the bank and have probable benefit exceeding the cost beyond one year are recognised as an intangible asset. These assets are amortised using the straight line method over their estimated useful life. Costs associated with the maintenance of existing computer software programs and modifications are expensed as incurred. Intangible assets are stated at cost net of accumulated amortisation and impairment losses.

Item	Useful life
Computer software	5 years

1.5 Financial instruments

Classification

The bank classifies financial assets and financial liabilities into the following categories:
- Financial assets at fair value through profit or loss - held for trading
- Financial assets at fair value through profit or loss - designated
- Held-to-maturity investment
- Loans, advances and receivables
- Available-for-sale financial assets

Classification depends on the purpose for which the financial instruments were obtained / incurred and takes place at initial recognition.

Financial assets

Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in profit or loss.

The Bank's financial assets fall into the following categories:

Held-to-maturity - Held-to-maturity investments are non derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. Where a sale occurs other than an insignificant amount of held-to-maturity assets, the entire category would be treated and classified as available-for-sale.

Available-for-sale financial assets - Financial assets that are not: (a) financial assets at fair value through profit or loss (b) loans, advances or receivables or (c) financial assets held-to-maturity; are recognised as available-for-sale financial assets.

Loans, advances and receivables - Loans, advances and receivables are financial assets with fixed or determinable payments that are not quoted in an active market other than:
- those that the entity intends to sell immediately or in the short term, which are classified as ''held for trading', and those that the entity upon initial recognition designated it as 'fair value
- those that the entity upon initial recognition designates as 'available-for-sale'; or
- those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

All assets with maturities greater than 12 months after the reporting date are classified as non-current assets. Subsequent to initial recognition, they are carried at amortised cost using the effective interest method. Changes in the carrying amount are recognised in the profit or loss.

NOTES (continued)

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

All assets with maturities greater than 12 months after the reporting date are classified as non-current assets. Subsequent to initial recognition, they are carried at amortised cost using the effective interest method. Changes in the carrying amount are recognised in the profit or loss.

Purchases and sales of financial assets are recognised on the trade date i.e. the date on which the Bank commits to purchase or sell the asset.

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

Gains and losses on disposal of investments whose changes in fair value were initially recognised in the profit or loss are determined by reference to their carrying amount and are taken into account in determining operating profit. On disposal of assets whose changes in fair value were initially recognised in equity, the gains/losses are recognised in the reserve, where the fair values were initially recognised. Any resultant surplus/deficit after the transfer of the gains/losses are transferred to retained earnings.

The Bank does not have any financial assets classified as either ‘held for trading’ or ‘fair value through profit or loss’.

Management classifies financial assets as follows:

Cash in hand, balances with Central Bank of Kenya, placements with and loans and advances from other banking institutions, other assets, tax recoverable and loans and advances to customers are classified as loans and receivables and are carried at amortised cost.

The portfolio of government securities has been split by bond into the ‘held-to-maturity’ and ‘’available-for-sale’ classes of financial assets. The fair values of government securities classified as available for sale are based on the market prices as at the reporting date.
Investment securities are classified as ‘available-for-sale’ (AFS) financial assets. The fair values of quoted investments and corporate bonds are based on current bid prices at the reporting date. Where fair values cannot be reliably measured (unquoted investments), the Bank carries these investments at cost less provision for impairment. cost less provision for impairment.
Where financial assets are carried at fair value in the statement of financial position, management classify the fair values of financial assets based on the qualitative characteristics of the fair valuation as at the financial year end.

The three hierarchy levels used by management are:
- **Level 1:** where fair values are based on non-adjusted quoted prices in active markets for identical financial assets.
- **Level 2:** where fair values are based on adjusted quoted prices and observable prices of similar financial assets.
- **Level 3:** where fair values are not based on observable market data.

Financial liabilities
The Bank’s financial liabilities which include customer deposits, deposits due to and borrowings from other banking institutions, current tax and other liabilities fall into the following category:
Financial liabilities measured at amortised cost: These are initially measured at fair value and subsequently measured at amortised cost, using the effective interest rate method.
Any difference between the proceeds (net of transaction costs) and the redemption value is recognised ‘as interest expense in the profit or loss under finance costs.
Financial liabilities are derecognised when, and only when, the Bank’s obligations are discharged, cancelled or expired.

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

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.5 Financial instruments

Classification

The bank classifies financial assets and financial liabilities into the following categories:

- Financial assets at fair value through profit or loss - held for trading
- Financial assets at fair value through profit or loss - designated
- Held-to-maturity investment
- Loans, advances and receivables
- Available-for-sale financial assets

Classification depends on the purpose for which the financial instruments were obtained / incurred and takes place at initial recognition.

Financial assets

Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in profit or loss.

The Bank's financial assets fall into the following categories:

Held-to-maturity - Held-to-maturity investments are non derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. Where a sale occurs other than an insignificant amount of held-to-maturity assets, the entire category would be treated and classified as available-for-sale.

Available-for-sale financial assets - Financial assets that are not: (a) financial assets at fair value through profit or loss (b) loans, advances or receivables or (c) financial assets held-to-maturity; are recognised as available-for-sale financial assets.

1.6 Tax

Current tax assets and liabilities

Current tax for current and prior periods is, to the extent unpaid, recognised as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess is recognised as an asset. Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the tax authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities

A deferred tax liability is recognised using the liability method for all taxable temporary differences.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.6 Tax (continued)

Tax expense

Current and deferred taxes are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from:

• a transaction or event which is recognised, in the same or a different period, to other comprehensive income, or
• a business combination.

Current tax and deferred taxes are charged or credited to other comprehensive income if the tax relates to items that are credited or charged, in the same or a different period, to other comprehensive income.

Current tax and deferred taxes are charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly in equity.

1.7 Leases

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

Finance leases - lessor

The company recognises finance lease receivables in the statement of financial position. Finance income is recognised based on a pattern reflecting a constant periodic rate of return on the company's net investment in the finance lease.

Operating leases - lessor Assets leased to third parties under operating leases are included in investment properties in the statement of financial position.

Operating leases – lessee Operating lease payments are recognised as an expense on a straight-line basis over the lease term. The difference between the amounts recognised as an expense and the contractual payments are recognised as an operating lease asset or liability.

Any contingent rents are expensed in the period they are incurred.

1.8 Impairment of financial assets

Assets carried at amortised cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred only if there is evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that a certain event has an impact on the estimated future cash flows of the financial asset.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Default in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower or issuer (for example, declining financial ratios)
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's or issuer's competitive position;
- Deterioration in the value of collateral; and
- The disappearance of an active market for that financial asset because of financial difficulties.

Impairment of loans and advances

Loans and advances are recognised when cash is advanced to borrowers. Loans and advances are initially recognised at fair value and are subsequently carried at amortised cost less provision for impairment losses.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.8 Impairment of financial assets (continued)

Management uses the Prudential Guidelines issued by the Central Bank of Kenya when arriving at impairment provisions (whether specific or general). Management classifies the performance of each loan account in line with the requirements of these guidelines as follows:

Category		Performance guideline for classification of account
• Normal	-	Accounts are performing as per the contractual terms, are not in arrears and are operating within the sanctioned credit limits
• Watch	-	Accounts that are in arrears and/or exceed the sanctioned limit for periods between 30 to 90 days
• Sub-standard	-	Accounts that are in arrears and/or exceed the sanctioned limit for periods between 90 to 180 days
• Doubtful	-	Accounts that are in arrears and/or exceed the sanctioned limit for periods between 180 to 365 days
• Loss	-	Accounts that are in arrears and/or exceed the sanctioned limit for periods over 365 days

A specific credit risk provision for loan impairment is established to provide for management's estimate of credit losses as soon as the recovery of an exposure is identified as doubtful. In arriving at such provisions, present value of future expected cash flows, including amounts recoverable from securities, discounted at effective interest rates of loans are taken into account.

A general credit risk provision for loan impairment is also provided for in accordance with the requirements of the Prudential Guidelines issued by the Central Bank of Kenya. This ranges from between 1% to 3% of the gross advances classified as Normal and Watch (per the categorisation required by the Central Bank of Kenya). These general provisions are held on the statutory loan loss reserve under shareholders equity.

Where provisions computed in accordance with the Prudential Guidelines exceed those under International Accounting Standard 39 (IAS 39) on 'Financial Instruments', the excess is credited to reserves under retained earnings.

The Prudential Guidelines and IAS 39 are used by the Bank to determine when a loan becomes impaired. The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is/or continues to be recognised are not included in a collective assessment of impairment.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the effective interest rate and the discounted value of the collateral. The carrying amount of the asset is reduced and the amount of the loss is recognised in profit or loss.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.8 Impairment of financial assets (continued)

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.
If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed in profit or loss.

Renegotiated loans

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are considered to be past due. They will continue to be treated as past due unless all past due interest is paid in cash at the time of renegotiation and a sustained record of performance has been maintained.

Assets classified at fair value on the statement of financial position

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets are impaired. In the case of equity investments held at fair value a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists, the cumulative loss (the difference between the acquisition cost and the current fair value, less any impairment losses previously recognised in profit or loss) is eliminated from equity and recognised in profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

1.9 Share capital

Ordinary shares are classified as equity.

1.10 Employee benefits

Short-term employee benefits

The cost of short-term employee benefits, (those payable within 12 months after the service is rendered, such as paid vacation leave and sick leave, bonuses, and non-monetary benefits such as medical care), are recognised in the period in which the service is rendered and are not discounted.

The expected cost of compensated absences is recognised as an expense as the employees render services that increase their entitlement or, in the case of non-accumulating absences, when the absence occurs.

Retirement benefit costs

The company contributes to the statutory National Social Security Fund. This fund is a defined contribution scheme registered under the National Social Security Fund Act. The company's obligations under this scheme are limited to specific contributions legislated from time to time and are currently limited to a maximum of Kshs 200 per employee per month.

The bank operates a defined contribution staff retirement benefit scheme for its permanent and pensionable employees. The scheme is administered by an insurance company. The Bank has no further payment obligations once the contributions have been paid.

The company's obligations to the schemes are recognised in the statement of comprehensive income.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Employee entitlements

The Employee entitlements to gratuity and long term service awards are recognised when they accrue to employees. A provision is made for the estimated liability for such entitlements as a result of services rendered by employees up to the statement of financial position date.

The estimated monetary liability for employee's accrued annual leave entitlement at the reporting date is recognised as an expense accrual.

1.11 Provisions and contingencies

Provisions are recognised when:

- the bank has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; ond
- a reliable estimate can be made of the obligation.

The amount of a provision is the present value of the expenditure expected to be required to settle the obligation.

1.12 Revenue recognition

Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the Bank.

The bank recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when the specific criteria have been met for each of the banks activities as described below. The amount of revenue is not considered to be reliably measured until all contingencies relating to the transaction have been resolved. The bank bases its estimates on historical results, taking into cosideration the type of customer, type of transaction and specifics of each arrangement.

Interest income is recognised on an accrual basis in profit or loss using the effective yield on the asset. Interest income includes income from loans and advances, income from placements with loans and advances to other banking institutions and income from government securities. When financial assets become impaired, interest income is thereafter recognised at rates used to discount future cash flows for the purposes of measuring the recoverable amount.

Fees and commissions income and hire purchase options fees are recognised at the time of effecting the transaction.

Foreign exchange trading income is recognised at the time of effecting the transaction. It includes income from spot and forward deals and translated foreign currency assets and liabilities.

Dividend income is recognised when the shareholders right to receive payment has been established.

Rental income is accrued by reference to time on a straight line basis over the lease term.

1.13 Impairment of non-financial assets

Any impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each date of the statement of financial position.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.14 Translation of foreign currencies

Foreign currency transactions

Transactions in foreign currencies during the year are converted into Kenya Shillings (functional currency) at rates ruling at the transaction dates.

At the end of the reporting period:
- foreign currency monetary items are translated using the closing rate;
- non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction; and
- non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period are recognised in the statement of comprehensive income in the period in which they arise.

1.15 Dividends

Proposed dividends are disclosed as a separate component of equity until declared.

Dividends are recognised as a liabilities in the period in which they are approved by the Bank's shareholders.

1.16 Foreign exchange forward contracts

Foreign exchange forward contracts are marked to market and are carried at their fair value and shown as commitments. Gains and losses on foreign exchange forward contracts are dealt with on a net basis in profit or loss in the year in which they arise.

1.17 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 of the financial effect of contingent liabilities is made by the management based on the information available up to the date the financial statements are approved for issue by the Directors. Any expected loss is charged to profit or loss.

1.18 Investment property

Investment properties are long-term investments in land and buildings that are not occupied substantially for own use. Investment properties are initially recognised at cost and subsequently stated at historical cost less accumulated depreciation.

Subsequent expenditure on investment properties where such expenditure increases the future economic value in excess of the original assessed standard of performance is added to the carrying amount of the investment property. All other expenditure is recognised as an expense in the year which it is incurred.

Depreciation is calculated on the straight line basis to write down the cost of the property to its residual value over its estimated useful life of 50 years.

The properties residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

The properties carrying amounts are written down immediately to their recoverable amount if the carrying amount is greater than their estimated recoverable amount. Gains or losses on disposal of investment property are determined by comparing the proceeds with the carrying amount and are taken into account in determining operating profit.

NOTES (continued)
SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.19 Statutory loan loss reserve

The Prudential Guidelines issued by the Central Bank of Kenya require the Bank to make general provisions against impairment of loans and advances. These amounts are recognised in the statutory loan loss reserve in shareholders equity.
The loan loss reserve is not distributable.

1.20 Interest expense

Interest for all interest-bearing financial liabilities is recognised within interest expense in profit or loss using the effective interest method.

Interest expense includes expense incurred on customer deposits, placements and overnight borrowings with other banking institutions.

2. New Standards and Interpretations

The abbreviations IFRS and IAS represent International Financial Reporting Standards and International Accounting Standards respectively.

2.1 Standards and interpretations effective and adopted in the current year

The following standards, interpretations and amendments became effective for the current financial year:

Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)

The amendements to IAS 19 clarify how an entity should account for contributions made by employees or third parties that are linked to services to defined benefit plans, based on whether those contributions are dependent on the number of years of service provided by the employee.

For contributions that are independent of the number of years of service, the entity may either recognise the contributions as a reduction of the service cost in the period in which the related service is rendered, or to attribute them to the employees' periods of service either using the plan's contribution formula or on a straight-line basis; whereas for contributions that are dependent on the number of years of service, the entity is required to attribute them to the employees' periods of service.

The effective date of the amendment is for years beginning on or after July 01, 2014.

The impact of the amendment is not material.

Annual Improvements to IFRSs 2010–2012 Cycle

The annual improvements include amendments to a number of IFRSs and IASs which have been summarised below:

- IFRS 2 (Share-based Payments) - The amendment clarifies the definition of 'vesting conditions' by defining a 'performance condition' and a 'service condition' and amends the definition of a 'market condition' to clarify that a market condition is a performance condition. It also clarifies that a 'market condition' can be based on the market price (or value) of the entity's equity instruments or the equity instruments of another entity in the same group and that a share market index is a non-vesting condition because it not only reflects the performance of the entity, but also of other entities outside the group.
- IFRS 3 (Business Combinations) - The amendment clarifies that the classification of contingent consideration in a business combination as either a financial liability or an equity instrument is based solely on the requirements of IAS 32 ('Financial Instruments: Presentation). It states that the subsequent measurement of contingent consideration in a business combination should be measured at fair value at each reporting and changes in fair value should be recognised in profit or loss, regardless of whether it is a financial instrument or a non-financial instrument.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Annual Improvements to IFRSs 2010–2012 Cycle (continued)

- IFRS 2 (Share-based Payments) - The amendment clarifies the definition of 'vesting conditions' by defining a 'performance condition' and a 'service condition' and amends the definition of a 'market condition' to clarify that a market condition is a performance condition. It also clarifies that a 'market condition' can be based on the market price (or value) of the entity's equity instruments or the equity instruments of another entity in the same group and that a share market index is a non-vesting condition because it not only reflects the performance of the entity, but also of other entities outside the group.
- IFRS 3 (Business Combinations) - The amendment clarifies that the classification of contingent consideration in a business combination as either a financial liability or an equity instrument is based solely on the requirements of IAS 32 ('Financial Instruments: Presentation). It states that the subsequent measurement of contingent consideration in a business combination should be measured at fair value at each reporting and changes in fair value should be recognised in profit or loss, regardless of whether it is a financial instrument or a non-financial instrument.
- IFRS 8 (operating Segments) - The amendment requires entities to disclose the judgements made in identifying their reportable segments when operating segments have been aggregated, including a brief description of the operating segments that have been aggragated and the economic indicators that determine the aggregation criteria. It also clarifies that the entity is required to provide a reconciliation between the total reportable segments' assets and the entity's assets only if the segment assets are regularly reported to the chief operating decision maker.
- IFRS 13 (Fair Value Measurement) - Amends the Basis for Conclusions to clarify that an entity is not required to discount short-term receivables and payables without stated interest rate below their invoice amount when the effect of discounting is immaterial.
- IAS 16 (Property, Plant and Equipment) and IAS 38 (Intangible Assets) - The amendment addresses the diversity in practice in calculating the accumulated depreciation or amortisation for an item of property, plant and equipment or intangible asset that is measured using the revaluation method. It clarifies that the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount and that the accumulated depreciation or amortisation is calculated as the difference between the gross carrying amount and the carrying amount after taking into account impairment losses.
- IAS 24 (Related Party Disclosures) - Amends the definition of a 'related party' in order to include 'management entities', that provide key management personnel services to the reporting entity. It also requires the disclosure of the amounts recognised by the reporting entity as a service fee to a separate management entity for the provision of the key management personnel services and provides a relief so that the reporting entity is not required to disclose components of the compensation to key management personnel where the compensation is paid via amanagement entity.

The effective date of these amendments are for years beginning on or after July 01, 2014.

The impact of these amendments are not material.

Annual Improvements to IFRSs 2011–2013 Cycle

The annual improvements include amendments to a number of IFRSs and IASs which have been summarised below:

- IFRS 1 (First-time Adoption of International Financial Reporting Standards) - Amends the Basis for Conclusions to clarify that a first time adopter has the choice between applying an existing and currently effective IFRS or, applying early, a new or revised IFRS that is not mandatorily effective, provided that the new or revised IFRS permits early application. A first time adopter is required however to apply the same version of IFRS throughout the periods covered by those first IFRS financial statements unless IFRS 1 provides an exemption or an exception that permits or requires otherwise.
- IFRS 3 (Business Combinations) - Amends IFRS 3 to exclude from its scope the accounting for the formation of all types of joint arrangements as defined in IFRS 11 (Joint Arrangements). It clarifies that the above mentioned scope exclusion only addresses the accounting in the financial statements of the joint arrangement itself, and not the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.19 Statutory loan loss reserve

- IFRS 13 (Fair Value Measurement) - Clarifies that the portfolio exception in IFRS 13.52 applies to all contracts accounted for within the scope of IAS 39 (Financial Instruments: Recognition and Measurement) or IFRS 9 (Financial Instruments), regardless of whether those contracts meet the definitions of financial assets or financial liabilities in accordance with IAS 32 (Financial Instruments: Presentation). This means, for example, that commodity contracts that can be settled net in cash and which are accounted for as financial instruments, can qualify for the exemption.
- IAS 40 (Investment Property) - Clarifies that IFRS 3 and IAS 40 are not mutually exclusive. Therefore, in determining whether a property is owner-occupied property or investment property requires judgement based on IAS 40.7-14 and whether the acquisition of an investment property meets the definition of a business combination or is the acquisition of an asset, reference should be made to IFRS 3 to determine whether it is a business combination (not to IAS 40.7- 14).

The effective date of the amendment is for years beginning on or after July 01, 2014.

The impact of these amendments are not material

2.2 Standards and interpretations not yet effective

The company has chosen not to early adopt the following standards and interpretations, which have been published and are mandatory for the company's accounting periods beginning on or after January 01, 2016 or later periods:

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

The amendments to IAS 16 prohibit the use of a revenue-based depreciation method for property, plant and equipment because:

- a depreciation method which is based on revenue allocates the asset's depreciable amount based on revenue generated in an accounting period as a proportion of total expected revenue during the asset's usefeul life
- revenue reflects a pattern of economic benefits that are generated from operating the business rather than the economic benefits that are being consumed through use of the asset.

The amendments to IAS 38 present a rebuttable presumption that a revenue-based amortisation method for intangible assets is innapropriate for the same reasons set out above. This rebuttable presumption can be overcome, i.e. a revenue-based amortisation method might be appropriate, only in two limited circumstances:

- the intangible asset is expressed as a measure of revenue, for example when the predominant limiting factor inherent in an intangible asset is the achievement of a revenue threshold, or
- when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

The effective date of the amendment is for years beginning on or after January 01, 2016.

It is unlikely that the amendment will have a material impact on the company's financial statements.

Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)

The amendments to IAS 16 (Property, Plant and Equipment) and IAS 41 (Agriculture) define a bearer plant and require biological assets that meet the definition of a bearer plant to be accounted for as property, plant and equipment in accordance with IAS 16, instead of IAS 41. In terms of the amendments, bearer plants can be measured using either the cost model or the revaluation model set out in IAS 16.

SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 Standards and interpretations not yet effective (continued)

On the initial application of the amendments, entities are permitted to use the fair value of items of bearer plants as their deemed cost as at the beginning of the earliest period presented. Any difference between the previous carrying amount and the fair value should be recognised in opening retained earnings at the beginning of the earliest period presented.

The produce growing on bearer plants continues to be accounted for in accordance with IAS 41.

The effective date of the amendment is for years beginning on or after January 01, 2016.

It is unlikely that the amendment will have an impact on the company's financial statements.

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

The amendments reinstate the equity method option allowing entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

The effective date of the amendment is for years beginning on or after January 01, 2016.
It is unlikely that the amendment will have animpact on the company's financial statements.

Annual Improvements to IFRSs 2012–2014 Cycle

The annual improvements include amendments to a number of IFRSs and IASs which have been summarised below:

- IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) - Amends IFRS 5 to clarify that a direct reclassification of an asset (or disposal group) from being held for sale to being held for distribution (or vicce-versa) is not treated as a cessation of held for sale classification. Accorddingly, the entity continues to measure the asset (or disposal group) at the lower of carrying amount and fair value less costs to sell. The amendments also state that when an entity determines that the asset (or disposal group) is no longer available for immediate distribution or that the distribution is no longer highly probable, it should cease held-for-distribution accounting and apply the guidance in paragraphs 27-29.
- IFRS 7 (Financial instruments: Disclosures) - The amendments provide additional guidance to help entities identify circumstances under which a contract to 'service' financial assets is considered to be 'continuing involvement' in those assets for the purposes of applying the disclosure requirements in paragraphs 42E-42H of IFRS 7. Such circumstances commonly arise when, for example, the servicing fee is dependant on the amount or timing of the cash flows collected from the transferred financial asset or when a fixed fee is not paid in full due to nonperformance of that asset. The amendments clarify that the additional disclosures required by the recent amendments to IFRS 7 (Disclosure - Offsetting Financial Assets and Liabilities) are not specifically required for all interim periods. However, these disclosures may still be required in some circumstances to meet the general principles of IAS 34 (Interim Financial Reporting).
- IAS 19 (Employee Benefits) - Paragraph 83 of IAS 19 requires that the currency abnd term of the corporate or government bonds used to determine the discount rate for post-employment benefit obligations must be consistent with the currency and estimated term of obligations. The amendments clarify that the assessment of the depth of the corporate bond market shall be made at the currency level rather than the country level.
- IAS (Interim Financial Reporting) - The amendments clarify the meaning of disclosure of information, 'elsewhere in the interim financial report' and require the inclusion of a cross-reference from the interim financial statements to the location of this information. The amendments specify that information incorporated by cross-reference must be available to users of the interim financial statements on the same terms and at the same time as those statements.

The effective date of these amendments is for years beginning on or after January 01, 2016.

It is unlikely that these amendments will have a material impact on the company's financial statements.

2. New Standards and Interpretations (continued)

The impact of these amendments are not material.

Annual Improvements to IFRSs 2011–2013 Cycle

The annual improvements include amendments to a number of IFRSs and IASs which have been summarised below:

- IFRS 1 (First-time Adoption of International Financial Reporting Standards) - Amends the Basis for Conclusions to clarify that a first time adopter has the choice between applying an existing and currently effective IFRS or, applying early, a new or revised IFRS that is not mandatorily effective, provided that the new or revised IFRS permits early application. A first time adopter is required however to apply the same version of IFRS throughout the periods covered by those first IFRS financial statements unless IFRS 1 provides an exemption or an exception that permits or requires otherwise.
- IFRS 3 (Business Combinations) - Amends IFRS 3 to exclude from its scope the accounting for the formation of all types of joint arrangements as defined in IFRS 11 (Joint Arrangements). It clarifies that the above mentioned scope exclusion only addresses the accounting in the financial statements of the joint arrangement itself, and not the accounting by the parties to the joint arrangement for their interests in the joint arrangement.
- IFRS 13 (Fair Value Measurement) - Clarifies that the portfolio exception in IFRS 13.52 applies to all contracts accounted for within the scope of IAS 39 (Financial Instruments: Recognition and Measurement) or IFRS 9 (Financial Instruments), regardless of whether those contracts meet the definitions of financial assets or financial liabilities in accordance with IAS 32 (Financial Instruments: Presentation). This means, for example, that commodity contracts that can be settled net in cash and which are accounted for as financial instruments, can qualify for the exemption.
- IAS 40 (Investment Property) - Clarifies that IFRS 3 and IAS 40 are not mutually exclusive. Therefore, in determining whether a property is owner-occupied property or investment property requires judgement based on IAS 40.7-14 and whether the acquisition of an investment property meets the definition of a business combination or is the acquisition of an asset, reference should be made to IFRS 3 to determine whether it is a business combination (not to IAS 40.7- 14).

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- when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

The effective date of the amendment is for years beginning on or after January 01, 2016.
It is unlikely that the amendment will have a material impact on the company's financial statements.

2. New Standards and Interpretations (continued)

Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)

The amendments to IAS 16 (Property, Plant and Equipment) and IAS 41 (Agriculture) define a bearer plant and require biological assets that meet the definition of a bearer plant to be accounted for as property, plant and equipment in accordance with IAS 16, instead of IAS 41. In terms of the amendments, bearer plants can be measured using either the cost model or the revaluation model set out in IAS 16.
On the initial application of the amendments, entities are permitted to use the fair value of items of bearer plants as their deemed cost as at the beginning of the earliest period presented. Any difference between the previous carrying amount and the fair value should be recognised in opening retained earnings at the beginning of the earliest period presented.

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Annual Improvements to IFRSs 2012–2014 Cycle

The annual improvements include amendments to a number of IFRSs and IASs which have been summarised below:

- IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) - Amends IFRS 5 to clarify that a direct reclassification of an asset (or disposal group) from being held for sale to being held for distribution (or vicce-versa) is not treated as a cessation of held for sale classification. Accorddingly, the entity continues to measure the asset (or disposal group) at the lower of carrying amount and fair value less costs to sell. The amendments also state that when an entity determines that the asset (or disposal group) is no longer available for immediate distribution or that the distribution is no longer highly probable, it should cease held-for-distribution accounting and apply the guidance in paragraphs 27-29.
- IFRS 7 (Financial instruments: Disclosures) - The amendments provide additional guidance to help entities identify circumstances under which a contract to 'service' financial assets is considered to be 'continuing involvement' in those assets for the purposes of applying the disclosure requirements in paragraphs 42E-42H of IFRS 7. Such circumstances commonly arise when, for example, the servicing fee is dependant on the amount or timing of the cash flows collected from the transferred financial asset or when a fixed fee is not paid in full due to nonperformance of that asset. The amendments clarify that the additional disclosures required by the recent amendments to IFRS 7 (Disclosure - Offsetting Financial Assets and Liabilities) are not specifically required for all interim periods. However, these disclosures may still be required in some circumstances to meet the general principles of IAS 34 (Interim Financial Reporting).
- IAS 19 (Employee Benefits) - Paragraph 83 of IAS 19 requires that the currency abnd term of the corporate or government bonds used to determine the discount rate for post-employment benefit obligations must be consistent with the currency and estimated term of obligations. The amendments clarify that the assessment of the depth of the corporate bond market shall be made at the currency level rather than the country level.
- IAS (Interim Financial Reporting) - The amendments clarify the meaning of disclosure of information, 'elsewhere in the interim financial report' and require the inclusion of a cross-reference from the interim financial statements to the location of this information. The amendments specify that information incorporated by cross-reference must be available to users of the interim financial statements on the same terms and at the same time as those statements.

The effective date of these amendments is for years beginning on or after January 01, 2016.

It is unlikely that these amendments will have a material impact on the company's financial statements.

2. New Standards and Interpretations (continued)

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

The Amendments to IFRS 10 and IAS 28 address an acknowledged inconsistency between IFRS 10 (Consolidated Financial Statements) and IAS 28 (Investments in Associates). This relates to accounting for transactions in which a parent entity loses control of a subsidiary by contributing it to an associate or joint venture.

The inconsistency stemmed originally from a conflict between the requirements of IAS 27 (Consolidated and Separate Financial Statements (Revised 2008)) and SIC-13 (Jointly Controlled Entities – Non-Monetary Contributions by Venturers). While IAS 27 required the full gain or loss to be recognised on the loss of control of a subsidiary, SIC-13 required a partial gain or loss recognition in transactions between an investor and its associate or joint venture. Although IFRS 10 supersedes IAS 27, and IAS 28 (2011) supersedes both IAS 28 and SIC-13, the conflict remained.

The Amendments alter IFRS 10 so that:

- the current requirements for the partial gain or loss recognition for transactions between an investor and its associate or joint venture only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in IFRS 3 (business Combinations)
- the gain or loss from the sale or contribution of assets that constitute a business between an investor and its associate or joint venture is recognised in full.

The effective date of the amendment is for years beginning on or after January 01, 2016.

It is unlikely that the amendment will have an impact on the company's financial statements.

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

The amendments to IFRS 11 (Joint Arrangements) provide guidance on how to account for the acquisition of an interest in a joint operation in which the activities constitute a business as defined in IFRS 3 (Business Combinations). Specifically, the amendments state that the relevant principles on accounting for business combinations in IFRS 3 and other standards should be applied. The same requirements should be applied to the formation of a joint operation if and only if an existing business is contributed to the joint operation by one of the parties that participate in the joint operation.

Additionally, consequential amendments to IFRS 1 (First-time Adoption of International Financial Reporting Standards) have been made so that IFRS 1's exemption for past business combinations can also apply to past acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business.
A joint operator is also required to disclose the relevant information required by IFRS 3 and other standards for business combinations.

The effective date of the amendment is for years beginning on or after January 01, 2016.

It is unlikely that the amendment will have an impact on the company's financial statements.

IFRS 14 - Regulatory Deferral Accounts

IFRS 14 specifies the accounting for regulatory deferral account balances that arise from rate-regulated activities. The Standard is available only to first-time adopters of IFRSs who recognised regulatory deferral account balances under their previous GAAP. IFRS 14 permits eligible first-time adopters of IFRSs to continue their previous GAAP rate-regulated accounting policies, with limited changes, and requires separate presentation of regulatory deferral account balances in the statement of financial position and statement of comprehensive income. Disclosures are also required to identify the nature of, and risks associated with, the form of rate regulation that has given rise to the recognition of regulatory deferral accounts.

The effective date of the standard is for years beginning on or after January 01, 2016.

It is unlikely that the standard will have a material impact on the company's financial statements.

2. New Standards and Interpretations (continued)

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

The publication introduces three narrow scope amendments to IFRS 10 and IAS 28 addressing the accouting for interests in investment entities and applying the consolidation exemption:

- Exemption from preparing consolidated financial statements: Under IFRS 10 (Consolidated Financial Statements), a parent entity is exempted from preparing consolidated financial statements if it meets certain criteria. One of these criteria si that the entity's ultimate or any immediate parent produces consolidated financial statements that are available for public use and comply with IFRSs.
- A subsidiary that provides services that relate to the parent's investment activities: The Amendments modify IFRS 10, clarifying that the consolidation requirement applies only to subsidiaries that are not themselves investment entities and whose main purpose and activities are providing services that relate to the investment entity's investment activities.
- Application of the equity method by a non-investment entity investor to an investment entity investee: The Amendments adds guidance to IAS 28. They provide relief to non-investment entity investors with interests in associates or joint ventures that are investment entities by allowing them to retain, when applying the equity method, the fair value measurement applied by the investment entity associates or joint ventures to their interests in subsidiaries.

The effective date of the amendment is for years beginning on or after January 01, 2016.

It is unlikely that the amendment will have a material impact on the company's financial statements.

Disclosure Initiative (Amendments to IAS 1)

The amendments are designed to further encourage companies to apply professional judgement in determining what information to disclose in their financial statements. Furthermore, the amendments clarify that companies should use professional judgement in determining where and in what order information is presented in the financial statements.

The amendments:

- clarify the materiality requirements in IAS 1 (Presentation of Financial Statements), including an emphasis on the potentially detrimental effect of obscuring useful information with immaterial information
- clarify that IAS 1's specified line items in the statement(s) of profit or loss and other comprehensive income and the statement of financial position can be disaggregated
- add requirements for how an entity should present sub-totals in the statement(s) of profit or loss and other comprehensive income and the statement of financial position
- clarify that entities have flexibility as to the order in which they present the notes, but also emphasise that understandability and comparability should be considered by an entity when deciding that order
- remove potentially unhelpful guidance in IAS 1 for identifying a significant acconting policy.

The effective date of the amendment is for years beginning on or after January 01, 2016.

It is unlikely that the amendment will have a material impact on the company's financial statements.

IFRS 15 - Revenue from Contracts with Customers

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. It will supersede the following revenue standards and interpretations upon its effective date:

- IAS 18 -Revenue
- IAS 11 - Construction Contracts
- IFRIC 13 - Customer Loyalty Programmes
- IFRIC 15 - Agreements for the Construction of Real Estate
- IFRIC 18 - Transfers of Assets from Customers; and
- SIC 31 - Revenue-Barter Transactions involving Advertising Services

Under IFRS 15, a customer of an entity is a party that has contracted with the entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration. Unlike the scope of IAS 18, the recognition and measurement of interest income and dividend income from debt and equity investments are no longer within the scope of IFRS 15. Instead, they are within the scope of IAS 39 - Financial Instruments: Recognition and Measurement (IFRS 9 - Financial instruments, if IFRS 9 is early adopted).It is unlikely that these amendments will have a material impact on the company's financial statements.

2. New Standards and Interpretations (continued)

The effective date of the standard is for years beginning on or after January 01, 2018.

The impact of this standard is currently being assessed.

IFRS 9 - Financial Instruments

IFRS 9 - Financial Instruments will replace IAS 39 (and all the previous versions of IFRS 9). It contains requirements for the classification and measurement of financial assets and financial liabilities, impairment, hedge accounting and derecognition.

IFRS 9 requires all recognised financial assets to be subsequently measured at amortised cost or fair value (through profit or loss or through other comprehensive income), depending on their classification by reference to the business model within which they are held and their contractual cash flow characteristics.

For financial liabilities, the most significant effect of IFRS 9 relates to cases where the fair value option is taken: the amount of change in fair value of a financial liability designated as at fair value through profit or loss that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income (rather than profit or loss), unless this creates an accounting mismatch.

For the impairment of financial assets, IFRS 9 introduces an ‘expected credit loss’ model based on the concept of providing for expected losses at inception of a contract; it will no longer be necessary for there to be objective evidence of impairment before a credit loss is recognised.

For hedge accounting, IFRS 9 introduces a substantial overhaul allowing financial statements to better reflect how risk management activities are undertaken when hedging financial and nonfinancial risk exposures.

The effective date of the standard is for years beginning on or after January 01, 2018.

The impact of this standard is currently being assessed

3. Financial risk management

Financial risk management

The Bank's activities exposes it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance.

The Bank's risk management policies are designed to identify and analyse these risks, to set risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date management information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

Risk management function is carried out by the Bank's risk management department under policies approved by the Board of Directors. The Bank's risk management department identifies, measures, monitors and controls financial risks in close coordination with various other departmental heads. The Bank has Board approved policies covering specific areas, such as credit risk, market risk, liquidity risk and operational risk. The most important types of risk are credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, interest rate risk and price risk.

Capital management

The bank's objectives when managing capital, which is a broader concept than the equity on the face of the statement of financial position are:
- To comply with the capital requirements set by the regulator, Central Bank of Kenya.
- To safeguard the bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders
- To maintain a strong capital base to support the development of its business.

The Bank monitors the adequacy of its capital using ratios established by Central Bank of Kenya. These ratios measure capital adequacy by comparing the Bank's core capital with total risk-weighted assets plus risk weighed off-balance sheet items, total deposit liabilities and total risk-weighted off balance sheet items.

Credit risk weighted assets

Assets are weighted according to broad categories of notional credit risk, being assigned a risk weighting according to the amount of capital deemed to be necessary to support them. Four categories of risk weights (0%, 20%, 50% and 100%) are applied e.g. cash in hand (domestic and foreign), balances held with Central Bank of Kenya including securities issued by the Government of Kenya have a zero risk weighting, which means that no capital is required to support the holding of these assets. Property, plant and equipment carries a 100% risk weighting. Based on these guidelines it means that they must be supported by capital equal to 100% of the carrying amount. Other asset categories have intermediate weightings.

Off-balance sheet credit related commitments such as guarantees and acceptances, performance bonds, documentary credit e.t.c. are taken into account by applying different categories of credit risk conversion factors, designed to convert these items into balance sheet equivalents. The resulting credit equivalent amounts are then weighted for credit risk using the same percentages as for statement of financial position assets. Core capital (Tier 1) consists of paid-up share capital, retained profits less non-dealing investments. Supplementary capital (Tier 2) includes general provisions and non-dealing investments.

Market risk weighted assets

This is the risk of loss in on and off balance sheet position arising from movement in market prices. These risks pertain to inherent risk related instruments in the trading book, commodities risk throughout the bank, equities risk and foreign exchange risk in the trading and banking books of the bank. Different risk weights are applied as per the Prudential Regulation.

3. Financial risk management (continued)

	2015 Kshs '000	2014 Kshs '000
Capital adequacy requirement calculation		
Tier 1 Capital	11,181,282	9,324,068
Tier 2 Capital	365,353	358,853
	11,546,635	9,682,921
Total deposit liabilities	52,928,623	48,683,189

Risk weighted amounts for loans and advances to customers are stated net of impairment losses. These balances have also been offset against fixed deposits and short term deposits placed by customers as securities. There is no borrower with either funded or non-funded facilities, exceeding twenty five percent of core capital.

	Actual Ratios		Minimum Requirement	
	2015	2014	2015	2014
Core capital to total risk weighted assets	26.30 %	23.28 %	10.50 %	10.50 %
Total capital to total risk weighted assets	27.10 %	24.18 %	14.50 %	12.00 %
Core capital to deposit liabilities	21.13 %	19.15 %	8.00 %	8.00 %

Credit risk

The Bank takes on exposure to credit risk, which is the risk that a customer will cause a financial loss for the Bank by failing to fulfil a contractual obligation. Credit risk is the most important risk for the Bank's business. Management therefore carefully manages its exposure to credit risk. Credit risk mainly arises from customer loans and advances, credit cards, investing activities and loan commitments (off balance sheet financial instruments). The credit risk management and control are centralised in credit and treasury departments of the bank.

Measurement of credit risk

- Loans and advances

In measuring credit risk of loans and advances to customers, the bank reflects on various components. These include:

- the probability of default by the borrower/client on their contractual obligations;
- current exposures on the borrower/client and the likely future development, from which the bank derives the exposure at default; and
- the likely recovery ratio on the defaulted obligations.

These credit risk measurements, which reflect expected loss, are embedded in the bank's daily operational management. The operational measurements can be contrasted with impairment allowances required under IAS 39 and the Banking Act which are based on losses that have been incurred at the date os the statement of financial position rather than expected loss.

The bank assesses the probability of default of individual borrower/client using internal rating methods tailored to the various categories of the borrower/client. These have been developed and combine statistical analysis with the credit department's judgement and are validated, where appropriate, by comparison with externally available data.

Management assesses the credit quality of the customer, taking into account their financial position, past experience and other factors.

Individual limits are set based on internal or external information in accordance with limits set by the management. The utilisation of credit limits is regularly monitored. Corrective action is taken where necessary.

- Investments

For investments, internal ratings taking into account the requirements of the Banking Act are used by the bank for managing the credit risk exposures. The investments in those securities are viewed as a way to gain a better credit quality mapping and maintain a readily available source to meet the funding requirment at the same time.

3. Financial risk management (continued)

- Risk limit control and mitigation policies

The bank manages, limits and controls concentrations of credit risk wherever they are identified. 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 industry segments. Such risks are monitored on a revolving basis and subject to annual or more frequent review, when considered necessary. Limits on the level of credit risk by product and industry sector are approved as and when required by the credit committee.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by charging these lending limits where appropriate.

Some other specific control and mitigation measures are outlined below:

- Collateral

The bank employs a range of policies and practices to mitigate credit risk. The most common one is to obtain collateral for loans and advances to customers. The types of collateral obtained include:
- Mortgages over properties;
- Charges over business assets such as land and buildings, inventory and receivables;
- Charges over financial instruments such as investments;
- Deposits placed under lien.

- Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and letters of credit carry the same credit risk as loans. Letters of credit (which are written undertakings by the bank on behalf of a customer authorising a third party to draw drafts on the bank up to a stipulated amount under specific terms and conditions) are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct advance or loan.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

- Impairment and provisioning policies

The bank's internal and external systems focus more on credit quality mapping from the inception of the lending of the loan or advance. In contrast, impairment provisions are recognised for financial reporting purposes only for losses that have been incured at the statement of financial position date based on objective evidence of impairment.

The impairment provision shown in the statement of financial position at the year-end is derived after taking various factors into consideration as described in the accounting policy. The bank's management uses basis under IAS 39 and the Prudential Guidelines to determine the amount of impairment.

- Exposure to credit risk

The management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the bank resulting from both its loan and advances portfolio and other financial assets based on the following:
- The maximum exposure to credit risk arises from investments in government securities which form 45.86% (2014: 45.25%) of total assets; 36.00% (2014: 35%) represents loans and advances to customers.
- Government securities are considered stable investments as the risk is considered negligible.
- 96.33% (2014: 97.51%) of the loans and advances portfolio is categorised in the top two grades of the internal rating system (Normal and Watch).
- 12.51% (2014: 1.95%) of the loans and advances portfolio are considered to be past due but not impaired.

3. Financial risk management (continued)

- Most of its loans and advances to customers are performing as per the respective covenants. Non-performing loans and advances have been provided for. The loans and advances are also secured.
- Cash in hand, balances with Central Bank of Kenya and placements with other banking institutions are held with sound financial institutions.
- Management considers the historical information available to assess the credit risk on investment securities.

Exposure to this risk has been quantified in each financial asset note in the financial statements along with any concentration of risk.

Liquidity risk

Liquidity risk is the risk that the bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are overdrawn.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain terms and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturity 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 iquidity of the bank and its exposure to changes in interest and exchange rates.

The bank does not maintain cash resources to meet all liabilities as they fall due as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainity. The management has set limits on the minimum portion of maturing funds available to meet such withdrawals and on the level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The management reviews the maturity profile on a weekly basis and ensures that sifficient liquidity is maintained to meet maturing deposits which substantially are generally rolled over into new deposits.The bank fully complies with the Central Bank of Kenya's minimum cash reserve ratio (5.25%) and liquidity ratio (20%) requirements, with the average liquidity maintained at 62.5% (2014: 60.5%) during the year.

The table overleaf analyses the bank's financial assets and liabilities into the relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

3. Financial risk management (continued)

Interest rate risk

The bank's operations are subject to the risk of interest rate fluctuations to the extent that interest earning assets and interest bearing liabilities mature or reprice at different times or in differing amounts. Risk management activities are aimed at optimizing net interest income, given market interest rates levels consistent with the bank's business strategies.

The bank is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows. The management closely monitors the interest rate trends to minimise the potential adverse impact of interest rate changes. The table summarises the exposure to interest rate risk at the balance sheet date. Included in the table are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The bank does not have any derivative financial instruments. The bank does not bear an interest rate risk on off balance sheet items.

Cash flow interest rate risk

3. Financial risk management (continued)

Market risk

Market risk is the risk that changes in the market prices, which includes currency exchange rate and interest rates, will affect the fair value or future cash flows of financial instruments. Market risk arises from open positions in interest rates and foreign currencies, both of which are exposed to general and specific market movements and changes in the level of volatility. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while optimising on the return on risk. Overall management for management of market risk rests with the Assets & Liability Committee (ALCO).

The treasury department is responsible for the development of detailed risk management policies, subject to review and approval by ALCO, and for the day to day implementation of the policies.

Market risks arise mainly from trading and non-trading activities.
Trading portfolios include those positions arising from market-making transactions where the bank acts as a principal with clients or with the market.

Non-trading portfolios primarily arise from the interest rate management of the entity's retail and commercial banking assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the bank's available-for-sale investments.

The major measurement techniques used to measure and control market risk are outlined below:

- ALCO review:

ALCO meets on an adhoc basis to review the following:
- A summary of the bank's aggregate exposure on market risk
- A summary of the bank's maturity/repricing gaps
- A report indicating that the bank is in compliance with the board's set exposure limit
- A comparison of past forecast or risk estimates with actual results to identify any shortcomings.

- Review by the treasury department:

The treasury department monitors foreign exchange risk in close collaboration with the management. Regular reports are prepared by the treasury department of the bank and discussed with the management. Some of these reports include:
- Net overnight positions by currency
- Maturity distribution by currency of the assets and liabilities for both on and off balance sheet items
- Outstanding contracts (if any) by settlement date and currency
- Total values of contracts, spots and futures
- Aggregate dealing limits
- Exception reports for example limits or line excesses.

Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the bank's processes, personnel, technology and infrastructure and from external factors other than credit, market and liquidity risks such as those arising out of legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risk arise from the bank's operations and is faced by all other business entities. The bank endeavors to manage the operational risk by creating a balance between avoidance of cost of financial losses and damage to the bank's reputation within overall cost effectiveness and to avoid control procedures that restrict creativity and initiative. The key responsibility for development and implementation of policies and programs to implement the bank's operational risk management is with the senior management of the bank.

The above is tried to be achieved by development of overall standards for the bank to manage the risk in the following areas:
- Segregation of duties including independent authorisation of transactions
- Monitoring and reconciliation of transactions

3. Financial risk management (continued)

- Compliance of regulatory and legal requirement
- Documentation of control and procedure
- Assessment of the operational risk on a periodic basis to address the deficiencies observed, if any
- Reporting of operational losses and initiation of remedial action
- Development of contingency plan
- Giving training to staff to improve their professional competency
- Ethical and business standards
- Obtaining insurance wherever feasible, as a risk mitigation measure.

Risk measurement and control

Interest rate, currency, credit, liquidity and other risks are actively managed by management to ensure compliance with the bank's risk limits. The bank's risk limits are assessed regularly to ensure their appropriateness given its objectives and strategies and current market conditions. A variety of techniques are used by the bank in measuring the risks inherent in its trading and non-trading positions.

Foreign exchange risk sensitivity

The table below summarises the effect on post-tax profit had the Kenya Shilling weakened by 10% against each currency, with all other variables held constant. If the Kenya Shilling strengthened against each currency, the effect would have been the opposite.

2015	**USD**	**GBP**	**EURO**	**Others**	**Total**
Effect on profit - Increase / (decrease)	(3,939)	2,157	(276)	1,694	(364)

2014	**USD**	**GBP**	**EURO**	**Other**	**Total**
Effect on profit - Increase / (decrease)	(9,468)	(62)	232	(2,662)	(11,960)

Price risk sensitivity

The Bank is exposed to price risk on quoted shares, corporate bonds and government securities because of investments that are classified on the statement of financial position as 'Available-for-sale'.

The table below summarises the impact on increase in the market price on the Bank's equity net of tax. The analysis is based on the assumption that the market prices had increased by 5% with all other variables held constant and all the Banks equity instruments moved according to the historical correlation with the price:

	2015 Kshs '000	2014 Kshs '000
	Impact on other comprehensive income	
Effect of increase	363,633	489,597