PARAMOUNT BANK

Enabling you to reach your peak

2018

ANNUAL REPORT AND FINANCIAL STATEMENTS

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KISUMU BRANCH Tuffoam Mall P.O. Box 3788 - 40100, Kisumu-Kenya Email: kisumubranch@paramountbank.co.ke	Telephone: 0709 935 000 (+254)20 4449266 / 7 / 8 Priority Line : 0709 935 000

Vision - To be one of the best regarded Banks in Kenya providing the highest quality products and services.

Mission - To develop a motivated professional staff that will profitably deliver high quality customer services that fill the financial needs of our customers and their businesses.

CORPORATE INFORMATION

DIRECTORS	Anwarali Padany - Chairman Ayaz Merali - Chief Executive Officer (CEO) Noorez Padamshi Muhammad Mujtaba Mercy Kamau Eunice Wamaitha
AUDIT COMMITTEE	Eunice Wamaitha - Chairlady Noorez Padamshi Mercy Kamau Henry Onkunya Deluxe Atanga
CREDIT COMMITTEE	Mercy Kamau - Chairlady Eunice Wamaitha Anwarali Padany Ayaz Merali Muhammad Mujtaba Michael Riitho Kapil Deo Sharma
ASSET LIABILITY COMMITTEE	Ayaz Merali - Chairman Nicholas Odera Muhammad Mujtaba Fred Maina Kapil Deo Sharma
RISK MANAGEMENT COMMITTEE	Eunice Wamaitha - Chairlady Anwarali Padany Noorez Padamshi Stanley Ngaruiya Ndungu
BOARD NOMINATIONS AND REMUNERATION COMMITTEE	Anwarali Padany - Chairman Noorez Padamshi Eunice Wamaitha
COMPANY SECRETARY	Winniefred Nyagoha Jumba Certified Public Secretary (Kenya) C/o Coulson Harney LLP - Bowmans 5th Floor, West Wing, ICEA Lion Centre Riverside Park, Chiromo Road, Nairobi P O Box 10643 Nairobi, GPO 00100
REGISTERED OFFICE	LR Plot No 1870/IX/140 4th Floor, Sound Plaza Woodvale Groove P O Box 14001Nairobi - Westlands 00800
AUDITORS	Deloitte & Touche Certified Public Accountants (Kenya) Deloitte Place, Waiyaki Way, Muthangari P O Box 40092 Nairobi GPO 00100

PRINCIPAL CORRESPONDENTS

Standard Bank of South Africa, Johannesburg
HDFC Bank, India
BMCE, Spain

LEGAL ADVISERS

Walker Kontos - Hakika House, Bishops Road
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Ngatia & Associates Advocates - Bishop Garden Towers, 1st Ngong Avenue
P O Box 56688 - Nairobi City Square 00200

Mwaniki Gachoka & Co Advocates
Design Centre, 3rd Floor Office suite no.1A & 3A
P O Box 13439 Nairobi GPO 00800

REPORT OF THE DIRECTORS

The directors submit their report together with the audited financial statements for the year ended 31 December 2018, in accordance with Section 653(1) of the Kenyan Companies Act, 2015, which discloses the state of affairs of Paramount Bank Limited (the "Group and the Bank").

INCORPORATION

The bank and its subsidiary, Parabank Insurance Agency Limited, are both incorporated in the Republic of Kenya under the Companies Act, 2015, and are domiciled in Kenya.

ACTIVITIES

The principal activity of the bank, which is licensed under the Banking Act, is the provision of banking, financial and related services. The principal activity of the subsidiary is to provide bank assurance services through insurance agency services.

GROUP RESULTS

The following is the summary of the results for the year ended 31 December 2018:

	Group		Bank	
	2018	2017	2018	2017
	Sh'000	Sh'000	Sh'000	Sh'000
Profit before taxation	151,530	96,508	150,789	95,965
Taxation	84,763	20,991	84,987	21,154
Profit for the year	236,293	177,499	235,776	177,119

BUSINESS REVIEW

The Bank

Paramount Bank Ltd began operations under the name Combined Finance Ltd in 1993. Their paid up capital was KES 25m and the services offered were general deposits and minor personal lending. Over the years it has grown into a fully-fledged bank offering almost all services that are offered in the banking industry today. It has seven branches spread across major towns in the country. For more information on the bank please refer to the bank's website www.paramountbank.co.ke.

External Environment

The external environment remained challenging with tighter credit conditions following the interest rate caps and a slow economic recovery from the general election. There was also a lot of uncertainty around the full impact of the new accounting standard IFRS 9. However, the macroeconomic environment remained stable with inflation, interest rates and exchange rates remaining largely unchanged.

The Bank's Performance

The Bank's performance remained stable. There has been a marginal 3% decline in Net Interest Income from Sh 373m in the previous year to Sh 363m in the current year due to further reduction in the capped interest rates. Total operating income increased by 2% from Sh. 471m in the previous year to Sh. 480m in the current year largely as a result of the increase in income from trade in government securities and income from non-funded products such as letters of credit, guarantee etc. There was a significant reduction in impairment losses on loans and advances as a result of the implementation of IFRS 9.Overall the profit before tax increased by 57% from Sh 96m in the previous year to Sh. 151 m in the current year.

REPORT OF THE DIRECTORS (Continued)

The Bank's Performance (Continued)

There was also a significant increase in tax recoverable largely as a result of the implementation of IFRS 9. This resulted in our profit after tax doubling to Sh. 236m from Sh. 117 in the previous year. On the balance sheet side, net assets grew by 4% from Sh. 9,541 in the previous year to Sh. 9,887 in the current year. There was a 19% increase in investment in government securities and a 4% decline in advances to customers as compared to the previous year. As a result of the IFRS 9 adjustment, there was a threefold increase in deferred tax asset from Sh. 28m in the previous year to Sh. 112m in the current year. Customer deposits increased by 5% from Sh. 7,729 in the previous year to Sh. 8,126 in the current year. There was a 4% decline in shareholder funds from Sh. 1,760 in the previous year to Sh. 1687 in the current year largely as a result of opening IFRS 9 adjustment.

Overall the bank registered steady and stable results will all its core capital and liquidity ratios remaining strong.

Looking ahead

The outlook for 2019 seems favourable with an expected improvement in economic conditions. We expect the macroeconomic variables like interest rates, inflation, exchange rates etc to remain stable. We expect the GDP to grow by at least 5% to 6% mainly due to the continued heavy infrastructure-led investment by the government, continued foreign investment in the country and improving general economy. Of concern is the ballooning government debt and its budget deficit. The interest rate caps are also capping the growth potential of the economy.

DIVIDENDS

The directors do not recommend the payment of a dividend in respect of the year ended 31 December 2018 (2017: Sh Nil).

DIRECTORS

The present members of the Board of Directors are shown on page 2.

DIRECTORS' STATEMENT AS TO INFORMATION GIVEN TO AUDITORS

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Group's auditors are unaware; and
- The Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Group's

AUDITORS

Deloitte & Touche, have expressed their willingness, continue in office in accordance provisions of section 719 (2) of the Kenyan Companies Act, 2015, and subject to approval by the Central Bank of Kenya in accordance with Section 24 of the Banking Act. The Directors monitor the effectiveness, objectivity and independence of the auditor. The Directors also approve the annual audit engagement contract, which sets out the terms of the auditor's appointment and the related fees.

BY ORDER OF THE BOARD

Secretary

26th March 2019

PARAMOUNT BANK LIMITED
STATEMENT ON CORPORATE GOVERNANCE

The bank's board of directors is responsible for the governance of the bank and is accountable to the shareholders for ensuring that the bank complies with the law, the highest standards of corporate governance and business ethics. The directors attach great importance to the need to conduct the business and operation of the bank with integrity and in accordance with generally accepted corporate practice and endorse the internationally developed principles of good corporate governance.

Board of Directors

The full board meets at least four times a year. The directors are given appropriate and timely information so that they can maintain full and effective control over strategic, financial, operational and compliance issues.

Except for direction and guidance on general policy, the board has delegated authority for conduct of day-to-day business to the Chief Executive Officer. The board nonetheless retains responsibility for establishing and maintaining the Group's overall internal control over financial, operational and compliance issues. Details of attendance for each member of the board are as below.

Directors	No. of meetings attended 2018
Anwarali Padany - (Chairman)	4
Ayaz Merali - Chief Executive Officer (CEO)	4
Noorez Padamshi	4
Muhammed Mujtaba	4
Mercy Kamau	4
Eunice Wamaitha	4

Directors' remuneration

Two executive directors are paid a monthly salary and are eligible for pension scheme membership. The other two non-executive directors are paid sitting allowance for Board meetings and Board sub-committee meetings. Directors emoluments are shown in note 30.

Committees of the Board

Audit Committee

The board has constituted an audit committee that meets as required. Its responsibilities include a review of financial information, budgets, development plans, compliance with accounting standards in financial reporting, and liaison with the external auditors, remuneration of external auditors and overseeing internal control systems. Internal and external auditors and other executives attend audit committee meetings as required.

Credit Committee

The board has constituted a credit committee that meets as required. Its responsibilities include a review of the overall lending policy of the bank, ensuring that there are effective policies and procedures to effectively manage credit risk, monitor and review all matters, which may materially impact the present and future quality of the institution's credit risk management.

Assets Liability Committee

The board has constituted an Assets and Liabilities Committee (ALCO) that meets as required Its responsibilities include deriving the most appropriate strategy in respect of the assets and liabilities of the bank given future expectations, changes and consequence of liquidity constraints, interest rate movements, changes in prices and foreign exchange exposures.

Risk Management Committee

The board has constituted a Risk Management Committee that meets as required. Its responsibilities include carrying out risk assessment and putting in place risk indicators and monitoring the risk.

Board Nominations and Remuneration Committee

The board has constituted Nominations and Remuneration Committee.The committee deals with all aspects of appointment of an institution's directors, review the mix of skills and experience and other qualities in order to assess the effectiveness of the board. The committee is also responsible for overseeing the compensation system in place on behalf of the Board of Directors.

Statement on risk management

The Bank recognises the responsibility to manage risks related to its business as a financial institution. The bank has built strong internal systems to ensure that sound banking practices result in income streams that are commensurate with the risks taken.

The Integrated Risk Management Policy of the bank is fully committed to adopting best practices in identifying, measuring, controlling and monitoring the risks faced.

Corporate Governance Statement on Conflict of Interest

The board of directors has approved a code of conduct that gives disclosure guidance on potential conflicts of interest situations. Reporting procedures are in place for this. The code of conduct has to be signed annually by all staff members.

The bank aims at:

- Integrating risk management into the culture of the organization.
- Eliminating or reducing risk to the lowest acceptable levels.
- Developing risk sensitivity as a core competency of all stakeholders.
- Continually identifying potential risks and pro-actively mitigating them.
- Focusing on key risks and controlling them cost-effectively.

The bank has developed a risk infrastructure that is appropriate to the size and volatility of the business. Decision making at all levels is inspired by the aspiration to be a risk intelligent organization. Risk management is used as an enabler to exploit the potential for increased business by taking informed risks with awareness and control.

Compliance

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

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Director **Director**

26th March 2019

CHAIRMAN'S REPORT FOR YEAR 2018

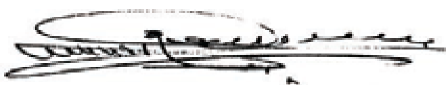
On behalf of the Board of Directors of Paramount Bank, I would like to present to you the Audited Financial Results for the year 2018.

The economy showed improved performance after recovering from a slump in the previous year 2017.The country's GDP grew by about 5.8% in 2017 on the back of the recovery in agriculture, tourism and manufacturing. Economic growth is expected to hit 6% in 2019 due to heavy public investment in the Big Four Agenda. If the ambitious agenda is implemented and executed well, the country's economic fortunes will change for the better. We at Paramount Bank will continue to support all efforts that can make the country better for all stakeholders involved.

While the operating environment was much better in 2018 than the previous year, there are still significant challenges that the banking sector faces. The most notable one is the negative impact of the law capping interest rates. This has led to limited access for SMEs which are the engine of growth for the country. This has not been helped by heavy government borrowing which has crowded out the private sector and SMEs in particular. This is because interest rate capping has locked out the riskier borrowers where most SMEs especially the startups fall in. We hope that our legislators will review this law with a view of improving access to credit for SMEs in order to spur growth across all sectors. The Board of Directors is continually assessing the situation in order to take up new opportunities that arise from changes in the industry. There is also the financial burden of compliance with the ever changing regulatory environment. These have acted as brakes to risk taking and growth into new markets or products that may have returns not commensurate with the risk exposure to the bank.

The financial performance of the bank showed marginal improvement due to the constraints I have indicated above. Net assets grew by 4% from Kes 9.5 Billion to 9.9 Billion, Customer deposits went up by 5% from 7.7 Billion to 8.1 Billion. Profit after tax increased to 236 Million from 117 Million in 2017 driven by good returns on the loan book and government securities. The Board will ensure going forward that the bank's financial performance remains steady and stable despite the challenges that the operating environment may present. The bank remains resilient and solid due to the collective efforts of everyone involved especially our customers who have continued to support it in all positive ways. This can only be good for all stakeholders and we shall continue relying on their confidence in the bank to ensure that their interests are taken care of. On behalf of the Board of Directors, I would like to thank everyone involved with the bank for the vote of confidence and we shall endeavour to exceed your expectations as we move forward.

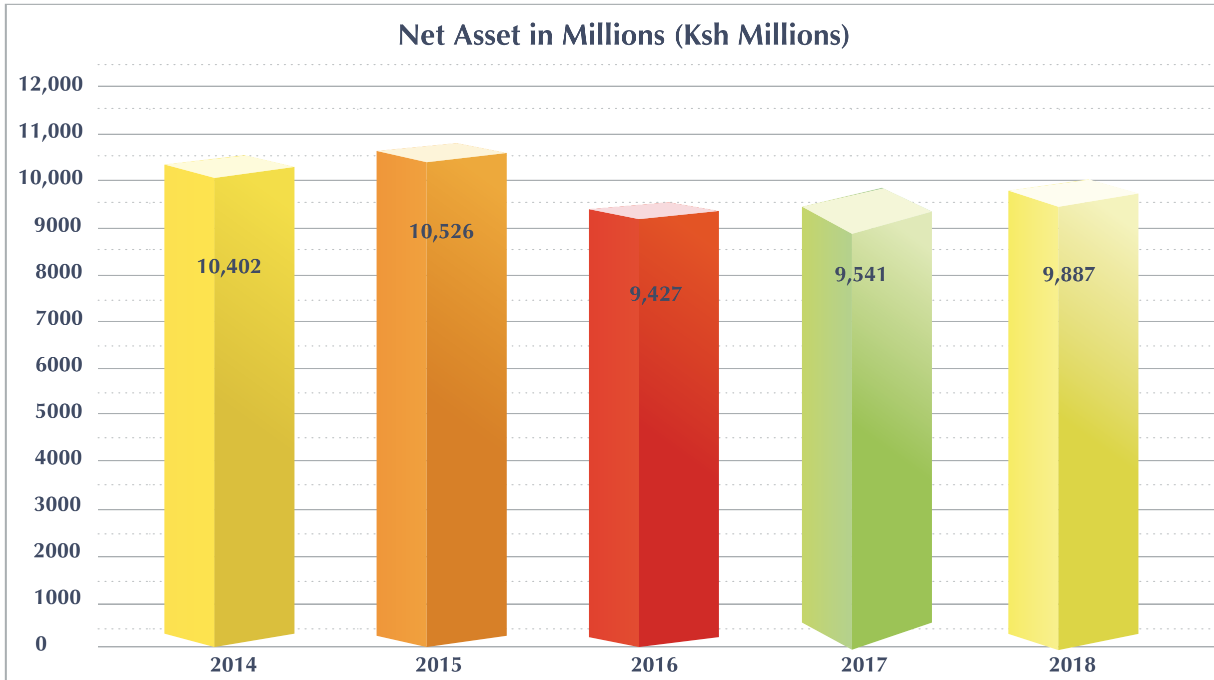
Thank you.

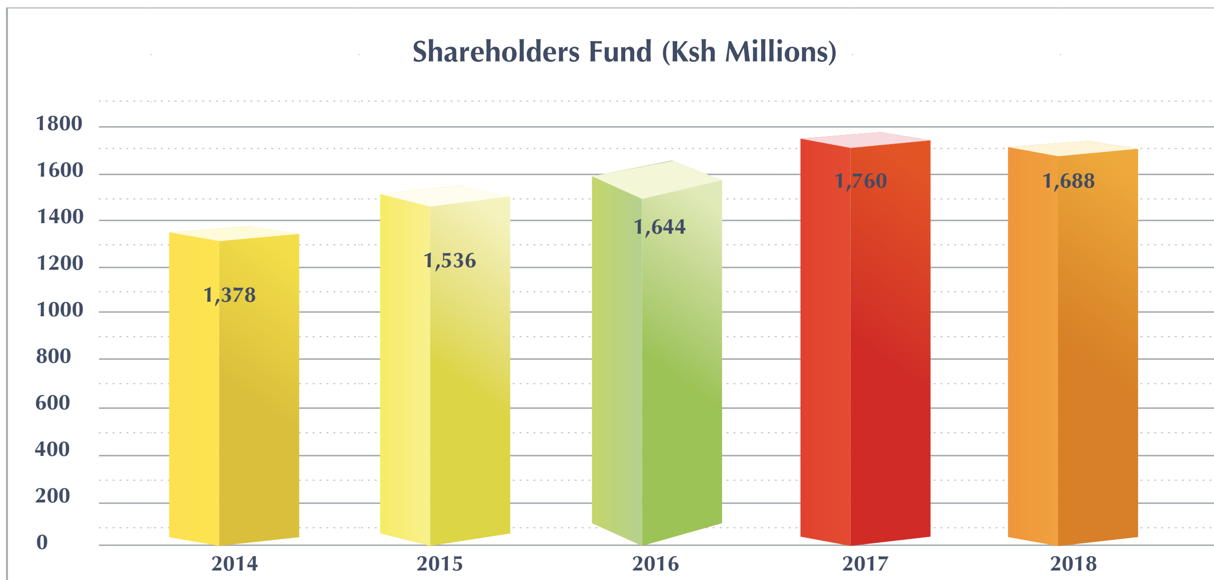


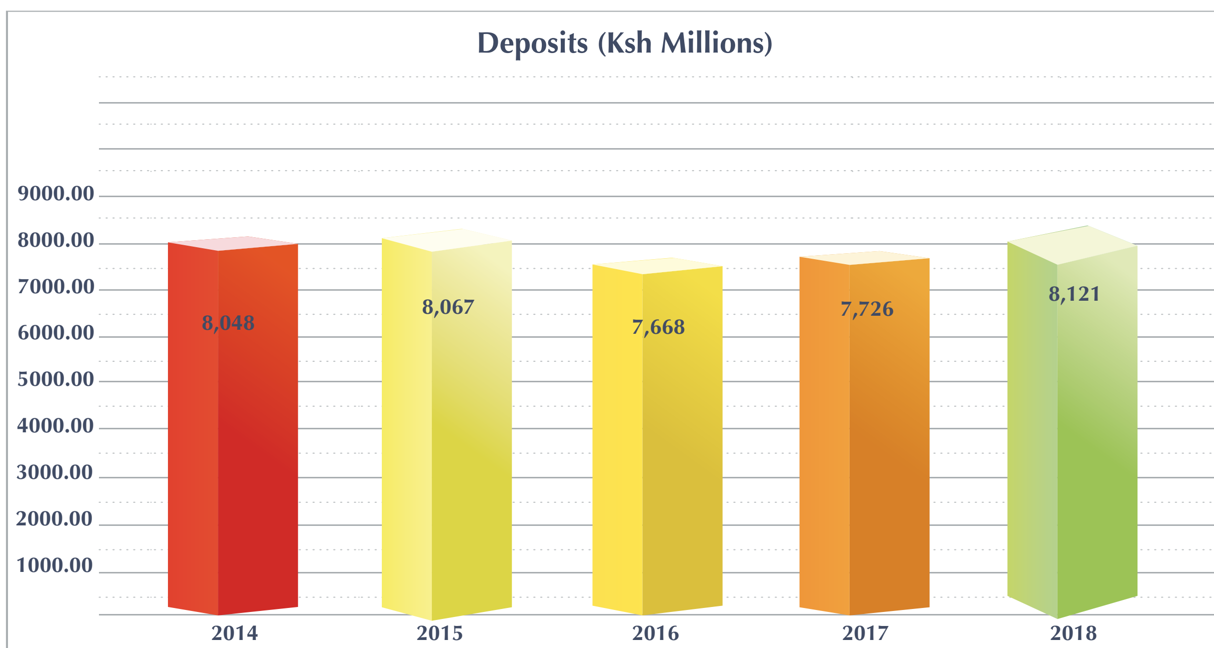
Anwarali Padany.

Chairman.

GRAPHIC REPORT

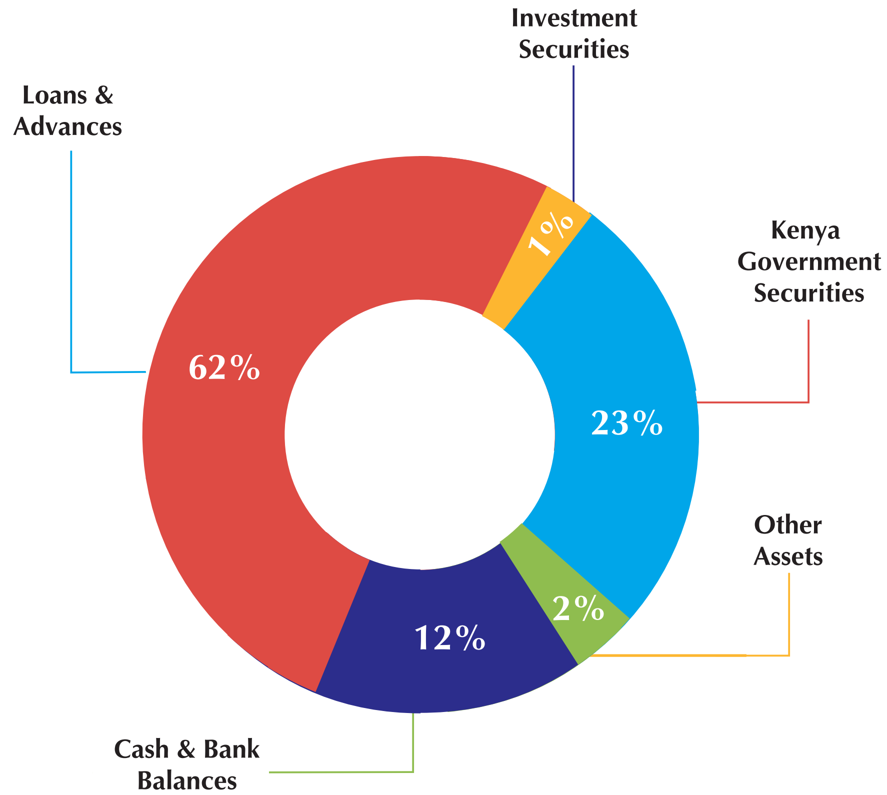




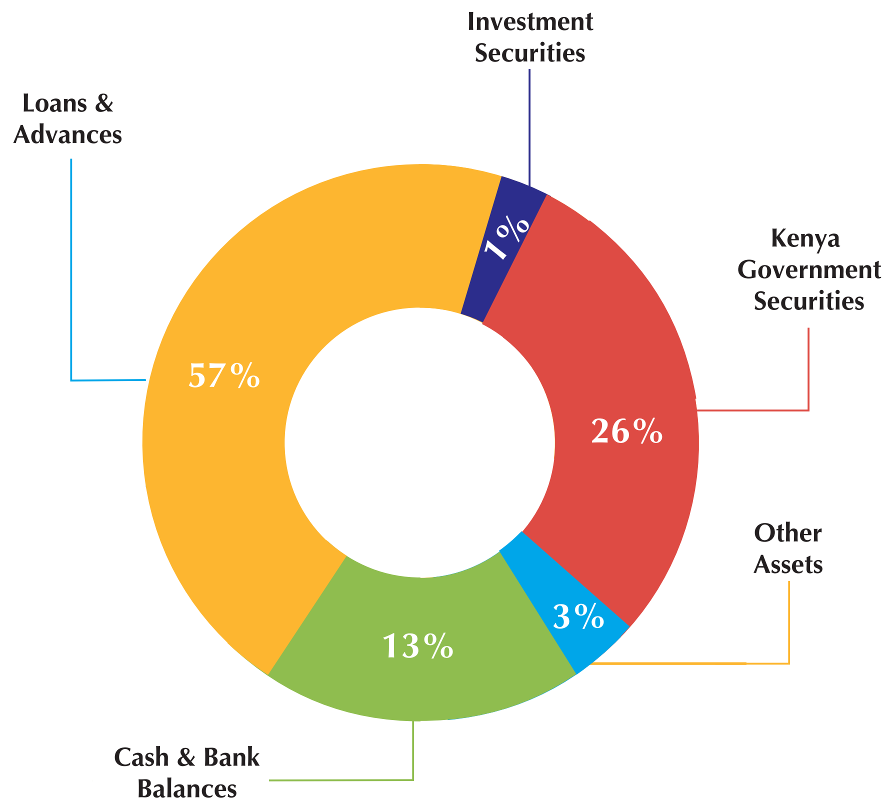


GRAPHIC REPORT

% Assets Distribution 2017



% Assets Distribution 2018



STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the bank and its subsidiary as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the bank and its subsidiary maintains proper accounting records that are sufficient to show and explain the transactions of the Group and disclose, with reasonable accuracy, the financial position of the Group. The directors are also responsible for safeguarding the assets of the bank and its subsidiary, and for taking reasonable steps for the prevention and detection of fraud and error.

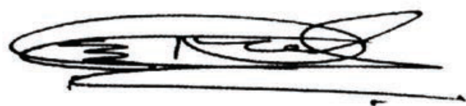
The directors accept responsibility for the preparation and presentation of these financial statements in accordance with the International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. They also accept responsibility for:

(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.

Having made an assessment of the bank and its subsidiary's ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the bank and its subsidiary's ability to continue as a going concern.

The directors acknowledge that the independent audit of the financial statements does not relieve them of their responsibilities.

Approved by the board of directors on 26th March 2019 and signed on its behalf by



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Director   **Director**

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INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PARAMOUNT BANK LIMITED

Report on the financial statements

Opinion

We have audited the accompanying financial statements of Paramount Bank Limited (the "Bank")and its subsidiary (together the "Group") set out on pages 12 to 79, which comprise the consolidated and bank statements of financial position as at 31 December 2018, and the consolidated and bank statements of profit or loss and other comprehensive income, the consolidated and bank statements of changes in equity and the consolidated and bank statements of cash flows for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Group and Bank as at 31 December 2018 and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015.

Basis for Opinion

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

Other information

The directors are responsible for the other information, which comprises the information included in the report of directors, the statement of corporate governance, the chairman's report and the graphic report. The other information does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities Of The Directors For The Financial Statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards, the requirements of the Kenyan Companies Act, 2015 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.

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- 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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern. 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 Group to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain responsible for our audit opinion

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

We also provide those charged with governance with a statement that we 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 our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we 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.

Report on other matters prescribed by the Kenya Companies Act, 2015

In our opinion, the information given in the Report of the Directors on pages 5 to 6 is consistent with the financial statements.

The engagement partner responsible for the audit resulting in this independent auditor's report is **CPA Charles Munkonge Luo - P/No 2294.**

Deloitte & Touche

Certified Public Accountants (Kenya)
26th March 2019

CONSOLIDATED AND BANK STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2018

		Group		Bank	
		2018	2017	2018	2017
	Note	Sh'000	Sh'000	Sh'000	Sh'000
INTEREST INCOME	4	997,288	1,016,207	997,288	1,016,207
INTEREST EXPENSE	5	(643,351)	(643,239)	(643,351)	(643,239)
NET INTEREST INCOME		362,937	372,968	362,937	372,968
Fees and commission income	6	67,664	54,705	64,251	51,313
Gains on foreign exchange dealings	7	6,611	10,260	6,611	10,260
Other operating income	8	45,877	35,985	45,877	35,985
OPERATING INCOME		483,089	473,918	479,676	470,526
Operating expenses	9	(347,860)	(329,300)	(345,188)	(326,451)
Impairment reversal/(losses) on loans and advances	18(b)	16,301	48,110)	16,301	(48,110)
PROFIT BEFORE TAXATION		151,530	96,508	150,789	95,965
TAXATION CREDIT	11(a)	84,763	20,991	84,987	21,154
PROFIT FOR THE YEAR		236,293	117,499	235,776	117,119
OTHER COMPREHENSIVE INCOME					
Fair value loss on available for sale treasury bonds		-	-	-	-
Fair value gain on available for sale infrastructure bonds		-	-	-	-
		-	-	-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		236,293	117,499	235,776	117,119
		Sh	Sh	Sh	Sh
EARNINGS PER SHARE – Basic and diluted	12	236.29	117.50	235.78	117.12

CONSOLIDATED AND BANK STATEMENTS OF FINANCIAL POSITION

AS AT 31 DECEMBER 2018

	Note	Group		Bank	
		2018	2017	2018	2017
		Sh'000	Sh'000	Sh'000	Sh'000
ASSETS					
Cash and balances with Central Bank of Kenya	13	940,696	1,065,129	940,696	1,065,129
Deposits and balances due from banking institutions	14	387,388	121,721	387,388	121,721
Government securities	15	2,571,381	2,167,646	2,571,381	2,167,646
Corporate bonds	16	35,695	74,681	35,695	74,681
Advances to customers (net)	17	5,642,629	5,902,032	5,642,629	5,902,032
Other assets	19	109,192	95,848	109,188	95,302
Corporate tax recoverable	11(c)	17,479	17,645	17,418	17,418
Equipment	20	58,669	57,572	58,669	57,572
Intangible assets	21	10,924	11,277	10,825	11,217
Deferred taxation asset	22	112,523	27,535	112,521	27,534
Investment in subsidiary	23	-	-	1,000	1,000
TOTAL ASSETS		9,886,576	9,541,086	9,887,410	9,541,252
LIABILITIES					
Customer deposits	24	8,121,434	7,725,963	8,126,183	7,729,302
Deposits and balances due to banking institutions	25	-	-	-	-
Other liabilities	26	77,296	55,370	73,959	52,258
TOTAL LIABILITIES		8,198,730	7,781,333	8,200,142	7,781,560
SHAREHOLDERS' FUNDS					
Share capital	27	1,000,000	1,000,000	1,000,000	1,000,000
Retained earnings		687,846	689,159	687,268	689,098
Statutory reserve		-	70,594	-	70,594
Fair value reserve		-	-	-	-
TOTAL SHAREHOLDERS' FUNDS		1,687,846	1,759,753	1,687,268	1,759,692
TOTAL SHAREHOLDERS' FUNDS AND LIABILITIES		9,886,576	9,541,086	9,887,410	9,541,252

The financial statements on pages 16 to 91 were approved and authorised for issue by the board of directors on 26th March 2018 and were signed on its behalf by:

Director

Director

Chief Executive Officer

Company Secretary

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Fair value reserve Sh'000	Total Sh'000
At 1 January 2017	1,000,000	559,770	82,484	1,636	1,643,890
Total comprehensive income for the year	-	117,499	-	-	117,499
Other comprehensive income	-	-	-	(1,636)	(1,636)
Transfer to statutory reserve	-	11,890	(11,890)	-	-
31 December 2017	1,000,000	689,159	70,594	-	1,759,753
At 1 January 2018	1,000,000	689,159	70,594	-	1,759,753
Effect of change in accounting policy - IFRS Day one adjustment (Note 1)*	-	(308,200)	-	-	(308,200)
At 1 January 2018 - Restated	1,000,000	380,959	-	-	1,451,553
Total comprehensive income for the year	-	236,293	-	-	236,293
Transfer to statutory reserve	-	70,594	(70,594)	-	-
31 December 2018	1,000,000	687,846	-	-	1,687,846

The statutory reserve represents an appropriation from retained earnings in compliance with Central Bank of Kenya prudential guidelines on impairment of loans and advances. It represents the excess of loans provisions as computed as per the Central Bank of Kenya prudential guidelines over impairment of loans and receivables computed as per IFRS 9. The statutory reserve is not distributable.

Retained earnings relate to the cumulative earnings from operations and is distributable.

BANK STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Fair value reserve Sh'000	Total Sh'000
At 1 January 2017	1,000,000	560,089	82,484	1,636	1,644,209
Total comprehensive income for the year	-	117,119	-	-	117,119
Other comprehensive income	-	-	-	(1,636)	(1,636)
Transfer to statutory reserve	-	11,890	(11,890)	-	-
At 31 December 2017	1,000,000	689,098	70,594	-	1,759,692
At 1 January 2018	1,000,000	689,098	70,594	-	1,759,692
Effect of change in accounting policy - IFRS Day one adjustment (Note 1)*	-	(308,200)	-	-	(308,200)
At 1 January 2018 - Restated	1,000,000	380,898	70,594	-	1,451,492
Total comprehensive income for the year	-	235,776	-	-	235,776
Transfer to statutory reserve	-	70,594	(70,594)	-	-
31 December 2018	1,000,000	687,268	-	-	1,687,268

The statutory reserve represents an appropriation from retained earnings in compliance with Central Bank of Kenya's prudential guidelines on impairment of loans and advances. It represents the excess of loans provisions as computed as per the Central Bank of Kenya prudential guidelines over impairment of loans and receivables computed as per IFRS 9. The statutory reserve is not distributable.

Retained earnings relates to the cumulative earnings from operations and is distributable.

CONSOLIDATED BANK STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018

		Group		Bank	
		2018	2017	2018	2017
	Note	Sh'000	Sh'000	Sh'000	Sh'000
CASH FLOWS FROM OPERATING ACTIVITIES					
Cash generated in operations	28(a)	166,369	218,938	166,240	218,719
Tax paid during the year	11(c)	(59)	(219)	-	-
Net cash generated from operating activities		166,310	218,719	166,240	218,719
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of equipment	20	(21,663)	(5,049)	(21,663)	(5,049)
Purchase of intangible assets	21	(3,368)	(814)	(3,298)	(814)
Proceeds from sale of Motor vehicle		100	405	100	405
Net cash used in investing activities		(24,931)	(5,458)	(24,861)	(5,458)
INCREASE IN CASH AND CASH EQUIVALENTS		141,379	213,261	141,379	213,261
CASH AND CASH EQUIVALENTS AT 1 JANUARY		1,176,520	963,259	1,176,520	963,259
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	28(b)	1,317,899	1,176,520	1,317,899	1,176,520

1. ACCOUNTING POLICIES

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), the Kenyan Companies Act, 2015 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 profit or loss and other comprehensive income.

Application of new and revised IFRSs (continued)

i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018 (Continued)

Impact of initial application of IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As a result of the adoption of IFRS 9, the Bank has adopted consequential amendments to IAS 1 Presentation of Financial Statements, which require separate presentation in the statement of profit or loss and OCI of interest revenue calculated using the effective interest method. Previously, the Bank disclosed this amount in the notes to the financial statements.

Additionally, the Bank has adopted consequential amendments to IFRS 7 Financial Instruments: Disclosures that are applied to disclosures about 2018, but have not been applied to the comparative information.

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below. The full impact of adopting the standard is set out in Note 2.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Bank classifies financial assets under IFRS 9.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

For an explanation of how the Bank classifies financial liabilities under IFRS 9, see Note 1 (m).

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

ii) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018

Impact of initial application of IFRS 9 Financial Instruments (Continued)

Impairment of Financial Assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments. Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see Note 1 (m).

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.
– Comparative periods generally have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

The Bank used the exemption not to restate comparative periods but considering that the amendments made by IFRS 9 to IAS 1 introduced the requirement to present 'interest income calculated using the effective interest rate' as a separate line item in the statement of profit
or loss and OCI, the Bank has reclassified comparative interest income on finance leases to 'other interest income' and changed the description of the line item from 'interest income' reported in 2017 to 'interest income calculated using the effective interest method'.

Financial assets and financial liabilities

I) Recognition and Initial Measurement

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

II) Classification

Financial assets – Policy applicable from 1 January 2018
On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.
A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are Solely

Application of new and revised IFRSs (continued)

i) New and amended IFRS Standards that are effective for the current year ended 31 December 2018 (Continued)

Impact of initial application of IFRS 9 Financial Instruments (Continued)
Financial assets and financial liabilities (Continued)

II) Classification (Continued)

Payments of Principal and Interest (SPPI).

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model(and the financial assets held within that business model) and its strategy for how those risks are managed;
- how managers of the business are compensated (e.g.whether compensation is based on the fair value of the assets managed or the contractual cashflows collected); and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation,but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment of whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse loans); and
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Bank holds a portfolio of long-term fixed-rate loans for which the Bank has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Bank has determined that the contractual cash flows of these loans are SPPI because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Non-recourse loans

In some cases, loans made by the Bank that are secured by collateral of the borrower limit the Bank's claim to cash flows of the underlying collateral (non-recourse loans). The Bank applies judgment in assessing whether the non-recourse loans meet the SPPI criterion. The Bank typically considers the following information when making this judgement:

- whether the contractual arrangement specifically defines the amounts and dates of the cash payments of the loan;
- the fair value of the collateral relative to the amount of the secured financial asset;
- the ability and willingness of the borrower to make contractual payments, notwithstanding the decline in the value of collateral;
- whether the borrower is an individual or a substantive operating entity or is a special-purpose entity;
- the Bank's risk of loss on the asset relative to a full-recourse loan;
- the extent to which the collateral represents all or a substantial portion of the borrower's assets; and
- whether the Bank will benefit from any upside from the underlying assets.

Assessment of whether contractual cash flows are solely payments of principal and interest (continued)

Contractually linked instruments

The Bank has some investments in securitisations that are considered contractually linked instruments. Contractually linked instruments each have a specified subordination ranking that determines the order in which any cash flows generated by the pool of underlying investments are allocated to the instruments. Such an instrument meets the SPPI criterion only if all of the following conditions are met:

- the contractual terms of the instrument itself give rise to cash flows that are SPPI without looking through to the underlying pool of financial instruments;
- the underlying pool of financial instruments (i) contains one or more instruments that give rise to cash flows that are SPPI; and (ii) may also contain instruments, such as derivatives, that reduce the cash flow variability of the instruments under (i) and the combined cash flows (of the instruments under (i) and (ii)) give rise to cash flows that are SPPI; or align the cash flows of the contractually linked instruments with the cash flows of the pool of underlying instruments under (i) arising as a result of differences in whether interest rates are fixed or floating or the currency or timing of cash flows; and
- the exposure to credit risk inherent in the contractually linked instruments is equal to or less than the exposure to credit risk of the underlying pool of financial instruments.

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

Classification of financial assets and financial liabilities on the date of initial application of IFRS9

The combined application of the business model and SPPI tests on adoption of IFRS 9 resulted in the reclassification of the following financial assets and liabilities.

(Application of new and revised IFRSs (continued)

i) New and amended IFRS Standards that are effective for the current year ended 31 December 2018(Continued)

Impact of initial application of IFRS 9 Financial Instruments Continued)

Classification of financial assets and financial liabilities on the date of initial application of IFRS9

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as at 1 January 2018.

	Note	Classification Under IAS 39	Classification Under IAS 39	Original Carrying Amount KShs'000	New Carrying Amount KShs'000
FINANCIAL ASSETS					
Cash and balances with Central Banks	13	Loans & Receivables	Amortised Cost	1,065,129	1,065,129
Loans and advances to customers	17	Loans & Receivables	Amortised Cost	5,902,032	5,603,399
Deposits and balances due from banking institutions	14	Loans & Receivables	Amortised Cost	121,721	121,721
Government Bonds	15	Loans & Receivables	Amortised Cost	2,167,646	2,159,134
Other assets and prepayments		Loans & Receivables	Amortised Cost	267,307	266,252
Tax recoverable	11(c)	Loans & Receivables	Amortised Cost	17,418	17,418
TOTAL ASSETS				9,541,253	9,233,053
FINANCIAL LIABILITIES					
Deposits from customers	24	Amortised Cost	Amortised Cost	7,729,302	7,729,302
Other liabilities and accrued expenses	26	Amortised Cost	Amortised Cost	52,258	52,258
TOTAL LIABILITIES				7,781,560	7,781,560

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(Application of new and revised IFRSs (continued)

i) New and amended IFRS Standards that are effective for the current year ended 31 December 2018(Continued)

Impact of initial application of IFRS 9 Financial Instruments Continued)

Classification of financial assets and financial liabilities on the date of initial application of IFRS9

The Bank's accounting policies on the classification off in financial instruments under IFRS9 are set out in above. The application of these policies resulted in the reclassifications set out in the table above.

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

In thousands Kenya Shillings	IAS39 carrying amount 31 December 2017	Re-measurement	IFRS9 Carrying amount 1January 2018
Financial assets			
Amortised cost			
Government Bonds:			
Opening balance	2,167,646		
Remeasurement		(8,512)	
Closing balance			2,159,134
Loans and advances to customers:			
Opening balance	5,902,032		
Remeasurement		(298,633)	
Closing balance			5,603,399
Loans and advances to customers:			
Opening balance	74,681		
Remeasurement		(1,055)	
Closing balance			73,626
Total amortised cost	**8,144,359**	**(308,200)**	**7,836,159**

The following table summarises the impact of transition to IFRS 9 on the opening balance of the liability credit reserve, retained earnings and NCI. There is no impact on other components of equity.

In thousands Kenya Shillings	Impact of adopting IFRS 9 at 1January 2018
Consolidated retained earnings	
Closing balance under IAS 39 (31 December 2017)	689,159
Recognition of expected credit losses under IFRS 9	(308,200)
Opening balance under IFRS 9 (1 January 2018)	380,959

(Application of new and revised IFRSs (continued)

i) New and amended IFRS Standards that are effective for the current year ended 31 December 2018(Continued)

Impact of initial application of IFRS 15 Revenue from Contracts with Customers

In the current year, the company has applied IFRS 15 Revenue from Contracts with Customers (as amended in April 2016) which is effective for an annual period that begins on or after 1 January 2018. IFRS 15 introduced a 5-step approach to revenue recognition. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Details of the new requirements as well as their impact on the company's financial statements are described below.

The company has applied IFRS 15 in accordance with the fully retrospective transitional approach without using the practical expedients for completed contracts in IFRS 15:C5(a), and (b), or for modified contracts in IFRS 15:C5(c) but using the expedient in IFRS 15:C5(d) allowing both non--disclosure of the amount of the transaction price allocated to the remaining performance obligations, and an explanation of when it expects to recognise that amount as revenue for all reporting periods presented before the date of initial application, i.e. 1 January 2018.

IFRS 15 uses the terms 'contract asset' and 'contract liability' to describe what might more commonly be known as 'accrued revenue' and 'deferred revenue', however, the Standard does not prohibit an entity from using alternative descriptions in the statement of financial position. The company has adopted the terminology used in IFRS 15 to describe such balances.

The company's accounting policies for its revenue streams are disclosed in detail below. Apart from providing more extensive disclosures for the company's revenue transactions, the application of IFRS 15 has not had a significant impact on the financial position and/or financial performance of the company.

(ii) New and revised IFRS Standards in issue but not yet effective

At the date of authorisation of these financial statements, The company has not applied the following new and revised IFRS Standards that have been issued but are not yet effective and in some cases had not yet been adopted by the:

New and Amendments to standards IFRS 16-Leases	Effective for annual periods beginning on or after 1 January 2019, with earlier application permitted
Amendments to IAS 19 Employee Benefits Plan Amendment, Curtailment or Settlement	1 January 2019, with earlier application permitted
IFRIC 23 Uncertainty over Income Tax Treatments	Effective for annual periods beginning on or after 1 January 2019
Annual Improvements to IFRS Standards 2015–2017 Cycle- Amendments to IFRS 3 Business Combinations, IFRS 11 Joint Arrangements IAS 12 Income Taxes and IAS 23 Borrowing Costs	1 January 2019, with earlier application permitted
IFRS 10 Consolidated Financial Statements and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint	1 January 2019, with earlier application permitted

(Application of new and revised IFRSs (continued)

(ii) New and revised IFRS Standards in issue but not yet effective (Continued)

IFRS 16 Leases

General impact of application of IFRS 16 Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related Interpretations when it becomes effective for accounting periods beginning on or after 1 January 2019. The date of initial application of IFRS 16 for the company will be 1 January 2019.

The company has chosen the full retrospective application of IFRS 16 in accordance with IFRS 16:C5 (a). Consequently, the company will restate the comparative information. In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

Impact of the new definition of a lease

The company will make use of the practical expedient available on transition to IFRS 16 not to reassess whether a contract is or contains a lease. Accordingly, the definition of a lease in accordance with IAS 17 and IFRIC 4 will continue to apply to those leases entered or modified before 1 January 2019.

The change in the definition of a lease mainly relates to the concept of control. IFRS 16 distinguishes between leases and service contracts on the basis of whether the use of an identified asset is controlled by the customer. Control is considered to exist if the customer has

- The right to obtain substantially all of the economic benefits from the use of an identified asset; and
- The right to direct the use of that asset.

The company will apply the definition of a lease and related guidance set out in IFRS 16 to all lease contracts entered into or modified on or after 1 January 2019 (whether it is a lessor or a lessee in the lease contract). In preparation for the first-time application of IFRS 16, the company is in the process of carrying out an implementation project. The directors of the company anticipate IFRS 16 will be adopted in the company's financial statements for the annual period beginning 1 January 2019. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until a detailed review has been completed.

Impact on Lessee Accounting

Operating leases

IFRS 16 will change how the company accounts for leases previously classified as operating leases under IAS 17, which were off-balance sheet.

On initial application of IFRS 16, for all leases (except as noted below), the company will:

a) Recognise right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments;

b Recognise depreciation of right-of-use assets and interest on lease liabilities in the consolidated statement of profit or loss;

c) Separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the consolidated cash flow statement.

(ii) New and revised IFRS Standards in issue but not yet effective (Continued)

Lease incentives (e.g. rent-free period) will be recognised as part of the measurement of the right-of-use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease liability incentive, amortised as a reduction of rental expenses on a straight-line basis.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 Impairment of Assets. This will replace the previous requirement to recognise a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as personal computers and office furniture), the company will opt to recognise a lease expense on a straight-line basis as permitted by IFRS 16.

Under IAS 17, all lease payments on operating leases are presented as part of cash flows from operating activities.

Amendments to IAS 19 Employee Benefits Plan Amendment, Curtailment or Settlement

The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognised in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19.99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 is first applied. The amendments to IAS 19 must be applied to annual periods beginning on or after 1 January 2019, but they can be applied earlier if an entity elects to do so.

The directors of the company do not anticipate that the application of the amendments in the future will have an impact on the company's financial statements.

IFRIC 23 Uncertainty over Income Tax Treatments

IFRIC 23 sets out how to determine the accounting tax position when there is uncertainty over income tax treatments. The Interpretation requires an entity to:

1) determine whether uncertain tax positions are assessed separately or as a company; and

(Application of new and revised IFRSs (continued)

(ii) New and revised IFRS Standards in issue but not yet effective (Continued)

IFRIC 23 Uncertainty over Income Tax Treatments

2) assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings:

- If yes, the entity should determine its accounting tax position consistently with the tax treatment used or planned to be used in its income tax filings.
- If no, the entity should reflect the effect of uncertainty in determining its accounting tax position.

The Interpretation is effective for annual periods beginning on or after 1 January 2019. Entities can apply the Interpretation with either full retrospective application or modified retrospective application without restatement of comparatives retrospectively or prospectively.

The directors of the company do not anticipate that the application of the amendments in the future will have an impact on the company's consolidated financial statements.

Annual improvements to IFRS Standards 2015 – 2017 Cycle

The Annual Improvements to IFRS Standards 2015-2018 cycle makes amendments to the following standards:

- IAS 12 Income Taxes - The amendments clarify that an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions that generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits.
- IAS 23 Borrowing Costs - The amendments clarify that if any specific borrowing remains out standing after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.
- IFRS 11 Joint Arrangements - The amendments to IFRS 11 clarify that when a party that partici pates in, but does not have joint control of, a joint operation that is a business obtains joint control of such a joint operation, the entity does not remeasure its PHI in the joint operation. All the amendments are effective for annual periods beginning on or after 1 January 2019 and generally require prospective application. Earlier application is permitted.

All the amendments are effective for annual periods beginning on or after 1 January 2019 and generally require prospective application. Earlier application is permitted.

The directors of the company do not anticipate that the application of the amendments in the future will have an impact on the consolidated and company financial statements.

(ii) New and revised IFRS Standards in issue but not yet effective (Continued)

IFRS 10 Consolidated Financial Statements and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted. The directors of the Bank anticipate that the application of these amendments may have an impact on the Group's consolidated financial statements in future periods should such transactions arise.

The directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group's consolidated financial statements.

(iii) Early adoption of standards

The Group and Bank did not early-adopt any new or amended standards in 2018.

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

(a) Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis except for certain properties and financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis.

1. ACCOUNTING POLICIES (Continued)

(a) Basis of preparation (Continued)

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which is described as follows:-

- Level 1 inputs are quoted in prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement dated.
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly, and
- Level 3 inputs are unobservable inputs for the asset or liability.

(b) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Group and entities controlled by theBank and its subsidiaries. Control is achieved when the Bank:

- has power over the investee
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Group has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally.

The Group considers all relevant facts and circumstances in assessing whether or not the company's voting rights in an investee are sufficient to give it power over the investee, including:

- the size of the Group's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Group, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Group has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholder's meetings.

1. ACCOUNTING POLICIES (Continued)

(c) Interest income and expense

Interest income and interest expense for all interest-bearing financial instruments are accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Interest income and expense on all trading assets and liabilities are considered to be incidental to the bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income. Fair value changes on other financial assets and liabilities carried at fair value through profit or loss, are also presented in net trading income included in the profit or loss.

Once a financial asset or a group of 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 purposes of measuring the allowance for impairment.

Interest income includes interest on loans and receivables, placements with other banks and investments in government securities, and is recognised in the year in which it is earned.

(d) 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.Fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

(e) Net trading income

Net trading income arises from the margins which are achieved through market marking and customer business and from changes in market caused by movements in interest and exchange rates, prices and other market variables. It comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes.

(f) Equipment

Equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of equipment over their expected useful lives using the following rates:

Computers and office equipment	20%
Motor vehicles	25%
Furniture, fittings and office renovations	12.5%
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1. ACCOUNTING POLICIES (Continued)

((g) Intangible assets-computer software costs

Generally, costs associated with developing computer software programmes are recognised as an expense incurred. However, a cost that is clearly associated with an identifiable and unique product which will be controlled by the bank and has a probable benefit exceeding the cost beyond one year, are recognised as an intangible asset.

Expenditure which enhances and extends computer software programmes beyond their original specifications and lives is recognised as a capital improvement and added to the original costs of the software. Computer software development costs recognised as assets are stated at cost less amortisation. Amortisation is calculated on a straight-line basis over the estimated useful lives not exceeding a period of 5 years.

(h) Impairment of non-financial assets

At the end of each reporting period, the bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual
cash-generating units, or otherwise, they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a 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 for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

1. ACCOUNTING POLICIES (Continued)

(i) Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

(i) Current taxation

The corporate tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

(ii) Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in associates, except where the bank is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.
in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

1. ACCOUNTING POLICIES (Continued)

(i) Taxation (Continued)

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a 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 for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(iii) Current and deferred tax for the year

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in the equity respectively.

(j) Foreign currencies

Transactions in foreign currencies during the year are translated at the rates ruling at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Kenya Shillings at the rates of exchange ruling at the end of each reporting date. Non-monetary items that are measured in terms of historical costs in a foreign currency are not retranslated. Gains and losses on the exchange of monetary items are dealt with in the profit or loss in the period in which it arises.

(k) Provisions

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

(l) 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 requires 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.

(m) Financial instruments

The Group applies IFRS 9 Financial Instruments to the recognition, classification and measurement, and derecognition of financial assets and financial liabilities and the impairment of financial assets.

Recognition

1. ACCOUNTING POLICIES (Continued)

(m) Financial instruments (Continued)

The Group applies IFRS 9 Financial Instruments to the recognition, classification and measurement, and derecognition of financial assets and financial liabilities and the impairment of financial assets.

Recognition

The Group recognises financial assets and liabilities when it becomes a party to the terms of the contract. Trade date or settlement date accounting is applied depending on the classification of the financial asset.

Classification and measurement

Financial assets are classified on the basis of two criteria:

i) the business model within which financial assets are managed, and
ii) their contractual cash flow characteristics (whether the cash flows represent 'solely payments of principal and interest' (SPPI)).

The Group assesses the business model criteria at a portfolio level. Information that is considered in determining the applicable business model includes (i) policies and objectives for the relevant portfolio, (ii) how the performance and risks of the portfolio are managed, evaluated and reported to management, and (iii) the frequency, volume and timing of sales in prior periods, sales expectation for future periods, and the reasons for such sales.

The contractual cash flow characteristics of financial assets are assessed with reference to whether the cash flows represent SPPI. In assessing whether contractual cash flows are SPPI compliant, interest is defined as consideration primarily for the time value of money and the credit risk of the principal outstanding. The time value of money is defined as the element of interest that provides consideration only for the passage of time and not a consideration for other risks or costs associated with holding the financial asset. Terms that could change the contractual cash flows so that it would not meet the condition for SPPI are considered, including: (i) contingent and leverage features, (ii) non-recourse arrangements and (iii) features that could modify the time value of money.

Financial assets will be measured at amortised cost if they are held within a business model whose objective is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent SPPI.

Financial assets will be measured at fair value through other comprehensive income if they are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and their contractual cash flows represent SPPI.

Other financial assets are measured at fair value through profit and loss. There is an option to make an irrevocable election on initial recognition for non traded equity investments to be measured at fair value through other comprehensive income, in which case dividends are recognised in profit or loss, but gains or losses are not reclassified to profit or loss upon derecognition, and impairment is not recognised in the income statement.

1. ACCOUNTING POLICIES (Continued)

(m) Financial instruments (Continued)

Accounting for loans and advances and deposits held at amortised cost under IFRS 9 effective from 1 January 2018

Loans and advances to customers and banks, customer accounts and most financial liabilities, are held at amortised cost. That is, the initial fair value (which is normally the amount advanced or borrowed) is adjusted for repayments and the amortisation of coupon, fees and expenses to represent the effective interest rate of the asset or liability. Balances deferred on-balance sheet as effective interest rate adjustments are amortised to interest income over the life of the financial instrument to which they relate. Financial assets that are held in a business model to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are SPPI, are measured at amortised cost. The carrying value of these financial assets at initial recognition includes any directly attributable transaction costs.

In determining whether the business model is a 'hold to collect' model, the objective of the business model must be to hold the financial asset to collect contractual cash flows rather than holding the financial asset for trading or short-term profit-taking purposes. While the objective of the business model must be to hold the financial asset to collect contractual cash flows this does not mean the Group is required to hold the financial assets until maturity. When determining if the business model objective is to collect contractual cash flows the Group Group will consider past sales and expectations about future sales.

Accounting for loans and advances and deposits held at amortised cost under IAS 39 for 2017 and 2016

Loans and advances to customers and banks, customer accounts, debt securities and most financial liabilities, are held at amortised cost. That is, the initial fair value (which is normally the amount advanced or borrowed) is adjusted for repayments and the amortisation of coupon, fees and expenses to represent the effective interest rate of the asset or liability. Balances deferred on-balance sheet as effective interest rate adjustments are amortised to interest income over the life of the financial instrument to which they relate. In accordance with IAS 39, where the Group no longer intends to trade in financial assets it may transfer them out of the held for trading classification and measure them at amortised cost if they meet the definition of a loan. The initial value used for the purposes of establishing amortised cost is fair value on the date of the transfer.

(i) Significant increase in credit risk

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Bank compares the risk of a default occurring on the financial instrument at the reporting date with the risk of a default occurring on the financial instrument at the date of initial recognition. In making this assessment, the Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort. Forward-looking information considered includes the future prospects of the industries in which the Banks' borrowers operate, obtained from economic expert reports, financial analysts, governmental bodies, relevant think-tanks and other similar organisations, as well as consideration of various external sources of actual and forecast economic information that relates to the Group's core operations.

1. ACCOUNTING POLICIES (Continued)

(m) Financial instruments (Continued)

In particular, the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- an actual or expected significant deterioration in the financial instrument's external (if available) or internal credit rating;
- significant deterioration in external market indicators of credit risk for a particular financial instru ment, e.g. a significant increase in the credit spread, the credit default swap prices for the debtor, or the length of time or the extent to which the fair value of a financial asset has been less than its amortised cost;
- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor's ability to meet its debt obligations;
- an actual or expected significant deterioration in the operating results of the borrower;
- significant increases in credit risk on other financial instruments of the same borrower;
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant decrease in the borrower's ability to meet its debt obligations.

Irrespective of the outcome of the above assessment, the Bank presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due, unless the Bank has reasonable and supportable information that demonstrates otherwise.

Despite the foregoing, the Bank assumes that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date. A financial instrument is determined to have low credit risk if:

- The financial instrument has a low risk of default,
- The borrower has a strong capacity to meet its contractual cash flow obligations in the near term,
- Adverse changes in economic and business conditions in the longer term may, but will not nec essarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

The Bank considers a financial asset to have low credit risk when the asset has external credit rating of 'investment grade' in accordance with the globally understood definition or if an external rating is not available, the asset has an internal rating of 'performing'. Performing means that the counter-party has a strong financial position and there is no past due amounts.

(ii) Definition of default

The Bank considers the following as constituting an event of default for internal credit risk management purposes as historical experience indicates that financial assets that meet either of the following criteria are generally not recoverable:

- when there is a breach of financial covenants by the borrower; or
- information developed internally or obtained from external sources indicates that the borrower is unlikely to pay its lenders and or creditors, including the Bank, in full (without taking into account any collateral held by the Bank).

(m) Financial instruments (Continued)

Irrespective of the above analysis, the Bank considers that default has occurred when a financial asset is more than 90 days past due unless the Bank has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

(iii) Credit-impaired financial assets

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired includes observable data about the following events:

(a) significant financial difficulty of the issuer or the borrower;
(b) a breach of contract, such as a default or past due event (see (ii) above);
(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
(d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
(e) the disappearance of an active market for that financial asset because of financial difficulties.

(iv) Write-off policy

The Bank writes off a financial asset when there is information indicating that the borrower is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the borrower has been placed under liquidation or has entered into bankruptcy proceedings, or, when the amounts are over two years past due, whichever occurs sooner. Financial assets written off may still be subject to enforcement activities under the Bank's recovery procedures, taking into account legal advice where appropriate. Any recoveries made are recognised in profit or loss.

(v) Measurement and recognition of expected credit losses

The measurement of expected credit losses is a function of the probability of default, loss given default (i.e. the magnitude of the loss if there is a default) and the exposure at default. The assessment of the probability of default and loss given default is based on historical data adjusted by forward-looking information as described above. As for the exposure at default, for financial assets, this is represented by the assets' gross carrying amount at the reporting date; for financial guarantee contracts, the exposure includes the amount drawn down as at the reporting date, together with any additional amounts expected to be drawn down in the future by default date determined based on historical trend, the Bank's understanding of the specific future financing needs of the borrower, and other relevant forward-looking information.

For financial assets, the expected credit loss is estimated as the difference between all contractual cash flows that are due to the Bank in accordance with the contract and all the cash flows that the Bank expects to receive, discounted at the original effective interest rate.

If the Bank has measured the loss allowance for a financial instrument at an amount equal to lifetime ECL in the previous reporting period, but determines at the current reporting date that the conditions for lifetime ECL are no longer met, the Bank measures the loss allowance at an amount equal to 12-month ECL at the current reporting date.

(m) Financial instruments (Continued)

Derecognition of financial assets

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset measured at amortised cost, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognised in profit or loss. In addition, on derecognition of an investment in a debt instrument classified as at FVTOCI, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss. In contrast, on derecognition of an investment in equity instrument, which the Bank has elected on initial recognition to measure at FVTOCI, the cumulative gain or loss previously accumulated in the investments revaluation reserve is not reclassified to profit or loss, but is transferred to retained earnings.

Financial liabilities

After initial recognition, the company measures all financial liabilities including customer deposits, cash collaterals other than liabilities held for trading at amortised cost. Liabilities held for trading (financial liabilities acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin) are subsequently measured at their fair values.

Derecognition of financial liabilities

Financial liabilities are derecognised when and only when the company obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

Borrowings

Borrowings are recorded at the proceeds received. Finance charges, including premiums payable on settlement or redemption, are accounted for on the accruals basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Offsetting financial instruments

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

(n) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with Central

1. ACCOUNTING POLICIES (Continued)

(n) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with Central Bank of Kenya (CBK), items in the course of collection from other banks, deposits held at call with banks and treasury bills with original maturities of less than three months. Such assets are generally 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.

(o) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Rentals payable under operating leases are charged to profit or loss for the year on a straight-line basis over the term of the relevant lease.

(p) 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 financial position transactions and disclosed as contingent liabilities.

(q) 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.

(r) Employee benefit costs

i) Bank's defined contribution retirement benefit scheme

The bank operates a defined contribution retirement benefit scheme for its permanent employees. The assets of the scheme are held and administered independently of the bank's assets by an insurance company. The scheme is funded by contributions from both the bank and employees.

ii) Statutory defined benefit obligation pension scheme

The bank contributes to the National Social Security Fund (NSSF). This is a defined contribution scheme registered under the National Social Security Act. Contributions are determined by local statute. The bank's contributions to the statutory retirement benefit scheme are charged to the profit or loss for the year to which they relate.

iii) Other employee entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the liability for annual leave outstanding at the financial position date.

(s) Comparatives

1. ACCOUNTING POLICIES (Continued)

(s) Comparatives

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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE BANK'S ACCOUNTING POLICIES

In the process of applying the entity's accounting policies, management has made estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are dealt with below:

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

Business model assessment

Classification and measurement of financial assets depends on the results of the SPPI and the business model test. The Bank determines the business model at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. This assessment includes judgement reflecting all relevant evidence including how the performance of the assets is evaluated and their performance measured, the risks that affect the performance of the assets and how these are managed and
how the managers of the assets are compensated. The Bank monitors financial assets measured at amortised cost that are derecognised prior to their maturity to understand the reason for their disposal and whether the reasons are consistent with the objective of the business for which the asset was held. Monitoring is part of the Bank's continuous assessment of whether the business model for which the remaining financial assets are held continues to be appropriate and if it is not appropriate whether there has been a change in business model and so a prospective change to the classification of those assets. No such changes were required during the periods presented.

Significant increase in credit risk

As explained in note 1, ECL is measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased, the Bank takes into account qualitative and quantitative reasonable and supportable forward-looking information.

Establishing groups of assets with similar credit risk characteristics

When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics. The Bank monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is appropriate re-segmentation of the

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE BANK'S ACCOUNTING POLICIES (CONTINUED)

Establishing groups of assets with similar credit risk characteristic (Continued)

assets. This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of that group of assets. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa, but it can also occur within portfolios that continue to be measured on the same basis of 12-month or lifetime ECLs but the amount of ECL changes because of the credit risk of the portfolios differ.

Models and assumptions used

The Bank uses various models and assumptions in estimating ECL. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk

ii) Key sources of estimation uncertainty

Establishing the number and relative weightings of forward-looking scenarios for each type of product and determining the forward-looking information relevant to each scenario:

When measuring ECL the Bank uses reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

Probability of default:

PD constitutes a key input in measuring ECL. PD is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, assumptions and expectations of future conditions.

Loss Given Default:

LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from collateral and integral credit enhancements.

Property and equipment

Critical estimates are made by the directors in determining depreciation rates for property and equipment.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE BANK'S ACCOUNTING POLICIES (CONTINUED)

Fair value measurement and valuation

Some of the company's assets and liabilities are measured at fair value for financial reporting process. In estimating the fair value of an asset or liabilities, the company uses market – observable data to the extent it is available. Where level 1 inputs are not available, the company engages third party qualified valuers to perform the valuation.

3 FINANCIAL RISK MANAGEMENT

This note presents information about the Bank's exposure to financial risks and the Bank's management of capital.

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

- Credit risk
- Liquidity risk
- Market risks

A. CREDIT RISK

Credit risk refers to the current or prospective risk to earnings and capital arising from an obligator's failure to meet the terms of any contract with the bank or if an obligator otherwise fails to perform as agreed. It arises principally from lending, leasing, trade finance and treasury activities. The Bank's credit risk is primarily attributable to its loans and receivables. The amounts presented in the statement of financial position are net of allowances for doubtful advances, estimated by the bank's management based on prior experience and their assessment of the current economic environment.

i) Credit quality analysis

An analysis of the Group's credit risk exposure per class of financial asset, internal rating and "stage" without taking into account the effects of any collateral or other credit enhancements is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represents gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in Note 3A(iii).

Year ended 2018

Loans and advances to customers at amortised cost	Stage 1 12-monthECL Kshs	Stage 2 LifetimeECL Kshs	Stage 3 LifetimeECL Kshs	Total Kshs	Stage 3 LifetimeECL Kshs
Grade 1: Normal	4,495,260	-	-	**4,495,260**	4,590,870
Grade 2: Watch	-	819,087	-	**819,087**	822,593
Grade 3: Substandard	-	-	430,140	**430,140**	370,450
Grade 4: Doubtful	-	-	313,782	**313,782**	252,866
Grade 5: Loss	-	-	-	-	-
Total gross carrying amount	4,495,260	819,087	743,922	6,058,269	6,036,779
Loss allowance	(117,050)	(94,362)	(204,228)	(415,640)	(134,747)
Carrying amount	4,378,210	724,725	539,694	5,642,629	5,902,032

The following table sets out information about the overdue status of loans and advances to customers in Stages 1, 2 and 3.

In thousands Kenya Shillings	2018				2017
Loans and advances to customers at amortised cost–gross carrying amount	Stage 1	Stage 2	Stage 3	Total	Total
Current	4,378,210	-	-	**4,378,210**	4,672,267
Overdue < 30 days	-	724,725	-	724,725	974,777
Overdue < 30 days	-	-	539,694	539,694	254,988
Total	4,378,210	724,725	539,694	5,642,629	5,902,032

i). Credit quality analysis (Continued)

Cash and cash equivalents

The Bank held cash and cash equivalents of Shs 1,318 million at 31 December 2018 (2017: Shs 1,177 million). The cash and cash equivalents are held with central banks and financial institution counterparties that are rated at least B to AA+, based on Moody's ratings.

ii). Collateral held and other credit enhancements

The Bank holds collateral and other credit enhancements against certain of its credit exposures. The following table sets out the principal types of collateral held against different types of financial assets.

Type of credit exposure

	Percentage of exposure that is subject to collateral requirements		
In thousands Kenya Shillings	**31 December 2018**	**31 December 2017**	**Principal type of collateral held**
Loans and advances to customers	1,456,945	1,455,200	Cash deposit
Loans and advances to customers	3,634,805	4,023,123	Property discounted forced sale value
Loans and advances to customers	484,879	417,009	Debenture (25% of registered value)
Loans and advances to customers	66,000	6,700	Others
	5,642,629	5,902,032	

The following table stratifies credit exposures from mortgage loans and advances to customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral.

The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. For credit-impaired loans the value of collateral is based on the most recent appraisals.

In thousands Kenya Shillings	**31 December 2018**	**31 December 2017**
LTV ratio		
Less than 50%	1,090,604	918,201
51–70%	560,882	1,010,824
71–90%	552,201	863,150
91–100%	709,111	632,731
More than 100%	2,229,348	1,908,366
Total	5,142,146	5,333,272
Credit-impaired loans		
Less than 50%	2,544	7,086
51–70%	-	-
More than 70%	497,939	561,674
Total	500,483	568,760
Total	**5,642,629**	**5,902,032**

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

ii) Collateral held and other credit enhancements (continued)

Loans and advances to corporate customers

The general creditworthiness of customers tends to be the most relevant indicator of credit quality of a loan extended to it. However, collateral provides additional security and the Bank generally requests that corporate borrowers provide it. The Bank may take collateral in the form of a first charge over real estate, floating charges over all corporate assets and other liens and guarantees.

Because of the Bank's focus on corporate customers' creditworthiness, the Bank does not routinely update the valuation of collateral held against all loans to corporate customers. Valuation of collateral is updated when the loan is put on a watch list and the loan is monitored more closely. For credit-impaired loans, the Bank obtains appraisals of collateral because it provides input into determining the management credit risk actions.

At 31 December 2018, the gross carrying amount of credit-impaired loans and advances to customers amounted to Shs 1,069 million (2017: Shs 928 million) and the value of identifiable collateral (mainly commercial properties) held against those loans and advances amounted to Shs 797 million (2017: Shs 586 million). For each loan, the value of disclosed collateral is capped at the nominal amount of the loan that it is held against.

Other types of collateral and credit enhancements

The Bank does not hold any other types of collateral and credit enhancements, such as second charges and floating charges for which specific values are not generally available.

The Bank has not obtained any assets by taking possession of collateral.

iii) Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for exposure by comparing:

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recogni tion of the exposure (adjusted where relevant for changes in prepayment expectations).

The Bank uses three criteria for determining whether there has been a significant increase in credit risk:

- quantitative test based on movement in PD;
- qualitative indicators; and
- a backstop of 30 days past due, except for [disclosure of the type of exposures], for which a backstop of 15 days past due is applied

Credit risk grades

The Bank allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates so, for example, the difference in risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3.

Each exposure is allocated to a credit risk grade on initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade. The monitoring typically involves use of the following data.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Corporate exposures	Retail exposures	All exposures
– Information obtained during periodic review of customer files –e.g. audited financial statements, management accounts, budgets and projections. Examples of areas of particular focus are: gross profit margins, financial leverage ratios, debt service coverage, compliance with covenants, quality of management, senior management changes – Data from credit reference agencies, press articles, changes in external credit ratings – Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities	– Internally collected data on customer behaviour – e.g. utilisation of credit card facilities – Affordability metrics – External data from credit reference agencies, including industry-standard credit scores	– Payment record – this includes over due status as well as a range of variables about payment ratio – Utilisation of the granted limit – Requests for and granting off or bearance – Existing and forecast changes in business, financial and economic conditions

– The table below provides an indicative mapping of how the Bank's internal credit risk grades relate to PD and to external credit ratings of Moody's.

– The customer loans portfolio of the Bank comprises ordinary loans, business loans, current account loans, credit cards and bank guarantees.

Grading	12-month weighted-average PD	External rating
Grades 1: Normal	15%	AAA to B
Grades 2: Watch	45%	B- to C
Grades 3–5: Substandard and Doubtful	100%	Default

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk

Generating the term structure of PD
The Bank collects sector-wise performance and default information about its credit risk exposures analysed by type of product and borrower. For some portfolios e.g government securities, information purchased from external credit reference agencies is also used.

The Bank employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

The method of PD parameter estimation is based on the ratio of PD = Gross Non-Performing Loan/Net Loans. The total gross GDP is projected from the previous year gross GDP using the GDP projection.The gross GDP per sector is then obtained by taking the ratio of the gross GDP per sector for the previous year and the total gross GDP for the previous year and multiplying that by the total gross GDP for the current year.The gross loans per sector is obtained by taking the ratio of the gross loans per sector for the previous year and the gross GDP per sector for the previous year and multiplying that by the gross GDP per sector for the current year.The gross NPLs are projected using the regression coefficients for each of the sectors. A regression is run on the gross NPLs against gross GDP for each of the sectors. The Bank uses one approach of generating PDs for all the loan portfolios.

Determining whether credit risk has increased significantly

The Bank assesses whether credit risk has increased significantly since initial recognition at each reporting date. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the sectorial information.

The Bank considers credit risk of a particular exposure to have increased significantly since initial recognition based on a loan being rated as “watch”. The Credit Committee reviews the loans periodically and the movement in the probability of default (PD) between the reporting period and initial recognition date of the loan to determine whether there has been a significant increase in credit risk.

Lifetime PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates.

The credit risk may also be deemed to have increased significantly since initial recognition based on qualitative factors linked to the Bank’s credit risk management processes that may not otherwise be fully reflected in its quantitative analysis on a timely basis. This will be the case for exposures that meet certain heightened risk criteria,such as placement on a watchlist. Such qualitative factors are based on its expert judgment and relevant historical experiences.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Significant increase in credit risk (continued)

Determining whether credit risk has increased significantly (Continued)
For an explanation of the relevant qualitative indicators used for determining whether there has been a significant increase in credit risk, see Note 1 (m)(i).

As a backstop, the Bank considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

As a backstop, the Bank considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL. Some qualitative indicators of an increase in credit risk, such as delinquency or forbearance, may be indicative of an increased risk of default that persists after the indicator itself has ceased to exist. In these cases, the Bank determines a three months probation period during which the financial asset is required to demonstrate good behaviour to provide evidence that its credit risk has declined sufficiently. When contractual terms of a loan have been modified, evidence that the criteria for recognising lifetime ECL are no longer met includes a history of up-to-date payment performance against the modified contractual terms.

The Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes 30 days past due;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit-impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month PD (Stage 1) and lifetime PD (Stage 2).

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Significant increase in credit risk (continued)

Definition of default

The Bank considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held);
- the borrower is more than 90 days past due on any material credit obligation to the Bank.
- Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding; or
- it is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to the borrower's inability to pay its credit obligations.
- In assessing whether a borrower is in default, the Bank considers indicators that are:
- qualitative: e.g. breaches of covenant;
- quantitative: e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and
- based on data developed internally and obtained from external sources .

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

The definition of default largely aligns with that applied by the Bank for regulatory capital purposes

Incorporation of forward-looking information

The Bank incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

The Bank formulates three economic scenarios: a base case, which is the median scenario assigned a 50% probability of occurring, and two less likely scenarios, one upside – Best Case and one downside – Worst Case, with Best Case having a 20% probability of occurring and Worst Case having a 30% Probability of occurring. The base case is aligned with information used by the Bank for other purposes such as strategic planning and budgeting. External information considered includes economic data and forecasts published by governmental bodies and monetary authorities in the countries where the Bank operates, supranational organisations such as the International Monetary Fund and selected private-sector and academic forecasters.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Periodically, the Bank carries out stress testing of more extreme shocks to calibrate its determination of the upside and downside representative scenarios. A comprehensive review is performed at least annually on the design of the scenarios by a panel of experts that advises the Bank's senior management.

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses.

The key drivers for credit risk is GDP growth which generally incorporates other indicates such as inflation, exchange rates etc. Another important source of information used is the sector-wise or industry-wise total loans and advances and non-performing loans and advances as experienced by the banking industry. This information is published by the Central Bank of Kenya annually. The exposures are classified as sector-wise and credit losses computed for each sector individually.

The economic scenarios used as at 31 December 2018 included the following key indicators for Kenya for the years ending 31 December 2019 to 2023.

	SCENARIO	2018	2019	2020	2021	2022
GDP Growth rate	Base Case	6.00%	6.20%	6.50%	6.40%	6.00%
GDP Growth rate	Best Case	7.2%	7.44%	7.80%	7.68%	7.2%
GDP Growth rate	Worst Case	4.8%	4.96%	5.20%	5.12%	4.80%

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Incorporation of forward-looking information (continued)

12 Months Probability of Default

SECTOR	Base Case	Best Case	Worst Case
Agriculture,Hunting,Fishing & Forestry	11.00%	11.00%	11.00%
Mining and Quarrying	25.00%	25.00%	26.00%
Manufacturing	15.00%	14.00%	15.00%
Electricity & Water	5.00%	5.00%	5.00%
Building & Construction	24.00%	24.00%	25.00%
Wholesale & Retail Trade	19.00%	19.00%	20.00%
Transport & Communication	10.00%	10.00%	11.00%
Tourism, Restaurant & Hotels	6.00%	6.00%	6.00%
Real Estate	11.00%	10.00%	11.00%
Finance & Insurance	14.00%	13.00%	14.00%
Social,Community & Personal Services	8.00%	7.00%	8.00%

Lifetime Probability of Default

SECTOR	Base Case	Best Case	Worst Case
Agriculture,Hunting,Fishing & Forestry	34.00%	33.00%	36.00%
Mining and Quarrying	64.00%	62.00%	66.00%
Manufacturing	43.00%	42.00%	45.00%
Electricity & Water	17.00%	16.00%	18.00%
Building & Construction	62.00%	60.00%	64.00%
Wholesale & Retail Trade	52.00%	51.00%	54.00%
Transport & Communication	33.00%	31.00%	34.00%
Tourism, Restaurant & Hotels	19.00%	18.00%	20.00%
Real Estate	33.00%	32.00%	35.00%
Finance & Insurance	41.00%	40.00%	43.00%
Social,Community & Personal Services	25.00%	24.00%	26.00%

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Predicted relationships between the key indicators and sector-wise default and loss rates of financial assets have been developed based on analysing historical data over the past 10 to 15 years.

Uncertain events

Uncertain events that are relevant to the risk of default occurring but for which, despite best efforts, the bank is not able to estimate the impact on ECL because of lack of reasonable and supportable information include:

1. Impact of the slowing down global economy on the growth rate of the Kenyan Economy
2. The unpredictable volatility of global oil prices and its impact on the Kenyan Economy. This is especially the case when is Kenya is a net importer.
3. Unpredictable weather conditions considering Kenya is a predominately agricultural economy.
4. The unpredictable political environment both local and regional which has a direct impact on economic performance.
5. The rising impact of the Kenya's debt to GDP ratio and its impact on the economic output.

Key Assumptions

In all the three scenarios of Base, Best and Worst case positive GDP growth is assumed. This assumption is well reasoned given the tested resilience strength of the Kenyan Economy during distress times.

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy.

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects the comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

The Bank renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities) to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Bank Credit Committee regularly reviews reports on forbearance activities.

For financial assets modified as part of the Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired. A customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired/in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to Stage 1.
Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:
- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.
The methodology of estimating PDs is discussed above under the heading 'Generating the term structure of PD'.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

For loans secured by retail property, LTV ratios are a key parameter in determining LGD. LGD estimates are recalibrated for different economic scenarios and, for real estate lending, to reflect possible changes in property prices. They are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For financial guarantees, the EAD represents the amount of the guaranteed exposure when the financial guarantee becomes payable. For some financial assets, EAD is determined by modelling the range of possible exposure outcomes at various points in time using scenario and statistical techniques.

As described above, and subject to using a maximum of a 12-month PD for Stage 1 financial assets, the Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for credit risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

However, for overdrafts facilities that include both a loan and an undrawn commitment component, the Bank measures ECL over a period longer than the maximum contractual period if the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period. These facilities do not have a fixed term or repayment structure and are managed on a collective basis. The Bank can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when the Bank becomes aware of an increase in credit risk at the facility level.

This longer period is estimated taking into account the credit risk management actions that the Bank expects to take, and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are Banked on the basis of shared risk characteristics that include:
- instrument type;
- collateral type;
- remaining term to maturity;
- industry;

iii) Amounts arising from ECL (Continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Measurement of ECL (continued)

The groupings are subject to regular review to ensure that exposures within a particular Bank remain appropriately homogeneous.

For portfolios in respect of which the Bank has limited historical data, external benchmark information is used to supplement the internally available data. The Bank does not have portfolios for which external benchmark information represents a significant input into measurement of ECL.

Loss allowance

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument. Comparative amounts for 2017 represent the allowance account for credit losses and reflect the measurement basis under IAS 39.

Loans and advances to customers	Stage 1 12-monthECL Kshs	Stage 2 LifetimeECL Kshs	Stage 3 LifetimeECL Kshs	Total Kshs
Loss allowance as at 31 December 2017	-	-	-	**134,747**
Restatement of the prior year	-	-	-	**298,633**
Loss allowance as at 1 January 2018	164,927	109,681	158,773	**433,381**
Changes in the loss allowance:				
– Transfer to stage 1	-	-	-	-
– Transfer to stage 2	-	-	-	-
– Transfer to stage 3	(6,600)	-	6,600	-
New financial assets originated	9,204	1,429	-	**10,633**
Financial assets derecognised	(37,529)	(18,333)	(6,726)	**(62,588)**
Financial Assets remeasured	(12,952)	1,685	45,481	**34,214**
Loss allowance as at 31 December 2018	**117,050**	**94,462**	**204,128**	**415,640**

More information about the significant changes in the gross carrying amount of financial assets during the period that contributed to changes in the loss allowance, is provided at the table below:

Loans and advances to customers	Stage 1 12-monthECL Kshs	Stage 2 LifetimeECL Kshs	Stage 3 LifetimeECL Kshs	Total Kshs
Gross carrying amount as at 31 December 2017&1 January 2018	4,457,165	932,273	647,341	6,036,779
Changes in the loss allowance:				
– Transfer to stage 1	-	-	-	-
– Transfer to stage 2	-	-	-	-
– Transfer to stage 3	(215,269)	-	215,269	-
New financial assets originated	1,171,110	12,995	-	1,184,105
Financial assets that have been derecognised	(917,746)	(126,181)	(118,688)	(1,162,615)
Gross carrying amount as at 31 December 2018	**4,495,260**	**819,087**	**743,922**	**6,058,269**

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Loss allowance (Continued)

The following table provides a reconciliation between:
- amounts shown in the above tables reconciling opening and closing balances of loss allow ance per class of financial instrument; and
- the 'impairment losses on financial instruments' line item in the consolidated statement of profit or loss and other comprehensive income.

In thousands Kenya Shillings	advances to customers atamortised cost	Cash and cash equivalents	Financialle ase receivable	Total
Net remeasurement of loss allowance	(17,740)	1,697	(258)	(16,301)
Recoveries of amounts previously written off	-	-	-	-
Total	(17,740)	1,697	(258)	(16,301)

Credit-impaired financial assets (2017: impaired financial assets)
Credit-impaired loans and advances are graded 3 to 5 in the Bank's internal credit risk grading system (see Note 3(A (i))).

The following table sets out a reconciliation of changes in the net carrying amount of credit-impaired (2017: impaired) loans and advances to customers.

In thousands Kenya Shillings	2019	2019
Credit-impaired (2017: impaired) loans and advances to customersat 1January	134,747	144,991
Change in allowance for impairment (Day 1 Adjustment)	298,633	-
Classified as credit-impaired (2017: impaired) during the year	-	48,110
Transferred to not credit-impaired (2017: impaired) during the year	(17,740)	-
Net repayments	-	-
Recoveries of amounts previously written off	-	-
Write off	-	(58,354)
Credit-impaired (2017: impaired) loans and advances to customersat 31 December	415,640	134,747

The contractual amount outstanding on financial assets that were written off during the year ended 31 December 2018 and that are still subject to enforcement activity is Shs Nil (2017: 58 million).

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iii) Amounts arising from ECL (Continued)

Modified financial assets

There were no financial assets that were modified while they had a loss allowance measured at an amount equal to lifetime ECL.

iv) Impaired financial assets – Comparative information under IAS 39

In thousands Kenya Shillings	Loans and Advances customers	
	2019	**2019**
Loans and Advances customers		
Gross carrying amount		
Impaired amount		
Allowance for impairment		
Net carrying amount		
Neither past due nor impaired	**4,495,260**	**4,590,870**
Past due but not impaired	**819,087**	**822,592**
Individually impaired		
Grade 10: Substandard	430,140	370,450
Grade 11: Doubtful	313,782	252,867
Grade 12: Loss	-	-
	6,058,269	**6,036,779**
Allowance for impairment		
Individual	(204,128)	(134,747)
Collective	(211,512)	-
Total allowance for impairment	**(415,640)**	**(134,747)**
Net remeasurement of loss allowance	**5,642,629**	**5,902,032**

Loans with renegotiated terms

Loans with renegotiated terms are defined as loans that have been restructured due to a deterioration in the borrower's financial position, for which the Bank has made concessions by agreeing to terms and conditions that are more favourable for the borrower than the Bank had provided initially and that it would not otherwise consider. A loan continues to be presented as part of loans with renegotiated terms until maturity, early repayment or write-off.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

iv) Impaired financial assets – Comparative information under IAS 39 (Continued)

Loans and investment debt securities that were past due but not impaired
Loans and investment debt securities that were 'past due but not impaired' are those for which contractual interest or principal payments were past due but the Bank believed that impairment was not appropriate on the basis of the level of security or collateral available and/or the stage of collection of amounts owed to the Bank. The amounts disclosed exclude assets measured at FVTPL.

v) Concentration of credit risk

The Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk from loans and advances, loan commitments, financial guarantees and investment securities is shown below.

(i) Advances to customers

	2018 Sh '000	%	2017 Sh '000	%
Real estate	1,514,567	25	1,543,533	26
Social community and personal services	545,244	9	322,790	5
Manufacturing	424,079	7	426,453	7
Transport and communications	363,496	6	245,139	4
Other	3,210,883	53	3,498,834	58
Total	6,058,269	100	6,036,749	100

ii) Customer deposits

	2018 Sh '000	%	2017 Sh '000	%
Co-operatives societies	-	-	-	-
Private enterprises	6,175,899	76	5,874,270	76
Non profit institutions and individuals	1,950,284	24	1,855,032	24
Total	8,126,183	100	7,729,302	100

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

v) Concentration of credit risk (Continued)

iii) Off – balance sheet items

	2018 Sh '000	%	2017 Sh '000	%
Business services	38,811	7	36,283	7
Wholesale and retail	449,101	81	419,851	81
Transport and communications	22,178	4	20,733	4
Other	44,356	8	41,467	8
Total	554,446	100	518,335	100

v) Offsetting financial assets and financial liabilities

There were no financial assets and financial liabilities that were offset in the Bank's statement of financial position and none are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments.

B LIQUIDITY RISK

Liquidity risk is the risk that the bank cannot obtain the necessary funds to meet its obligations associated with financial instruments as they fall due. The amount of liquidity required depends very much on the bank's ability to forecast demand and its access to outside sources. The board of directors has assigned the authority for the management oversight of the liquidity risk policy to the Assets and Liability Committee (ALCO). The committee which is composed of the CEO, Treasury Manager, and other bank officers as necessary review various liquidity and funding decisions and related risks. Formal minutes pertaining to committee actions are recorded and maintained for review by the board of directors.

Liquidity management

The bank manages the liquidity structure of assets, liabilities and commitments so that cash flows are appropriately matched to ensure that all funding obligations are met when due. Banking operations are such that mismatch of assets and liabilities according to their maturity profiles cannot be avoided. However, management ensures that the mismatch is controlled in line with allowable risk levels. Liquidity is managed on a daily basis and incorporates assets and liabilities of the bank based on the remaining period up to 31 December 2018 to the contractual maturity date.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

B LIQUIDITY RISK (Continued)

Liquidity risk is addressed through the following measures:

- 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 invests in short term liquid instruments which can easily be sold in the market when the need arises.
- Investments in equipment are properly budgeted for and done when the bank has sufficient cash flows.

The key measure used by the company for managing liquidity risk is the ratio of net liquid assets to deposits from customers. The table below details the liquidity ratio trends over the year:

As at 31 December	2018 %	2017 %
Average for the period	46	42
Maximum for the period	48	45
Minimum for the period	42	41
Statutory minimum requirement by Central Bank of Kenya	20	20
	====	====

Undiscounted cash flows

The table below shows the undiscounted cash outflows on the bank's financial liabilities based on their contractual maturity dates and the discounted cash inflows on the bank's financial assets based on their expected maturity dates. The banks expected cash flows on these instruments could 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.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

B LIQUIDITY RISK (Continued)

Undiscounted cash flows (continued)

	Upto 1 Month Sh '000	1-3 Months Sh '000	4-12 Months Sh '000	1-5 Years Sh '000	Over 5 Years Sh '000	Total Sh'000
As at 31 December 2018						
FINANCIAL ASSETS						
Cash and balances with CBK	940,696	-	-	-	-	940,696
Deposits and balances from banking institutions	387,388	-	-	-	-	387,388
Government securities	-	-	1,064,231	367,679	1,139,471	2,571,381
Other investments	-	-	35,695	-	-	35,695
Advances to customers	478,912	906,126	1,201,271	2,303,560	752,760	5,642,629
	1,806,996	906,126	2,301,197	2,671,239	1,892,231	9,577,789
FINANCIAL LIABILITIES						
Customer deposits	1,319,562	5,737,176	502,854	566,591	-	8,126,183
	1,319,562	5,737,176	502,854	566,591	-	8,126,183
Net liquidity gap	487,434	(4,831,050)	1,798,343	2,104,648	1,892,231	1,451,606
As at 31 December 2016						
Total financial assets	1,678,049	993,333	1,960,282	3,856,558	1,878,604	10,366,826
Total financial liabilities	1,410,464	5,359,736	477,928	481,174	-	7,729,302
Net liquidity gap	267,585	(4,366,403)	1,482,354	3,375,384	1,878,604	2,637,524

The gross nominal inflow/(outflow) disclosed is the contractual, undiscounted cash flow on the financial liability or commitment.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

C. MARKET RISK (Continued)

(i) Interest rate risk

The bank is exposed to the risk that the value of a financial instrument will fluctuate due to changes in market interest rate. Interest rates on advances to customers are either pegged to the bank's base lending rate or Treasury bill rate.

The interest rates, therefore, fluctuate depending on the movement in the market interest rates. The bank also invests in fixed interest rate instruments issued by the Central Bank of Kenya. Interest rate on customer deposits is negotiated between the bank and the customer. The bank has the discretion to change the rates in line with changes in market trends.

The board of directors has assigned the authority for the management oversight of the interest rate risk policy to the Assets and Liability Committee (ALCO). The committee which is composed of the CEO, Treasury Manager, and other bank officers meets as necessary for specific credit risk situations, reviews various liquidity and funding decisions and related risks.

Formal minutes pertaining to committee actions are recorded and maintained for review by the board of directors.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3. FINANCIAL RISK MANAGEMENT OBJECTIVES & POLICIES (Continued)

c) Market Risk (Continued)

(i) Interest rate risk (Continued)

The table below summarises the exposure to interest rate risks. Included in the table are the bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The bank does not bear an interest rate risk on off financial position items. All figures are in thousands of shillings.

	Up to 1 Month Sh '000	1-3 Months Sh '000	4-12 Months Sh '000	1-5 years Years Sh '000	Over 5 Years Sh '000	Non-interest Bearing Sh '000	Total Sh'000
FINANCIAL ASSETS							
Cash in hand	-	-	-	-	-	145,440	145,440
Balances with Central Bank of Kenya	-	-	-	-	-	795,256	795,256
Deposits and balances due from banking institutions	387,388	-	-	-	-	-	387,388
Government securities	-	149,578	914,653	367,679	1,139,471	-	2,571,381
Corporate bonds	-	-	35,695	-	-	-	35,695
Advances to customers	478,912	906,126	1,201,271	2,303,560	752,760	-	5,642,629
Total financial assets	866,300	1,055,704	2,151,619	2,671,239	1,892,231	940,696	9,577,789
FINANCIAL LIABILITIES							
Customer deposits	-	5,737,176	502,854	566,591	-	1,319,562	8,126,183
Total financial liabilities	-	5,737,176	502,854	566,591	-	1,319,562	8,126,183
Interest rate sensitivity gap	866,300	(4,681,472)	1,648,765	2,104,648	1,892,231	(378,866)	1,451,606
As at 31 December 2017							
Total financial assets	521,977	926,818	1,528,588	3,125,093	2,072,660	1,156,072	9,331,208
Total financial liabilities	-	5,458,871	477,928	478,479	-	1,314,024	7,729,302
Interest rate sensitivity gap	521,977	(4,532,053)	1,050,660	2,646,614	2,072,660	(157,952)	1,601,906

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the bank. It is unusual for a bank's interest to completely be matched due to the nature of business terms and types.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

C. MARKET RISK (Continued)

(i) Interest rate risk (continued)

Exposure to interest rate risk

The group is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows. ALCO closely monitors the interest rate trends to minimize the potential adverse impact of interest rate changes. The table below summarises the exposure to interest rate risk at the statement of financial position date.

Interest rate risk – stress test-as at 31 December 2018

	Amount Sh'000	Scenario 10% Increase in net margin Sh'000	Scenario 10% Decrease in net margin Sh'000
Profit before taxation	150,789	178,624	122,954
Adjusted core capital	1,574,544	1,602,379	1,546,709
Adjusted total capital	1,574,544	1,602,379	1,546,709
Risk-weighted assets (RWA)	5,517,940	5,517,940	5,517,940
Adjusted core capital to RWA	29%	29%	28%
Adjusted total capital to RWA	29%	29%	28%
	=======	=======	========

Interest rate risk – stress test-as at 31 December 2017

	Amount Sh'000	Scenario 10% increase in net margin Sh'000	Scenario 10% Decrease in net margin Sh'000
Profit before taxation	94,329	130,757	57,900
Adjusted core capital	1,663,060	1,699,488	1,626,632
Adjusted total capital	1,739,026	1,775,454	1,702,598
Risk weighted assets (RWA)	5,879,538	5,879,538	5,879,538
Adjusted core capital to RWA	28%	29%	28%
Adjusted total capital to RWA	30%	30%	30%
	=======	=======	========

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

C. MARKET RISK (Continued)

ii) Foreign exchange risk

Foreign exchange risk is the risk that may occur to earnings or capital that results from movement of foreign exchange rates. This type of risk affects the bank due to cross-border investing and operating activities. The board of directors has assigned authority for management oversight of the foreign exchange risk policy to the CEO and Treasury manager.

Management of foreign exchange risk

The bank operates wholly within Kenya and its assets and liabilities are reported in the local currency. The bank's currency risk is managed within the Central Bank of Kenya exposure guideline of 20% core capital. The bank's management monitors foreign currency exposure on a daily basis.

The bank's currency position is as follows:

	KES Sh '000	GBP Sh '000	USD Sh '000	EURO Sh '000	OTHERS Sh '000	Total Sh '000
At 31 December 2018						
FINANCIAL ASSETS						
Cash in hand	94,027	3,294	38,937	9,137	45	145,440
Balances with CBK	785,071	-	-	-	-	785,071
Deposits and balances due from banking institutions	4,304	165,496	141,607	78,419	7,746	397,572
Government securities	2,571,381	-	-	-	-	2,571,381
Other securities	35,695	-	-	-	-	35,695
Advances to customers	4,983,018	1,830	580,038	77,743	-	5,642,629
Other assets	304,450	1,487	3,315	369	-	309,252
Total financial assets	8,777,946	172,107	763,897	165,299	7,791	9,887,040
FINANCIAL LIABILITIES						
Customer deposits	7,041,795	173,426	745,502	165,460	-	8,126,183
Other Liabilities	57,425	(93)	16,611	50,084	16	73,959
Total financial liabilities	7,099,220	173,333	762,113	165,476	-	8,200,142
Net balance sheet position	1,678,726	(1,226)	1,784	(177)	7,791	1,686,898
At 31 December 2017						
Total financial assets	8,645,955	67,168	651,950	113,067	554	9,478,694
Total financial liabilities	6,949,009	67,219	650,797	112,361	-	7,781,560
Net balance sheet position	1,694,772	(51)	1,153	706	554	1,697,134

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

C. MARKET RISK (Continued)

ii) Foreign exchange risk (Continued)

The table below shows the foreign exchange risk sensitivity analysis. The net position is after a 10% increase or decrease in foreign currency exchange rates against the Kenya shilling.

At 31 December 2018

	Amount Sh'000	Scenario 10% increase in foreign currency rate Sh'000	Scenario 10% decrease in foreign currency rate Sh'000
Profit before taxation	151,530	155,268	146,304
Adjusted core capital	1,574,544	1,579,226	1,570,262
Adjusted total capital	1,574,544	1,579,226	1,570,262
Risk weighted assets (RWA)	5,517,940	5,517,940	5,517,940
Adjusted core capital to RWA	29%	29%	28%
Adjusted total capital to RWA	29%	29%	28%
	=======	=======	========

At 31 December 2017

	Amount Sh'000	Scenario 10% increase in foreign currency rate Sh'000	Scenario 10% decrease in foreign currency rate Sh'000
Profit before taxation	96,508	114,290	74,367
Adjusted core capital	1,663,060	1,681,205	1,641,283
Adjusted total capital	1,739,026	1,751,799	1,711,877
Risk weighted assets (RWA)	5,879,538	5,879,538	5,879,538
Adjusted core capital to RWA	28%	29%	28%
Adjusted total capital to RWA	30%	30%	29%
	=======	=======	========

iii) Price risk

Treasury bonds held at fair value are stated at their market valueon the last day of business in the year. These are subject to frequent variations due to changes in their market prices.

An increase or decrease in rates by 10% with all other variables held constant, will have no impact on shareholders' equity (2017: Nil).

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

D. CAPITAL MANAGEMENT

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the bank.

The bank's objectives when managing capital are:

- To safeguard the bank's 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 the 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 Sh1 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 8%;
c) Maintain a core capital of not less than 8% of total deposit liabilities and
d) Maintain total capital of not less than 12% of risk-weighted assets plus risk-weighted off financial position items.

In addition to the above minimum capital adequacy ratios of 8% and 12%, with effect from 1 January 2017, institutions are required to hold a capital conservation buffer of 2.5% over and above these minimum ratios to enable institutions to withstand future periods of stress. This brings the minimum core capital to risk weighted assets and total capital to risk weighted assets requirements to 10.5% and 14.5% respectively. The capital conservation buffer is made up of high-quality capital which should comprise mainly of common equity, premium reserves and retained earnings.

Institutions that currently meet the minimum capital ratios of 8% and 12% but remain below the buffer-enhanced ratios of 10% and 14.5% should maintain prudent earnings retention policies with a view to meeting the conservation buffer within 24 months effective from 1 January 2017.

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

- Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, after deductions for intangi ble assets (excluding computer software), investments in equity instruments of other institutions and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

- Tier 2 capital, which includes 25% revaluation surplus which has received CBK approval, qualifying subordinated liabilities and collective impairment allowances.

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

The bank has complied with all externally imposed capital requirements throughout the period.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

D. CAPITAL MANAGEMENT

Regulatory capital (Continued)

The bank's regulatory capital position at 31 December was as follows:

	Nominal financial position amounts		Risk weighted amounts	
ASSETS	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Cash (including foreign notes and coins)	145,440	109,453	-	-
Cash balances with Central Bank of Kenya	795,256	955,676	-	-
Government securities	2,571,381	2,167,645	-	-
Corporate bonds	35,695	74,681	-	-
Deposits and balances due from banking institutions	387,388	121,721	13,044	11,100
Loans and advances to customers	5,642,629	5,902,032	3,993,460	4,299,271
Other assets	109,188	95,302	109,188	95,302
Property and equipment	58,669	57,572	58,669	57,572
Intangible assets	10,825	11,217	10,825	11,217
Deferred tax asset	112,521	27,534	112,521	6,380
Tax recoverable	17,418	17,418	17,418	17,418
Total assets on balance sheet	9,886,410	9,541,251	4,315,125	4,498,260
Total asset off-balance sheet	554,446	518,335	319,429	443,291
Total risk weighted assets	10,440,856	10,059,586	4,634,554	4,941,551
Tier 1 Capital	1,574,544	1,663,060		
Tier 1 + Tier 2 Capital	1,574,544	1,739,026		
Basel ratio				
Tier 1 (CBK minimum – 8%)	29%	28%		
Tier 1 + Tier 2 (CBK min – 12%)	29%	29%		

The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Risk and Credit, and is subject to review by the Credit Committee or ALCO as appropriate.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

E. OPERATING RISK

Non-financial risk management disclosures

The Board of Directors has put in place a framework for management of non-financial risk management of the bank. The Board Risk Management Committee (BMRC) is responsible for monitoring compliance of this framework with the bank's overall risk management policies and procedures, and review of the adequacy of the risk management framework in relations to non-financial risks faced by the bank.

The key non-financial risks the bank faces are strategic risk, operational risks, reputational risk, compliance/legal risk.

i) Strategic risk

Strategic risk is a function of the internal and the external environment. The strategic risk policy of the bank provides direction and guidance to the board of directors for anticipating change, both externally and internally.

The bank uses key indicators to measure strategic risk such as: Current and forecasted economic conditions such as economic growth, inflation, interest rates, foreign exchange trends and other useful key economic data such as demography and demographic structures; trends within the banking sector such as, Competition both from existing players and new entrants; Merger and acquisition activities; Changes in customer needs, wants and behaviour; development of new products and use of technology; Changes in the bank's various sector exposures and the associated risks; and achievement of the targets, goals and objectives set by the board.

Responsibilities of strategic risk

The board of directors is responsible for the formulation and overall implementation of the bank's strategy. Strategy execution, strategic risk planning and overall strategic risk management is delegated to managing director.

Management of strategic risk

The board and management use the board, committees, and strategic plan to manage strategic risk. Regular and adhoc meetings of the board, the board committees review reports of the management and take corrective action. The execution of the bank's 5 year strategic plan is a key tool for strategic risk with the current strategic plan being 2010-2018. The next strategic plan cycle plan is being developed.

ii) Bank operational risk

The bank's operational risk framework is designed to identify risks, measures and mitigate operational risks. These are risks associated with human error, system failures or technological failure, inadequate procedures and controls, unforeseen catastrophes, or other operational problems which may result in unexpected losses.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

E. OPERATING RISK

Responsibilities for operational risk management

The General Manager-Operations, continually reports to the Managing Director on all the key risks of the bank. Risk & Compliance department as well as Internal Audit reports both report to the managing director and their respective board committees.

Management of operational risk

Through the use of key performance indicators (KPI's) so as to adequately reflect the key risk area, and report on them. KPI's are reported monthly, quarterly, or on emergencies, whichever is appropriate.
Examples of a KPI is 'Incident/Fraud/ Suspicious Activities and Transaction Reports. '
These detail those process-related operational risk incidents combined with what remedial action was taken and what steps implemented to avoid a repeat occurrence. These reports are submitted as soon as the incident is discovered and notable trends reported quarterly on a summary report.

Reporting operational risk is a key part of risk management and staff are required to report all incidents which could fall within any of the six key risk areas (as above) – whether or not they resulted in any actual loss to the bank.

iii) Reputational risk

Reputational risk is the potential that negative publicity may lead to decline of its customer base, costly litigation, revenue reduction and subsequently its value and brand. All other risks may lead to reputational risks.

Main source of reputational risks are: business viability, business practices, fraudulent activities, litigations, customer satisfaction, anti-money laundering (AML) and rumours.

Responsibilities for reputational risk

The responsibility for management of reputational risk lies with the board of directors of the bank. Nonetheless, risk and audit management committees are responsible for reviewing adequacy and effectiveness of internal control systems relating to reputation risk and means through which exposures related to reputation risk are managed. Their purpose is to ensure that all stakeholders meet the bank's reputational risk objectives.

Management of Reputational risk

Overall, the bank promotes a corporate culture that adequately addresses stakeholder concerns and result in a gain of confidence. Internally, the bank has developed a code of conduct for directors and senior management and all staff. The bank also fully complies with applicable laws, legislation, and regulations. Finally, we continually communicate to the staff and regulators and the public on our compliance and standards.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

E. OPERATING RISK

Non-financial risk management disclosures (Continued)

iv) Compliance (legal/regulatory) risk

Compliance risk refers to the potential of loss arising from non-compliance or violation of laws, rules, regulations, obligatory practices/standards, contractual agreements. The bank is variously exposed to compliance risk due to relations with a wide number of stakeholders, e.g. regulators, customers, counter parties, as well as tax authorities, local authorities and other authorized agencies. The bank meets high standards of compliance with the Central Bank of Kenya, County governments, Occupational Safety and Health Administration (OSHA) and National Environment Management Authority (NEMA) etc.

Management of regulatory and legal risk

The risk & 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.

The board risk management committee receive the risk & compliance department's report on the strength of the bank's compliance risk framework to enable them to determine whether it is under control.

Management of regulatory risks

The board of directors and senior management through adoption of the bank's corporate governance and code of conduct sets a culture of integrity. All employees are required to attest to this code when they join the bank and thereafter annually, indicating that they have understood it and that they have complied with its provisions.

The bank has implemented compliance risk in key areas such as Know Your Customer (KYC) policy. Customer due diligence (CDD) and transactions monitoring has been ongoing. Cash transaction reporting (CTR) and Suspicious Account Transactions Reporting (SATR) is done as required by FRC. The risk and compliance department periodically update business units on the Anti Money Laundering's on UN Security Committees reports on individuals and entities who been placed on travel ban and funds frozen and embargo on arms as well as other regional and national bodies involved in fighting Money Laundering and Combating terrorism including the FAFT 40 and the Wolfsberg-Private Banking Principles.

v) IT risk

The bank's information technology risk management ensures the presence of an effective mechanism to identify, measure, monitor, and control the risks inherent in the banks' IT systems, ensure data integrity, availability, confidentiality and consistency and provide the relevant early warning mechanism.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

E. OPERATING RISK

v) IT risk (continued)

Responsibilities for Management of IT Risk

The three key functions responsible are the board, senior management and IT Head. The board ensures there is an IT governance structure that meets its risk tolerance. Senior management ensures staff understands and adheres to IT Risk Management. The Head of IT is key in decision making on business development that require the use of IT and that such system meet the bank's needs.

Management of IT Risk

By restricted access to both the IT system and physical access to IT infrastructure(s), IT security deployment and periodic IT Audit.

F. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The table below shows an analysis of financial instruments at fair value by level of the fair value hierarchy. The financial instruments are grouped into levels 1 to 3 based on the degree to which the fair value is observable.

i) Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;

ii) 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 a price) or indirectly (i.e. derived from prices);and

iii) 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).

4. INTEREST INCOME

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Advances to customers	743,887	767,682	743,887	767,682
Government securities - Held to maturity	239,091	220,667	239,091	220,667
Government securities - At fair value through profit or loss and Available for sale	-	-	-	-
Corporate bonds - Held to maturity	6,886	11,207	6,886	11,207
Deposits/balances due from other financial institutions	7,424	16,651	7,424	16,651
	997,288	1,016,207	997,288	1,016,207

5. INTEREST EXPENSE

	Group		Bank	
Customer deposits	634,351	643,239	634,351	643,239
	634,351	643,239	634,351	643,239

6. FEES AND COMMISSION INCOME

	Group		Bank	
	2018	2017	2018	2017
Transaction related fees	39,027	28,844	35,614	25,452
Credit related fees and commissions	28,637	25,861	28,637	25,861
	67,664	54,705	64,251	51,313

7. GAIN ON FOREIGN EXCHANGE DEALINGS

Gains on foreign currency dealings arose from trading in foreign currency transactions and also on the translation of foreign currency assets and liabilities.

8. OTHER OPERATING INCOME

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Locker rental income	1,282	1,228	1,282	1,228
Other operating income	8,991	7,048	8,991	7,048
Net gains from trading – treasury bonds (Available for sale) (Note 15 (d))	35,604	26,073	35,604	26,073
Reclassification of fair value on disposal of available for sale infrastructure bonds (Note 15(d))	-	1,636	-	1,636
	45,877	35,985	45,877	35,985

9. OPERATING EXPENSES

	Group		Bank	
Staff costs (note 10)	134,623	136,193	132,928	134,843
Contribution to Deposit Protection Fund	11,673	11,971	11,673	11,971
Depreciation (note 20)	20,205	19,252	20,205	19,252
Amortisation of intangible assets (note 21)	3,721	3,500	3,690	3,471
Directors' emoluments	28,960	26,292	28,960	26,292
Auditors' remuneration	3,416	3,440	3,148	3,190
Rent and rates	32,300	35,302	32,300	35,302
Legal and professional fees	31,148	15,718	30,908	15,718
Insurance	6,102	5,432	6,500	5,432
Security	13,133	14,275	13,133	14,275
Telephone and postage	11,096	11,938	11,096	11,938
Repairs and maintenance	8,450	4,866	8,450	4,866
Commission expenses	775	704	-	-
Other expenses	42,258	40,417	42,197	39,901
	347,860	329,300	345,188	326,451

10. STAFF COSTS

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Salaries and allowances	125,798	127,573	124,169	126,289
Staff training	2,005	267	2,005	267
Terminal dues	1,072	1,972	1,072	1,972
Pension contributions-defined contribution scheme	5,021	4,950	4,955	4,884
Medical expenses	727	1,431	727	1,431
	134,623	136,193	132,928	134,843

11. TAXATION

	Group		Bank	
(a) Taxation charge				
Current taxation based on the taxable profit for the period at 30%	225	27	-	-
Deferred taxation (credit)/charge (note 22):-				
- current year (credit)	(84,990)	(16,885)	(84,987)	(17,021)
- prior year under provision	2	(4,133)	-	(4,133)
	(84,763)	(20,991)	(84,987)	(21,154)
(b) Reconciliation of taxation credit to the expected taxation based on profit before taxation				
Profit before taxation	151,530	96,508	150,789	95,965
Tax at the applicable rate of 30%	45,459	28,952	45,237	28,780
Effect of expenses disallowed for taxation purposes	3,888	4,125	3,888	4,125
Effect of income not subject to taxation	(46,483)	(49,935)	(46,483)	(49,926)
Effect of IFRS 9 - adjustment through reserves	(87,629)	-	(87,629)	-
Prior year underprovision	2	(4,133)	-	(4,133)
Taxation charge	(84,763)	(20,991)	(84,987)	(21,154)

	Group		Bank	
(c) Corporate tax recoverable	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
At 1 January	17,645	17,453	17,418	17,418
Taxation charge	(225)	(27)	-	-
Tax paid in the year	59	219	-	-
At 31 December	17,479	17,645	17,418	17,418

12 . EARNINGS PER SHARE

Earnings per share are calculated by dividing the profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	Group		Bank	
	2018	2017	2018	2017
Earnings				
Earnings for the year attributable to ordinary shareholders (Sh'000)	236,293	117,499	235,776	117,119
Number of shares				
Weighted average number of ordinary shares in issue	1,000,000	1,000,000	1,000,000	1,000,000
Earnings per share-Basic (Sh)				
Ordinary shares	236.29	117.50	235.78	117.12

The diluted earnings per share is the same as the basic earnings per share as there were no potentially dilutive shares as at 31 December 2018 or 31 December 2017 respectively.

13. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Cash on hand	145,440	109,453	145,440	109,453
Balances with Central Bank of Kenya				
- Deposits held under lien	10,185	10,330	10,185	10,330
- Current account with CBK	785,071	945,346	785,071	945,346
	940,696	1,065,129	940,696	1,065,129
	940,696	1,065,129	940,696	1,065,129

The cash ratio requirement is based on the customer deposits with the bank as adjusted by the Central Bank of Kenya requirements. As at 31 December 2018 the cash reserve ratio requirement was 5.25% (2017: 5.25%) of all customer deposits. The deposits held under lien are to support foreign currency clearing. These funds are not available for the day to day operations of the bank

14. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Balances due from banking institutions	387,388	121,721	387,388	121,721

The weighted average effective interest rate for deposits and balances due from banking institutions at 31 December 2018 was 6.0% (2017 – 8.5%).

MATURITY ANALYSIS OF DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	Group & Bank	
	2018 Sh'000	2017 Sh'000
Due on demand	387,388	121,721
Maturing within one month	-	-
	387,388	121,721

15. GOVERNMENT SECURITIES - Group and Bank

	Group & Bank	
	2018 Sh'000	2017 Sh'000
(a) **Treasury bills held to maturity**		
At amortized cost – maturing within 90 days		
Face value	950,000	-
Less: unearned discount	(36,428)	-
	913,572	-
Held to maturity – at amortised cost (maturing within 5 years)	1,450,356	854,509
Held to maturity – at amortised cost (maturing after 5 years)	1,121,025	1,313,137
	2,571,381	2,167,646
	2,571,381	2,167,646

The weighted average effective interest rate for treasury bonds as at 31 December 2018 was 9.43% (2017 – 9.56%).Included in the above balances are treasury bonds amounting to ShNil(2017 – Sh 130,000,000) pledged with local commercial banks as security for letters of credit and guarantee facilities.

Included in Government Bonds maturing within 5 years is an impairment provision of Sh 10,209,000 (2017: 8,512,000 – Day 1 adjustment). The impairment loss charged through profit or loss during the year ended 31 December 2018 was Shs 1,697,000 (2017: Nil).

Movement in treasury bonds can be summarised as follows:

	Group &	Bank
	2017 Shs'000	2017 Shs'000
At 1 January	-	91,636
Additions	10,662,000	6,775,000
Disposals	(10,626,396)	(6,838,927)
Net gains on trading	(35,604)	(26,073)
Reclassification of fair value gains on disposals	-	(1,636)
At 31 December	-	-

16. CORPORATE BONDS - Group and Bank

Held to maturity- at amortised cost		
Kengen Limited bonds maturing within 5 years	35,695	74,681

The weighted average effective interest rate on the bonds at 31 December 2018 was8.1% (2017 – 7%).

Movement in corporate bonds held to maturity can be summarised as follows:

	2017 Shs'000	2017 Shs'000
At 1 January – as previously reported	74,681	114,445
IFRS 9 Day 1 Adjustment	(1,055)	-
At 1 January – Restated	73,626	-
Redemption	(34,725)	(34,725)
Net amortisation	(3,464)	(5,039)
Reversal of impairment through profit or loss	258	-
At 31 December	35,695	74,681

17. ADVANCES TO CUSTOMERS

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Loans and advances to customers	6,057,369	6,035,879	6,057,369	6,035,879
Bills discounted	900	900	900	900
	6,058,269	6,036,779	6,058,269	6,036,779
Provision for impaired loans and advances (note 18)	(415,640)	(134,747)	(415,640)	(134,747)
	5,642,629	5,902,032	5,642,629	5,902,032

The weighted average effective interest rate on advances to customers as at 31 December 2018 was12.20% (2017 –13.60%).

Included in net advances are loans and advances amounting to Sh539,695,000(2017 – Sh 488,568,000), net of specific provisions, which have been classified as non-performing.

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Analysis of gross advances by maturity:				
Maturing within one year	2,752,172	2,730,447	2,752,172	2,730,447
Over one year to three years	2,487,871	2,447,684	2,487,871	2,447,684
Over three to five years	818,226	858,648	818,226	858,648
	6,058,269	6,036,779	6,058,269	6,036,779

18. PROVISION FOR IMPAIRED LOANS AND ADVANCES

	Group		Bank	
At 1 January	134,747	144,991	134,747	144,991
IFRS 9 Day 1 adjustment	298,633	-	298,633	-
As restated	433,380	144,991	433,380	144,991
Provisions in the year charged to profit or loss	(17,740)	48,110	(17,740)	48,110
Write offs	-	(58,354)	-	(58,354)
At 31 December	415,640	134,747	415,640	134,747

19. OTHER ASSETS

	Group		Bank	
Items in course of collection	8,937	12,954	8,937	12,954
Prepayments	48,200	49,068	48,200	49,068
Other receivables	52,055	33,826	52,051	33,280
	109,192	95,848	109,188	95,302

20. EQUIPMENT - Group and Bank

	Computers & office equipment Sh'000	Motor vehicles Sh'000	Furniture, fittings and office renovations Sh'000	Total Sh'000
COST				
At 1 January 2017	88,893	10,533	167,456	266,882
Additions	3,957	760	332	5,049
Disposal	-	(830)	-	(830)
At 31 December 2017	92,850	10,463	167,788	271,101
At 1 January 2018	92,850	10,463	167,788	271,101
Additions	1,618	18,000	2,045	21,663
Disposal	-	(723)	-	(723)
At 31 December 2018	94,468	27,740	169,833	292,041
DEPRECIATION				
At 1 January 2017	67,508	6,997	120,602	195,107
Charge for the year	6,661	1,513	11,078	19,252
Disposal	-	(830)	-	(830)
At 31 December 2017	74,169	7,680	131,680	213,529
At 1 January 2018	74,169	7,680	131,680	213,529
Charge for the year	6,667	5,753	7,785	20,205
Disposal	-	(362)	-	(362)
At 31 December 2018	80,836	13,071	139,465	233,372
NET BOOK VALUE				
At 31 December 2018	13,632	14,669	30,368	58,669
At 31 December 2017	18,681	2,783	36,108	57,572

Included in equipment are assets with a cost of Sh 114,783,246 (2017 - Sh 128,908,362) which were fully depreciated. The notional depreciation charge in respect of these assets for the year is Sh 17,217,487 (2017 – Sh 20,975,227).

21. INTANGIBLE ASSETS COMPUTER SOFTWARE

	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
COST				
At 1 January	43,903	43,089	43,754	42,904
Additions	3,368	814	3,298	814
At 31 December	47,271	43,903	47,052	43,754
AMORTISATION				
At 1 January	32,626	29,126	32,537	29,066
Charge for the year	3,721	3,500	3,690	3,471
At 31 December	36,347	32,626	36,227	32,537
NET BOOK VALUE				
At 31 December	10,924	11,277	10,825	11,277

22. DEFERRED TAXATION ASSET

	Group		Bank	
The deferred tax asset, computed at the enacted rate of 30%, is attributable to the following items:				
Accelerated capital allowances	3,393	6,082	3,397	6,082
Leave pay provision	1,450	1,427	1,450	1,427
Other provisions	5,980	3,838	5,974	3,838
Unrealised fair vaue gain on financial assets	88,270	-	88,270	2,817
Tax losses	13,430	16,188	13,430	16,187
	112,523	27,535	112,521	27,534
The movement on the deferred tax asset account is as follows:				
As at 1 January	27,535	6,517	27,534	6,380
Credit for the year – note 11(a)	84,990	16,885	84,987	17,021
Prior year underprovision - note 11(a)	(2)	4,133	-	4,133
At 31 December	112,523	27,535	112,521	27,534

23. INVESTMENT IN SUBSIDIARY – Bank

	No. of shares	Holding	2018 Sh'000	2017 Sh'000
Parabank Insurance Agency Limited	1,000	100%	1,000	1,000

The subsidiary is wholly owned Limited Liability Company incorporated and domiciled in Kenya. The company was incorporated on 22 May 2017 and licenced to operate Insurance Agency/brokerage business.

24. CUSTOMER DEPOSITS

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Current accounts	604,533	635,924	609,282	639,263
Savings accounts	391,331	394,809	391,331	394,809
Call deposits	321,944	285,114	321,944	285,114
Fixed deposits	6,803,626	6,410,116	6,803,626	6,410,116
	8,121,434	7,725,963	8,126,183	7,729,302
Analysis of customer deposits by maturity:				
Payable within 90 days	7,047,749	6,766,861	7,052,498	6,770,200
Payable after 90 days and within one year	502,854	477,928	502,854	477,928
Payable after one year	570,831	481,174	570,831	481,174
	8,121,434	7,725,963	8,126,183	7,729,302

The weighted average effective interest rate on interest-bearing customer deposits at 31 December 2018 was 8.03% (2017 – 8.33%).

Customers deposits from related parties are disclosed in note 30 and concentrations of customer deposits are covered under note 3(a).

25. DEPOSITS AND BALANCES DUE TO BANKING INSTITUTIONS – Group & Bank

	2017 Sh'000	2017 Sh'000
Deposits due to banking institutions	-	-

The weighted average effective interest rate for deposits and balances due to banking institutions at 31 December 2018 was Nil (2017 – 5%).

26. OTHER LIABILITIES

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Sundry payables	53,174	32,514	53,174	32,514
Accruals	17,482	16,340	15,947	14,989
Premiums payable	1,802	1,761	-	-
Leave pay provision	4,838	4,755	4,838	4,755
	77,296	55,370	73,959	52,258

27. SHARE CAPITAL

	Group & Bank	
	2017 Sh'000	2017 Sh'000
Authorised, issued and fully paid:		
1,000,000 ordinary shares of Sh 1,000 each	1,000,000	1,000,000

28. NOTES TO THE STATEMENT OF CASH FLOWS

(a) Reconciliation of profit before taxation to cash (used in)/generated from operations

	Group		Bank	
	2018 Sh '000	2017 Sh '000	2018 Sh '000	2017 Sh '000
Profit before taxation	151,530	96,508	150,789	95,965
Adjustments for:				
Depreciation	20,205	19,252	20,205	19,252
Amortization of intangible assets	3,720	3,500	3,690	3,471
Gain/(loss) on sale of motor vehicle	7	(405)	7	(405)
Amortization of infrastructure bonds	-	(1,636)	-	(1,636)
Working capital changes :	175,462	117,219	174,691	116,647
Increase in balances held by Central Bank of Kenya under lien	145	(90)	145	(90)
Decrease/(Increase) in advances to customers	259,403	(102,488)	259,403	14,159
Decrease in treasury bonds	(403,735)	136,674	(403,735)	136,674
Decrease in corporate bonds	38,986	39,764	38,986	39,764
Decrease/(increase) in other assets	(13,344)	30,477	(13,886)	29,374
Increase/(decrease) in customer deposits	395,471	60,250	396,881	61,400
Decrease in advances from other local banks	-	(51,334)	-	(51,334)
(Decrease)/Increase in other liabilities	22,181	(11,534)	21,955	(11,228)
Changes due to IFRS 9 Day 1 adjustment	(308,200)	-	(308,200)	-
Cash (used in) operations	166,369	218,938	166,240	218,719

28. NOTES TO THE STATEMENT OF CASH FLOWS (Continued)

	Group		Bank	
	2018 Sh '000	2017 Sh '000	2018 Sh '000	2017 Sh '000
(b) Analysis of balances of cash and cash equivalents as shown in the financial position and notes (Noted 13)				
Cash on hand	145,440	109,453	145,440	109,453
Deposits and balances due from banking institutions	387,388	121,721	387,388	121,721
Current account with Central Bank of Kenya	785,071	945,346	785,071	945,346
	1,317,899	1,176,520	1,317,899	1,176,520

For the purposes of the statement of cash flows, cash equivalents include short term liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the dates of the advances.

29. CONTINGENCIES AND COMMITMENTS INCLUDING OFF FINANCIAL POSITION ITEMS

	2018 Sh'000	2017 Sh'000
(a) Contingent liabilities		
Letters of credit	12,336	56,315
Letters of guarantee and performance bonds	486,278	172,342
Bills for collection	55,832	289,678
	554,446	518,335

Letters of credit are commitments by the bank to make payments to third parties, on production of documents, on behalf of customers and are reimbursable by customers.

Letters of guarantee and performance bonds are issued by the bank, on behalf of customers, to guarantee performance by customers to third parties. The bank will only be required to meet these obligations in the event of default by the customers.

Contingent liabilities arising from lawsuits as at 31 December 2018 amounted to Sh7,250,000 (2017- Sh 10,700,000).

(b) The Group had no capital commitments as at 31 December 2018(2017 – Shnil).

(c) Commitments to extend credit

Commitments to lend are agreements to lend to a customer in the future subject to certain conditions. Such commitments are normally made for a fixed period. The bank may withdraw without incurring any charges from its contractual obligation to extend credit by giving reasonable notice to the customer.

29. CONTINGENCIES AND COMMITMENTS INCLUDING OFF FINANCIAL POSITION ITEMS (Continued

d) Operating lease arrangements

The bank as a lessee

At the financial position date, the bank had outstanding commitments under operating leases which fall due as follows:

	2018 Sh'000	2017 Sh'000
Within one year	19,589	19,236
In the second to fifth year inclusive	45,186	64,618
	64,775	83,854

30. 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.

Placements at 31 December 2018 include placements made in the bank by directors, their associates and companies associated with directors. Advances to customers and deposits at 31 December 2018 include loans and advances to companies associated with directors employees of the bank and, also deposits held with related parties respectively.Contingent liabilities at 31 December 2018 include guarantees and letters of credit for companies associated to directors.

These balances are included in the loans and advances and deposits balances at year end.

	Directors' associated companies		Employees/staff	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Movement in related party balances was as follows:				
Loans and advances:				
At 1 January	610,940	332,852	71,983	72,994
Net movement during the year	(26,627)	278,088	(4,059)	(1,011)
At 31 December	584,313	610,940	67,924	71,983
Interest earned	75,961	85,532	6,453	6,838
Deposits:				
At 1 January	466,841	385,749	11,576	16,974
Net movement during the year	10,134	81,092	797	(5,398)
At 31 December	476,975	466,841	12,373	11,576
Interest paid	47,698	46,684	1,114	926

30. RELATED PARTY TRANSACTIONS (Continued)

	2018 Sh'000	2017 Sh'000
Guarantees and letters of credit to companies associated to directors	25,366	29,308

Key management compensation

The remuneration of directors and other members of key management during the year were as follows:

	2018 Sh'000	2017 Sh'000
Key management salaries and other benefits	62,163	61,606
Directors emoluments	29,030	26,292

The remuneration of directors and key executives is determined by the board of directors having regard to the performance of the individuals and market trends.

31. FIDUCIARY ACTIVITIES

At 31 December 2018, the bank did not hold asset security documents on behalf of customers (2017: none).

32. COUNTRY OF INCORPORATION

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

33. CURRENCY

The financial statements are presented in Kenya Shillings thousands (Sh'000), the bank's functional and presentation currency.

34. EVENTS AFTER REPORTING PERIOD

There are no significant events after the reporting period which has been reported in these financial statements.

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