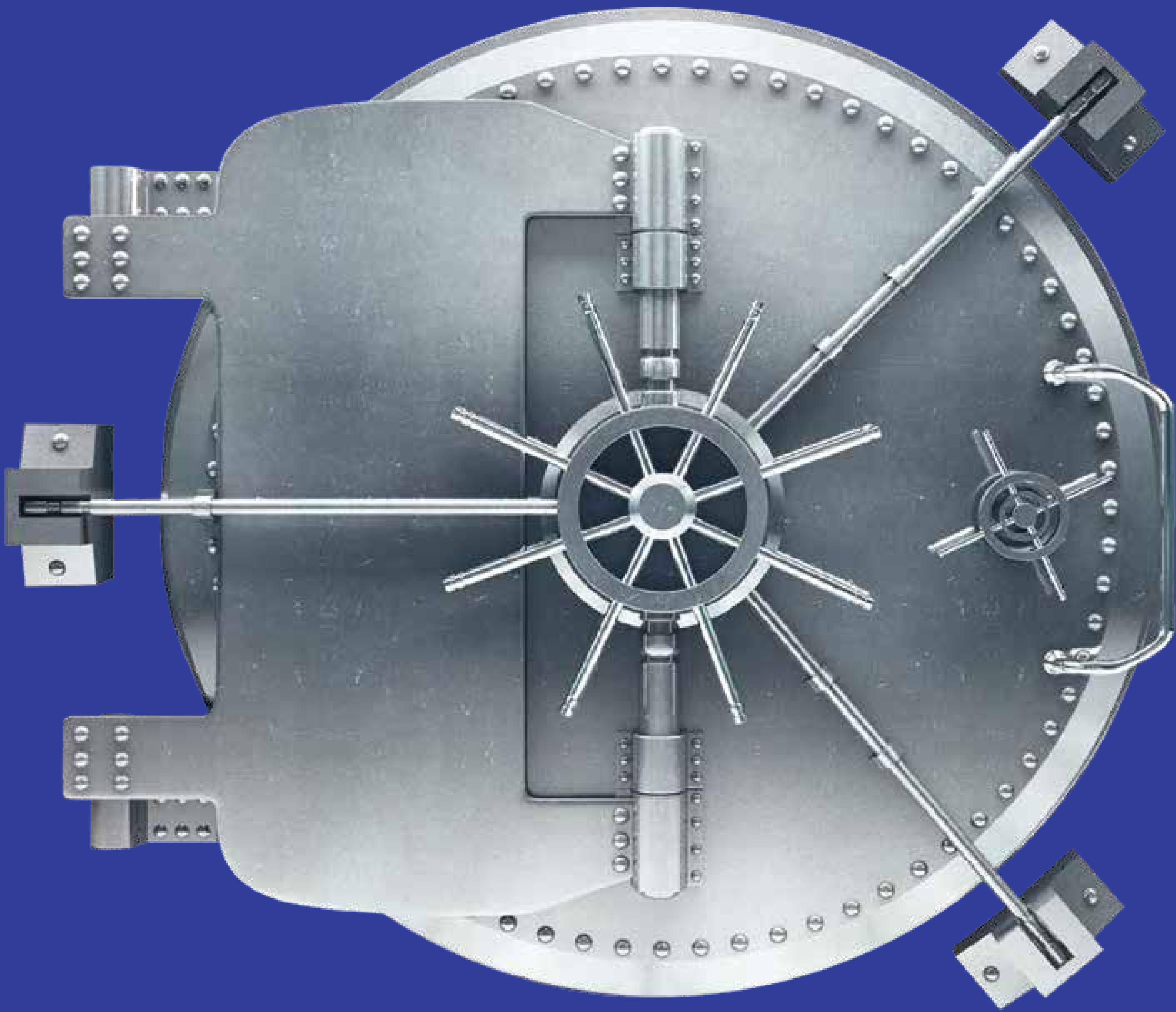
Guardian BANK
Your Preferred Bank

GUARDIAN BANK

ANNUAL REPORT

31ST DECEMBER 2016



GUARDIANBANK
ANNUAL REPORT

Guardian Bank Limited ("the Bank" or "the company") is a company domiciled in Kenya. The consolidated financial statements of the Bank as at 31 December 2016 comprise the Bank and its subsidiaries (together referred to as the "Group" or "consolidated").

TABLE OF CONTENT

DIRECTORS AND STATUTORY INFORMATION

DIRECTORS

Dr. Maganlal M Chandaria*	Chairman
Vasant K Shetty	Managing Director
Hetul D. Chandaria	Executive Director
Bhavnish Chandaria	Non-Executive Director
Rajeshwar Sahi*	Independent Non-Executive Director
Shantilal R. Shah	Independent Non-Executive Director
Dr. Samson Ndegwa	Independent Non-Executive Director
Mr. Ajay Shah	Independent Non-Executive Director

* British

SECRETARY
Jophece Yogo
PO Box 69952-00400
Nairobi

AUDITORS
KPMG Kenya
Certified Public Accountants
8th Floor, ABC Towers
Waiyaki Way
PO Box 40612-00100 GPO
Nairobi

REGISTERED OFFICE/ HEAD OFFICE
Guardian Centre
Biashara Street
PO Box 67437-00100 GPO
Nairobi

LAWYERS
Ochieng', Onyango, Kibet & Ohaga Advocates
Coulson Harney Advocates
AB Patel & Patel Advocates
Nyairo & Co Advocates
Kiruti & Co Advocates
LG Menezes Advocates
Ogolla Okello & Company Advocates
Oyatta & Associates Advocates
Iseme Kamau & Maema Advocates
Kabiru & Company Advocates
Anjarwalla & Khanna Advocates
Taibjee & Bhalla Advocates

CORRESPONDENT BANKS
DCB Bank, Mumbai (India)
Standard Bank of South Africa Ltd
Habib Bank (UK & NY)
HDFC Bank Ltd, (India)
Bank of India, Nairobi
KCB Bank Kenya Ltd, Nairobi

BRANCHES

Biashara Street
Guardian Centre
PO Box 67437-00200
Nairobi

Westlands Branch
Brick Court House
Mpaka Road
PO Box 66568-00800
Nairobi

Mombasa Road Branch
Tulip House
PO Box 42060-00100
Nairobi

Mombasa Branch
Oriental Building
Nkurumah Road
PO Box 40619-80100
Mombasa

Eldoret Branch
Beharilal House
Uganda Road
PO Box 7685-30100
Eldoret

Kisumu Branch
Amalo Plaza
Oginga Odinga Road,
Central Square
PO Box 2816-40100
Kisumu

Ngong Road Branch
The Green House
PO Box 9822-00200
Nairobi

Nyali Branch
Links Plaza
PO Box 34375-80118
Nyali
Mombasa

Nakuru Branch
Parana House
Kenyatta Avenue
PO Box 18633–20100
Nakuru

STATEMENT OF CORPORATE GOVERNANCE

BOARD/MANAGEMENT COMMITTEES

Tabulated below are Board/Management Committees, their composition and membership, functions and the frequency of meetings

	Credit Committee	Audit Committee	Risk Management Committee	Strategy Committee	Human Resource Committee	Assets & Liabilities Management Committee	Business Continuity Management Committee (BCM):
Composition	Non-Executive Directors, Managing Director Executive director	Non-Executive Directors.	Non-Executive Directors and Managing Director Executive Director	Managing Director, Executive Director, Chief Executive officer, Senior Management	Managing Director, Executive Director, Chief Executive officer, Senior Management	Managing Director, Executive Director, Chief Executive officer & Senior Management	Senior Management
Chairman	Dr. Shantilal R. Shah	Mr. Raj Sahi	Dr.Samson Ndegwa	Mr.Hetul D. Chandaria	Mr.Vasant K. Shetty	Mr.Vasant K. Shetty	Mr. K R. Sahasramanam
Members	Dr. Maganlal M. Chandaria Mr. Raj Sahi Mr.Vasant K. Shetty Mr.Hetul D. Chandaria	Dr. Shantilal R. Shah Mr. Ajay Shah Mr. Bhavnish Chandaria	Mr.Vasant K. Shetty Mr.Hetul Chandaria Mr. Bhavnish Chandaria	Mr. Vasant K. Shetty Mr. N. Sabesan Mr. K R. Sahasramanam Mr. N.P. Thaker Mr. Joseph Wachira Ms. Shilpa Shah Mrs Lorraine Miranda Mr. Raj Sehmi Ms Grace Nyende Mr. G.S. Matharu Mr. Imtiaz Harunani	Mr.Hetul Chandaria Mr. N. Sabesan Mr. N.P. Thaker Mr. Joseph Wachira	Mr.Hetul Chandaria Mr. N. Sabesan Mr. K R. Sahasramanam Mr. N.P. Thaker Mrs Lorraine Miranda Mr. K. Solanki	Mrs Lorraine Miranda Mr. Thaker Ms.Grace Nyende Ms. Shilpa Shah Mr. Joseph Wachira
Main Functions	Review and oversee the lending policy of the bank, sanctioning new/review credit proposals within the delegated authority, evaluate / review bank's risk under Credit Risk Management	To ensure that the financial statements are prepared in timely and accurate manner, review internal controls, review the management report of external auditors, comply with CBK inspection report, approve annual audit plan, and review internal audit report.	Review/ Implementation of Risk Management Framework -Review/ Monitor and deliberation on risk mitigation approach. -Enhance overall risk awareness and control.	Drawing short term/long term business strategy of the bank, preparation of annual business budget, monitoring the Performance of the branches vis-à-vis the target, marketing/ publicity, branch expansions.	Selection / recruitment, promotions, performance review, disciplinary issues, staff training, staff welfare, preparation/ updating of HR Policy of the bank.	Compliance with the legal and regulatory requirements, monitoring the liquidity of the bank, take investment decision, fix rate of interest on deposit/bank's lending Rate, evaluate / review liquidity risk management, interest rate risk management price risk management.	"BCM Team" is responsible for - Protecting the interest of stake holders and meeting CBK compliance/legal requirements, - Developing disaster mitigation and resumption strategies for various business process, - Allocate resources for Disaster Recovery centre - Creating awareness amongst staff about the Disaster Recover Management, -Facilitating creation and updating of Business Continuity Policy,
Frequency of Meetings	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Monthly	Quarterly

STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)

Board Meetings Attendance

Names	23.03.16	29.06.16	13.09.16	28.11.16	% Attendance
Maganlal M. Chandaria	X	X	X	X	100
Vasant K. Shetty	X	X	X	X	100
Hetul Chandaria	-	X	X	X	75
Rajeshwar Sahi	X	-	X	X	75
Shantilal R. Shah	X	X	-	X	75
Ajay Shah	X	X	-	X	75
Samson Ndegwa	X	-	X	X	75
Bhavnish D. Chandaria	X	X	X	X	100

X Present

- Absent

Evaluation of the Board of Directors

An annual evaluation of the Board of Directors was undertaken in 2016 and every other year, as required by the Central Bank of Kenya.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

The directors have pleasure in submitting their report together with the audited financial statements for the year ended 31 December 2016 which disclose the state of affairs of the Group and Company, in accordance with Section 22 of the Banking Act and the Kenyan Companies Act, 2015.

1. ACTIVITIES

The company is licensed to operate as a bank under the Banking Act.

2. RESULTS

The results for the year are set out on page 15.

3. DIVIDEND

The directors do not recommend the payment of a dividend (2015 – Nil).

4. DIRECTORS

The directors who served during the year and up to the date of this report are set out on page 4.

During the year 2016, there were 4 (2015 – 4) scheduled board meetings and the attendance by the directors is as tabulated on page 6.

Evaluation of board of directors was suitably carried out as required by Central Bank of Kenya regulations.

5. BUSINESS OVERVIEW

Performance

Despite various challenges and uncertainties, more particularly confidence crisis in the banking industry, which has led to movement of large volume of deposit from the private sector banks to bigger banks, Guardian Bank has performed fairly well.

Risk management

Bank has managed the risk associated with various segments fairly well by maintaining various business ratios above the statutory requirements. The Bank is committed to maintain a sustainable business growth and focus strongly on exemplary operational risk management and the concept of zero tolerance towards regulatory breaches. The Bank's approach to risk management, including financial risk management objectives and policies and information on the Bank's exposure to credit, liquidity, market and operational risk, is discussed on pages 42 to 61 of the financials.

Post Balance Events

There has been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Outlook

The year 2017 is expected to be a tough year globally. There will be a range of uncertainties in the external environment including those related to general elections in the Republic of Kenya and the interest rate capping. The bank will continue to deliver on its strategic agenda and live up to the expectations of the various stakeholders, its customers, staff, investors, regulators and the society.

6. RELEVANT AUDIT INFORMATION

The Directors in office at the date of this report confirm that:

(i) There is no relevant audit information of which the Group's auditor is unaware; and

(ii) Each director has taken all the steps that they ought to have taken as a director so as to be aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

7. AUDITORS

The auditors, KPMG Kenya, continue in office in accordance with Section 719(2) of the Kenyan Companies Act, 2015 and subject to Section 24(1) of the Banking Act (Cap. 488).

8. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on 28th March 2017

BY ORDER OF THE BOARD

Jophece Yogo
Secretary

Date: 28th March 2017

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and fair presentation of the consolidated financial statements of Guardian Bank Limited set out on pages 15 to 80 which comprise the statements of financial position of the Group and the Company at 31 December 2016, the Group's statement of profit and loss and other comprehensive income, the Group and Company statement of changes in equity and the Group statement of cash flows for the year then ended, and the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and fairly presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015 and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Under the Kenyan Companies Act, 2015 the Directors are required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group and the Company as at the end of the financial year and of the operating results of the Group and the Company for that year. It also requires the Directors to ensure the Company keeps proper accounting records which disclose with reasonable accuracy the financial position of the Group and the Company.
The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Group and the Company and of the Group's operating results.

The Directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

The Directors have made an assessment of the Group's ability to continue as a going concern and have no reason to believe the Group and its subsidiaries will not be a going concern for at least the next twelve months from the date of this statement.

Approval of the financial statements
The financial statements, as indicated above, were approved by the Board of Directors on 28th March 2017 and were signed on its behalf by:

Director	**Director**	**Director**
Vasant K Shetty	Hetul D. Chandaria	Samson Ndegwa

CHAIRMAN'S REPORT

I am privileged to present the Annual Report and the Financial Statements of Guardian Bank for the financial year ending 31 December 2016.

The Banking Industry faced many challenges during the financial year 2016. The Parliament passed Banking Amendment Act 2015 (capping of interest rate on advances and deposit) and the same was assented by His Excellency President Uhuru Kenyatta. The said Act became effective from 14th September 2016. With the implementation of the Act, the spread between yield on advances and cost of deposit reduced considerably which had negative impact on the profitability of commercial Banks. Besides, failure of rain and other challenging business environment, there was a surge in the non-performing assets of the banks which resulted into substantial increase in the provisioning. Coupled with the same, the interest capping on advances slowed down the credit expansion, particularly to sectors that are traditionally vulnerable to political and economic vagaries. On the other hand, tight liquidity had pushed the cost of deposit of the banks that had in turn increased the cost of operation. The net effect of these factors, banks were looking for areas for cost-cutting that included reducing their man power and closure of Branches that are uneconomical to operate.

Central Bank of Kenya has put in place stricter measures by seeking management Information Reports at regular intervals to ensure that Corporate Governance principles are adhered to by the banks so that the health of the Banks remain robust and any slip up in the health of the Banks is identified without delay. This made the banks to be more focused on quality of doing business while engaged in increasing the volume of business.

Guardian Bank had performed reasonably well in the background of what has been stated above. The Bank had not resorted to any of the harsh measures that some of the banks were implementing, especially closing down branches and retrenchment of staff. The Bank further implemented, in true spirit of the Act, the 'Interest Capping Act' with effect from 14th September 2016 and the benefit of interest capping, both for the lending and deposits, was passed on to even to the existing customers of the bank despite its adverse effect on the Bank's profitability.

The total assets of the bank reached a level of Kshs. 14.705 billion as at 31 December 2016, an increase by Kshs. 96 mn over the previous year. The total deposit of the bank stood at Kshs. 12.313 billion whereas the gross advances of the bank reached Kshs. 9.636 billion; while the deposits increased marginally, the advances dropped from the level of the previous year. The Bank adopted a rigorous vetting process of Credit applications to safeguard against the prevailing economic conditions and also to avoid accounts slipping into the default category; it is a matter of record that the rate growth of Non-performing assets in the industry was high. But our Bank has been maintaining a very healthy credit portfolio. The net non-performing assets of the bank as at the date of balance sheet stood at Kshs. 151.685 mn which was 1.57% of the gross advances. This ratio is much lower than the industry level position.

The gross profit of the Bank as at 31 December 2016 stood at Kshs. 452.191 mn. The Bank has been strictly adhering to the prudential guidelines in classifying the advances and making provision in respect of non-performing assets. The net profit of the bank as at 31 December 2016, after making provision for taxation and non-performing assets stood at Kshs. 230.127 mn. as against Kshs. 229.330 mn. during the previous year. The shareholders of the bank have been ploughing back the net profit of the bank since the inception of the bank and the total retained earnings of the bank stood at Kshs. 1.699 billion; and the core capital was Kshs. 2.149 billion as at 31 December 2016, as against the statutory requirements of Kshs. 1.000 billion.

The Bank has been maintaining a very comfortable liquidity ratio and the same stood at 40.66% as against the statutory requirements of 20.0%. The total capital to total risk weighted assets {capital adequacy ratio} stood at 19.62% as against the statutory requirements of 14.50%

The Board of Directors of the bank consists of two Executive Directors, two Non-Executive Directors and four Independent Non-Executive Directors. The Board has established various board level and management level committees to guide the management and these committees meet regularly. All the Board level committees are chaired by Non-Executive Directors as per the prudential guidelines. Management has, with the approval of the Board put in place various policy documents and working guidelines for the operational staff to follow and comply .

The day to day affairs of the bank are managed by qualified, experienced and dynamic professional management. The Bank has also installed various software to monitor the daily transactions, more particularly large transactions and ensure strict compliance of 'Know Your Customer' guidelines and provisions of "Anti Money Laundering Act".

The customer service extended at the branches is of very high standard. "Customer Service Committee' is established at every branch and the committee meets on monthly basis to review the level of customer service. Meetings of such committee are attended by customers, randomly selected, who give valuable suggestions which are given consideration for implementation.

I would like to thank all my colleagues in the Board for the excellent co-operation and invaluable guidance / advice to the management from time to time for improving the performance of the bank.
I also thank the team of KPMG Kenya, the Bank's statutory Auditors, for carrying timely audit of the books of the bank and their continued support and guidance.

My sincere appreciation goes to the Governor, the officials of Central Bank of Kenya and the Ministry of Finance for their co-operation and valuable guidance from time to time.
The dedicated team of the Bank is the back-bone for the progress of the Bank. I thank each and every member of "Guardian Family' for their dedication, loyalty and hard work and request each one of them to continue to give their best in the development of the Bank's business.

Thanking you

Dr. Maganlal M Chandaria.
Chairman

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF GUARDIAN BANK LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

OPINION

We have audited the Group financial statements of Guardian Bank Limited ("the Group") set out on pages 15 to 80 which comprise the Group and Company statement of financial position as at 31 December 2016, Group statement of profit and loss and other comprehensive income, Group and Company statement of changes in equity and Group statement of cash flows, for the year then ended, and a summary of significant accounting policies and other explanatory information.

In our opinion, the financial statements give a true and fair view of the Group and Company financial position at 31 December 2016, and the Group's and Company's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act, 2015.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the "Auditors' Responsibilities for the Audit of the Financial Statements" section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and in accordance with other ethical requirements applicable to performing audits in Kenya. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

OTHER INFORMATION

The Directors are responsible for the other information. The other information comprises the information included in the Annual Report and Financial Statements but does not include the financial statements and our auditors' report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, then we are required to report that fact. We have nothing to report in this regard.

Responsibilities of directors for the financial statements

As stated on page 9, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (IFRSs) and in the manner required by the Kenyan Companies Act, 2015 and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The directors are responsible for overseeing the Group's financial reporting process.

Auditors' responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Conclude on the appropriateness of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

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

Report on other legal and regulatory requirements

As required by the Kenyan Companies Act, 2015 we report to you, based on our audit, that:

(i) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of our audit;

(ii) In our opinion, proper books of account have been kept by the Company, so far as appears from our examination of those books; and

(iii) The statement of financial position of the Company is in agreement with the books of account.

The Engagement Partner responsible for the audit resulting in this independent auditors' report is CPA Alexander Mbai - P/2172.

Date: 28th March 2017

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

	Notes	2016 KShs '000'	2015 KShs '000'
Interest income	5	1,975,942	1,996,277
Interest expense	5	(1,005,612)	(1,049,382)
Net interest income		**970,330**	**946,895**
Net fees and commissions income	6	**83,924**	**71,614**
Net trading income	7	41,840	49,811
Other revenue	8	22,521	48,947
		64,361	**98,758**
Revenue		**1,118,615**	**1,117,267**
Net impairment losses on financial assets	16(d)	(150,287)	(101,598)
Personnel expenses	9(a)	(351,489)	(331,281)
Prepaid operating lease rentals amortisation	20	(7,999)	(4,378)
Depreciation and amortisation		(46,787)	(40,278)
Other operating expenses	9(b)	(260,149)	(310,769)
Profit before income tax	10	**301,904**	**328,963**
Income tax expense	11	(71,777)	(99,633)
Profit for the year		**230,127**	**229,330**
Other comprehensive income			
Other comprehensive income for the year, net of income tax		-	-
Total comprehensive income for the year		**230,127**	**229,330**
Basic earnings per share	12	**KShs 10.22**	**KShs 10.18**

The notes set out on pages 21 to 80 are an integral part of these consolidadted financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

	Note	2016 KShs '000	2015 KShs '000
Assets			
Cash and balances with Central Bank of Kenya	13	1,532,007	1,320,403
Placements with other banks	14	548,346	721,061
Investments in Government securities	15	2,938,898	2,655,249
Loans and advances to customers (net)	16(a)	8,974,527	9,242,735
Other assets	17	227,831	171,152
Property and equipment	19	135,674	169,722
Prepaid operating lease rentals	20	250,074	258,073
Intangible assets	21	4,943	4,525
Tax recoverable	11(b)	7,353	19,213
Deferred tax assets	22	85,697	47,359
Total assets		**14,705,350**	**14,609,492**
Liabilities			
Customers deposits	23	12,312,710	12,494,301
Other liabilities	24	126,088	102,493
Provisions	25	51,959	28,232
Total liabilities		**12,490,757**	**12,625,026**
Equity (Page 18)			
Share capital	26(a)	450,375	450,375
Statutory credit risk reserve	26(b)	65,112	-
Retained earnings		1,699,106	1,534,091
Total equity		**2,214,593**	**1,984,466**
Total liabilities and equity		**14,705,350**	**14,609,492**

The financial statements on pages 21 to 80 were approved by the Board of Director on **28th March 2017** and were signed on its behalf by:

Director
Vasant K Shetty

Director
Hetul D. Chandaria

Director
Samson Ndegwa

Board secretary
Jophece Yogo

The notes set out on pages 21 to 80 are an integral part of these consolidated financial statements.

COMPANY STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

	Note	2016 KShs '000	2015 KShs '000
			Assets
Cash and balances with Central Bank of Kenya	13	1,532,007	1,320,403
Placements with other banks	14	548,346	721,061
Investments in Government securities	15	2,938,898	2,655,249
Loans and advances to customers (net)	16(b)	8,963,164	9,223,218
Other assets	17	227,831	171,152
Investment in subsidiaries	18(a)	300,375	300,375
Property and equipment	19	135,674	169,722
Prepaid operating lease rentals	20	250,074	258,073
Intangible assets	21	4,943	4,525
Tax recoverable	11(b)	7,353	19,213
Deferred tax asset	22	85,697	47,359
		14,994,362	**14,890,350**
Liabilities			
Customers deposits	23	12,312,710	12,494,301
Due to subsidiary companies	18(b)	366,213	366,313
Other liabilities	24	126,088	102,493
Provisions	25	51,959	28,232
		12,856,970	**12,991,339**
Equity (Page 19)			
Share capital	26(a)	450,375	450,375
Statutory credit risk reserve	26(b)	65,112	-
Revenue reserves		1,621,905	1,448,636
		2,137,392	**1,899,011**
Total liabilities and equity		**14,994,362**	**14,890,350**

The financial statements on pages 21 to 80 were approved by the Board of Directors on 28th March 2017 and were signed on its behalf by:

Director
Vasant K Shetty

Director
Hetul D. Chandaria

Director
Samson Ndegwa

Board secretary
Jophece Yogo

The notes set out on pages 21 to 80 are an integral part of these consolidated financial statements.

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

	Share capital KShs'000	Retained earnings KShs'000	Statutory credit risk reserve KShs'000	Total equity KShs'000
2016				
At 1 January 2016	450,375	1,534,091	-	1,984,466
Profit for the year	-	230,127	-	230,127
Other comprehensive income				
Transfer to statutory credit risk reserve	-	(65,112)	65,112	-
At 31 December 2016	**450,375**	**1,699,106**	**65,112**	**2,214,593**
2015				
At 1 January 2015	450,375	1,278,647	26,114	1,755,136
Profit for the year	-	229,330	-	229,330
Other comprehensive income				
Transfer from statutory credit risk reserve	-	26,114	(26,114)	-
At 31 December 2015	**450,375**	**1,534,091**	**-**	**1,984,466**

The notes set out on pages 21 to 80 are an integral part of these consolidadted financial statements.

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

	Share capital KShs'000	Retained earnings KShs'000	Statutory Credit risk reserve KShs'000	Total equity KShs'000
2016				
At 1 January 2016	450,375	1,448,636	-	1,899,011
Profit for the year	-	238,381	-	238,381
Other comprehensive income				
Transfer to statutory credit risk reserve	-	(65,112)	65,112	-
At 31 December 2016	**450,375**	**1,621,905**	**65,112**	**2,137,392**
2015				
At 1 January 2015	450,375	1,216,393	26,114	1,692,882
Profit for the year	-	206,129	-	206,129
Other comprehensive income				
Transfer from statutory credit risk reserve	-	26,114	(26,114)	-
At 31 December 2015	**450,375**	**1,448,636**	**-**	**1,899,011**

The notes set out on pages 21 to 80 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 KShs'000	2015 KShs'000
Net cash flow from operating activities	**28(a)**	**(485,219)**	**625,141**
Investing activities			
Purchase of intangible assets	21	(3,020)	(3,692)
Purchase of operating lease on land	20	-	(239,201)
Purchase of property and equipment	19	(10,187)	(78,589)
Proceeds from sale of property and equipment		675	5,215
Net cash flows from investing activities		**(12,532)**	**(316,267)**
Net increase in cash and cash equivalents	28(b)	(497,751)	308,874
Cash and cash equivalents at 1 January		2,784,109	2,475,235
Cash and cash equivalents at 31 December	**28(b)**	**2,286,358**	**2,784,109**

The notes set out on pages 21 to 80 are an integral part of these consolidated financial statements.

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

1. REPORTING ENTITY

Guardian Bank Limited ("the Bank" or "the company") is a company domiciled in Kenya. The consolidated financial statements of the Bank as at end of the year 31 December 2016 comprise the Bank and its subsidiaries (together referred to as the "Group" or "consolidated"). The Group is involved in investment, corporate and retail banking. The address of the Group's registered office is as follows:

Guardian Centre
Biashara Street
PO Box 67437 - 00100 GPO
Nairobi

2. BASIS OF PREPARATION

(a) Statement of compliance

The consolidated financial statements of the company and its subsidiaries together referred to as "the financial statements", have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and the Kenyan Companies Act, 2015.

For the Kenyan Companies Act, 2015 reporting purposes in these financial statements, the balance sheet is represented by the statement of financial position and the profit and loss account is represented by the statement of profit or loss and other comprehensive income.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis of accounting.

(c) Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates and assumptions are based on the Directors' best knowledge of current events, actions, historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In particular, information about significant areas of estimation and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is set out below:

(i) Impairment of loans and receivables

The Group'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. Impairment losses determined on a portfolio basis are assessed based on the profitability of default inherent within the portfolio of impaired loans or receivables

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.

(ii) Fair value of financial instruments

Where the fair values of the financial assets and finance 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.

(iii) 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 Group 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 Group 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 Group 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 Group to realise the net deferred tax assets recorded at the reporting date could be impacted.

(iv) Useful lives and residual values of property and equipment

The company tests annually whether the useful life and residual value estimates were appropriate and in accordance with its accounting policy. Useful lives and residual values of property and equipment have been determined based on previous experience and anticipated disposal values when the assets are disposed. The rates used are set out on Note 3(d).

(d) Functional and presentation currency

The financial statements are presented in Kenya Shillings which is also the Group's functional and presentation currency, the currency of the primary economic environment in which the entity operates. Except when otherwise indicated, financial information presented in Kenya Shillings (KShs) has been rounded to the nearest thousand.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

The consolidated financial statements include the Company and subsidiaries in which the company holds 100% of the voting rights. A listing of the company's subsidiaries is set out in Note 18. Subsidiaries are investees controlled by the Group. The Group controls an investee when it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

All inter-company balances and transactions are eliminated upon consolidation. Investments in subsidiaries are accounted for at cost at company level. The carrying amounts of these investments are reviewed annually and written down for impairment where considered necessary.

(b) Revenue recognition

Income is derived substantially from banking business and related activities. Revenue comprises of net interest income and non-interest income. The group 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 group's activities as described below. The amount of revenue is not considered to be reliably measured until all contingencies relating to the sale have been resolved. The group bases its estimates on historical results, taking into consideration the type of customer, type of transaction and specifics of each arrangement

(i) Interest income and interest expense

For all financial instruments measured at amortized cost, interest income or expense is recognized at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recognized as interest income or expense. The calculation of effective interest rate includes transaction costs and fees that are an integral part of the effective interest rate.

(ii) Fees and commission income

Fees and commissions are generally recognized on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognized as an adjustment to the effective interest rate on the loan. Commission and fees arising from negotiating, or participating in the negotiation of a transaction for a third party is recognized on completion of the underlying transaction. Other fees and commission income including account servicing fees and placement fees are recognized as the related services are performed. Other fees and commission expense relate mainly to transaction and services fee, which are expensed as the services are received.

(c) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies as at the reporting date are translated into Kenya Shillings at the exchange rate ruling at that date. The foreign currency gain or loss on monetary items is the difference between the amortised cost in the functional currency at the beginning of the year adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the year. Resulting exchange differences are recognised in profit or loss for the year. Non monetary assets and liabilities denominated in foreign currency are recorded at the exchange rate ruling at the transaction date.

(d) Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at historical cost less accumulated depreciation and impairment losses.

Cost includes expenditure that are directly attributable to the acquisition of the asset.

(ii) Subsequent cost

The cost of replacing a component of an item of property or equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property, plant and equipment are recognised in the profit or loss.

(iii) Depreciation

Depreciation is charged to the profit or loss on a straight line basis over the estimated useful lives of each item of property, plant and equipment. The estimated useful lives are as follows:

• Leasehold improvements	5 years
• Equipment, fixtures and fittings, motor vehicles	3 to 8 years
• Buildings	40 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

(iv) Disposal of property and equipment

Gain and losses on disposal of an item of property and equipment are determined by comparing the proceeds from the disposal with the carrying amount of the property and equipment and are recognised net in profit or loss.

(e) Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is recognised in profit or loss in the year in which the expenditure is incurred.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Software is amortised on a straight line basis in profit or loss over its estimated useful life, from the date that is available for use. The estimated useful life of software is 3 years.

The amortisation method, useful life and the residual value are reviewed at each financial year-end and adjusted if appropriate. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in profit or loss in the expense category consistent with the function of the intangible asset.

(f) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Payments made under operating leases are charged to the profit and 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. The Company holds prepaid operating leases over two pieces of land which are being amortised on a straight line basis over 33 years and 40 years.

(g) Taxation

Tax on the profit or loss for the year comprises current tax and deferred tax. Current tax is provided on the results in the year as shown in the financial statements adjusted in accordance with tax legislation.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities 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.

A deferred tax asset on tax losses 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 tax asset is reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax is calculated on the basis of the tax rates currently enacted.

(h) Financial instruments

(i) Classification

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability of another entity. Financial instruments are classified as follows:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods and services directly to a debtor, with no intention of trading the receivable. Loans and receivables comprise loans and advances, placements with other banks and cash and bank balances.

Held-to-maturity

Held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the bank has the positive intent and ability to hold to maturity. Were the Group to sell, other than insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale. These include treasury bills and bonds and other investments.

Other Financial liabilities

The Group classifies financial liabilities as other financial liabilities at amortised cost. Other financial liabilities include customer deposits, borrowings and deposits from banking and non-banking financial institutions.

(ii) Recognition and measurement

The Group initially recognises loans and advances, deposits and debt securities issues on the date at which they are originated. All other financial assets and liabilities (including assets designated at fair value through the income statement) are initially recognized on the trade date, which is the date the Group becomes party to the contractual provisions of the instrument.

A financial asset of financial liability is initially measured at fair value plus, for items not at fair value through profit or loss, translation costs are directly attributable to the acquisition or issue.

Subsequent to initial recognition, financial liabilities (deposits and debt securities) are measured at their amortised cost using the effective rate method except where the Group design liabilities at fair value through profit or loss.

(iii) De-recognition

A financial asset is derecognised when the Group loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when its contractual obligations are discharged or cancelled or expire.

On de-recognition of a financial asset, the difference between the carrying amount of the asset and the consideration received is recognised in profit or loss.

Held-to-maturity instruments and originated loans and receivables are derecognised on the day they are repaid in full or when they are transferred by the Bank to a third party.

(iv) Identification and measurement of impairment of financial assets

At each reporting date the Group 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 that can be estimated reliably.

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

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

In assessing collective impairment the Group 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.

(v) Offsetting of financial assets and financial liabilities

Financial assets and financial 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.

(vi) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

(i) Impairment of non-financial assets

The carrying amounts of the Group'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 asset's recoverable amount is estimated.

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

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.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(j) Contingent liabilities

Letters of credit, guarantees, bills for collection and swaps 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 are 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 the profit or loss.

(k) Cash and cash equivalents

For the purpose of presentation of the cash flows in the financial statements the cash and cash equivalents include cash and balances with Central Bank of Kenya (CBK) available to finance the bank's day-to-day operations, net balances from banking institutions and treasury bills and bonds which mature within three months or less from the date of acquisition. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(l) Employee benefits

(i) Short term employee benefits

Short term employee benefits are expensed as the related services are provided. A liability is recognised for the amount expected to be paid if the company has a present or constructive obligation to pay this amount as a result of past services provided by the employee and the obligation can be estimated reliably.

(ii) Post-employment benefits

The Bank operates gratuity scheme. The gratuity policy provides that an employee who works for more than 5 years, is eligible for the gratuity amount based on the lower of six months monthly salary or an equivalent of 15 days salary for every year worked; however, this is at management's discretion. A provision is made in the Bank's financial statements for the accrued liability in respect of the benefits promised under the arrangement and movements in the provision are recognised in profit or loss.

The Bank's net obligation in respect of the scheme is calculated separately as the present value of the benefits in respect of service completed to the valuation date but based on projected earnings to the date of retirement or earlier exit for each employee. The total accrued (past service) liability (or the required balance sheet provision as at the valuation date) is obtained by summing the individual benefits over all employees. There is no separate pool of assets is set aside to meet the accrued liabilities under the arrangement.

The required contribution rate for future years expressed as a percentage of basic salaries is determined as the cost of accrual of benefit in the year after the valuation date, but based on projected earnings to date of retirement. The retirement age, sex and salary distribution is expected to remain relatively stable provided that the age, sex and salary distribution of the employees remains broadly unchanged. If in the absence of new entrants, the average age of the employees were to rise, then other things being equal, the required contribution rate would be expected to rise.

The calculation of defined benefit obligation in the current year has been performed by a qualified actuary using the projected unit credit method.

(m) Dividends

Dividends on ordinary shares are recognised as a liability in the period in which they are declared and proposed dividends are disclosed as a separate component of equity.

(n) Provisions

Provisions are recognised when the company has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

(o) Earnings per share

Basic and diluted earnings per share (EPS) data for ordinary shares are presented in the financial statements. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, if any.

(p) Determination of fair values

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 prices 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.

(q) New standards and interpretations effective and adopted during the year

The Group has adopted the following new standards and amendments during the year ended 31 December 2016, including any consequential amendments to other standards, with a date of initial application of 1 January 2016. The nature and effects of the changes are explained below:

- *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 amendments did not have significant impact on the Group's financial statements, as the Group did not acquire any interests in joint ventures during the year.

- *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 did not affect the amounts and disclosures of the Group's property, plant and equipment and intangible assets.

- *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 did not have a significant impact on the Group's financial statements as the Group does not have bearer plants.

- *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 adoption of these changes did not affect the amounts and disclosures of the Group'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 did not have an impact the financial statements of the Group given that it is not a first time adopter of IFRS.

- *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. The adoption of these changes will not affect the amounts and disclosures of the Group's financial statements as all subsidiaries are consolidated.

- *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 adoption of these changes did not have a significant impact on the financial statements of the Company.

- *Annual improvements cycle (2012-2014) – various standards*

Standard	Amendments
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations	Changes in methods of disposal Adds specific guidance in IFRS 5 for cases in which an entity reclassifies an asset from held for sale to held for distribution or vice versa and cases in which held-for-distribution accounting is discontinued.
IFRS 7 Financial Instruments: Disclosures (with consequential amendments to IFRS 1)	Servicing contracts Adds additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset for the purpose of determining the disclosures required. Applicability of the amendments to IFRS 7 to condensed interim financial statements Clarifies the applicability of the amendments to IFRS 7 on offsetting disclosures to condensed interim financial statements.
IAS 19 Employee Benefits	Discount rate: regional market issue Clarifies that the high quality corporate bonds used in estimating the discount rate for post-employment benefits should be denominated in the same currency as the benefits to be paid (thus, the depth of the market for high quality corporate bonds should be assessed at currency level).
IAS 34 Interim Financial Reporting	Disclosure of information 'elsewhere in the interim financial report' Clarifies the meaning of 'elsewhere in the interim report' and requires a cross-reference

The adoption of these changes did not affect the amounts and disclosures of the Group's financial statements.

(r) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2016

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2016, and have not been applied in preparing these financial statements. These are summarised below and the extent of the impact has not been determined. The Group does not plan to early adopt these standards.

- *Disclosure Initiative (Amendments to IAS 7)*

The amendments in Disclosure Initiative (Amendments to IAS 7) come with the objective that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

The International Accounting Standards Board (IASB) requires that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

The IASB defines liabilities arising from financing activities as liabilities “for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities”. It also stresses that the new disclosure requirements also relate to changes in financial assets if they meet the same definition.

The amendments state that one way to fulfil the new disclosure requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities.
Finally, the amendments state that changes in liabilities arising from financing activities must be disclosed separately from changes in other assets and liabilities.

The amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted. Since the amendments are being issued less than one year before the effective date, entities need not provide comparative information when they first apply the amendments.

The Group is assessing the potential impact on its financial statements resulting from the application of IAS 7.

- *Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)*

  The amendments in Recognition of Deferred Tax Assets for Unrealised Losses clarify the following aspects:

  - Unrealised losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use.
  - The carrying amount of an asset does not limit the estimation of probable future taxable profits.
  - Estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences.
  - Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12) - continued
  - An entity assesses a deferred tax asset in combination with other deferred tax assets. Where tax law restricts the utilisation of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

    The amendments are effective for annual periods beginning on or after 1 January 2017 with early application permitted. As transition relief, an entity may recognise the change in the opening equity of the earliest comparative period in opening retained earnings on initial application without allocating the change between opening retained earnings and other components of equity. The Board has not added additional transition relief for first-time adopters.

  The Group is assessing the potential impact on its financial statements resulting from the application of IAS 12.

- *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 permitted. The application of IFRS 15 is not expected to have a significant impact on the Group's financial statements.

- *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 amortized 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.

- *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)*

The amendments in Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts' (Amendments to IFRS 4) provide two options for entities that issue insurance contracts within the scope of IFRS 4:

- an option that permits entities to reclassify, from profit or loss to other comprehensive income, some of the income or expenses arising from designated financial assets; this is the so-called overlay approach;
- an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4; this is the so-called deferral approach.

The application of both approaches is optional and an entity is permitted to stop applying them before the new insurance contracts standard is applied.

An entity applies the overlay approach retrospectively to qualifying financial assets when it first applies IFRS 9. Application of the overlay approach requires disclosure of sufficient information to enable users of financial statements to understand how the amount reclassified in the reporting period is calculated and the effect of that reclassification on the financial statements.

An entity applies the deferral approach for annual periods beginning on or after 1 January 2018. Predominance is assessed at the reporting entity level at the annual reporting date that immediately precedes 1 April 2016. Application of the deferral approach needs to be disclosed together with information that enables users of financial statements to understand how the insurer qualified for the temporary exemption and to compare insurers applying the temporary exemption with entities applying IFRS 9. The deferral can only be made use of for the three years following 1 January 2018. Predominance is only reassessed if there is a change in the entity's activities.

The adoption of these changes will not affect the amounts and disclosures of the Group's financial statements as the Group does not issue out any contracts that fall within the premise of IFRS 4 as insurance contracts.

- *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 company 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

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 application of IFRS 16 is not expected to have a significant impact on the Group's financial statements.

- *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 effective date for these changes has now been postponed until the completion of a broader review.

  The amendment is not expected to have a significant impact on the Group's financial statements, as the Group does not have associates and joint ventures

4. FINANCIAL RISK MANAGEMENT

Introduction and overview

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

- credit risk
- liquidity risk
- market risks; and
- operational risks

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has established the Group Asset and Liability (ALCO), Credit and Operational Risk committees, which are responsible for developing and monitoring Group risk management policies in their specified areas.

All Board committees have both executive and non-executive members and report regularly to the Board of Directors on their activities.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, 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 Group, 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.

The Group Risk Management Committee is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(a) Credit risk

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

For risk management purposes, credit risk arising on trading securities is managed independently, but reported as a component of market risk exposure.

Management of credit risk

The Board of Directors has delegated responsibility for the management of credit risk to its Group Credit Committee. A separate Group Credit department, reporting to the Group Credit Committee, is responsible for oversight of the Group's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.

- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to business unit Credit Officers. Larger facilities require approval by Group Credit Department, Head of Group Credit, Group Credit Committee or the Board of Directors as appropriate.

- Reviewing and assessing credit risk. Group Credit Department assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.

- Limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).

- Developing and maintaining the Group's risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of eight grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate. Risk grades are subject to regular reviews by Group Risk Management Department.

- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to Group Credit Department on the credit quality of local portfolios and appropriate corrective action is taken.

- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of credit risk.

Each business unit is required to implement Group credit policies and procedures, with credit approval authorities delegated from the Group Credit Committee. Each business unit has a Chief Credit Risk officer who reports on all credit related matters to local management and the Group Credit Committee. Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, including those subject to central approval.

Regular audits of business units and Group Credit processes are undertaken by Internal Audit.

Exposure to credit risk Loans and advances to customers Note		2016 Group KShs'000	 Company KShs'000	2015 Group KShs'000	 Company KShs'000
Carrying amount	16(a) & (b)	**8,974,527**	**8,963,164**	**9,242,735**	**9,223,218**
Individually impaired:					
Grade 4: Doubtful		786,925	641,898	1,014,882	805,417
Grade 3: Substandard		-	-	14,255	14,255
		786,925	641,898	1,029,137	819,672
Allowances for Impairment	16(c) & (d)	(635,240)	(501,576)	(748,105)	(558,157)
Carrying amounts		**151,685**	**140,322**	**281,032**	**261,515**
Collectively impaired:					
Grade 1: Normal		8,732,140	8,732,140	8,969,588	8,969,588
Grade 2: Watch		117,036	117,036	20,398	20,398
		8,849,176	8,849,176	8,989,986	8,989,986
Allowances for Impairment	16(c)	(26,334)	(26,334)	(28,283)	(28,283)
Carrying amounts		**8,822,842**	**8,822,842**	**8,961,703**	**8,961,703**
Past due and not impaired:					
Grade 1: Normal		518,499	518,499	47,440	47,440
Grade 2: Watch		117,036	117,036	20,398	20,398
		635,535	635,535	67,838	67,838
Past due comprises:					
01-30 Days		518,499	518,499	47,440	47,440
31-60 Days		117,036	117,036	20,398	20,398
		635,535	**635,535**	**67,838**	**67,838**
Neither past due nor impaired:					
Grade 1: Normal		8,213,641	8,213,641	8,922,148	8,922,148
Grade 2: Watch		-	-	-	-
		8,213,641	**8,213,641**	**8,922,148**	**8,922,148**

Impaired loans and securities

Impaired loans and securities are loans and securities for which the Group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan / securities agreement(s). These loans are graded 3 to 5 in the Group's internal credit risk grading system.

Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Group.

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring.

Allowances for impairment

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-off policy

The Group writes off a loan / security balance (and any related allowances for impairment losses) when Group Credit determines that the loans / securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardised loans, charge off decisions generally are based on a product specific past due status.

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of individually impaired assets by risk grade.

Loans and advances - Group	Gross KShs'000	Net KShs'000
31 December 2016		
Grade 3: Individually impaired	-	-
Grade 4: Individually impaired	786,925	151,685
	786,925	**151,685**
31 December 2015		
Grade 3: Individually impaired	14,255	8,715
Grade 4: Individually impaired	1,014,882	272,317
	1,029,137	**281,032**

The Group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2016 or 2015.

An estimate of the fair values of collateral against loans and advances to customers is shown below:

	2016 KShs'000	2015 KShs'000
Against impaired accounts	292,232	533,555
Against accounts not impaired	9,819,985	10,087,015
	10,112,217	**10,620,570**

The Group monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown below:

Concentration by sector	2016 KShs'000	2015 KShs'000
Agriculture, hunting, fishing and forestry	42,590	161,746
Manufacturing	1,148,135	860,235
Trade	4,368,530	4,413,220
Transport	399,989	553,531
Real estate	1,581,088	2,036,205
Personal loans	1,083,069	940,667
Others	1,012,700	1,053,519
	9,636,101	**10,019,123**

The other financial assets are neither past due nor impaired.

Cash and balances with Central Bank of Kenya	1,532,007	1,320,403
Placements with other banks	548,346	721,061
Investments in government securities	2,938,898	2,655,249
Other assets – items in transit	172,709	102,032
	5,191,960	**4,798,745**

Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transactions the Group mitigates this risk by conducting settlements through a settlement / clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from Group Risk.

(a) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations from its financial liabilities.

Management of liquidity risk

The Group'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 Group's reputation.

The Group's central treasury receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Central Treasury then 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 within the Group as a whole. The liquidity requirements of business units and subsidiaries are met through short-term loans from Central Treasury to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements.

When an operating subsidiary or branch is subject to a liquidity limit imposed by its local regulator, the subsidiary or branch is responsible for managing its overall liquidity within the regulatory limit in co-ordination with Central Treasury. Central Treasury monitors compliance of all operating subsidiaries and foreign branches with local regulatory limits on a daily basis.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of both the Group and operating subsidiaries and foreign branches. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

Exposure to liquidity risk

The key measure used by the Group for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. Details of the reported Group ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2016	**2015**
Average for the period	37.22%	35.77%
Maximum for the period	40.66%	38.42%
Minimum for the period	32.08%	31.51%

Residual contractual maturities of assets and liabilities
b) Liquidity risk

Customer deposits represent current, savings, call and fixed deposit balances, which past experience have shown to be stable.

	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Total KShs'000
31 December 2016					
Assets					
Cash and balances with Central Bank of Kenya	1,532,007	-	-	-	1,532,007
Investment in Government Securities	848,430	960,167	404,689	725,612	2,938,898
Placements with other banks	548,346	-	-	-	548,346
Loans and advances to customers (net)	1,698,232	3,369,144	2,732,164	1,174,987	8,974,527
Other assets	172,709	-	-	-	172,709
Total financial assets	**4,799,724**	**4,329,311**	**3,136,853**	**1,900,599**	**14,166,487**
Liabilities					
Customers' deposits	11,874,557	488,713	-	-	12,363,270
Other liabilities	-	126,088	-	-	126,088
Total financial liabilities	**11,874,557**	**614,801**	**-**	**-**	**12,489,358**
	(7,074,833)	**3,714,510**	**3,136,853**	**1,900,599**	**1,677,129**

(b) Liquidity risk (continued)

	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Total KShs'000
31 December 2015					
Assets					
Cash and balances with Central Bank of Kenya	1,320,403	-	-	-	1,320,403
Investment in Government Securities	1,393,040	342,314	435,322	484,573	2,655,249
Placements with other banks	721,061	-	-	-	721,061
Loans and advances to customers (net)	5,177,955	695,070	2,466,541	903,169	9,242,735
Other assets	102,032	-	-	-	102,032
Total financial assets	**8,714,491**	**1,037,384**	**2,901,863**	**1,387,742**	**14,041,480**
Liabilities					
Customers' deposits	12,002,658	602,881	-	-	12,605,539
Other liabilities	-	102,493	-	-	102,493
Total financial liabilities	**12,002,658**	**705,374**	**-**	**-**	**12,708,032**
	(3,288,167)	**332,010**	**2,901,863**	**1,387,742**	**1,333,448**

The previous table shows the undiscounted cash flows on the Group's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The Group's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognised loan commitments are not all expected to be drawn down immediately.

The gross nominal inflow/(outflow) disclosed in the previous table is the contractual, undiscounted cash flow on the financial liability or commitment. The disclosure for derivatives shows a net amount for derivatives that are net settled, but a gross inflow and outflow amount for derivatives that have simultaneous gross settlement (e.g., forward exchange contracts and currency swaps).

(b) Market risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

The Group separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios mainly are held by the corporate banking unit, and include positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

With the exception of translation risk arising on the Group's net investment in its foreign operations, all foreign exchange risk within the Group is transferred and sold down by Central Treasury to the corporate Banking unit. Accordingly, the foreign exchange position is treated as part of the Group's trading portfolios for risk management purposes.

Overall authority for market risk is vested in ALCO. Group Risk is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation.

Exposure to interest rate risk – non-trading portfolios

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by Risk Management in its day-to-day monitoring activities.

Interest rate risk

This table shows the extent to which the group's interest rate exposures on assets and liabilities are matched. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and maturity date.

	Effective interest rate	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Non-interest bearing KShs'000	Total KShs'000
31 December 2016							
Assets							
Cash and balances with Central Bank of Kenya	-	-	-	-	-	1,532,007	1,532,007
Investment in Government Securities	11.01%	848,430	960,167	404,689	725,612	-	2,938,898
Placements with other banks	5.30%	548,346	-	-	-	-	548,346
Loans and advances to customers (net)	14.86%	1,698,232	3,369,144	2,732,164	1,174,987	-	8,974,527
Other assets		-	-	-	-	172,709	172,709
Total financial assets		**3,095,008**	**4,329,311**	**3,136,853**	**1,900,599**	**1,704,716**	**14,166,487**
Liabilities							
Customers' deposits	7.61%	11,874,557	488,713	-	-	-	12,363,270
Other liabilities		-	-	-	-	126,088	126,088
Total financial liabilities		**11,874,557**	**488,713**	**-**	**-**	**126,088**	**12,489,358**
		(8,779,549)	**3,840,598**	**3,136,853**	**1,900,599**	**1,578,628**	**1,677,129**

	Effective interest rate	Due within 3 months KShs'000	Due between 3 and 12 months KShs'000	Due between 1 and 5 years KShs'000	Due after 5 years KShs'000	Non-interest bearing KShs'000	Total KShs'000
31 December 2016							
Assets							
Cash and balances with Central Bank of Kenya	-	-	-	-	-	1,320,403	1,320,403
Investment in Government Securities	10.82%	1,393,040	342,314	435,322	484,573	-	2,655,249
Placements with other banks	13.29%	721,061	-	-	-	-	721,061
Loans and advances to customers (net)	15.43%	5,177,955	695,070	2,466,541	903,169	-	9,242,735
Other assets		-	-	-	-	102,032	102,032
Total financial assets		**7,292,056**	**1,037,384**	**2,901,863**	**1,387,742**	**1,422,435**	**14,041,480**
Liabilities							
Customers' deposits	7.95%	12,002,658	602,881	-	-	-	12,605,539
Other liabilities		-	-	-	-	102,493	102,493
Total financial liabilities		**12,002,658**	**602,881**	**-x**	**x**	**102,493**	**12,708,032**
		(4,710,602)	**434,503**	**2,901,863**	**1,387,742**	**1,319,942**	**1,333,448**

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point (bp) parallel fall or rise in all yield curves worldwide and a 50 bp rise or fall in the greater than 12-month portion of all yield curves. Overall non-trading interest rate risk positions are managed by Central Treasury, which uses investment securities, advances to banks, deposits from banks and derivative instruments to manage the overall position arising from the Group's non-trading activities.

Exposure to other market risks – non-trading portfolios

Credit spread risk (not relating to changes in the obligor / issuer's credit standing) on debt securities held by Central Treasury and equity price risk is subject to regular monitoring by Group Risk, but is not currently significant in relation to the overall results and financial position of the Group.

The result of structural foreign exchange positions on the Group's net investments in foreign subsidiaries and branches, together with any related net investment hedges, is recognised in equity. The Group's policy is only to hedge such exposures when not to do so would have a significant impact on the regulatory capital ratios of the Group and its banking subsidiaries. The result of this policy is that hedging generally only becomes necessary when the ratio of structural exposures in a particular currency to risk-weighted assets denominated in that currency diverges significantly from the capital ratio of the entity being considered.

Currency risk

The group is exposed to currency risk through transactions in foreign currencies. The group's transactional exposures give rise to foreign currency gains and losses that are recognised in the statement of comprehensive income. In respect of monetary assets and liabilities in foreign currencies, the group ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate. The table below summarizes the foreign currency exposure as at 31 December 2015 and 31 December 2016:

	2016 **KShs'000**	**2015** **KShs'000**
Assets in foreign currencies	826,274	947,337
Liabilities in foreign currencies	(824,176)	(914,185)
Net foreign currency exposure	**2,098**	**33,152**

The following table demonstrates the sensitivity to a reasonably possible change in the below mentioned exchange rates, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities).

Increase/decrease in exchange rate		**Effect on profit before tax**	
		2016 **KShs'000**	**2015** **KShs'000**
USD	10%	(155)	2,779
GBP	10%	9	184
EURO	10%	(60)	257

The table below analyses the currencies to which the group is exposed at 31 December 2016:

At 31 December 2016 – KShs'000	USD	GBP	EURO	OTHER	TOTAL
Assets					
Cash and balances with Central Bank of Kenya	86,660	2,999	2,174	5	91,838
Deposits and balances due from banking institutions	224,877	43,628	22,984	4,244	295,733
Loans and advances to customers (net)	418,793	-	15,785	-	434,578
Other assets	4,125	-	-	-	4,125
Total foreign currency assets	**734,455**	**46,627**	**40,943**	**4,249**	**826,274**
Liabilities					
Other liabilities	1,782	66	27,847	21	29,716
Deposits and balances due to banking institutions	734,222	46,467	13,699	72	794,460
Total foreign currency liabilities	**736,004**	**46,533**	**41,546**	**93**	**824,176**
Foreign currency exposure at 31 December 2016	**(1,549)**	**94**	**(603)**	**4,156**	**2,098**
Off balance sheet items	**523,015**	**-**	**55,918**	**-**	**578,933**

At 31 December 2015 – KShs'000	USD	GBP	EURO	OTHER	TOTAL
Assets					
Cash and balances with Central Bank of Kenya	85,602	4,089	2,111	169	91,971
Deposits and balances due from banking institutions	239,064	54,406	16,628	852	310,950
Loans and advances to customers (net)	533,227	-	-	-	533,227
Other assets	11,189	-	-	-	11,189
Total foreign currency assets	**869,082**	**58,495**	**18,739**	**1,021**	**947,337**
Liabilities					
Other liabilities	1,521	124	11,178	19	12,842
Deposits and balances due to banking institutions	839,773	56,534	4,988	48	901,343
Total foreign currency liabilities	**841,294**	**56,658**	**16,166**	**67**	**914,185**
Foreign currency exposure at 31 December 2015	**27,788**	**1,837**	**2,573**	**954**	**33,152**
Off balance sheet items	**517,255**	**4,647**	**30,474**	**22,630**	**575,006**

(c) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Group's operations and are faced by all business entities.

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Group standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective.

Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Group.

(d) Capital management

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the Group as a whole. The parent company and individual banking operations are directly supervised by the regulator.

In implementing current capital requirements, the Central Bank of Kenya requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The Group calculates requirements for market risk in its trading portfolios based upon the Group's value at risk (VaR) models and uses its internal grading as the basis for risk weightings for credit risk.

The Group's regulatory capital is analysed into two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings, translation reserve and minority interests after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 percent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of banks and certain other regulatory items.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Group recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the period.

There have been no material changes in the Group's management of capital during the period. The Group's regulatory capital position at 31 December was as follows:

Core capital (Tier 1)	2016 KShs'000	2015 KShs'000
Paid up share capital	450,375	450,375
Retained earnings	1,468,979	1,304,761
Net after tax profits	230,127	229,330
Core capital	2,149,481	1,984,466
Supplementary capital (Tier 2)	65,112	-
Total capital	**2,214,593**	**1,984,466**
On balance sheet risk weighted assets	10,349,126	10,296,661
Off balance sheet risk weighted assets	938,780	959,132
Total risk weighted assets	**11,287,906**	**11,255,793**
Capital adequacy ratios		
Percentage of Core Capital to Risk Weighted Asset ratio	19.04%	17.60%
Minimum requirement	10.50%	10.50%
Percentage of Total Capital to Risk Weighted Asset ratio	19.62%	17.60%
Minimum requirement	14.50%	14.50%
Percentage of Core Capital to Deposits ratio	17.46%	15.90%
Minimum requirement	8.00%	8.00%

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Risk Management Committee and is subject to review by the Credit Committee or Assets and Liability Management Committee as appropriate.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Group to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Group's longer term strategic objectives. The Group's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

Financial assets and liabilities and their fair values

The table below sets out the Group's classification of each class of financial assets and liabilities, and their fair values (excluding accrued interest):

At 31 December 2016	Held to maturity KShs'000	Loans and receivables KShs'000	Other amortised cost KShs'000	Total carrying amount KShs'000	Fair values KShs'000
Assets					
Cash and cash equivalents	-	-	1,532,007	1,532,007	1,532,007
Placements with other banks	-	-	548,346	548,346	548,346
Investments in Government securities	2,938,898	-	-	2,938,898	2,938,898
Loans and advances to customers (net)	-	8,974,527	-	8,974,527	8,974,527
Other assets – items in transit	-	172,709	-	172,709	172,709
Total assets	**2,938,898**	**9,147,236**	**2,080,353**	**14,166,487**	**14,166,487**
Liabilities and shareholders' funds					
Customers' deposits	-	-	12,312,710	12,312,710	12,312,710
Total liabilities	**-**	**-**	**12,312,710**	**12,312,710**	**12,312,710**

At 31 December 2015	Held to maturity KShs'000	Loans and receivables KShs'000	Other amortised cost KShs'000	Total carrying amount KShs'000	Fair values KShs'000
Assets					
Cash and cash equivalents	-	-	1,320,403	1,320,403	1,320,403
Placements with other banks	-	-	721,061	721,061	721,061
Investments in Government securities	2,655,249	-	-	2,655,249	2,655,249
Loans and advances to customers (net)	-	9,242,735	-	9,242,735	9,242,735
Other assets – items in transit	-	102,032	-	102,032	102,032
Total assets	**2,655,249**	**9,344,767**	**2,041,464**	**14,041,480**	**14,041,480**
Liabilities and shareholders' funds					
Customers' deposits	-	-	12,494,301	12,494,301	12,494,301
Total liabilities	**-**	**-**	**12,494,301**	**12,494,301**	**12,494,301**

The financial instruments have been disclosed at either original cost or amortised cost. The market has not developed a standard yield curve that can be used to fair value securities held to maturity (HTM). The total HTM portfolio is therefore reflected at amortised cost. Loans and advances are not actively traded in the market, rendering fair valuation impractical. The carrying amount approximates the fair value of the financial instruments.

5. NET INTEREST INCOME

Interest income	2016 KShs'000	2015 KShs'000
Loans and advances to customers	1,607,476	1,630,122
Interest on government securities	332,255	301,358
Placements with other banks and banking institutions	36,211	64,797
Total interest income	**1,975,942**	**1,996,277**
Interest expense		
Customer deposits	968,985	1,024,918
Deposits from other banks and banking institutions	229	1,325
Other interest expenses	36,398	23,139
Total interest expense	**1,005,612**	**1,049,382**

6. FEES AND COMMISSION INCOME

Fees and commission on loans and advances	65,205	57,032
Other fees and commissions	18,719	14,582
	83,924	**71,614**

7. NET TRADING INCOME

Foreign exchange	29,925	35,736
Other	11,915	14,075
	41,840	**49,811**

8. OTHER REVENUE

Service income	13,516	13,489
Other income	9,005	35,458
	22,521	**48,947**

9. OPERATING EXPENSES

(a) Personnel expenses		
Salaries	342,052	321,105
Other staff costs	9,437	10,176
	351,489	**331,281**
(b) Other operating expenses		
Donations	10,775	10,968
Insurance expenses	37,571	35,999
Legal expenses	5,813	67,177
Occupancy expenses	73,186	71,244
Other operating expenses	132,804	125,381
	260,149	**310,769**

10. PROFIT BEFORE INCOME TAX	2016 KShs'000	2015 KShs'000
Profit before income tax is arrived at after charging/(crediting):		
Depreciation expense (Note 19)	44,185	36,653
Amortisation of prepaid operating lease rentals (Note 20)	7,999	4,378
Amortisation of intangible assets (Note 21)	2,602	3,625
Directors fee - As directors	4,885	4,460
- As employees	54,875	52,505
Auditors remuneration	4,025	4,025
Profit on sale of property and equipment	(625)	(2,955)

11. INCOME TAX

(a Income tax expense		
Current tax expense:		
- Current year	110,128	106,814
- Adjustment for prior year	(13)	4,758
	110,115	111,572
Deferred tax credit (Note 22):		
- Current year	(38,338)	(18,574)
- Adjustment for prior year	-	6,635
	(38,338)	(11,939)
Total tax expense	**71,777**	**99,633**

The tax on the bank's profit differs from the theoretical amount using the basic tax rate as follows:

	2016 KShs'000	2015 KShs'000
Profit before income tax	**301,904**	**328,963**
Tax at applicable rate	90,571	98,688
Net effect of non-deductible costs and non-taxable income	(18,781)	(10,448)
Prior year over provision of deferred tax asset	-	6,635
Prior year under/(over) provision of current tax	(13)	4,758
Total tax expense	**71,777**	**99,633**

(b) Tax (recoverable)/payable

At 1 January	(19,213)	(3,962)
Charge for the year	110,115	111,572
Paid during the year	(98,255)	(126,823)
At 31 December	**(7,353)**	**(19,213)**

12. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share is based on:

Net profit for the year attributable to shareholders (KShs '000)	**230,127**	**229,330**
Number of ordinary shares in issue during the year	**22,518,750**	**22,518,750**
Earnings per share (KShs)	**10.22**	**10.18**

At 31 December 2016 there are no ordinary shares with dilutive potential (2015 – Nil).

13. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

Group and Company	**2016 KShs'000**	**2015 KShs'000**
Cash on hand	126,159	126,155
Balances with Central Bank of Kenya:		
- Cash reserve ratio	642,425	650,395
- Other	763,423	543,853
	1,532,007	**1,320,403**

The cash ratio reserve which is non-interest earning and is based on the value of deposits as adjusted for Central Bank of Kenya requirements. At 31 December 2016, the cash reserve ratio requirement was 5.25% of eligible deposits (2015 – 5.25%). The funds are available for use by the Bank in its day-to-day operations in a limited way provided that on any given day this balance does not fall below 3.00% requirement and provided the overall average in the month is at least 5.25%.

14. PLACEMENTS WITH OTHER BANKS	2016 KShs'000	2015 KShs'000
Group and company		
Due within 12 months of reporting date	548,346	721,061

15. INVESTMENTS IN GOVERNMENT SECURITIES

Group and Company

Held to maturity		
Treasury Bills:		
Maturing within 90 days of reporting date	848,430	1,393,040
Maturing after 90 days of reporting date	960,167	342,314
	1,808,597	1,735,354
Treasury bonds:		
Maturing between 1 year and 5 years	404,689	435,322
Maturing after 5 years	725,612	484,573
	1,130,301	919,895
	2,938,898	**2,655,249**

The weighted average effective interest rate on Government securities at 31 December 2016 was 11.01% (2015 – 10.82%).

16. LOANS AND ADVANCES TO CUSTOMERS

(a) Group

	2016 KShs'000	2015 KShs'000
Overdrafts	3,891,571	3,884,527
Loans	4,460,678	4,858,436
Bills discounted	487,670	566,535
Hire purchase	483,719	475,732
Premium financing	307,192	213,087
Bills purchased	5,271	20,806
	9,636,101	10,019,123
Less: Impairment losses reserve (Note 16(c))	(661,574)	(776,388)
	8,974,527	**9,242,735**

(b) Company

	2016 KShs'000	2015 KShs'000
Overdrafts	3,802,205	3,795,260
Loans	4,405,017	4,741,045
Bills discounted	487,670	566,535
Hire purchase	483,719	475,732
Premium financing	307,192	213,087
Bills purchased	5,271	17,999
	9,491,074	9,809,658
Less: Impairment losses reserve (Note 16(d))	(527,910)	(586,440)
	8,963,164	**9,223,218**

(c) Impairment losses reserve – Group

2016:	Specific impairment KShs '000	Portfolio impairment KShs '000	Total KShs '000
At 1 January 2016	748,105	28,283	776,388
Impairment losses made in the year	266,608	(1,949)	264,659
Impairment recovered/unrequired in the year	(114,392)	-	(114,392)
Write-offs during the year	(265,081)	-	(265,081)
At 31 December 2016	**635,240**	**26,334**	**661,574**
2015:			
At 1 January 2015	668,304	38,131	706,435
Impairment losses made in the year	160,168	2,679	162,847
Impairment recovered/unrequired in the year	(53,807)	(12,527)	(66,334)
Write-offs during the year	(26,560)	-	(26,560)
At 31 December 2015	**748,105**	**28,283**	**776,388**

(d) Impairment losses reserve – Company

2016:	Specific Losses KShs '000	Portfolio impairment KShs '000	Total KShs '000
At 1 January 2016	558,157	28,283	586,440
Impairment losses made in the year	322,891	(1,949)	320,942
Impairment recovered/unrequired in the year	(114,391)	-	(114,391)
Write-offs during the year	(265,081)	-	(265,081)
At 31 December 2016	**501,576**	**26,334**	**527,910**

2015:			
At 1 January 2015	457,999	38,131	496,130
Impairment losses made in the year	179,525	2,679	182,204
Impairment recovered/unrequired in the year	(52,807)	(12,527)	(65,334)
Write-offs during the year	(26,560)	-	(26,560)
At 31 December 2015	**558,157**	**28,283**	**586,440**

(d) Net impairment (write backs)/losses – Group	**2016 KShs'000**	**2015 KShs'000**
Impairment losses made in the year (Note 16(c))	264,659	162,847
Recoveries during the year	(114,372)	(61,249)
Net charge to profit or loss	**150,287**	**101,598**

(e) Non-performing loans and advances – Group

Loans and advances include a net amount of KShs 151,685,000 (2015 – KShs 281,032,000), which have been classified as non-performing. The estimated value of securities held against this net balance is KShs 292,232,000 (2015– KShs 533,555,000).

	2016 KShs'000	**2015 KShs'000**
Interest on impaired loans and advances which has not yet been received in cash	**261,979**	**262,197**

17. OTHER ASSETS

Group and company	**2016 KShs'000**	**2015 KShs'000**
Items in transit	172,709	102,032
Accounts receivable and prepayments	55,122	69,120
	227,831	**171,152**

18. INVESTMENT IN SUBSIDIARIES

(a) Investment in subsidiaries

Company ownership		2016 KShs'000	2015 KShs'000
The First National Finance Bank Limited	100%	104,375	104,375
Guilders International Bank Limited	100%	196,000	196,000
		300,375	**300,375**

(b) Balances due to subsidiary companies

	2016 KShs'000	2015 KShs'000
Balance as at 1 January 2016	366,313	369,551
Net loans movement	(100)	(3,138)
Decrease in unredeemed certificates of deposit	-	(100)
Balance as at 31 December 2016	**366,213**	**366,313**
Comprising of:		
The First National Finance Bank Limited	156,245	156,245
Guilders International Bank Limited	209,968	210,068
	366,213	**366,313**

19. PROPERTY AND EQUIPMENT

Group and Company

2016	Buildings	Leasehold improvements	Equipment furniture and fittings	Motor vehicles	Capital work in progress	Total
	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
At 1 January 2016*	51,503	116,485	135,636	47,649	-	351,273
Additions	-	3,696	5,041	1,450	-	10,187
Write offs	-	(56)	(7,266)	-	-	(7,322)
Disposals	-	-	-	(1,200)	-	(1,200)
At 31 December 2016	51,503	120,125	133,411	47,899	-	352,938
Depreciation						
At 1 January 2016	13,994	72,856	85,445	9,256	-	181,551
Charge for the year	1,570	15,836	15,238	11,541	-	44,185
Write offs	-	(56)	(7,266)	-	-	(7,322)
Disposals	-	-	-	(1,150)	-	(1,150)
At 31 December 2016	15,564	88,636	93,417	19,647	-	217,264
Carrying amount						
At 31 December 2016	**35,939**	**31,489**	**39,994**	**28,252**	**-**	**135,674**

* In 2015, the Company leased additional land for KShs 239,201,000 with a term of 33 years. This has since been reclassified from Property, Plant and Equipment and disclosed as an operating lease (Note 20).

The gross carrying value of fully depreciated leasehold improvements and equipment that are still in use is KShs 96,621,276 (2015 – KShs 87,866,937). Such assets would have attracted a notional depreciation of KShs 21,266,074 (2015 – KShs 17,925,630).

Group and Company

2015	Buildings	Leasehold improvements	Equipment furniture and fittings	Motor vehicles	Capital work in progress	Total
	KShs'000	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**
At 1 January 2015	51,503	111,199	106,348	23,477	7,944	300,471
Additions	-	14,704	28,733	35,152	-	78,589
Write offs	-	(16,807)	-	-	-	(16,807)
Transfers	-	7,389	555	-	(7,944)	-
Disposals	-	-	-	(10,980)	-	(10,980)
At 31 December 2015	51,503	116,485	135,636	47,649	-	351,273
Depreciation						
At 1 January 2015	12,424	73,416	72,038	12,547	-	170,425
Charge for the year	1,570	16,247	13,407	5,429	-	36,653
Write offs	-	(16,807)	-	-	-	(16,807)
Disposals	-	-	-	(8,720)	-	(8,720)
At 31 December 2015	13,994	72,856	85,445	9,256	-	181,551
Carrying amount						
At 31 December 2015	**37,509**	**43,629**	**50,191**	**38,393**	**-**	**169,722**

20. PREPAID OPERATING LEASE RENTALS

Group and company

The net historical book value of leasehold land has been classified as prepaid operating lease rentals as below:

	2016 KShs'000	2015 KShs'000
Cost		
At 1 January	269,201	30,000
Additions	-	239,201
At 31 December	269,201	269,201
Amortisation		
At 1 January	11,128	6,750

Amortisation for the year	7,999	4,378
At 31 December	19,127	11,128
Carrying amount as at 31 December	**250,074**	**258,073**

21. INTANGIBLE ASSETS - SOFTWARE

Group and company

Cost		
At 1 January	23,864	22,878
Additions	3,020	3,692
Write-offs	(933)	(2,706)
At 31 December	25,951	23,864
Amortisation		
At 1 January	19,339	18,420
Amortisation during the year	2,602	3,625
Write-offs	(933)	(2,706)
At 31 December	21,008	19,339
Carrying amount as at 31 December	**4,943**	**4,525**

22. DEFERRED TAX ASSET

Group and company

Deferred tax asset at 31 December 2015 and 2016 are attributable to the items detailed in the table below:

2016	At 1 January 2016 KShs'000	Prior year (over)/under provision KShs'000	Recognised in profit or loss KShs '000	At 31 December 2016 KShs '000
Arising from:				
Property and equipment	17,867	-	2,110	19,977
Provision for loans and advances	21,971	-	28,401	50,372
Gratuity provision	5,250	-	8,100	13,350
Leave accrual	2,271	-	(273)	1,998
	47,359	**-**	**38,338**	**85,697**

2015	At 1 January 2015 KShs'000	Prior year (over)/under provision KShs'000	Recognised in profit or loss KShs '000	At 31 December 2015 KShs '000
Arising from:				
Property and equipment	20,064	(6,639)	4,442	17,867
Provision for loans and advances	11,434	5	10,532	21,971
Gratuity provision	1,650	-	3,600	5,250
Leave accrual	2,272	(1)	-	2,271
	35,420	**(6,635)**	**18,574**	**47,359**

23. CUSTOMERS DEPOSITS

Group and Company	2016 KShs'000	2015 KShs'000
Non-profit institutions and individuals	8,910,211	7,969,801
Private enterprises	2,608,040	3,623,157
Foreign currency accounts	794,459	901,343
	12,312,710	**12,494,301**

24. OTHER LIABILITIES

Group and Company		
Sundry creditors	76,726	69,518
Accruals	49,362	32,975
	126,088	**102,493**

25. PROVISIONS

Group and Company

(a) Gratuity provision

The Company operates a non-contributory gratuity scheme for qualifying employees paid at the discretion of management. An employee who works for more than five years, is eligible for the gratuity amount based on the lower of six months monthly salary or an equivalent of 15 days salary for every year worked. The lump sum benefits are payable to the employees of the Bank on their normal retirement at age 55, on leaving service, on ill-health early retirement or on death in service based on service completed and salary at date of leaving service. The most recent actuarial valuations of the present value of the obligation were carried out at 31 December 2016 by Alexander Forbes.

A provision is made in the financial statements for the estimated liability in respect of the benefits promised under the arrangement. The movement in provision is as shown below:

	2016 KShs'000	2015 KShs'000
Value of obligation at 1 January	17,500	5,500
Actuarial loss – obligation	27,000	12,000
	44,500	17,500
Included in profit or loss		
Actuarial loss – obligation	**27,000**	**12,000**

The principal assumptions used for the purposes of the actuarial valuations were as follows:

Discount rate	14.5% per annum
Salary escalation rate	6% per annum
Mortality–in–service	A 1949/52 Ultimate
Ill-health early retirement arrangements	At rates consistent with similar
Withdrawals arrangements.	At rates consistent with similar
Retirement age	55 years

The actuarial valuation of the gratuity arrangement are sensitive to the actuarial assumptions made which could change based on future events.

(b) Other provisions	**2016 KShs'000**	**2015 KShs'000**
Leave provision	6,659	7,570
Utility costs	800	3,162
	7,459	**10,732**

26. RESERVES

Group and Company

(a) Share capital

Authorised 25,000,000 ordinary shares of KShs 20 each	**500,000**	**500,000**
Issued and fully paid 22,518,750 ordinary shares of KShs 20 each	**450,375**	**450,375**

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at general meetings of the parent company.

(b) Statutory credit risk reserve

This represents an amount set aside to cover additional provisions for loan losses required to comply with the requirements of Central Bank of Kenya Prudential Guidelines. The amount is not available for distribution. The reserve balance as at 31 December 2016 was KShs 65,112,000 (2015 – Nil).

27. ASSETS PLEDGED AS SECURITY

As at 31 December 2016, treasury bonds/bills amounting to KShs 100,000,000 with Bank of India pledged as security for letter of credit facilities.

28. NOTES TO THE STATEMENT OF CASH FLOWS

(a) Reconciliation of profit before income tax to cash flows from operating activities	**2016** **KShs '000**	**2015** **KShs '000**
Profit before income tax	301,904	328,963
Depreciation	44,185	36,653
Amortisation of intangible asset	2,602	3,625
Prepaid operating lease rentals amortisation	7,999	4,378
Profit on sale of property and equipment	(625)	(2,955)
	356,065	370,664

(Increase)/decrease in operating assets		
Central Bank of Kenya cash reserve ratio	7,970	8,150
Other investments	-	192,223
Loans and advances to customers	268,208	192,006
Investment in Government securities	(828,259)	155,374
Other assets	(56,679)	26,258
	(608,760)	574,011
Increase/(decrease) in operating liabilities		
Customers deposits	(181,591)	(148,440)
Unredeemed bearer certificate of deposit	-	(500)
Other liabilities	23,595	(32,722)
Provisions	23,727	(11,049)
	(134,269)	(192,711)
Net cash flows from operations before income tax	(386,964)	751,964
Income taxes paid	(98,255)	(126,823)
Net cash flows from operating activities	**(485,219)**	**625,141**

(b) Analysis of the balances of cash and cash equivalents

	2016 KShs '000	**2015 KShs '000**	**Change in the year KShs '000**
Balances with Central Bank of Kenya	763,423	543,853	219,570
Cash on hand	126,159	126,155	4
Placements with other banks	548,346	721,061	(172,715)
Treasury bill maturing within 3 months	848,430	1,393,040	(544,610)
	2,286,358	**2,784,109**	**(497,751)**

29. CONTINGENT LIABILTIES

Group and Company

In the ordinary course of business, the Group conducts business involving guarantees, acceptances and performance bonds. These facilities are offset by corresponding obligations of third parties. At the year end, the contingencies were as follows:

	2016 KShs '000	2015 KShs '000
Commitments with respect to:		
Irrevocable letters of credit	367,993	367,478
Guarantees	594,928	606,685
Bills for collection	36,834	52,241
Swaps	26,765	11,178
	1,026,520	**1,037,582**

Nature of contingent liabilities

Guarantees are generally written by a bank to support performance by a customer to third parties. The Bank will only be required to meet these obligations in the event of the customer's default.

Letters of credit commit the Bank to make payment to third parties, on production of documents, which are subsequently reimbursed by customers.

An acceptance is an undertaking by a bank to pay a bill of exchange drawn on a customer. The Bank expects most acceptances to be presented and reimbursement by the customer is almost immediate.

In the ordinary course of business, the bank and its subsidiaries are defendants in various litigation and claims. Although there can be no assurances, the directors believe, based on the information currently available and legal advice, that the claims can be successfully defended and therefore no provision has been made in the financial statements.

30. RELATED PARTY TRANSACTIONS

(a) Loans and advances

The Bank has entered into transactions with its staff, directors, significant shareholders and their affiliates.

The aggregate amount of loans:	2016 KShs'000	2015 KShs'000
Loans to employees:		
Balance at the beginning of the year	28,733	33,530
Loans advanced during the year	15,995	8,275
Loans repayments received	(22,510)	(13,072)
Balance at end of year	**22,218**	**28,733**
Loans and advances to directors, shareholders and associates	**301,063**	**329,016**
Off balance sheet items	**16,556**	**16,442**

The related interest income in 2016 was KShs 35,052,516 (2015 – KShs 50,482,108).

(b) Key management remuneration	2016 KShs '000	2015 KShs '000
Salaries and other employee benefits	**73,399**	**67,919**

Salaries and other employee benefits include those relating to the senior management.

(c) The aggregate amounts of deposits withdrawn from related parties at 31 December 2016 were KShs 1,067,806,226 (2015 – KShs 713,379,734). The transactions were carried out on commercial terms and conditions.

(d) In the normal course of business, the bank has entered into transactions with certain related parties. These transactions are at commercial terms and conditions.

31. OPERATING LEASES

Operating lease rentals are payable as follows:	2016 KShs'000	2015 KShs'000
Tenancy		
Less than one year	40,423	40,226
Between one and five year	120,291	82,301
Over 5 years	35,013	55,840
	195,727	**178,367**

The Bank leases a number of bank premises under operating leases. The leases typically run for an initial period of between five and six years with an option to renew the lease at its expiry. During the year ended 31 December 2016, KShs 49,411,750 (2015 – KShs 48,636,058) was recognised as an expense in the statement of comprehensive income in respect of operating leases.

NOTES

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