Consolidated Bank

Growing with you

Annual Report & Financial Statements

As at 31st December 2016

ABOUT US

Our Vision

To be the Bank of choice offering pleasant and convenient services.

Our Mission

To provide flexible financial solutions that support our customers achieve success.

Our Core Values

We are guided by the following core values in our day to day activities.

Customer focus - The customer is at the centre of our service delivery.

Integrity - We undertake to operate with the highest degree of honesty and integrity.

Professionalism - We adhere to high professional and personal standards in the conduct of our business.

Team work - We work as a team and nurture a performance driven culture.

Innovation - We continuously make product improvements to serve the evolving needs of our customers.

TABLE OF CONTENTS

THE YEAR THAT WAS

CUSTOMER SERVICE WEEK

'Listening to the customer' was our theme in the internationally recognized Customer Service Week. Isiolo Branch Staff cut a cake with their Customers during the week to appreciate them for their continued support.

INTERBANKS SPORTS COMPETITION

The Interbank trophy is ours to keep! Consolidated Bank's team captain (Wycliffe Wanjie) receiving the much coveted Interbanks Sports Competition soccer trophy. The Bank has reclaimed the football title for 3 years running.

ANNUAL STAFF PARTY

After twelve (12) months of hard work the Staff relax during the Annual End of Year Staff Party. They were adorned in one of the Bank's brand colours – Red.

JOB SHADOW WEEK

Building good leaders starts now. The Bank partnered with Junior Achievement Kenya and hosted students from Olympic High School during the Junior Achievers Job Shadow Week.

SECURITY GUARDS TRAINING

Service cuts across all departments in the Bank. In order to ensure seamless delivery of service to our Customers, the Bank held the first ever Security Guards Training on Customer Service.

ANNUAL GENERAL MEETING

Consolidated Bank Chairman, Dr. Benson Ateng' (centre), with the CEO, Mr. Thomas Kiyai (left) and the Head of Legal and Company Secretary, Mrs. Wakonyo Igeria (right) deliberate on the proceedings during the AGM.

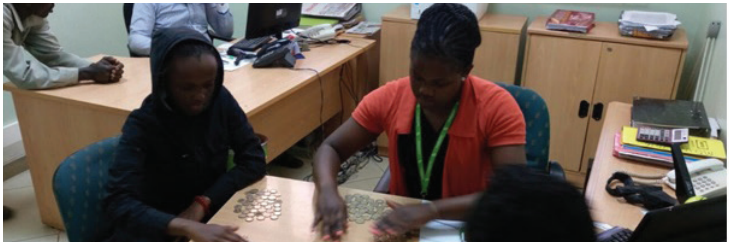
CUSTOMER TESTIMONIAL

Focused Pipeline Self Help Group

In 2012, a group of friends who were visiting one of their own during his recovery period after sustaining a broken leg, started a Chama to help each other. They started by saving Kshs. 50/= per person and have since grown to contributing Kshs. 2,000/= per person. They are all business people and matatu operators. The group currently has a membership of 11 people. The account was marketed to them by a bank representative, Ms. Sheila Too. So far since the aim of the group is to save, they have benefited from the Fixed Deposit product of the Bank. The Chairman, Mr. David Mwangi is willing to recommend the account to another group when the opportunity arises.

JUNIOR SAVER ACCOUNT PARTY

The Junior Saver Savings Account is a unique method of training children on how to save. Nyeri Branch Staff assist Junior Savers to bank their 'hard earned' money.



POST BUDGET BRIEF

The National Budget puts into perspective the economic opportunities which businesses can harness. Customers from our medium to large corporate account docket attended a breakfast presentation on the Budget.

BOARD OF DIRECTORS

DR. BENSON ATENG' – CHAIRMAN

Dr. Ateng' was appointed Chairman of Consolidated Bank with effect from 4th January 2014. In his academic accolades, he holds both a PhD and an M.A. in Economics from the University of Nairobi. In addition, he has a First Class Honors in a Bachelor of Education double Program in Economics and Education from the University of Nairobi.

Dr. Ateng' worked in the World Bank for 30 years. During his career at the World Bank, he rose through the ranks to the position of Country Manager Papua New Guinea and then Country Manager Yemen, a position he held until December 2011 when he retired from the World Bank. Currently, he is a senior lecturer as well as the Chairman of the Department of Economics and Public Policy at the Technical University of Kenya, where he is also the Ag. Director of the School of Social and Development Studies. In addition, he is also a private Consultant. Dr. Ateng' has written numerous publications that include World Bank Reports. He has won honors and awards from the University of Nairobi and World Bank. At the World Bank he won numerous Spot Awards and nominations to the Diversity and Inclusion Leadership Award and Good Manager Award.

THOMAS KIPKEMEI KIYAI – CHIEF EXECUTIVE OFFICER

Thomas Kipkemei Kiyai joined Consolidated Bank in April 2015. He has over 20 years of banking and finance experience having joined Consolidated Bank of Kenya from Kenya Commercial Bank, where he served as Director, Financial planning and Control.

He holds a Bachelors of Commerce Degree in Accounting and a Masters of Business Administration Degree in Corporate Finance from the University of Nairobi. In addition to this, he is also an alumni of the Oxford University Management & Leadership Development Programme. Thomas Kiyai is a member of the Institute of Certified Public Accountants of Kenya (ICPAK).

AMBASSADOR CHARLES MBAGAYA AMIRA – DIRECTOR

Ambassador Amira was appointed Director of Consolidated Bank with effect from 3rd January, 2014. He has an MBA with citation for the best academic performance on MBA program 7, from the University of Brunel - United Kingdom. He holds Advanced Management Certificates from the University of Nairobi and the Kenya Institute of Management; Post Graduate certificates in Communications from the University of Ohio - USA, Certificate in Arbitration and Dispute Resolution and Certificate in Directors' Corporate Governance amongst others.

He has been a board member of the CCK, ICL, and Public Procurement Administrative Review Board. He was a Senior Consultant for the UN Economic Commission for Africa (UNECA), the Organization of African Unity (OAU) on Governance, United Nations Transport and Communications Decade Programmes for Regional Integration and a Commissioner of the Communication Commission of Kenya (CCK). He is currently a Senior Consultant at United Nations/ International Institutions and is a member of both the Institute of Directors and the Kenya Institute of Management.

MIRIAM CHEROGONY – DIRECTOR

Ms. Miriam Cherogony was appointed director on 3rd February 2014. She has over 20 years local, regional and international development finance experience in Rural, Micro and Agricultural Finance. This experience spans her work with Ministry of Agriculture, Kenya; University of Manitoba, Canada; K-Rep Development Agency, Kenya; Africa Rural Agricultural and Credit Association (AFRACA); the International Fund for Agricultural Development (IFAD) and a multi- donor Initiative for smallholder finance.

She has developed knowledge products on community based financial organizations, credit guarantee schemes, lines of credit, key performance indicators and performance based contracts, and rural youth finance for IFAD. Ms. Cherogony holds a Master's of Science degree (Agricultural Economics), and Bachelor of Science degree (Agricultural Economics) from the University of Manitoba, Canada.

GEORGE OMINO – ALTERNATE DIRECTOR TO THE CABINET SECRETARY, THE NATIONAL TREASURY

George Omino is the Alternate Director to the Cabinet Secretary to the National Treasury. He is Deputy Director and Head of Financial Services Sector in Economic Affairs Department. Omino is originally from the Central Bank of Kenya, where he has worked since 1978, rising to the position of Assistant Director and Head of Microfinance Division in Bank Supervision Department.

George Omino has a wealth of experience in regulation and supervision of banks and other financial institutions, having been a bank examiner for over 20 years. He has also been a statutory manager of a bank. He was instrumental in the development of the Microfinance Act, 2008 and the regulations made thereunder. 2006 and the original draft Unclaimed Financial Assets legislation in 2008. He was a member of the taskforce that has developed the Sacco Societies Act, 2008 and the regulations made thereunder.

PAPIUS KIRONGOTHI MUHINDI – DIRECTOR

Papius Muhindi was appointed Director of Consolidated Bank on 3rd February, 2014. He holds a Bachelor of Commerce (Accounting option) from the University of Nairobi and Association of Certified Accountants Professional 1. In addition, he is a trained systems engineer.

Muhindi worked for 10 years with a multinational oil company as an International Auditor overseeing the operations in the East African region. Further, he worked for fifteen and a half years in the Central Bank of Kenya - Banking Supervision Department. He also worked at Equity Bank as the Head of Risk Management and Compliance till his retirement. Currently, he works at Monetary Dynamics Company Ltd as a Consultant in Banking and Finance.

EVANS GAVALA VITISIA – DIRECTOR

Evans Vitisia was appointed Director of Consolidated Bank with effect from 3rd January, 2014. He holds a Bachelor of Arts Degree in Economics and Government from the University of Nairobi and a Diploma in Business Administration (Henley) through the Standard Chartered Bank distance learning program - Nairobi. He has banking experience of over 25 years.

He previously worked at ABC Bank as the Head of Retail and SME banking. Prior to that, he was the Deputy Head of Personal Banking and Head of Business Banking at CFC Stanbic Bank. In addition, he held the capacity of Head of Credit and SME Banking at Standard Chartered Bank. He is the founder and current manager of Torch Credit Consultants Ltd, a Micro Finance Institution.

DR. RAYMOND OMOLLO – DIRECTOR

Dr. Raymond Omollo was appointed Director of Consolidated Bank on 2nd October 2015. He is the Head of Data Centre and Statistician at DNDi Africa. Raymond is an external examiner at the University of Witwatersrand, South Africa and a part time lecturer in Applied Statistics at the University of Nairobi. He has worked as a consultant statistician for the WHO and a number of institutions like FAO, AMREF, Hoffman La Roche and I-TECH.

Raymond has a PhD in Applied Statistics from Maseno University and an MSc in Applied Statistics and BSc in Statistics from the University of Nairobi. He also obtained a Certificate in Epidemiology and Biostatistics from the University of Washington. Raymond is a member of the International Society for Clinical Biostatistics (ISCB) and Young African Statisticians Association (YASA).

WAKONYO IGERIA – COMPANY SECRETARY

Wakonyo Igeria was appointed as the Head of Legal Services and Company Secretary in June 2004. She holds a Bachelor of Laws Degree and a Diploma in Law from the Kenya School of Law.

She is an Advocate of the High Court of Kenya of 23 years experience, a Commissioner for Oaths and Notary Public and a Certified Public Secretary (Kenya). Wakonyo Igeria is a member of the Law Society of Kenya and the Institute of Certified Public Secretaries of Kenya.

DR. ANTHONY OMERIKWA – AG. MANAGING TRUSTEE, NSSF

Dr. Anthony Omerikwa is the Acting CEO/Managing Trustee of the National Social Security Fund. Prior to his current position, he served as the Acting General Manager Operations in the same institution overseeing Information Technology, Human Resource, Administration and Procurement functions.

He holds a Doctoral degree from the University of Georgia, a specialist advanced degree in labour, workforce development and education and a Master of Science degree in Human Resource Development both from Pittsburg State University, a Bachelor of Arts degree in Economics from Kenyatta University and a Diploma in data processing and management from Strathmore College.

Dr. Omerikwa is an associate member of the Institute of Human Resource Management and Institute of Directors and a member of the Kenya Institute of Management.

He has written a number of research papers, publications and presentations and undertaken various consultancy jobs with international and regional developments institutions.

JOSEPH KIPKETER KOSKEY – DIRECTOR

Mr. Joseph Koskey was appointed director of Consolidated Bank on 2nd October, 2015. He is the Group Chief Executive Officer of Sovereign Group Limited. Prior to his current position, he served as the Group Chief Operating Officer in the same institution. He has wealth of experience in the design and management of business operations, business development, procurement strategies and execution plan to ensure operational excellence, growth and profitability of companies.

He holds an MBA (Strategic Management) and a Bachelor of Commerce (Accounting) from the University of Nairobi and is currently pursuing his PHD at the University of Nairobi.

Director Koskey is a Certified Public Accountant (CPA-K), Certified Public Secretary (CPS-K) and Certified Trainer on Corporate Governance and is a member of the Institute of Certified Public Accountants (ICPAK), Institute of Certified Public Secretaries (ICPSK) and Institute of Directors of Kenya (IODK).

SENIOR MANAGEMENT

Japheth Kisilu – Chief Commercial Officer

Martin Omido – Head of ICT

Zakary Muchai – Ag.Head of Credit

Josephine Kioko – Head of Retail & SME

Edward Nthuli – Head of Operations

Erastus Gachoya – Head of Corporate Banking

Wakonyo Igeria –
Company secretary & Head of Legal Services

Joseph Njuguna –
Head of Finance

Jacinta Lwanga –
Head of Human Resource

George Rutto –
Head of Internal Audit

Joshua Kagia –
Head of Treasury

Harrison Muthoka
– Manager Risk and Compliance

CONSOLIDATED BANK OF KENYA LIMITED
CORPORATE INFORMATION

DIRECTORS:

Dr. B. Ateng - Chairman - (Term ended 9 January 2017)
T. Kiyai - Chief Executive Officer
Cabinet Secretary, National Treasury
Managing Trustee - NSSF
M. Cherogony - (Term ended 3 February 2017)
E. Vitisia - (Term ended 3 February 2017)
C. Amira - (Term ended 3 February 2017)
P. Muhindi - (Term ended 3 February 2017)
Dr. R. Omollo
J. Koskey

AUDIT COMMITTEE:

J. Koskey - Chairman
E. Vitisia
C. Amira
Dr. R. Omollo
Cabinet Secretary - National Treasury

STAFF COMMITTEE:

C. Amira - Chairman
T. Kiyai
Cabinet Secretary, National Treasury
Managing Trustee - NSSF
J.Koskey

COMPANY SECRETARY:

Wakonyo Igeria
Certified Public Secretary (Kenya)

P. O. Box 51133 – 00200, Nairobi

AUDITORS:

Principal auditors:
The Auditor General
Anniversary Towers

P. O. Box 30084 – 00100, Nairobi

Delegated Auditors:

Deloitte & Touche

Certified Public Accountants (Kenya)

Deloitte Place, Waiyaki Way, Muthangari

P. O. Box 40092 – 00100, Nairobi

LEGAL ADVISERS:

Hamilton Harrison & Mathews

Delta Suites, Waiyaki Way ,

P.O. Box 30333 – 00100, Nairobi, Kenya

Ndungu, Njoroge & Kwach Advocates

12th Floor, International House

Mama Ngina Street

P. O. Box 41546 – 00100, Nairobi, Kenya

RISK COMMITTEE:

P. Muhindi - Chairman
E. Vitisia
M. Cherogony
T. Kiyai
Dr. R. Omollo

FINANCE AND CREDIT COMMITTEE:

M. Cherogony-Chairman
E. Vitisia
P. Muhindi
T. Kiyai
Managing Trustee - NSSF
Cabinet Secretary - National Treasury

REGISTERED OFFICE:

Consolidated Bank House
23 Koinange Street
P. O. Box 51133 - 00200, Nairobi

CORRESPONDENT BANKS:

ABSA Bank Limited
Vostro Department
P.O. Box 585 Johannesburg 2000

Deutsche Bank AG London
Winchester House
1 Great Winchester Street
London EC2N 2DB

MESSAGE FROM THE CHAIRMAN

Joseph Koskey
Director

I am pleased to present to you the Annual Report and Financial Statements for the year ended December 31, 2016. The Bank made a net after-tax loss of KShs 211 million as a result of the capital constraints it faced and the difficult environment under which it operated. I would like to draw your attention to the business environment during the period under review.

Market environment

According to the Economic Intelligence Unit, Kenya's GDP grew at 5.7% in 2016 compared to 5.6% in 2015, an improvement attributable to strong household consumption, closer integration with EAC and recovery in the tourism numbers. As a result of the La Nina weather pattern, food-basket regions experienced depressed rainfall which contributed to a slow-down in agricultural sector growth which came in at 3.9% Compared to 5.5% in 2015. The Manufacturing sector contracted to 1.9% growth compared to 3.3% growth; this was attributable to slower growth in the manufacturing of both food and non-food products. The completion of the first phase of the Standard Railway Gauge project led to a pull-back in growth for the construction sector which posted a rise of 9.3% compared to 15.6% in 2015. The tourism sector continued on its path to recovery growing 13.8% in 2016 compared to 6.5% in 2015, supported by hosting high profile meetings and improved security conditions.

Inflation remained stable in 2016 and averaged 6.3% due to subdued oil prices, lower electricity tariffs due to increased reliance on drought

"It has been agreed that the Bank be recapitalized through a new Rights Issue with an underwriter on board and this is expected to be completed by the fourth quarter of the year 2017"

resistant geothermal power and low food prices. In the currency market, the shilling remained resilient during the year 2016 though showing slight weakness at the tail end of the year. The shilling received support from the narrowing of the current account deficit, improved diaspora remittances and the grass-roots recovery in the tourism sector.

In the year 2016, the Equity Market experienced a downward trend especially in the third quarter of the year particularly in the financial sector counters as a result of the accenting into law of the Banking (Amendment) Act 2016 which capped interest rates. The general economic downturn, BREXIT and changes in investor sentiments due to the uncertain outcome of the United States of America (USA) election and the upcoming general election in Kenya in August 2017 also led to the downward trend.

The Banking (Amendment) Act, 2016 that came into effect in September 2016, capped the interest rate chargeable by banks at 4% above the Central Bank Rate (CBR). The law also set the minimum interest rate payable on interest-bearing deposits at 70% of the CBR. According to the IMF, interest rate caps in Kenya pose a great risk to financial stability and this will slow the country's ambitions of being the regional leader in financial inclusion. IMF reported that the effects of the interest rate caps include:

- Reduced access to credit as many lenders opt to invest in safer Government securities, rather than lend to small and micro sized enterprises;
- Increased illiquidity in the economy as money backed investment schemes continuously seek other investment alternatives; and
- Contraction of the economy as businesses and individuals continue to find it hard to access credit, making them unable to participate in economic activities. This will in the long run affect the country's productivity.

There is evidence that micro-and small sized enterprises are struggling to get loans following the enforcement of the Banking (Amendment) Act, 2016.

Commercial banks now have to adjust to a new operating environment characterized by rate caps, the prospect of further Government intervention, a high ratio of non-performing loans and the rise of competing services in the mobile financial services sector. The National Treasury, Kenya Bankers Association (KBA) and Central Bank of Kenya (CBK) are currently undertaking a comprehensive assessment of the impact of the interest rate capping law on credit expansion to the private sector and future growth of the economy.

Financial overview

The Bank's financial performance for the year 2016 was influenced by both external and internal factors which include the difficult economic environment, the turbulence experienced in the banking sector, the implementation of interest rates capping in the fourth quarter and the lack of adequate capital to meet regulatory requirements and support execution of the Bank's business plan for the year.

As a result of the above, the overall balance sheet declined marginally by 2% to KShs 13.9 billion from KShs 14.1 billion the previous year. The net advances remained steady at KShs 9.2 billion as at 31 December 2016 compared to the same period the previous year. The customer deposits declined by 5% to KShs 9.5 billion from KShs 9.9 billion as at 31 December 2016 due to the tight liquidity in the market. The Bank therefore recorded an after-tax loss of KShs 211 million compared with a profit of KShs 44 million in 2015.

Capital requirements

In the last four years, the bank has not met the minimum capital ratios prescribed in the Prudential Guidelines. The Board of Directors and Management of the Bank has been consulting the National Treasury with a view of unlocking the full potential of the Bank through recapitalization. On the basis of these consultations, it has been agreed that the Bank be recapitalized through a new Rights Issue with an underwriter on board and this is expected to be completed by the fourth quarter of the year 2017.

Board changes

The following board changes were effected early 2017:

1. Dr. Benson Ateng': term as chairman ended on 9 January 2017
2. Miriam Cherogony: term as director ended on 3 February 2017
3. Evans Vitisia: term as director ended on 3 February 2017
4. Charles Amira: term as director ended on 3 February 2017
5. Papius Muhindi: term as director ended on 3 February 2017

I take this opportunity on behalf of the Board to thank the above Board Members for their 3 years' service to the Bank and especially the chairman for his able leadership to the Board and the bank at large during his tenure. I wish them all success in their future endeavors.

We are awaiting the National Treasury to appoint new directors to replace those whose term ended.

Corporate Social Responsibility

The objective of Corporate Social Responsibility (CSR) is to ensure organizations voluntarily take steps to improve the quality of life for employees and their families as well as for the local community and society at large. Consolidated Bank recognizes its corporate responsibility commitments and is determined to sustain high standards of corporate citizenship by preserving and promoting human values as well as the social and cultural value systems of the society in which it operates. The Bank partnered with Junior Achievement Kenya and hosted students from Olympic High School during the Junior Achievers Job Shadow Week.

Conclusion

While the Bank is not where we envisioned it to be by the end of the year, I do appreciate the effort that has been expended to bring it this far. We anticipate even better results in the coming years as we double our efforts to secure capital and put the Bank on a growth path. I take this opportunity to express my sincere appreciation to our customers, shareholders, the Government, management, staff, suppliers and fellow board members for their dedicated contribution and support towards the growth of the Bank.

Joseph Koskey

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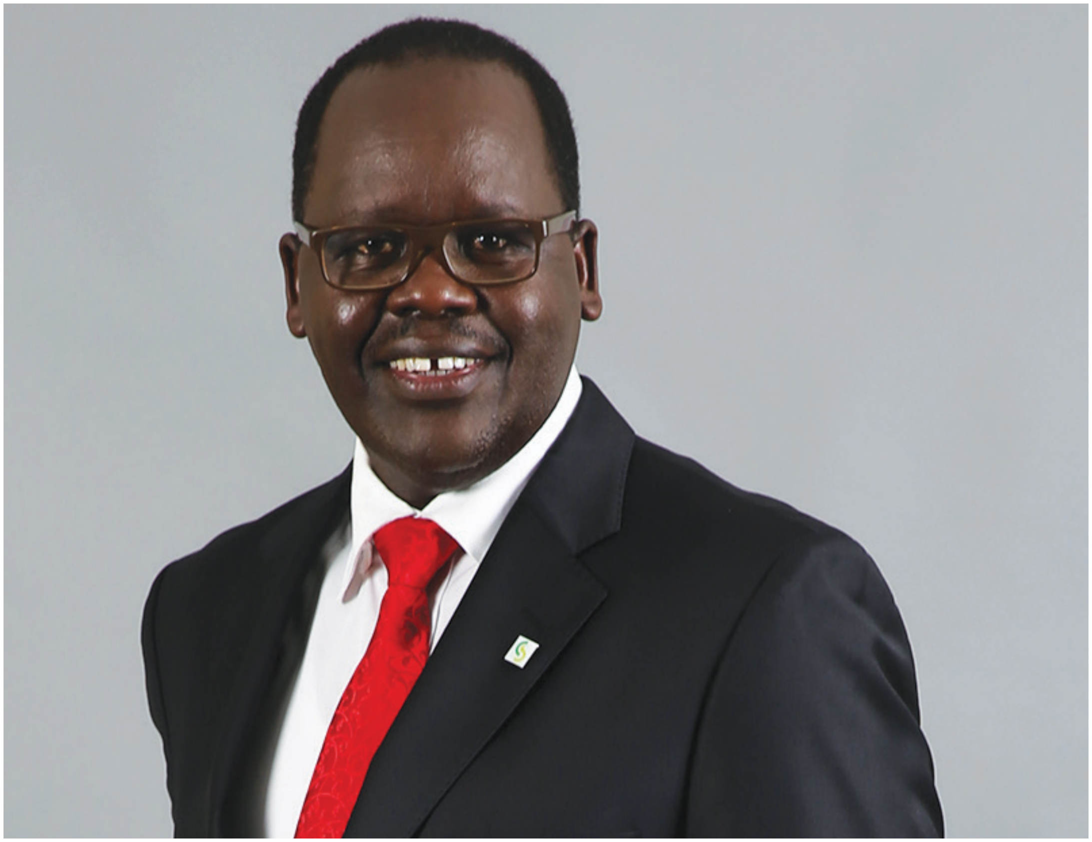
Director

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER



THOMAS KIPKEMEI KIYAI
Chief Executive Officer

Despite the Kenyan economy recording growth of 5.7%, 2016 proved to be an extremely difficult and challenging year for the businesses. Growth was largely boosted by the investment in major infrastructure projects such as roads, energy and geothermal and the Standard Gauge Rail. The key production sectors of agriculture and manufacturing however witnessed decelerated growth because of the difficult operating environment.

The banking sector witnessed tremendous change with the introduction of the law capping interest rates which took effect in September 2016.The law which aimed at reducing interest rates for borrowers to make loans affordable resulted in significant reduction in the sector's margins. This has forced banks to readjust their business models with focus shifting to cutting costs through staff lay off/retrenchment and branch closures. The sector posted the slowest growth since 2012 to stand at 6.9 per cent in 2016 compared to 9.4 per cent in 2015. The relatively depressed performance was mainly as a result of a decelerated growth of 6.7 per cent in earnings partly due to uncertainty associated with the capping of interest rates. The stability of the sector also came into sharp focus following the collapse of Chase Bank in April 2016 coming less than a year after the fall of Imperial and Dubai Bank in 2015.

Overview of Financial Performance

The Bank's business plan for the year 2016 was anchored on the expectation that shareholders would inject additional capital to enable the

"I remain indebted to all employees and the Board of Directors for their commitment and dedication to the Bank throughout the year. We remain resolute to continue serving our customers and providing value to our stakeholders going into the future"

bank comply with the prudential capital ratios and support growth of the balance sheet. The Bank thus implemented a Rights Issue seeking to raise Kshs 1.8 billion in the first quarter of the year. Unfortunately, the exercise was not successful since all the shareholders opted not to take up their rights. This greatly impacted the bank's growth plans for the year.

The balance sheet shrank by 2% to Kshs 13.92 billion compared with Kshs 14.13 billion in 2015. Loans and advances declined by 1% from Kshs 9.22 billion to Kshs 9.16 billion the previous year. Customer deposits also declined by 5% to Kshs 9.49 billion from Kshs 9.99 billion the previous year. Overall the bank recorded an after-tax loss of Kshs 211 million on the backdrop of inability to implement the business plan due to capital constraints and reduced interest margins as a result of the law capping interest rates from September 2016.

Recovery of Non-performing Loans

As part of the turnaround strategy, we continue to focus on the recovery of non-performing loans and management of our Portfolio at Risk (PaR). Gross non-performing loans however increased marginally by 4% from Kshs 1.96 billion to Kshs 2.03 billion on the backdrop of the difficult operating environment in the economy. The bank however managed to collect in excess of Kshs 684 million from our debt recovery efforts with a write back of Kshs 345 million to income.

Capitalization

Capitalization is one of the key pillars underpinning the implementation of the bank's five-year strategic plan for the year 2015 to 2019. Following the unsuccessful Rights Issue in April 2016 the bank initiated fresh consultations with the major shareholders including the National Treasury and the National Social Security Fund (NSSF) on the way forward towards recapitalization.

As a result of these consultations it was decided that the bank be recapitalized through a new Rights Issue with an underwriter on board to guarantee its success by taking up any shares that may not be taken up by the existing shareholders. An appetite check conducted in October 2016 established that there is overwhelming interest in the underwriting transaction. With an Underwriter on board, I am confident that this time around the bank will secure the requisite capital to resolve the capitalization challenges facing the bank.

Strategic Focus and Business Plan 2017

As outlined above recapitalization of the bank is key to support the growth of the balance sheet and ensure compliance with the prudential ratios. We therefore look forward to closing this exercise in the second half of the year. The bank is also at advanced stage of rolling out a digital banking platform to enhance the mobile banking offering and enable customer access more and improved services through the mobile phones. The bank will also explore restructuring options to address the reduced interest margins occasioned by the implementation of the interest rates capping law.

Corporate Social Responsibility

We believe our purpose as a business is to positively impact the public including our staff and customers. As part of our commitment to partner with the communities where it operates, the bank has in the past partnered with Kenyatta National Hospital and AMREF Flying Doctors to offer corrective surgery for mothers suffering from fistula condition. We will continue to play our role and partner with like-minded organizations and institutions to bring solutions to problems affecting the community.

Going forward therefore, we shall continue to honour our corporate responsibility commitments and sustain high standards of corporate citizenship by preserving and promoting human values as well as the social and cultural value systems of the society in which it operates.

Appreciation

On behalf of the management, I extend my deepest gratitude to firstly, our customers, for believing in us and continuing to retain us as their preferred banking partners. To our shareholders, we thank you for your support. To our regulator, as well as the communities we exist in, thank you for creating an enabling environment for our operations.

Lastly, I remain indebted to all employees and the Board of Directors for their commitment and dedication to the Bank throughout the year. We remain resolute to continue serving our customers and providing value to our stakeholders going into the future.

Thomas Kipkemei Kiyai

Chief Executive Officer

CONSOLIDATED BANK OF KENYA LIMITED
STATEMENT OF CORPORATE GOVERNANCE

Corporate governance defines the process and structure used to direct and manage the business affairs of Consolidated Bank of Kenya Limited ("the Bank") with the aim of enhancing corporate accounting and shareholders' long term value while taking into account the interests of other stakeholders.

The Board of Directors is responsible for the governance of the Bank and is committed to ensuring that its business operations are conducted with integrity and in compliance with the law, internationally accepted principles and best practices of corporate governance and business ethics. To this end the Bank has put in place processes, systems, practices and procedures which are frequently reviewed and updated embracing the changing corporate environment and world trends.

Business Ethics

The Bank conducts its business in compliance with high ethical standards of business practice. In this respect, transactions with its clients, intermediaries, insiders, employees and other stakeholders are conducted at arm's length, with integrity and transparency. The business is conducted with high levels of transparency and accountability.

Board of Directors

The members of the board as at 31st December are shown on page 8-11.

The Board fulfils its fiduciary responsibility to the shareholders by maintaining control over the strategic, financial, operational and compliance issues of the Bank. Whilst the Board provides direction and guidance on strategic and general policy matters and remains responsible for establishing and maintaining overall internal controls over financial, operational and compliance issues, it has delegated authority to the Chief Executive Officer to conduct the day-to-day business of the Bank.

The Board consists of nine non-executive directors (including the Chairman) and the Chief Executive Officer. The Board members possess extensive experience in a variety of disciplines in banking, business and financial management, all of which are applied in the overall management of the Bank. The Board meets at least once every two months, and has a formal schedule of matters reserved for it. The Directors are given appropriate and timely information so that they can perform their fiduciary responsibilities effectively.

a) Directors' Emoluments and Loans

The remuneration of all Directors is subject to the guidelines issued by the Office of the President on terms and conditions of service for State Corporations. The Directors are not eligible for membership of the pension scheme and do not participate in any of the Bank's bonus schemes. Information on the compensation received and the dealings of the Directors with the Bank are included in notes 11 and 38 to the financial statements.

b) Related Party Transactions

There have been no materially significant related party transactions, pecuniary transactions or relationships between the Bank and its Directors or Management except those disclosed in Note 38 to the financial statements.

The Board has set up working committees to assist in discharging its duties and responsibilities as follows:

Audit Committee

The Board is mandated to raise the standards of corporate governance by reviewing the quality and effectiveness of the internal control systems, the internal and external audit functions and the quality of financial reporting. In addition to advising the Board on best practice, the committee also monitors management's compliance with relevant legislation, regulations and guidelines as well as the Bank's laid down policies and procedures. The committee has direct access to the Internal Audit function, the Company Secretary and the external auditors. During the year the committee received and reviewed the findings of the internal and external audit reports and management's action to address them.

Risk Committee

The committee is responsible for overseeing the implementation of the Bank's risk management framework to ensure that all existing and potential significant risks are identified and effectively managed. The committee considers both internal and external sources of information regarding risks to keep abreast with new developments and their potential impact to the business. The committee receives periodic reports from the risk and compliance function relating to the Bank's strategic risk, credit risk, market risk (interest rate risk, price risk, and foreign exchange risk), operational risk, regulatory risk, reputational risk, and liquidity risk.

Finance and Credit Committee

The committee is mandated to review and make recommendations on the Bank's credit, financial and accounting policies, and review and make recommendations on the Bank's Annual Budget, oversight of the overall lending policy of the Bank and deliberate and consider loan applications beyond the credit discretion limits set for management. The committee also reviews and considers all issues that may materially impact the present and future quality of the Bank's credit risk management function as well as the quality of the loan portfolio and ensure adequate bad debt provisions are maintained in line with the Central Bank of Kenya prudential guidelines. The committee also reviews, approves and monitors the management's compliance with applicable statutory provisions, Bank policies and guidelines relating to the monitoring of price, liquidity, exchange rate and interest rate risks.

Staff Committee

The committee is mandated to formulate staff policies and procedures and ensure an adequately staffed and professionally managed human resource. The committee assists the Board in discharging its corporate governance role by reviewing staffing needs of the Bank, appoints senior management staff, reviews training needs and undertake disciplinary measures as per the staff policies.

Board meeting attendance

During the year under review, the Board held main board meetings and working committee meetings. The Board members attendance for 2016 is as follows:

Name	Board Meeting			Audit Committee			Risk & Compliance Committee			Credit & Finance Committee			Staff Committee		
	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%
T. Kiyai - (Chief Executive Officer)	14	14	100%	-	-	-	4	3	75%	7	7	100%	5	5	100%
George Omino – Representing Cabinet Secretary National Treasury	14	9	64%	6	4	67%	-	-	-	7	7	100%	5	5	100%
P.Metto- Alternate to Managing Trustee - NSSF	14	12	86%	-	-	-	-	-	-	7	4	57%	5	5	100%
Dr. Raymond Omollo	14	12	86%	6	5	83%	4	4	100%	-	-	-	-	-	-
Joseph Koskey	12	9	75%	6	6	100%	-	-	-	-	-	-	2	1	50%
Dr. B. Ateng - (Chairman)	14	13	93%	-	-	-	-	-	-	-	-	-	-	-	-
Amb. C. Amira	14	14	100%	6	6	100%	4	4	100%	-	-	-	5	5	100%
M. Cherogony	14	11	79%	-	-	-	4	4	100%	7	7	100%	-	-	-
P. Muhindi	14	14	100%	-	-	-	4	4	100%	7	7	100%	-	-	-
E. Vitisia	14	12	86%	6	5	83%	-	-	-	7	7	100%	5	5	100%

Board Performance Evaluation

The chairman conducts evaluations of the performance of the Board, individual Directors and Board Committees annually. In addition the Board and its Committees undertake an annual evaluation of their performance and report their findings and any resulting recommendations to the Board. The Board also undertakes an evaluation of the performance of the Chairman. The Board discusses the results of its evaluations and uses the process to constructively improve the effectiveness of the Board.

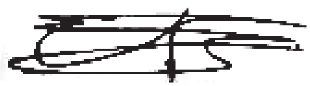
Shareholders

The list of the shareholders and their individual holdings at the year ended 31 December 2016 was as follows:

	No. of Ordinary Shares	%	No. of Preference Shares	%
Cabinet Secretary/The National Treasury	35,000,000	77.9%	-	-
National Social Security Fund	2,225,000	5.0%	8,050,000	22.3%
Kenya National Assurance (2001)	1,094,487	2.4%	3,958,300	11.0%
Kenya National Assurance Company Limited	835,513	1.9%	3,021,700	8.4%
Kenya Pipeline Company Limited	720,000	1.6%	2,631,500	7.3%
Kenya National Examination Council	695,000	1.5%	2,520,000	7.0%
Public Trustees	660,000	1.5%	2,420,000	6.7%
Telkom Kenya Limited	620,000	1.4%	2,250,000	6.2%
National Hospital Insurance Fund	590,000	1.3%	2,120,000	5.9%
LAPTRUST Retirement Services Limited	486,000	1.1%	1,756,000	4.9%
Total of 10 above	***42,926,000***	***95.6%***	***28,727,500***	***79.7%***
Other Shareholders	**1,994,000**	**4.4%**	**7,329,000**	**20.3%**
TOTAL SHAREHOLDING	**44,920,000**	**100%**	**36,056,500**	**100%**

Compliance

The Bank is governed by the Banking Act, among other legal requirements, and adopts certain universally accepted principles in the areas of human rights labour standards in its commitment to best practice. Additionally, the Bank prepares its financial statements in accordance with International Financial Reporting Standards (IFRS).



Director

28th March 2017

CONSOLIDATED BANK OF KENYA LIMITED
REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their report together with the audited financial statements of Consolidated Bank of Kenya limited ("the Bank") for the year ended 31 December 2016, which show the state of affairs of the Bank.

ACTIVITIES

The principal activities of the Bank, which is governed by the Banking Act, are the provision of banking, financial and related services.

RESULTS	Sh'000
Loss before taxation	(276,777)
Taxation credit	65,417
Loss for the year transferred to accumulated deficit	(211,360)

DIVIDEND

The Directors do not recommend the payment of a dividend for the year (2015: nil).

DIRECTORS

The current members of the Board of Directors are shown on page 9-11.The following changes took place early 2017.

- Dr. Benson Ateng term as chairman ended on 9 January 2017.
- Miriam Cherogony term as director ended on 3 February 2017.
- Evans Vitisia term as director ended on 3 February 2017.
- Charles Amira term as director ended on 3 February 2017.
- Papius Muhindi term as director ended on 3 February 2017.

AUDITORS

The Auditor General is responsible for the statutory audit of the Bank's books of account in accordance with section 14 and section 39(i) of the Public Audit Act, 2004 which empowers the Auditor General to nominate other auditors to carry out the audit on his behalf and subject to the approval by the Central Bank of Kenya in accordance with the requirements of Section 24(1) of the Banking Act.

Deloitte &Touche, who were nominated by the Auditor General, carried out the audit of the financial statements for the year ended 31 December 2016.

BY ORDER OF THE BOARD

Secretary

Nairobi

28th March 2017

CONSOLIDATED BANK OF KENYA LIMITED
STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

The Directors accept responsibility for the preparation and presentation of these annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Bank and of its operating results.

The Directors also accept responsibility for:

i) designing, implementing and maintaining such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;

ii) selecting suitable accounting policies and applying them consistently; and

iii) making accounting estimates and judgements that are reasonable in the circumstances.

The Directors have considered the Bank's non-compliance with the minimum capital requirements of the Central Bank of Kenya Prudential Guidelines as discussed in note 3 to the financial statements which indicates that, as at 31 December 2016, the Bank's total regulatory capital to risk weighted assets ratio was 8.0% which is below the CBK minimum prudential ratio of 14.5%. The Directors in consultation with National Treasury are taking the necessary measures to recapitalise the Bank and ensure compliance with the regulatory and prudential requirements. The National Treasury (the majority shareholder with 77.9% stake) is in the process of seeking necessary approvals from the Cabinet and the National Assembly for the implementation of the agreed recapitalisation strategy. Based on the foregoing the Directors believe that the Bank will remain a going concern in the foreseeable future.

Nothing else has come to the attention of the Directors to indicate that the Bank will not remain a going concern for at least the next twelve months from the date of this statement.

Approved by the board of directors on 28th March 2017 and signed on its behalf by:

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Director

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Director

REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF CONSOLIDATED BANK OF KENYA LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of Consolidated Bank of Kenya Limited set out on pages 40 to 102, which comprise the statement of financial position as at 31 December 2016, and the statement of profit or loss and other comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by Deloitte & Touché, auditors appointed under Section 23 of the Public Audit Act, 2015 and in accordance with the provisions of Article 29 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, the accompanying financial statements present fairly in all material respects the financial position of Consolidated Bank of Kenya Limited as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and comply with Companies Act, 2015 and the Banking Act.

Basis for Opinion

The audit was conducted in accordance with International Standards on Auditing. My responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I am independent of the Bank in accordance with ISSAI 30 and the International Ethics Standards Board for Accountants on Code of Ethics for Professional Accountants (IESBA Code). I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with the ethical requirements applicable to performing audits of the financial statements in Kenya.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the financial statements of the current year. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters. For each matter below, a description of how the audit addressed the matter is provided in that context.

I have fulfilled responsibilities described in the Auditor's Responsibilities for the Audit of the financial statements section of the report, including in relation to these matters. Accordingly, the audit included the performance of procedures designed to respond to the assessment of the risks of material misstatement of the financial statements. The result of the audit procedures, including the procedures performed to address the matters below, provide the basis for my audit opinion on the accompanying financial statements.

Key Audit Matters (Continued)	How Our Audit Addressed the Key Audit Matter
1.Impact of regulatory capital requirements on going concern As disclosed in note 5 of the financial statements, the Bank is subject to certain minimum capital requirements per the Central Bank of Kenya Prudential Guidelines, which are a key determinant of the Bank's ability to continue as a going concern. As at 31 December 2016, the Bank had a total regulatory capital/risk weighted assets ratio of 8.0% (2015:9.4%) against a regulatory minimum ratio of 14.5%. The Bank therefore had not met the minimum regulatory capital requirements. Accordingly, the assessment of the Bank's going concern requires significant judgement by the Directors and therefore is considered a key audit matter. I identified that the most significant judgement in assessing the Bank's ability to continue as a going concern was the assessment of the Bank's ability to obtain additional capital to ensure compliance with regulatory capital, and evaluating the assumptions used in the cash flow forecasts. Refer to the statement of Directors' responsibilities for Director's considerations on going concern and note 3 of the financial statements for the Impact of the regulatory requirements on the going concern disclosure.	I evaluated the appropriateness of the Directors' assessment of the Bank's going concern and the adequacy of the disclosures made. My audit procedures included challenging the Directors on the suitability of the planned measures to be put in place to ensure compliance with the capital requirements and the reasonableness of the assumptions made through performing the following audit procedures: • Understanding the root cause of the non-compliance with regulatory capital requirements and understanding the impact thereof on the Bank's ability to continue operating; • Evaluating correspondence with the key shareholders on the future plans of the Bank; • Considering the impact of recent regulatory developments, as applicable; and • Evaluating the cash flow forecasts and assessing the reliability of the Directors' forecast through a review of actual performance against previous forecasts. Based on my procedures, I found the Directors' key judgement and assumptions to be reasonable. I validated the appropriateness of the related disclosures in note 3 of the financial statements.

Key Audit Matters (Continued)	How Our Audit Addressed the Key Audit Matter
2. Provision for impaired loans and advances Impairment against loans and advances amounting to Shs 438.5 million against an advances balance of Shs 9.6 billion, described in notes 18 and 19, represents the shortfall between the present value of future expected cash flows, discounted at the original effective interest rate, and the carrying value of the advance in respect of loans that exhibit indicators of impairment. Significant judgement is required by the Directors in assessing the impairment against loans and advances. The significant judgements applied in determining the impairment include: • the expected realisable value of the collateral securing the advance; and • the probability that an advance will result in loss. • Accordingly, the provisions for impaired loans and advances is considered a key audit matter. Refer to note 2 of the financial statements for critical accounting judgements and key sources of estimation uncertainty and notes 18 and 19 of the financial statements for loans and receivables and provision for impairment disclosures.	I have assessed the operating effectiveness of controls in respect of the recognition of impairment losses on loans and advances, specifically over impairment data and calculations. Where impairment was individually calculated, I tested controls over the timely identification of potentially impaired loans. I assessed the adequacy of the provisions by focussing my audit on the following procedures: • I tested a sample of loans and advances to ascertain whether the loss event (that is the point at which impairment is recognised) had been identified in a timely manner. • Where impairment had been identified, I examined the forecasts of future cash flows prepared by the Directors to support the calculation of the impairment, challenging the assumptions and comparing estimates to external evidence where applicable. • I tested the validity and valuation of collateral held on a sample basis. • I tested the historical accuracy of the provisions and the assumptions and judgements made by management in arriving at the provisions recorded. In the case of some impairment provisions, I formed a different view from that of the Directors, but in my view the differences were within a reasonable range of outcomes in the context of the overall loans and advances as disclosed in the financial statements. I validated the appropriateness of the related disclosures in the notes of the financial statements.

Directors' Responsibilities for the Financial Statements

The Directors are responsible for the preparation and fair presentation of financial statements in accordance with International Financial Reporting Standards, the requirements of the Companies Act, 2015 and the Banking Act, and for such internal controls as 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, the Directors are responsible for assessing the Bank'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 Bank or to cease operations, or have no realistic alternative but to do so.

Those charged with Governance are responsible for overseeing the Bank's financial reporting process.

The Directors are also responsible for the submission of the financial statements to the Auditor-General in accordance with the provision of Section 47 of the Public Audit Act, 2015.

Auditor's Responsibilities for the Audit of the Financial Statements

The audit 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 my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution of Kenya. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs 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 ISSAIs, I exercise professional judgement and maintain professional scepticism throughout the audit. I 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 my 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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my report. However, future events or conditions may cause the Bank to cease to continue as a going concern. Refer to the going concern uncertainty included under key audit matters.
- 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.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entity or business activities within the Bank to express an opinion on the financial statements.

I 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 I identify during my audit.

I also provide those charged with governance with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

From the matters communicated with the Directors, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. These matters are described in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Companies Act 2015, I report to you, based on my audit, that:

i) I have obtained all the information and explanations which to the best of my knowledge and belief, were necessary for the purposes of the audit;

ii) In my opinion, adequate accounting records have been kept by the Bank, so far as appears from the examination of those books of account; and

iii) The Bank's financial statements are in agreement with the accounting records.

FCPA Edward R. O. Ouko, CBS

AUDITOR-GENERAL

Nairobi

25th May 2017

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

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

	Notes	2016 Sh'000	2015 Sh'000
INTEREST INCOME	**6**	**1,671,787**	**1,957,414**
INTEREST EXPENSE	**7**	**(985,700)**	**(938,585)**
NET INTEREST INCOME		**686,087**	**1,018,829**
Fee and commission income	8	269,932	316,865
Foreign exchange trading income	9	30,548	36,628
Other operating income	10	451,245	642,713
OPERATING INCOME		**1,437,812**	**2,015,035**
Operating expenses	11	(1,405,572)	(1,377,562)
Impairment charge on loans and advances	19	(309,017)	(588,684)
(LOSS)/PROFIT BEFORE TAXATION		**(276,777)**	**48,789**
TAXATION CREDIT/(CHARGE)	**13(a)**	**65,417**	**(4,367)**
(LOSS)/PROFIT FOR THE YEAR		**(211,360)**	**44,422**
OTHER COMPREHENSIVE INCOME			
Items that may be reclassified subsequently to profit or loss:			
Net fair value (loss)/gains on available-for-sale financial			
assets	21	(782)	2,973
Total other comprehensive (loss)/income		**(782)**	**2,973**
TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR		**(212,142)**	**47,395**
(LOSS)/EARNINGS PER SHARE		Sh	Sh
Basic and diluted	14	(4.71)	0.99

CONSOLIDATED BANK OF KENYA LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2016

CONSOLIDATED BANK OF KENYA LIMITED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

ASSETS	Notes	31 December 2016 Sh'ooo	31 December 2015 Sh'ooo
Cash and balances with Central Bank of Kenya	15	652,941	759,717
Balances due from banking institutions	16(a)	53,713	104,709
Government securities	17	2,663,491	2,688,034
Loans and receivables	18	9,161,484	9,221,256
Other assets	20	243,099	250,486
Quoted equity shares	21	6,097	6,879
Taxation recoverable	13(c)	-	12,165
Deferred tax asset	27	56,634	-
Property and equipment	22	795,453	844,438
Intangible assets	23	278,004	240,695
Prepaid operating lease rentals	24	6,979	7,149
TOTAL ASSETS		**13,917,895**	**14,135,528**
LIABILITIES AND SHAREHOLDERS' FUNDS			
LIABILITIES			
Deposits and balances due to banking institutions	16(b)	91,258	275,463
Balances due to Central Bank of Kenya	16(c)	820,000	-
Customer deposits	25	9,491,803	9,996,058
Other liabilities	26	223,784	240,821
Taxation payable	13(c)	2,029	-
Deferred tax liability	27	-	38,677
Borrowings	28	1,885,948	1,969,294
TOTAL LIABILITIES		**12,514,822**	**12,520,313**
SHAREHOLDERS' FUNDS			
Share capital	29(b)	1,619,530	1,619,530
Revaluation surplus	30	387,751	396,372
Accumulated deficit	31	(873,623)	(533,841)
Statutory reserve	32	264,186	127,143
Fair value reserve	33	5,229	6,011
TOTAL SHAREHOLDERS' FUNDS		1,403,073	1,615,215
TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS		**13,917,895**	**14,135,528**

The financial statements on pages 40 to 102 were approved and authorised for issue by the Board of Directors on 28th March 2017 and were signed on its behalf by:

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Director

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Director

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Chief Executive Officer

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Company Secretary

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

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

	Note	Capital awaiting allotment Sh'000	Share capital Sh'000	Revaluation surplus Sh'000	Accumulated deficit Sh'000	Statutory reserve Sh'000	Fair value reserve Sh'000	Total Sh'000
At 1 January 2015		500,000	1,119,530	405,999	(531,528)	70,781	3,038	1,567,820
Profit for the year		-	-	-	44,422	-	-	44,422
Other comprehensive income		-	-	-	-	-	2,973	2,973
Total comprehensive income		**-**	**-**	**-**	**44,422**	**-**	**2,973**	**47,395**
Capital alloted in the year	29(c)	(500,000)	500,000	-	-	-	-	-
Transfer of excess depreciation	30	-	-	(13,753)	13,753	-	-	-
Deferred tax on excess depreciation	30	-	-	4,126	(4,126)	-	-	-
Transfer to statutory reserve	32	-	-	-	(56,362)	56,362	-	-
At 31 December 2015		**-**	**1,619,530**	**396,372**	**(533,841)**	**127,143**	**6,011**	**1,615,215**
At 1 January 2016		-	1,619,530	396,372	(533,841)	127,143	6,011	1,615,215
Loss for the year		-	-	-	(211,360)	-	-	(211,360)
Other comprehensive loss		-	-	-	-	-	(782)	(782)
Total comprehensive income		**-**	**-**	**-**	**(211,360)**	**-**	**(782)**	**(212,142)**
Transfer of excess depreciation	30	-	-	(12,316)	12,316	-	-	-
Deferred tax on excess depreciation	30	-	-	3,695	(3,695)	-	-	-
Transfer to statutory reserve	32	-	-	-	(137,043)	137,043	-	-
At 31 December 2016		**-**	**1,619,530**	**387,751**	**(873,623)**	**264,186**	**5,229**	**1,403,073**

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

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

	Note	2016 Sh'000	2015 Sh'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash (used in)/generated from operations	34(a)	(287,182)	153,478
Tax paid	13(c)	(15,700)	(12,307)
Net cash (used in)/generated from operating activities		(302,882)	141,171
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment	22	(47,706)	(11,331)
Proceeds on sale of property and equipment		2,003	-
Purchase of intangible assets	23	(109,925)	(19,482)
Net cash used in investing activities		(155,628)	(30,813)
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of borrowings	28	(321,281)	(330,878)
NET DECREASE IN CASH AND CASH			
EQUIVALENTS DURING THE YEAR		(779,791)	(220,520)
CASH AND CASH EQUIVALENTS AT 1 JANUARY		246,112	466,632
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**34(b)**	**(533,679)**	**246,112**

CONSOLIDATED BANK OF KENYA LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016

1. REPORTING ENTITY

Consolidated Bank of Kenya Limited (The "Bank") provides commercial banking services.

The address of its registered office is as follows:
Consolidated Bank House, Koinange Street
P O Box 51133 - 00200
Nairobi

2. (a) ACCOUNTING POLICIES

Statement of Compliance

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

For the Kenyan Companies Act reporting purposes, in these financial statements the balance sheet is represented by/is equivalent to the statement of financial position and the profit and loss account is presented in the statement of comprehensive income.

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

i) *Relevant new standards and amendments to published standards effective for the year ended 31 December 2016*
Several new and revised standards and interpretations became effective during the year. The Directors have evaluated the impact of their new standards and interpretations and none of them had a significant impact on the Bank's financial statements.

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

New and Amendments to standards	Effective for annual periods beginning on or after
IFRS 9 Financial Instruments	1 January 2018, with earlier application permitted
IFRS 15 Revenue from contracts with customers	1 January 2018, with earlier application permitted only if IFRS 16 is also adopted
IFRS 16 Leases	1 January 2019, with earlier application permitted
Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions	1 January 2018, with earlier application permitted
Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and itsAssociate or Joint Venture	Effective for annual periods beginning on or after a date to be determined
Amendments to IAS 7 Disclosure Initiative	1 January 2017, with earlier application permitted
Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses	1 January 2017, with earlier application permitted

2. (a) ACCOUNTING POLICIES (Continued)

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

iii) Impact of relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2016

IFRS 9 Financial Instruments

In July 2014, the IASB finalised the reform of financial instruments accounting and issued IFRS 9 (as revised in 2014), which contains the requirements for:

a) the classification and measurement of financial assets and financial liabilities;

b) impairment methodology; and

c) general hedge accounting.

Key requirements of IFRS 9:

- **Classification and measurement.** Financial assets are classified by reference to the business model within which they are held and their contractual cash flow characteristics. The 2014 version of IFRS 9 introduces a 'fair value through other comprehensive income' category for certain debt instruments. Financial liabilities are classified in a similar manner to under IAS 39, however there are differences in the requirements applying to the measurement of an entity's own credit risk.

- **Impairment.** The 2014 version of IFRS 9 introduces an 'expected credit loss' model for the measurement of the impairment of financial assets, so it is no longer necessary for a loss event to have occurred before a credit loss is recognised.

- **Hedge accounting.** Introduces a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

- **De-recognition.** The requirements for de-recognition of the financial assets and liabilities are carried forward from IAS 39. The Directors of the company anticipate that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the company's financial assets and financial liabilities However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed by the Bank.

IFRS 15 Revenue from Contracts with Customers

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

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

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

2. (a) ACCOUNTING POLICIES (Continued)

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

iii) Impact of relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2016 (Continued).

IFRS 15 Revenue from Contracts with Customers (Continued)

Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

In April 2016, the IASB issued Clarifications to IFRS 15 in relation to the identification of performance obligations, principal versus agent considerations, as well as licensing application guidance.

The Directors are still in the process of assessing the full impact of the application of IFRS 15 on the Bank's financial statements and it is not practicable to provide a reasonable financial estimate of the effect until the Directors complete the detailed review. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

IFRS 16 Leases

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

IFRS 16 applies to annual reporting periods beginning on or after 1 January 2019.The Directors anticipate that the adoption of IFRS 16 will not have a significant impact on the Bank's financial statements.

Amendments to IAS 7 Disclosure Initiative

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

The amendments apply prospectively for annual periods beginning on or after 1 January 2017 with earlier application permitted. The Directors of the Bank do not anticipate that the application of these amendments will have a material impact on the Bank's financial statements.

Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify the following:

- Decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference, irrespective of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use, or whether it is probable that the issuer will pay all the contractual cash flows;
- When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, and the tax law restricts the utilisation of losses to deduction against income of a specific type (e.g. capital losses can only be set off against capital gains), an entity assesses a deductible temporary difference in combination with other deductible temporary differences of that type, but separately from other types of deductible temporary differences;

2. (a) ACCOUNTING POLICIES (Continued)

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

iii) Impact of relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2016 (Continued).

Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealized Losses (Continued)

- The estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and
- In evaluating whether sufficient future taxable profits are available, an entity should compare the deductible temporary differences with future taxable profits excluding tax deductions resulting from the reversal of those deductible temporary differences.

The amendments apply retrospectively for annual periods beginning on or after 1 January 2017 with earlier application permitted. The Directors of the Bank do not anticipate that the application of these amendments will have a material impact on the Bank's financial statements.

iv) Early adoption of standards

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

The principal accounting policies applied in the preparation of the financial statements are set out below. These policies have been applied consistently.

Basis of preparation

The financial statements have been prepared on the historical cost basis of accounting except for certain properties that are measured at revalued amounts and certain financial instruments, measured at fair value:

Consolidation

The financial statements of the dormant subsidiaries listed in note 35 have not been consolidated as the amounts involved are not material and would, therefore, be of no real value. The parent Company has determined that the investments are not material and have no impact on the reported profit or loss and its statement of financial position. The Group and Company numbers are the same after taking into account the investments in the subsidiaries.

Investments in subsidiary companies

Investments in subsidiary companies are stated at cost less impairment loss where applicable. The dormant subsidiaries listed in note 35 have not been consolidated because the parent Company has determined that the investments are not material and have no impact to the reported profit or loss and its statement of financial position.

Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised in the profit or loss on accrual basis using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or when appropriate, a shorter period) to the net carrying amount of the financial asset or liability.

2. (a) ACCOUNTING POLICIES (Continued)

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

Interest income and expense (Continued)

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

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

Fees and commission income

In the normal course of business, the Bank earns fees and commission income from a diverse range of services to its customers. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment management fees, placement fees and syndication fees, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period.

Other fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

Property and equipment

Property and equipment are stated at cost or as professionally re-valued from time to time less accumulated depreciation and any accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The Bank's policy is to professionally revalue freehold land and buildings at least once every three years.

Any increase arising on the revaluation is recognised in other comprehensive income and accumulated in the revaluation surplus. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and charged against the revaluation surplus; all other decreases are charged to profit or loss.

Depreciation

Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of each asset or the revalued amounts, to its residual values over its estimated useful life as follows:

Fixtures, fittings, equipment& ATMs	5 years
Leasehold improvements	8 years or lease period if shorter
Computers	3 years
Motor vehicles	4 years
Buildings	40 years or land lease period if shorter

Freehold land is not depreciated as it is deemed to have an indefinite life.

The depreciation charge to profit and loss is based on the carrying amounts of the property and equipment. The excess of this charge over that based on the historical cost of the property and equipment is released each year from the revaluation surplus to retained earnings.

2. (a) ACCOUNTING POLICIES (Continued)

Intangible assets - computer software costs

Costs incurred on computer software are initially accounted for at cost and subsequently at cost less any accumulated amortisation and accumulated impairment losses. Amortisation is calculated on a straight line basis over the estimated useful lives not exceeding a period of 5 years.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the Bank as a lessee. All other leases are classified as operating leases.

When a lease includes land and buildings elements, the Bank assesses the classification of each element as either a finance lease or an operating lease. In determining classification of the land element, an important consideration is that land normally has an indefinite economic life. Therefore the finance lease or operating lease classification of the land is considered a critical area of judgement. See note 2(b) to these financial statements.

The Bank as lessor

Assets held under finance leases are recognised as assets of the Bank at their fair value at the date of acquisition. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the fair value of the assets acquired, are charged to the statement of comprehensive income over the term of the relevant lease so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

The Bank as lessee

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Impairment of non-financial assets

At the reporting date, the Bank reviews the carrying amount of its tangible and intangible assets to determine whether there is any indication that these assets have suffered an impairment loss

If objective evidence on impairment losses exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit or loss. In cases where the asset is carried at revalued amount, the impairment loss is treated as a revaluation decrease.

In determining the recoverable amount, the Bank considers the higher of the fair value of the asset less costs to sell, and value in use. In estimating value in use, the Bank is cognisant of the estimated future cash flows discounted to the present value using a pre-tax discount rate that is reflective of the current market assessment of time value of money and the risks specific to the asset itself.

Intangible assets with indefinite useful life are tested for impairment annually, and when there is indication that the asset may be impaired.

Where impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised, unless such asset is carried at revalued amount, in which case the reversal of the impairment loss is treated as revaluation income.

2. (a) ACCOUNTING POLICIES (Continued)

Foreign currencies

i) *Functional and presentation currency*

The financial statements of the Bank are measured using the currency of the primary economic environment in which the Bank operates ('the functional currency'). The financial statements are presented in Kenya Shillings, which is the Bank's functional and presentation currency. Except as indicated, financial information presented in Kenya Shillings has been rounded to the nearest thousand (Sh'000).

ii) *Transactions and balances*

Foreign currency transactions that are transactions denominated, or that requires settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. At the reporting date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.

Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised through profit or loss.

Taxation

The tax expense for the year comprises current and deferred income tax. Tax is recognised in profit or loss except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax enacted or substantively enacted at the reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying values in the financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted at the reporting date and are expected to apply when the related deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Financial instruments

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

Financial assets

a) Classification and measurement

The Bank classifies its financial assets into the following IAS 39 categories: Financial assets at fair value through profit or loss; loans and receivables; held- to- maturity investments; and available-for-sale financial assets. Management determines the appropriate classification of its financial instruments at initial recognition, depending on the purpose and intention for which the financial instrument was acquired and their characteristics

2. (a) ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

a) Classification and measurement (Continued)

i) *Financial assets at fair value through profit or loss*

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

ii) *Due from Banks and loans and receivables*

Due from Banks and loans and receivables include non–derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are recognised when cash is advanced to borrowers.

After initial recognition, amounts 'Due from Banks' and 'Loans and advances to customers' are subsequently measured at amortised cost using the effective interest rates, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in 'Interest and similar income' in the profit and loss. The losses arising from impairment are recognised in profit or loss.

iii) *Held-to-maturity financial assets*

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has the positive intention and ability to hold to maturity.

Held to maturity financial assets are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost using the effective interest method less any impairment, with revenue recognised on an effective yield basis. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate and recognised in the profit or loss.

Where a sale occurs other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and classified as available for sale. Furthermore, the Bank would be prohibited from classifying any financial asset as held to maturity during the following two years.

iv) *Available-for-sale financial assets*

Available for sale investments are those that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates or equity prices or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Available-for-sale investments are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets which are recognised in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss. Dividends on available for sale equity instruments are recognised in profit and loss when the Bank's right to receive the dividends is established.

2. (a) ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

b) Derecognition of financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired.
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement; and either:
  - the Bank has transferred substantially all the risks and rewards of the asset, or
  - the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass–through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

c) Impairment and uncollectability of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each reporting date. The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after initial recognition of the asset (a 'loss' event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

If it is probable that the Bank will not be able to collect all amounts due (principal and interest) according to the contractual terms of loans and receivables, or held-to-maturity investments carried at amortised cost, an impairment or bad debt loss has occurred. The amount of the loss is the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate (recoverable amount). The carrying amount of the asset is reduced to its estimated recoverable amount through use of the provision for bad and doubtful debts account. The amount of the loss incurred is included in profit or loss for the period.

The Bank assesses whether objective evidence of impairment exist individually for assets that are individually significant and individually or collectively for assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

2. (a) ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

c) Impairment and uncollectability of financial assets (Continued)

i) *Assets carried at amortised cost*

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instruments effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss.

ii) *Loans and receivables*

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and advances is established when there is objective evidence that the Bank will not be able to collect all amounts due according to the original terms of the loans. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the profit or loss as 'impairment loss on loans and receivables'. When a loan or advance is uncollectible, it is written off against the related allowance account. Subsequent recoveries of amounts previously written off are credited through profit or loss.

Objective evidence that loans and receivables are impaired can include significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue), 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 are considered indicators that the loans or receivable is impaired.

In assessing impairment losses, the Bank considers the following factors, in each category:

a) **Individually assessed loans**

- The aggregate exposure to the Bank.
- The viability of the customer's business model and its capacity to trade successfully out of financial difficulties and generate sufficient cash flows to meet its debt obligations.
- The realisable value of the security (or other migrants) and likelihood of successful repossession net of any costs involved in recovery of amounts.
- The amount and timing of expected receipts and, in cases of liquidation or bankruptcy, dividend available.
- The extent and complexity of other creditor's commitment ranking paripassu with the Bank and the likelihood of other creditors continuing to support the customer.

b) **Collectively assessed**

- For loans not subject to individual assessment, to cover losses which have been incurred but have not yet been identified.
- For homogeneous groups of loans that are not considered individually significant, where there is objective evidence of impairment.

2. (a) ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

ii) Loans and receivables (continued)

b) **Collectively assessed (Continued)**

- *Homogeneous groups of loans*
  For homogeneous groups of loans that are not considered individually significant, or in other cases, when the portfolio size is small or when information is insufficient or not reliable enough, the Bank adopts a formulaic approach which allocates progressively higher percentage loss rates in line with the period of time for which a customer's loan is overdue. Loss rates are calculated from the discounted expected future cash flows from a portfolio. These rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.
- *Loan write – offs*
- An uncollectible loan is written off against the relevant provision for impairment, either partially or in full, when there is no realistic prospect of recovery and the proceeds from realising the security have been substantially or fully recovered.
- *Restructured* loans
  Restructured loans, whose terms have been renegotiated are no longer considered to be past due but are treated as new loans after the minimum required number of payments under the new arrangement have been received.

iii) *Available-for-sale financial assets*

In the case of investment classified as available for sale, significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the asset is impaired. Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of equity to profit or loss.

When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

Financial liabilities and equity instruments issued by the Bank

a) Classification and measurement

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

i) *Equity instruments*
An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Bank are recorded at the proceeds received, net of direct issue costs.

2. (a) ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial liabilities and equity instruments issued by the Bank (Continued)

a) Classification and measurement (Continued)

ii) *Other financial liabilities*

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

b) Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire.

Offsetting

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

Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Statutory reserve

IAS 39 requires the Bank to recognise an impairment loss when there is objective evidence that loans and receivables are impaired. However, Central Bank of Kenya prudential guidelines require the Bank to set aside amounts for impairment losses on loans and advances in addition to those losses that have been recognised under IAS 39. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining profit or loss. These amounts are dealt with in the statutory reserve.

2. (a) ACCOUNTING POLICIES (Continued)

Cash and cash equivalents

Cash and cash equivalents include cash in hand, unrestricted balances held with the Central Bank of Kenya and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are generally written by the 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. These obligations are accounted for as off balance sheet transactions and disclosed as contingent liabilities.

Fiduciary activities

Assets and income arising thereon together with related undertakings to return such assets to customers are excluded from these financial statements where the Bank acts in a fiduciary capacity such as nominee, trustee or agent.

Sale and repurchase agreements

Securities sold to Central Bank of Kenya subject to repurchase agreements ('repos') are retained in the financial statements under government securities and the counterparty liability is included in advances from Central Bank of Kenya. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Employee benefit costs

The Bank operates a defined contribution retirement benefit scheme for all its employees. The scheme is administered by an independent investment management company and is funded by contributions from both the Bank and employees.

The Bank also contributes to the statutory National Social Security Fund. This is a defined contribution scheme registered under the National Social Security Fund Act. The obligations under the scheme are limited to specific contributions legislated from time to time.

The Bank's contributions in respect of retirement benefit costs are charged to the profit and loss in the year to which they relate.

Employee entitlement to leave not taken is charged to profit or loss as it accrues.

Comparatives

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

2.(b) CRITICAL JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Bank's accounting policies, which are described in note 2, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in 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.

i) Critical judgements in applying the Bank's accounting policies

The following are the critical judgements, apart from those involving estimations (see (ii) overleaf), that management have made in the process of applying the Bank's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment regularly. In determining whether an impairment loss should be recorded in the profit and loss, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Classification of leases of land as finance or operating leases

At the inception of each lease of land, the Bank considers the substance rather than the form of the lease contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- The lease transfers ownership of the asset to the lessee by the end of the lease term;
- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- The leased assets are of such a specialised nature that only the lessee can use them without major modifications.

The Bank also considers indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease. Examples of such indicators include:

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

The Bank did not acquire any new leases in the year ended 31 December 2016.

2b. CRITICAL JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (Continued)

i) Critical judgements in applying the Banks accounting policies (Continued)

Impairment of available-for-sale investments

The Bank reviews its debt securities classified as available–for–sale investments at each reporting date to assess whether they are impaired. This requires similar judgement as applied to the individual assessment of loans and advances.

The Bank also records impairment charges on available–for–sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Bank evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Held -to-maturity investments

The Bank follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgement. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortised cost.

ii) Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Property, equipment and intangible assets

Critical estimates are made by management in determining depreciation rates and residual values for property, equipment and intangible assets.

Fair value of trade receivables and payables

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Bank for similar financial instruments.

Taxation

The Bank is subjected to numerous taxes and levies by various government and quasi- government regulatory bodies. As a rule of thumb, the Bank recognises liabilities for the anticipated tax /levies payable with utmost care and diligence. However, significant judgement is usually required in the interpretation and applicability of those taxes /levies. Should it come to the attention of management, in one way or the other, that the initially recorded liability was erroneous, such differences will impact on the income and liabilities in the period in which such differences are determined.

3. IMPACT OF REGULATORY CAPITAL REQUIREMENTS ON GOING CONCERN

As at 31 December 2016, the Bank had a total regulatory capital/risk weighted assets ratio of 8.0% (2015:9.4%) against a regulatory minimum ratio of 14.5%. The Bank therefore had not met the minimum regulatory capital requirements. The Directors, in consultation with National Treasury, are taking the necessary measures to recapitalise the Bank and ensure compliance with the regulatory and prudential requirements. The National Treasury (the majority shareholder with 77.9% stake) is in the process of seeking necessary approvals from the Cabinet and the National Assembly for the implementation of the agreed recapitalisation strategy. The critical judgements made by the directors in assessing the Bank's ability to continue as a going concern were the assessment of the Bank's ability to obtain additional capital to ensure compliance with minimum regulatory capital requirements, and evaluating the assumptions used in the cash flow forecasts.

Based on the foregoing the Directors believe that the Bank will remain a going concern in the foreseeable future.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES

A) FINANCIAL RISK

The Bank defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors. The Bank aims to achieve an appropriate balance between risk and return and minimise the potential adverse effects of the Bank's financial performance.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The board has established a risk management committee comprising of three non-Executives Directors to assist in the discharge of this responsibility. The board has also established the Bank Asset and Liability (ALCO), Credit and Operational Risk committees, which are responsible for developing and monitoring risk management policies in their specified areas. These committees comprise of executive members and report regularly to the board of Directors on their activities.

The Board provides written principles for overall risk management as well as written policies covering specific risk areas. The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and best market practices. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Board Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. This committee is assisted in these functions by the Internal Audit Function. The Internal Audit Function undertakes reviews of risk management controls and procedures, the results of which are reported to the committee.

The most important type of risks to which the Bank is exposed to are financial risks which include:

i) Credit risk

ii) Liquidity risk

iii) Market risks

i) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Bank's loans and advances to customers and other Banks and investment securities but can also arise from credit enhancement provided such as financial guarantees, letters of credit and acceptances. The Bank is also exposed to other credit risks arising from its trading activities including derivatives.Credit risk is the single largest risk for the Bank's business and management carefully manages its exposure to credit risk. For risk management reporting purposes, the Bank 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 oversight of credit risk to its Finance and Credit Committee comprising of four non-executive directors. The implementation of the credit risk policies and monitoring of the credit portfolio to ensure that risks are managed within acceptable standards is the responsibility of the credit committee comprising of executive management. The committee assisted by the credit department is responsible for the management of the Bank'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 delegated to the head of credit and the credit committee while larger facilities require approval by the Board of Directors.
- Limiting concentrations of exposure to counterparties, geographies and industries for loans and advances.
- Developing and maintaining the Bank'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. Risk grades are subject to regular reviews by credit 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 Bank credit committee on the credit quality of local portfolios and appropriate corrective action is taken.
- Providing advice, guidance and specialist skills to branches to promote best practice throughout the Bank in the management of credit risk.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

i) Credit risk (Continued)

Credit risk measurement

In measuring credit risk of loans and advances to customers, the Bank takes into account the following factors:

- The probability of default: this is the possibility of the customer failure to pay over the stipulated period in the contract.
- Current exposure on the borrower and the likely future development from which the Bank derives the exposure at default
- Estimated recovery ratio should default occur; this is the amount that can be recovered through sale of collateral

The Bank assesses the probability of default of individual borrowers using internal rating methods tailored to the various categories of the borrower. In assessing the credit quality of the customer the Bank takes into account the customers financial position, past experience and other industry specific factors. The credit risk measurements are embedded in the Bank's daily operational management and closely aligned to the Central Bank of Kenya loan classifications. The impairment allowances on loans and advances computed through the Bank's internal measures and the Central Bank of Kenya prudential guidelines are contrasted with the measurement of impairment under the IAS 39.

Risk limit control and mitigation policies

The Bank structures the level of credit risk it undertakes by placing limits on amounts of risk accepted in relation to one borrower or a group of borrowers. Such risks are monitored on a revolving basis and are subject to annual or more frequent review.

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

The Bank takes security for funds advances and implements guidelines on the acceptability of specific classes of collateral. To minimise credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances. Collateral held for other financial assets other than loans and advances depends on the nature of the instrument.

The primary purpose of acceptances, letters of credit and guarantees is to ensure funds are available to a customer as required. Guarantees and standby letters of credit carry the same risk as loans. Documentary and commercial letters of credit which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions are collateralised by the underlying goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorisation to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments as most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The Bank has no significant concentration of credit risk, with exposure spread over a diversity of personal and commercial customers.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

i) Credit risk (Continued)

Maximum exposure to credit risk before collateral held

	2016 Sh'000	%	2015 Sh'000	%
Credit Exposures				
On – balance sheet items				
Cash and balances with the CBK	652,941	4	759,717	5
Government securities	2,663,491	19	2,688,034	18
Balances due from banking institutions	53,713	-	104,709	1
Loans and advances to customers	9,146,232	64	9,221,256	62
	12,516,377	**87**	**12,773,716**	**86**
Off-balance sheet items				
Acceptances and letters of credit	90,760	1	39,620	1
Guarantees	818,721	6	761,208	5
Undrawn formal stand-by facilities, credit lines and other commitments to lend	931,756	6	1,252,551	8
	1,841,237	**13**	**2,053,379**	**14**
At 31 December	**14,357,614**	**100**	**14,827,095**	**100**

The above represents the worst case scenario of credit exposure for 31 December 2016 and 2015, without taking into account any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures, set out above are based on net carrying amount as reported on the statement of financial position.

Loans and advances to customers comprise of 64% (2015 - 62%) of the total maximum exposure. The fair value of collateral held in respect of assets subject to credit risk as at 31 Decembers 2016 was Sh 22,068,634,000 (2015- Sh16, 268,384,000).

While collateral is an important mitigant to credit risk, the Bank's policy is to establish that loans are within the capacity of the customer to repay, as the primary way out. The Bank 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.

The Bank is confident that its policies and procedures provide sufficient safeguards against exposure on credit risk as shown on the table overleaf.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

i) Credit risk (Continued)

Classification of Loans and receivables	2016 Sh'000	2015 Sh'000
Carrying amount		
Individually impaired		
Grade 6: Impaired (substandard)	305,463	312,857
Grade 7: Impaired (doubtful)	1,627,707	1,499,300
Grade 8: Impaired (loss)	104,335	145,704
Gross amount	**2,037,505**	**1,957,861**
Allowance for impairment	(400,977)	(479,550)
Interest in suspense	(559,398)	(398,739)
Carrying amount	1,077,130	1,079,572
Collectively impaired (past due but not impaired)		
Grade 4-5: Watch list	1,253,493	1,021,970
Allowance for impairment	(37,605)	(30,659)
Carrying amount	1,215,888	991,311
Neither past due nor impaired		
Grade 1-3: Normal	6,868,466	7,150,373
Total carrying amount	**9,161,484**	**9,221,256**

Apart from the loans and receivables to customers all other credit exposures are neither past due nor impaired.

Loans and receivables neither past due nor impaired

The Bank classifies loans and advances under this category for those exposures that are up to date and in line with contractual agreements. These exposures will normally be maintained within approved product programs and with no signs of impairment or distress. These exposures are categorised internally as grade 1-3, that is, normal accounts in line with CBK prudential guidelines and a provision of 1 % is made and appropriated from revenue reserves to statutory reserves.

Loans and receivables past due but not impaired loans

Loans where the contractual interest or principal payments are past due but the Bank 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 Bank are classified as past due but not impaired. These exposures are graded internally as category 4-5 that is watch accounts in the Bank's internal credit risk grading system, in line with CBK guidelines.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

i) Credit risk (Continued)

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 Bank has made concessions that it would not otherwise consider. Loans whose terms have been renegotiated are no longer treated as past due but are reclassified as performing loans. In subsequent years, the renegotiated terms apply in determining whether the asset is considered past due.

Allowances for impairment

The Bank 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 homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

The internal credit risk grading system which is in line with CBK prudential guidelines focus on expected credit losses – that is taking into account the risk of future events giving rise to losses. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the date of the statement of financial position based on objective evidence of impairment. Due to the different methodologies applied, the amount of incurred credit losses provided for in the statement of comprehensive income is usually lower than the amount determined from the expected loss model that is used for internal operational management and banking regulation purposes.

Write-off policy

When a loan is uncollectible it is written off against the related provisions for loan impairment. Such loans are written off after all the necessary recovery procedures have been completed and the amount of loan has been determined. Subsequent recoveries of amounts previously written off are recognised as gains in the profit or loss.

The Bank 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.

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

	Loans and advances to customers	
	2016 Sh'000	2015 Sh'000
Against individually impaired property	1,437,977	1,695,050
Against collectively impaired property	2,380,731	1,995,622
Total	**3,818,708**	**3,690,672**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

i) Credit risk (Continued)

Settlement risk

The Bank'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.

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 the Bank's Credit Committee.

Concentration of risk

Details of significant concentrations of the Bank's assets, liabilities and off balance sheet items by industry groups are as detailed below:

	2016 Sh'000	%	2015 Sh'000	%
i) Advances to customers- gross				
Manufacturing	189,975	2	353,236	4
Wholesale and retail	4,056,249	40	3,788,579	36
Transport and communication	1,466,237	14	1,288,804	12
Agricultural	65,188	1	110,720	1
Business services	93,536	1	135,367	1
Real estate	3,235,397	32	4,215,151	40
Other	1,052,882	10	637,087	6
	10,159,464	**100**	**10,528,944**	**100**
ii) Customer deposits				
Central and local Government	168,659	2	499,403	5
Non-financial public enterprises	207,199	2	155,862	2
Co-operative societies	662,380	7	1,782,118	18
Insurance companies	618,687	6	400,843	4
Private enterprises and individuals	7,853,584	82	6,946,413	69
Non-profit institutions	24,937	1	211,419	2
	9,535,446	**100**	**9,996,058**	**100**
iii) Off balance sheet items (Letters of credit and guarantees)				
Manufacturing	10,350	1	10,150	1
Wholesale and retail	694,860	71	516,081	65
Transport and communication	72,143	7	38,018	5
Business services	208,903	21	234,372	29
Other	130	-	2,207	-
	986,386	**100**	**800,828**	**100**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

ii) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments or other cash outflows.

Management of liquidity risk

The Bank's liquidity risk management is carried out within the Bank and monitored by the Asset

Liability committee (ALCO).

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Liquidity risk is addressed through the following measures:

- The treasury department monitors liquidity ratios on a daily basis against internal and regulatory requirements
- Day to day funding is managed by monitoring future cash flows to ensure that requirements can be met. These include replenishment of funds as they mature or are borrowed by customers.
- The Bank invests in short term liquid instruments which can easily be sold in the market when the need arises.
- The Bank enters into lending contracts subject to availability of funds.
- The Bank has an aggressive strategy aimed at increasing the customer deposit base.
- The Bank borrows from the market through interbank transactions with other Banks and The Central Bank of Kenya for short term liquidity requirements.
- Investments in property and equipment are properly budgeted for and done when the Bank has sufficient cash flows.

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 the board. Daily reports covering the liquidity position of the Bank are regularly submitted to Asset and Liability Committee.

Exposure to liquidity risk

The key measure used by the Bank 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. The Central Bank of Kenya minimum liquidity ratio is 20%. Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2016	2015
At 31 December	26%	32%
Average for the period	25%	34%
Maximum for the period	34%	36%
Minimum for the period	20%	32%

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

ii) Liquidity risk (Continued)

Liquidity risk based on undiscounted cash flows

The table below analyses the cash flows payable by the Bank under non-derivative financial liabilities by remaining contractual maturities and non-derivative financial assets by expected maturity dates as at the date of the statement of financial position.

AT 31 DECEMBER 2016	Up to 1 month Sh'000	1 – 3 months Sh'000	4 - 12 months Sh'000	1 - 5 Years Sh'000	Total Sh'000
FINANCIAL ASSETS					
Cash and balances with the CBK	468,752	170,544	13,645	-	652,941
Balances due from banking institutions	53,713	-	-	-	53,713
Government securities	-	144,631	-	2,743,039	2,887,670
Loans and advances to customers	2,394,857	217,040	392,207	7,220,113	10,224,217
Total financial assets	**2,917,322**	**532,215**	**405,852**	**9,963,152**	**13,818,541**
FINANCIAL LIABILITIES					
Balance due to Central Bank of Kenya	820,000	-	-	-	820,000
Deposits and balances due to banking institutions	91,258	-	-	-	91,258
Customer deposits	4,232,742	5,339,885	427,221	2,416	10,002,264
Borrowed funds	88,363	-	30,523	1,989,712	2,108,598
Total financial liabilities	**5,232,363**	**5,339,885**	**457,744**	**1,992,128**	**13,022,120**
Net liquidity gap	**(2,315,041)**	**(4,807,670)**	**(51,892)**	**7,971,024**	**796,421**
AT 31 DECEMBER 2015					
Total financial assets	2,598,492	759,934	2,409,739	8,791,032	14,621,633
Total financial liabilities	6,113,820	4,231,140	763,292	2,061,563	13,169,815
Net liquidity gap	**(3,515,328)**	**(3,471,206)**	**1,646,447**	**6,729,469**	**1,451,818**

The above table shows the undiscounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The Bank'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.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

iii) Market risks

Market risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk arise from open positions in interest rates, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, equity prices, foreign exchange rates and credit spreads. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Bank separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with clients or with the market. Non-trading portfolios mainly arise from the interest rate management of the entity's retail and commercial Banking assets and liabilities.

Management of market risks

Overall responsibility of managing market risk rests with the Asset and Liability Committee (ALCO). The Treasury department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation. The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken which is monitored daily.

Exposure to interest rate risk

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 instruments because of a change in market interest rates. The ALCO is the monitoring body for compliance with these limits and is assisted by Treasury Department in its day-to-day monitoring activities.

The table below summarises the Bank's exposures to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of the contractual repricing or maturity dates. The Bank does not bear an interest rate risk on off balance sheet items.

AT 31 DECEMBER 2016	Up to 1 month Sh'000	1 – 3 months Sh'000	4 - 12 months Sh'000	1 - 5 Years Sh'000	Non-interest bearing Sh'000	Total Sh'000
FINANCIAL ASSETS						
Cash and balances with the CBK	-	-	-	-	652,941	652,941
Balances due from other banking institutions	53,713	-	-	-	-	53,713
Government securities	-	144,631		2,518,860		2,663,491
Loans and advances to customers	9,161,484	-	-	-	-	9,161,484
Total financial assets	**9,215,197**	**144,631**	**-**	**2,518,860**	**652,941**	**12,531,629**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

iii) Market risks (Continued)

AT 31 DECEMBER 2016	Up to 1 month Sh'ooo	1 – 3 months Sh'ooo	4 - 12 months Sh'ooo	1 - 5 Years Sh'ooo	Non-interest bearing Sh'ooo	Total Sh'ooo
FINANCIAL LIABILITIES						
Balance due to Central Bank of Kenya	820,000	-	-	-	-	820,000
Deposits and balances due to banking institutions	91,258	-	-	-	-	91,258
Customer deposits	1,100,612	4,894,487	391,587	2,416	3,102,701	9,491,803
Borrowed funds	88,363	30,523	-	1,767,062	-	1,885,948
Total financial liabilities	**2,100,233**	**4,925,010**	**391,587**	**1,769,478**	**3,102,701**	**12,289,009**
Interest rate sensitivity gap	**7,114,964**	**(4,780,379)**	**(391,587)**	**749,382**	**(2,449,760)**	**242,620**
AS AT 31 DECEMBER 2015						
Total financial assets	9,325,965	138,975	-	2,549,059	759,717	12,773,716
Total financial liabilities	1,546,278	4,565,692	1,772,059	1,830,873	2,525,913	12,240,815
Interest rate sensitivity gap	**7,779,687**	**(4,426,717)**	**(1,772,059)**	**718,186**	**(1,766,196)**	**532,901**

Currency risk

The bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cashflows. The board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions which are monitored daily.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

iii) Market risks (Continued)

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December. Included in the table are the Bank's financial instruments categorised by currency.

AT 31 DECEMBER 2016	KSH Sh'000	USD Sh'000	GBP Sh'000	EURO Sh'000	OTHERS Sh'000	TOTAL Sh'000
FINANCIAL ASSETS						
Cash and balances with Central Bank of Kenya	614,056	25,993	3,716	7,469	1,707	652,941
Balances due from Banking institutions	19,161	22,116	2,622	9,419	395	53,713
Government securities	2,663,491	-	-	-	-	2,663,491
Loans and advances to customers	8,944,814	216,670	-	-	-	9,161,484
Total financial assets	**12,241,522**	**264,779**	**6,338**	**16,888**	**2,102**	**12,531,629**
FINANCIAL LIABILITIES						
Balance due to Central Bank of Kenya	820,000	-	-	-	-	820,000
Deposits and balances due to banking institutions	86,473	4,785	-	-	-	91,258
Customer deposits	9,334,513	133,327	7,327	16,636	-	9,491,803
Borrowed funds	1,687,963	-	-	197,985	-	1,885,948
Total financial liabilities	**11,928,949**	**138,112**	**7,327**	**214,621**	**-**	**12,289,009**
NET ON BALANCE SHEET POSITION	315,573	126,667	(989)	(197,733)	2,102	245,620
NET OFF BALANCE SHEET POSITION	884,866	91,872	-	4,593	5,055	986,386
AT 31 DECEMBER 2015						
Total financial assets	**12,308,880**	**399,646**	**11,560**	**53,338**	**292**	**12,773,716**
Total financial liabilities	**11,641,434**	**337,775**	**6,531**	**255,076**	**-**	**12,240,816**
NET ON BALANCE SHEET POSITION	667,446	61,871	5,029	(201,738)	292	532,900
NET OFF BALANCE SHEET POSITION	744,077	106,559	7,617	46,940	-	905,193

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

iii) Market risks (Continued)

Market risks - sensitivity analysis

A principal part of the Bank's management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling) and the sensitivity of future earnings and capital to varying foreign exchange rates. Stress tests provide an indication of the potential size of losses that could arise in extreme conditions. Consolidated Bank aims, through its management of market risk, to mitigate the impact of prospective interest rate movements and foreign exchange fluctuations which could reduce future earnings and capital.

For simulation modelling, the Bank uses a combination of scenarios relevant to local businesses and local markets. These scenarios are used to illustrate the effect on the Bank's earnings and capital.

Interest rate risks – increase/decrease of 10% in net interest margin

The Interest rate risks sensitivity analysis is based on the following assumptions.

- Changes in the market interest rates affect the interest income or expenses of variable interest financial instruments.
- Changes in Market interest rates only affect interest income or expenses in relation to financial instruments with fixed interest rates if these are recognized at their fair value.
- The interest rate changes will have a significant effect on interest sensitive assets and liabilities and hence simulation modelling is applied to Net interest margins.
- The interest rates of all maturities move by the same amount and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged.
- The projections make other assumptions including that all positions run to maturity.

The table below sets out the impact on future net interest income of an incremental 10% parallel fall or rise in all yield curves at the beginning of each quarter during the 12 months from 1 January 2016.

	Amount 31 December 2016 Sh'000	Scenario 1 10% appreciation Sh'000	Scenario 2 10% Depreciation Sh'000
Loss before taxation	(276,777)	(208,168)	(345,386)
Adjusted Core Capital	644,005	712,614	575,396
Adjusted Total Capital	917,250	985,859	848,641
Risk Weighted Assets (RWA)	12,669,090	12,669,090	12,669,090
Adjusted Core Capital to RWA	5.1%	5.6%	4.5%
Adjusted total Capital to RWA	7.2%	7.8%	6.7%

Assuming no management actions, a series of such appreciation would increase net interest income for 2016 by Sh 68,609,000 (2015 - Sh 101, 882,900), while a series of such falls would decrease net interest income for 2016 by Sh 68,609,000 (2015 -Sh 101,882,900).

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

A) FINANCIAL RISK (Continued)

iii) Market risks (Continued)

Market risks - sensitivity analysis (Continued)

Also a series of such rises would increase the adjusted core capital to RWA and Adjusted total capital to RWA by 0.5% (2015: 0.7%) and 0.5% (2015: 0.7%) respectively, while a series of such falls would decrease the adjusted core capital to RWA and Adjusted total capital to RWA by 0.5% (2015: 0.7 %) and 0.5% (2015: 0.7%) respectively.

Foreign exchange risks – appreciation/depreciation of Kshs against other currencies by 10%

The Foreign Exchange Risks sensitivity analysis is based on the following assumptions:

- Foreign exchange exposures represent net currency positions of all currencies other than Kenya Shillings.
- The Currency Risk sensitivity analysis is based on the assumption that all net currency positions are highly effective.
- The Base currency in which the Bank's business is transacted is Kenya Shillings.

The table below sets out the impact on future earnings of an incremental 10% parallel fall or rise in all foreign currencies at the beginning of each quarter during the 12 months from 1 January 2016.

Assuming no management actions, a series of such rise and fall would impact the future earnings and capital as illustrated in the table below:

	Amount 31 December 2016 Sh'000	Scenario 1 10% appreciation Sh'000	Scenario 2 10% Depreciation Sh'000
Loss before taxation	(276,777)	(273,722)	(279,832)
Adjusted Core Capital	644,005	647,060	640,950
Adjusted Total Capital	917,250	920,305	914,195
Risk Weighted Assets (RWA)	12,669,090	12,669,090	12,669,090
Adjusted Core Capital to RWA	5.1%	5.1%	5.1%
Adjusted total Capital to RWA	7.2%	7.2%	7.2%

Assuming no management actions, a series of such appreciation would increase earnings for 2016 by Sh. 3,055,000 (2015 - Sh 3,662,800), while a series of such falls would decrease earning for 2016 by Sh. 3,055,000(2015 – Sh3, 662,800).

Also a series of such rises would increase the adjusted core capital to RWA and Adjusted total capital to RWA by,0.0 % (2015 - 0.0%) and 0.0% (2015 - 0.1 %) respectively, while a series of such falls would decrease the adjusted core capital to RWA and Adjusted total capital to RWA by0.0% (2015 - 0.1%) and 0.0% (2015 - 0%) respectively.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

B) OTHER RISKS

Non-financial risk management disclosures:

a) **Strategic risk**

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation.

The Bank faces several strategic risks from its environment which include:

- Macro-economic changes.
- Competition from the financial industry and organisations providing similar services.
- Technological changes.
- Key legislative and regulatory changes.
- Major political events.
- Human capital or social/demographic trends and changes.

The Board of Directors is ultimately responsible for the overall generation and implementation of the Bank's strategy for purposes of enhancing shareholders' value. It has however delegated the implementation aspects to the Chief Executive Officer and the Senior Management team. The Board of Directors, with support of the Chief Executive Officer Senior Management, develops and implements a new strategic cycle every 5 years to cater for the next growth phase of the Bank.

The Chief Executive Officer supported by the (Executive Committee) EXCOM is responsible for the execution of the approved strategic objectives on a day to day basis and actively monitors business performance against these objectives through periodic reviews. The business carries out business performance reviews periodically but at a minimum on a monthly basis against pre-determined milestones and key performance indicators. The reviews are reported to the Board of Directors for information and advice, or action where significant deviations occur. These reports include identifying the key risks faced by the Bank and how they are being managed.

Each business head is responsible for ensuring that strategic initiatives are aligned to the overall strategy of the Bank and supported by the relevant and appropriate operating policies and programs that direct behaviour. They are also responsible for monitoring, managing and reporting on the effectiveness and risks of their business' strategic objectives, and the progress they have made towards achieving these. They oversee the direction and trends of significant current and emerging risks related to their business units and that mitigating actions are taken where appropriate.

The Chief Executive Officer co-ordinates an annual strategic planning process intended to align individual business strategies to overall enterprise level strategies as approved by the Board of Directors. They include a comprehensive review and evaluation of the business strategies, competitive positioning, financial performance, initiatives of strategic executions, and key business risks.

The Bank's financial and non-financial performance, including its key risks, is reported to the Board of Directors on a bi monthly basis for review and action, where necessary.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

B) OTHER RISKS

Non-financial risk management disclosures:

b) **Operational risk**

Operational Risk is "the risk that the Bank will incur direct or indirect loss due to an event or action causing the failure of technology, processes, infrastructure, personnel, and other risks having an operational impact". The impact of these risks can result in significant financial loss, reputational harm or regulatory censure and penalties.

The major operational risks faced by the Bank include:

- People and related issues such as staff retention, frauds, amongst others.
- Systems and processes changes related to the drive to meet our clients' needs.

The Board of Directors takes the lead in establishing the "tone at the top" which promotes a strong risk management culture. The Bank has also put in place a corporate culture that is guided by strong risk management and that supports and provides appropriate standards and incentives for professional and responsible behaviour.

All members of staff are responsible for the management and mitigation of Operational risks. This is reflected in the continuous control environment, risk awareness and management style. Specific roles or responsibilities are assigned for leading and managing the internal control environment through the following people:

- Board and CEO;
- Audit Committee;
- Internal Audit Department;
- Board Risk Management Committee;
- Risk Management Committee;
- Risk & Compliance Department;
- Business Operational Risk functions in corporate, Retail and SME;
- Information Technology (IT) Steering Committee; and
- Business Heads and Operations Head.

Internal Audit is responsible for assessing compliance with Operational Risk policy and for reporting significant issues to the Board Audit Committee and the Board of Directors.

The Bank seeks to minimise actual or potential losses arising from Operational Risk failures. These include inadequately defined procedures or policies, systems failure, internal control flaws or breaches, insufficiently skilled staff, unmanageable events or customer actions. To achieve this, the Bank ensures:

- Robust operational Risk Policy and procedures that reflects industry practice are put in place and operationalized. These include toolkits to help identify, assess, control, manage and report on key Operational Risks. Toolkits in the Operational Risk Procedures manual include inter alia:

  i) Framework for the Bank, businesses, and support functions to identify their major Operational Risks and mitigation plans;

  ii) Key control standards;

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

B) OTHER RISKS (Continued)

Non-financial risk management disclosures:

b) **Operational risk (Continued)**

iii) Indicators to identify Operational Risk; and

iv) Incident and issues tracking mechanisms to identify causal factors and operational losses:

- All staff in business and support functions, are aware of their responsibilities for Operational Risk Management.
- Potential Operational Risk impact of Bank activities and products are considered at their outset with a view to minimising these as far as possible.
- There are structured processes to report control failures to designated individuals and escalate material issues to Risk Management Committee, Executive Committee (EXCOM) and Board Risk Management Committee as appropriate.
- Employees are given Operational Risk training appropriate to their roles.
- Employee and Bank assets are adequately protected.
- Workable Business Continuity Plans are established (including Disaster Recovery and Crisis Management procedures) to minimise the impact of unplanned events on business operations and customer service.
- The financial impact of operational losses is mitigated through the utilisation of insurance or other risk transfer mechanisms where appropriate.

c) **Compliance (policy/legal/regulatory) risk:**

Compliance risk is the current or prospective risk to earnings and capital arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards, as well as from the possibility of incorrect interpretation of effective laws or regulations.

The Bank is committed to ensuring that its business activities are conducted in accordance with applicable laws and regulations, internal rules, policies and procedures, and ethical standards (“compliance laws, rules and standards”). The Bank has established appropriate policies, procedures and controls that will ensure effective compliance with laws, regulations and codes relevant to its businesses, customers and staff.

Business unit heads have the responsibility and accountability of managing regulatory and legal risks relating to their units on a day to day basis with assistance / advice and oversight from Legal and Compliance Department. The Risk and Compliance Department identifies and monitors the key risks and is responsible for ensuring that the day to day business controls comply with applicable legislation and are in line with best practice. Internal and external legal counsel work closely with business units to identify areas of existing and potential regulatory/legal risks and actively manage them to reduce the Bank’s exposures.

Senior Management and the Board Risk Management Committee receive the Risk Management Department’s opinions / reports on the strength of the Banks Compliance Risk Framework to enable them to determine whether it is under control and where not, tracks significant corrective actions to finality. Additionally, significant exposures under “for or against” litigation are reviewed periodically.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

B) OTHER RISKS (Continued)

d) Reputational risk

Reputational risk is the potential that negative stakeholder impressions or perceptions, whether true or not, regarding the Bank's business practices, actions or inactions, will or may cause a decline in customer base, liquidity, and overall brand value. It is a resultant effect of all other risks highlighted in this report and therefore cannot be managed in isolation. Therefore, when all the other risks are managed well, this risk is substantially minimised.

The Bank's reputation is an invaluable and fragile asset that is broad and far reaching and includes image, goodwill and brand equity. Reputational risk management supports value creation and seeks to deal effectively with potential future events that create uncertainty.

Ultimate responsibility for this risk rests with the Board of Directors and Senior Management who examine the Bank's reputational risk as part of their regular mandate. They are assisted in this aspect by the Corporate Communications Department. Their purpose is to ensure that all products, services, and activities meet the Bank's reputational risk objectives in line with the Board of Director's approved appetite. The Bank's reputational risk strategy however cascades into the other Bank's policies procedures each level of management is responsible for the appropriateness of policies, processes and controls within its purview.

Senior Management and the Board of Directors receive periodic reports on the assessment of the Bank's reputational risk exposures that arise from its business activities so as to form a view on associated risks and implement corrective actions.

C) FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1: fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Financial assets held for trading	Note	Level 1	Level 2	Level 3	Total
31 December 2016		**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
Quoted investments		6,097	-	-	6,097
		6,097	**-**	**-**	**6,097**
31 December 2015					
Quoted investments		6,879	-	-	6,879
		6,879	**-**	**-**	**6,879**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

C) FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The above were valued at quoted bid prices in an active market (Nairobi Securities Exchange).

Except as detailed above, the Directors consider that the carrying amounts of financial assets and financial liabilities recognised in the statement of financial position approximate their fair values.

This note provides information about how the Bank determines fair values of various financial assets and financial liabilities.

Fair value of the Bank's financial assets and liabilities that are measured at fair value on a recurrent basis.

Some of the Bank's financial assets and financial liabilities are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets and financial liabilities are determined (in particular, the valuation technique(s) and inputs used):

Financial assets/ liabilities	Fair value as at		Fair value hierarchy	Valuation technique (s) and key inputs	Significant unobservable inputs	Relationship of unobservable inputs to fair value
	31/12/16 Shs '000	31/12/15 Shs'000				
Quoted investments	6,097	6,879	Level 1	Quoted bid prices in an active market	N/A	N/A

There were no transfers between levels 1, 2 and 3 in the period (2015: none)

5. CAPITAL MANAGEMENT

Regulatory capital

The Banks objectives when managing capital are:

- To safeguard the Banks' ability to continue as a going concern so that it can continue to provide returns for the shareholders and benefits for the other stakeholders.
- To maintain a strong capital base to support the current and future development needs of the business.
- To comply with the capital requirements set by the Central Bank of Kenya.

Capital adequacy and use of regulatory capital are monitored by management employing techniques based on the guidelines developed by the Central Bank of Kenya for supervisory purposes. The required information is filed with the Central Bank of Kenya on a monthly basis.

The Central Bank of Kenya requires each Bank to:

a) Hold the minimum level of regulatory capital of Sh 1 billion.

b) Maintain a ratio of total regulatory capital; to risk weighted assets plus risk weighted off balance assets at above the required minimum of 10.5%;

c) Maintain a core capital of not less than 10.5% of total deposit liabilities; and

d) Maintain total capital of not less than 14.5% of risk weighted assets plus risk weighted off balance sheet items.

5. CAPITAL MANAGEMENT (Continued)

Regulatory capital (Continued)

The Bank had not complied with this requirement as at 31 December 2016 and 31 December 2015.

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

- Tier 1 capital, which includes ordinary share capital, non-cumulative irredeemable non-convertible preference shares, disclosed reserves such as share premiums, retained earnings, and 50% un-audited after tax profit less investment in subsidiaries conducting banking business, investments in equity of other institutions, intangible assets (excluding computer software) and goodwill.
- Tier 2 capital, which includes 25% revaluation surplus which have received prior CBK approval, subordinated debt, hybrid capital instruments or any other capital instruments approved by CBK.

The Bank's regulatory capital position at 31 December 2016 and 31 December 2015 was as follows:

	2016 Sh '000	2015 Sh '000
Tier 1 capital		
Ordinary share capital	898,400	898,400
Capital awaiting allocation		
Non-cumulative irredeemable shares	721,130	721,130
Share capital	1,619,530	1,619,530
Accumulated deficit	(873,623)	(533,841)
Total	745,907	1,085,689
Tier 2 capital		
Revaluation reserves (25%)	96,938	99,093
General loan loss provision-statutory reserve	158,364	127,143
Total	255,302	226,236
Total regulatory capital	**1,001,209**	**1,311,925**
Risk-weighted assets	**12,669,090**	**13,973,956**
Capital ratios:		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum 14.5%)	8.00%	9.40%
Total tier 1 capital expressed as a percentage of risk-weighted assets (CBK minimum 10.5%)	5.90%	7.8%

	2016 Sh '000	2015 Sh '000
6. INTEREST INCOME		
Interest on loans and advances	1,444,256	1,729,428
Interest on Bank placements	1,737	6,470
Interest on government securities - Held to maturity	225,794	221,516
	1,671,787	**1,957,414**
7. INTEREST EXPENSE		
Interest on customer deposits	625,294	634,718
Interest on inter-bank borrowings	16,113	34,409
Interest on Central Bank of Kenya Repos	106,358	23,429
Interest on borrowed funds	237,935	246,029
	985,700	**938,585**
8. FEE AND COMMISSION INCOME		
Ledger related fees and commissions	46,024	55,060
Credit related fees and commissions	103,080	130,433
Transaction related fees	120,828	131,372
	269,932	**316,865**

9. FOREIGN EXCHANGE INCOME – NET

Foreign exchange net income includes gains and losses from spot and forward contracts and translated foreign currency assets and liabilities.

	2016 Sh '000	2015 Sh '000
10. OTHER OPERATING INCOME		
Gain on bond trading	-	11,721
Rental income	71,039	65,637
Recoveries on loans and advances	379,780	564,220
Loss on disposal of property and equipment	(1,468)	-
Sundry income	1,894	1,135
	451,245	**642,713**

	2016 Sh '000	2015 Sh '000
11. OPERATING EXPENSES		
Staff costs (note 12)	742,100	711,921
Directors' emoluments - Fees	11,828	13,197
- Other	22,090	15,124
Depreciation (note 22)	93,220	104,599
Amortisation of intangible assets (note 23)	72,616	60,771
Amortisation of operating lease (note 24)	170	170
Contribution to Kenya Deposit Insurance Corporation	15,475	17,775
Auditors' remuneration-Current year	4,834	4,158
-Prior year under provision	2,193	-
Other operating expenses	441,046	449,847
	1,405,572	**1,377,562**
12. STAFF COSTS		
Salaries and wages	615,454	578,223
Training, recruitment and staff welfare costs	36,758	44,160
Pension contributions	38,912	35,731
Medical expenses	42,579	37,534
Leave pay provision	(2,870)	5,598
Staff insurance	6,340	6,938
Gratuity provision	4,200	3,042
NSSF contributions	727	695
	742,100	**711,921**

	2016 Sh '000	2015 Sh '000
13. TAXATION		
a) Taxation charge		
Current tax based on the taxable profit for the year at 30%	19,322	7,300
Deferred tax (credit)/charge (note 27)	(84,965)	15,607
Prior year under/(over) provision- current taxation	10,572	(858)
Prior year over provision- deferred taxation	(10,346)	(17,682)
	(65,417)	**4,367**
b) Reconciliation of expected tax based on accounting (loss)/profit to tax charge		
(Loss)/profit before taxation	**(276,777)**	**47,789**
Tax calculated at a tax rate of 30%	(83,033)	14,637
Tax effect of expenses not deductible for tax purposes	19,190	10,070
Non-taxable income	(1,800)	(1,800)
Prior year under/(over) provision- current taxation	10,572	(858)
Prior year over provision- deferred taxation	(10,346)	(17,682)
	(65,417)	**4,367**
c) Taxation (payable)/recoverable		
At 1 January	12,165	6,300
Charge for the year	(19,322)	(7,300)
Prior year (under)/over provision	(10,572)	858
Tax paid during the year	15,700	12,307
At 31 December	**(2,029)**	**12,165**

14. LOSS)/EARNINGS PER SHARE

(Loss)/earnings per share is calculated by dividing the net (loss)/profit attributable to shareholders by the number of ordinary shares in issue during the year.

	2016 Sh '000	2015 Sh '000
(Loss)/profit for the year (Sh'000)	**(211,360)**	**44,422**
Number of ordinary shares (number in thousands)	**44,920**	**44,920**
(Loss)/earnings per share		
Basic and diluted (Sh)	**(4.71)**	**0.99**

There were no potentially dilutive shares outstanding as at 31 December 2016 and 31 December 2015, respectively. Diluted earnings per share are therefore the same as basic earnings per share.

15. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2016 Sh '000	2015 Sh '000
Cash in hand	305,079	360,933
Balances with Central Bank of Kenya:		
• Cash ratio reserve	329,075	342,851
• Other balances (available for use by the Bank)	18,787	55,933
	652,941	**759,717**

Cash in hand and balances with Central Bank of Kenya are non-interest bearing. The cash ratio reserve is based on the value of customer deposits as adjusted by the Central Bank of Kenya requirements. As at 31 December 2016 the cash ratio reserve requirement was 5.25% (2015 – 5.25%) of all customer deposits held by the Bank. These funds are not available to finance the Bank's day to day operations.

	2016 Sh '000	2015 Sh '000

16. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	2016 Sh '000	2015 Sh '000
a) Balances due from banking institutions maturing within 90 days:		
Balances with correspondent banks	45,924	54,709
Balances with local banks	7,789	50,000
	53,713	**104,709**
b) Balances due to banking institutions maturing within 90 days:		
Deposits from local banks	**91,258**	**275,463**
c) Balances due to Central Bank of Kenya maturing within 90 days:		
Borrowing from Central Bank of Kenya	**820,000**	**-**

Deposits with/from local banks as at 31 December 2016 represent overnight lending. The effective interest rate on deposits due from and due to local banking institutions at 31 December 2016 was 12% (2015 – 12.34%) and nil (2015–nil) for balances with correspondent banks.

The borrowing from Central Bank of Kenya was a REPO:

- Tenure: The period of the borrowing was 1 month from 6 December 2016 to 3 January 2017.
- Interest rate: the borrowing attracted an interest rate of 10%.
- Security: pledge of the Banks only a portion of the Treasury Bonds whose fair value was sh 1,025,000,000.

17. GOVERNMENT SECURITIES HELD TO MATURITY

	2016 Sh '000	2015 Sh '000
Treasury bonds –at amortised cost	**2,663,491**	**2,688,034**
The maturity profile of government securities is as follows:		
Less than 1 year	92,765	138,975
3 years to 5 years	434,645	92,114
Over 5 years	2,136,081	2,456,945
	2,663,491	**2,688,034**

The weighted average effective interest rate on treasury bonds was 8.9% (2015 –8.4%).

As at 31 December 2016 treasury bonds with a fair value of sh 1,025,000,000 (2015 –nil) had been pledged to secure borrowings from Central Bank of Kenya.

	2016 Sh '000	2015 Sh '000
18. LOANS AND RECEIVABLES		
a) Commercial loans	4,176,279	3,938,853
Overdrafts	1,101,559	1,434,106
Mortgages	2,147,948	2,632,763
Asset finance loans	1,535,671	1,122,914
Staff loans	638,609	602,829
Gross loans and receivables	9,600,066	9,731,465
Less:		
Impairment losses on loans and receivables (note 19)	(438,582)	(510,209)
Net loans and receivables	**9,161,484**	**9,221,256**

The weighted average effective interest rate on loans and receivables as at 31 December 2016 was 14% (2015 – 17.9%).

Included in gross loans and receivables of Sh 9,600,066,000 (2015 – Sh 9,731,465,000) are non-performing loans amounting to Sh 1,478,108,230 (2015 – Sh 1,558,664,000). These are included in the statement of financial position net of specific provisions of Sh 400,977,000 (2015 – Sh 479,550,000).

	2016 Sh '000	2015 Sh '000
b) Analysis of gross loans and receivables by maturity		
Maturing:		
Within 1 year	4,237,462	4,295,461
Between 1 and 3 years	1,543,009	1,564,129
After 3 years	3,819,595	3,871,875
Loans and receivables to customers	**9,600,066**	**9,731,465**

The related party transactions and balances are covered under note 37 and concentration of advances to customers is covered under note 4.

19. IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	2016 Sh '000	2015 Sh '000
At 1 January	510,209	1,101,143
Increase in impairment allowances	309,017	588,684
Write offs	(35,369)	(617,838)
Reversals in impairment allowances	(345,275)	(561,780)
At 31 December	**438,582**	**510,209**
Collectively assessed impairment	37,605	30,659
Individually assessed impairment	400,977	479,550
	438,582	**510,209**

	2016 Sh '000	2015 Sh '000
20. OTHER ASSETS		
Un-cleared items in the course of collection	28,212	24,638
Prepayments	42,344	39,274
Rent receivable	9,755	8,599
Deposits for services	15,585	15,015
Others*	147,203	162,960
	243,099	**250,486**

* mainly relate to Mpesa and Kenswitch balances.

21. QUOTED EQUITY SHARES – AVAILABLE FOR SALE

	2016 Sh '000	2015 Sh '000
At beginning of the year	6,879	3,906
(Loss)/gain in market value of investment	(782)	2,973
At end of the year	**6,097**	**6,879**

The investment consists of 21,699 shares of Kakuzi Limited which are in the name of Jimba Credit Corporation Limited, a dormant subsidiary company.

In accordance with IFRS 13, the fair value ranking of the available for sale equity investment is at level 1.

22. PROPERTY AND EQUIPMENT

	Freehold land and buildings Sh'000	Leasehold improvements Sh'000	Motor vehicles Sh'000	Fixtures, fittings, equipment& ATMs Sh'000	Computers Sh'000	Work in progress	Total Sh'000
COST/VALUATION							
At 1 January 2015	719,000	405,552	17,988	303,594	134,902	-	1,581,036
Additions	-	308	-	6,373	4,650	-	11,331
Reclassification- intangible assets	-	-	-	-	(2,550)	-	(2,550)
At 31 December 2015	719,000	405,860	17,988	309,967	137,002	-	1,589,817
At 1 January 2016	719,000	405,860	17,988	309,967	137,002	-	1,589,817
Additions	-	22,782	9,887	9,201	4,002	1,834	47,706
Disposal	-	(16,825)	(7,399)	-	(81)	-	(24,305)
At 31 December 2016	719,000	411,817	20,476	319,168	140,923	1,834	1,613,218
Comprising							
At cost	-	411,817	20,476	319,168	140,923	1,834	894,218
At valuation 2014	719,000	-	-	-	-	-	719,000
	719,000	411,817	20,476	319,168	140,923	1,834	1,613,218

22. PROPERTY AND EQUIPMENT (Continued)

	Freehold land and buildings Sh'000	Leasehold improvements Sh'000	Motor vehicles Sh'000	Fixtures, fittings, equipment& ATMs Sh'000	Computers Sh'000	Work in progress	Total Sh'000
ACCUMULATED DEPRECIATION							
At 1 January 2015	-	295,400	15,740	207,929	124,261	-	643,330
Charge for the year	17,225	41,678	999	31,798	12,899	-	104,599
Reclassification intangible assets	-	-	-	-	(2,550)	-	(2,550)
At 31 December 2015	17,225	337,078	16,739	239,727	134,610	-	745,379
At 1 January 2016	17,225	337,078	16,739	239,727	134,610	-	745,379
Charge for the year	15,425	42,839	2,930	32,018	8	-	93,220
Elimination on disposal	-	(13,400)	(7,399)	-	(35)	-	(20,834)
At 31 December 2016	32,650	366,517	12,270	271,745	134,583	-	817,765
NET BOOK VALUE							
At 31 December 2016	**686,350**	**45,300**	**8,206**	**47,423**	**6,340**	**1,834**	**795,453**
At 31 December 2015	**701,775**	**68,782**	**1,249**	**70,240**	**2,392**	**-**	**844,438**

Freehold land and buildings were last revalued as at 31 December 2014, by Vidmerck Limited, independent valuers. Valuations were made on the basis of the open market value using the highest and best use valuation model resulting in a total valuation surplus of Sh 151,293,000. The book values of the properties were adjusted to the revalued amounts and the resultant surplus was credited to the revaluation surplus.

Motor vehicles, fixtures fittings and equipment with a cost of Sh.495, 121,167(2015- Sh 419, 038,164) were fully depreciated as at 31 December 2016. The notional depreciation charge on these assets would have been Sh 113, 523,331 (2015- Sh 84, 673,625).

In accordance with IFRS 13, the fair value ranking of the land and buildings is at Level 2 as the fair value measurement is derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly as prices or indirectly as derived from prices.

If the land and buildings were stated on the historical cost basis, their carrying amounts would be as follows:

	2016 Sh '000	2015 Sh '000
At 1 January	135,639	140,160
Depreciation charge	(4,521)	(4,521)
At 31 December	**131,118**	**135,639**

23. INTANGIBLE ASSETS

	Computer Software Sh'ooo	Work in Progress Sh'ooo	Total Sh'ooo
COST/VALUATION			
At 1 January 2015	332,946	-	332,946
Additions	19,482	-	19,482
Reclassification	2,550	-	2,550
At 31 December 2015	354,978	-	354,978
At 1 January 2016	354,978	-	354,978
Additions	35,905	74,020	109,925
At 31 December 2016	390,883	74,020	464,903
ACCUMULATED AMORTISATION			
At 1 January 2015	50,962	-	50,962
Charge for the year	60,771	-	60,771
Reclassification	2,550	-	2,550
At 31 December 2015	114,283	-	114,283
At 1 January 2015	114,283	-	114,283
Charge for the year	72,616	-	72,616
At 31 December 2016	**186,899**	**-**	**186,899**
NET BOOK VALUE			
At 31 December 2016	**203,984**	**74,020**	**278,004**
At 31 December 2015	**240,695**	**-**	**240,695**

Work in progress relates to the digital banking and EMV (Euro Pay Master Card and Visa) project which are at various stages of completion.

24. PREPAID OPERATING LEASE RENTALS (LEASEHOLD LAND)

	2016 Sh '000	2015 Sh '000
COST		
At 1 January and 31 December	45,298	45,298
ACCUMULATED AMORTISATION		
At 1 January	38,149	37,979
Charge for the year	170	170
At 31 December	38,319	38,149
NET BOOK VALUE		
At 31 December	**6,979**	**7,149**

25. CUSTOMER DEPOSITS

Current and demand accounts	2,983,985	2,480,424
Savings accounts	1,171,715	1,171,694
Fixed deposit accounts	5,288,488	6,298,451
Margins	47,615	45,489
	9,491,803	**9,996,058**
Maturity analysis of customer deposits:		
Repayable:		
On demand	4,203,315	3,697,607
Within one year	5,288,488	6,298,451
	9,491,803	**9,996,058**

The weighted average effective interest rate on interest bearing customer deposits at 31 December 2016 was 6.8% (2015 – 7.2%). The related party transactions and balances are covered under note 37 and concentration of customers' deposits is covered under note 4.

	2016 Sh '000	2015 Sh '000
26. OTHER LIABILITIES		
Accrued expenses	5,145	5,824
Gratuity (note 26(a))	7,242	3,042
Leave pay accrual (note 26(b))	8,022	10,892
Tenants deposits	17,569	15,741
Cheques for collection	3,009	329
Deferred income	38,623	-
Sundry payables	144,173	204,993
	223,783	**240,821**

26. OTHER LIABILITIES (Continued)

	2016 Sh '000	2015 Sh '000
a) Gratuity		
Balance as at 1 January	3,042	-
Charge for the year	4,200	3,042
Balance as at 31 December	**7,242**	**3,042**
b) Leave pay accrual		
Balance as at 1 January	10,892	5,294
(Credit)/charge for the year	(2,870)	5,598
Balance as at 31 December	**8,022**	**10,892**

27. DEFERRED TAX (ASSET)/LIABILITY

The deferred tax (asset)/liability computed at the enacted rate of 30% is attributed to the following items:

	2016 Sh '000	2015 Sh '000
Deferred tax assets:		
General bad debts provision	(20,391)	(1,573)
Provision for leave pay	(2,406)	(3,268)
Provision for gratuity	(2,173)	(912)
Provision for fraud	-	(5,527)
Accelerated depreciation allowances	(7,782)	(1,574)
Tax losses	(188,288)	(116,569)
	(221,040)	(129,423)
Deferred tax liabilities		
Revaluation surplus	164,406	168,10
	164,406	168,100
Net deferred tax (asset)/liability	**(56,634)**	**38,677**
Movement in deferred tax (asset)/ liability is as follows:		
At 1 January	38,677	40,752
(Credit)/charge to profit or loss (note 13)	(84,965)	15,607
Prior year overprovision (note 13)	(10,346)	(17,682)
At 31 December	**(56,634)**	**38,677**

As at 31 December 2016, the Bank had accumulated tax losses amounting to Sh 627,625,339 (2015 –Sh 385,692,845) available to be offset against future taxable profit.

Under Kenyan legislation, tax losses can only be carried forward to a maximum of ten years. Deferred tax on tax losses had been provided based on management's projections of profits within the 10 years period.

	2016 Sh '000	2015 Sh '000
28. BORROWINGS		
As 1 January	1,969,294	2,054,143
Interest expense	237,935	246,029
Repayments during the year	(321,281)	(330,878)
At the end of the year	**1,885,948**	**1,969,294**
Analysis by currency:		
Borrowings in Euros	197,985	239,742
Borrowings in Kenya Shillings (Sh)	1,687,963	1,729,552
	1,885,948	**1,969,294**
Analysis by lender:		
European Investment Bank (EIB)	197,985	239,742
Corporate bond – medium term notes	1,687,963	1,729,552
	1,885,948	**1,969,294**

Facility terms:

a) EIB Loan facility: The facility from European investment Bank was credit line of Eur 6,500,000 received by the Bank as part of its participation in the global loan facility extended by EIB to a group of financial institutions in Kenya under the Cotonou Agreement. The facility terms are as follows:

- Tenure: The period of the financing which shall be between 4 to 10 years save in respect of sub-loans for small projects where the sub loan is less than the equivalent of EUR 50,000 and finance leases, which shall have a minimum tenor of 3 years.
- Interest rate: For a tranche denominated in EUR or Usd as margin of 2.88% per annum and for tranches denominated in Kenya shillings will attract additional currency risk premium depending on the tenor of the loan
- Security: a negative pledge on present and future business undertakings together with all the assets or revenues of the Bank.

b) Medium term notes: this refers to a series of senior and subordinated notes issued by the Bank and traded on the Nairobi Securities Exchange. The issued and currently traded notes have a face value Sh 1,678,200,000.

- Tenor: the notes mature on 22 July 2019
- Interest rate: the notes attract a fixed interest rate of 13.5 % for the senior notes and 13.25% for the subordinated notes.

29. SHARE CAPITAL

	2016 Sh '000	2015 Sh '000
a) Authorised:		
55,000,000 ordinary shares of Sh 20 each	1,100,000	1,100,000
80,000,000 4% non-cumulative irredeemable		
non-convertible preference shares of Sh 20 each	1,600,000	1,600,000
	2,700,000	**2,700,000**
b) Issued and fully paid:		
44,920,000 ordinary shares of Sh 20 each (2015 – 19,920,000)	898,400	898,400
36,056,500 4% non-cumulative irredeemable		
Non-convertible preference shares of Sh 20 each	721,130	721,130
	1,619,530	**1,619,530**
Facility terms:		
c) Capital awaiting allotment:		
As at 1 January	-	500,000
Received in the year		-
Allotted in the year	-	(500,000)
	-	**-**

Non-convertible non-participating preference shares are entitled to receive a discretionary dividend before any dividend is declared to the ordinary shareholders. The preference shares have no right to share in any surplus assets or profits and no voting rights.

30. REVALUATION SURPLUS

	2016 Sh '000	2015 Sh '000
At 1 January	396,372	405,999
Transfer of excess depreciation	(12,316)	(13,753)
Deferred tax on transfer of excess depreciation- Buildings	3,695	4,126
At 31 December	**387,751**	**396,372**

The revaluation surplus arises on the revaluation of freehold land and buildings. Where revalued land or buildings are sold, the portion of the revaluation surplus that relates to that asset, and is effectively realised, is transferred directly to revenue reserves. The revaluation surpluses are non-distributable.

	2016 Sh '000	2015 Sh '000
31. ACCUMULATED DEFICIT		
At 1 January	(533,841)	(531,528)
(Loss)/profit for the year	(211,360)	44,422
Transfer of excess depreciation	12,316	13,753
Deferred tax on transfer of excess depreciation	(3,695)	(4,126)
Transfer to statutory reserve	(137,043)	(56,362)
At 31 December	**(873,623)**	**(533,841)**
32. STATUTORY RESERVE		
At 1 January	127,143	70,781
Transfer from accumulated deficit	137,043	56,362
At 31 December	**264,186**	**127,143**
33. FAIR VALUE RESERVE		
At 1 January	6,011	3,038
(Loss)/gain in market value of quoted equity shares	(782)	2,973
At 31 December	**5,229**	**6,011**

The fair value deficit shows the effects from the fair value measurement of available-for-sale quoted investments. Any gains and losses are not recognised in the profit or loss until the asset has been sold or impaired. Refer to note 4 (c) for additional fair value disclosures.

34. NOTES TO THE STATEMENT OF CASH FLOWS

	2016 Sh '000	2015 Sh '000
a) Reconciliation of (loss)/profit before taxation to cash used in operations		
(Loss)/profit before taxation	(276,777)	48,789
Adjustments for:		
Depreciation of property and equipment (note 22)	93,220	104,599
Amortisation of intangible assets (note 23)	72,616	60,771
Amortisation of leasehold land (note 24)	170	170
Loss on disposal of property and equipment	1,468	-
Interest expense on borrowings (note 28)	237,935	246,029
Impairment (credit)/charge on loans and advances (note 19)	(36,258)	26,904
Profit before working capital changes	92,374	487,262
Decrease in cash ratio balance	13,777	225,431
Decrease/(increase) in other assets	7,387	(15,171)
Decrease/(increase) in gross loans and receivables	96,030	(35,579)
Decrease in customer deposits	(504,255)	(645,901)
(Decrease)/increase in other liabilities	(17,038)	1,946
Decrease in treasury bonds	24,543	135,490
Cash (used in)/generated from operations	**(287,182)**	**153,478**
b) Analysis of the balances of cash and cash equivalents as shown in the statement of financial position and notes		
Cash on hand	305,079	360,933
Balances with Central Bank of Kenya –other	18,787	55,933
Balances with other banking institutions	53,713	104,709
Balance from Central Bank	(820,000)	-
Deposits and balances from other banking institutions	(91,258)	(275,463)
	(533,679)	**246,112**

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short term highly liquid investments with original maturities of three months or below, less advances from banks repayable within three months from the dates of the advances.

35. INVESTMENTS IN SUBSIDIARIES

The subsidiary companies of Consolidated Bank of Kenya Limited are:

- Jimba Credit Corporation Limited
- Kenya Savings & Mortgages Limited
- Citizen Building Society
- Estate Building Society
- Estate Finance Company of Kenya Limited
- Business Finance Company Limited
- Home Savings and Mortgages Limited
- Union Bank of Kenya Limited
- Nationwide Finance Company Limited

The operations of the above companies were vested in the Bank in July 2002. All the subsidiaries are dormant and are wholly owned by the Bank. The subsidiaries had a nil carrying value as at 31 December 2016 (2015: Nil). The subsidiaries have not been consolidated because the parent Company has determined that the investments are not material and have no impact to the reported profit or loss and its statement of financial position.

36. SEGMENT REPORTING

The bank's business comprises the following reportable segments:

- Corporate Banking – This include banking services such as business current accounts, fixed deposits, overdrafts, loans, asset finance and other credit facilities in local and foreign currencies
- Retails & SME – incorporating banking current accounts, savings accounts, individual fixed deposits, personal loans, retail and SME lending
- Treasury – operates the bank's fund management and investment activities.

Others comprise rental income and other incidental income from the rental space in the Bank's Head Office building at Consolidated Bank House.

The table below summarizes the breakdown of segmental assets, liabilities, income and expenses;

Profit or loss for the year ended 31 December 2016

	Corporate banking	Retail banking	Treasury	Other	Total
	Sh '000	Sh '000	Sh '000	Sh '000	Sh '000
Net interest income	190,557	628,405	(132,875)	-	686,087
Net fee and commission	68,727	201,205	-	-	269,932
Other income	-	379,780	30,548	71,465	481,793
Operating income	259,284	1,209,390	(102,327)	71,465	1,4337,812
Operating expenses	(71,482)	(1,617,182)	(15,785)	(10,140)	(1,714,589)
Profit/(loss) before tax	**187,802**	**(407,792)**	**(118,112)**	**61,325**	**(276,777)**

36. SEGMENT REPORTING (Continued)

Profit or loss for the year ended 31 December 2016

	Corporate banking Sh '000	Retail banking Sh '000	Treasury Sh '000	Other Sh '000	Total Sh '000
Net interest income	108,294	986,417	(75,882)	-	1,018,829
Net fee and commission	58,500	258,365	-	-	316,865
Other income	101,560	462,661	48,348	66,772	679,341
Operating income	268,354	1,707,443	(27,534)	66,772	2,015,035
Operating expenses	(348,351)	(1,586,930)	(13,544)	(17,421)	(1,966,246)
Profit/(loss) before tax	**(79,997)**	**120,513**	**(41,078)**	**49,351**	**48,789**

Statement of financial position as at 31 December 2016

	Corporate banking Sh '000	Retail banking Sh '000	Treasury Sh '000	Other Sh '000	Total Sh '000
Assets					
Short term funds	-	358,792	3,011,353	-	3,370,145
Loans	2,586,681	6,574,803	-	-	9,161,484
Other assets	-	699,916	-	686,350	1,386,266
Total Assets	**2,586,681**	**7,633,511**	**3,011,353**	**686,350**	**13,917,895**
Liabilities and equity:					
Customer deposits	2,367,834	7,123,969	-	-	9,491,803
Borrowed funds	-	-	2,797,206	-	2,797,206
Other liabilities	-	225,813	-	-	225,813
Shareholders' funds	-	1,403,073	-	-	1,403,073
Total liabilities and equity	**2,367,834**	**8,752,855**	**2,797,206**	**-**	**13,917,895**

36. SEGMENT REPORTING (Continued)

Statement of financial position as at 31 December 2015

	Corporate banking Sh '000	Retail banking Sh '000	Treasury Sh '000	Other Sh '000	Total Sh '000
Assets					
Short term funds	-	465,642	3,086,818	-	3,552,460
Loans	1,870,261	7,350,995	-	-	9,221,256
Other assets	-	660,037	-	701,775	1,361,812
Total Assets	**1,870,261**	**8,476,674**	**3,086,818**	**701,775**	**14,135,528**
Liabilities and equity:					
Customer deposits	3,594,965	6,401,093	-	-	9,996,058
Borrowed funds	-	-	2,244,757	-	2,244,757
Other liabilities	-	279,498	-	-	279,498
Shareholders' funds	-	1,615,215	-	-	1,615,215
Total liabilities and equity	**3,594,965**	**8,295,806**	**2,244,757**	**-**	**14,135,528**

37. CONTINGENCIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS

a) Contingent liabilities

In common with other financial institutions, the Bank conducts business involving acceptances, letters of credit, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties.

	2016 Sh '000	2015 Sh '000
Acceptances and letters of credit	167,665	39,620
Guarantees	818,721	761,208
Forwards and spot contingents	117,782	104,365
	1,104,168	**905,193**
Litigations against the bank	**13,000**	**41,175**

Nature of contingent liabilities:

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, but reimbursement by the customer is normally immediate.

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

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

Concentrations of contingent liabilities are covered under note 4.

37. CONTINGENCIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS (Continued)

a) **Contingent liabilities (Continued)**

Litigations against the Bank relate to civil suits lodged against the Bank by customers and employees in the normal course of business. The likely outcome of these suits cannot be determined as at the date of signing these financial statements. The Directors, however, do not anticipate that any liability will accrue from the pending suits.

b) **Commitments to extend credit**

	2016 Sh '000	2015 Sh '000
Undrawn formal stand-by facilities, credit lines and other commitments to lend	**931,757**	**1,252,551**

Commitments to extend credit are agreements to lend to a customer in future subject to certain conditions. Such commitments are normally made for a fixed period. The Bank may withdraw from its contractual obligation to extend credit by giving reasonable notice to the customer.

c) **Capital commitments**

	2016 Sh '000	2015 Sh '000
Authorised but not contracted for	**223,154**	**481,092**

Capital commitments relate to, construction of five new branches, data storage upgrade, core banking enhancement and three branch renovations.

d) **Operating lease commitments**

Rental income earned during the year was Sh71,038,863 (2015 – Sh65,636,988). At the reporting date, the Bank had contracted with tenants for the following minimum future lease receivables:

The Bank as a lessor:	2016 Sh '000	2015 Sh '000
Within one year	56,784	60,830
In the second to fifth year inclusive	150,428	168,628
After five years	6,877	420
	214,089	**229,878**

Operating leases relate to the buildings and are negotiated for an average term of 6 years, with the rentals being reviewed every two years and hence classified as operating leases. The leases are cancellable with a penalty when the tenants do not give three months' notice to vacate the premises.

All operating lease contracts contain market review clauses in the event that the lessor exercises its option to renew. The lessees do not have an option to purchase the property at the expiry of the lease period. The operating lease contracts are cancellable.

37. CONTINGENCIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS (Continued)

d) Operating lease commitments (Continued)

The Bank as a lessee

At the reporting date, the Bank had outstanding commitments under operating leases which fall due as follows:

	2016 Sh '000	2015 Sh '000
Within one year	49,815	41,813
In the second to fifth year inclusive	165,454	183,062
After five years	20,201	18,364
	235,470	**243,239**

Operating lease payments represent rentals payable by the Bank for its office premises.

38. RELATED PARTY TRANSACTIONS

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

Placings are made in the Bank by Directors, their associates and companies associated to Directors. Advances to customers at 31 December 2016 include advances and loans to companies associated with the directors. Contingent liabilities at 31 December 2016 include guarantees and letters of credit for companies associated with the Directors.

All transactions with related parties are at arm's length in the normal course of business, and on terms and conditions similar to those applicable to other customers.

	Directors	
	2016 Sh '000	2015 Sh '000
Movement in related party balances was as follows:		
Loans and advances:		
At 1 January	6,846	-
Advanced during the year	-	7,300
Interest earned	383	71
Repaid during the year	(3,186)	(525)
At 31 December	**4,043**	**6,846**

As at 31 December 2016 loans and advances to staff amounted to Sh 638,578,840(2015– Sh 602, 984,650).

The loans and advances to related parties are performing and are adequately secured.

38. RELATED PARTY TRANSACTIONS (Continued)

	Directors	
	2016 Sh '000	2015 Sh '000
Customer Deposits:		
At 1 January	2,300	-
Placed during the year	7,475	2,300
Net interest applied	111	-
Withdrawals	(8,646)	-
At 31 December	**1,240**	**2,300**
Key management compensation		
The remuneration of Directors and other members of key management during the year were as follows:		
Short term benefits		
Salaries and other benefits	126,432	92,140
Fees for services as Directors	11,828	13,197
	138,260	**105,337**

39. INCORPORATION

The Bank is domiciled and incorporated in Kenya under the Kenyan Companies Act.

40. CURRENCY

These financial statements are prepared in Kenya shillings thousands (Sh'000) which is the Bank's functional and presentation currency.

41. EVENTS AFTER THE REPORTING DATE

No material events or circumstances have arisen between the reporting date and the date of this report that require disclosure.

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