SIDIAN BANK LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

Contents **Page**

Directors	**Executive**	
	Chege Thumbi	
	Non-executive	
	James Mworia	(Chairman)
	Mary Ann Musangi	
	Kimanthi Mutua	
	Tom Kariuki	Independent
	Catherine Mturi-Wairi	Independent
	Oscar Kang'oro	Independent (Appointed 5 January 2018)
Board Committees		
Audit and Risk Committee	Catherine Mturi-Wairi	- Chairperson
	Kimanthi Mutua	
	Tom Kariuki	
	Mary Ann Musangi	
	Oscar Kang'oro	
Asset and Liability Committee	Kimanthi Mutua	- Chairperson
	Catherine Mturi-Wairi	
	Chege Thumbi	
	Mary Anne Musangi	
	Oscar Kang'oro	
Credit Committee	Tom Kariuki	- Chairperson
	Kimanthi Mutua	
	Chege Thumbi	
	Oscar Kang'oro	
Nominations and Governance Committee	Mary Ann Musangi	- Chairperson
	Catherine Mturi-Wairi	
	Chege Thumbi	
	Tom Kariuki	
Company Secretary	Daisy Ajima R/CPS 2003 Certified Public Secretary P O Box 25363 - 00603 Nairobi	
Registered Office	K-Rep Centre Wood Avenue, Kilimani P O Box 25363 - 00603 Nairobi	
Auditor	PricewaterhouseCoopers PwC Tower, Waiyaki Way / Chiromo Road, Westlands P O Box 43963 - 00100 Nairobi	

Legal Advisers

Mohammed Muigai & Co. Advocates
K-Rep Centre, 4th floor,
Wood Avenue, Off Lenana Road, Kilimani.
P.O Box 61323 – 00200
Nairobi

Munyao Muthama & Kashindi Co. Advocates,
ACK Cathedral Complex, Office No. 14
1st Floor, Cathedral Road, Off Nkrumah Road
P.O Box 2419 - 80100
Mombasa

The directors submit their report together with the audited financial statements of Sidian Bank Limited (the "Bank" or "Company") and its subsidiary, Sidian Insurance Agency Limited (the "Subsidiary") (together, the "Group") for the year ended 31 December 2018.

Principal activities

The Group is engaged in the business of banking and the provision of related services as well as provision of bancassurance services.

Business review

A detailed business review is included on pages 4 to 6 of this report.

Results and dividend

The loss for the year of Shs 377,883,000 (2017: loss of Shs 406,299,000) has been added to retained earnings. The directors did not recommend payment of a dividend for the year (2017: Nil).

Directors

The directors who held office during the year and to the date of this report are shown on page 1.

Disclosures to auditors

The directors confirm that with respect to each director at the time of approval of this report:

(a) there was, as far as each director is aware, no relevant audit information of which the Group's auditor is unaware; and

(b) each director had taken all steps that ought to have been taken as a director so as to be aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

Terms of appointment of auditors

PricewaterhouseCoopers continue in office in accordance with the Company's Articles of Association and Section 719 of the Kenyan Companies Act, 2015.

The directors monitor the effectiveness, objectivity and independence of the auditor. This responsibility includes the approval of the audit engagement contract and the associated fees on behalf of the shareholders.

Approval of financial statements

The financial statements set out on pages 14 to 99 were approved at a meeting of the directors held on 8 March 2019.

By order of the Board

Daisy Ajima
Company Secretary

8 March 2019

Overall performance

The Group recorded a loss of Shs 377,883,000 in 2018. The loss is largely attributed to the reduced interest rates on loans and advances due to the impact of interest rate capping as well as increased impairment losses on the Bank's non-performing assets. The impact of this was however reduced by the over 58% growth in non-funded income following the Bank's change in strategy to focus on non-funded business. Further, the Bank's operating expenses were well contained with only a 2% growth in the year driven by stringent cost management measures.

Net interest income increased by 1% with the minimal increase attributed to reduced lending rates in the year courtesy of interest rate capping as well as the impact of higher interest expense from the increased Deposits from customers. Non-funded income was driven by Trade Finance business, foreign exchange income and banc assurance income which the Bank continues to focus on. Trade Finance business recorded significant growth of over 139% in the year.

Net loans and advances to customers increased by 15% as the bank fully resumed lending in the year supported by its increased liquidity as well as improved economic conditions. Deposits from customers increased by 33% in the year driven by Trade finance related deposits, increased transactions by the bank's customers as well as better deposit mobilization through the forty-one branch network.

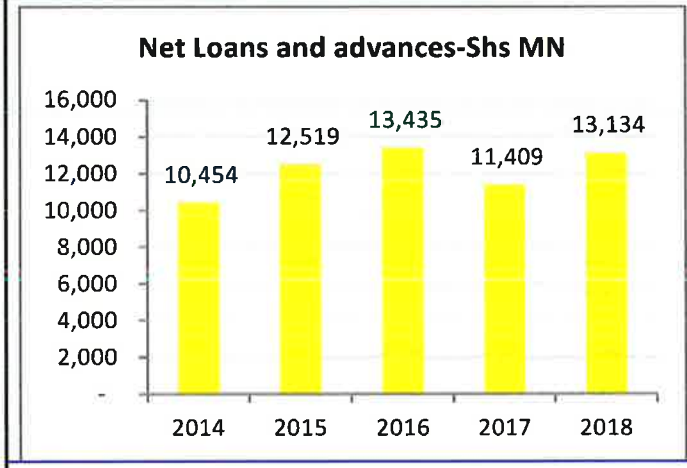
During the year, the bank raised additional share capital of Shs 1.1 billion via a rights issue, with the capital anticipated to support the Bank's growth in the medium term.

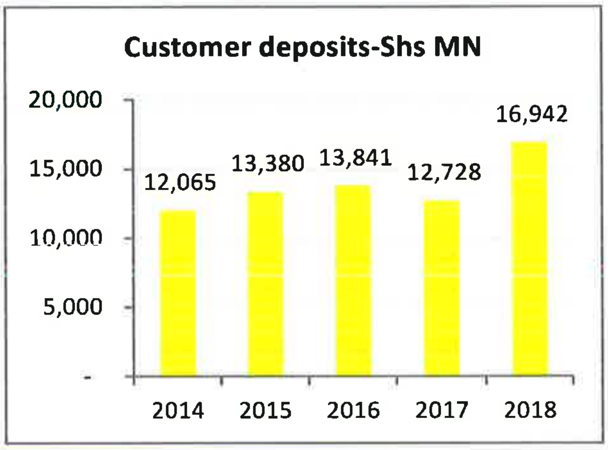
The Group's financial performance over the last five years is detailed below;

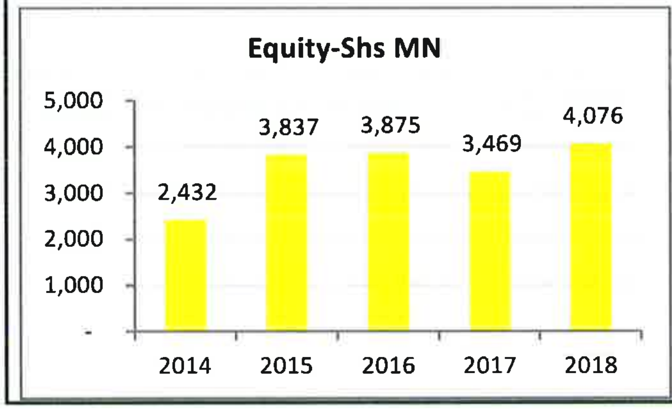
	2014	2015	2016	2017	2018
BALANCE SHEET	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
Assets					
Cash and bank balances with CBK and banking institutions	2,668,823	2,978,963	3,101,778	3,842,281	6,126,706
Investment securities	1,868,105	2,361,914	2,522,997	1,899,299	3,629,951
Loans and advances to customers	10,453,714	12,519,387	13,434,572	11,409,325	13,134,315
Other assets	810,797	1,246,293	1,812,513	2,138,777	2,417,952
Total assets	15,801,439	19,106,557	20,871,860	19,289,682	25,308,924
Liabilities and equity					
Deposits from banks	34,830	831,411	2,269,645	2,379,413	3,523,597
Deposits from customers	12,065,178	13,379,556	13,840,644	12,727,825	16,941,908
Borrowings	992,207	642,123	589,149	434,340	413,450
Other liabilities	277,450	415,982	297,477	279,458	353,661
Equity	2,431,774	3,837,485	3,874,945	3,468,646	4,076,308
Total liabilities and equity	15,801,439	19,106,557	20,871,860	19,289,682	25,308,924
INCOME STATEMENT					
Interest income	2,413,764	2,726,530	3,095,572	2,013,912	2,118,405
Interest expense	(753,312)	(1,069,641)	(1,194,873)	(966,574)	(1,055,421)
Net interest income	1,660,452	1,656,889	1,900,699	1,047,338	1,062,984
Non- interest income	586,100	616,060	586,379	674,484	1,066,242
Total income	2,246,552	2,272,949	2,487,078	1,721,822	2,129,226
Credit impairment losses	(93,480)	(188,901)	(300,542)	(463,571)	(762,941)
Operating expenses	(1,424,011)	(1,564,315)	(2,124,644)	(1,869,821)	(1,903,647)
Profit/ (loss) before income tax	729,061	519,733	61,892	(611,570)	(537,262)
Income tax expense	(215,017)	(147,413)	(33,844)	205,271	159,479
Profit / (loss) for the year	514,044	372,320	28,048	(406,299)	(377,883)

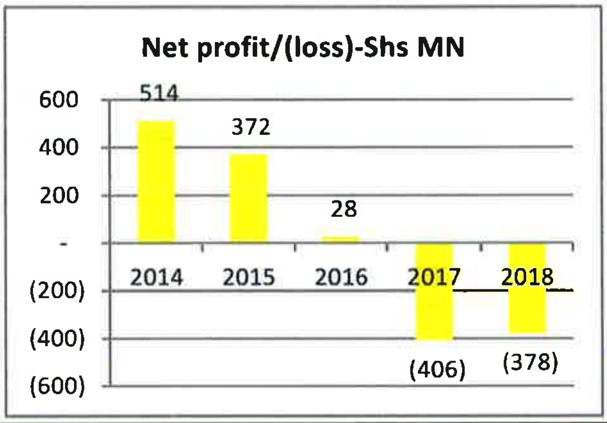
Overall performance (continued)

	2014	2015	2016	2017	2018
PERFORMANCE RATIOS					
Net Interest margin	12.2%	10.1%	10.3%	5.8%	5.3%
Cost to income	63.4%	68.8%	85.4%	109.0%	89.4%
Return on equity	23.9%	11.9%	0.7%	-11.1%	-10.0%
Return on assets	3.6%	2.1%	0.1%	-2.0%	-1.7%
NPL ratio	6.9%	12.0%	16.8%	20.6%	20.1%









Capital and liquidity

The Bank's capital and liquidity ratios are strong with sufficient headroom above the regulatory requirements. As a result, the Bank is well positioned to support future growth as per the strategy in the medium term and beyond.

	2014	2015	2016	2017	2018
CAPITAL STRENGTH					
Core capital to risk weighted assets (min: 10.5%)	20.2%	24.5%	23.1%	16.3%	15.7%
Total capital to risk weighted assets (min: 14.5%)	20.6%	24.7%	23.2%	16.5%	15.7%
LIQUIDITY RATIOS					
Net Loans and advances to deposits	87%	94%	97%	90%	78%
Liquidity ratio (min: 20%)	36.8%	32.2%	25.5%	24.3%	35.4%

Potential threats

Description	Example	Mitigation Measures
Credit risk		
Failure of an obligor of the bank to repay principal or interest at the stipulated time or failure of otherwise to perform as agreed.	Default on credit facilities	Monitoring and reporting of loan book, setting appetite limits, sector concentration limits, risk adjusted loan pricing.
Cyber risk		
Cyber risk' means any risk of financial loss, disruption or damage to the reputation of an organization from some sort of failure of its information technology systems.	Cyber security attack	Cyber Security Policy and framework, increase awareness and train and retrain staff, monitor anti-virus and anti-malware software, put in place security controls to avert penetration and to constantly test and monitor.
Information risk		
Risk arising from weaknesses in the ICT environment, system availability or data integrity.	Data fraud, phishing and privacy breaches Stringent information protection processes and policies	IT security policy, IT operations and monitoring firewalls, strong BCP, stringent information protection processes and policies.
Market risk		
Market risk at the Bank includes: interest rate risk, foreign exchange risk, investment risk, settlement risk and liquidity risk. This poses a potential loss of earning or economic value due to sudden shifts in financial and economic factors.	Loss in economic value due to shift in interest rate	Regular monitoring of the Bank's risk profile against risk appetite limits e.g. Exposure and risk limits, liquidity and solvency ratios which are contained in the market risk framework.
Compliance risk		
Failure to adhere to prudential guidelines, new or existing legislation as well as internal compliance policies	Introduction of new or changes to existing legislation, regulation and prudential guidelines.	Gap analysis and enhancement of the internal policy environment Identification of changes to the regulatory environment. Internal compliance checks and assessments. AML, FT, FATCA etc. policies.
Reputational risk		
Potential that negative publicity regarding the Bank's business practices, whether true or not, will cause a decline in the customer confidence, costly litigation or revenue reductions. This risk may be due to the failure of the bank to effectively manage all the other risks.	Negative publicity	Senior management oversight, effective and efficient complaint management system, monitoring print, electronic and social media and resolution of issues. Strong risk management and ethics culture.
Country risk		
The collection of risks associated with investing in a country.	Political risk, economic risk and sovereign risk	Regular monitoring of inflation rates, political climate and proper business continuity programs.

2019 Focus

The Bank is in the process of raising additional long-term funding to enhance its regulatory capital ratios and support the Bank's growth including growing its loan book, Trade Finance business as well as non-funded income. Trade Finance will continue to be the key driver of the Bank's growth in the medium term as the Bank positions itself as the 'Go To Bank' for Trade Finance solutions. Further, in 2019 the Bank will focus on recovering its non-performing loans and improving its asset quality.

Statement of Corporate Governance

This statement sets out the key components of Sidian Bank's Corporate Governance Framework. Corporate Governance is central to the Bank's approach to safeguard shareholders and stakeholders' interest and at the same time enhance shareholder value. The overall control over the activities, affairs, operations, business and property of the Bank is vested in the Bank's Board of Directors ("BOD"). The BOD notes that maintenance and consistent practice and application of good corporate governance practices is key to the long-term success of the Bank.

The Board is committed and confirms full compliance of all the relevant laws including the Central Bank of Kenya (CBK) Guidelines on Corporate Governance (CBK/PG/02) issued under Section 33(4) of the Banking Act, guidelines set by itself in accordance with international best practices. The Bank has adopted the highest standards of integrity and ethics in all undertakings. The Board has adopted a comprehensive framework of Corporate Governance Guidelines, designed to ensure performance of the Bank's enhanced targets and regulatory compliance.

The Bank ensures that there is adequate accountability in its actions and openness in relation with stakeholders, shareholders and the general public.

Board of Directors

The Board consists of seven members chaired by Mr. James Mworia. It consists of six non-executive directors and one executive director. To further enhance skills within the board, Mr. Oscar Kang'oro was appointed as a Director in January 2018. The Board collectively pools together vast experience in various relevant fields inter alia, investment management, banking, finance and marketing. With this, it is able to effectively ensure that the Bank establishes and maintains internal controls that drive profitability and sustainable growth.

Authority and Delegation

The Board delegates its authority to Board Committees, which are Board Credit Committee, Board Audit and Risk Committee, Board Asset and Lability Committee and Board Nominations and Governance Committee, which meet quarterly or whenever a need arises. The Board Credit Committee further acts as an operational committee that is vested to review customer credit requests within the board limit. The authority for the day to day running of the Bank is delegated to the Chief Executive Officer, who runs the Bank together with the Executive Management Committee / Management Committee. The Board Charter sets out the Board authority and matters reserved for determination and approval by the Board. The Board Chair plays a crucial role in fostering constructive dialogue between shareholders, the Board and management at the Annual General Meeting and other shareholder meetings.

Corporate Planning

The Board is responsible for formulating the strategic plan of the Bank. The Board has been instrumental in formulating sustainable policies and strategies to ensure that the Bank stays profitable. The Board holds an annual strategic planning workshop with the senior management at which the projections and targets are reviewed and amended as circumstances dictate.

Board Effectiveness

The Board of Directors comprises of six non-executive Directors and one executive Director, the Chief Executive Officer. This arrangement initiates the significance of impartiality in matters of corporate governance. It also ensures that the Board is free from undue influence on matters affecting the day to day running of the Bank. Generally, the conduct of the Board in particularly the non-executive Directors, are regulated by the Bank's Memorandum and Articles of Association as well as a Board Charter, Terms of Reference and Directors' Code of Board Principles and Conduct. Management also ensures that the Board is well informed on the operations of the Bank at all times. The annual Board evaluation exercise for the year 2018 was conducted in February 2019 internally.

Executive Management Committee

The implementation of the Bank's strategic decisions is handled by the Executive Management Committee which is chaired by the Chief Executive Officer. The Committee meets once a month to review the Bank's performance, control overall direction of business and make strategic decisions. The Committee is composed of departmental heads of Human Resources, Finance, Credit, Treasury, Trade Finance, Branch Banking, Legal and Information and Communication Technology (ICT). The Heads of Enterprise Risk and Audit are invited to give an overview.

Board Committees

The Board has established Board Committees to assist in discharging its duties and responsibilities. The Board committees have formally determined terms of reference, which define their role, function, reporting procedures and scope of authority. The existing committees are Audit and Risk Committee, Asset and Liability Committee, Credit Committee, and Nominations and Governance Committee. The Board also ensures that effective communication with shareholders is upheld. This is done through holding of the Annual General Meeting and also provision of annual report and financial statements in full compliance with the requirements of the Kenyan Companies Act, 2015 and the International Financial Reporting Standards (IFRSs).

The agenda of each committee is guided by the Board Charter together and the plan set at the beginning of the year.

Board Audit and Risk Committee

This committee consists of non –executive directors who check on the quality of financial reporting, selection of internal and external auditing functions, advise the board on best practices, provide oversight on risk management and compliance with relevant local legislation, regulations and guidelines issued by regulatory bodies together with the Bank's laid down policies and procedures.

The committee further defines the scope of risk management work, ensures that adequate risk policies and strategies are in place to identify, monitor and effectively mitigate the various risk issues the Bank is exposed to in the day to day activities. On a yearly basis, the committee reviews the proposed work plans for the internal audit function. The committee is also responsible for ensuring that the Bank operates within the set risk appetite levels and must ensure that any deviations are corrected within a given time frame. The Chair of this committee is a member of Institute of Certified Public Accountants of Kenya (ICPAK).

Asset and Liability Committee (ALCO)

The ALCO committee is set up to derive the most appropriate strategy for the Bank by optimizing returns while prudently managing and observing the assets and liabilities. It also considers the potential consequences of interest rate movements, market risk, liquidity constraints, and foreign exchange exposure and capital adequacy. The committee ensures compliance with the Bank's strategies on statutory requirements on liquidity, foreign exchange exposure and cash ratio.

Nominations and Governance Committee

The purpose of the Nominations and Governance Committee is to ensure that the Board fulfills its legal, ethical and functional responsibilities through adequate governance policy development, recruitment strategies, training programs, monitoring of Board activities and evaluation of Board members' performance

Credit Committee

The Credit committee oversees the establishing and implementing of the credit and lending policies of the Bank. It is responsible for the sanction of credit proposals in line with the Bank's Credit Policy and effective follow up of all credit-related matters. The Committee is also responsible for formulating the credit policies of the Bank.

The Board scheduled six board meetings during the year which were inclusive of two Special Board meetings. The average attendance of board meetings is above 95%.

Board meeting membership and attendance for the year ended 31 December 2018 is as below;

	January	March	May	July	August	October	Percentage Attendance
James Mworia	Yes	Yes	Yes	-	Yes	Yes	83%
Mary Ann Musangi	Yes	Yes	Yes	Yes	-	Yes	83%
Kimanthi Mutua	Yes	Yes	Yes	Yes	Yes	Yes	100%
Tom Kariuki	Yes	Yes	Yes	Yes	Yes	Yes	100%
Catherine Mturi-Wairi	Yes	Yes	Yes	Yes	Yes	Yes	100%
Oscar Kang'oro	N/A	Yes	Yes	Yes	Yes	Yes	100%
Chege Thumbi	Yes	Yes	Yes	Yes	Yes	Yes	100%
Average							95%

Board Evaluation

In line with the requirements of the Bank's Corporate Governance Policy and the relevant prudential guideline issued by the CBK, each member of the Board (including the Chairman) conducts a peer as well as self-evaluation of the Board and the returns made to the CBK. A self-evaluation was conducted in February 2019.

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, sustainable banking and labour standards in its commitment to best practice. Additionally, the Bank prepares its financial statements in accordance with International Financial Reporting Standards (IFRS).

Shareholding structure

The Bank's shareholders at 31 December 2018 are detailed below;

	Shareholders	Number of shares	Percentage shareholding
1	Bakki Holdco Limited	3,273,344	79.99%
2	K-Rep Group Limited	501,430	12.25%
3	KWA Multi-Purpose Coop Limited	143,376	3.50%
4	Centum Investment Company Plc	82,273	2.01%
5	Kimanthi Mutua	21,040	0.51%
6	Sarah Godana	15,495	0.38%
7	Kabiru Kinyanjui	12,222	0.30%
8	Mwenda Thiribi	10,316	0.25%
9	Anthony Wainaina	3,785	0.09%
10	Francis Kihiko	8,871	0.22%
11	The Estate of the Late Amb. Bethuel Kiplagat	8,254	0.20%
12	Aleke Dondo	6,495	0.16%
13	Judith Behemuka	4,995	0.12%
14	Francis Kimunyu	500	0.01%
	Total	**4,092,396**	**100.00%**

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 Group and of the Company as at the end of the financial year and of their profit or loss for that year. It also requires the directors to ensure that the Group and Company keep proper accounting records that: (a) show and explain the transactions of the Group and Company; (b) disclose, with reasonable accuracy, the financial position of the Group and Company; and (c) enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Kenyan Companies Act, 2015.

The directors accept responsibility for the preparation and presentation of these financial statements in accordance with 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 Group's and Company'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 Group's and Company'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 8 March 2019 and signed on its behalf by:

………………………………	………………………………
Chege Thumbi	Tom Kariuki
Chief Executive Officer	Director

8 March 2019

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF SIDIAN BANK LIMITED

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Sidian Bank Limited (the "Bank") and its subsidiary (together, the "Group") set out on pages 14 to 99, which comprise the consolidated statement of financial position at 31 December 2018 and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, together with the Bank statement of profit or loss and other comprehensive income, Bank statement of financial position at 31 December 2018, the statement of changes in equity and statement of cash flows for the Bank 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 of Sidian Bank Limited give a true and fair view of the financial position of the Group and the Bank 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 (ISAs). 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 Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information. 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 identified above 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, 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.

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF SIDIAN BANK LIMITED (CONTINUED)

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 and the requirements of the Kenyan Companies Act 2015, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, 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.

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 ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- 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.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF SIDIAN BANK LIMITED (CONTINUED)

Auditor's responsibilities for the audit of the financial statements (continued)

- 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.

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

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

In our opinion the information given in the report of the directors on page 3 is consistent with the financial statements.

PricewaterhouseCoopers.

Certified Public Accountants
Nairobi

27th March **2019**

FCPA Michael Mugasa, Practising certificate No. 1478
Signing partner responsible for the independent audit

Consolidated statement of profit or loss and other comprehensive income

	Notes	2018 Shs'000	2017 Shs'000
Interest income	5	2,118,405	2,013,912
Interest expense	6	(1,055,421)	(966,574)
Net interest income		1,062,984	1,047,338
Fee and commission income	7	853,312	547,660
Fee and commission expense	7	(2,988)	(3,000)
Net fee and commission income		850,324	544,660
Net trading income	8	210,070	112,410
Credit impairment losses	9	(762,941)	(463,571)
Other operating income	10	5,848	17,414
Net other operating expense		(547,023)	(333,747)
Operating expenses	11	(1,903,647)	(1,869,821)
Loss before income tax		(537,362)	(611,570)
Income tax credit	13	159,479	205,271
Loss for the year		(377,883)	(406,299)
Other comprehensive income		-	-
Total comprehensive loss		(377,883)	(406,299)

Bank statement of profit or loss and other comprehensive income

	Notes	2018 Shs'000	2017 Shs'000
Interest income	5	2,118,405	2,013,912
Interest expense	6	(1,055,421)	(966,574)
Net interest income		1,062,984	1,047,338
Fee and commission income	7	813,630	515,175
Fee and commission expense	7	(2,587)	(3,000)
Net fee and commission income		811,043	512,175
Trading income	8	210,070	112,410
Credit impairment losses	9	(762,941)	(463,571)
Other income	10	5,848	17,414
Net other operating expense		(547,023)	(333,747)
Operating expenses	11	(1,889,069)	(1,858,707)
Loss before income tax		(562,065)	(632,941)
Income tax credit	13	166,668	211,131
Loss for the year		(395,397)	(421,810)
Other comprehensive income		-	-
Total comprehensive loss		(395,397)	(421,810)

Consolidated statement of financial position

Assets	Notes	2018 Shs'000	2017 Shs'000	2016 Shs'000
Cash and balances with Central Bank of Kenya	15	2,140,313	2,621,332	2,216,043
Derivative financial instruments	16	106,579	40,508	8,514
Deposits with other banks	17	3,986,393	1,220,949	885,735
Investment securities	18	3,629,951	1,899,299	2,522,997
Loans and advances to customers	19	13,134,315	11,409,325	13,434,572
Other assets and prepayments	20	936,534	929,548	772,136
Current income tax	13	113,250	106,431	101,538
Property and equipment	21	433,216	497,282	537,399
Intangible assets	22	336,407	296,166	335,737
Deferred income tax	23	491,966	268,842	57,189
Total assets		25,308,924	19,289,682	20,871,860
Liabilities and equity				
Liabilities				
Derivative financial instruments	16	6,397	2,151	1,930
Deposits from banks	24	3,523,597	2,379,413	2,269,645
Deposits from customers	25	16,941,908	12,727,825	13,840,644
Other liabilities and accrued expenses	26	347,264	277,307	295,547
Borrowings	27	413,450	434,340	589,149
Total liabilities		21,232,616	15,821,036	16,996,915
Equity				
Share capital	28	2,046,198	1,470,175	1,470,175
Share premium	28	1,246,599	706,082	706,082
Revaluation reserve		67,376	68,161	68,553
Regulatory reserve		-	11,686	14,832
Retained earnings		716,135	1,212,542	1,615,303
Total equity		4,076,308	3,468,646	3,874,945
Total liabilities and equity		25,308,924	19,289,682	20,871,860

The financial statements on pages 14 to 99 were approved by the Board of Directors on 8 March 2019 and were signed on its behalf by:

....
Chege Thumbi
Chief Executive Officer

....
Tom Kariuki
Director

Bank statement of financial position

Assets	Notes	2018 Shs'000	2017 Shs'000
Cash and balances with Central Bank of Kenya	15	2,140,313	2,621,332
Derivatives financial assets	16	106,579	40,508
Deposits with other banks	17	3,986,393	1,220,949
Investment securities	18	3,629,951	1,899,299
Investment in subsidiary	34	1,000	1,000
Loans and advances to customers	19	13,134,315	11,409,325
Other assets and prepayments	20	963,597	944,508
Current income tax	13	111,315	108,903
Property and equipment	21	433,176	497,192
Intangible assets	22	331,257	290,416
Deferred income tax	23	491,273	268,320
Total assets		25,329,169	19,301,752
Liabilities and equity			
Liabilities			
Derivatives financial liabilities	16	6,397	2,151
Deposits from banks	24	3,523,597	2,379,413
Deposits from customers	25	17,001,480	12,760,791
Other liabilities and accrued expenses	26	347,119	278,079
Borrowings	27	413,450	434,340
Total liabilities		21,292,043	15,854,774
Equity			
Share capital	28	2,046,198	1,470,175
Share premium	28	1,246,599	706,082
Revaluation reserve		67,376	68,161
Regulatory reserve		-	11,686
Retained earnings		676,953	1,190,874
Total equity		4,037,126	3,446,978
Total liabilities and equity		25,329,169	19,301,752

The financial statements on pages 14 to 99 were approved by the Board of Directors on 8 March 2019 and were signed on its behalf by:

....
Chege Thumbi
Chief Executive Officer

....
Tom Kariuki
Director

Consolidated statement of changes in equity

	Notes	Share capital Shs'000	Share Premium Shs'000	Revaluation reserve Shs'000	Regulatory reserve Shs'000	Retained earnings Shs'000	Total Shs'000
Year ended 31 December 2017							
At start of year		1,470,175	706,082	68,553	14,832	1,615,303	3,874,945
Total comprehensive income for the year:							
Loss for the year		-	-	-	-	(406,299)	(406,299)
Transfer from regulatory reserve		-	-	-	(3,146)	3,146	-
Transfer of excess depreciation		-	-	(560)	-	560	-
Deferred tax on transfer		-	-	168	-	(168)	-
At end of year		1,470,175	706,082	68,161	11,686	1,212,542	3,468,646
Year ended 31 December 2018							
At start of year		1,470,175	706,082	68,161	11,686	1,212,542	3,468,646
Changes on initial application of IFRS 9		-	-	-	(11,686)	(119,309)	(130,995)
Restated balance at 1 January 2018		1,470,175	706,082	68,161	-	1,093,233	3,337,651
Total comprehensive income for the year:							
Loss for the year		-	-	-	-	(377,883)	(377,883)
Transfer of excess depreciation		-	-	(1,121)	-	1,121	-
Deferred tax on transfer		-	-	336	-	(336)	-
Transactions with owners, recorded directly in equity:							
Proceeds from issue of shares	28	576,023	540,517	-	-		1,116,540
At end of year		2,046,198	1,246,599	67,376	-	716,135	4,076,308

Bank statement of changes in equity

	Notes	Share capital Shs'000	Share Premium Shs'000	Revaluation reserve Shs'000	Regulatory reserve Shs'000	Retained earnings Shs'000	Total Shs'000
Year ended 31 December 2017							
At start of year		1,470,175	706,082	68,553	14,832	1,609,146	3,868,788
Total comprehensive income for the year:							
Loss for the year		-	-	-	-	(421,810)	(421,810)
Transfer from regulatory reserve		-	-	-	(3,146)	3,146	-
Transfer of excess depreciation		-	-	(560)	-	560	-
Deferred tax on transfer		-	-	168	-	(168)	-
At end of year		1,470,175	706,082	68,161	11,686	1,190,874	3,446,978
Year ended 31 December 2018							
At start of year		1,470,175	706,082	68,161	11,686	1,190,874	3,446,978
Changes on initial application of IFRS 9		-	-	-	(11,686)	(119,309)	(130,995)
Restated balance at 1 January 2018		1,470,175	706,082	68,161	-	1,071,565	3,315,983
Total comprehensive income for the year:							
Loss for the year		-	-	-	-	(395,397)	(395,397)
Transfer of excess depreciation		-	-	(1,121)	-	1,121	-
Deferred tax on transfer		-	-	336	-	(336)	-
Transactions with owners, recorded directly in equity							
Proceeds from issue of shares	28	576,023	540,517	-	-	-	1,116,540
At end of year		2,046,198	1,246,599	67,376	-	676,953	4,037,126

Consolidated statement of cash flows

	Notes	2018 Shs'000	2017 Shs'000
Cash flows from operating activities			
Cash generated from operations	31(a)	2,822,064	248,740
Income tax paid	13(a)	(14,298)	(7,500)
Net cash flows from operating activities		2,807,766	241,240
Cash flows from investing activities			
Purchase of investment securities		(3,591,092)	(699,707)
Proceeds from sale of investment securities		2,228,283	1,555,167
Purchase of property and equipment	21	(36,043)	(86,381)
Purchase of intangible assets	22	(119,500)	(47,085)
Proceeds from sale of property and equipment		99	717
Net cash flows from investing activities		(1,518,253)	722,711
Cash flows from financing activities			
Proceeds from borrowings	27	57,890	202,000
Repayments of borrowings	27	(116,265)	(425,448)
Proceeds from issue of shares	28	1,116,540	-
Net cash flows from financing activities		1,058,165	(223,448)
Net increase in cash and cash equivalents		2,347,678	740,503
Cash and cash equivalents at start of year	31 (b)	3,842,281	3,101,778
Cash and cash equivalents at end of year	31 (b)	6,189,959	3,842,281

Bank statement of cash flows

	Notes	2018 Shs'000	2017 Shs'000
Cash flows from operating activities			
Cash generated from operations	31(a)	2,810,298	248,365
Income tax paid	13(a)	(2,532)	(951)
Net cash flows from operating activities		2,807,766	247,414
Cash flows from investing activities			
Purchase of investment securities		(3,591,092)	(699,707)
Proceeds from sale of investment securities		2,228,283	1,555,167
Purchase of property and equipment	21	(36,043)	(86,381)
Purchase of intangible assets	22	(119,500)	(47,085)
Proceeds from sale of property and equipment	21	99	717
Transfer of intangible assets		-	(6,000)
Transfer of property and equipment		-	(174)
Net cash flows from investing activities		(1,518,253)	716,537
Cash flows from financing activities			
Proceeds from borrowings	27	57,890	202,000
Repayments of borrowings	27	(116,265)	(425,448)
Proceeds from issue of shares	28	1,116,540	-
Net cash flows from financing activities		1,058,165	(223,448)
Net increase in cash and cash equivalents		2,347,678	740,503
Cash and cash equivalents at start of year	31 (b)	3,842,281	3,101,778
Cash and cash equivalents at end of year	31 (b)	6,189,959	3,842,281

Notes

1 Corporate information

Sidian Bank Limited (the "Bank") and its subsidiary Sidian Insurance Agency Limited (the "Subsidiary") are incorporated and domiciled in Kenya and operate in Kenya. The registered address of the Bank and its subsidiary is:

K-Rep Centre,
Wood Avenue, Kilimani
P O Box 25363 - 00603
Nairobi.

The Bank is licensed under the Kenyan Banking Act (Chapter 488).

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

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee (IFRS IC) applicable to companies reporting under IFRS. The financial statements comply with IFRS as issued by the International Accounting Standards Board (IASB).

(i) Basis of measurement

The measurement basis used is the historical cost basis except where otherwise stated in the accounting policies below.

For those assets and liabilities measured at fair value, 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. When measuring the fair value of an asset or a liability, the Group and Bank use market observable data as far as possible. If the fair value of an asset or a liability is not directly observable, it is estimated by the Group and Bank using valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs (e.g. by use of the market comparable approach that reflects recent transaction prices for similar items or discounted cash flow analysis). Inputs used are consistent with the characteristics of the asset / liability that market participants would take into account.

Fair values are categorised into three levels of fair value hierarchy based on the degree to which the inputs to the measurements are observable and the significance of the inputs to the fair value measurement in its entirety:

- Level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- 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).

Transfers between levels of the fair value hierarchy are recognised by the Group at the end of the reporting period during which the change occurred.

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(ii) Use of estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

(iii) Changes in accounting policies and disclosures

(a) New and amended standards adopted by the Group

The following standards and amendments have been applied by the Group for the first time for the financial year beginning 1 January 2018:

IFRS 9 - Financial Instruments

The Group has adopted IFRS 9 as issued by the IASB in July 2014 with a date of transition of 1 January 2018, which has resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. The Group did not early adopt any part of IFRS 9 in previous periods.

As permitted by the transitional provisions of IFRS 9, the Group elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition was recognised in the opening retained earnings and other reserves of the current period.

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also been applied only to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

The adoption of IFRS 9 has resulted in changes in the accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7, "Financial Instruments: Disclosures".

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Group. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail in Note 2(e).

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(iii) Changes in accounting policies and disclosures (continued)

(a) New and amended standards adopted by the Group (continued)

IFRS 9, 'Financial instruments' (continued)

(i) Classification and measurement of financial instruments

The measurement category and the carrying amount of the Group's financial assets and liabilities in accordance with IAS 39 and IFRS 9 at 1 January 2018 are compared as follows:

Group	**Original classification under IAS 39**	**New classification under IFRS 9**	**Original carrying amount under IAS 39**	**New carrying amount under IFRS 9**
Financial assets			**Shs' 000**	**Shs' 000**
Cash and balances with Central Bank of Kenya	Loans and receivables	Amortised cost	2,621,332	2,621,332
Derivative financial instruments	Fair value through profit or loss ('FVTPL')	FVTPL	40,508	40,508
Deposits with other banks	Loans and receivables	Amortised cost	1,220,949	1,211,072
Investment securities	Held to Maturity	Amortised cost	1,899,299	1,899,299
Loans and advances to customers	Loans and receivables	Amortised cost	11,409,325	11,232,067
Other financial assets	Loans and receivables	Amortised cost	252,394	252,394
Total financial assets			17,443,807	17,256,672
Financial liabilities				
Derivative financial instruments	FVTPL	FVTPL	2,151	2,151
Deposits from banks	Other liabilities	Amortised cost	2,379,413	2,379,413
Deposits from customers	Other liabilities	Amortised cost	12,727,825	12,727,825
Borrowings	Other liabilities	Amortised cost	434,340	434,340
Total financial liabilities			15,543,729	15,543,729

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(iii) Changes in accounting policies and disclosures (continued)

(a) New and amended standards adopted by the Group (continued)

IFRS 9, 'Financial instruments' (continued)

(i) Classification and measurement of financial instruments

The measurement category and the carrying amounts of the Bank's financial assets and liabilities in accordance with IAS 39 and IFRS 9 at 1 January 2018 are compared as follows:

Bank	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 Shs' 000	New carrying amount under IFRS 9 Shs' 000
Financial assets				
Cash and balances with Central Bank of Kenya	Loans and receivables	Amortised cost	2,621,332	2,621,332
Derivative financial instruments	FVTPL	FVTPL	40,508	40,508
Deposits with other banks	Loans and receivables	Amortised cost	1,220,949	1,211,072
Investment securities:	Held To Maturity	Amortised cost	1,899,299	1,899,299
Loans and advances to customers	Loans and receivables	Amortised cost	11,409,325	11,232,067
Other financial assets	Loans and receivables	Amortised cost	269,392	269,392
Total financial assets			17,460,805	17,273,670
Financial liabilities				
Derivative financial instruments	FVTPL	FVTPL	2,151	2,151
Deposits from banks	Other liabilities	Amortised cost	2,379,413	2,379,413
Deposits from customers	Other liabilities	Amortised cost	12,760,791	12,760,791
Borrowed funds	Other liabilities	Amortised cost	434,340	434,340
Total financial liabilities			15,576,695	15,576,695

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(iii) Changes in accounting policies and disclosures (continued)

(a) New and amended standards adopted by the Group (continued)

IFRS 9, 'Financial instruments' (continued)

(ii). Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

The Group performed a detailed analysis of its business models and managing financial assets as well as their cash flow characteristics. The following table reconciles the carrying amount of financial assets from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018.

Group Financial assets	IAS 39 carrying amount 31 December 2017 Shs' 000	Reclassification Shs' 000	Remeasurement Shs' 000	IFRS 9 carrying amount 1 January 2018 Shs' 000
At amortised cost:				
Cash and balances with Central Bank of Kenya				
Opening balance as per IAS 39 and closing balance as per IFRS 9	2,621,332	-	-	2,621,332
Deposits with other banks				
Opening balance as per IAS 39	1,220,949	-	-	-
Remeasurement: ECL allowance	-	-	(9,877)	-
Closing balance as per IFRS 9	-	-	-	1,211,072
Investment securities				
Opening balance as per IAS 39 and closing balances as per IFRS 9	1,899,299	-	-	1,899,299
Loans and advances to customers				
Opening balance as per IAS 39	11,409,325	-	-	-
Remeasurement: ECL allowance	-	-	(177,258)	-
Closing balance as per IFRS 9	-	-	-	11,232,067
Other assets (financial)				
Opening balance as per IAS 39 and closing balances as per IFRS 9	252,394	-	-	252,394
Total financial assets measured at amortised cost	17,403,299	-	(187,135)	17,216,164
Fair value through profit or loss (FVTPL):				
Derivative financial assets				
Opening balance as per IAS 39 and closing balance as per IFRS 9	40,508	-	-	40,508
Total financial assets at FVTPL	40,508	-	-	40,508
Total financial assets	17,443,807	-	(187,135)	17,256,672

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(iii) Changes in accounting policies and disclosures (continued)

(a) New and amended standards adopted by the Group (continued)

IFRS 9, 'Financial instruments' (continued)

(ii). Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 (continued)

Bank **Financial assets**	**IAS 39 carrying amount 31 December 2017** **Shs' 000**	**Reclassification** **Shs' 000**	**Remeasurement** **Shs' 000**	**IFRS 9 carrying amount 1 January 2018** **Shs' 000**
At amortised cost:				
Cash and balances with Central Bank of Kenya				
Opening balance as per IAS 39 and closing balance as per IFRS 9	2,621,332	-	-	2,621,332
Deposits with other banks				
Opening balance as per IAS 39	1,220,949	-	-	-
Remeasurement: ECL allowance	-	-	(9,877)	-
Closing balance as per IFRS 9	-	-	-	1,211,072
Investment securities				
Opening balance as per IAS 39 and closing balances as per IFRS 9	1,899,299	-	-	1,899,299
Loans and advances to customers				
Opening balance as per IAS 39	11,409,325	-	-	-
Remeasurement: ECL allowance	-	-	(177,258)	-
Closing balance as per IFRS 9	-	-	-	11,232,067
Other assets (financial)				
Opening balance as per IAS 39 and closing balances as per IFRS 9	269,392	-	-	269,392
Total financial assets measured at amortised cost	17,420,297	-	(187,135)	17,233,162
Fair value through profit or loss (FVTPL):				
Derivative financial assets				
Opening balance as per IAS 39 and closing balance as per IFRS 9	40,508	-	-	40,508
Total financial assets at FTVPL	40,508	-	-	40,508
Total financial assets	17,460,805	-	(187,135)	17,273,670

The total remeasurement loss of Shs 130,995,000 (net of deferred income tax of Shs 56,140,000) was recognized in opening retained earnings and regulatory reserves at 1 January 2018.

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(iii) Changes in accounting policies and disclosures (continued)

(a)New and amended standards adopted by the Group (continued)

IFRS 9, 'Financial instruments' (continued)

(iii) Reconciliation of impairment allowance balances from IAS 39 to IFRS 9

The following table reconciles the prior year's closing impairment allowances measured in accordance with IAS 39 incurred loss model and to the new impairment allowance measured in accordance with the IFRS 9 expected credit loss model at 1 January 2018.

Group and Bank

Measurement category	Credit loss allowance under IAS 39	Reclassification	Remeasurement	Credit loss allowance under IFRS 9
	Shs' 000	Shs' 000	Shs' 000	Shs' 000
Cash and balances with Central Bank of Kenya	-	-	-	-
Deposits with other banks	-	-	9,877	9,877
Loans and advances to customers	1,026,618	-	177,258	1,203,876
Investment securities at amortised cost	-	-	-	-
Other financial assets	51,046	-	-	51,046
Total	1,077,664		187,135	1,264,799

The group has established internal models for measurement of expected credit loss (ECL) on non-loan financial instruments, such as investments securities, interbank and balances and other financial assets.

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(iii) Changes in accounting policies and disclosures (continued)

(a) New and amended standards adopted by the Group (continued)

IFRS 15 Revenue from contracts with customers

This standard became effective on 1 January 2018 and replaced the existing revenue standards and their related interpretations. The standard set out the requirements for recognising revenue that applies to all contracts with customers (except for contracts that are within the scope of the standards on leases, insurance contracts or financial instruments). The core principle of the standard is that revenue recognised reflects the consideration to which the company expects to be entitled in exchange for the transfer of promised goods or services to the customer. The standard incorporates a five step analysis to determine the amount and timing of revenue recognition. The standard however does not apply to revenue associated with financial instruments, and therefore does not impact the majority of the Group's revenue streams. The Group identified and reviewed the contracts with customers that are within the scope of this standard and concluded that the adoption of IFRS 15 did not materially impact the Group's revenue recognition models and there were no material transition adjustments required.

(b) *New and revised standards and interpretations that have been issued but are not yet effective*

The Group has not applied any new or revised standards and interpretations that have been published but are not yet effective for the year beginning 1 January 2018, and the directors do not plan to apply any of them until they become effective. The Group's assessment of the impact of these new standards and interpretations is as follows:

IFRS 16 Leases

The standard replaces IAS 17 and its related interpretations (SIC 15, and 27, and IFRIC 4). IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee. The model reflects that, at the start of a lease, the lessee obtains the right to use an asset for a period of time and has an obligation to pay for that right. The lessee is not required to recognise assets and liabilities for short-term leases (less than 12 months), and leases for which the underlying asset is of low value (such as laptops and office furniture).

A lessee measures lease liability at the present value of future lease payments. A lessee measures lease asset, initially at the same amount as lease liabilities, and also includes costs directly related to entering into the lease. Lease assets are amortised in a similar way to other assets such as property, plant and equipment. If lease payments are made over time, a company also recognises a financial liability representing its obligation to make future lease payments. One of the implications of the new standard is that there will be a change to key financial ratios derived from a lessee's assets and liabilities (for example, leverage and performance ratios). The new standard is effective for annual periods beginning on or after 1 January 2019.

The standard will affect primarily the accounting for the group's operating leases. At the reporting date, the group has non-cancellable operating lease commitments of Shs 778 million, see note 35. The Group estimates that approximately 23% of these relate to payments for short-term and low value leases which will be recognised on a straight-line basis as an expense in profit or loss. However, the Group has not yet assessed what other adjustments, if any, are necessary for example because of the change in the definition of the lease term and the different treatment of variable lease payments and of extension and termination options. It is therefore not yet possible to estimate the amount of right-of-use assets and lease liabilities that will have to be recognised on adoption of the new standard and how this may affect the group's profit or loss and classification of cash flows going forward.

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

(iii) Changes in accounting policies and disclosures (continued)

(b)New and revised standards and interpretations that have been issued but are not yet effective (continued)

IFRIC 23, 'Uncertainty over income tax treatments' - Annual periods beginning on or after 1 January 2019. IFRIC 23 provides a framework to consider, recognise and measure the accounting impact of tax uncertainties. The Interpretation provides specific guidance in several areas where previously IAS 12 was silent. The Interpretation also explains when to reconsider the accounting for a tax uncertainty. Most entities will have developed a model to account for tax uncertainties in the absence of specific guidance in IAS 12. These models might, in some circumstances, be inconsistent with IFRIC 23 and the impact on tax accounting could be material. Management should assess the existing models against the specific guidance in the Interpretation and consider the impact on income tax accounting.

There are no other standards or interpretations that are not yet effective that would be expected to have a material impact on the Group financial statements.

(b) Consolidation

(i) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets.

Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date carrying amount of the acquirer's previously held equity interest in the acquiree is re-measured at fair value at the acquisition date; any gains or losses arising from such re-measurement are recognised in profit or loss.

Any contingent consideration to be transferred by the group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If the total of consideration transferred, non-controlling interest recognised and previously held interest measured is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the statement of profit or loss.

Notes (continued)

2 Summary of significant accounting policies (continued)

(b) Consolidation (continued)

(i) Subsidiaries (continued)

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated. When necessary amounts reported by subsidiaries have been adjusted to conform to the Group's accounting policies.

(ii) Changes in ownership interests

Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions – that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

(iii) Disposal of subsidiaries

When the Group ceases to have control any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

(c) Foreign currency translation

(i) Functional and presentation currency

The accounting records are maintained in the currency of the primary economic environment in which the Group and Bank operate (the "Functional Currency"). The financial statements are presented in Kenya Shillings, which is the Group's and Bank's functional and presentation currency. The figures shown in the financial statements are stated in Kenya Shillings (Shs), rounded to the nearest thousand.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except for differences arising on translation of non-monetary financial assets carried at fair value through other comprehensive income, which are recognised in other comprehensive income.

Monetary items denominated in foreign currency are translated at the closing rate at the reporting date.

Translation differences on non-monetary financial instruments, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary financial instruments, such as equities classified as available-for-sale financial assets, are included in other comprehensive income.

(d) Sale and re-purchase agreements

Securities sold subject to repurchase agreements ('repos') are classified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in amounts due to Central Bank of Kenya, due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate.

Notes (continued)

2 Summary of significant accounting policies (continued)

(d) Sale and re-purchase agreements (continued)

Securities purchased from Central Bank of Kenya under agreements to resell ('reverse repos') are disclosed separately as they are purchased and are not negotiable/discounted during their tenure. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

(e) Financial instruments

Financial assets and liabilities

Measurement methods

Amortised cost and effective interest rate

The amortised cost is the amount at which the financial asset of financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and, for financial assets, adjusted for any loss allowances.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired financial assets – assets that are credit-impaired at initial recognition, the Group calculates the credit adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

When the Group revises the estimates of future cash flows, the carrying amount of the respective financial asset or financial liability is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the profit or loss account.

Interest income and expense

Interest income and interest expense on interest bearing financial instruments is calculated by applying the effective interest rate to the gross carrying amount, except for:

(a) Purchased or originated credit impaired (POCI) financial assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset; and

(b) Financial assets that are not "POCI" but have subsequently become credit-impaired, for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e.net of the expected credit loss provision) in subsequent reporting periods.

Initial recognition and measurement

Financial assets and financial liabilities are recognised when the entity becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on trade-date, the date which the Group commits to purchase or sell the asset.

At initial recognition, the Group measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through the profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such fees and commissions. Transaction costs of financial assets and financial liabilities are carried at fair value through profit or loss are expensed in profit or loss. Immediately after the initial recognition, an expected credit loss allowance (ECL) is recognised for the financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial instruments (continued)

Financial assets and liabilities (continued)

Measurement methods (continued)

Initial recognition and measurement (continued)

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the entity recognises the difference as follows:

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognised as a gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

Financial assets

(i) Classification and subsequent measurement

From January 2018, the Group has applied IFRS 9 and classifies its financial assets in the following measurement categories:
- Fair value through profit or loss (FVTPL)
- Amortised cost.

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse. Classification and subsequent measurement of debt instruments depend on:
(i) the Group's business model for managing the asset; and
(ii) the contractual cash flow characteristics of the financial asset.

Based on these factors, the Group classifies its debt instruments into one of the following two measurement categories:

- Amortised cost: assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest (SPPI), and that are not designated at FVPL, as measured at amortised cost. The carrying amount of these assets are adjusted by any expected credit loss allowance. Interest income from financial assets is included in "interest income" using the effective interest rate method.
- Fair value through profit or loss: assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented within "Net trading income" in the period in which it arises. Interest income from these financial assets is included in "interest income" using the effective interest rate method.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial instruments (continued)

Financial assets and liabilities (continued)

Financial assets (continued)

(i) Classification and subsequent measurement (continued)

Debt instruments (continued)

Business model: The business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of "other" business model and measured at FVPL. Factors considered by the Group in determining the business model for a group of assets include past experience on how cash flows for these assets were collected, how the asset's performance is evaluated and reported by key management personnel, how risks are assessed and managed and how managers are compensated. For example, the liquidity portfolio of assets is held by the Group as part of liquidity management and is generally classified with the hold to collect and sell business model. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. These securities are classified in the "other" business model and measured at FVPL.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash flows represents solely payments of principal and interest (the "SPPI test"). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

The Group reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. The changes are expected to be very infrequent and none occurred during the year.

(ii) Impairment

The Group implemented IFRS 9 effective 1 January 2018, which requires assessment on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial instruments continued)

Financial assets and liabilities(continued)

Financial assets (continued)

(iii) Modifications of loans

The Group sometimes renegotiates or otherwise modifies the contractual cash flows of loans and advances to customers. When this happens, the Group assesses whether or not the new terms are substantially different to the original terms. The Group does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share/equity based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change is interest rate.
- Change in the currency of the loan.
- Insertion of collateral, other security or credit enhancement that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Group derecognises the original financial asset and recognises a "new" asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred.

However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Group recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate of credit-adjusted effective interest rate for POCI financial assets.

(iv) Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Group transfers substantially all the risks and rewards of ownership, or (ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

The Group enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as "pass through" transfers that result in derecognition if the Group:

(i) Has no obligation to make payments unless it collects equivalent amounts from the assets;
(ii) Is prohibited from selling or pledging the assets; and
(iii) Has an obligation to remit any cash it collects from assets without material delays.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial instruments continued)

Financial assets and liabilities(continued)

Financial assets (continued)

(iv) Derecognition other than on a modification (continued)

Collateral (shares and bonds) furnished by the Group under standard repurchase agreements and securities lending and borrowings transactions are not derecognized because the Group retains substantially all the risks and rewards on the basis of predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Group retains a subordinated residual interest.

(ii) Financial Liabilities

The Group's holding in financial liabilities represents mainly deposits from banks and customers and other liabilities. Such financial liabilities are initially recognised at fair value and subsequently measured at amortised cost.

(i) Classification and subsequent measurement

Financial liabilities are classified as subsequently measured at amortised cost, except for:
- Financial liabilities at fair value through profit or loss such as derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair values of the financial liability that is attributable to changes in the credit risk of that liability) and partially profit or loss (the remaining amount of change in the fair value of the liability);
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments

(ii) Derecognition of financial liabilities

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

The exchange between the Group and its original lenders of debt instruments with substantially different terms, as well as substantial modification of the terms of the existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If the exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange of modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

Offsetting of financial instruments

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(f) Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of the debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities. Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

Loan commitments provided by the Group are measured as the amount of the loss allowance. The Group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument, other than for staff facilities.

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Group cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognised together with the loss allowance for the loan to the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognised as provision.

(g) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. Funds restricted for a period of more than three months on origination and cash reserve deposits with the Central Bank of Kenya are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

(h) Property and equipment

Land and buildings comprise mainly branches and offices. All equipment used by the Group is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repair and maintenance costs are charged to profit or loss during the financial period in which they are incurred. depreciation.

Freehold land is not depreciated. Depreciation is calculated on the straight line basis to allocate their cost less their residual values over their estimated useful lives, as follows:

Office premises	40 years
Office improvements	10 years
Furniture, fittings and equipment	8 years
Motor vehicles	4 years
Computer equipment	3 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. The Group assesses at each reporting date whether there is any indication that any item of property and equipment is impaired. If any such indication exists, the Group estimates the recoverable amount of the relevant assets.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in 'operating expenses' in profit or loss.

Notes (continued)

2 Summary of significant accounting policies (continued)

(i) Intangible assets – software

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Group are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives of 5 years. Costs associated with maintaining computer software programmes are recognised as an expense as incurred.

(j) Impairment of non – financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

(k) Employee benefits

Retirement benefit obligations

The Group and all its employees contribute to the National Social Security Fund, which is a defined contribution scheme. A defined contribution plan is a retirement benefit plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Group's contribution to the defined contribution scheme is charged to profit or loss in the year in which it falls due. The Group has no further obligations once the contribution is paid.

(l) Income tax

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(l) Income tax (continued)

(i) Current income tax

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

(ii) Deferred income tax

Deferred income tax is recognised, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. However, the deferred income tax is not accounted for if it arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same entity or different taxable entities where there is an intention to settle the balances on a net basis.

(m) Dividend payable

Dividends on ordinary shares are charged to equity in the period in which they are declared.

(n) Share capital

Ordinary shares are classified as 'share capital' in equity. Any premium received over and above the par value of the shares is classified as 'share premium' in equity.

(o) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank has retained no part of the loan package for itself or has retained a part at the same effective interest rate as the other participants. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as the arrangement of the acquisition of shares or other securities, or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis. Performance-linked fees or fee components are recognised when the performance criteria are fulfilled.

(p) Acceptances and letters of credit

Acceptances and letters of credit are accounted for as off-balance sheet transactions and disclosed as contingent liabilities.

Notes (continued)

2 Summary of significant accounting policies (continued)

(q) Derivative financial instruments

The Group enters into derivative financial instruments to manage its exposure to foreign currency exchange rate risks. Derivatives solely comprise currency forward exchange contracts.

Derivatives are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value at the end of each reporting period. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of recognition of gains or losses in the profit or loss will depend on the nature of the hedge relationship.

All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

(r) Accounting for leases

Leases are divided into finance leases and operating leases.

(a) The Group is the lessee

(i) Operating lease

Leases in which a significant portion of the risks and rewards of ownership are retained by another party, the lessor, are classified as operating leases. Payments, including pre-payments, made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

The total payments made under operating leases are charged to 'other operating expenses' on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

(ii) Finance lease

Leases of assets where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in deposits from banks or deposits from customers depending on the counter party. The interest element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The leases entered into by the Group are primarily operating leases.

(b) The Group is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. Finance income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return.

(c) Fees paid in connection with arranging leases

The Group makes payments to agents for services in connection with negotiating lease contracts with the Group's lessees. For operating leases, the letting fees are capitalised within the carrying amount of the related asset, and depreciated over the life of the lease.

Notes (continued)

3 Critical accounting estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities at the date of the financial statements and the income and expenses during the reporting period.

All estimates and assumptions required in conformity with IFRS are best estimates undertaken in accordance with the applicable standard. Estimates and judgements are evaluated on a continuous basis, and are based on past experience and other factors, including expectations with regard to future events.

This note provides an overview of the areas that involve a higher degree of judgment or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year. Detailed information about each of these estimates and judgements is included in the related notes together with information about the basis of calculation for each affected line item in the financial statements.

(i) Measurement of expected credit loss allowance

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses).

A number of significant judgements are also required in applying the accounting requirement for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing the appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL;
- Establishing groups of similar financial assets for the purposes of measuring ECL;
- Determining the relevant period of exposure to credit risk when measuring ECL for credit cards and revolving credit facilities; and
- Determining the appropriate business models and assessing the "solely payments of principal and interest (SPPI)" requirements for financial assets.

(ii) Fair value of financial instruments

The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques (for example, models) are used to determine fair values, they are calibrated and periodically reviewed by qualified management personnel independent of the area that created them to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data; however, areas such as credit risk (both own credit risk and counterparty risk), volatilities and correlations require the directors to make estimates. At 31 December 2018 there were no financial instruments measured at fair value using valuation techniques and level 3 inputs other than as described in 4(d) below.

Notes (continued)

3 Critical accounting estimates and judgements (continued)

(iii) Impairment of non-financial assets

The Group assesses whether there are any indicators of impairment for all non-financial assets at each reporting date. Non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

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. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded securities or other available fair value indicators.

(iv) Income taxes

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

4 Financial risk management

This section provides an overview of the Group's approach to risk management and a description of the nature and extend of risks. Risk is an integral part of the banking business and the Group aims to deliver superior shareholder value by achieving an appropriate trade-off between risk and returns. The Group incurs its major risk exposure from extending credit to customers through lending operations. In addition to credit risk, the Group is also exposed to other risks such as liquidity and market risk among other risks that are inherent in the product range, sector concentration and geographical coverage of the Group.

Risk Management Structure

Key roles and responsibilities regarding risk management are summarized below –

Level of management	Role
Board of Directors	Approving risk management policies, setting risk appetite while ensuring that the executive management focuses on managing risks.
Board Audit and Risk Committee	Assessment, management and mitigation of risk in the Group. It is accountable to the Board of directors.
Board ALCO Committee	Assessment, management and mitigation of liquidity, capital and market risks in the Group. It is accountable to the Board of directors.
Internal Audit Department	Independently reviews the risks on a periodic basis and reports to the Board Audit and Risk Committee.
Enterprise Risk Management (ERM) Department	Carries out risk management under policies approved by the board. The responsibility of identifying, evaluating and hedging risks lies here with close corporation with operating units.

Notes (continued)

4 Financial risk management (continued)

Risk Management Framework

This encompasses practices relating to the identification, analysis, evaluation, treatment, mitigation and monitoring of risks.

The Group's risk management framework is based on a clear understanding of various risks, disciplined risk assessment and measurement procedures and continuous monitoring. The policies and procedures established for this purpose are continuously benchmarked with the industry best practices.

Taking risk is core to the Group's business and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return, and minimize potential adverse effects on its financial performance and this involves

- *Risk identification, analysis and evaluation* – includes periodic assessment of the business environment, incident analysis and analysis of bank's performance relative to set objectives. Risk analysis is carried out using scenario bases assessments to determine the likelihood of occurrence and potential impact of risk.

- *Risk treatment* – implementing measures to alleviate the impact of the identified risk. These measures include avoiding the risk, transferring risk to another entity, reducing level of risk or accepting the risk.

- *Risk mitigation and monitoring* – mitigation measures are put in place and agreed upon by the business teams. The indicators and levels of risks are measured continuously.

- *Risk reporting and disclosures* – The Group uses a risk dashboard to track external and internal indicators of each risk. The analysis and impact of risks is periodically presented and discussed at the board level.

Credit risk

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations. Credit risk arises mainly from loans and advances, credit cards, and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, financial guarantees, letters of credit, endorsements and acceptances.

The Group is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its trading activities ('trading exposures'), including non-equity trading portfolio assets, derivatives and settlement balances with market counterparties and reverse repurchase loans.

Credit risk is the single most significant risk for the Group's business; the directors therefore carefully manage the exposure to credit risk. The credit risk management and controls are centralizes in a credit risk management team, which reports to the Board of Directors and head of each business unit regularly.

The Group measures, monitors and manages credit risk for each borrower and also at the portfolio level. The Group has a standardised credit approval process, which includes a well-established procedure of comprehensive credit appraisal and rating. The Group has developed internal credit rating methodologies for rating obligors as well as for products and facilities. The credit risk attached to every borrower is reviewed at least annually and for higher risk credits and large exposures at shorter intervals.

Sector knowledge has been institutionalized across the Group through the availability of sector-specific information from the various publications of the Central Bank of Kenya and of the Ministry of Finance and is included in the Credit Risk Policy. Industry knowledge is constantly updated through field visits, interactions with clients, regulatory bodies and industry experts. In respect of the retail credit business, the Group has a system of centralized approval of all products and policies and monitoring of the retail portfolio.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

The Group's credit risk is primarily attributable to its loans and advances. The Group structures the level of credit risk it undertakes by placing limits on amounts of risk accepted in relation to one borrower or a group of borrowers. Such risks are monitored on a revolving basis and are subject to annual or more frequent review. Limits on the level of credit risk by product, industry sector and by region are approved quarterly by the Board of Directors.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate guarantees. Credit risks are spread over a diversity of microfinance, personal and commercial customers. The exposure to any one borrower is further restricted by sub-limits covering exposures recognized and not recognized in the statement of financial position.

(i) Credit risk measurement

Loans and advances (including loan commitments and guarantees)

The estimation of credit exposure is complex and requires the use of models, as the value of a product varies with changes in market variables, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties.

The Group has developed models to support the quantification of the credit risk. These rating and scoring models are in use for all key credit portfolios and form the basis for measuring default risks. In measuring credit risk of loans and advances at a counterparty level, the Group considers three components: (i) the 'Probability of Default' (PD) by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and its likely future development, from which the Group derive the 'Exposure at Default' (EAD); and (iii) the likely recovery ratio on the defaulted obligations (the 'Loss Given Default') (LGD). The models are reviewed regularly to monitor their robustness relative to actual performance and amended as necessary to optimise their effectiveness.

Credit risk grading

The Group uses internal credit risk gradings that reflect its assessment of the probability of defaults of individual counterparties. The Group uses internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application (such as disposable income, the level of collateral for retail exposures, and turnover and industry type for wholesale exposures) is fed into this rating model. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgment from the credit officers to be fed into the final internal credit rating for each exposure. This allows for the considerations which may not be captured as part of the other data input into the model.

The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade. For example, this means that the difference in the PD between A and A- rating grade is lower than the difference in the PD between a B and B- rating grade.

The following are additional considerations for other types of portfolio held by the Group:

Debt Securities and Placements with Banks

For debt securities and placements with banks, external rating agency credit grades will be used. These published grades will be continuously monitored and updated. The PDs associated with each grade will be determined based on realised default rates over the prior 12 months, as published by the rating agency.

The group has not yet established internal models for measurement of expected credit loss (ECL) on non-loan financial instruments such as investment securities, interbank balances and other financial assets. However as at 1 Jan 2018 and 31 December 2018, the Group estimated the ECL for these financial assets using external data as proxy and concluded ECL not to be recognised on these instruments. The Group will continue to evaluate this in future.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

(ii) Expected credit loss measurement

IFRS 9 outlines a 'three-Stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the bank.
- If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward looking information.
- Purchased or originated credit-impaired financial assets are those financial assets that are credit impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

The key judgements and assumptions adopted by the Group in addressing the requirement of the standard are as follows;

(a) Significant Increase in credit risk (SICR)

The Group's decision on whether expected credit losses are based on 12-month expected credit losses or lifetime expected credit losses depends on whether there has been a significant increase in credit risk since initial recognition. An assessment of whether credit risk has increased significantly is made at each reporting date.

The Group considers a financial instruments to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

Quantitative Criteria

The quantitative criteria is based on relative and not absolute changes in credit quality as stated in the table above driven by ratings and days past due.

The Group considers that financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of a default occurring over the next 12 months may be a reasonable approximation of the changes in the lifetime risk of a default occurring and could be used to determine whether credit risk has increased significantly since initial recognition.

The Group considers if there has been an increase in the customer's rating, the facility is deemed to have a significant increase in credit risk. The standard also sets out a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. This 30 days past due simplification permits the use of delinquency or past due status to identify a significant increase in credit risk. In adherence to the standard, the Group shall at every reporting period assess the loan portfolio individually for possible breach of the 30 days past due SICR criterion. Where there is a breach and the loan has not been transferred to stage 2, the Group shall rebut the 30 days rebuttable presumption based on availability of supportable and reasonable information to justify that credit quality has not deteriorated significantly since initial recognition.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

(ii) Expected credit loss measurement (continued)

(a) Significant Increase in credit risk (SICR) (continued)

Quantitative Criteria (continued)

The Group's quantitative credit grading, as compared to CBK's prudential guidelines, into five prudential guidelines categories as follows:

IFRS 9 credit staging	CBK PG/04 Guidelines	Days past due
1	Normal	Up to date and in line with contractual agreements or within 30 days' arrears
2	Watch	31 to 90 days overdue
3	Substandard	91 to 180 days overdue
	Doubtful	181 – 365 days overdue
	Loss	Over 365 overdue

Qualitative Criteria

In addition to the above, the Group considers other qualitative factors in determining the classification above, and may accelerate the classification of credit facilities where deemed appropriate. They include but not limited to the following:

1. Significant changes in the terms of the same instrument if it were issued at the reporting date that indicate a change in credit risk since initial recognition, e.g. increase in credit spread; more stringent covenants; increased amounts of collateral or guarantees; or higher income coverage.

2. Significant changes in external market indicators of credit risk for the same financial instrument (or similar instrument of the borrower), e.g. other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments; or external credit rating (actual or expected).

3. Actual or expected adverse changes in business, financial or economic conditions significantly affecting borrower's ability to meet its debt obligations

4. Significant changes in the value of collateral which are expected to reduce the borrower's economic incentive to pay or otherwise affect the probability of default.

5. Expected changes in the loan documentation (e.g. breach of contract leading to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees).

6. Significant changes in the expected performance and behavior of the borrower, including changes in the payment status of borrowers in the group (e.g. increase in delayed contractual payments or number of credit card borrowers expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount).

Backstop

A backstop is applied and the financial instrument is considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

(ii) Expected credit loss measurement (continued)

(b) Definition of default and credit-impaired assets

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Qualitative criteria
The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance;
- The borrower is deceased;
- The borrower is insolvent or becoming probable that the borrower will enter bankruptcy;
- The borrower is in breach of financial covenants;
- An active market for that financial asset has disappeared because of financial difficulties;
- Concessions have been made by the lender relating to the borrower's financial difficulty;
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

Quantitative criteria
The Group considers a facility that is more than 90 days past due and its rating is greater than or equal to 8 as credit impaired as per internal risk rating.

The above criteria have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) throughout the Group's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months. This period of six months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

c) Measuring expected credit loss – inputs, assumptions and estimation techniques

The expected credit loss (ECL) is measured on either a 12-month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows;

- The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD).
- LGD represents the Group's expectations of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type of seniority of claim and availability of collateral or other credit support. LGD is calculated on a 12-month or lifetime basis, where 12 month LGD is the percentage of loss expected to be made if the default occurs over the next 12 months and lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each individual exposure or collective segment. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

(ii) Expected credit loss measurement (continued)

c) Measuring expected credit loss – inputs, assumptions and estimation techniques

The lifetime PD is developed by applying a maturity profile to the current 12 month PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and a credit grade. This is supported by a historical analysis.

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type:

- For amortising products or bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis. This will also be adjusted for any expected overpayments made by the borrower. Early repayments/refinance assumptions are also incorporated.
- For revolving products, the exposure at default is predicted by taking the current drawn-down balance and adding a "credit conversion factor" which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilisation band, based on analysis of the Group's recent default data.

The 12-month and lifetime LGDs are determined based on the factors which impact the recoverable amount post default. These vary by product type:

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.
- For unsecured products, LGDs are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGDs are influenced by collection strategies, including contracted debt sales and prices.

Forward-looking economic information is also included in determining the 12-month and lifetime PD, EAD and LGD. These assumptions vary by product type.

The assumptions underlying the ECL calculation – such as how the maturity profile of the PDs and how collateral values change etc. – are monitored and reviewed on a quarterly basis.

d) Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Group has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio. These economic variables and their associated impact on PD, EAD and LGD vary by financial instrument.

Forecasts of the base economic scenario and the possible scenarios along with scenario weightings are prepared by an expert economic team. The impact of these economic variables on the PD, EAD and LGD is determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Group's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible outcomes.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

(ii) Expected credit loss measurement (continued)

d) Forward-looking information incorporated in the ECL models (continued)

Economic variable assumptions

The most significant assumptions affecting the ECL allowance are as follows. The scenarios "base", "upside" and "downside" were used for all portfolios.

	All segments		
	Base	**Upside**	**Downside**
EXCHANGE RATE USD	100.85	97.16	104.54
GDP: Nominal GDP	6.00%	5.77%	6.2%
MONEY SUPPLY	2.18%	2.12%	2.23%
FISCAL: Total revenue	2.90%	2.77%	3.03%
INFLATION	4.70%	4.5%	4.9%

The weightings assigned to each economic scenario at 1 January 2018 and 31 December 2018 were as follows:

	Base	**Upside**	**Downside**
Weightings	50%	30%	20%

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have been considered, but are not deemed to have a material impact on therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

Sensitivity analysis

Set out below are the changes to the ECL at 31 December 2018 that would result from reasonably possible changes in the Group's probability weightings from actual assumptions used in the Group's economic variable assumptions:

Impact of 10% increase/decrease in base case probability weighting

	Base	**Downside**	**Upside**	**ECL Change'000**
Weightings (+10%)	60%	25%	15%	33,425
Weightings (-10%)	40%	35%	25%	- 33,961

e) Grouping of instruments for losses measured on a collective basis

For expected credit losses provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogenous. In performing this grouping, there must be sufficient information for the group to be statistically credible. Where sufficient information is not available internally, the Group has considered benchmarking internal/external supplementary data to use for modelling purposes.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

e) Credit risk exposure

Maximum exposure to credit risk before collateral held

Group	**Notes**	**2018 Shs'000**	**%**	**2017 Shs'000**	**%**
Items recognised in the statement of financial position:					
Balances with Central Bank of Kenya	15	1,407,645	3.6	1,961,536	8.1
Derivative financial assets	16	106,579	0.3	40,508	0.2
Deposits with other banks	17	3,986,393	10.2	1,220,949	5.1
Investments at amortised cost	18(a)	3,317,236	8.5	1,899,299	7.9
Investments FVTPL	18(b)	312,715	0.8	-	0
Loans and advances to customers	19	13,134,315	33.6	11,409,325	47.4
Other assets	20	936,534	2.4	929,548	3.9
		23,201,417	59.4	17,461,165	72.5
Items not recognised in the statement of financial position:					
Letters of credit	33	1,306,939	3.3	549,820	2.3
Acceptances and Guarantees	33	14,528,418	37.2	6,067,064	25.2
		39,036,774	100	24,078,049	100

Bank	**Notes**	**2018 Shs'000**	**%**	**2017 Shs'000**	**%**
Items recognised in the statement of financial position:					
Balances with Central Bank of Kenya	15	1,407,645	3.6	1,961,536	8.1
Derivative financial assets	16	106,579	0.3	40,508	0.2
Placements with other banks	17	3,986,393	10.2	1,220,949	5.1
Investments at amortised cost	18(a)	3,317,236	8.5	1,899,299	7.9
Investments FVTPL	18(b)	312,715	0.8	-	-
Loans and advances to customers	19	13,134,315	33.6	11,409,325	47.4
Other assets	20	963,597	2.5	944,508	3.9
		23,228,480	59.5	17,476,125	72.5
Items not recognised in the statement of financial position:					
Letters of credit	33	1,306,939	3.3	549,820	2.3
Acceptances and Guarantees	33	14,528,418	37.2	6,067,064	25.2
		39,063,837	100	24,093,009	100

The above table represents a worst case scenario of credit risk exposure to the Bank at 31 December 2018 and 31 December 2017 without taking account of any collateral held or other credit enhancement attached. For assets recognised in the statement of financial position, the exposures set out above are based on carrying amounts as reported in the statement of financial position.

Loans and advances to customers are secured by collateral in the form of charges over cash, land and building and/or plant and machinery or corporate guarantees. Management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the Bank resulting from both its loans and advances portfolio and debt securities.

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

e) Credit risk exposure (continued)

Maximum exposure to credit risk before collateral held

Loans and advances (continued)

The breakdown of loans and advances is summarised below:

Group and Bank	**2018**				**2017**
	Stage 1 12 month ECL	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**	
	Shs' 000	**Shs' 000**	**Shs' 000**	**Shs' 000**	**Shs' 000**
Individually impaired / non performing facilities					
Grade 3: Substandard	-	-	563,464	563,464	595,162
Grade 4: Doubtful	-	-	2,149,901	2,149,901	1,892,164
Grade 5: Loss	-	-	228,353	228,353	108,236
Gross amount	-	-	**2,941,718**	**2,941,718**	**2,595,562**
Credit impairment losses	-	-	866,787	866,787	969,098
Carrying amount	-	-	**2,074,930**	**2,074,930**	**1,626,464**
Collectively impaired					
Grade 1: Normal	11,083,714	-	-	11,083,714	8,962,462
Grade 2: Watch	-	386,937	-	386,937	877,919
Gross amount	**11,083,714**	**386,937**	-	**11,470,651**	**9,840,381**
Credit impairment losses	363,983	47,284	-	411,267	57,520
Carrying amount	**10,719,731**	**339,653**	-	**11,059,384**	**9,782,860**
Total carrying amount	**10,719,731**	**339,653**	**2,074,930**	**13,134,315**	**11,409,325**

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

e) Credit risk exposure (continued)

Maximum exposure to credit risk before collateral held

Other financial assets – financial instruments subject to impairment

The other financial assets mainly relate to government securities and balances held with Central Bank and other financial institutions that are highly rated and therefore considered low risk. None of these were past due or impaired except for a balance of Shs 303,439,726 (2017: Shs 303,439,726) within other assets as disclosed in Note 19. The summarized information on other financial instrument is tabulated below:

Group	**Balance at 31 December 2018 Shs '000**	**Stage**	**ECL Shs '000**
Balances with Central bank	2,140,313	1	-
Due from Banking institutions	3,986,393	1	63,252
Government securities	3,317,236	1	-
Other receivables	610,935	1	204,832
	10,054,877		268,084

Bank	**Balance at 31 December 2018 Shs '000**	**Stage**	**ECL Shs '000**
Balances with Central bank	2,140,313	1	-
Due from Banking institutions	3,986,393	1	63,252
Government securities	3,317,236	1	-
Other receivables	642,231	1	204,832
	10,086,173		63,252

Other financial assets – financial instruments not subject to impairment

Group	**Balance at 31 December 2018 Shs '000**
Derivative financial assets	106,579
Government securities	312,715
	419,294

Bank	**Balance at 31 December 2018 Shs '000**
Derivative financial assets	106,579
Government securities	312,715
	419,294

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

f) Collateral and other credit enhancements

The Group uses a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for funds advanced, which is common practice. The acceptability of collateral for credit risk mitigation is guided by the Group's procedures and policies. The main types of collateral taken are:

Type of lending	Common collateral type
Mortgage lending	First ranking legal charge over the property financed.
Commercial loans	Debentures over the Bank's assets, cash cover in cash margin account, first ranking legal charge over both commercial and residential properties, directors' personal guarantees and Bank guarantees.
Personal loans	Checkoffs and cash backed
Asset finance	Secured by motor vehicles and chattel registrations
Other loans and advances	Debentures over the Bank's assets, cash cover in cash margin account, first ranking legal charge over both commercial and residential properties, directors' personal guarantees and Bank guarantees.

Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured. In addition, in order to minimise the credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances. The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the period.

Valuation of collateral
The Group has a panel of valuers who undertake valuation of property and other assets to be used as Collateral. The valuers in the panel are qualified professional valuers with adequate experience in the field of property and machinery valuation. Valuation of collateral are performed between 3 to 5 year intervals.

Financial effect of collateral
At 31 December 2018, 88% (2017: 89%) of the impaired loans (net of suspended interest) were covered by collateral.

The Group closely monitors collateral held for financial assets considered to be credit impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Individually assessed impaired loans and advances:		
Micro loans	472,362	404,618
SME loans	2,469,356	2,190,944
	2,941,718	2,595,562
Fair value of collateral held	2,823,105	3,171,556

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

f) Collateral and other credit enhancements (continued)

Lending limits

The Group maintains strict control limits on net open derivative positions (that is, the difference between purchase and sale contracts) by both amount and term. The amount subject to credit risk is limited to expected future net cash inflows of instruments, which in relation to derivatives are only a fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not always obtained for credit risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from the Bank's market transactions on any single day.

Master netting arrangements

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of assets and liabilities of the statement of financial position, as transactions are either usually settled on a gross basis or under most netting agreements the right of set off is triggered only on default. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if a default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as it is affected by each transaction subject to the arrangement.

Financial covenants (for credit related commitments and loan books)

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards (often referred to as financial covenants).

The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Notes (continued)

4 Financial risk management (continued)

(a) Credit risk (continued)

f) Impairment and provisioning policies

The loss allowance recognised in the period is impacted by a variety of factors as follows:

- Transfers between Stage 1 and Stage 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit impaired in the period, and the consequent "step up" or "step down" between 12-month and lifetime ECL;
- Additional allowance for new financial instruments recognised during the period, as well as releases for financial instruments de-recognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period.

The following tables explain the changes in the loss allowance in the year due to these factors:

Group and Bank	**Stage 1 12-month ECL Shs '000**	**Stage 2 Lifetime ECL Shs '000**	**Stage 3 Lifetime ECL Shs '000**	**Total Shs '000**
Loss allowance at 31 December 2017	52,388	5,132	969,098	1,026,618
Changes on application of IFRS 9	73,743	104,499	(984)	177,258
Loss allowance at 1 January 2018	126,131	109,631	968,114	1,203,876
Net staging transfers	225,167	(76,464)	(148,702)	-
Changes in PDs/LGDs/EADs	-	-	-	-
Changes in model assumptions	-	-	-	-
Modification of contractual cash flows	-	-	-	-
Unwind of discount	-	-	-	-
New financial assets originated or purchased	188,535	21,876	168,104	378,515
Net charge to profit or loss in the year	539,833	55,043	987,516	1,582,391
Other movements with no P&L impact:				
Net staging transfers	-	-	-	-
Financial assets derecognised	(5,254)	(7,759)	(27,098)	(40,111)
Write-offs	-	-	(93,630)	(93,630)
At year end	**534,578**	**47,284**	**866,788**	**1,448,650**

Notes (continued)

4 Financial risk management (continued)

(a) Credit risk (continued)

f) Impairment and provisioning policies (continued)

The following table below shows the movement in gross carrying amount of loans and advances to help explain the changes in the loss allowance for the same portfolio:

Group and Bank	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	Shs '000	Shs '000	Shs '000	Shs '000
Gross carrying amount at 31 December 2017	8,962,462	877,919	2,595,562	12,435,943
Changes on initial application of IFRS 9	-	-	-	-
Gross carrying amount at 1 January 2018	8,962,462	877,919	2,595,562	12,435,943
Net staging transfers	259,887	(541,658)	281,771	-
Financial assets derecognised	(3,814,667)	(78,479)	(161,016)	(4,054,162)
New financial assets originated	5,846,626	129,156	579,375	6,555,157
Modification of contractual cash flows				
Changes in interest accrual				
Write-offs			(353,973)	(353,973)
FX translation and other movements				
At year end	**11,254,309**	**386,938**	**2,941,718**	**14,582,965**

(g)Concentrations of risks of financial assets with credit exposure

To avoid excessive concentration in any one of several industrial sectors and, by extension, the overall safety of the Group and Bank, the lending portfolio is monitored and managed at all times. Equally, care is taken to avoid over-exposure to any one borrower. There are restrictions to the maximum exposure permitted with respect to any one name based on capital and these restrictions which are strictly adhered to, are laid down by regulation. Any changes made to the portfolio management plan are subject to the approval of the Board of Directors. The economic sector risk concentrations within the customer loans and advances portfolios at the end of the year were as follows:

	Group and Bank	
	2018	2017
	%	%
Agriculture	1,6	2.2
Manufacturing	0.4	0.7
Building and construction	2.1	2.4
Mining and Quarrying	0.0	0.0
Energy and water	1.6	2.1
Trade	38.6	32.7
Tourism, restaurant and Hotels	1.0	0.8
Transport and Communication	8.6	7.9
Real Estate	15.6	19.5
Financial Services	6.4	2.3
Personal Household	24.1	29.5
	100	100

Notes (continued)

4 Financial risk management (continued)

a) Credit risk (continued)

Write-off policy

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the group's recovery methods foreclosing on collateral and the value of the collateral is such that there is no reasonable expectations of recovering in full.

The Group may write-off financial assets that are still subject to enforcement activity. The outstanding contractual amounts of such assets written-off during the year was Shs 354 (2017: Shs 394 million). The Group still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of recovering in full.

Modification of financial assets

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery.

Such restructuring activities include extended repayment term arrangements, payment holidays and payment forgiveness. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset. The Group monitors the subsequent performance of modified assets. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more. The gross carrying amount of such assets at 31 December 2018 was Shs 1,147 million (2017: Shs 822 million).

The Group continues to monitor if there is a subsequent significant increase in credit risk in relation to such assets through the use of specific models for modified assets.

b) Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows, such as debt maturities or margin calls for derivatives. Such outflows would deplete available cash resources for client lending, trading activities and investments. In extreme circumstances, lack of liquidity could result in reductions in the statement of financial position and sales of assets, or potentially an inability to fulfil lending commitments. The risk that the Bank will be unable to do so is inherent in all banking operations and can be affected by a range of institution specific and market-wide events including, but not limited to, credit events, merger and acquisition activity, systemic shocks and natural disasters.

Notes (continued)

4 Financial risk management (continued)

b) Liquidity risk

Liquidity risk management process

The Bank's liquidity management process, as carried out within the Bank and monitored by a separate team in Bank Treasury, includes:

- Day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers. The Bank maintains an active presence in global money markets to enable this to happen;
- Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- Monitoring the liquidity ratios of the statement of financial position against internal and regulatory requirements; and
- Managing the concentration and profile of debt maturities.

The Asset and Liability Committee's (ALCO) role in liquidity is to manage the day to day treasury operations, ascertain adequacy of funds to meet the bank's obligations, advises on pricing of assets and liabilities, prepares cash flow projections to ensure the bank's liquidity is within set limits by CBK, monitors maturities of assets and liabilities and finally advises on placements and liquidations as appropriate. The Group also ensures the CBK cash and liquidity ratios are maintained.

The tables below represents cash flows payable by the bank under non-derivative financial liabilities by remaining periods to maturity at the reporting date.

Notes (continued)

4 Financial risk management (continued)

b) Liquidity risk (continued)

Group

Expected maturity dates	**On demand Shs'000**	**1 - 3 months Shs'000**	**3 – 12 months Shs'000**	**1 - 5 years Shs'000**	**Over 5 years Shs'000**	**Total Shs'000**
2018						
Financial assets						
Cash and balances with Central Bank of Kenya	2,140,313	-	-	-	-	2,140,313
Deposits with other banks	1,660,820	2,274,218	51,355	-	-	3,986,393
Investments	-	2,079,740	-	-	1,550,211	3,629,951
Loans and advances to customers	747,338	898,724	1,140,925	8,304,832	2,042,496	13,134,315
Other assets	936,534	-	-	-	-	936,534
Total financial assets	5,485,005	5,252,682	1,192,280	8,304,832	3,592,707	23,827,506
Financial liabilities						
Deposits due to banks	6,248	3,465,748	51,601	-	-	3,523,597
Deposits from customers	13,478,897	2,303,563	1,146,444	12,545	459	16,941,908
Other liabilities and accrued expenses	347,264	-	-	-	-	347,264
Borrowings	-	-	127,450	286,000	-	413,450
Total financial liabilities	13,832,409	5,769,311	1,325,495	298,545	459	21,226,219
Liquidity gap	(8,347,404)	(516,629)	(133,215)	8,006,287	3,592,248	2,601,287
Financial guarantees	-	4,027,235	7,200,678	4,597,444	10,000	15,835,357
Foreign currency swaps	-	65,157	35,024	-	-	100,182

Notes (continued)

4 Financial risk management (continued)

b) Liquidity risk (continued)

Group

Expected maturity dates	On demand Shs'000	1 - 3 months Shs'000	3 – 12 months Shs'000	1 - 5 years Shs'000	Over 5 years Shs'000	Total Shs'000
2017						
Financial assets						
Cash and balances with Central Bank of Kenya	2,621,332	-	-	-	-	2,621,332
Deposits with other banks	485,546	735,403	-	-	-	1,220,949
Investments	-	349,340	-	-	1,549,959	1,899,299
Loans and advances to customers	958,563	179,253	1,004,791	6,595,944	2,670,774	11,409,325
Other assets	929,548	-	-	-	-	929,548
Total financial assets	4,994,989	1,263,996	1,004,791	6,595,944	4,220,733	18,080,453
Financial liabilities						
Deposits due to banks	-	2,379,413	-	-	-	2,379,413
Deposits from customers	9,582,555	2,442,130	719,417	16,250	439	12,760,791
Other liabilities and accrued expenses	277,307	-	-	-	-	277,307
Borrowings	-	-	-	480,294	53,753	534,047
Total financial liabilities	9,859,862	4,821,543	719,417	496,544	54,192	15,951,558
Liquidity gap	(4,864,873)	(3,557,547)	285,374	6,099,400	4,166,541	2,128,895
Financial guarantees	-	1,142,797	1,955,630	3,515,117	3,340	6,616,884
Foreign currency swaps	-	25,816	12,540	-	-	38,356

Notes (continued)

4 Financial risk management (continued)

b) Liquidity risk (continued)

Bank

Expected maturity dates	**On demand Shs'000**	**1 - 3 months Shs'000**	**3 – 12 months Shs'000**	**1 - 5 years Shs'000**	**Over 5 years Shs'000**	**Total Shs'000**
2018						
Financial assets						
Cash and balances with Central Bank of Kenya	2,140,313	-	-	-	-	2,140,313
Deposits with other banks	1,660,820	2,274,218	51,355	-	-	3,986,393
Investments	-	2,079,740	-	-	1,550,211	3,629,951
Loans and advances to customers	747,338	898,724	1,140,925	8,304,832	2,042,496	13,134,315
Other assets	963,597	-	-	-	-	963,597
Total financial assets	5,512,068	5,252,682	1,192,280	8,304,832	3,592,707	23,854,569
Financial liabilities						
Deposits due to banks	6,248	3,465,748	51,601	-	-	3,523,597
Deposits from customers	13,538,469	2,303,563	1,146,444	12,545	459	17,001,480
Other liabilities and accrued expenses	347,119	-	-	-	-	347,119
Borrowings	-	-	127,450	286,000	-	413,450
Total financial liabilities	13,891,836	5,769,311	1,325,495	298,545	459	21,285,646
Liquidity gap	(8,379,768)	(516,629)	(133,215)	8,006,287	3,592,248	2,568,923
Financial guarantees	-	4,027,235	7,200,678	4,597,444	10,000	15,835,357
Foreign currency swaps	-	65,157	35,024	-	-	100,182

Notes (continued)

4 Financial risk management (continued)

b) Liquidity risk (continued)

Bank

Expected maturity dates	**On demand Shs'000**	**1 - 3 months Shs'000**	**3 – 12 months Shs'000**	**1 - 5 years Shs'000**	**Over 5 years Shs'000**	**Total Shs'000**
2017						
Financial assets						
Cash and balances with Central Bank of Kenya	2,621,332	-	-	-	-	2,621,332
Deposits with other banks	485,546	735,403	-	-	-	1,220,949
Investments	-	349,340	-	-	1,549,959	1,899,299
Loans and advances to customers	958,563	179,253	1,004,791	6,595,944	2,670,774	11,409,325
Other assets	944,508	-	-	-	-	944,508
Total financial assets	5,009,949	1,263,996	1,004,791	6,595,944	4,220,733	18,095,413
Financial liabilities						
Deposits due to banks	-	2,379,413	-	-	-	2,379,413
Deposits from customers	9,582,555	2,442,130	719,417	16,250	439	12,760,791
Other liabilities and accrued expenses	278,079	-	-	-	-	278,079
Borrowings	-	-	-	480,294	53,753	534,047
Total financial liabilities	9,860,634	4,821,543	719,417	496,544	54,192	15,952,330
Liquidity gap	(4,850,685)	(3,557,547)	285,374	6,099,400	4,166,541	2,143,083
Financial guarantees	-	1,142,797	1,955,630	3,515,117	3,340	6,616,884
Foreign currency swaps	-	25,816	12,540	-	-	38,356

Notes (continued)

4 Financial risk management (continued)

c) Market risk

The objective of the Group's market risk management is to manage and control market risk exposures in order to optimize return on risk while maintaining a market profile consistent with the bank's mission.

Market risk is the risk that movements in market risk factors, including foreign exchange rates and interest rates will reduce the Group's income or capital. A principal part of the Group's management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling) and the sensitivity of future earnings and capital to varying foreign exchange rates. The Group aims, through its management of market risk, to mitigate the impact of prospective interest rate movements and foreign exchange fluctuations which could reduce future earnings and capital. The Group monitors foreign exposure positions, ensures there is adequate foreign currency to meet obligations as well as takes corrective action if the exposure exceeds the set limits.

For simulation modelling, the Group uses a combination of scenarios relevant to local businesses and local markets. These scenarios are used to illustrate the effect on the Bank's earnings and capital. The overall responsibility for managing market risk rests with the Board Asset and Liability Committee (ALCO). The ERM department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO).

The major market risk sensitivity analysis measurements techniques used to measure and control market risks are outlined below:

i) Foreign exchange risk

The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions, which are monitored daily.

The table below summarises the Bank's exposure to foreign exchange risk at 31 December 2018. Included in the table are the Bank's financial instruments at carrying amounts, categorised by currency.

Notes (continued)

4 Financial risk management (continued)

c) Market risk (continued)

i) Foreign exchange risk (continued)

Group

	USD	EURO	GBP	Other	Total
At 31 December 2018	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
Financial assets					
Cash and balances with CBK	56,091	41,634	8,238	189	106,153
Deposits with other banks	3,179,230	674,191	184,729	4,285	4,042,435
Loans and advances	923,773	27,999	1	-	951,772
	4,159,094	743,824	192,968	4,474	5,100,360
Financial liabilities					
Customers deposits	1,493,520	180,007	1,146	281	1,674,954
Borrowings	204,099	-	-	-	204,099
	1,697,619	180,077	1,146	281	1,879,053
Net exposure	2,461,475	563,747	191,822	4,193	3,221,307
At 31 December 2017					
Financial assets					
Cash and balances with CBK	1,116,146	2,020	897	71	1,119,134
Deposits with other banks	1,031,548	131,646	8,693	872	1,172,759
Loans and advances	165,034	4	1	-	165,039
	2,312,728	133,670	9,591	943	2,456,932
Financial liabilities					
Customers deposits	569,434	34,049	347	-	603,830
Borrowings	207,230	-	-	-	207,230
	776,664	34,049	347	943	811,060
Net exposure	1,536,064	99,621	9,244	943	1,645,872

Notes (continued)

4 Financial risk management (continued)

c) Market risk (continued)

i) Foreign exchange risk (continued)

Bank

	USD	EURO	GBP	Other	Total
At 31 December 2018	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
Financial assets					
Cash and balances with CBK	56,091	41,634	8,238	189	106,153
Deposits with other banks	3,179,230	674,191	184,729	4,285	4,042,435
Loans and advances	923,773	27,999	1	-	951,772
	4,159,094	743,824	192,968	4,474	5,100,360
Financial liabilities					
Customers deposits	1,493,520	180,007	1,146	281	1,674,954
Borrowings	204,099	-	-	-	204,099
	1,697,619	180,077	1,146	281	1,879,053
Net exposure	2,461,475	563,817	191,822	4,193	3,221,307
At 31 December 2017					
Financial assets					
Cash and balances with CBK	1,116,146	2,020	897	71	1,119,134
Deposits with other banks	1,031,548	131,646	8,693	872	1,172,759
Loans and advances	165,034	4	1	-	165,039
	2,312,728	133,670	9,591	943	2,456,932
Financial liabilities					
Customers deposits	569,434	34,049	347	-	603,830
Borrowings	207,230	-	-	-	207,230
	776,664	34,049	347	943	811,060
Net exposure	1,536,064	99,621	9,244	943	1,645,872

Notes (continued)

4 Financial risk management (continued)

c) Market risk (continued)

i) Foreign exchange risk (continued)

The following table presents sensitivities of profit or loss and equity to reasonably possible changes in exchange rates applied at the end of the reporting period relative to functional currency of the Group, with all other variables held constant:

Group and Bank

Shs/ US dollar	**2018 Shs'000**	**2017 Shs'000**
Effect on profit before tax of a +/-5% change in exchange rates	123,074	87,165
Shs / Euro		
Effect on profit before tax of a +/-5% change in exchange rates	28,191	4,981

ii) Interest rate risk

The Group 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 are either pegged to the Group's base lending rate or Treasury bill rate. The interest rates, therefore, fluctuate depending on the movement in the market interest rates. The Group also invests in fixed and variable interest rate instruments issued by the Central Bank of Kenya. Interest rates on deposits from customers are negotiated between the Group and the customer. The Group has the discretion to change the rates in line with changes in market trends.

These measures minimize the Group's exposure to interest rate risk.

Changes in the market interest rates affect the interest income or expenses of variable interest financial instruments:

- Changes in market interest rates only affect interest income or expenses in relation to financial instruments with fixed interest rates if these are recognized at their fair value.
- The projections make other assumptions including that all positions run to maturity.

Sensitivity analysis

The sensitivity analysis on the income statement is the effect of the assumed changes in interest rates on loans and advances on the Group's profit before income tax and for the year and equity.

	Group		**Bank**	
	2018 Shs'000	**2017 Shs'000**	**2018 Shs'000**	**2017 Shs'000**
Effect on profit before tax of a +/-2% change in interest rates	181,957	149,197	181,957	149,197
Effect on profit before tax (%)	+/- 34%	+/- 25%	+/- 32%	+/- 25%

Notes (continued)

4 Financial risk management (continued)

c) Market risk (continued)

ii) Interest rate risk (continued)

The table below analyses the Group's interest rate risk exposure on non-trading financial assets and liabilities. The Group's assets and liabilities are included at carrying amount categorized by the earlier of contractual re-pricing or maturity dates. The sensitivity computations assume that the financial assets maintain a constant rate of return from one year to the next. The bank bases its sensitivity analysis on the interest sensitivity gap.

Group 2018	**Up to 1 month Shs'000**	**1-3 months Shs'000**	**3-12 months Shs'000**	**1-5 Years Shs'000**	**Over 5 years Shs'000**	**Non-interest bearing Shs'000**	**Carrying amount Shs'000**
Financial assets:							
Cash and balances with the Central Bank of Kenya	-	-	-	-	-	2,140,313	2,140,313
Deposits with other banks	1,856,777	354,188	51,355	-	-	1,724,073	3,986,393
Investments securities	608,620	1,471,119	-	-	1,550,212	-	3,629,951
Loans advances to customers	747,338	898,724	1,140,925	8,304,832	2,042,496	-	13,134,315
	3,212,735	2,724,031	1,192,280	8,304,832	3,592,708	3,864,386	22,890,972
Financial liabilities:							
Deposits due to banks	3,099,854	365,894	51,601	-	-	6,248	3,523,597
Deposits from customers	7,269,873	2,303,563	1,146,444	12,545	459	6,209,024	16,941,908
Borrowings	-	-	-	355,560	57,890	-	413,450
	10,369,727	2,669,457	1,198,045	368,105	58,349	6,215,272	20,878,955
Total interest repricing gap	(7,156,992)	54,574	(5,765)	7,936,727	3,534,359	(2,350,886)	2,012,017

Notes (continued)

4 Financial risk management (continued)

c) Market risk (continued)

iii) Interest rate risk (continued)

Group 2017	**Up to 1 month Shs'000**	**1-3 months Shs'000**	**3-12 months Shs'000**	**1-5 Years Shs'000**	**Over 5 years Shs'000**	**Non-interest bearing Shs'000**	**Carrying amount Shs'000**
Financial assets:							
Cash and balances with the Central Bank of Kenya						2,621,332	2,621,332
Deposits with other banks	569,692	165,658	-	-	-	485,599	1,220,949
Investments securities	349,340	-	-	-	1,549,959	-	1,899,299
Loans advances to customers	958,563	179,253	1,004,791	6,595,944	2,670,774	-	11,409,325
	1,877,595	344,911	1,004,791	6,595,944	4,220,733	3,106,931	17,150,905
Financial liabilities:							
Deposits due to banks	2,379,413	-	-	-	-	-	2,379,413
Deposits from customers	3,906,753	2,442,195	719,418	16,250	439	5,675,736	12,760,791
Borrowings	-	-	227,110	-	207,230	-	434,340
	6,286,166	2,442,195	946,528	16,250	207,669	5,675,736	15,574,544
Total interest repricing gap	(4,408,570)	(2,097,284)	58,263	6,579,694	4,013,064	(2,568,805)	1,576,361

Notes (continued)

4 Financial risk management (continued)

c) Market risk (continued)

iv) Interest rate risk (continued)

Bank 2018	**Up to 1 month Shs'000**	**1-3 months Shs'000**	**3-12 months Shs'000**	**1-5 Years Shs'000**	**Over 5 years Shs'000**	**Non-interest bearing Shs'000**	**Carrying amount Shs'000**
Financial assets:							
Cash and balances with the Central Bank of Kenya	-	-	-	-	-	2,140,313	2,140,313
Deposits with other banks	1,856,777	354,188	51,355	-	-	1,724,073	3,986,393
Investments securities	608,620	1,471,119	-	-	1,550,212	-	3,629,951
Loans advances to customers	747,338	898,724	1,140,925	8,304,832	2,042,496	-	13,134,315
	3,212,735	2,724,031	1,192,280	8,304,832	3,592,708	3,864,386	22,890,972
Financial liabilities:							
Deposits due to banks	3,099,854	365,894	51,601	-	-	6,248	3,523,597
Deposits from customers	7,269,872	2,303,563	1,146,444	12,545	459	6,268,597	17,001,480
Borrowings	-	-	-	355,560	57,890	-	413,450
	10,369,726	2,669,457	1,198,045	368,105	58,349	6,274,845	20,938,527
Total interest repricing gap	(7,156,991)	54,574	(5,765)	7,936,727	3,534,359	(2,410,459)	1,952,445

Notes (continued)

4 Financial risk management (continued)

c) Market risk (continued)

v) Interest rate risk (continued)

Bank 2017	**Up to 1 month Shs'000**	**1-3 months Shs'000**	**3-12 months Shs'000**	**1-5 Years Shs'000**	**Over 5 years Shs'000**	**Non-interest bearing Shs'000**	**Carrying amount Shs'000**
Financial assets:							
Cash and balances with the Central Bank of Kenya						2,621,332	2,621,332
Deposits with other banks	569,692	165,658	-	-	-	485,599	1,220,949
Investments securities	349,340	-	-	-	1,549,959	-	1,899,299
Loans advances to customers	958,563	179,253	1,004,791	6,595,944	2,670,774	-	11,409,325
	1,877,595	344,911	1,004,791	6,595,944	4,220,733	3,106,931	17,150,905
Financial liabilities:							
Deposits due to banks	2,379,413	-	-	-	-	-	2,379,413
Deposits from customers	3,906,753	2,442,195	719,418	16,250	439	5,675,736	12,760,791
Borrowings	-	-	227,110	-	207,230	-	434,340
	6,286,166	2,442,195	946,528	16,250	207,669	5,675,736	15,574,544
Total interest repricing gap	(4,408,570)	(2,097,284)	58,263	6,579,694	4,013,064	(2,568,805)	1,576,361

Notes (continued)

4 Financial risk management (continued)

d) Fair value of financial assets and liabilities

The Group's and Bank's fair value of government securities listed at NSE at 31 December 2018 is estimated at Shs 3,042,614,000 (2017: Shs 1,435,926,000) compared to their carrying value of Shs 3,317,236,000 (2017: Shs 1,899,299,000). The Held for Trading investment securities are carried at fair value in the Bank's books. The fair values of the Bank's other financial assets and liabilities approximate the respective carrying amounts, due to the generally short periods to contractual repricing or maturity dates as set out above. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the Bank at the balance sheet date.

Fair value estimation

The table below analyses financial instruments carried at fair value by valuation method. The different levels are defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

	Level 1	Level 2	Level 3
Group and Bank			
At 31 December 2018	**Shs'000**	**Shs'000**	**Shs'000**
Investment securities	3,629,951	-	-
Freehold land and buildings	-	-	138,000
	3,629,951	-	138,000
At 31 December 2017			
Investment securities	1,899,299	-	-
Freehold land and buildings	-	-	141,000
	1,899,299	-	141,000

e) Offsetting disclosure

Financial instruments subject to offsetting, enforceable master netting arrangements or similar agreements

The following table sets out the impact of offset, as well as financial assets and financial liabilities that are subject to enforceable master netting arrangement or similar agreement, irrespective of whether they have been offset in accordance with IAS 32, as required by IFRS 7R disclosure requirements.

Notes (continued)

4 Financial risk management (continued)

e) Offsetting disclosure (continued)

The gross amounts of financial asset and financial liabilities and their net amounts disclosed in the table below have been measured in the statement of financial position on the following bases:

- Derivative asset and liabilities – fair value;
- Loans and advances – amortised cost and

Deposits from customers – amortised cost

Group	Gross amount of recognised financial assets	Gross amounts of recognised financial liabilities offset in statement of financial position	Net amounts of financial assets presented in the statement of financial position	Financial instruments, financial collateral and cash collateral received	Net amount
At December 2018	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
Assets					
Loans and advances	13,134,315	-	13,134,315	-	13,134,315
Derivative assets	106,579	-	106,579	-	106,579
	13,240,894	-	13,240,894	-	13,240,894
Liabilities					
Deposits	16,943,954	-	16,943,954	-	16,943,954
Derivative liabilities	6,397	-	6,397	-	6,397
	16,950,351	-	16,950,351	-	16,950,351
At December 2017					
Assets					
Loans and advances	11,409,325	-	11,409,325	-	11,409,325
Derivative assets	40,508	-	40,508	-	40,508
	11,449,833	-	11,449,833	-	11,449,833
Liabilities					
Deposits	12,760,791	-	12,760,791	-	12,760,791
Derivative liabilities	2,151	-	2,151	-	2,151
	12,762,942	-	12,762,942	-	12,762,942

Notes (continued)

4 Financial risk management (continued)

e) Offsetting disclosure (continued)

Bank	Gross amount of recognised financial assets	Gross amounts of recognised financial liabilities offset in statement of financial position	Net amounts of financial assets presented in the statement of financial position	Financial instruments, financial collateral and cash collateral received	Net amount
At December 2018	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
Assets					
Loans and advances	13,134,315	-	13,134,315	-	13,134,315
Derivative assets	106,579	-	106,579	-	106,579
	13,240,894	-	13,240,894	-	13,240,894
Liabilities					
Deposits	17,001,480	-	17,001,480	-	17,001,480
Derivative liabilities	6,397	-	6,397	-	6,397
	17,007,877	-	17,007,877	-	17,007,877
At December 2017					
Assets					
Loans and advances	11,409,325	-	11,409,325	-	11,409,325
Derivative assets	40,508	-	40,508	-	40,508
	11,449,833	-	11,449,833	-	11,449,833
Liabilities					
Deposits	12,760,791	-	12,760,791	-	12,760,791
Derivative liabilities	2,151	-	2,151	-	2,151
	12,762,942	-	12,762,942	-	12,762,942

Notes (continued)

4 Financial risk management (continued)

e) Offsetting disclosure (continued)

The ISDA* and similar master netting arrangements do not meet the criteria for offsetting in the statement of financial position. This is because they create for the parties to the agreement a right of set-off of recognised amounts that is enforceable only following an event of default, insolvency or bankruptcy of the bank or the counterparties following other predetermined events. In addition the bank and its counterparties do not intent to settle on a net basis or to realise the assets and the liabilities simultaneously.

The bank receives collateral in the form of cash in respect of lending.

The table below sets out the nature of agreement, and the types of rights relating to items which do not qualify for offset but that are subject to a master netting arrangement or similar agreement.

Financial instrument	Nature of agreement	Basis on which amounts are compiled
Derivative assets and liabilities	ISDAs	The agreement allows for offset in the event of default.
Trading assets and trading liabilities	Global master repurchase agreements	The agreement allows for offset in the event of default.
Deposits with other banks	Banking Act	In the event of liquidation or bankruptcy, offset shall be enforceable subject to meeting Banking Act requirements.
Deposits and current accounts	Banking Act	In the event of liquidation or bankruptcy, offset shall be enforceable subject to meeting Banking Act requirements.

IAS 32 Financial Instruments: Presentation (IAS 32) requires financial assets and financial liabilities to be offset and the net amount presented in the statement of financial position when, and only when, the bank has a current legally enforceable right to set off recognised amounts, as well as the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

f) Management of capital

The Bank monitors the adequacy of its capital using ratios established by the Central Bank of Kenya. The ratios measure capital adequacy by comparing the bank's eligible capital with its assets in the statement of financial position, commitments not recognized in the statement of financial position, market and other risk positions at a weighted amount to reflect their relative risk.

The Bank manages its capital to ensure that it is a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance. The capital structure of the Bank consists of debt which includes the borrowings, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings.

The Bank's Enterprise Risk Management Department reviews the capital structure on a semi-annual basis. As part of this review, the Department considers the cost of capital and the risks associated with each class of capital. Based on recommendations of the Department, the bank will balance its overall capital structure.

Notes (continued)

4 Financial risk management (continued)

f) Management of capital (continued)

The Bank has 3 main capital objectives:

- To comply with the capital requirements set by the Central Bank of Kenya
- To safeguard the bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits of other stakeholders
- Maintain a strong capital base to support the developments of the business

Capital adequacy and use of regulatory capital are monitored regularly 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 a bank to maintain at all times:

- A minimum level of core capital of Shs 1 billion
- A core capital of not less than 8.0% (2017:8.0%) of total deposit liabilities
- A core capital of not less than 10.5% (2017: 10.5%) of risk weighted assets plus risk weighted assets not recognized in the statement of financial position.
- A total capital of not less than 14.5% (2017:14.5%) of risk-weighted assets plus risk-weighted items not recognized in the statement of financial position.

The Bank's total regulatory capital is divided into two tiers:

Tier 1 capital (core capital): Share capital, share premium, plus retained earnings

Tier 2 capital (supplementary capital): 25% (subject to prior approval) of revaluation reserves, subordinated debt not exceeding 50% of Tier 1 capital and hybrid capital instruments. Qualifying Tier 2 is limited to 100% of Tier 1 Capital.

Assets are weighted according to broad categories of notional credit risk, being assigned a risk weighted according to the amount of capital deemed to be necessary to support them. Five categories of risk weights (0%, 20%, 50%, 70% and 100%) are applied. Tier 1 capital consists of shareholders equity while Tier 2 capital consists of the bank's eligible long-term debt, 25% of Revaluation reserve and statutory reserves.

Notes (continued)

4 Financial risk management (continued)

f) Management of capital (continued)

	2018 Shs'000	2017 Shs'000
Tier I Capital		
Share capital	2,046,198	1,470,175
Share premium	1,246,599	706,082
Retained earnings	1,030,700	1,190,874
Less: Deferred tax asset	(94,299)	(42,227)
	4,229,198	3,324,904
Tier II Capital		
Revaluation reserve	16,844	17,040
Regulatory reserve	-	11,686
Total regulatory capital	4,246,042	3,353,630
Risk Weighted Assets	27,021,094	20,377,205
Core capital/ total deposits liabilities (Minimum: 8.0%)	24.9%	26.1%
Core capital/total risk weighted assets (Minimum: 10.5%)	15.7%	16.3%
Total capital/ total risk weighted assets (Minimum: 14.5%)	15.7%	16.5%

The Bank was compliant with the capital adequacy ratios throughout the year. The Bank raised additional share capital of Shs 1.1 billion in 2018 to mitigate the impact IFRS 9 adoption as well as support business growth.

5 Interest income

	Group and Bank 2018 Shs'000	2017 Shs'000
Loans and advances to customers	1,703,292	1,762,317
Investment securities	355,128	231,763
Deposits with other banks	59,985	19,832
	2,118,405	2,013,912
Portfolio analysis		
Interest on financial assets held at amortised cost	2,118,405	2,013,912

Notes (continued)

6 Interest expense

	Group and Bank 2018 Shs'000	Group and Bank 2017 Shs'000
Term deposits from customers	709,261	610,925
Savings accounts	19,947	22,750
Deposits from banks	280,623	265,960
Borrowings	45,590	66,939
	1,055,421	966,574
Portfolio analysis		
Interest on financial liabilities held at amortised cost	1,055,421	966,574

7 Net fee and commission income

	Group 2018 Shs'000	Group 2017 Shs'000	Bank 2018 Shs'000	Bank 2017 Shs'000
Ledger fees and commissions	52,300	74,033	52,300	74,049
Credit fees and commissions	336,739	299,496	336,739	299,496
Transactions fees income	424,587	141,630	424,591	141,630
Insurance premium commissions	39,686	32,501	-	-
Fee and commission income	853,312	547,660	813,630	515,175
Fee and commission expense	(2,988)	(3,000)	(2,587)	(3,000)
Net fee and commission income	850,324	544,660	811,043	512,175

8 Trading income

	Group and Bank 2018 Shs'000	Group and Bank 2017 Shs'000
Net foreign exchange gain	196,592	112,410
Gain on sale of financial assets at fair value through profit or loss	10,074	-
Fair value gains on assets at fair value through profit or loss	3,404	-
	210,070	112,410

Gains on foreign currency dealings arose from trading in foreign currency transactions, translation of foreign currency assets and liabilities to Kenya Shillings at year-end and trading of securities held for trading.

Notes (continued)

9 Credit impairment losses

	Group		Bank	
	2018	2017	2018	2017
Statement of profit or loss:	Shs'000	Shs'000	Shs'000	Shs'000
Charge for the year:				
- Loans and advances (Note 19)	573,718	464,126	573,718	464,126
- Deposits with other banks (Note 17)	53,375	-	53,375	-
- Other assets and prepayments (Note 20)	153,786	13,781	153,787	13,781
Credits due to recoveries	(17,939)	(14,336)	(17,939)	(14,336)
	762,941	463,571	762,941	463,571

10 Other income

	Group and Bank	
	2018	2017
	Shs'000	Shs'000
Gain on disposal of property and equipment	4	717
Sundry income	5,844	16,697
	5,848	17,414

11 Operating expenses

Operating expenses include the following:

	Group		Bank	
	2018	2017	2018	2017
	Shs'000	Shs'000	Shs'000	Shs'000
Employee benefits (Note 12)	803,825	786,529	793,317	778,084
Directors' remuneration (Note 34)	60,873	48,740	60,873	48,740
Auditor's remuneration	11,407	5,161	11,010	4,576
Depreciation of property and equipment (Note 21)	100,015	126,450	99,964	126,365
Amortisation of intangible assets (Note 22)	79,259	86,656	78,659	86,406
Other operating expenses	848,268	816,285	845,246	814,536
	1,903,647	1,869,821	1,889,069	1,858,707

Notes (continued)

12 Employee benefits

	Group 2018 Shs'000	Group 2017 Shs'000	Bank 2018 Shs'000	Bank 2017 Shs'000
Salaries and allowances	658,464	667,948	649,146	660,691
Pension contributions				
- Defined contribution benefits scheme	41,310	37,185	40,799	36,671
- National Social Security Fund	1,089	2,138	1,077	2,127
Staff medical expenses	54,018	58,753	53,438	58,280
Staff welfare and training expenses	48,944	20,504	48,857	20,315
	803,825	786,529	793,317	778,084

Average number of employees during the year	Group 2018	Group 2017	Bank 2018	Bank 2017
Management	108	143	107	142
Supervisory	52	43	51	42
Clerical	295	267	292	264
	455	453	450	448

13 Income tax

a) Statement of financial position	Group 2018 Shs'000	Group 2017 Shs'000	Bank 2018 Shs'000	Bank 2017 Shs'000
At start of year	106,431	101,538	108,903	104,177
Prior year understatement	25	3,986	25	3,775
Income tax expense	(7,505)	(6,593)	(145)	-
Paid during the year	14,298	7,500	2,532	951
At end of year	113,250	106,431	111,315	108,903

b) Income statement

	Group 2018 Shs'000	Group 2017 Shs'000	Bank 2018 Shs'000	Bank 2017 Shs'000
Current income tax	(7,505)	(6,593)	(145)	-
Deferred income tax credit (Note 23)	166,984	211,653	166,813	211,131
Under provision in the prior year	-	211	-	-
	159,479	205,271	166,668	211,131

Notes (continued)

13 Income Tax (continued)

Reconciliation of tax expense to tax based on loss before income tax:

	Group		Bank	
	2018	**2017**	**2018**	**2017**
	Shs'000	**Shs'000**	**Shs'000**	**Shs'000**
Loss before income tax	537,362	611,570	562,065	632,941
Tax at the applicable rate of 30% (2017: 30%)	161,209	183,471	168,620	189,882
Tax effect of expenses not deductible for tax	(1,730)	21,800	(1,952)	21,249
Tax credit for the year	159,479	205,271	166,668	211,131

14 Earnings per share

Earnings per share is calculated by dividing the profit attributable to equity holders of the Group by the weighted average number of ordinary shares in issue during the year.

Group	**2018**	**2017**
Loss for purposes of basic and diluted earnings per share (in Shs'000)	(377,883)	(406,299)
Weighted average number of ordinary shares for purposes of basic and diluted earnings per share (in thousands)	3,393	2,940
Earnings per share - basic and diluted (Shs)	(111.6)	(138.2)

There were no potentially dilutive shares outstanding at 31 December 2018 and 31 December 2017. Therefore, diluted earnings per share is the same as the basic earnings per share.

15 Cash and balances with Central Bank of Kenya

	Group and Bank	
	2018	**2017**
	Shs '000	**Shs '000**
Cash in hand	732,668	659,796
Balances with Central Bank of Kenya (CBK)		
• Cash reserve ratio balance	890,410	650,719
• Other current accounts	517,235	1,310,817
	2,140,313	2,621,332

Cash balances with the Central Bank of Kenya do not earn interest. They are available for use by the Bank and are not pledged as security.
The cash reserve ratio with Central Bank of Kenya (CBK) is non-interest earning and is based on the value of deposits as adjusted for CBK requirements. At 31 December 2018, the cash reserve ratio requirement was 5.25% of eligible deposits. The Bank is free to deviate from the 5.25% requirement on any given day, but not to fall below 3%, provided that the overall average for the month will be at least 5.25%.

Notes (continued)

16 Derivative financial instruments

The Bank trades in currency exchange forward contracts and currency swap contracts. The contracts are marked to market on daily basis.

Forward currency exchange contracts are agreements to buy or sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate. A currency swap generally involves the exchange, or notional exchange, of equivalent amounts of two currencies and a commitment to exchange interest periodically until the principal amounts are re-exchanged on a future date. As compensation for assuming the option risk, the option writer generally receives premium at the start of the option period.

The notional amounts are the respective gross amounts underlying the contract at the reporting date.

	Group and Bank		
2018	**Notional amount**	**Assets**	**Liabilities**
	Shs'000	**Shs'000**	**Shs'000**
Currency exchange forward contracts	2,858,708	41,648	1,102
Currency swap contracts	3,823,823	64,931	5,296
	6,682,531	106,579	6,397
2017			
Currency exchange forward contracts	1,783,783	40,508	214
Currency swap contracts	109,619	-	1,937
	1,893,402	40,508	2,151

All the derivative financial instrument contracts were maturing within 30 to 180 days after the year end.

Notes (continued)

17 Deposits with other banks

	Group and Bank	
	2018	**2017**
	Shs '000	**Shs '000**
Maturing within 90 days of the reporting date:		
Due from local banks	2,525,567	931,781
Due from foreign banks	1,524,079	289,168
	4,049,646	1,220,949
Provision for expected credit losses	(63,251)	-
	3,986,393	1,220,949

The weighted average effective interest rate for deposits due from banking institutions at 31 December 2018 was 2.6% (2017: 2.8%).

The movement in the provision for expected credit losses for deposits with other banks is as follows:

	Group and Bank	
	2018	**2017**
	Shs '000	**Shs '000**
At start of year	-	-
Changes on application of IFRS 9	9,877	-
Charged to profit or loss	53,374	-
At end of year	63,251	-

18 Investment securities

	Group and Bank	
	2018	**2017**
Investment securities at amortised cost	**Shs'000**	**Shs'000**
Treasury bills and bonds:		
- Maturing within one year	1,768,893	349,340
- Maturing after 1 year	1,548,343	1,549,959
	3,317,236	1,899,299
Investment securities at fair value through profit or loss		
Treasury bonds	312,715	-
	3,629,951	1,899,299

The weighted average effective interest rate for treasury investments at 31 December 2018 was 10.9% (2017: 11.4%).

Notes (continued)

19 Loans and advances to customers

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Term loans	13,211,772	11,836,502
Overdrafts	1,368,628	599,441
Credit cards	2,565	-
Gross loans and advances	14,582,965	12,435,943
Expected credit losses allowance	(1,448,650)	(1,026,618)
	13,134,315	11,409,325

Analysis of gross loans and advances by maturity

Maturing within one year	2,957,583	2,145,169
Between two and three years	6,333,377	3,716,459
Over three years	5,292,005	6,574,315
	14,582,965	12,435,943

	Group		Bank	
	2018	**2017**	**2018**	**2017**
Statement of financial position:	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
At start of year	1,026,618	1,024,248	1,026,618	1,024,248
Charged through profit or loss in the year (loans and advances)	573,718	464,126	573,718	464,126
Charged to opening retained earnings	177,258	-	177,258	-
Write - offs in the year	(328,944)	(461,756)	(328,944)	(461,756)
At end of year	1,448,650	1,026,618	1,448,650	1,026,618

The aggregate amount of non-performing advances was Shs 2,941,718,493 (2017: Shs 2,595,562,371) against which provisions of Shs 866,787,000 (2017: Shs 969,097,864) have been made leaving a net balance of Shs 2,074,931,493 (2017: Shs 1,626,464,136) which is included in the statement of financial position in the loans and advances line item. The collateral held against these loans includes mortgages, motor vehicles, land and building, chattels, share certificates among other assets. Loans and advances to customers are measured at amortised cost.

The weighted average effective interest rate on loans and advances at 31 December 2018 was 11.2% (2017:13.0%).

Additional disclosures on impairments and provisions for credit losses are set out under Note 4 (a)-(f).

Notes (continued)

20 Other assets and prepayments

Group	2018 Shs'000	2017 Shs'000
Items in the course of collection	51,841	27,909
Prepaid staff loan benefits	228,925	182,995
Other receivables and prepayments	860,600	769,690
Provision for expected credit losses	(204,832)	(51,046)
	936,534	929,548

Bank		
Items in the course of collection	51,840	27,909
Due from subsidiary company	31,296	16,998
Prepaid staff loan benefits	228,925	182,995
Other receivables and prepayments	856,368	767,652
Provision for expected credit losses	(204,832)	(51,046)
	963,597	944,508

The movement in the provision for expected credit losses on other receivables is as follows:

	Group and Bank	
	2018 Shs '000	2017 Shs '000
At start of year	51,046	37,265
Charged to profit or loss	153,786	13,781
At end of year	204,832	51,046

Notes (continued)

21 Property and equipment

Group	Freehold land and buildings Shs'000	Furniture and fittings Shs'000	Motor vehicles Shs'000	Office equipment & computers Shs'000	Leasehold improvements Shs'000	Total Shs'000
Year ended 31 December 2018						
Cost or valuation						
At start of year	150,000	142,573	16,044	590,195	601,018	1,499,830
Additions	-	6,117	-	7,900	22,027	36,044
Disposals	-	(100)	-	(102)	-	(202)
Transfers	-	79	-	(79)	-	-
At end of year	150,000	148,669	16,044	597,914	623,045	1,535,672
Depreciation						
At start of year	9,000	79,389	6,918	515,476	391,765	1,002,548
Charge for the year	3,000	10,204	2,488	48,522	35,801	100,015
Disposals	-	(5)	-	(102)	-	(107)
Transfers	-	79	-	(79)	-	-
At end of year	12,000	89,667	9,406	563,817	427,566	1,102,456
Net carrying amount						
At end of year	138,000	59,002	6,638	34,097	195,479	433,216
Year ended 31 December 2017						
Cost or valuation						
At start of year	150,000	133,008	6,177	611,977	552,804	1,453,966
Additions	-	14,583	9,954	13,630	48,214	86,381
Disposals	-	(5,018)	(87)	(35,412)	-	(40,517)
At end of year	150,000	142,573	16,044	590,195	601,018	1,499,830
Depreciation						
At start of year	6,000	74,723	5,544	481,905	348,395	916,567
Charge for the year	3,000	9,684	1,461	68,934	43,371	126,450
Disposals	-	(5,018)	(87)	(35,364)	-	(40,469)
Transfers						
At end of year	9,000	79,389	6,918	515,475	391,766	1,002,548
Net carrying amount						
At end of year	141,000	63,184	9,126	74,720	209,252	497,282

Notes (continued)

21 Property and equipment (continued)

Bank	Freehold land and buildings Shs'000	Furniture and fittings Shs'000	Motor vehicles Shs'000	Office equipment & computers Shs'000	Leasehold improvements Shs'000	Total Shs'000
Year ended 31 December 2018						
Cost or valuation						
At start of year	150,000	142,522	16,044	589,918	601,018	1,499,502
Additions	-	6,116	-	7,900	22,027	36,043
Disposals	-	(100)	-	(102)	-	(202)
Transfers	-	79	-	(79)	-	-
At end of year	150,000	148,617	16,044	597,637	623,045	1,535,343
Depreciation						
At start of year	9,000	79,374	6,918	515,253	391,765	1,002,310
Charge for the year	3,000	10,199	2,488	48,476	35,801	99,964
Disposals	-	(5)	-	(102)	-	(107)
Transfers	-	79	-	(79)	-	-
At end of year	12,000	89,647	9,406	563,548	427,566	1,102,167
Net carrying amount						
At end of year	138,000	58,970	6,638	34,089	195,479	433,176
Year ended 31 December 2017						
Cost or valuation						
At start of year	150,000	133,008	6,177	611,977	552,804	1,453,966
Additions	-	14,583	9,954	13,630	48,214	86,381
Disposals	-	(5,018)	(87)	(35,412)	-	(40,517)
Transfers	-	(51)	-	(277)	-	(328)
At end of year	150,000	142,522	16,044	589,918	601,018	1,499,502
Depreciation						
At start of year	6,000	74,723	5,544	481,905	348,395	916,567
Charge for the year	3,000	9,678	1,461	68,856	43,370	126,365
Disposals	-	(5,018)	(87)	(35,363)	-	(40,468)
Transfers	-	(9)	-	(145)	-	(154)
At end of year	9,000	79,374	6,918	515,253	391,765	1,002,310
Net carrying amount						
At end of year	141,000	63,148	9,126	74,665	209,253	497,192

Notes (continued)

21 Property and equipment (continued)

If the revalued freehold land and building were measured using the cost model, the carrying amounts would be as follows:

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Cost	77,151	77,151
Accumulated depreciation	(35,403)	(33,524)
At end of year	41,748	43,627

22 Intangible assets

	Group		Bank	
Computer software	**2018**	**2017**	**2018**	**2017**
	Shs'000	**Shs'000**	**Shs'000**	**Shs'000**
Cost				
At start of year	593,526	546,441	587,526	546,441
Additions	118,046	47,085	118,046	47,085
Transfers	1,454	-	1,454	(6,000)
At end of year	713,026	593,526	707,026	587,526
Amortisation				
At start of year	297,360	210,704	297,110	210,704
Charge for the year	79,259	86,656	78,659	86,406
At end of year	376,619	297,360	375,769	297,110
Net carrying amount				
At end of year	336,407	296,166	331,257	290,416

Notes (continued)

23 Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 30% (2017: 30%). The gross movement on the deferred income tax account is as follows:

	Group		Bank	
	2018 Shs'000	2017 Shs'000	2018 Shs'000	2017 Shs'000
At start of year	268,842	57,189	268,320	57,189
Changes on application of IFRS 9	56,141	-	56,141	-
Credit to profit or loss (Note 13)	166,984	211,653	166,813	211,131
At end of year	491,967	268,842	491,274	268,320

The deferred income tax is computed at the enacted tax rate of 30% and is attributable to the following:

Group	1 January 2018 Shs '000	Initial application of IFRS 9	Profit or loss Shs '000	31 December 2018 Shs '000
Property and equipment	(52,081)	-	15,614	(36,467)
Other temporary differences	(174,534)	(56,141)	(163,063)	(393,738)
Tax losses carried forward	(42,227)	-	(19,536)	(61,763)
Net deferred income tax asset	(268,842)	(56,141)	(166,984)	(491,967)

	1 January 2017 Shs '000	Profit or loss Shs '000	31 December 2017 Shs '000
Property and equipment	(30,081)	(22,000)	(52,081)
Other temporary differences	(27,108)	(147,426)	(174,534)
Tax losses carried forward	-	(42,227)	(42,227)
Net deferred income tax asset	(57,189)	(211,653)	(268,842)

Notes (continued)

23 Deferred income tax (continued)

Bank	**1 January 2018**	**Initial application of IFRS 9**	**Profit or loss**	**31 December 2018**
	Shs '000		**Shs '000**	**Shs '000**
Property and equipment	(51,561)	-	15,786	(35,775)
Other temporary differences	(174,532)	(56,141)	(163,063)	(393,736)
Tax losses carried forward	(42,227)	-	(19,536)	(61,763)
Net deferred income tax asset	(268,320)	(56,141)	(166,813)	(491,274)

	1 January 2017	**Profit or loss**	**31 December 2017**
	Shs '000	**Shs '000**	**Shs '000**
Property and equipment	(30,081)	(21,480)	(51,561)
Other temporary differences	(27,108)	(147,424)	(174,532)
Tax losses carried forward	-	(42,227)	(42,227)
Net deferred income tax asset	(57,189)	(211,131)	(268,320)

The opening balance of deferred income tax asset has been adjusted by a debit of Shs 56,140,000 relating to changes in credit loss allowances on initial application of IFRS 9.

24 Deposit from banks

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Due to local banks	3,523,597	2,379,413

The deposits due to banking institutions relate to overnight borrowings from other commercial banks. The weighted average interest rate on the deposits for the year ended 31 December 2018 was 10.3% (2017: 9.8%).

Notes (continued)

25 Deposits from customers

Group	Group 2018 Shs'000	Group 2017 Shs'000	Bank 2018 Shs'000	Bank 2017 Shs'000
Call and fixed deposits	8,037,534	6,363,053	8,039,580	6,396,019
Current and demand accounts	6,211,071	4,438,138	6,268,597	4,438,138
Savings accounts	2,693,303	1,926,634	2,693,303	1,926,634
	16,941,908	12,727,825	17,001,480	12,760,791
Analysis of Deposits from customers by maturity:				
Payable within one year	16,928,904	12,711,203	16,988,476	12,744,169
Between one year and three years	13,004	16,622	13,004	16,622
	16,941,908	12,727,825	17,001,480	12,760,791

Included in 'Deposits from customers' were deposits of Shs 2,548,430,500 (2017: Shs 701,863,953) that have been pledged to the Bank by the customers as securities for loans and advances as well as for guarantees.

The weighted average effective interest rate on interest bearing deposits from customers for the year ended 31 December 2018 was 8.9% (2017: 9.4%).

26 Other liabilities and accrued expenses

	Group 2018 Shs'000	Group 2017 Shs'000	Bank 2018 Shs'000	Bank 2017 Shs'000
Items in the course of collection	25,919	20,541	25,919	20,541
Due to subsidiary	-	-	7,157	7,157
Other payables and accrued expenses	321,345	256,766	314,043	250,381
	347,264	277,307	347,119	278,079

27 Borrowings

	Group and Bank 2018 Shs'000	Group and Bank 2017 Shs'000
Terms loans:		
Oiko Credit Ecumenical Development Co-operative Society U.A	151,407	227,110
Pamiga Finance SA	204,099	207,230
East Africa Development Bank ("EADB")	57,944	-
	413,450	434,340

Notes (continued)

27 Borrowings (continued)

The borrowings are repayable as follows:

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Within one year	127,460	75,000
Between one year to three years	285,990	359,340
	413,450	434,340

The movement in borrowings is a summarised below:

At start of year	434,340	589,149
Additions	57,890	202,000
Repayments	(116,265)	(425,448)
Accrued interest payable	40,585	63,939
Currency translation (gain)/loss	(3,100)	4,700
At end of year	413,450	434,340

The weighted average effective interest rate on the borrowings at 31 December 2018 was 11.9% for LCY loans and 4.25% for FCY loans (2017: 10.66% for LCY and 4.25% for LCY). The borrowings are measured at amortised cost and are all unsecured except EADB which is secured, details as per Note 37.

The Oiko Credit loan was issued in two tranches. The first tranche of Shs 300 million was received on 22 September 2014 and fully repaid in 2017. The second tranche was received on 8 December 2016. It accrued interest at the rate of 10.84%, for the first six months, thereafter net interest rate was reviewed by Oiko Credit and adjusted semi-annually based on the 182-day T-bill rate plus a margin of 1.25%, subject to a minimum rate of 10% p.a. Interest is repayable semi-annually with 4 equal annual instalments of the principal Shs 75 million after the date of disbursement.

The Pamiga loan of USD 2 million was received on 30 July 2017 at a fixed rate of 4.25 % p.a. The first principal instalment is payable after a grace period of 2 years over a period of 3 years. Interest is repayable semi-annually.

The EADB loan of Euro 2 million is being issued in tranches in Kenya shillings. The first tranche of Shs 57.89 million (equivalent to Euro 500,000) was received on 28 December 2018. It accrues interest at a rate of 8.5 %. The interest is payable semi-annually. The loan will be paid in 14 equal semi-annual instalments of equivalent Euro 142,857 after 12 months grace period from the date of first drawdown. The loan is secured by treasury bonds (Note 37).

The loans financial covenants relating to the non-performing loans and operational self- sufficiency ratios for the Oiko Credit loan and the non-performing loans ratio for the Pamiga loan were not met at 31 December 2018. The two lenders, Pamiga and Oiko, have not recalled the loans.

The fair value of borrowings approximates their carrying amount.

Notes (continued)

28 Share capital

	2018 Shs'000	2017 Shs'000
Authorised share capital:		
At 1 January 2018 (4,000,000 ordinary shares of Shs 500 each)	2,000,000	2,000,000
Issue of shares (1,000,000 ordinary shares of Shs 500 each)	500,000	-
At 31 December (5,000,000 ordinary shares of Shs 500 each)	2,500,000	2,000,000

Share capital	Number of shares	Share capital Shs'000	Share premium Shs'000
At 31 December 2016, 1 January 2017 and 31 December 2017	2,940,350	1,470,175	706,082
Issue of shares	1,152,046	576,023	540,517
At 31 December 2018	4,092,396	2,046,198	1,246,599

At 31 December 2018 the authorised share capital comprised 5 million ordinary shares (2017:4 million of Shs 500 each. All issued shares are fully paid.

In 2018, the Bank issued 1,152,046 shares at Shs 970 per share through a rights issue to the shareholders.

29 Revaluation reserve

The revaluation reserve is used to record increases in the fair value of land and buildings, net of deferred income tax.

30 Regulatory reserve

The regulatory reserve represents an appropriation from retained earnings to comply with the Prudential Guidelines of the Central Bank of Kenya on loan loss provisions. The balance represents the excess of loan provision computed in accordance with the Central Bank of Kenya prudential guidelines over the provision for impairment of loans and advances computed in accordance with IFRS 9, *Financial Instruments* (2017: IAS 39, *Financial Instruments: Recognition and Measurement*). The regulatory reserve is not distributable.

The opening balance of regulatory reserve has been adjusted by a debit of Shs 11,686,000 relating to the increase in expected credit loss allowance on loans and advances initial application of IFRS 9.

Notes (continued)

31 a) Cash generated from operations

Reconciliation of profit before income tax to cash generated from operations:

Group	**2018 Shs'000**	**2017 Shs'000**
Profit before income tax	(537,362)	(611,570)
Adjustments for:		
Depreciation of property and equipment (Note 21)	100,015	126,449
Amortisation of intangible assets (Note 22)	79,259	86,656
Interest on borrowings (Note 27)	40,585	63,939
Revaluation of borrowing (Note 27)	(3,100)	4,700
Interest income on investments securities at amortised cost (Note 18a)	(355,128)	(231,762)
Interest income on investment securities at FVTPL (Note 18b)	(9,312)	
Revaluation of investment securities at FVTPL(Note 18b)	(3,403)	-
Gain on sale of assets	(4)	(611)
IFRS 9 provision of financial assets (Note 20)	53,375	-
Operating profit before changes in operating assets and liabilities	(635,075)	(562,199)
Changes in operating assets and liabilities:		
- Loans and advances to customers	(1,902,248)	2,025,247
- Other assets and prepayments	(87,354)	(189,406)
- Deposits from customers	4,214,083	(1,112,819)
- Balances due to banking institutions	1,144,184	109,768
- Other liabilities and accrued expenses	88,474	(21,851)
Cash generated from operations	2,822,064	248,740
Bank		
Profit before income tax	(562,065)	(632,941)
Adjustments for:		
Depreciation on property and equipment (Note 21)	99,964	126,365
Amortisation of intangible assets (Note 22)	78,659	86,406
Interest on borrowings (Note 27)	40,585	63,939
Revaluation of borrowing (Note 27)	(3,100)	4,700
Interest income on investment securities at amortised cost (Note 18a)	(355,128)	(231,762
Interest income on investment securities at FVTPL (Note 18b)	(9,311)	-
Revaluation of investment securities at FVTPL(Note 18b)	(3,404)	-
Gain on sale of assets	(4)	(611)
IFRS 9 provision of financial assets (Note 20)	53,375	-
Operating profit before changes in operating assets and liabilities	(660,429)	(583,654)
Changes in operating assets and liabilities:		
- Loans and advances to customers	(1,902,248)	2,025,247
- Other assets and prepayments	(85,159)	(195,852)
- Deposits from customers	4,240,689	(924,302)
- Balances due to banking institutions	1,144,184	109,768
- Other liabilities and accrued expenses	73,261	(182,592)
Cash generated from operations	2,810,298	248,365

Notes (continued)

31 b) Analysis of cash and cash equivalents as shown in the cash flow statement:

	Group and Bank 2018 Shs'000	2017 Shs'000
Cash in hand (Note 15)	732,668	659,796
Balance with Central Bank of Kenya	1,407,646	1,961,536
Deposits with other banks (Note 17)	4,049,646	1,220,949
	6,189,959	3,842,281

For purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 91 days maturity from the date of acquisition, including: cash and balances with Central Banks, treasury bills and bonds and amounts due from other banks. Cash and cash equivalents exclude the cash reserve ratio requirement held with the Central Banks.

32 Contingent liabilities

The Bank is a defendant in various legal suits. In the opinion of the Directors, after taking appropriate legal advice, the outcome of such suits are unlikely to result in any significant loss. The legal suits include claims against various issues including claims for general and specific damages and suits challenging the bank's actions on customers' accounts.

	Group and Bank 2018 Shs'000	2017 Shs'000
Pending legal suits	4,009	1,676

33 Off balance sheet items

In the ordinary course of business, the Group conducts business involving letters of credit, performance bonds and guarantees. Letters of guarantee and performance bonds are issued by the Bank, on behalf of customers, to guarantee performance by a customer to third parties. Letters of credit commit the Bank to make payment to third parties, on production of documents, which are subsequently reimbursed by customers. The Bank holds cash collateral to the extent of the guarantee that is realised in the events of default by customers (Note 24).

Even though these obligations are not recognised on the statement of financial position, they contain credit risk and are part of the overall risk of the Bank (Note 4).

	Group and Bank 2018 Shs'000	2017 Shs'000
Letters of credit	1,306,939	549,820
Guarantees	14,528,418	6,067,064
	15,835,357	6,616,884

The provision for expected credit losses on loans and advances includes an amount of Shs 272,655,000 relating to off balance credit facilities.

Notes (continued)

34 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 operation decisions, or one other party controls both.

The Bank's immediate parent company is Bakki Holdco Limited, which is a wholly owned subsidiary of Centum Investment Company Plc, both incorporated in Kenya. There are other companies which are related to the Bank through common shareholdings or common directorships.

The Bank has a wholly owned subsidiary, Sidian Insurance Agency limited that commenced operations in August 2015.

In the normal course of business, a number of banking transactions are entered into with related parties. These are staff, directors, their associates and companies associated with directors. They include loans, deposits and foreign currency transactions.

Included in loans and advances to customers and deposits from customer at 31 December 2018 and 31 December 2017 were the following related party balances:

	Group and Bank	
i) Loans and advances to related parties	**2018**	**2017**
	Shs'000	**Shs'000**
a) Staff loans		
At start of year	432,309	316,733
Advanced during the year	124,048	186,953
Interest charged	70,763	65,681
Repayments	(253,205)	(137,058)
At end of year	373,915	432,309
b) Key management staff		
At start of year	64,116	55,404
Advances during the year	74,200	23,202
Interest charged	8,299	3,116
Repayments	(39,852)	(17,607)
At end of year	106,763	64,116

The loans to key management are personal loans, car loans and mortgages. All the loans are charged at an interest rate of 6%. Personal and car loans have a maximum period of 5 years and are secured by property and cars respectively. Mortgages have a maximum of 25 years.

Notes (continued)

34 Related party transactions (continued)

i) Loans and advances to related parties (continued)

Year ended 31 December 2018

	Group and Bank				
	1 Jan 2018 Shs '000	**Advances Shs '000**	**Interest Shs '000**	**Repayment Shs '000**	**31 December 2018 Shs '000**
KWA Multipurpose Co-operative Society	10,897	-	1,195	(9,270)	2,822
Directors and their associates	38,986	-	5,259	(13,951)	30,294
Kings Beverages Limited	15,966	-	2,033	(9,858)	8,141
	65,849	-	8,487	(33,079)	41,257

Year ended 31 December 2017

	1 Jan 2017 Shs '000	**Advances Shs '000**	**Interest Shs '000**	**Repayment Shs '000**	**31 December 2017 Shs '000**
KWA Multipurpose Co-operative Society	20,990	3,000	3,183	(16,276)	10,897
Directors and their associates	25,530	20,000	6,374	(12,918)	38,986
Kings Beverages Limited	22,710	-	3,179	(9,923)	15,966
Makao Mashinani Limited	9,390	-	1,315	(10,705)	-
	78,620	23,000	14,051	(49,822)	65,849

Loan and advances to staff members are at an average interest rate of 6 percent whereas other advances are at commercial rates. The loans are running for an average period of 12 years (2017: 12 years).

Notes (continued)

34 Related party transactions (continued)

ii) Deposits from related parties

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Ace Nairobi One Limited	113,355	62,805
Almasi Beverages Limited	978,668	973,755
Athena Properties Limited	990	2,081
Centum Investment Company Limited	500,304	447,203
Greenblade Growers Limited	169	2,169
King Beverage Limited	71	164
Kisii Bottlers Limited	322	49,919
K-Rep Development Agency	1,358	2,400
KWA Multipurpose Society	935	943
KWA Multipurpose Limited	61	3,387
Longhorn Publishers Limited	9,078	1,081
Makao Mashinani Limited	2,529	6,257
Mount Kenya Bottlers Limited	528,887	343,288
Nabo Capital Limited	2,807	369
Platinum Credit Limited	-	1,016
Premier Kenya Limited	-	15,444
Rift Valley Bottlers Limited	173	19,326
Rasimu Limited	4	-
Tribus TSG Limited	6,311	-
Two Rivers Development Limited	1,009	555
Two Rivers Lifestyle Centre Limited	341	5,230
Two Rivers Property Owners Company Limited	7,363	120
Two Rivers Theme Park Ltd	2,797	674
Two Rivers Water & Sanitation Company Limited	736	1,517
Uhuru heights Limited	4,270	-
Vipingo Development Limited	92,036	26,629
Zohari Leasing Limited	17,193	771
	2,271,767	1,967,103

Deposits received from related parties attract interest rates at bank's floating interest rates.

iii) Other transactions with related parties

The Group and Company paid rental expenses to related parties as per below

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
K-Rep Group Limited	18,595	17,372
Two Rivers Lifestyle Centre Limited	10,085	-
	28,680	17,372

Notes (continued)

34 Related party transactions (continued)

K-Rep Development Agency, Makao Mashinani and K-Rep Fedha Limited are related to the Bank by virtue of the significant influence and control exercised by their common holding company, K-Rep Group Limited. On the other hand, KWA Multipurpose Co-operative Society and Centum Investment Company Plc are shareholders of the Bank. The rest of the entities disclosed above are Centum affiliated companies.

iii) Key management remuneration

Key management personnel include all the directors and senior management who are referred to as Heads of Department. The remuneration of directors and other members of key management during the year were as follows:

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Short term benefits	134,226	137,845
Post-employment benefits	8,395	5,203
Termination benefits	-	5,808
	142,621	148,855

iv) Directors' remuneration

	2018	2017
As Executive Directors	48,167	39,403
Fees	12,706	9,337
	60,873	48,740

Notes (continued)

35 Future rental commitments under operating leases

Non-cancellable operating lease rentals are payable as follows:

	Group and Bank	
	2018	**2017**
	Shs'000	**Shs'000**
Less than one year	188,846	37,691
Between one and five years	584,254	130,023
More than five years	5,149	88,490
	778,249	256,204

The Group has entered into commercial property leases for its office spaces. These non-cancellable leases have remaining terms of between 3 and 6 years. All leases include a clause to enable upward revision of the rental charge on an annual basis according to prevailing market conditions.

Operating lease rentals

Operating lease rentals disclosed in note 11 relates to amounts paid out for rent for premises.

36 Capital commitments

The Group and Bank had nil capital commitments at 31 December 2018 (2017: Nil).

37 Assets pledged as security

At 31 December 2018, treasury bonds amounting to Shs 256 million were pledged to secure EADB loan of Euro 2 million (approximately Shs 236 million). At 31 December 2017, treasury bonds amounting to Shs 1 billion were pledged to secure a borrowing of Shs 1 billion from the Central Bank of Kenya.

38 Consolidation of subsidiary

Effective 1 January 2018, the Bank started consolidating the financial results of its wholly owned subsidiary, Sidian Insurance Agency Limited. The Agency commenced operations in 2015 with its financial performance becoming significant from 2018 thus the decision to consolidate. The directors believe that consolidated financial statements provide reliable and more relevant information about the effects of transactions, other events or conditions on the Group's financial position, financial performance or cash flows.

In line with this accounting policy change, a statement of financial position at 31 December 2016 has been included in the financial statements.

Previously the results of the subsidiary were consolidated in the accounts of Centum Investments Company Plc (the ultimate parent) and as such, the Bank was not preparing consolidated financial statements.

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