# SBM BANK (KENYA) LIMITED

# ANNUAL REPORT AND FINANCIAL STATEMENTS

# FOR THE YEAR ENDED

# 31 DECEMBER 2018

CONTENTS PAGE

**GROUP DIRECTORS**

| Director's name | Nationality | Position | Date of appointment | Date of resignation | Percentage of individual shareholding in the Bank as at 31 December 2017 | Percentage of individual shareholding in the Bank as at 31 December 2018 | Number of board meetings attended |
|---|---|---|---|---|---|---|---|
| Kee Chong Li Kwong Wing | Mauritian | Non-Executive Director (Chairman) | 10-May-17 | - | - | - | 4 |
| Moezz Mir | Kenyan | Executive Director/Chief Executive Officer | 01-Nov-18 | - | - | - | 1 * |
| Jotham Mutoka | Kenyan | Executive Director/Deputy Chief Executive Officer | 10-Aug-17 | - | - | - | 4 |
| Sharad Rao | Kenyan | Non-Executive Director | 10-May-17 | - | - | - | 4 |
| Azim Currimjee | Mauritian | Non-Executive Director | 10-May-17 | - | - | - | 4 |
| Medha Gunputh | Mauritian | Non-Executive Director | 10-May-17 | - | - | - | 4 |
| James McFie | Kenyan | Non-Executive Director | 10-May-17 | - | - | - | 4 |
| Flora Mutahi | Kenyan | Non-Executive Director | 10-May-17 | - | - | - | 3 |
| Raj Dussoye | Mauritian | Non-Executive Director | 10-May-17 | 03-Aug-18 | - | - | 1 |
| Andrew Bainbridge | British | Non-Executive Director | 06-Feb-19 | - | - | - | 0 ** |
| Nayen Koomar Ballah | Mauritian | Non-Executive Director | 10-May-17 | - | - | - | 0 *** |

* Appointed in the latter part of the year
** Appointed in 2019
*** No meeting attended during the year

**REGISTERED OFFICE AND HEAD OFFICE**

Riverside Mews Building
Riverside Drive
P.O. Box 34886 - 00100
Nairobi, Kenya

**PRINCIPAL SHAREHOLDERS AS AT 31 DECEMBER 2018**

| | | |
|---|---|---|
| SBM Africa Holdings Limited | - | 100% |

**PRINCIPAL OFFICERS AS AT 31 DECEMBER 2018**

| | | |
|---|---|---|
| Moezz Mir | - | Chief Executive Officer |
| Jotham Mutoka | - | Deputy Chief Executive Officer & Chief Business Development Officer |
| Arigala Smiles | - | Chief Operating Officer |
| Andrew Munyao | - | Chief Finance Officer |
| Allan Mwangi | - | Chief Compliance Officer |
| Sreenivasa Rao | - | Treasurer |
| Amos Aketch | - | Head of Credit Administration |
| David Kiarie | - | Head of Internal Audit |
| Gideon Okumu | - | Head of Operations and IT Risk |
| George Odete | - | Head of Legal and Company Secretary |

**BANK SECRETARY**

George Odete
Certified Public Secretary
P.O. Box 34886 -00100
Nairobi, Kenya

**LEGAL ADVISORS**

Anjarwalla & Khanna Advocates
5th Floor, The Oval,
Westlands,
P.O. Box 200-00606
Nairobi, Kenya

**PRINCIPAL VALUERS**

Knight Frank Kenya Limited
Kenya Valuers & Estates Agents Limited
Lloyd Masika Limited
Tysons Limited
Kenya Loss Assessors & Surveyors Limited
Regent Auto Valuers
Ardhiworth (Real Estate) Limited

**PRINCIPAL CORRESPONDENT BANKS**

| | |
|---|---|
| Standard Chartered Bank, London | United Kingdom |
| Standard Chartered Bank, New York | United States of America |
| SBM Bank, India | India |
| Standard Chartered Bank, Frankfurt | Germany |
| Standard Chartered Bank, Tokyo | Japan |
| Standard Bank of South Africa | South Africa |
| SBM Bank ( Mauritius) Limited | Mauritius |
| Development Credit Bank | India |
| Rand Merchant Bank | South Africa |
| Central Bank of Kenya | Kenya |

**AUDITOR**

Ernst & Young LLP
Kenya-Re Towers, Upper-hill
Off Ragati Road
P.O. Box 44286 – 00100,
Nairobi, Kenya

## BRANCH NETWORK

**Head Office**
Riverside Mews Building
Riverside Drive
P.O. Box 34886 - 00100,
Nairobi, Kenya
Email: atyourservice@sbmbank.co.ke

**City Centre Branch**
Jubilee Insurance Exchange Building, Ground Floor
Kaunda Street
P.O. Box 34886, 00100, Nairobi
Email: citycentre@sbmbank.co.ke

**Hurlingham Branch**
Landmark Plaza
Argwings Kodhek
42426-00100, Nairobi
Email: hurlingham@sbmbank.co.ke

**Thika Branch**
Nelleon Plaza
Kenyatta Road
P.O. Box 14087-00800,
Thika
Email: thika@sbmbank.co.ke

**Donholm Branch**
Eastgate Plaza
Outering Road
P.O. Box 78765-00507,
Nairobi
Email: donholm@sbmbank.co.ke

**Kisumu Branch**
Western Emporium 1975
Oginga Odinga Street
P.O. Box 1983-40100,
Kisumu
Email: kisumu@sbmbank.co.ke

**Diamond Plaza Branch**
Diamond Plaza
Masari Road
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Email: diamondplaza@sbmbank.co.ke

**Malindi Branch**
Oasis Mall Plaza
Lamu Road
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Malindi
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**Riverside Branch**
Riverside Mews Building
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Email: riversidemews@sbmbank.co.ke

**Village Market Branch**
Greenhills Investments Limited
Limuru Road
P.O. Box 300-621,Nairobi
Email: villagemarket@sbmbank.co.ke

**Corner House Branch**
Corner House, Ground Floor
Kimathi Street
P.O. Box 34886 - 00100,
Nairobi, Kenya
Email: customercarecornerhouse@sbmbank.co.ke

**Nakuru Branch**
Spikes Centre
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Nakuru
Email:nakuru@sbmbank.co.ke

**Ngara Branch**
Peace Towers
Ngara Road
P.O. Box 14078-00100,
Nairobi
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**Eldoret Branch**
Utamaduni House
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P.O. Box 6007-30100,
Eldoret
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**Windsor, Ridgeways Branch**
Ridgeways Mall
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P.O. Box 45403-00100,
Nairobi
Email: windsor@sbmbank.co.ke

**Upperhill Branch**
KMA Plaza
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Email: upperhill@sbmbank.co.ke

**BRANCH NETWORK (continued)**

**Nyali Branch**
Nyali Centre
Links Road
P.O. Box 34363-80118,
Mombasa
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**Strathmore Branch**
Strathmore Research and Consultancy Centre,
Ole Sengale
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**NOCK, Ngong Road Xpress**
National Oil Service Station
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Nairobi
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**Sameer Park Branch**
Sameer Business Park
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**Rongai Branch**
Masaai Mall, Ongata Rongai
Magadi road
P.O. Box 78780-00507,
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Email: rongai@sbmbank.co.ke

**Mombasa, Old Town Branch**
Opposite Central Police Station
Makadara Road
P.O. Box 87087-00801
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Email: everyoneoldtown@sbmbank.co.ke

**Lunga Lunga Branch**
Lunga Lunga Service Station
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P.O. Box 78730-00507,
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**Madaraka Xpress Branch**
Total Petrol Station Dagoretti
Langata Road
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**Buruburu Branch**
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**Kisii Branch**
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**SBM Elite Branch**
ABC Place
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**Mtwapa Branch**
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**Machakos Branch**
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Machakos
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**River Road Branch**
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P.O. Box 72134-00400,
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**Dagoretti Corner Xpress Branch**
Total Petrol Station Dagoretti
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**Kitale Branch**
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**BRANCH NETWORK (continued)**

**Kimathi Branch**
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**Lavington Branch**
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**Kasuku Xpress Branch**
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**Jomvu Xpress Branch**
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Total Service Station
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**Ngong Branch**
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**Westlands Branch**
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**Kericho Branch**
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**BRANCH NETWORK (continued)**

**Diani Branch**
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**Kilimani, Lenana Rd Branch**
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Email: moiavenue.mombasa@sbmbank.co.ke

**BOARD COMMITTEES**

The board committees as at the date of this report comprise

| Board Audit Committee | Board Credit Committee | Board Risk Management Committee | Remuneration and Nomination Committee | Corporate Governance and Conduct Review Committee |
|---|---|---|---|---|
| **Composition** | | | | |
| The Committee comprises three independent non-executive directors and two non-executive directors. | The Committee comprises three independent non-executive directors and one non-executive director. | The Committee comprises four non-executive directors and one executive director. | The Committee comprises three independent non-executive directors and two non-executive directors. | The Committee comprises three independent non-executive directors and two non-executive directors. |
| **Main function** | | | | |
| The Committee meets to review the external auditor's plans and reports, Group internal audit reports and any proposals/reports that affect the Group's internal control environment and corporate risk management/exposure and compliance. | The Committee reviews and oversees the overall lending position of the Bank, reviews and updates the Bank's credit policy from time to time, considers credit facilities applications, monitors and classifies all loans and advances as recommended by Central Bank of Kenya prudential guidelines and ensures adequate provisions, and ensures effective procedures and resources to identify and manage irregular credits, minimize credit loss and maximize recoveries. | The Committee ensures quality risk management of the Bank that at least encompasses all the risks as specified by the Central Bank of Kenya risk management guidelines. It reviews and assesses the effectiveness of all existing risk and compliance management policies and controls. The Committee also seeks professional advice on technical matters that are of importance in improving the risk management and compliance functions of the Bank. | The Committee is mandated to recruit the Bank's directors, review the structure, size and composition of the Board, identify, nominate and recommend the candidates to fill Board vacancies and ensure effective succession planning for both the Board and Senior Management.<br><br>The Committee is also mandated to recruit all senior staff members of the Bank and set their remuneration package. It rewards and motivates all senior staff members who show exemplary performance in their duties. The Committee oversees job analysis of all senior Bank positions to ensure that they are handled by people that have the relevant skills. | The Committee ensures that there are adequate policies and procedures to comply with the Corporate Governance Code and the Central Bank of Kenya Prudential Guidelines, ensures compliance with the Bank's Code of Ethics and Business Conduct, assesses the non-financial management policies and practices relating to safety, health and environment, equal opportunities and human capital development, and reviews all the Bank's policies and procedures to ensure their continued relevance, fitness for purpose and enforcement. |
| **Frequency of meetings per annum** | | | | |
| 4 | 7 | 4 | 4 | 4 |

**BOARD COMMITTEES (continued)**

| Board Audit Committee | Board Credit Committee | Board Risk Management Committee | Remuneration and Nomination Committee | Corporate Governance and Conduct Review Committee |
|---|---|---|---|---|
| **Chairperson** | | | | |
| James McFie<br>*(Independent non-executive Director)* | Flora Mutahi<br>*(Independent non-executive Director)* | Sharad Rao<br>*(Independent non-executive Director)* | Sharad Rao<br>*(Independent non-executive Director)* | Sharad Rao<br>*(Independent non-executive Director)* |
| **Members** | | | | |
| Flora Mutahi<br>*(Independent non-executive director)* | Sharad Rao<br>*(Independent non-executive director)* | Kee Chong Li Kwong Wing<br>*(Non-executive director)* | Kee Chong Li Kwong Wing<br>*(Non-executive director)* | Azim Currimjee<br>*(Non-executive director)* |
| Sharad Rao<br>*(Independent non-executive director)* | Azim Currimjee<br>*(Non-executive director)* | Nayen Kumar Ballah<br>*(Non-executive director)* | James McFie<br>*(Independent non-executive director)* | James McFie<br>*(Independent non-executive director)* |
| Azim Currimjee<br>*(Non-executive director)* | James McFie<br>*(Independent non-executive director)* | Azim Currimjee<br>*(Non-executive director)* | Flora Mutahi<br>*(Independent non-executive director)* | Flora Mutahi<br>*(Independent non-executive director)* |
| Medha Gunputh<br>*(Non-executive director)* | | Jotham Mutoka<br>*(Executive director)* | Medha Gunputh<br>*(Non-executive director)* | Medha Gunputh<br>*(Non-executive director)* |

Corporate Governance is the process by which companies are directed, controlled and held to account. Although private companies, SBM Bank (Kenya) Limited and its subsidiaries adopt the best practice in Corporate Governance and are committed to continuously improve.

The Bank's board is responsible for development of Corporate Governance practice and ensuring compliance by the Bank and its subsidiaries. It does this through board committees and by having in place business principles and practice, internal control and risk management processes that seek to ensure efficient utilisation of resources and increase in stakeholders' confidence.

The key features of the current Corporate Governance practices are as follows:

Board of Directors

The current Board of Directors consists of two executive directors and eight non-executive directors, three of whom are independent. The directors are chosen for their business knowledge and wide range of skills and experience.

The Board is responsible for setting the direction of the Group by establishing strategic objectives, key policies and approval of the budgets/plans. It meets at least quarterly, on pre-set dates, to review and monitor the implementation of strategies/business plans, review quarterly financial results, approve financial reports and maintain effective control over strategic, financial, operational and compliance issues.

To enable the Board to function effectively, directors are given appropriate and timely information which, in the case of board meetings, consist of comprehensive board papers covering regular business progress reports and discussion papers on specific matters.

Board evaluation

Each year the Board is required by the Central Bank of Kenya to review its mix of skills and experience and other qualities in order to assess its effectiveness in discharging its duties. Due to the acquisition of certain assets and the assumption of specific liabilities of Chase Bank (Kenya) Limited (in receivership) in August 2018, and the resultant transitional processes leading to and after the acquisition, the Board did not undergo an evaluation in 2018. Board evaluation will be carried out in 2019.

Committees of the Board

1. Board Audit Committee
2. Board Credit Committee
3. Board Risk Management Committee
4. Remuneration and Nomination Committee
5. Corporate Governance and Conduct Review Committee

Internal controls

The Board has the ultimate responsibility for monitoring and reviewing the effectiveness of the Group's internal control procedures and continuously improving upon them.

The systems are designed to manage, rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material financial misstatements or loss. The systems are designed to:

- Identify and manage business risks;
- Identify and adopt best business practice;
- Maintain compliance with appropriate legislation;
- Maintain proper accounting records;
- Provide reliable financial information; and
- Safeguard assets.

The Board satisfies itself that the internal control framework is operating effectively through:

- Having terms of reference for the Board and each of its committees;
- A clear organisational structure with documented delegation of authority;
- Defined procedures for the approval of major transactions;
- Establishment and monitoring of the internal control framework by the management; and,
- Review of the internal and external audit reports.

Conflict of interest

The directors are required to act in the best interest of the Group at all times. It is the Group's policy to ensure that directors avoid putting themselves in positions whereby their interests conflict with the Group's interests. Any business transacted with the Group's directors or their companies must be at arm's length.

The Board has adopted a policy, which also applies to management and staff, which ensures that directors, management and staff disclose all possible conflict of interest sources and are required to exclude themselves in decisions where conflict of interest may arise.

Directors' emoluments and loans

The aggregate amount of emoluments paid to directors for services rendered during the year 2018 is disclosed in Notes 12 and 37 to the financial statements.

Neither at the end of the financial year, nor at any time during the year, did there exist any arrangement to which the Group is a party, under which directors acquired benefits by means of acquisition of the Group's shares. Aggregate amount of loans advanced to directors is summarized in Note 37 to the financial statements.

Corporate social responsibility

The Group recognises its social responsibilities to improve the well-being of the society and is committed to being a responsible citizen and believes in giving back to society.

Following the commencement of business in Kenya, the Bank is looking forward to participate in several activities aimed at giving back to the society in the coming days.

The directors submit their annual report together with the audited financial statements for the year ended 31 December 2018, which show the state of affairs of SBM Bank (Kenya) Limited (the "Bank") and its subsidiaries (together the "Group").

1. INCORPORATION

The Group is domiciled in Kenya where it consists of entities incorporated as private companies limited by shares under the Kenyan Companies Act, 2015. The subsidiaries are disclosed in note 20. The address of the registered office is set out on page 2.

2. ACQUISITION OF CERTAIN ASSETS AND ASSUMPTION OF SPECIFIC LIABILITIES OF CHASE BANK (KENYA) LIMITED (IN RECEIVERSHIP)

On 18 August 2018, SBM Bank (Kenya) Limited acquired certain assets and liabilities of Chase Bank (Kenya) Limited (in receivership) through an asset purchase agreement between the Bank, Chase Bank (Kenya) Limited (in Receivership) (CBLIR) and the Central Bank of Kenya.
The acquisition and assumption of assets and liabilities represented a business combination as per IFRS 3 - Business Combination. The disclosures of this transaction are in note 7 to the financial statements.

3. DIRECTORATE

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

4 PRINCIPAL ACTIVITIES OF THE GROUP

The principal activities of the Group are the provision of banking, financial, insurance brokerage and related services. The Bank is licensed under the Kenyan Banking Act, Cap 488 and provides banking, financial and related services.

5. DIVIDENDS

The directors do not recommend the declaration of a dividend for the year (2017: NIL).

6. RESULTS

| | Group | | Bank | |
|---|---|---|---|---|
| | **31 December 2018** | **31 December 2017** | **31 December 2018** | **31 December 2017** |
| | **KShs' 000** | **KShs' 000** | **KShs' 000** | **KShs' 000** |
| Profit/(loss) before tax | 964,054 | (358,060) | 955,731 | (360,627) |
| Tax credit | 360,151 | 27,956 | 360,151 | 29,537 |
| Profit/(loss) for the year | 1,324,205 | (330,104) | 1,315,882 | (331,090) |

7. BUSINESS REVIEW

The Group recorded pre-tax profit of KShs 964 million which was a significant turn-around from the loss before tax of KShs 358 million reported in 2017. The improved performance during the year is largely attributable to the stabilization of the Bank, following the purchase of certain assets and assumption of specific liabilities of CBLIR on 18 August 2018.

On the back of the country's macroeconomic environment, and the successful acquisition of certain assets and liabilities of CBLIR on 18 August 2018, the Group closed the year with total assets of KShs 70.7 billion which increased from KShs 11.5 billion reported in December 2017. The growth in total assets year-on-year, is largely accredited to the take on assets and liabilities of CBLIR.

As at close of the year the Group operated 52 branches spread across the country with customer deposits valued at KShs 51 billion. Net loans and advances closed the year at KShs 12.2 billion holding steady from the balance taken over from CBLIR. The Groups' investment in government securities stood at KShs 43.3 billion as at December 2018, representing 61% of the total assets.
On the income side, the Group reported an after tax profit of KShs 1.3 billion. Total interest income for the year was KShs 2.5 billion, with 60% (KShs 1.5 billion) contributed by interest income from government securities.

The Group delivered total operating income of KShs 4.8 billion with non-funded income contributing 78% (KShs 3.7 billion). Fees and commission income on loans and advances was at KShs 23.4 million with other fees and commissions income earned in the year aggregating to KShs 102.2 million anchored by customer transactions on the Bank's alternative channels which include Mfukoni, Online Banking, Agency Banking, and Card business. Foreign exchange income earned in the year was KShs 178 million driven by trading volumes and revaluation of assets and liabilities held in foreign currency.

The Group's total operating expenses for the year, excluding loan loss provisions, was KShs 2.3 billion to support the business. Workforce costs was KShs 1 billion, administrative costs was KShs 998 million, KShs 268 million relates to depreciation and amortization of assets, and KShs 291 million was incurred on occupancy.

7. BUSINESS REVIEW (continued)

The loan loss provision charge for the year was KShs 1.5 billion signifying a cost of risk of 5.8%. The gross non-performing loans and advances stood at KShs 16.3 billion with total provisions held on the same at KShs 12.9 billion.

The Group's Core Capital stood at KShs 6.9 billion and was compliant with all the Central Bank of Kenya prudential ratios. Core and Total Capital to Total Risk Weighted Assets was 24.3% compared to the CBK minimum requirement of 10.5% and 14.5% respectively. The Bank's liquidity ratio stood at 82.8% against a minimum requirement of 20.0%.

The economic outlook for the country is positive. The IMF has projected Kenya's GDP at 6.1%, in 2019 anchored by;

(i) Decent agriculture production and mild improvements in credit conditions,
(ii) Improvements in private sector activity,
(iii) Investments in some of the productive sectors of the economy to support the Government's Big 4 agenda.

8. STATEMENT AS TO DISCLOSURE TO THE GROUP'S AUDITOR

With respect to each director at the time this report was approved:

(a) there is, so far as the person is aware, no relevant audit information of which the Group's auditor is unaware; and,
(b) the person has taken all the steps that the person ought to have taken as a director so as to be aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

9. TERMS OF APPOINTMENT OF THE AUDITOR

Ernst & Young LLP, who were appointed during the year in accordance with Section 717 of the Kenyan Companies Act, 2015, have expressed their willingness to continue in office in accordance with Section 719 of the Act. The directors monitor the effectiveness, objectivity and independence of the auditor. The directors also approve the annual audit engagement contract which sets out the terms of the auditor's appointment and the related fees. The agreed auditor's remuneration of KShs 9,500,000 has been charged to profit or loss in the year.

By order of the Board

..........................................................................
Company Secretary

6 March ..........................................................................., 2019

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 Bank 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 Bank and its subsidiaries keep proper accounting records that: (a) show and explain the transactions of the Bank and the subsidiaries; (b) disclose, with reasonable accuracy, the financial position of the Bank and the subsidiaries; 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 Bank's and the subsidiaries' ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the Bank's and its subsidiaries' 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 6 March 2019 and signed on its behalf by:

Moezz Mir
Director

James McFie
Director

Building a better working world

Ernst & Young LLP
Certified Public Accountants
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# INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF SBM BANK (KENYA) LIMITED

## REPORT ON THE AUDIT OF THE CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

### *Opinion*

We have audited the accompanying consolidated and separate financial statements of SBM Bank (Kenya) Limited (the "Bank") and its subsidiaries (together, the "Group"), set out on pages 17 to 99, which comprise the consolidated and separate statements of financial position as at 31 December 2018, and the consolidated and separate statements of profit or loss and other comprehensive income, the consolidated and separate statements of changes in equity, and the consolidated and separate statements of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the Group and the Bank as at 31 December 2018, and its consolidated and separate financial performance and its consolidated and separate 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). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code, and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Other Information*

The directors are responsible for the other information. The other information comprises Group information, Corporate Governance and the Report of the Directors as required by the Kenyan Companies Act, 2015. The other information does not include the consolidated and separate financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

### *Responsibilities of the Directors for the* Consolidated and Separate *Financial Statements*

The directors are responsible for the preparation and fair presentation of the consolidated and separate financial statements 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 consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

*Responsibilities of the Directors for the* Consolidated and Separate *Financial Statements (continued)*

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

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

*Auditor's Responsibilities for the Audit of the* Consolidated and Separate *Financial Statements*

Our objectives are to obtain reasonable assurance about whether the consolidated and separate 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 consolidated and separate financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated and separate 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 and the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's and the Bank'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 consolidated and separate 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 and/or the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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.

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REPORT ON OTHER MATTERS PRESCRIBED BY THE KENYAN COMPANIES ACT, 2015

In our opinion, the information given in the report of the directors on pages 11-12 is consistent with the financial statements.

*The engagement partner responsible for the audit resulting in this independent auditor's report is CPA Churchill Atinda - P/No. P. 1425.*

Nairobi, Kenya

12th April 2019

## CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

| FOR THE YEAR ENDED 31 DECEMBER 2018 | Notes | 2018<br>KShs' 000 | 2017<br>KShs' 000 |
|---|---|---|---|
| Interest income | | 2,518,551 | 637,516 |
| Interest expense | | (1,462,570) | (476,835) |
| Net interest income | 8 | 1,055,981 | 160,681 |
| Fee and commission income | | 125,574 | 45,096 |
| Fee and commission expense | | (5,587) | (4,342) |
| Net fee and commission income | 9 | 119,987 | 40,754 |
| Other income | | | |
| Profit arising from dealing in foreign currencies | | 178,004 | 7,638 |
| Bargain purchase gain | 10(c) | 2,790,776 | - |
| Other operating income | 10(a) | 648,608 | 95,240 |
| Dividend income | 10(b) | 174 | 86 |
| | | 3,617,562 | 102,964 |
| Non-interest income | | 3,737,549 | 143,718 |
| Operating income | | 4,793,530 | 304,399 |
| Personnel expenses | 11 | (1,023,647) | (264,233) |
| Other expenses | 12(a) | (998,359) | (331,794) |
| Depreciation on property and equipment | 12(b) | (124,230) | (38,062) |
| Amortisation of intangible assets | 12(b) | (144,242) | (39,186) |
| Other gains/(losses) | 12(c) | 3,265 | - |
| Non-interest expense | | (2,287,213) | (673,275) |
| Profit before credit loss expense | | 2,506,317 | (368,876) |
| Net (increase)/decrease in impairment losses on financial instruments | 13(c) | (1,542,263) | 10,816 |
| Profit / (loss) before income tax | | 964,054 | (358,060) |
| Tax credit | 14(b) | 360,151 | 27,956 |
| Profit / (loss) for the year | | 1,324,205 | (330,104) |
| OTHER COMPREHENSIVE INCOME | | | |
| *Items that may be reclassified to profit or loss in subsequent periods (net of tax):* | | | |
| Net loss on government securities designated at fair value through other comprehensive income | 18 | (14,703) | - |
| *Items that will not be reclassified subsequently to profit or loss (net of tax):* | | | |
| Decrease in revaluation of property | 21 | (62,631) | - |
| Total other comprehensive income | | (77,334) | - |
| Total comprehensive income for the year | | 1,246,871 | (330,104) |
| Earnings per share | | | |
| Basic and diluted earnings | 15 | 0.03 | (0.81) |

## BANK'S STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

### FOR THE YEAR ENDED 31 DECEMBER 2018

| | Notes | 2018 KShs' 000 | 2017 KShs' 000 |
|---|---|---|---|
| Interest income | | 2,518,551 | 637,516 |
| Interest expense | | (1,462,570) | (476,835) |
| Net interest income | 8 | 1,055,981 | 160,681 |
| Fee and commission income | | 113,905 | 45,096 |
| Fee and commission expense | | (5,072) | (4,342) |
| Net fee and commission income | 9 | 108,833 | 40,754 |
| Other income | | | |
| Profit arising from dealing in foreign currencies | | 178,004 | 7,638 |
| Bargain purchase gain | 10(c) | 2,790,776 | - |
| Other operating income | 10(a) | 648,639 | 86,002 |
| Dividend income | 10(b) | 174 | 86 |
| | | 3,617,593 | 93,726 |
| Non-interest income | | 3,726,426 | 134,480 |
| Operating income | | 4,782,407 | 295,161 |
| Personnel expenses | 11 | (1,022,795) | (264,233) |
| Other expenses | 12(a) | (1,010,728) | (325,161) |
| Depreciation on property and equipment | 12(b) | (124,199) | (38,024) |
| Amortisation of intangible assets | 12(b) | (144,242) | (39,186) |
| Other gains/(losses) | 12(c) | 17,551 | - |
| Non-interest expense | | (2,284,413) | (666,604) |
| Profit before credit loss expense | | 2,497,994 | (371,443) |
| Net (increase)/decrease in impairment losses on financial instruments | 13(c) | (1,542,263) | 10,816 |
| Profit / (loss) before income tax | | 955,731 | (360,627) |
| Tax credit | 14(b) | 360,151 | 29,537 |
| Profit / (loss) for the year | | 1,315,882 | (331,090) |
| OTHER COMPREHENSIVE INCOME | | | |
| *Items that may be reclassified to profit or loss in subsequent periods (net of tax):* | | | |
| Net loss on government securities designated at fair value through other comprehensive income | 18 | (14,703) | - |
| *Items that will not be reclassified subsequently to profit or loss (net of tax):* | | | |
| Decrease in revaluation of property | 21 | (60,074) | - |
| Total other comprehensive income | | (74,777) | - |
| Total comprehensive income for the year | | 1,241,105 | (331,090) |
| Earnings per share | | | |
| Basic and diluted earnings | 15 | 0.03 | (0.81) |

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

### AS AT 31 DECEMBER 2018

| | Notes | 2018 | 2017 |
|---|---|---|---|
| | | KShs' 000 | KShs' 000 |
| ASSETS | | | |
| Cash and cash equivalents | 16(a) | 8,137,819 | 1,804,815 |
| Placements with other banking institutions | 16(b) | 3,024,424 | 813,382 |
| Loans and advances to non-bank customers | 17 | 12,206,233 | 4,399,953 |
| Financial assets at fair value through profit and loss | 7(e) | 926,112 | - |
| Government securities | 18 | 43,339,371 | 2,882,958 |
| Investment securities | 19 | 301,677 | 3,573 |
| Tax recoverable | 14(c) | 62,783 | 59,695 |
| Other assets | 25 | 757,922 | 50,710 |
| Property and equipment | 21 | 1,466,332 | 241,541 |
| Intangible assets | 22 | 431,389 | 160,594 |
| Investment property | 23 | - | 440,043 |
| Deferred tax asset | 24 | - | 676,049 |
| Total assets | | 70,654,062 | 11,533,313 |
| LIABILITIES | | | |
| Deposits from banks | 26 | - | 413,329 |
| Customers' deposits | 27 | 51,028,451 | 6,415,126 |
| Other liabilities | 29 | 2,627,485 | 218,122 |
| Due to group companies | 30 | 36,390 | - |
| Amounts due to Central Bank of Kenya | 28 | 9,104,981 | 2,892,626 |
| Financial liabilities at fair value through profit and loss | 7(b) | 926,112 | - |
| Deferred tax liability | 24 | 421 | - |
| Total liabilities | | 63,723,840 | 9,939,203 |
| EQUITY | | | |
| Share capital | 32(a) | 2,165,500 | 2,045,570 |
| Shareholder's contribution pending allotment | 32(b) | - | 618,000 |
| Share premium | 32(c) | 6,701,945 | 1,572,222 |
| Preference share capital | 32(d) | 100,000 | 100,000 |
| Accumulated losses | | (2,022,520) | (2,810,569) |
| Revaluation reserve | 32(e) | - | 62,631 |
| Fair value reserve of financial assets at fair value through comprehensive income | 32(f) | (14,703) | - |
| Statutory credit risk reserve | 32(g) | - | 6,256 |
| Total equity | | 6,930,222 | 1,594,110 |
| Total equity and liabilities | | 70,654,062 | 11,533,313 |

The financial statements were approved by the Board of Directors on 6 March 2019 and signed on its behalf by: -

Moezz Mir
Director

James McFie
Director

**BANK'S STATEMENT OF FINANCIAL POSITION**

| AS AT 31 DECEMBER 2018 | Notes | 2018 | 2017 |
|---|---|---|---|
| | | KShs' 000 | KShs' 000 |
| ASSETS | | | |
| Cash and cash equivalents | 16(a) | 8,137,819 | 1,804,815 |
| Placements with other banking institutions | 16(b) | 3,024,424 | 813,382 |
| Loans and advances to non-bank customers | 17 | 12,209,536 | 4,404,664 |
| Financial assets at fair value through profit and loss | 7(e) | 926,112 | - |
| Government securities | 18 | 43,339,371 | 2,882,958 |
| Investment securities | 19 | 301,626 | 3,491 |
| Tax recoverable | 14(c) | 60,108 | 60,108 |
| Other assets | 25 | 756,751 | 49,153 |
| Investment in subsidiaries | 20 | - | 336,394 |
| Property and equipment | 21 | 1,460,603 | 241,339 |
| Intangible assets | 22 | 431,389 | 160,594 |
| Investment property | 23 | - | 313,148 |
| Deferred tax asset | 24 | - | 675,099 |
| Total assets | | 70,647,739 | 11,745,145 |
| LIABILITIES | | | |
| Deposits from other banking institutions | 26 | - | 413,097 |
| Customers' deposits | 27 | 51,043,920 | 6,429,040 |
| Other liabilities | 29 | 2,627,485 | 215,189 |
| Due to group companies | 30 | 6,335 | 188,032 |
| Amounts due to Central Bank of Kenya | 28 | 9,104,981 | 2,892,626 |
| Financial liabilities at fair value through profit and loss | 7(b) | 926,112 | - |
| Deferred tax liability | 24 | 1,399 | - |
| Total liabilities | | 63,710,232 | 10,137,984 |
| EQUITY | | | |
| Share capital | 32(a) | 2,165,500 | 2,045,570 |
| Shareholder's contribution pending allotment | 32(b) | - | 618,000 |
| Share premium | 32(c) | 6,701,945 | 1,572,222 |
| Preference share capital | 32(d) | 100,000 | 100,000 |
| Accumulated losses | | (2,015,235) | (2,794,961) |
| Revaluation reserve | 32(e) | - | 60,074 |
| Fair value reserve of financial assets at fair value through comprehensive income | 32(f) | (14,703) | - |
| Statutory credit risk reserve | 32(g) | - | 6,256 |
| Total equity | | 6,937,507 | 1,607,161 |
| Total equity and liabilities | | 70,647,739 | 11,745,145 |

The financial statements were approved by the Board of Directors on 6 March 2019 and signed on its behalf by: -

Moezz Mir
Director

James McFie
Director

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

**FOR THE YEAR ENDED 31 DECEMBER 2018**

| | Share capital | Shareholders' contribution pending allotment | Preference share capital | Share premium | Retained earnings | Statutory credit risk reserve | Fair value reserve of financial assets at FVOCI* | Revaluation reserve | Total |
|---|---|---|---|---|---|---|---|---|---|
| | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 |
| | *Note 32(a)* | *Note 32(b)* | *Note 32(d)* | *Note 32(c)* | | *Note 32(g)* | *Note 32(f)* | *Note 32(e)* | |
| As at start of year | 2,045,570 | 618,000 | 100,000 | 1,572,222 | (2,810,569) | 6,256 | - | 62,631 | 1,594,110 |
| Impact of adopting IFRS 9 (note 4) | - | - | - | - | (542,412) | - | - | - | (542,412) |
| Restated opening balance under IFRS 9 | 2,045,570 | 618,000 | 100,000 | 1,572,222 | (3,352,981) | 6,256 | - | 62,631 | 1,051,698 |
| Transfer to share capital [note 32(b)] | 14,116 | (618,000) | - | 603,884 | - | - | - | - | - |
| Issue of share capital [note 32(a)] | 105,814 | - | - | 4,525,839 | - | - | - | - | 4,631,653 |
| Profit for the year | - | - | - | - | 1,324,205 | - | - | - | 1,324,205 |
| Other comprehensive income | - | - | - | - | - | - | (14,703) | (62,631) | (77,334) |
| Total comprehensive income for the year | - | - | - | - | 1,324,205 | - | (14,703) | (62,631) | 1,246,871 |
| Transfer from statutory credit risk reserve | - | - | - | - | 6,256 | (6,256) | - | - | - |
| As at end of year | 2,165,500 | - | 100,000 | 6,701,945 | (2,022,520) | - | (14,703) | - | 6,930,222 |

*FVOCI - Fair value through other comprehensive income

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)**

**FOR THE YEAR ENDED 31 DECEMBER 2017**

| | Share capital | Shareholders' contribution pending allotment | Preference share capital | Share premium | Retained earnings | Statutory credit risk reserve | Revaluation reserve | Total |
|---|---|---|---|---|---|---|---|---|
| | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 |
| | *Note 32(a)* | *Note 32(b)* | *Note 32(d)* | *Note 32(c)* | | *Note 32(g)* | *Note 32(e)* | |
| As at start of year | 1,530,070 | - | 100,000 | 25,722 | (2,583,142) | 108,933 | 62,631 | (755,786) |
| Increase in share capital [note 32(a)] | 515,500 | - | - | 1,546,500 | - | - | - | 2,062,000 |
| Increase in shareholder's contribution pending allotment [note 32(b)] | - | 618,000 | - | - | - | - | - | 618,000 |
| Loss for the year | - | - | - | - | (330,104) | - | - | (330,104) |
| Other comprehensive income | - | - | - | - | - | - | - | - |
| Total comprehensive income for the year | - | - | - | - | (330,104) | - | - | (330,104) |
| Transfer from statutory credit risk reserve | - | - | - | - | 102,677 | (102,677) | - | - |
| As at end of year | 2,045,570 | 618,000 | 100,000 | 1,572,222 | (2,810,569) | 6,256 | 62,631 | 1,594,110 |

**BANK'S STATEMENT OF CHANGES IN EQUITY**

**FOR THE YEAR ENDED 31 DECEMBER 2018**

| | Share capital | Shareholders' contribution pending allotment | Preference share capital | Share premium | Retained earnings | Statutory credit risk reserve | Fair value reserve of financial assets at FVOCI* | Revaluation reserve | Total |
|---|---|---|---|---|---|---|---|---|---|
| | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 |
| | *Note 32(a)* | *Note 32(b)* | *Note 32(d)* | *Note 32(c)* | | *Note 32(g)* | *Note 32(f)* | *Note 32(e)* | |
| As at start of year | 2,045,570 | 618,000 | 100,000 | 1,572,222 | (2,794,961) | 6,256 | - | 60,074 | 1,607,161 |
| Impact of adopting IFRS 9 (note 4) | - | - | - | - | (542,412) | - | - | - | (542,412) |
| Restated opening balance under IFRS 9 | 2,045,570 | 618,000 | 100,000 | 1,572,222 | (3,337,373) | 6,256 | - | 60,074 | 1,064,749 |
| Transfer to share capital [note 32(b)] | 14,116 | (618,000) | - | 603,884 | - | - | - | - | - |
| Issue of share capital [note 32(a)] | 105,814 | - | - | 4,525,839 | - | - | - | - | 4,631,653 |
| Profit for the year | - | - | - | - | 1,315,882 | - | - | - | 1,315,882 |
| Other comprehensive income | - | - | - | - | - | - | (14,703) | (60,074) | (74,777) |
| Total comprehensive income for the year | - | - | - | - | 1,315,882 | - | (14,703) | (60,074) | 1,241,105 |
| Transfer from statutory credit risk reserve | - | - | - | - | 6,256 | (6,256) | - | - | - |
| As at end of year | 2,165,500 | - | 100,000 | 6,701,945 | (2,015,235) | - | (14,703) | - | 6,937,507 |

*FVOCI - Fair value through other comprehensive income

**BANK'S STATEMENT OF CHANGES IN EQUITY (continued)**

**FOR THE YEAR ENDED 31 DECEMBER 2017**

| | Share capital | Shareholders' contribution pending allotment | Preference share capital | Share premium | Accumulated losses | Statutory credit risk reserve | Revaluation reserve | Total |
|---|---|---|---|---|---|---|---|---|
| | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 |
| | *Note 32(a)* | *Note 32(b)* | *Note 32(d)* | *Note 32(c)* | | *Note 32(g)* | *Note 32(e)* | |
| As at start of year | 1,530,070 | - | 100,000 | 25,722 | (2,566,548) | 108,933 | 60,074 | (741,749) |
| Increase in share capital [note 32(a)] | 515,500 | - | - | 1,546,500 | - | - | - | 2,062,000 |
| Increase in shareholder's contribution pending allotment [note 32(b)] | - | 618,000 | - | - | - | - | - | 618,000 |
| Loss for the year | - | - | - | - | (331,090) | - | - | (331,090) |
| Other comprehensive income | - | - | - | - | - | - | - | - |
| Total comprehensive income for the year | - | - | - | - | (331,090) | - | - | (331,090) |
| Transfer from statutory credit risk reserve | - | - | - | - | 102,677 | (102,677) | - | - |
| As at end of year | 2,045,570 | 618,000 | 100,000 | 1,572,222 | (2,794,961) | 6,256 | 60,074 | 1,607,161 |

## CONSOLIDATED STATEMENT OF CASH FLOWS

### FOR THE YEAR ENDED 31 DECEMBER 2018

| | Notes | 2018<br>KShs '000 | 2017<br>KShs '000 |
|---|---|---|---|
| Net cash flows (utilised in)/generated from operating activities | 36(a) | (15,174,631) | 1,436,721 |
| Cash flows from investing activities | | | |
| Cash and cash equivalents from business combination | 7(b) | 17,370,405 | - |
| Dividends from investment securities | 10(b) | 174 | 86 |
| Purchase of property and equipment | 21 | (53,443) | (4,939) |
| Purchase of intangible assets | 22 | (1,110) | - |
| Proceeds from disposal of property and equipment | 21 | - | 7,381 |
| Net cash flows generated from investing activities | | 17,316,026 | 2,528 |
| Cash flows from financing activities | | | |
| Proceeds from issue of share capital | 32(a) | 105,814 | 515,500 |
| Proceeds from shareholders' contribution pending allotment | 32(b) | - | 618,000 |
| Share premium from issue of share capital | 32(c) | 4,525,839 | 1,546,500 |
| Repayment of borrowings secured by government securities | | - | (2,215,000) |
| Receipts from Central Bank of Kenya borrowings | 28 | - | 259,017 |
| Repayment of amounts due to Central Bank of Kenya | 28 | (43,413) | (285,387) |
| Net cash flows generated from financing activities | | 4,588,240 | 438,630 |
| As at the beginning of the year | | 1,896,946 | 19,067 |
| Effect of exchange rate changes on cash and cash equivalents | | 580 | 6,851 |
| Net increase in cash and cash equivalents | | 6,729,055 | 1,871,028 |
| As at the end of the year | 36(b) | 8,626,581 | 1,896,946 |

## BANK'S STATEMENT OF CASH FLOWS

**FOR THE YEAR ENDED 31 DECEMBER 2018**

| | Notes | 2018<br>KShs '000 | 2017<br>KShs '000 |
|---|---|---|---|
| Net cash flows (utilised in)/generated from operating activities | 36(a) | (15,174,863) | 1,436,953 |
| Cash flows from investing activities | | | |
| Cash and cash equivalents from business combination | 7(b) | 17,370,405 | - |
| Dividends from investment securities | 10(b) | 174 | 86 |
| Purchase of property and equipment | 21 | (53,443) | (4,939) |
| Purchase of intangible assets | 22 | (1,110) | - |
| Proceeds from disposal of property and equipment | 21 | - | 7,381 |
| Net cash flows generated from investing activities | | 17,316,026 | 2,528 |
| Cash flows from financing activities | | | |
| Proceeds from issue of share capital | 32(a) | 105,814 | 515,500 |
| Proceeds from shareholders' contribution pending allotment | 32(b) | - | 618,000 |
| Share premium from issue of share capital | 32(c) | 4,525,839 | 1,546,500 |
| Repayment of borrowings secured by government securities | | - | (2,215,000) |
| Receipts from Central Bank of Kenya borrowings | 28 | - | 259,017 |
| Repayment of amounts due to Central Bank of Kenya | 28 | (43,413) | (285,387) |
| Net cash flows generated from financing activities | | 4,588,240 | 438,630 |
| As at the beginning of the year | | 1,897,178 | 19,067 |
| Effect of exchange rate changes on cash and cash equivalents | | 580 | 6,851 |
| Net increase in cash and cash equivalents | | 6,728,823 | 1,871,260 |
| As at the end of the year | 36(b) | 8,626,581 | 1,897,178 |

## 1. REPORTING ENTITY

SBM Bank (Kenya) Limited ("the Bank") is incorporated as a limited company in Kenya under the Kenyan Companies Act, 2015, and is domiciled in Kenya. The Bank is regulated by the Central Bank of Kenya. The address of its registered office is as shown on page 1.

The consolidated financial statements for the year ended 31 December 2018 comprise the Bank and its subsidiaries, Finsure Insurance Brokers Limited, Rover Investment Limited, Richardson Properties Limited and Kentbury Investments Limited (together referred to as the "Group" and individually as the "Bank") which provide banking, financial, insurance brokerage and related services in Kenya.

The Bank operates 52 branches within Kenya including a card division.

## 2. BASIS OF PREPARATION

**(a)** Statement of compliance

The consolidated and separate financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and in the manner required by the Kenyan Companies Act, 2015.

For Kenyan Companies Act, 2015 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.

**(b)** Basis of measurement

The financial statements of the Group have been prepared on the historical cost basis except for investment properties, leasehold land and buildings and financial assets carried at fair value in the statement of financial position.

**(c)** Functional and presentation currency

These consolidated and separate financial statements are presented in Kenya Shillings (KShs), which is the Bank's functional currency.

Items included in the financial statements are measured using the currency of primary economic environment in which the entity operates i.e. Kenya Shillings. Financial information presented in Kenya Shillings has been rounded to the nearest thousand (KShs'000), except as otherwise indicated.

**(d)** Significant accounting judgements and key sources of estimation uncertainty

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions. It also requires directors to exercise judgment in the process of applying the Group's accounting policies. Although these estimates are based on the directors' best knowledge of current events and circumstances, actual results may differ from those estimates. Note 6 below on 'significant accounting judgements, estimates and assumptions' highlights the areas that involve a higher level of judgement, or where the estimates or assumptions used are significant to the financial statements.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (a) Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiaries as at 31 December 2018. Control is achieved by the Group over an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee); and
- Exposure, or rights, to variable returns from its involvement with the investee; and,
- The ability to use its power over the investee to affect its returns

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee including:

- The contractual arrangement(s) with other vote holders of the investee
- Rights from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(a) Basis of consolidation (continued)**

Profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- Derecognises the assets (including goodwill) and liabilities of the subsidiary
- Derecognises the carrying amount of any non-controlling interests
- Derecognises the cumulative translation differences recorded in equity
- Recognises the fair value of the consideration received
- Recognises the fair value of any investment retained
- Recognises any surplus or deficit in profit or loss
- Reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities

**(b) Business combinations, goodwill or bargain purchase gain**

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquirer, if any.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IFRS 9 Financial Instruments, is measured at fair value with the changes in fair value recognised in the statement of profit or loss in accordance with IFRS 9. Other contingent consideration that is not within the scope of IFRS 9 is measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests and any previous interest held over the net identifiable assets acquired and liabilities assumed). If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit (CGU) and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

**(c) Revenue recognition**

Income is derived substantially from banking, insurance brokerage business and renting of property.

Prior to 1 January 2018, the Group recognised revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when the specific criteria have been met for each of the Group's activities. The amount of revenue is not considered to be reliably measured until all contingencies relating to the sale have been resolved. The Group based its estimates on historical results, taking into consideration the type of customer, type of transaction and specifics of each arrangement.

Effective 1 January 2018, revenue from contracts with customers is recognised when control of goods and services are transferred to the customers at an amount that reflects the consideration to which the Group expects to be entitled in exchange for the goods and services. The Group has generally concluded that it is the principal in its revenue arrangements.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (c) Revenue recognition (continued)

(i) Recognition of interest income

*The effective interest rate (EIR) method*

Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost and financial instruments designated at fair value through profit and loss (FVPL). Interest income on interest bearing financial assets measured at fair value through other comprehensive income (FVOCI) under IFRS 9, similarly to interest bearing financial assets classified as available-for-sale or held to maturity under IAS 39 are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The EIR (and therefore, the amortised cost of the asset) is calculated by taking into account any discount or premium on acquisition, fees and costs that are an integral part of the EIR. The Bank recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. Hence, it recognises the effect of potentially different interest rates charged at various stages, and other characteristics of the product life cycle (including prepayments, penalty interest and charges).

If expectations regarding the cash flows on the financial asset are revised for reasons other than credit risk, the adjustment is booked as a positive or negative adjustment to the carrying amount of the asset in the statement of financial position with an increase or reduction in interest income. The adjustment is subsequently amortised through Interest and similar income in the profit or loss.

*Interest and similar income (Effective 1 January 2018)*

The Bank calculates interest income by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets. When a financial asset becomes credit-impaired and is, therefore, regarded as 'Stage 3', the Bank calculates interest income by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Bank reverts to calculating interest income on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Interest income on all trading assets and financial assets mandatorily required to be measured at FVPL is recognised using the contractual interest rate in net trading income and Net gains/(losses) on financial assets at fair value through profit or loss, respectively.

(ii) Fee and commission income

*Prior to 1 January 2018*

Fees and commission income and expense are recognized on an accrual basis when the service has been provided. Commission and fees arising from negotiation of transactions with third parties, or participating in the negotiation of a transaction for a third party is recognized on completion of the underlying transaction. Fees and commission that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income including account servicing fees, investment management fees, sales commission, placement fees and syndication fees, are recognized as the related services are performed. Other fees and commission expense relate mainly to transaction and services fee, which are expensed as the services are received.

*Effective 1 January 2018*

The Bank earns fee and commission income from a diverse range of financial services it provides to its customers. Fee and commission income is recognised at an amount that reflects the consideration to which the Bank expects to be entitled in exchange for providing the services.

The performance obligations, as well as the timing of their satisfaction, are identified, and determined, at the inception of the contract. The Bank's revenue contracts do not typically include multiple performance obligations, as explained further here below.

When the Bank provides a service to its customers, consideration is invoiced and generally due immediately upon satisfaction of a service provided at a point in time or at the end of the contract period for a service provided over time.

The Bank has generally concluded that it is the principal in its revenue arrangements because it typically controls the services before transferring them to the customer.

*(a) Fee and commission income from services where performance obligations are satisfied over time*

Performance obligations satisfied over time are those which the customer simultaneously receives and consumes the benefits provided by the Bank's performance as the Bank performs. These include the following:

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

(ii) Fee and commission income (continued)

*Effective 1 January 2018 (continued)*

*(a) Fee and commission income from services where performance obligations are satisfied over time (continued)*

*Commitment charges and processing fees on loans:*
These are fixed annual fees paid by customers for loan and other credit facilities with the Bank, but where it is unlikely that a specific lending arrangement will be entered into with the customer and the loan commitment is not measured at fair value. The Bank promises to provide a loan facility for a specified period. As the benefit of the services is transferred to the customer evenly over the period of entitlement, the fees are recognised as revenue on a straight-line basis. Payment of the fees is due and received monthly in arrears.

*Interchange fees:*
The Bank provides its customers with debit and credit card processing services (i.e., authorisation and settlement of transactions executed with the Bank's credit cards) where it is entitled to an interchange fee for each transaction (i.e., when a credit cardholder purchases goods and services from merchants using the Bank's credit card). These services represent a single performance obligation comprised of a series of distinct daily services that are substantially the same and have the same pattern of transfer over the contract period. The fees vary based on the number of transactions processed and are structured as either a fixed rate per transaction processed or at a fixed percentage of the underlying cardholder transaction. The variable interchange fees are allocated to each distinct day, based on the number and value of transactions processed that day, and the allocated revenue is recognised as the entity performs.

*(b) Fee and commission income from providing services where performance obligations are satisfied at a point in time*

Services provided where the Bank's performance obligations are satisfied at a point in time are recognised once control of the services is transferred to the customer. This is typically on completion of the underlying transaction or service or, for fees or components of fees that are linked to a certain performance, after fulfilling the corresponding performance criteria. These include fees and commissions arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement/participation or negotiation of the acquisition of shares or other securities, or the purchase or sale of businesses, brokerage and underwriting fees.

*Brokerage fees and commission:*
The Bank buys and sells securities on behalf of its customers and receives a fixed commission for each transaction. The Bank's performance obligation is to execute the trade on behalf of the customer and revenue is recognised once each trade has been executed (i.e., on the trade date). Payment of the commission is typically due on the trade date. The Bank pays certain sales commission to agents for each contract that they obtain for some of its brokerage services. The Bank has elected to apply the optional practical expedient for costs to obtain a contract which allows it to immediately expense such sales commission because the amortisation period of the asset that it otherwise would have used is one year or less.

(iii) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities and includes all realised and unrealised fair value changes, interest and foreign exchange differences.

(iv) Dividends

Dividend income is recognised when the right to receive income is established.

**(d) Foreign currency transactions**

The Group's consolidated financial statements are presented in Kenya Shillings, which is also the Group's functional currency. Transactions in foreign currencies are recognised at the rates of exchange prevailing at the dates of the transactions.
At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates prevailing at that date. Differences arising on settlement or translation of monetary items are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of the gain or loss on the change in fair value of the item (i.e., translation differences on items whose fair value gain or loss is recognised in OCI or profit or loss are also recognised in OCI or profit or loss, respectively).

**(e) Tax**

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

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the end of reporting period. Current tax relating to items recognised outside profit or loss is recognised outside profit or loss. Current tax items are recognised in correlation to the underlying transaction either in profit or loss, other comprehensive income or directly in equity.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (e) Tax (continued)

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences at the end of the reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognised for all taxable temporary differences, except:

(i) where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(ii) in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

(i) where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and,

(ii) in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each end of the reporting period and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

The Group offsets deferred tax assets and deferred tax liabilities if and only if it has a legally enforceable right to set off current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the end of reporting period. Deferred income tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in profit or loss, other comprehensive income or directly in equity.

Value Added Tax

Revenues, expenses and assets are recognised net of the amount of value added tax except where the value added tax incurred on a purchase of assets or services is not recoverable from the Kenya Revenue Authority (KRA), in which case the value added tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and receivables and payables are stated with the amount of value added tax included.

The net amount of value added tax recoverable from, or payable to, tax authorities is included as part of other assets or other payables in the statement of financial position.

### (f) Property and Equipment

Property and equipment is measured at cost or at the revalued amount (as appropriate) net of accumulated depreciation and impairment losses, if any. Cost comprises expenditure initially incurred to bring the asset to its location and condition ready for its intended use and directly attributable to the acquisition of the asset.

Subsequent costs are included in the asset's carrying amount or 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 can be reliably measured. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are recognised in profit or loss during the financial year in which they are incurred.

Depreciation is calculated on a straight-line basis to write down the cost of each asset to its residual value over its estimated useful life using the following annual rates:

| | |
|---|---|
| Buildings | 2.5% |
| Office renovations | 12.5% |
| Computers & software | 25.0% |
| Motor vehicles | 25.0% |
| Furniture and fittings | 12.5% |
| Office equipment | 12.5% |

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (f) Property and Equipment (continued)

Land is depreciated on a straight-line basis over the remainder of the lease term.

Land and buildings are measured at fair value less accumulated depreciation and impairment losses recognised after the date of revaluation. Valuations are performed with sufficient frequency to ensure that the carrying amount of a revalued asset does not differ materially from its fair value. A revaluation surplus is recorded in OCI and credited to the asset revaluation surplus in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in profit or loss, the increase is recognised in profit and loss. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation surplus. The revaluation surplus included in equity is transferred directly to retained earnings when the asset is retired or derecognised.
Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation surplus relating to the particular asset being sold is transferred to retained earnings.

The Group reviews the estimated useful lives, the methods of depreciation and residual values of property and equipment at the end of each reporting period and adjusts them prospectively, if appropriate. During the financial year, no changes to the useful lives and residual values were identified by the directors.

An item of property and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss when the asset is derecognised.

### (g) Investment properties

Investment property is a long-term investment in leasehold land that is not occupied substantially for own use and an office block that is expected to earn rental income once completed and leased out. Investment property is initially recognised at cost and subsequently carried at fair value representing open market value at the reporting date and is determined annually by independent external registered values. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Changes in fair value are recorded in profit or loss.

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

Investment properties are derecognised either when they have been disposed of or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. Gains and losses on disposal of investment properties (calculated as the difference between the net proceeds from disposal and the carrying amount of the asset) are recognised in profit or loss.

### (h) Intangible assets

Computer software

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

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Software is amortised on a straight line basis and the amortisation expenses are recognised in profit or loss over its estimated useful life, from the date it is available for use. The estimated useful life of software for the current and comparative period is 4 years.

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

Derecognition of intangible assets

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal.

Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(i) Financial instruments – initial recognition**

*(i) Date of recognition*

Financial assets and liabilities, with the exception of loans and advances to customers and balances due to customers, are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The Bank recognises balances due to customers when funds are transferred to the Bank.

*(ii) Initial measurement of financial instruments*

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments, as described in notes below. Financial instruments are initially measured at their fair value except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount. Trade receivables are measured at the transaction price. When the fair value of financial instruments at initial recognition differs from the transaction price, the Bank accounts for the Day 1 profit or loss, as described below.

*(iii) Day 1 profit or loss*

When the transaction price of the instrument differs from the fair value at origination and the fair value is based on a valuation technique using only inputs observable in market transactions, the Bank recognises the difference between the transaction price and fair value in net trading income. In those cases where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in profit or loss when the inputs become observable, or when the instrument is derecognised.

**(j) Financial assets and liabilities**

**Measurement categories of financial assets and liabilities**

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost
- FVOCI
- FVPL

The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Before 1 January 2018, the Bank classified its financial assets as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity (amortised cost).

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading and derivative instruments or the fair value designation is applied.

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL.

*(i) Cash and balances including cash held with Central Bank of Kenya, placements with other banking institutions, loans and advancements, government securities, investment securities and other assets measured at amortised cost*

Before 1 January 2018, these were classified as loans and receivables at amortised cost. They included non–derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Bank intended to sell immediately or in the near term
- That the Bank, upon initial recognition, designated as at FVPL or as available-for-sale
- For which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

From 1 January 2018, these are measured at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

The details of these conditions are outlined below

*Business model assessment*

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial assets and liabilities (continued)**

*(i) Cash and balances including cash held with Central Bank of Kenya, placements with other banking institutions, loans and advancements, government securities, investment securities and other assets measured at amortised cost (continued)*

- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

*The SPPI test*

As a second step of its classification process the Bank assesses the contractual terms of financial instruments to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than *de minimis* exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

*(ii) Financial assets or financial liabilities held for trading*

The Bank classifies financial assets or financial liabilities as held for trading when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Held-for-trading assets and liabilities are recorded and measured in the statement of financial position at fair value. Changes in fair value are recognised in net trading income. Interest and dividend income or expense is recorded in net trading income according to the terms of the contract, or when the right to payment has been established.

Included in this classification are debt securities, equities, short positions and customer loans that have been acquired principally for the purpose of selling or repurchasing in the near term.

*(iii) Debt instruments at FVOCI (Policy applicable from 1 January 2018)*

The Bank applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

These instruments largely comprise assets that had previously been classified as financial investments available for-sale under IAS 39.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest income and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. The ECL calculation for Debt instruments at FVOCI is explained in notes below.

Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first–in first–out basis. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

*(iv) Financial assets and financial liabilities at fair value through profit or loss*

Financial assets and financial liabilities in this category are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9. Management only designates an instrument at FVPL upon initial recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis, or
- The liabilities (and assets until 1 January 2018 under IAS 39) are part of a group of financial liabilities (or financial assets, or both under IAS 39), which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, or
- The liabilities (and assets until 1 January 2018 under IAS 39) containing one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial assets and liabilities (continued)**

*(iv) Financial assets and financial liabilities at fair value through profit or loss (continued)*

Financial assets and financial liabilities at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the own credit reserve through OCI and do not get recycled to the profit or loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income or interest expense, respectively, using the EIR, taking into account any discount/ premium and qualifying transaction costs being an integral part of the instrument. Interest earned on assets mandatorily required to be measured at FVPL is recorded using contractual interest rate.

Dividend income from equity instruments measured at FVPL is recorded in profit or loss as other operating income when the right to the payment has been established.

*(v) Financial guarantees, letters of credit and undrawn loan commitments*

The Bank issues financial guarantees, letters of credit and loan commitments. Financial guarantees are initially recognised in the financial statements (within Provisions) at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and – under IAS 39 – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 – an ECL provision. The premium received is recognised in the income statement in Net fees and commission income on a straight-line basis over the life of the guarantee.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the statement of financial position.

The nominal values of these instruments together with the corresponding ECLs are disclosed in Note 33(b).

The Bank occasionally issues loan commitments at below market interest rates drawdown. Such commitments are subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

*(vi) Available-for-sale financial investments (Policy applicable before 1 January 2018)*

Available-for-sale investments include equity and debt securities. Equity investments classified as available-for-sale are those which are neither classified as held for trading nor designated at FVPL. Debt securities in this category are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or in response to changes in market conditions.
After initial measurement, available-for-sale financial investments are subsequently measured at fair value.

The Bank has not designated any loans or receivables as available-for-sale.

Unrealised gains and losses are recognised directly in OCI in the available-for-sale reserve. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in profit or loss, in other operating income. Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first–in first–out basis. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the EIR which takes into account any discount/premium and qualifying transaction costs that are an integral part of the instrument's yield. Dividends earned whilst holding available-for-sale financial investments are recognised in the profit or loss as other operating income when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the profit or loss in 'impairment losses on financial investments' and removed from the revaluation reserve.

*(vii) Financial liabilities measured at amortised costs*

The accounting for these largely remained the same as it was under IAS 39.

These are recognised initially at fair value net of directly attributable transaction costs. After initial recognition, financial liabilities at amortised cost are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in profit or loss.

This category generally applies to deposits from banks (note 26), Customers' deposits (note 27), Other liabilities (note 29), Due to group companies (note 30 ) and amounts due to Central Bank of Kenya (note 28).

*(viii) Identification and measurement of impairment of financial assets*

***Prior to 01 January 2018***

At each reporting date the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset than can be estimated reliably.

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

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial assets and liabilities (continued)**

***(viii) Identification and measurement of impairment of financial assets (continued)***

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would otherwise not consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Group, or economic conditions that correlate with defaults in the Group.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends. Default rate, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows (excluding future credit losses that have not yet been incurred) discounted at the assets' original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest income on an impaired asset or group of assets is recognised using the interest rate used to discount the future cash flows for the purpose of measuring the impairment losses.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

***From 1 January 2018***

The Bank recognises loss allowances for ECLs on all financial assets measured at amortised costs including off balance sheet items of financial guarantee contracts, bills and letters of credit

With the exception of purchased or originated credit-impaired (POCI) assets, ECLs are required to be measured through a loss allowance at an amount equal to:

- 12-month ECL, that is, lifetime ECL that result from those default events on the financial instrument that are possible within 12 months after the reporting date, (referred to as stage 1); or
- full lifetime ECL, that is, lifetime ECL that result from all possible default events over the life of the financial instrument, (referred to as stage 2 and stage 3).

A loss allowance for fulltime ECL is required for a financial instrument if the credit risk on that financial instrument has increased significantly since initial recognition. For all other financial instruments, ECLs are measured at an amount equal to the 12-month ECL. The Bank considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood 'investment grade'.

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);

- financial assets that are credit impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

The Bank measures ECL on a collective basis for portfolios of loans that share similar economic risk characteristics. The measurement of the loss allowance is based on the present value of the asset's expected cash flows using the asset's original EIR, regardless of whether it is measured on an individual basis or a collective basis.

**Credit-impaired financial asset**

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

(a) significant financial difficulty of the issuer or the borrower;
(b) a breach of contract, such as a default or past due event;
(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender would not otherwise consider;

***Prior to 01 January 2018***

Specific allowances are made on impaired advances and are calculated as the shortfall between the carrying amounts of the advances and their recoverable amounts. The recoverable amount is the present value of expected future cash flows discounted at the original effective interest rate of the advance.

***From 01 January 2018***

The adoption of IFRS 9 has fundamentally changed the Bank's loan loss impairment method by replacing IAS 39's incurred loss approach with a forward-looking ECL approach. From 01 January 2018, the Bank has been recording allowance for expected credit losses for all loans and other debt financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts, in this section all referred to as 'financial instruments'. Equity instruments are not subject to impairment under IFRS 9.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial assets and liabilities (continued)**

***(viii) Identification and measurement of impairment of financial assets (continued)***

**Credit-impaired financial asset (continued)**

***From 01 January 2018 (continued)***

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The 12mECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Both LTECLs and 12mECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the above process, the Bank groups its loans into stage 1, stage 2, stage 3 and POCI, as described below:

- Stage 1: When loans are first recognised, the Bank recognises an allowance based on 12mECLs. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from stage 2.
- Stage 2: When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
- Stage 3: Loans considered credit-impaired. The Bank records an allowance for the LTECLs.
- POCI: Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest income is subsequently recognised based on a credit-adjusted EIR. ECLs are only recognised or released to the extent that there is a subsequent change in the expected credit losses.

For financial assets for which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

***The calculation of ECLs***

The Bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

- PD - The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.
- EAD - The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.
- LGD - The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

When estimating the ECLs, the Bank considers three scenarios (a base case, an upside, and a downside). Each of these is associated with different PDs, EADs and LGDs. When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset.

With the exception of credit cards and other revolving facilities, the maximum period for which the credit losses are determined is the contractual life of a financial instrument unless the Bank has the legal right to call it earlier.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

The mechanics of the ECL method are summarised below:

**Stage 1:** The 12mECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Bank calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR. This calculation is made for each of the three scenarios, as explained above.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial assets and liabilities (continued)**

***The calculation of ECLs (continued)***

**Stage 2:** When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.

**Stage 3:** For loans considered credit-impaired, the Bank recognises the lifetime expected credit losses for these loans. The method is similar to that for Stage 2 assets, with the PD set at 100%.

**POCI:** POCI assets are financial assets that are credit impaired on initial recognition. The Bank only recognises the cumulative changes in lifetime ECLs since initial recognition, based on a probability-weighting of the three scenarios, discounted by the credit adjusted EIR.

**Loan commitments and letters of credit:** When estimating LTECLs for undrawn loan commitments, the Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan.

For credit cards and revolving facilities that include both a loan and an undrawn commitment, ECLs are calculated and presented separately with the loan. For loan commitments and letters of credit, the ECL is recognised within Provisions.

**Financial guarantee contracts:** The Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and the ECL provision. For this purpose, the Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs The shortfalls are discounted by the risk-adjusted interest rate relevant to the exposure. The calculation is made using a probability-weighting of the three scenarios. The ECLs related to financial guarantee contracts are recognised within provisions.

***Debt instruments measured at fair value through OCI***

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the assets.

***Purchased or originated credit impaired financial assets (POCI)***

For POCI financial assets, the Bank only recognises the cumulative changes in LTECL since initial recognition in the loss allowance.

***Credit cards and other revolving facilities***

The Bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities with one day's notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behaviour, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Bank's expectations, the period over which the Bank calculates ECLs for these products is one year.

The ongoing assessment of whether a significant increase in credit risk has occurred for revolving facilities is similar to other lending products. This is based on shifts in the customer's internal credit grade, but greater emphasis is also given to qualitative factors such as changes in usage.

The interest rate used to discount the ECLs for credit cards is based on the average effective interest rate that is expected to be charged over the expected period of exposure to the facilities. This estimation takes into account that many facilities are repaid in full each month and are consequently charged no interest.

The calculation of ECLs, including the estimation of the expected period of exposure and discount rate is made on an individual basis for both corporate and retail products.

***Forward looking information***

Incorporation of forward looking information

The Group incorporates forward-looking information in the assessment of significant increase in credit risk and the measurement of ECLs. The Group uses global GDP forecasts to evaluate a range of possible outcomes, the Group formulates three scenarios: a base case, a worse case and a best case.

The base case scenario represents the more likely outcome resulting from the Group's normal financial planning and budgeting process, while the best case and worse case scenarios represent more optimistic or pessimistic outcomes. For each scenario, the Group derives an ECL and applies a probability weighted approach to determine the impairment allowance.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial assets and liabilities (continued)**

***Forward looking information (continued)***

Incorporation of forward looking information (continued)

The Group uses internal information coming from internal economic experts, combined with published external information from government and private economic forecasting services. Both the Risk and Finance management teams approve the forward-looking assumptions before they are applied for different scenarios

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

Limitation of estimation techniques

The models that applied by the Group may not always capture all characteristics of the market at a point in time, as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are made until the base models are updated. Although the Group uses data that is as current as possible, models used to calculate ECLs will be based on data that is one month in arrears and adjustments are made for significant events occurring prior to the reporting date.

***Collateral valuation***

To mitigate its credit risks on financial assets, the Bank seeks to use collateral, where possible. The collateral comes in various forms, such as cash, securities, letters of credit/guarantees and property. The Bank's accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same is it was under IAS 39. Collateral, unless repossessed, is not recorded on the Bank's statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on an annual basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Bank uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as property, is valued based on data provided by third parties such as mortgage brokers, or based on housing price indices.

***Collateral repossessed***

The Bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. The Bank's policy is to determine whether a repossessed asset can be best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of their repossessed value or the carrying value of the original secured asset. Assets for which selling is determined to be a better option are transferred to assets held for sale at their fair value (if financial assets) and fair value less cost to sell for non-financial assets at the repossession date in line with the Bank's policy.

In its normal course of business, the Bank does not physically repossess properties or other assets in its retail portfolio, but engages external agents to recover funds, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers/obligors. As a result of this practice, the properties under legal repossession processes are not recorded on the statement of financial performance.

***Write-offs***

The Bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

***Reclassification of financial assets and liabilities***

From 1 January 2018, the Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank acquires, disposes of, or terminates a business line.

Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets or liabilities in 2018.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial assets and liabilities (continued)**

**Derecognition of financial assets and liabilities**

***Derecognition due to substantial modification of terms and conditions***

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- Change in currency of the loan
- Introduction of an equity feature
- Change in counterparty
- If the modification is such that the instrument would no longer meet the SPPI criterion

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

***Derecognition other than for substantial modification***

*Financial Assets*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when the rights to receive cash flows from the financial asset have expired. The Bank also derecognises the financial asset if it has both transferred the financial asset and the transfer qualifies for derecognition.

The Bank has transferred the financial asset if, and only if, either:

- The Bank has transferred its contractual rights to receive cash flows from the financial asset, or
- It retains the rights to the cash flows, but has assumed an obligation to pay the received cash flows i n full without material delay to a third party under a 'pass–through' arrangement

Pass-through arrangements are transactions whereby the Bank retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), when all of the following three conditions are met:

- The Bank has no obligation to pay amounts to the eventual recipients unless it has collected equivalent amounts from the original asset, excluding short-term advances with the right to full recovery of the amount lent plus accrued interest at market rates
- The Bank cannot sell or pledge the original asset other than as security to the eventual recipients
- The Bank has to remit any cash flows it collects on behalf of the eventual recipients without material delay.

In addition, the Bank is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents including interest earned, during the period between the collection date and the date of required remittance to the eventual recipients.

A transfer only qualifies for derecognition if either:

- The Bank has transferred substantially all the risks and rewards of the asset, or
- The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

The Bank considers control to be transferred if and only if, the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer.

When the Bank has neither transferred nor retained substantially all the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Bank's continuing involvement, in which case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration the Bank could be required to pay.

If continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the continuing involvement is measured at the value the Bank would be required to pay upon repurchase. In the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

*Financial Liabilities*

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

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Offsetting of financial assets and financial liabilities**

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a currently enforceable legal right to set off recognised amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

**Fair value of financial assets and financial liabilities**

Fair value of financial assets and financial liabilities 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. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability

**(k) Impairment of non-financial assets**

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs of disposal and its value in use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

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 cost of disposal, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

Impairment losses are recognised in profit or loss in expense category (other gains/losses) consistent with the function of impaired asset, except for properties previously valued with the valuation taken to other comprehensive income. For such properties, the impairment is recognised in other comprehensive income up to the amount of any previous revaluation.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, or exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

**(l) Employee benefits**

(i) Defined contribution plans

The Group operates a defined contribution pension scheme for its employees, the assets of which are held in a separate trustee administered guaranteed scheme managed by an insurance company.

The pension plan is funded by contributions from the employees and the Group. The Group's contributions are charged to profit or loss in the year to which they relate. The Group has no further payment obligations once the contributions have been paid.

The Group and its employees contribute to the National Social Security Fund (NSSF), a statutory defined contribution scheme registered under the NSSF Act. The Group's contributions to the defined contribution schemes are charged to profit or loss in the year to which they relate.

(ii) Leave accrual

The monetary value of the unutilised leave by staff as at year end is carried in accruals as a payable and the movement in the year debited/credited to the profit or loss.

(iii) Short-term benefits

Short-term benefits consist of salaries, bonuses and any non-monetary benefits such as medical aid contributions and free services. They exclude equity based benefits and termination benefits. Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided;

(a) as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.
(b) as an expense, unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset.

**(n) Cash and cash equivalents**

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash in hand, balances due from and due to other banking institutions, balances with Central Bank of Kenya (excluding cash reserve ratio) and government securities maturing within 91 days from the date of acquisition. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (o) Leases

Determination
The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Group as a lessee

Leases which do not transfer to the Group substantially all the risk and benefits incidental to ownership of the leased items are operating leases. Operating lease payments are recognised as an expense in profit or loss on a straight line basis over the lease term. Contingent rental payable are recognised as expenses in the period in which they are incurred.

Lease incentives received are recognised as an integral part of the total lease expense, over the term 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.

Payments to acquire leasehold interests in land are treated as prepaid operating lease rentals and amortised over the period of the lease and recognised in profit or loss under operating expenses.

Group as a lessor

Leases where the Group does not transfer substantially all of the risk and benefits of ownership of the asset are classified as operating leases. Rental income is recorded as earned based on the contractual terms of the lease in other operating income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

As at 31 December 2018, the Group had no contingent rent.

### (p) Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are accounted for as off statement of financial position's transactions and disclosed as contingent liabilities. Estimates of the outcome and of the financial effect of contingent liabilities is made by the management based on the information available up to the date the financial statements are approved for issue by the directors. Any expected loss is charged to profit or loss.

### (q) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to a provision is recognised in profit or loss net of any reimbursement.

### (r) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instrument.

### (s) Fiduciary assets

When the Group acts in a fiduciary capacity such as nominee or agent, assets and income arising thereon with related undertakings to return such assets to customers are excluded from these financial statements. As at 31 December 2018, the Group did not earn any income from the fiduciary assets.

### (t) Earnings per share

Basic earnings per share are calculated by dividing the profit attributable to shareholders by the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share are computed using the weighted average number of equity shares and dilutive potential ordinary shares outstanding during the year. During the year there were no outstanding shares with dilutive potential.

### (u) Dividends

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

### (v) 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.
The Group's fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible by the Group.
The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(v) Fair value (continued)**

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. External valuers are involved for valuation of significant assets, such as properties.

**(w) Changes in accounting policies and disclosures**

**New and amended standards and interpretations**

The Group applied for the first time the following standards and amendments, which are effective for annual periods beginning on or after 1 January 2018.

- IFRS 9 Financial Instruments
- IFRS 15 Revenue from Contracts with Customers
- IFRS 2 Classification and Measurement of Share- based Payment Transactions - Amendments to IFRS 2
- Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts - Amendments to IFRS 4
- Transfers of Investment Property - Amendments to IAS 40
- IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration
- AIP IFRS 1 First-time Adoption of International Financial Reporting Standards - Deletion of short-term exemptions for first-time adopters
- AIP IAS 28 Investments in Associates and Joint Ventures - Clarification that measuring investees at fair value through profit or loss is an investment - by - investment choice

The nature and the effect of the new standards, amendments and interpretations which are relevant to the Group are described below:

***IFRS 9 Financial Instruments***

IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The Group elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39.

The Group has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed in note 4 to the financial statements.

i) Changes to classification and measurement

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:

- Debt instruments at amortised cost
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition
- Financial assets FVPL

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements are presented in OCI with no subsequent reclassification to profit or loss.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(w) Changes in accounting policies and disclosures (continued)**

***IFRS 9 Financial Instruments (continued)***

i) Changes to classification and measurement (continued)

The Group's classification of its financial assets and liabilities is explained in Notes 3 (j) The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 4.

ii) Changes to the impairment calculation

The adoption of IFRS 9 has fundamentally changed the Group's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Group to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

Details of the Group's impairment method are disclosed in Note 3 (j). The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 4.

iii) IFRS 7R

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the Group has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 4. Reconciliations from opening to closing ECL allowances are presented in notes 4 and 17.

In summary, the impact of IFRS 9 adoption has had marginal impact to the Group since most facilities were already more than 50% provided for.

***IFRS 15 Revenue from contracts with customers***

This standard replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers and SIC-31 Revenue – Barter of Transactions Involving Advertising Services.

The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The standard specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures.
The standard provides a single, principles based five-step model to be applied to all contracts with customers in recognising revenue being:

- identify the contract(s) with a customer;
- identify the performance obligations in the contract;
- determine the transaction price;
- allocate the transaction price to the performance obligations in the contract;
- recognise revenue when (or as) the entity satisfies a performance obligation

***Transfers of Investment Property - Amendments to IAS 40***

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date.

Retrospective application in accordance with IAS 8 is only permitted if it is possible without the use of hindsight. Effective for annual periods beginning on or after 1 January 2018. The Group had a change in use in its investment property as disclosed in note 23.

***IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration***

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the transaction date for each payment or receipt of advance consideration. Entities may apply the amendments on a fully retrospective basis. Alternatively, an entity may apply the Interpretation prospectively to all assets, expenses and income in its scope that are initially recognised on or after:

- The beginning of the reporting period in which the entity first applies the interpretation; or
- The beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**New and amended standards and interpretations (continued)**

***IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration (continued)***

The Interpretation is effective for annual periods beginning on or after 1 January 2018. Early application of interpretation is permitted and must be disclosed. However, since the Group's current practice is in line with the Interpretation, the Group does not expect any effect on its financial statements.

**Standards, improvements and amendments issued but not yet effective**

The following standards have been issued and are effective for annual periods beginning on or after 1 January 2019. The Group has not opted for their early adoption.

- IFRS 16 Leases
- IFRS 17 Insurance Contracts
- IFRIC Interpretation 23 Uncertainty over Income Tax Treatments
- Prepayment Features with Negative Compensation - Amendments to IFRS 9
- Long-term Interests in Associates and Joint Ventures - Amendments to IAS 28
- Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2
- AIP IFRS 3 Business Combinations - Previously held Interests in a joint operation
- AIP IFRS 11 Joint Arrangements - Previously held Interests in a joint operation
- AIP IAS 12 Income Taxes - Income tax consequences of payments on financial instruments classified as equity
- AIP IAS 23 Borrowing Costs - Borrowing costs eligible for capitalisation

***IFRS 16: Leases***

On 13 January 2016 the IASB issued IFRS 16 Leases, completing the IASB's project to improve the financial reporting of leases. IFRS 16 replaces the previous leases standard, IAS 17 Leases, and related interpretations.

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The standard defines a lease as a contract that conveys to the customer ('lessee') the right to use an asset for a period of time in exchange for consideration.

The Group assesses whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time.

The standard eliminates the classification of leases as either operating leases or finance leases for a lessee and introduces a single lessee accounting model. All leases are treated in a similar way to finance leases. Applying that model significantly affects the accounting and presentation of leases and consequently, the lessee is required to recognise:

(a) Assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. The Group recognises the present value of the unavoidable lease payments and shows them either as lease assets (right-of-use assets) or together with property, plant and equipment. If lease payments are made over time, the Group also recognises a financial liability representing its obligation to make future lease payments.
(b) depreciation of lease assets and interest on lease liabilities in profit or loss over the lease term; and
(c) separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (typically presented within either operating or financing activities) in the statement of cash flows

IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. However, compared to IAS 17, IFRS 16 requires a lessor to disclose additional information about how it manages the risks related to its residual interest in assets subject to leases.

The standard does not require the Group to recognise assets and liabilities for:

(a) short-term leases (i.e. leases of 12 months or less) and;

(b) leases of low-value assets

The new Standard is effective for annual periods beginning on or after 1 January 2019. Early application is permitted insofar as the recently issued revenue Standard, IFRS 15 Revenue from Contracts with Customers is also applied.

The adoption of these changes will affect the amounts and disclosures of the Group's financial statements. The Group has performed an impact assessment of IFRS 16 adoption and is expected to be as follows:

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Standards, improvements and amendments issued but not yet effective (continued)**

***IFRS 16: Leases (continued)***

**Impact on the statement of financial position [increase/(decrease)] as at 31 December 2018**

| | **KShs '000** |
|---|---|
| *Assets* | |
| Right-of-use assets | 587,773 |
| *Liabilities* | |
| Lease liabilities | (587,773) |
| **Net impact on equity** | **-** |

| | **KShs '000** |
|---|---|
| **Impact on the statement of profit or loss** | |
| Increase in interest expense | 56,029 |
| Increase in depreciation expense | 252,623 |
| Operating lease expense | (308,652) |
| **Net impact on profit or loss** | **-** |

**NOTES (continued)**

## 4 TRANSITION DISCLOSURES

The following pages set out the impact of adopting IFRS 9 on the statement of financial position and retained earning including the effect of replacing IAS 39's incurred loss calculations with IFRS 9 expected credit losses.

Reconciliation of impairment allowance balance between IAS 39 and IFRS 9:
This table reconciles the prior period's closing impairment allowance measured in accordance with IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected credit loss model as of 01 January 2018.

Summary of impact on measurement of financial assets and liabilities as at 1 January 2018.

| The only impact on measurement was on loans and advances to non-bank customers as shown below. | Loan loss allowance under IAS 39 | Reclassification | Remeasurement | Loan loss allowance under IFRS 9 |
|---|---|---|---|---|
| Loans and advances to non-bank customers | 2,325,359 | - | 542,412 | 2,867,771 |

**The impact of transition to IFRS 9 retained earnings is as follows:**

| | Retained earnings | |
|---|---|---|
| | **Group KShs' 000** | **Bank KShs' 000** |
| **Retained earnings** | | |
| Closing balance under IAS 39 (31 December 2017) | (2,810,569) | (2,794,961) |
| Reclassification adjustments in relation to adopting IFRS 9 | (542,412) | (542,412) |
| ***Opening balance under IFRS 9 (01 January 2018)*** | (3,352,981) | (3,337,373) |

**NOTES**

## 4 TRANSITION DISCLOSURES

The table below sets out the impact of adopting IFRS 9 on the statement of financial position, and retained earnings including the effect of replacing IAS 39's incurred credit loss calculations with IFRS 9's ECLs for the Group.

**GROUP (KShs'000)**

| | IAS 39 Measurement | | Re- | Remeasurement | | IFRS 9 | |
|---|---|---|---|---|---|---|---|
| | Category | Amount | Classification | ECL | Other | Amount | Category |
| **Financial assets** | | | | | | | |
| Cash and balances with central banks | Loans and receivables | 1,804,815 | - | - | - | 1,804,815 | Amortised cost |
| Due from banks | Loans and receivables | 813,382 | - | - | - | 813,382 | Amortised cost |
| Loans and advances to customers | Loans and receivables | 4,399,953 | - | 542,412 | - | 4,942,365 | Amortised cost |
| Other assets | Loans and receivables | 12,512 | - | - | - | 12,512 | Amortised cost |
| Government securities (debt instruments at amortised cost) | Loans and receivables | 2,882,958 | - | - | - | 2,882,958 | Amortised cost |
| | | 9,913,620 | - | 542,412 | - | 10,456,032 | Amortised cost |
| Investment securities [financial assets at fair value through profit or loss (designated)] | Financial assets at fair value through profit or loss (designated) | 3,573 | - | - | - | 3,573 | Financial assets at fair value through profit or loss (designated) |
| | | 9,917,193 | - | 542,412 | - | 10,459,605 | |
| **Financial liabilities** | | | | | | | |
| Deposits from banks | Amortised cost | 413,329 | - | - | - | 413,329 | Amortised cost |
| Customers' deposits | Amortised cost | 6,415,126 | - | - | - | 6,415,126 | Amortised cost |
| Amounts due to Central Bank of Kenya | Amortised cost | 2,892,626 | - | - | - | 2,892,626 | Amortised cost |
| Other liabilities | Amortised cost | 180,255 | - | - | - | 180,255 | Amortised cost |
| | | 9,901,336 | - | - | - | 9,901,336 | |
| Off balance Sheet | Off balance Sheet | 490,046 | - | - | - | 490,046 | |

**NOTES (continued)**

**4 TRANSITION DISCLOSURES (continued)**

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as of 01 January 2018 is, as follows:

**Bank (KShs'000)**

| | IAS 39 Measurement | | Re- | Remeasurement | | IFRS 9 | |
|---|---|---|---|---|---|---|---|
| | Category | Amount | Classification | ECL | Other | Amount | Category |
| **Financial assets** | | | | | | | |
| Cash and balances with central banks | Loans and receivables | 1,804,815 | - | - | - | 1,804,815 | Amortised cost |
| Due from banks | Loans and receivables | 813,382 | - | - | - | 813,382 | Amortised cost |
| Loans and advances to customers | Loans and receivables | 4,404,664 | - | 542,412 | - | 4,947,076 | Amortised cost |
| Other assets | Loans and receivables | 10,956 | - | - | - | 10,956 | Amortised cost |
| Government securities (debt instruments at amortised cost) | Loans and receivables | 2,882,958 | - | - | - | 2,882,958 | Amortised cost |
| | | 9,916,775 | - | 542,412 | - | 10,459,187 | Amortised cost |
| Investment securities [financial assets at fair value through profit or loss (designated)] | Financial assets at fair value through profit or loss (designated) | 3,491 | - | - | - | 3,491 | Financial assets at fair value through profit or loss (designated) |
| | | 9,920,266 | - | 542,412 | - | 10,462,678 | |
| **Financial liabilities** | | | | | | | |
| Deposits from banks | Amortised cost | 413,097 | - | - | - | 413,097 | Amortised cost |
| Customers' deposits | Amortised cost | 6,429,040 | - | - | - | 6,429,040 | Amortised cost |
| Amounts due to Central Bank of Kenya | Amortised cost | 2,892,626 | - | - | - | 2,892,626 | Amortised cost |
| Other liabilities | Amortised cost | 180,255 | - | - | - | 180,255 | Amortised cost |
| Amounts due to group companies | Amortised cost | 188,032 | - | - | - | 188,032 | Amortised cost |
| | | 10,103,050 | - | - | - | 10,103,050 | |
| Off balance Sheet | Off balance sheet | 490,046 | - | - | - | 490,046 | |

## 5. FINANCIAL RISK MANAGEMENT

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

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

Risk management is carried out by the Group's treasury and credit department under policies approved by the Board of Directors. The Group's treasury and credit departments identify, evaluate and mitigate financial risks in close co-operation with various other departmental heads.

The Board provides written principles for overall risk management, as well as written policies covering specific areas such as credit risk, market risk, liquidity risk and operational risk.

The most important types of risks are credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, interest rate risk and price risk.

### (a) Credit Risk

Credit risk is the risk that the Bank will incur a loss because its customers or counterparties fail to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

Credit risk is monitored by the credit risk department of the Bank's independent Risk Controlling Unit. It is their responsibility to review and manage credit risk, including environmental and social risk for all types of counterparties. Credit risk consists of line credit risk managers who are responsible for their business lines and manage specific portfolios and experts who support both the line credit risk manager, as well as the business with tools like credit risk systems, policies, models and reporting.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process aims to allow the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective actions.

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

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

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

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

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

*Impairment and provisioning policies (Policy applicable from 1 January 2018)*

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Bank considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default
- The borrower requesting emergency funding from the Bank
- The borrower having past due liabilities to public creditors or employees
- The borrower is deceased
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral
- A material decrease in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Bank
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection
- Debtor's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(a) Credit Risk (continued)**

*Impairment and provisioning policies (Policy applicable from 1 January 2018) (continued)*

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

*Internal rating and PD estimation process*

The Bank's independent Credit Risk Department operates its internal rating models. The Bank runs separate models for its key portfolios in which its customers are rate from 1 to 5 using internal grades. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. Where practical, they also build on information from rating agencies. These information sources are first used to determine the PDs within the Bank's Basel III framework. The internal credit grades are assigned based on these Based III grades. PDs are then adjusted for IFRS 9 ECL calculations to incorporate forward looking information and the IFRS 9 Stage classification of the exposure. This is repeated for each economic scenarios as appropriate.

<u>Treasury, trading and interbank relationships</u>
The Bank's treasury, trading and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank's credit risk department analyses publicly available information such as financial information and other external data and assigns the internal rating.

<u>Corporate and small business lending</u>
For corporate and investment banking loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

<u>Consumer lending and retail mortgages</u>
Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing
- Retail mortgages: GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing

The 5 internal risk grades adopted by the Bank are as below:

Grade 1 - Normal risk
Grade 2 - Watch risk
Grade 3 - Substandard risk
Grade 4 - Doubtful risk
Grade 5 - Loss

For purposes of matching the Bank's internal risk grading and IFRS 9, Grade 1 loans can be equated to Stage 1, Grade 2 to Stage 2 and Grades 3, 4 and 5 to Stage 3.

The Group manages, limits and controls concentrations of credit risk wherever they are identified. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subjected to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product and industry sector are approved as and when required by the credit committee.

*Exposure at default (LGD)*

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. However, if a Stage 1 loan that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(a) Credit Risk (continued)**

*Loss given default*

For corporate and investment banking financial instruments, LGD values are assessed by account managers and reviewed and approved by the Bank’s specialised credit risk department. The credit risk assessment is based on a standardised LGD assessment framework borrowed from the Basel III framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics.

Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group. The Bank estimates regulatory and IFRS 9 LGDs on a different basis. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI IFRS 9 segment of each asset class for each economic scenario as appropriate.

*Significant increase in credit risk*

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list. In certain cases, the Bank may also consider that events explained above under Impairment and provisioning policies are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

The Bank calculates its ECL's on an individual basis as per its internal models.

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(a) Credit risk (continued)**

The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements is as follows:

**Group**
**At 31 December 2018**

| | Up to 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 months KShs '000 | 1 – 5 years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash balances with Central Bank of Kenya and other banks | 3,268,334 | 2,535,662 | - | - | - | 5,803,996 |
| Government securities | 3,186,550 | 4,935,230 | 19,030,592 | 8,083,901 | 8,103,098 | 43,339,371 |
| Investment securities | - | - | 299,513 | - | - | 299,513 |
| Placements with other banking institutions | 2,080,139 | 944,285 | - | - | - | 3,024,424 |
| Other assets | 437,599 | - | - | - | - | 437,599 |
| Off statement of financial position* | 838,856 | 1,893,760 | 1,177,967 | 500 | 19,640 | 3,930,723 |
| Loans and advances to non-bank customers | 2,063,448 | 125,191 | 723,984 | 4,216,040 | 5,077,570 | 12,206,233 |
| Financial assets at fair value through profit and loss | 926,112 | - | - | - | - | 926,112 |
| | 12,801,038 | 10,434,128 | 21,232,056 | 12,300,441 | 13,200,308 | 69,967,971 |

* These include letters of credit, guarantees, forwards, swaps, options and funds held on behalf of customers for purchase of securities

**Bank**
**At 31 December 2018**

| | Up to 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 months KShs '000 | 1 – 5 years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash balances with Central Bank of Kenya and other banks | 3,268,334 | 2,535,662 | - | - | - | 5,803,996 |
| Government securities | 3,186,550 | 4,935,230 | 19,030,592 | 8,083,901 | 8,103,098 | 43,339,371 |
| Investment securities | - | - | 299,513 | - | - | 299,513 |
| Placements with other banking institutions | 2,080,139 | 944,285 | - | - | - | 3,024,424 |
| Other assets | 436,428 | - | - | - | - | 436,428 |
| Off statement of financial position* | 838,856 | 1,893,760 | 1,177,967 | 500 | 19,640 | 3,930,723 |
| Loans and advances to non-bank customers | 2,066,751 | 125,191 | 723,984 | 4,216,040 | 5,077,570 | 12,209,536 |
| Financial assets at fair value through profit and loss | 926,112 | - | - | - | - | 926,112 |
| | 12,803,170 | 10,434,128 | 21,232,056 | 12,300,441 | 13,200,308 | 69,970,103 |

* These include letters of credit, guarantees, forwards, swaps, options and funds held on behalf of customers for purchase of securities

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(a)** Credit risk (continued)

The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements is as follows:

**Group**
**At 31 December 2017**

| | Up to 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 months KShs '000 | 1 – 5 years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash balances with Central Bank of Kenya and other banks | 1,686,222 | - | - | - | - | 1,686,222 |
| Government securities | - | - | 192,223 | 331,426 | 2,359,309 | 2,882,958 |
| Placements with other banking institutions | 813,382 | - | - | - | - | 813,382 |
| Other assets | - | 10,956 | 1,557 | - | - | 12,513 |
| Off statement of financial position* | 33,017 | 27,981 | 424,064 | 4,984 | - | 490,046 |
| Loans and advances to non-bank customers | 1,483,583 | 114,894 | 958,325 | 930,721 | 912,430 | 4,399,953 |
| | 4,016,204 | 153,831 | 1,576,169 | 1,267,131 | 3,271,739 | 10,285,074 |

* These include letters of credit, guarantee and funds held on behalf of customers for purchase of securities

**Bank**
**At 31 December 2017**

| | Up to 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 months KShs '000 | 1 – 5 years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash balances with Central Bank of Kenya and other banks | 1,686,222 | - | - | - | - | 1,686,222 |
| Government securities | - | - | 192,223 | 331,426 | 2,359,309 | 2,882,958 |
| Placements with other banking institutions | 813,382 | - | - | - | - | 813,382 |
| Other assets | - | 10,956 | - | - | - | 10,956 |
| Off statement of financial position* | 33,017 | 27,981 | 424,064 | 4,984 | - | 490,046 |
| Loans and advances to non-bank customers | 1,488,294 | 114,894 | 958,325 | 930,721 | 912,430 | 4,404,664 |
| | 4,020,915 | 153,831 | 1,574,612 | 1,267,131 | 3,271,739 | 10,288,228 |

* These include letters of credit, guarantee and funds held on behalf of customers for purchase of securities

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(b)** Market Risk

Market risk is the risk that changes in the market prices, which include currency exchange rates, interest rates and bid prices, will affect the fair value or future cash flows of financial instruments.

Market risk arises from open positions in interest rates and foreign currencies, both of which are exposed to general and specific market movements and changes in the level of volatility. The objectives of market risk management is to manage and control market risk exposures within acceptable limits, while optimising on the return on risk. Overall management of market risk rests with the Assets and Liability Committee (ALCO).

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

Market risks arise mainly from trading and non-trading activities.

Trading portfolios include those positions arising from market-making transactions where the Group acts as a principal with clients or with the market.

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

**ALCO review**

ALCO meets on a monthly basis to review the following:

- A summary of the Group's aggregate exposure on market risk.
- A summary of the Group's maturity/repricing gaps.
- A report indicating that the Group is in compliance with the board's set exposure limits.
- A comparison of past forecast or risk estimates with actual results to identify any shortcomings.

**Review by treasury department**

The treasury department monitors foreign exchange risk in close collaboration with the Board of Directors.

- Net overnight positions by currency.
- Maturity distribution by currency of the assets and liabilities for both on and off statement of financial position items.
- Exception reports for example limits or line excesses.

(i) Currency risk

The Group operates wholly within Kenya and its assets and liabilities are reported in the local currency. It conducts trade with correspondent banks and takes deposits and lends in other currencies. The Bank's currency position and exposure are managed within the exposure guideline of 10% of the core capital as stipulated by the Central Bank of Kenya. This position is reviewed on a daily basis by the management. The significant currency positions are as detailed out below:

| **At 31 December 2018** | | | **GROUP AND BANK** | | |
|---|---|---|---|---|---|
| | **US $** | **GB £** | **Euros** | **Others** | **Total** |
| | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** |
| Financial assets | | | | | |
| Cash in hand | 158,345 | 102,622 | 1,042,882 | 25,016 | 1,328,865 |
| Balances with Central Bank of Kenya | 225,885 | 59,145 | 55,249 | 545 | 340,824 |
| Placements with other banking institutions | 2,134,096 | 197,847 | 416,796 | 19,768 | 2,768,507 |
| Loans and advances to customers | 4,121,208 | 20,686 | 163,726 | 806 | 4,306,426 |
| Total financial assets | 6,639,534 | 380,300 | 1,678,653 | 46,135 | 8,744,622 |
| Financial liabilities | | | | | |
| Customer deposits | 5,624,749 | 437,580 | 704,083 | 11,401 | 6,777,813 |
| Deposits due to other banking institutions | - | - | - | - | - |
| Total financial liabilities | 5,624,749 | 437,580 | 704,083 | 11,401 | 6,777,813 |
| Net statement of financial position gap | 1,014,785 | (57,280) | 974,570 | 34,734 | 1,966,809 |

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(b)** Market Risk (continued)

(i) Currency risk (continued)

| **At 31 December 2017** | **GROUP AND BANK** | | | | |
|---|---|---|---|---|---|
| | **US $** | **GB £** | **Euros** | **Others** | **Total** |
| | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** |
| Financial assets | | | | | |
| Cash in hand | 10,625 | 2,711 | 9,053 | 10 | 22,399 |
| Balances with Central Bank of Kenya | 34,480 | 17,551 | 33,142 | - | 85,173 |
| Placements with other banking institutions | 1,038,378 | 27,142 | 137,453 | 1,702 | 1,204,675 |
| Loans and advances to customers | 617,197 | 30 | 144,430 | 3 | 761,660 |
| Total financial assets | 1,700,680 | 47,434 | 324,078 | 1,715 | 2,073,907 |
| Financial liabilities | | | | | |
| Customer deposits | 953,991 | 52,601 | 325,018 | - | 1,331,610 |
| Deposits due to other banking institutions | 413,097 | - | - | - | 413,097 |
| Total financial liabilities | 1,367,088 | 52,601 | 325,018 | - | 1,744,707 |
| Net statement of financial position gap | 333,592 | (5,167) | (940) | 1,715 | 329,200 |

Foreign exchange risk sensitivity

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

| **At 31 December 2018** | **GROUP AND BANK** | | | | |
|---|---|---|---|---|---|
| | **US $** | **GB £** | **Euros** | **Others** | **Total** |
| | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** |
| Effect on profit or loss | 101,479 | (5,728) | 97,457 | 3,473 | 196,681 |
| Effect on equity | 71,035 | (4,010) | 68,220 | 2,431 | 137,677 |
| Closing exchange rates | 101.85 | 129.79 | 116.51 | | |

| **At 31 December 2017** | **GROUP AND BANK** | | | | |
|---|---|---|---|---|---|
| | **US $** | **GB £** | **Euros** | **Others** | **Total** |
| | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** | **KShs '000** |
| Effect on profit or loss | (33,359) | 517 | 94 | (172) | (32,920) |
| Effect on equity | (23,351) | 362 | 66 | (120) | (23,043) |
| | KShs | KShs | KShs | | |
| Closing exchange rates | 103.25 | 139.57 | 123.82 | | |

(ii) Interest rate risk

The Group is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows. Management closely monitors the interest rate trends to minimise the potential adverse impact of interest rate changes.

The table on the next page summarises the exposure to interest rate risk at the reporting date. Included in the table are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The Group does not have any derivative financial instruments. The Group does not bear an interest rate risk on off statement of financial position items.

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(b)** Market Risk (continued)

(ii) Interest rate risk (continued)

| GROUP | Upto 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 Months KShs '000 | 1 - 5 Years KShs '000 | Over 5 years KShs '000 | Non-interest bearing KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|---|
| **At 31 December 2018** | | | | | | | |
| Assets | | | | | | | |
| Cash in hand | - | - | - | - | - | 2,333,823 | 2,333,823 |
| Balances with Central Bank of Kenya | 2,500,000 | - | - | - | - | 3,020,420 | 5,520,420 |
| Government and investment securities | 3,184,386 | 4,935,230 | 19,330,105 | 8,083,901 | 8,105,262 | 2,164 | 43,641,048 |
| Placements with other banking institutions | 2,242,771 | 944,285 | - | - | - | 120,944 | 3,308,000 |
| Other assets | - | - | - | - | - | 437,599 | 437,599 |
| Loans and advances to customers | 1,996,017 | 125,191 | 723,984 | 4,216,040 | 5,145,001 | - | 12,206,233 |
| Financial assets at fair value through profit and loss | 926,112 | - | - | - | - | - | 926,112 |
| Total assets | 10,849,286 | 6,004,706 | 20,054,089 | 12,299,941 | 13,250,263 | 5,914,950 | 68,373,235 |
| Liabilities | | | | | | | |
| Customer deposits | 9,138,563 | 4,286,010 | 11,364,998 | 17,295,854 | 4,788 | 8,938,238 | 51,028,451 |
| Due to Central Bank of Kenya | - | - | - | 9,104,981 | - | - | 9,104,981 |
| Financial liabilities at fair value through profit and loss | 926,112 | - | - | - | - | - | 926,112 |
| Other liabilities | - | - | - | - | - | 1,425,952 | 1,425,952 |
| Total liabilities | 10,064,675 | 4,286,010 | 11,364,998 | 26,400,835 | 4,788 | 10,364,190 | 62,485,496 |
| On statement of financial position interest sensitivity gap | 784,611 | 1,718,696 | 8,689,091 | (14,100,894) | 13,245,475 | (4,449,240) | 5,887,739 |

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(b)** Market Risk (continued)

(ii) Interest rate risk (continued)

| BANK | Upto 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 Months KShs '000 | 1 - 5 Years KShs '000 | Over 5 years KShs '000 | Non-interest bearing KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|---|
| **At 31 December 2018** | | | | | | | |
| Assets | | | | | | | |
| Cash in hand | - | - | - | - | - | 2,333,823 | 2,333,823 |
| Balances with Central Bank of Kenya | 2,500,000 | - | - | - | - | 3,020,420 | 5,520,420 |
| Government and investment securities | 3,184,386 | 4,935,230 | 19,330,105 | 8,083,901 | 8,105,262 | 2,113 | 43,640,997 |
| Placements with other banking institutions | 2,242,771 | 944,285 | - | - | - | 120,944 | 3,308,000 |
| Other assets | - | - | - | - | - | 436,428 | 436,428 |
| Loans and advances to customers | 1,999,321 | 125,191 | 723,983 | 4,216,040 | 5,145,001 | - | 12,209,536 |
| Financial assets at fair value through profit and loss | 926,112 | - | - | - | - | - | 926,112 |
| Total assets | 10,852,590 | 6,004,706 | 20,054,088 | 12,299,941 | 13,250,263 | 5,913,728 | 68,375,316 |
| Liabilities | | | | | | | |
| Customer deposits | 9,138,563 | 4,286,010 | 11,364,998 | 17,295,854 | 4,788 | 8,953,707 | 51,043,920 |
| Due to Central Bank of Kenya | - | - | - | 9,104,981 | - | - | 9,104,981 |
| Financial liabilities at fair value through profit and loss | 926,112 | - | - | - | - | - | 926,112 |
| Other liabilities | - | - | - | - | - | 1,425,952 | 1,425,952 |
| Total liabilities | 10,064,675 | 4,286,010 | 11,364,998 | 26,400,835 | 4,788 | 10,379,659 | 62,500,965 |
| On statement of financial position interest sensitivity gap | 787,915 | 1,718,696 | 8,689,090 | (14,100,894) | 13,245,475 | (4,465,931) | 5,874,351 |

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(b)** Market Risk (continued)

(ii) Interest rate risk (continued)

| **GROUP** | **Upto 1 month KShs '000** | **1 - 3 months KShs '000** | **4 - 12 Months KShs '000** | **1 - 5 Years KShs '000** | **Over 5 years KShs '000** | **Non-interest bearing KShs '000** | **Total KShs '000** |
|---|---|---|---|---|---|---|---|
| **At 31 December 2017** | | | | | | | |
| Assets | | | | | | | |
| Cash in hand | - | - | - | - | - | 118,593 | 118,593 |
| Balances with Central Bank of Kenya | - | - | - | - | - | 892,376 | 892,376 |
| Government securities | - | - | 192,223 | 331,426 | 2,359,309 | - | 2,882,958 |
| Placements with other banking institutions | - | - | - | | | 1,607,228 | 1,607,228 |
| Other assets | - | - | - | - | - | 12,512 | 12,512 |
| Loans and advances to customers | 1,483,583 | 114,894 | 958,325 | 930,721 | 912,430 | - | 4,399,953 |
| Total assets | 1,483,583 | 114,894 | 1,150,548 | 1,262,147 | 3,271,739 | 2,630,709 | 9,913,620 |
| Liabilities | | | | | | | |
| Customer deposits | 1,723,216 | 2,285,776 | 1,573,453 | 39,587 | - | 793,094 | 6,415,126 |
| Deposits from other banking institutions | 413,329 | - | - | - | - | - | 413,329 |
| Due to Central Bank of Kenya | | - | - | - | - | 2,892,626 | 2,892,626 |
| Other liabilities | - | - | - | - | - | 180,255 | 180,255 |
| Total liabilities | 2,136,545 | 2,285,776 | 1,573,453 | 39,587 | - | 3,865,975 | 9,901,336 |
| On statement of financial position interest sensitivity gap | (652,962) | (2,170,882) | (422,905) | 1,222,560 | 3,271,739 | (1,235,266) | 12,284 |

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(b)** Market Risk (continued)

(ii) Interest rate risk (continued)

| **BANK** | **Upto 1 month KShs '000** | **1 - 3 months KShs '000** | **4 - 12 Months KShs '000** | **1 - 5 Years KShs '000** | **Over 5 years KShs '000** | **Non-interest bearing KShs '000** | **Total KShs '000** |
|---|---|---|---|---|---|---|---|
| **At 31 December 2017** | | | | | | | |
| Assets | | | | | | | |
| Cash in hand | - | - | - | - | - | 118,593 | 118,593 |
| Balances with Central Bank of Kenya | - | - | - | - | - | 892,376 | 892,376 |
| Government securities | - | - | 192,223 | 331,426 | 2,359,309 | - | 2,882,958 |
| Placements with other banking institutions | - | - | - | | | 1,607,228 | 1,607,228 |
| Other assets | - | - | - | - | - | 10,956 | 10,956 |
| Loans and advances to customers | 1,488,294 | 114,894 | 958,325 | 930,721 | 912,430 | - | 4,404,664 |
| Total assets | 1,488,294 | 114,894 | 1,150,548 | 1,262,147 | 3,271,739 | 2,629,153 | 9,916,775 |
| Liabilities | | | | | | | |
| Customer deposits | 1,737,130 | 2,285,776 | 1,573,453 | 39,587 | - | 793,094 | 6,429,040 |
| Deposits from other banking institutions | 413,097 | - | - | - | - | - | 413,097 |
| Due to Central Bank of Kenya | | - | - | - | - | 2,892,626 | 2,892,626 |
| Other liabilities and amounts due to group | - | - | - | - | - | 368,287 | 368,287 |
| Total liabilities | 2,150,227 | 2,285,776 | 1,573,453 | 39,587 | - | 4,054,007 | 10,103,050 |
| On statement of financial position interest sensitivity gap | (661,933) | (2,170,882) | (422,905) | 1,222,560 | 3,271,739 | (1,424,854) | (186,275) |

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(b)** Market Risk (continued)

(ii) Interest rate risk (continued)

The table below summarises the effective interest rates calculated on a weighted average basis, by major currencies for monetary financial assets and liabilities:

| Group and Bank | 2018 | | | | 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | **KShs %** | **US $ %** | **GB £ %** | **Euro %** | **KShs %** | **US $ %** | **GB £ %** | **Euro %** |
| Government securities | 10.25 | - | - | - | - | - | - | - |
| Deposits and balances due from banking institutions | 6.00 | 2.88 | 1.22 | 1.17 | 7.52 | - | - | - |
| Loans and advances to customers | 11.39 | 3.95 | 1.17 | 0.39 | 14.00 | 8.50 | 8.50 | 8.50 |
| Customer deposits | 5.16 | 1.29 | 1.74 | 0.28 | 8.70 | - | - | - |

Interest rate risk sensitivity

At 31 December 2018, if the weighted average interest rate for loans and advances at that date had been 1 percent higher with all other variables held constant, post-tax profit for the year would have been KShs 123 million (2017: KShs 45.53 million) higher, arising mainly as a result of higher interest income.

At 31 December 2018, if the weighted average interest rate for customer deposits and deposits from other banking institutions, at that date had been 1 percent higher with all other variables held constant, post-tax profit for the year would have been KShs 145 million (2017: KShs 56 million) lower, arising mainly as a result of higher interest expense. Similar decrease in interest rate

A similar decrease in interest rate would have yielded the same impact in the opposite direction in both cases.

(iii) Price risk sensitivity

The Bank is exposed to price risk on quoted investment securities

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

| | **Impact on profit or loss and equity** | |
|---|---|---|
| | **2018 KShs'000** | **2017 KShs'000** |
| Effect of increase - profit | 108 | 179 |

**(c)** Liquidity risk

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

*Management of liquidity risk*

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

Treasury receives information from other departments of the Bank regarding cash requirements and integrates this information in form of projected cash flows. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

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

The Bank's liquidity ratio as at 31 December 2018 was 82.84% (2017: 24.40%)

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

*Exposure to liquidity risk*

The table overleaf summarises the maturity profile of the Bank's financial assets and liabilities at 31 December based on contractual undiscounted payments.

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(c)** Liquidity risk (continued)

**GROUP**

| | Upto 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 Months KShs '000 | 1 - 5 Years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| **At 31 December 2018** | | | | | | |
| Assets | | | | | | |
| Cash in hand | 2,333,823 | - | - | - | - | 2,333,823 |
| Balances with Central Bank of Kenya | 5,665,775 | - | - | - | - | 5,665,775 |
| Government securities | 4,536,366 | 5,339,944 | 20,891,826 | 14,699,634 | 12,206,278 | 57,674,048 |
| Placements and balances with other banking institutions | 2,364,589 | 944,462 | - | - | - | 3,309,051 |
| Other assets | 437,599 | - | - | - | - | 437,599 |
| Loans and advances to customers | 1,575,090 | 143,588 | 781,799 | 8,375,629 | 10,656,287 | 21,532,393 |
| Financial assets at fair value through profit and loss | 926,112 | - | - | - | - | 926,112 |
| Total assets | 17,839,354 | 6,427,994 | 21,673,625 | 23,075,263 | 22,862,565 | 91,878,801 |
| Liabilities | | | | | | |
| Customer deposits | 13,668,886 | 8,594,685 | 11,364,998 | 18,370,236 | 4,788 | 52,003,593 |
| Due to Central Bank of Kenya | - | - | - | 9,104,981 | - | 9,104,981 |
| Financial liabilities at fair value through profit and loss | 926,112 | - | - | - | - | 926,112 |
| Other liabilities | 1,425,952 | - | - | - | - | 1,425,952 |
| Total liabilities | 16,020,950 | 8,594,685 | 11,364,998 | 27,475,217 | 4,788 | 63,460,638 |
| Net liquidity gap | 1,818,404 | (2,166,691) | 10,308,627 | (4,399,954) | 22,857,777 | 28,418,163 |

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(c)** Liquidity risk (continued)

**BANK**

| | Up to 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 Months KShs '000 | 1 - 5 Years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| **At 31 December 2018** | | | | | | |
| Assets | | | | | | |
| Cash in hand | 2,333,823 | - | - | - | - | 2,333,823 |
| Balances with Central Bank of Kenya | 5,665,775 | - | - | - | - | 5,665,775 |
| Government securities | 4,536,366 | 5,339,944 | 20,891,826 | 14,699,634 | 12,206,278 | 57,674,048 |
| Placements and balances with other banking institutions | 2,364,589 | 944,462 | - | - | - | 3,309,051 |
| Other assets | 436,428 | - | - | - | - | 436,428 |
| Loans and advances to customers | 1,578,393 | 143,588 | 781,799 | 8,375,629 | 10,656,287 | 21,535,696 |
| Financial assets at fair value through profit and loss | 926,112 | - | - | - | - | 926,112 |
| Total assets | 17,841,486 | 6,427,994 | 21,673,625 | 23,075,263 | 22,862,565 | 91,880,933 |
| Liabilities | | | | | | |
| Customer deposits | 13,684,355 | 8,594,685 | 11,364,998 | 18,370,236 | 4,788 | 52,019,062 |
| Due to Central Bank of Kenya | - | - | - | 9,104,981 | - | 9,104,981 |
| Financial liabilities at fair value through profit and loss | 926,112 | - | - | - | - | 926,112 |
| Other liabilities | 1,425,952 | - | - | - | - | 1,425,952 |
| Total liabilities | 16,036,419 | 8,594,685 | 11,364,998 | 27,475,217 | 4,788 | 63,476,107 |
| Net liquidity gap | 1,805,067 | (2,166,691) | 10,308,627 | (4,399,954) | 22,857,777 | 28,404,826 |

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(c)** Liquidity risk (continued)

**GROUP**

| | Up to 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 Months KShs '000 | 1 - 5 Years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| **At 31 December 2017** | | | | | | |
| Assets | | | | | | |
| Cash in hand | 118,593 | - | - | - | - | 118,593 |
| Balances with Central Bank of Kenya | 892,376 | - | - | - | - | 892,376 |
| Government securities | - | 76,869 | 158,744 | 1,200,561 | 3,558,220 | 4,994,394 |
| Placements with other banking institutions | 1,607,228 | - | - | - | - | 1,607,228 |
| Other assets | - | - | 12,512 | - | - | 12,512 |
| Loans and advances to customers | 1,492,238 | 129,256 | 1,025,408 | 1,256,474 | 1,551,130 | 5,454,506 |
| Total assets | 4,110,435 | 206,125 | 1,196,664 | 2,457,035 | 5,109,350 | 13,079,609 |
| Liabilities | | | | | | |
| Customer deposits | 2,522,019 | 2,308,442 | 1,635,901 | 47,430 | - | 6,513,792 |
| Deposits from other banking institutions | 413,329 | - | - | - | - | 413,329 |
| Due to Central Bank of Kenya | - | - | - | - | 2,892,626 | 2,892,626 |
| Other liabilities | - | - | 180,255 | - | - | 180,255 |
| Total liabilities | 2,935,348 | 2,308,442 | 1,816,156 | 47,430 | 2,892,626 | 10,000,002 |
| Net liquidity gap | 1,175,087 | (2,102,317) | (619,492) | 2,409,605 | 2,216,724 | 3,079,607 |

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

**(c)** Liquidity risk (continued)

**BANK**

| | Upto 1 month KShs '000 | 1 - 3 months KShs '000 | 4 - 12 Months KShs '000 | 1 - 5 Years KShs '000 | Over 5 years KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| **At 31 December 2017** | | | | | | |
| Assets | | | | | | |
| Cash in hand | 118,593 | - | - | - | - | 118,593 |
| Balances with Central Bank of Kenya | 892,376 | - | - | - | - | 892,376 |
| Government securities | - | 76,869 | 158,744 | 1,200,561 | 3,558,220 | 4,994,394 |
| Placements with other banking institutions | 1,607,228 | - | - | | - | 1,607,228 |
| Other assets | - | - | 10,956 | - | - | 10,956 |
| Loans and advances to customers | 1,496,976 | 129,256 | 1,025,408 | 1,256,474 | 1,551,130 | 5,459,244 |
| Total assets | 4,115,173 | 206,125 | 1,195,108 | 2,457,035 | 5,109,350 | 13,082,791 |
| Liabilities | | | | | | |
| Customer deposits | 2,535,979 | 2,308,442 | 1,635,901 | 47,430 | - | 6,527,752 |
| Deposits from other banking institutions | 413,097 | - | - | - | - | 413,097 |
| Due to Central Bank of Kenya | - | - | - | - | 2,892,626 | 2,892,626 |
| Other liabilities | - | - | 368,287 | - | - | 368,287 |
| Total liabilities | 2,949,076 | 2,308,442 | 2,004,188 | 47,430 | 2,892,626 | 10,201,762 |
| Net liquidity gap | 1,166,097 | (2,102,317) | (809,080) | 2,409,605 | 2,216,724 | 2,881,029 |

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

**NOTES**

**5. FINANCIAL RISK MANAGEMENT (continued)**

(d) Operational risk

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

The Group endeavours to manage the operational risk by creating a balance between avoidance of cost or financial losses and damage to the Group's reputation within overall cost effectiveness and to avoid control procedures that restrict creativity and initiative. The key responsibility for development policies and programs to implement the Group's operational risk management is with the senior management of the Group.

The above is achieved by development of overall standards for the Group to manage the risk in the following areas:

- Segregation of duties including independent authorisation of transactions
- Monitoring and reconciliation of transactions
- Compliance to regulatory and legal requirements
- Documentation of controls and procedures
- Assessment of the operational risk on a periodic basis to address the deficiencies observed, if any
- Reporting of operational losses and initiation of remedial action
- Development of contingency plans
- Training staff to improve their professional competency
- Exercising good ethical and business standards.

(e) Compliance and regulatory risk

Compliance and regulatory risk includes the risk of bearing the consequences of non-compliance with regulatory requirements. The Compliance function is responsible for establishing and maintaining an appropriate framework of Bank compliance policies and procedures. Compliance with such policies and procedures is the responsibility of all Managers.

(f) Environmental and social risks

Environmental and social risks are the risks that the Bank could bear the consequences of socio-environmental fall-out of transactions. Such risks could arise from failure of the Bank to assess the impacts of activities (of both the Bank and its clients) which could hurt the environment or have negative social impact.

The Bank is aware that it has a responsibility to ensure that its internal practice and its lending activities do not have negative environmental and social impacts and is thus committed to ensure that such risks are sufficiently managed through its Environmental and Social Management policy and by adopting the country’s Labour and environmental laws. The Bank also adheres to international best practice (IFC performance standards and ILO standards as ratified by the Kenya government). An Environmental and Social Management system is being put in place to ensure due diligence and monitoring of the Environmental and Social risk is done efficiently. Compliance with these laws is monitored by the compliance function.

## 6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

In the process of applying the Group's accounting policies, the directors have made estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities within the next financial year.

Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

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

The key areas of judgement and sources of estimation uncertainty are as set out below:

*Revaluation of property and equipment and investment properties*

The Group carries certain property and equipment and its investment properties at fair value, with changes in fair value being recognised in other comprehensive income and profit or loss respectively. The Group engaged an independent valuer, Ardhiworth (Real Estate) Limited, to assess the fair value as at 19th November 2018 for the investment properties and leasehold land and building. The properties were valued using the market approach, by reference to market-based evidence, using comparable prices for similar properties adjusted for specific market factors such as nature, condition and location of the property.

Further details on property and equipment and investment properties are given in Notes 21 and 23 to the financial statements respectively.

*Fair value of financial instruments*

When the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. The judgements include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments. See note 3 (j), note 7, note 18 and note 19 to the financial statements, for further discussion.

*Impairment losses on non financial assets*

At each reporting date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. Impairment exists when the carrying amount of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. The fair value less costs of disposal calculation is based on available data from binding sales transactions, conducted at arm's length, for similar assets or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows do not include restructuring activities that the Group is not yet committed to or significant future investments that will enhance the asset's performance of the CGU being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash-inflows and the growth rate used for extrapolation purposes. In assessing whether there is any indication that the tangible and intangible assets may be impaired, the Group considers the following indications:

a) there are observable indications that the asset's value has declined during the period significantly more than would be expected as a result of the passage of time or normal use.

b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.

c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially.

d) the carrying amount of the net assets of the entity is more than its market capitalisation.

e) evidence is available of obsolescence or physical damage of an asset.

f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.

g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected

The carrying amount of property and equipment is given in Note 21 to the financial statements and intangible assets in Note 22 to the financial statements.

## 6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (Continued)

*Impairment losses on financial assets*

Effective 1 January 2018
The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model, which assigns PDs to the individual grades
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models

Disclosures on impairment losses on financial assets are described in accounting policy 3(j) (viii).

Prior to 1 January 2018
Financial assets accounted for at amortised cost are evaluated for impairment on a basis described in accounting policy 3(j) (viii). The specific component of total allowances for impairment applies to loans and advances evaluated individually for impairment and is based upon management's best estimate of the present value of cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor's financial situation and the net realizable value of any underlying collateral. Estimates of cash flows considered recoverable are independently approved by the credit risk committee.

Collectively assessed impaired allowances cover credit losses inherent in portfolios of loans and advances with similar economic characteristics when there is objective evidence to suggest that they contain impaired loans and advances but the individual impaired items cannot yet be identified. In considering the collective loan loss allowances, management considers the historical loan loss rate and the emergence period.
The accuracy of the allowance depends on how well these estimated future cash flows for specific debtor's allowances, the model assumptions and parameters used in determining collective allowances.

*Useful lives and residual values of property and equipment and intangible assets.*

The Group reviews the estimated useful lives and residual values of property and equipment and intangible assets at the end of each reporting period. In reviewing the useful lives of property and equipment and intangible assets, the Group considers the remaining period over which an asset is expected to be available for use by the Group. Management also looks at the number of production or similar units expected to be obtained from the property and equipment. Judgment and assumptions are required in estimating the remaining useful period and estimates of the number of production or similar units expected to be obtained from the property and equipment and intangible assets.

During the financial year, no changes to the useful lives were identified by the directors.

*Contingent liabilities*

As disclosed in Note 33(b) to the financial statements, the Group is exposed to various contingent liabilities in the normal course of business. The directors evaluate the status of these exposures on a regular basis to assess the probability of the Group incurring related liabilities. However, provisions are only made in the financial statements where, based on the directors' evaluation, a present obligation has been established. Judgement and assumptions are required in:

- assessing the existence of a present obligation (legal or constructive) as a result of a past event;
- assessing the probability that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- Estimating the amount of the obligation to be paid out.

*Income taxes*

The Bank is subject to income taxes in Kenya. Significant judgement is required in determining the Bank'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 recognizes 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.

Further details on income taxes are disclosed in Note 14 to the financial statements.

*Deferred tax*

Deferred tax assets are recognised for all deductible temporary differences and tax losses carried forward to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and tax losses carried forward can be utilized. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. Further details on income taxes are disclosed in Note 24 to the financial statements.

**NOTES**

## 7. BUSINESS COMBINATION

### (a) Acquisition of certain assets and assumption of certain liabilities of Chase Bank (Kenya) Limited (in receivership)

On 18th August 2018, the Bank completed the acquisition of certain assets and assumption of specific liabilities of Chase Bank (Kenya) Limited-In Receivership (CBLIR).

For the period from 18 August 2018 to 31 December 2018, the newly acquired assets of CBLIR contributed a net interest income of KShs 1.262 billion and profit before tax of KShs 546 million to the Bank's results. Given that the acquisition was for the carved out assets and liabilities of CBLIR, the performance of the book from 01 January 2018 to 31 December 2018 is not available hence no disclosure on performance has been provided. The business combination placed the Bank in Tier 2 within the industry with increased market share.

The fair valuation of the assets acquired and liabilities assumed as per IFRS 3, Business combinations, resulted in a bargain purchase gain of KShs 3,827,425,000 because the fair value of consideration transferred was lower than net fair value of the identifiable net assets acquired as shown below.

### (b) Assets acquired and liabilities assumed

The fair values of the identifiable assets and liabilities of CBLIR as at the date of acquisition were:

| | Fair value recognised on acquisition KShs '000 |
|---|---|
| **ASSETS** | |
| Cash (both local and foreign) | 472,417 |
| Balances due from Central Bank of Kenya | 3,083,726 |
| Kenya Government Securities | 8,813,480 |
| Corporate Bonds | 462,001 |
| Deposits and balances due from local banking institutions | 13,814,262 |
| Loans and advances to customers (net) | 8,103,524 |
| Fully written off loans | - |
| Islamic Loans | 926,112 |
| Third party properties (Properties to be transferred to the Bank) | - |
| Property and equipment | 1,263,951 |
| Intangible assets | 536,567 |
| Other Assets | - |
| - Items in transit | 234,964 |
| - Prepayments | 123,720 |
| - Guarantee deposits | 177,413 |
| - Sundry debtors | 677,228 |
| - Due from Central Bank | 31,057,566 |
| **Total assets** | **69,746,931** |
| **LIABILITIES** | |
| Customer deposits | 57,122,104 |
| Balances due to Central Bank of Kenya | 6,013,001 |
| Other liabilities | 1,858,289 |
| **Total liabilities** | **64,993,394** |
| **Fair value of identifiable net assets acquired** | **4,753,537** |

**Gain from bargain purchase arising from the combination is determined as follows:**

| | KES'000 |
|---|---|
| Fair value of consideration transferred: | |
| Contingent consideration | |
| - Fully written off loans | - |
| - Islamic Loans | 926,112 |
| - Third party properties (Properties to be transferred to the Bank) | - |
| Less: net fair value of the identifiable net assets acquired | (4,753,537) |
| Gain from bargain purchase arising on acquisition [note 10(c)] | **(3,827,425)** |

**NOTES**

**7. BUSINESS COMBINATION (continued)**

**Contingent consideration related to Islamic Loan portfolio measured at fair value**

| | KShs '000 |
|---|---|
| (Financial liabilities at fair value through profit or loss) | |
| As at 1 January 2018 | - |
| Liability arising on business combination | 926,112 |
| Remittances of collections | - |
| Unrealised fair value changes recognised in profit or loss | - |
| As at 31 December 2018 | **926,112** |

The descriptions of the contingent considerations are as follows;

**(i) Fully written off loans**

There was certain fully impaired loan portfolio with a carrying amount of KShs 21.453 billion at the acquisition date, which the Bank acquired as part of the business combination. These were non-performing, unsecured loans without repayment history and no proper credit documentation, a proportion of which was disputed by the customers. As required by IFRS 3, Business combination, these loans were, therefore, recognised at nil fair value at the acquisition date.
As a result, a contingent consideration, representing future cash flows related to the proceeds that may be received from any recoveries of these loans, arose. This contingent consideration is fair valued at nil, which is the same as the fair value of the related loans.

**(ii) Properties to be transferred to the Bank**

As at the acquisition date, there were certain properties with a market value of KShs 7.31 billion in which CBLIR had interest but could not be transferred to the Group at the acquisition date. As required by IFRS 3, Business combination, the properties were recognised at fair value determined at nil. As a result, a contingent consideration, representing future cash flows related to the proceeds that may be received from the disposal of these properties, arose. This contingent consideration is fair valued at nil, which is the same as the fair value of the related properties.

**(iii) Islamic Loan Portfolio**

As at the acquisition date, there was certain Islamic loan portfolio of carrying amount of KShs 3.179 billion, which the Bank acquired as part of the business combination on transitory basis. The Bank is in the process of disposing off this portfolio.
As required by IFRS 3 on business combination, these loans were recognised at a fair value of KShs 926.112 million as at acquisition date. As a result, a contingent consideration, representing future cash flows related to the proceeds that may be received from the sell down of this portfolio, arose. This contingent consideration is fair valued at KShs 926.112 million, which is the same as the fair value of the related loans.

The loans will continue being measured at fair value through profit or loss up to the time when the portfolio will be derecognised by way of a sell down.

Balances as at 31 December 2018 is as below;

| | KShs '000 |
|---|---|
| *Financial assets at fair value through profit or loss* | |
| As at 1 January 2018 | - |
| Financial assets arising on business combination | 926,112 |
| Remittances of collections | - |
| Unrealised fair value changes recognised in profit or loss | - |
| As at 31 December 2018 | **926,112** |

**Net cash flow on acquisition of CBLIR**

| | KShs '000 |
|---|---|
| Consideration paid in cash | - |
| Less Cash (both local and foreign) | 472,417 |
| Balances due from Central Bank of Kenya | 3,083,726 |
| Deposits and balances due from local banking institutions | 13,814,262 |
| As at 31 December 2018 | **17,370,405** |

**NOTES (continued)**

## 8. NET INTEREST INCOME

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Interest income | | | | |
| Loans and advances | 789,909 | 373,537 | 789,909 | 373,537 |
| Government securities | 1,518,844 | 245,014 | 1,518,844 | 245,014 |
| Money market lending | 182,400 | 18,965 | 182,400 | 18,965 |
| Other investment securities | 27,398 | - | 27,398 | - |
| | 2,518,551 | 637,516 | 2,518,551 | 637,516 |
| Interest expense | | | | |
| Customer deposits | (1,215,852) | (374,780) | (1,215,852) | (374,780) |
| Money market borrowings | (31,217) | (102,055) | (31,217) | (102,055) |
| Other borrowings (note 28) | (215,501) | - | (215,501) | - |
| | (1,462,570) | (476,835) | (1,462,570) | (476,835) |
| Net interest income | 1,055,981 | 160,681 | 1,055,981 | 160,681 |

## 9. NET FEE AND COMMISSION INCOME

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Fee and commission income | | | | |
| Commitment charges on loans | 9,720 | 7,421 | 9,720 | 7,421 |
| Processing fees on loans | 13,703 | 14,976 | 13,703 | 14,976 |
| Ledger fees | 21,767 | 11,522 | 21,767 | 11,522 |
| Commission fees and charges | 80,384 | 11,177 | 68,715 | 11,177 |
| | 125,574 | 45,096 | 113,905 | 45,096 |
| Fee and commission expense | | | | |
| Correspondent and other bank charges | (3,485) | (4,342) | (2,970) | (4,342) |
| Brokerage fees and commissions | (2,102) | - | (2,102) | - |
| | (5,587) | (4,342) | (5,072) | (4,342) |
| Net fee and commission | 119,987 | 40,754 | 108,833 | 40,754 |

## 10. OTHER INCOME

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| **(a) Other operating income** | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Gain on sale of government securities | 128 | - | 128 | - |
| Card income | 29,672 | 1,703 | 29,672 | 1,703 |
| Write back of impairment losses on loans and advances [note 17(b)] | 568,463 | 561 | 568,463 | 561 |
| Bad debts recovered | 4,770 | - | 4,770 | - |
| Other miscellaneous income | 45,575 | 88,424 | 45,606 | 79,186 |
| Gain on disposal of property and equipment | - | 4,552 | - | 4,552 |
| | 648,608 | 95,240 | 648,639 | 86,002 |
| **(b) Dividend income** | | | | |
| Dividend from investment securities | 174 | 86 | 174 | 86 |
| **(c) Gain from bargain purchase** | | | | |
| Gain from bargain purchase arising on acquisition (note 7) | 3,827,425 | - | 3,827,425 | - |
| Deferred tax liability on recognition of gain from bargain purchase (note 14) | (1,036,649) | - | (1,036,649) | - |
| | 2,790,776 | - | 2,790,776 | - |

**NOTES (continued)**

## 11. PERSONNEL EXPENSES

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Salaries and wages | 693,466 | 220,062 | 692,614 | 220,062 |
| Staff leave accrual | 25,396 | 1,841 | 25,396 | 1,841 |
| Social security and pension contributions | 24,949 | 6,276 | 24,949 | 6,276 |
| Staff welfare cost | 1,602 | - | 1,602 | - |
| Staff insurances | 62,375 | - | 62,375 | - |
| Performance incentive | 149,187 | - | 149,187 | - |
| Other staff costs* | 66,672 | 36,054 | 66,672 | 36,054 |
| | 1,023,647 | 264,233 | 1,022,795 | 264,233 |

* Other staff costs include expenses relating to staff trainings, staff relocation costs and miscellaneous staff allowances

The average number of persons employed during the year, by category, were:

| | Bank and Group | |
|---|---|---|
| | 31 December 2018 | 31 December 2017 |
| Management and administration | 454 | 144 |

## 12. OPERATING EXPENSES

### (a) Other expenses

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Contribution to Kenya Deposit Insurance Corporation | 13,042 | 12,234 | 13,042 | 12,234 |
| Software licensing and other information technology cost | 281,147 | 18,315 | 281,147 | 18,315 |
| Auditors' fees | 9,500 | 6,800 | 9,500 | 6,800 |
| Professional fees | 19,781 | 48,007 | 19,781 | 48,007 |
| Directors' fees | 8,387 | 19,028 | 8,387 | 19,028 |
| Utilities | 15,378 | 5,384 | 15,378 | 5,384 |
| Marketing costs | 28,573 | 5,589 | 28,573 | 5,589 |
| Operating lease rentals (note 31) | 291,456 | 59,787 | 291,456 | 59,787 |
| Licence and other registration fees | 39,003 | 3,493 | 38,963 | 3,493 |
| Other general and administrative expenses* | 292,092 | 153,157 | 304,501 | 146,524 |
| | 998,359 | 331,794 | 1,010,728 | 325,161 |

* Other general and administrative expenses mainly consist of security expenses, insurances, office expenses and bank charges.

### (b) Depreciation and amortization charges

| | | | | |
|---|---|---|---|---|
| Depreciation on property and equipment (note 21) | 124,230 | 38,062 | 124,199 | 38,024 |
| Amortisation of intangible assets (note 22) | 144,242 | 39,186 | 144,242 | 39,186 |
| | 268,472 | 77,248 | 268,441 | 77,210 |

### (c) Other losses/(gains)

| | | | | |
|---|---|---|---|---|
| Write back of general provisions | (465,160) | - | (470,165) | - |
| Write back of amounts due to Rover Investments Limited | - | - | (198,322) | - |
| Impairment of investment in subsidiaries (note 20) | - | - | 336,394 | - |
| Loss on revaluation of property (note 21) | 174,778 | - | 179,783 | - |
| Impairment of property and equipment (note 21) | 44,112 | - | 47,221 | - |
| Impairment of intangible assets (note 22) | 122,640 | | 122,640 | |
| Impairment of investment property (note 23) | 126,895 | - | - | - |
| | 3,265 | - | 17,551 | - |

## 13. IMPAIRMENT LOSSES ON FINANCIAL INSTRUMENTS

The following table below summarises the net impairment charges recorded in the statement of comprehensive income under IFRS 9 in 2018 and IAS 39 during 2017:

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| **(a) Total portfolio and specific impairment** | | | | |
| - On-balance sheet advances | 1,542,164 | (63,936) | 1,542,164 | (63,936) |
| - Off-balance sheet exposure | - | - | - | - |
| | 1,542,164 | (63,936) | 1,542,164 | (63,936) |
| **(b) Direct write-offs** | | | | |
| Bad debts written off for which no provisions were made | 99 | 53,120 | 99 | 53,120 |

**NOTES (continued)**

**13. IMPAIRMENT LOSSES ON FINANCIAL INSTRUMENTS (continued)**

**(c) Net increase/(decrease) in impairment loss on financial instruments**

| | Group | | Bank | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Total portfolio and specific impairment | 1,542,164 | (63,936) | 1,542,164 | (63,936) |
| Direct write offs | 99 | 53,120 | 99 | 53,120 |
| | 1,542,263 | (10,816) | 1,542,263 | (10,816) |
| *Of which:* | | | | |
| *Expected credit loss on loans and advances* | 1,472,645 | (10,816) | 1,472,645 | (10,816) |
| *Expected credit loss on Government securities* | 69,618 | - | 69,618 | - |
| *Expected credit loss on corporate bonds* | - | - | - | - |
| *Expected credit loss on bank balances securities* | - | - | - | - |
| *Expected credit loss on Central bank balances* | - | - | - | - |
| | 1,542,263 | (10,816) | 1,542,263 | (10,816) |

**14. TAX**

**(a) Profit / (loss) before tax is arrived at after charging:**

| | Group | | Bank | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Depreciation on property and equipment (Note 21) | 124,230 | 38,062 | 124,199 | 38,024 |
| Amortisation of intangible assets (Note 22) | 144,242 | 39,186 | 144,242 | 39,186 |
| Directors' emoluments; | | | | |
| - Fees as non-executives | 8,387 | 19,028 | 8,387 | 19,028 |
| - Other | - | 32,844 | - | 32,844 |
| Auditors' remuneration | 9,500 | 6,800 | 9,500 | 6,800 |
| Other losses/(gains) | 3,265 | - | 17,551 | |
| And after crediting: | | | | |
| - Gain on disposal of property and equipment | - | 4,552 | - | 4,552 |

**(b) Income tax (credit)/expense**

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Current tax | - | 1,581 | - | - |
| Adjustment in respect of current income tax of prior years | - | - | - | - |
| Deferred tax (Note 24) | | | | |
| - originating and temporary difference | (367,001) | (27,193) | (367,001) | (27,193) |
| - (Under)/over provision in the prior year | 6,850 | (2,344) | 6,850 | (2,344) |
| | (360,151) | (27,956) | (360,151) | (29,537) |
| Deferred tax on business combination | | | | |
| - Bargain purchase gain | 1,036,649 | - | 1,036,649 | - |

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Profit/ (loss) before tax | 964,054 | (358,060) | 955,731 | (360,627) |
| Tax calculated at a rate of 30% (2017: 30%) | 289,216 | (107,418) | 286,719 | (108,188) |
| - Deferred tax on business combination | (1,036,649) | - | (1,036,649) | - |
| - Expenses not deductible for tax purposes | 380,432 | 86,938 | 382,929 | 85,284 |
| - (Under)/over provision of deferred tax in prior year | 6,850 | (2,344) | 6,850 | (2,344) |
| - Income not subject to tax | - | (5,132) | - | (4,289) |
| Tax charge | (360,151) | (27,956) | (360,151) | (29,537) |

**(c) Tax recoverable**

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| At 1 January | 59,695 | 61,276 | 60,108 | 60,108 |
| Adjustment in respect of current income tax of prior years | - | - | - | - |
| Paid during the year | 3,088 | - | - | - |
| Charge for the year | - | (1,581) | - | - |
| At 31 December | 62,783 | 59,695 | 60,108 | 60,108 |

**NOTES (continued)**

## 15. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit/(loss) attributable to the shareholders and by the weighted average number of shares outstanding during the year.

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Profit for the year attributable to shareholders (KShs'000) | 1,324,205 | (330,104) | 1,315,882 | (331,090) |
| Weighted average number of ordinary shares in issue (thousands) | 51,703,007 | 408,705 | 51,703,007 | 408,705 |
| Earnings per share: | | | | |
| - Basic and diluted (KShs) | 0.03 | (0.81) | 0.03 | (0.81) |

There were no dilutive potential ordinary shares outstanding at 31 December 2018 (2017:nil).

## 16. CASH AND CASH EQUIVALENTS

### (a) Cash and bank balances

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Cash in hand | 1,004,959 | 118,593 | 1,004,959 | 118,593 |
| Foreign currency notes and coins | 1,328,864 | - | 1,328,864 | - |
| Balances with Central Bank of Kenya: | | | | |
| Restricted balances (cash reserve ratio) | 2,535,662 | 307,922 | 2,535,662 | 307,922 |
| Unrestricted balances with central bank [1] | 2,984,758 | 584,454 | 2,984,758 | 584,454 |
| Balances with banks | 283,576 | 793,846 | 283,576 | 793,846 |
| | 8,137,819 | 1,804,815 | 8,137,819 | 1,804,815 |

[1] Unrestricted balances with central banks represent amounts above the minimum cash reserve requirement. As at 31 December 2018, the cash reserve ratio requirement was 5.25% (2017 - 5.25%) of all customer deposits.

### (b) Placements with other banking institutions

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| Loans to and placements with other banks [2] | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| - in Kenya | 2,080,139 | 25,069 | 2,080,139 | 25,069 |
| - outside Kenya | 944,285 | 788,313 | 944,285 | 788,313 |
| | 3,024,424 | 813,382 | 3,024,424 | 813,382 |

[2] The balances above relate to loans and placements with banks having an original maturity of up to three months.

## 17. LOANS AND ADVANCES TO NON-BANK CUSTOMERS

### a) Loans and advances

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Overdrafts | 4,753,360 | 1,540,312 | 4,756,663 | 1,545,023 |
| Commercial loans | 19,004,631 | 4,998,304 | 19,004,631 | 4,998,304 |
| Invoices and bills discounted | 1,313,223 | 40,815 | 1,313,223 | 40,815 |
| Credit cards | 69,550 | 145,881 | 69,550 | 145,881 |
| | 25,140,764 | 6,725,312 | 25,144,067 | 6,730,023 |
| Less allowance for impairment losses | (12,934,531) | (2,325,359) | (12,934,531) | (2,325,359) |
| | 12,206,233 | 4,399,953 | 12,209,536 | 4,404,664 |

**NOTES (continued)**

**17. LOANS AND ADVANCES TO NON-BANK CUSTOMERS (continued)**

**(b) Impairment losses on loans and advances to non-bank customers (continued)**

***Prior to 01 January 2018***

The calculation of specific allowance for credit impairment requires management to estimate the recoverable amount of each impaired asset, which is the estimated future cash flows discounted at the original effective interest rate of the advance. Where cash flows for large credits include the realisable value of collateral securing the credit, the value of such collateral is based on the opinion of independent and qualified appraisers.

The Bank's allowance for portfolio impairment is determined based on the guidelines of the Central Bank of Kenya. The guidelines require the Bank to make portfolio provision of not less than 1% on unimpaired loans and advances showing no signs of inherent weakness and 3% on unimpaired loans and advances exhibiting initial signs of weakness and is generally higher than the historical loss rate of the loan portfolio of the Bank. However, the Directors have estimated that the resulting impairment charge to the statement of profit or loss is not materially different from what would have resulted had the Bank determine its portfolio provisioning based on the incurred loss model under IAS 39.

***From 01 January 2018***

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank’s ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank’s internal credit grading model, which assigns PDs to the individual grades;
- The Bank’s criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulas and the choice of inputs;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

The table below explains the movement in ECL during the year. Stage 1 and 2 relate to performing accounts while stage 3 relate to non performing accounts

**Group**

| | Stage 3 ECL | Stage 1 &2 ECL | Total |
|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 |
| At 01 January 2018 | 2,268,609 | 56,750 | 2,325,359 |
| IFRS 9 Transition adjustment to opening balances | 542,412 | - | 542,412 |
| Allowance for credit impairment for the year [Note 13(a)] | 1,282,110 | 190,535 | 1,472,645 |
| Loans written off | (1,971,118) | - | (1,971,118) |
| Loans taken over from CBLIR | 10,982,132 | 151,564 | 11,133,696 |
| Provision write back (note 10) | (568,463) | - | (568,463) |
| **At 31 December 2018** | 12,535,682 | 398,849 | 12,934,531 |

**Bank**

| | Stage 3 ECL | Stage 1 &2 ECL | Total |
|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 |
| At 01 January 2018 | 2,268,609 | 56,750 | 2,325,359 |
| IFRS 9 Transition adjustment to opening balances | 542,412 | - | 542,412 |
| Allowance for credit impairment for the year [Note 13(a)] | 1,282,110 | 190,535 | 1,472,645 |
| Loans written off | (1,971,118) | - | (1,971,118) |
| Loans taken over from CBLIR | 10,982,132 | 151,564 | 11,133,696 |
| Provision write back (note 10) | (568,463) | - | (568,463) |
| **At 31 December 2018** | 12,535,682 | 398,849 | 12,934,531 |

**NOTES (continued)**

**17. LOANS AND ADVANCES TO NON-BANK CUSTOMERS (continued)**

**(b) Impairment losses on loans and advances to non-bank customers (continued)**

***From 01 January 2018***

The table below shows the credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system and year-end stage classification. The amounts presented are gross of impairment allowances. Details of the Bank's internal grading system are set out in note 5.

| GROUP | 31 December 2018 | | | | 31 December 2017 |
|---|---|---|---|---|---|
| Internal rating grade | Stage 1 | Stage 2 | Stage 3 | Total | Total |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Normal | 7,104,849 | - | - | 7,104,849 | 1,381,725 |
| Watch | - | 1,728,327 | - | 1,728,327 | 1,431,084 |
| Substandard | - | - | 743,991 | 743,991 | 2,836 |
| Doubtful | - | - | 785,435 | 785,435 | 2,634,494 |
| Loss | - | - | 14,778,162 | 14,778,162 | 1,275,173 |
| **Total** | 7,104,849 | 1,728,327 | 16,307,588 | 25,140,764 | 6,725,312 |

| BANK | 31 December 2018 | | | | 31 December 2017 |
|---|---|---|---|---|---|
| Internal rating grade | Stage 1 | Stage 2 | Stage 3 | Total | Total |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Normal | 7,104,849 | - | - | 7,104,849 | 1,381,725 |
| Watch | - | 1,728,327 | - | 1,728,327 | 1,431,084 |
| Substandard | - | - | 743,991 | 743,991 | 2,836 |
| Doubtful | - | - | 785,435 | 785,435 | 2,639,205 |
| Loss | - | - | 14,781,465 | 14,781,465 | 1,275,173 |
| **Total** | 7,104,849 | 1,728,327 | 16,310,891 | 25,144,067 | 6,730,023 |

An analysis of changes in the gross carrying amount and the corresponding ECL allowances for the year is as follows:

| GROUP | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| | KShs'000 | KShs'000 | KShs'000 | KShs'000 |
| Gross carrying amount as at 01 January 2018 | 1,381,725 | 1,431,084 | 3,912,503 | 6,725,312 |
| Net new assets originated | 9,145,702 | 901,498 | 6,397,134 | 16,444,334 |
| Assets derecognised (excluding write offs) | | | | |
| Transfers from stage 1 | (3,545,453) | 222,293 | 3,323,160 | - |
| Transfers from stage 2 | 122,875 | (867,516) | 744,641 | - |
| Transfers from stage 3 | - | 40,968 | (40,968) | - |
| Changes to contractual cash flows due to modifications not resulting in derecognition | - | - | - | - |
| Amounts written off | - | - | 1,971,118 | 1,971,118 |
| **At 31 December 2018** | 7,104,849 | 1,728,327 | 16,307,588 | 25,140,764 |

| BANK | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| | KShs'000 | KShs'000 | KShs'000 | KShs'000 |
| Gross carrying amount as at 01 January 2018 | 1,381,725 | 1,431,084 | 3,917,214 | 6,730,023 |
| Net new assets originated | 9,145,702 | 901,498 | 6,395,726 | 16,442,926 |
| Assets derecognised (excluding write offs) | | | | |
| Transfers from stage 1 | (3,545,453) | 222,293 | 3,323,160 | - |
| Transfers from stage 2 | 122,875 | (867,516) | 744,641 | - |
| Transfers from stage 3 | - | 40,968 | (40,968) | - |
| Changes to contractual cash flows due to modifications not resulting in derecognition | - | - | - | - |
| Amounts written off | - | - | 1,971,118 | 1,971,118 |
| **At 31 December 2018** | 7,104,849 | 1,728,327 | 16,310,891 | 25,144,067 |

**NOTES (continued)**

## 17. LOANS AND ADVANCES TO NON-BANK CUSTOMERS (continued)

### (b) Impairment losses on loans and advances to non-bank customers (continued)

**GROUP**

| | Stage 1 | Stage 2 | Stage 3 | Total ECL Allowance |
|---|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| ECL allowance as at 01 January 2018 | 29,907 | 32,437 | 2,805,427 | 2,867,771 |
| Increase / (decrease) in impairment | 98,015 | 253,393 | 11,686,471 | 12,037,879 |
| Transfers from stage 1 | (19,930) | 9,386 | 10,544 | - |
| Transfers from stage 2 | 3,738 | (20,373) | 16,635 | - |
| Transfers from stage 3 | - | 12,276 | (12,276) | - |
| Amounts written off | - | - | (1,971,119) | (1,971,119) |
| **At 31 December 2018** | 111,730 | 287,119 | 12,535,682 | 12,934,531 |

**BANK**

| | Stage 1 | Stage 2 | Stage 3 | Total ECL Allowance |
|---|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| ECL allowance as at 01 January 2018 | 29,907 | 32,437 | 2,805,427 | 2,867,771 |
| Increase / (decrease) in impairment | 98,015 | 253,393 | 11,686,471 | 12,037,879 |
| Transfers from stage 1 | (19,930) | 9,386 | 10,544 | - |
| Transfers from stage 2 | 3,738 | (20,373) | 16,635 | - |
| Transfers from stage 3 | - | 12,276 | (12,276) | - |
| Amounts written off | - | - | (1,971,119) | (1,971,119) |
| **At 31 December 2018** | 111,730 | 287,119 | 12,535,682 | 12,934,531 |

**NOTES (continued)**

**18. GOVERNMENT SECURITIES**

Treasury bonds and bills are classified as follows:

| | GROUP | | BANK | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| (a) Government securities measured at amortised cost | | | | |
| *Treasury bills* | 25,788,486 | - | 25,788,486 | - |
| *Treasury bonds* | 11,080,691 | 2,882,958 | 11,080,691 | 2,882,958 |
| | 36,869,177 | 2,882,958 | 36,869,177 | 2,882,958 |
| (b) Government securities mandatorily measured at fair value through profit or loss (FVPL) | | | | |
| *Treasury bills* | - | - | - | - |
| *Treasury bonds* | 714,935 | - | 714,935 | - |
| | 714,935 | - | 714,935 | - |
| (c) Government securities measured at fair value through other comprehensive income (FVOCI) | | | | |
| *Treasury bills* | - | - | - | - |
| *Treasury bonds* | 5,755,259 | - | 5,755,259 | - |
| | 5,755,259 | - | 5,755,259 | - |
| **Total government securities** | 43,339,371 | 2,882,958 | 43,339,371 | 2,882,958 |

The movement in treasury bills and bonds for each of the categories during the year is as follows:
(a) Treasury bills and bonds at amortized cost

| | GROUP | | BANK | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| At start of the year | 2,882,958 | 2,828,194 | 2,882,958 | 2,828,194 |
| Acquired from CBLIR (note 7) | 8,813,480 | - | 8,813,480 | - |
| Purchases | 25,184,741 | 200,000 | 25,184,741 | 200,000 |
| Maturities | (608,480) | (109,009) | (608,480) | (109,009) |
| Movement in accrued interest | (51,933) | (3,676) | (51,933) | (3,676) |
| Amortisation of discounts and premiums | 718,029 | (32,551) | 718,029 | (32,551) |
| ECL impairment loss | (69,618) | - | (69,618) | - |
| | 36,869,177 | 2,882,958 | 36,869,177 | 2,882,958 |

(b) Government securities mandatorily measured at FVPL

| | GROUP | | BANK | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| At start of the year | - | - | - | - |
| Acquired from CBLIR | - | - | - | - |
| Purchases | 701,556 | - | 701,556 | - |
| Maturities | - | - | - | - |
| Movement in accrued interest | 13,417 | - | 13,417 | - |
| Amortisation of discounts and premiums | (38) | - | (38) | - |
| | 714,935 | - | 714,935 | - |

(c) Government securities measured at FVOCI

| | GROUP | | BANK | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| At start of the year | - | - | - | - |
| Acquired from CBLIR | - | - | - | - |
| Purchases | 6,157,849 | - | 6,157,849 | - |
| Maturities | (518,987) | - | (518,987) | - |
| Movement in accrued interest | 145,980 | - | 145,980 | - |
| Amortisation of discounts and premiums | (14,880) | - | (14,880) | - |
| Fair valuation | (14,703) | - | (14,703) | - |
| | 5,755,259 | - | 5,755,259 | - |

**NOTES (continued)**

**18. GOVERNMENT SECURITIES (continued)**

Government securities amounting to KShs 6.879 billion were held under lien as at 31 December 2018 (2017 - KShs 9 million). Refer to note 34 for further details.

The fair value of the government securities measured at fair value through profit or loss are under the Level 1 class of fair value based on the information set out in accounting policy 3 (j) (iv) on 'Financial assets at fair value through profit or loss'.

The fair value of the government securities measured at fair value through other comprehensive income are under the Level 1 class of fair value based on the information set out in accounting policy 3 (j) (iii) on 'Financial assets at fair value through other comprehensive income'.

The fair value of the treasury bonds in government securities measured at amortised cost as at 31 December 2018 was KShs 10,340,224,000 (2017:KShs. 2,202,029,000). These are under the Level 1 class of fair value.

**19. INVESTMENT SECURITIES**

| | GROUP | | BANK | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Investment securities measured at amortised cost | | | | |
| *Corporate bonds (amortised cost)* | 299,513 | - | 299,513 | - |
| Investment securities designated at FVTPL | | | | |
| *Equity investments* | 2,164 | 3,573 | 2,113 | 3,491 |
| **Total investment in securities** | 301,677 | 3,573 | 301,626 | 3,491 |

(a) Movement in corporate bonds classified as investment securities measured at amortised during the year is as follows:

| | GROUP | | BANK | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| At start of the year | - | - | - | - |
| Acquired from CBLIR (note 7) | 462,001 | - | 462,001 | - |
| Purchases | - | - | - | - |
| Maturities | (164,150) | - | (164,150) | - |
| Movement in accrued interest | (6,546) | - | (6,546) | - |
| Impairment loss | 8,208 | - | 8,208 | - |
| | 299,513 | - | 299,513 | - |

(b) Movement in investment securities at FVPL during the year which are made up of quoted equity investments were as follows

| | GROUP | | BANK | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| At start of year | 3,573 | 3,549 | 3,491 | 3,491 |
| Additions | - | 24 | - | - |
| Fair value loss recognized in profit or loss | (1,409) | - | (1,378) | - |
| | 2,164 | 3,573 | 2,113 | 3,491 |

The fair values of the quoted equity instruments are under the Level 1 class of fair value based on the information set out in Note 3 (i) on 'Financial instruments'.

**20. INVESTMENT IN SUBSIDIARIES**

| | | 31 December 2018 | 31 December 2017 |
|---|---|---|---|
| | | KShs' 000 | KShs' 000 |
| Company | % held | | |
| Kentbury Investments Limited (Trading) | 100% | 17,587 | 17,587 |
| Finsure Insurance Brokers Limited (Insurance brokerage) | 100% | 10,025 | 10,025 |
| Richardson Properties Limited (Real estate investment) | 100% | 121,340 | 121,340 |
| Rover Investments Limited (Real estate investment) | 100% | 187,442 | 187,442 |
| | | 336,394 | 336,394 |
| **Less: impairment loss*** | | (336,394) | - |
| | | - | 336,394 |

* Management carried out an impairment test on the investment on subsidiaries, and recorded an impairment loss of KShs 336,394,000 (2017- nil) as the carrying amount of investment in subsidiaries exceeded its recoverable amount by KShs 336,394,000. In impairing the investment in subsidiaries, management considered the fact that the companies are currently dormant and are not expected to generate any revenues. Management is considering liquidating the companies.

**NOTES (continued)**

## 21. PROPERTY AND EQUIPMENT

### GROUP

**Year ended 31 December 2018**

| | Leasehold land | Leasehold land and buildings | Office renovations | Computers copiers and faxes | Motor vehicles | Furniture and fittings | Office equipment | Work -in- process | Total |
|---|---|---|---|---|---|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Cost or Valuation | | | | | | | | | |
| At start of the year | 22,690 | 146,636 | 174,893 | 100,539 | 16,855 | 26,925 | 93,098 | - | 581,636 |
| Additions | - | - | - | 1,080 | - | 54,151 | 21,871 | (23,659) | 53,443 |
| Acquired from CBLIR (note 7) | - | - | - | 10,327 | 60,753 | 662,834 | 303,818 | 226,219 | 1,263,951 |
| Reclassification from investment property | | 313,148 | | - | - | - | - | - | 313,148 |
| Reclassification between assets' classes | (22,690) | 22,690 | (174,893) | | | 174,893 | | | - |
| Loss on revaluation* | - | (237,409) | - | - | - | - | - | - | (237,409) |
| Transfer** | - | (7,617) | - | - | - | - | - | - | (7,617) |
| Impairment*** | - | - | - | (2,199) | - | (56,526) | (16,356) | - | (75,081) |
| At end of the year | - | 237,448 | - | 109,747 | 77,608 | 862,277 | 402,431 | 202,560 | 1,892,071 |
| Depreciation | | | | | | | | | |
| At start of the year | 918 | 6,699 | 125,078 | 93,255 | 13,567 | 19,920 | 80,658 | - | 340,095 |
| Charge for the year | - | 2,448 | - | 10,064 | 8,560 | 71,415 | 31,743 | - | 124,230 |
| Reclassification | (918) | 918 | (125,078) | - | - | 125,078 | - | - | - |
| Transfer** | | (7,617) | | | | | | | (7,617) |
| Impairment*** | - | - | - | - | - | (19,920) | (11,049) | - | (30,969) |
| At end of the year | - | 2,448 | - | 103,319 | 22,127 | 196,493 | 101,352 | - | 425,739 |
| Net carrying amount | - | 235,000 | - | 6,428 | 55,481 | 665,784 | 301,079 | 202,560 | 1,466,332 |

**Year ended 31 December 2017**

| | Leasehold land | Buildings | Office renovations | Computers copiers and faxes | Motor vehicles | Furniture and fittings | Office equipment | Work -in- process | Total |
|---|---|---|---|---|---|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | | KShs' 000 |
| Cost or Valuation | | | | | | | | | |
| At start of the year | 22,690 | 146,636 | 172,665 | 98,486 | 31,110 | 26,567 | 92,798 | - | 590,952 |
| Additions | - | - | 2,228 | 2,053 | - | 358 | 300 | - | 4,939 |
| Disposals | - | - | - | - | (14,255) | - | - | - | (14,255) |
| At end of the year | 22,690 | 146,636 | 174,893 | 100,539 | 16,855 | 26,925 | 93,098 | - | 581,636 |
| Depreciation | | | | | | | | | |
| At start of the year | 804 | 5,048 | 109,138 | 85,265 | 22,504 | 18,124 | 72,576 | - | 313,459 |
| Charge for the year | 114 | 1,651 | 15,940 | 7,990 | 2,489 | 1,796 | 8,082 | - | 38,062 |
| On disposal | - | - | - | - | (11,426) | - | - | - | (11,426) |
| At end of the year | 918 | 6,699 | 125,078 | 93,255 | 13,567 | 19,920 | 80,658 | - | 340,095 |
| Net carrying amount | 21,772 | 139,937 | 49,815 | 7,284 | 3,288 | 7,005 | 12,440 | - | 241,541 |

Reclassifications includes an amount of KShs 313,148,000 from investment property as disclosed in note 23 to the financial statements. Reclassification between asset's classes is so as to harmonise the Group's assets' classes after the acquisition of CBLIR.

*In 2018, the leasehold land and building was revalued to KShs 235,000,000. This resulted in a loss on revaluation of KShs 174,778,000 (note 12) after offsetting an existing surplus of KShs 62,631,000 in the asset revaluation surplus. Valuation of the property was done by Ardhiworth (Real Estate) Limited on 16 November 2018.

**This transfer relates to the accumulated depreciation as at the revaluation date that was eliminated against the gross carrying amount of the revalued asset.

***In 2018 an impairment loss of KShs 44,112,000 represented the write down of certain property and equipment as a result of closure of several branches. The cost of the written down assets was KShs 75,081,000 with an accumulated depreciation of KShs 30,969,000.

Leasehold land and building LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way have been pledged as security to Central Bank of Kenya for amounts borrowed under the liquidity support framework as disclosed in Note 28.

There were no commitments to acquire property, plant and equipment as at year end (2017: none)

**NOTES (continued)**

**21. PROPERTY AND EQUIPMENT (CONTINUED)**

**BANK**

**Year ended 31 December 2018**

| | Leasehold land | Leasehold land and buildings | Office renovations | Computers copiers and faxes | Motor vehicles | Furniture and fittings | Office equipment | Work -in-process | Total |
|---|---|---|---|---|---|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Cost or Valuation | | | | | | | | | |
| At start of the year | 22,690 | 146,636 | 174,893 | 100,182 | 16,855 | 26,318 | 93,098 | - | 580,672 |
| Additions | - | - | - | 1,080 | - | 54,151 | 21,871 | (23,659) | 53,443 |
| Acquired from CBLIR | - | - | - | 10,327 | 60,753 | 662,834 | 303,818 | 226,219 | 1,263,951 |
| Reclassification from investment property | - | 313,148 | - | - | - | - | - | - | 313,148 |
| Reclassification between assets' classes | (22,690) | 22,690 | (174,893) | - | - | 174,893 | - | - | - |
| Loss on revaluation* | - | (239,857) | - | - | - | - | - | - | (239,857) |
| Transfer** | - | (7,617) | - | - | - | - | - | - | (7,617) |
| Impairment*** | - | - | - | (2,199) | - | (56,526) | (16,356) | - | (75,081) |
| At end of the year | - | 235,000 | - | 109,390 | 77,608 | 861,670 | 402,431 | 202,560 | 1,888,659 |
| Depreciation | | | | | | | | | |
| At start of the year | 918 | 6,699 | 125,078 | 92,923 | 13,542 | 19,682 | 80,491 | - | 339,333 |
| Charge for the year | - | 2,448 | - | 10,064 | 8,560 | 71,384 | 31,743 | - | 124,199 |
| Reclassification | (918) | 918 | (125,078) | - | - | 125,078 | - | - | - |
| Transfer** | - | (7,617) | - | - | - | - | - | - | (7,617) |
| Impairment*** | - | - | - | - | - | (19,682) | (8,177) | - | (27,859) |
| At end of the year | - | 2,448 | - | 102,987 | 22,102 | 196,462 | 104,057 | - | 428,056 |
| Net carrying amount | - | 232,552 | - | 6,403 | 55,506 | 665,208 | 298,374 | 202,560 | 1,460,603 |

**Year ended 31 December 2017**

| | Leasehold land | Buildings | Office renovations | Computers copiers and faxes | Motor vehicles | Furniture and fittings | Office equipment | Work -in-process | Total |
|---|---|---|---|---|---|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Cost or Valuation | | | | | | | | | |
| At start of the year | 22,690 | 146,636 | 172,665 | 98,129 | 31,110 | 25,960 | 92,798 | - | 589,988 |
| Additions | - | - | 2,228 | 2,053 | - | 358 | 300 | - | 4,939 |
| Disposals | - | - | - | - | (14,255) | - | - | - | (14,255) |
| At end of the year | 22,690 | 146,636 | 174,893 | 100,182 | 16,855 | 26,318 | 93,098 | - | 580,672 |
| Depreciation | | | | | | | | | |
| At start of the year | 804 | 5,048 | 109,138 | 84,946 | 22,504 | 17,886 | 72,409 | - | 312,735 |
| Charge for the year | 114 | 1,651 | 15,940 | 7,977 | 2,464 | 1,796 | 8,082 | - | 38,024 |
| On disposal | - | - | - | - | (11,426) | - | - | - | (11,426) |
| At end of the year | 918 | 6,699 | 125,078 | 92,923 | 13,542 | 19,682 | 80,491 | - | 339,333 |
| Net carrying amount | 21,772 | 139,937 | 49,815 | 7,259 | 3,313 | 6,636 | 12,607 | - | 241,339 |

Reclassifications includes an amount of KShs 313,148,000 from investment property as disclosed in note 23 to the financial statements. Reclassification between asset's classes is so as to harmonise the Group's assets' classes after the acquisition of CBLIR.

*In 2018, the leasehold land and building was revalued to KShs 235,000,000. This resulted in a loss on revaluation of KShs 179,783,000 (note 12) after offsetting an existing surplus of KShs 60,074,000 in the asset revaluation surplus. The revaluation was done by Ardhiworth (Real Estate) Limited on 16 November 2018.

**This transfer relates to the accumulated depreciation as at the revaluation date that was eliminated against the gross carrying amount of the revalued asset.

***In 2018 an impairment loss of KShs 47,221,000 represented the write down of certain property and equipment as a result of closure of several branches. The cost of the written down assets was KShs 75,081,000 with an accumulated depreciation of KShs 27,859,000.

Leasehold land and building LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way have been pledged as security to Central Bank of Kenya for amounts borrowed under the liquidity support framework as disclosed in Note 28.

There were no commitments to acquire property, plant and equipment as at year end (2017: none)

**NOTES (continued)**

**21. PROPERTY AND EQUIPMENT (CONTINUED)**

Leasehold land and buildings are carried at fair value. The fair value of the leasehold land and building is included within Level 3 of the fair value hierarchy.

The revalued classes of property and equipment were leasehold land and buildings, and the carrying amounts that would have been recognised had the assets been carried under the cost model would have been as follows:

| | Group and Bank | |
|---|---|---|
| | Leasehold land | Buildings |
| | KShs' 000 | KShs' 000 |
| 31 December 2018: | | |
| Cost | 7,826 | 89,082 |
| Accumulated depreciation | (342) | (6,441) |
| Net carrying amount | 7,484 | 82,641 |
| 31 December 2017: | | |
| Cost | 8,127 | 94,400 |
| Accumulated depreciation | (301) | (5,318) |
| Net carrying amount | 7,826 | 89,082 |

There was no revaluation surplus on property and equipment for the Group and Bank as at 31 December 2018 (2017: KShs 62,631,000 and KShs 60,074,000 respectively) as valuations done in the year showed a decline in value utilising all surplus recorded in prior periods.

The valuations were based on market value as follows:

*Comparable Method for valuation of leasehold land and buildings*

Fair value of the properties was determined by using market comparable method. This means that valuations performed by the valuer are based on active market prices, significantly adjusted for difference in the nature, location or condition of the specific property.

Management has ensured that:

1) The highest and best use of the properties is its current use, and
2) The principal market or in its absence, the most advantageous market, exit market, for the properties is the same as the market in which the properties was or would be purchased, entry market.

Sensitivity analysis

The significant unobservable inputs used in the fair value measurement of the Bank's investment properties and leasehold land and buildings are price per acre, estimated rental value per square meter per month. Significant increases/(decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement.

Description of valuation techniques used and key inputs to valuation of land and buildings

| | Valuation technique | Significant unobservable inputs | Range (weighted average) | Sensitivity of the input to fair value |
|---|---|---|---|---|
| Leasehold land, land and buildings (included in property and equipment and investment properties) | Market comparable approach | Estimated amount for which property should exchange between willing seller and willing buyer | KShs 25 million - KShs 235 million | 0.5% (2017: 0.5%) increase (decrease) would result in an average increase (decrease) in fair value by KShs 1.17 million |

**NOTES (continued)**

## 22. INTANGIBLE ASSETS - SOFTWARE COSTS

| | Group and Bank | |
|---|---|---|
| | 2018 Total | 2017 Total |
| | KShs' 000 | KShs' 000 |
| Cost | | |
| At start of year | 327,703 | 327,703 |
| Additions | 1,110 | - |
| Acquired from CBLIR (note 7) | 536,567 | - |
| Impairment* | (328,813) | - |
| At end of year | 536,567 | 327,703 |
| Amortisation | | |
| At start of year | 167,109 | 127,923 |
| Charge for the year | 144,242 | 39,186 |
| Impairment* | (206,173) | - |
| At end of year | 105,178 | 167,109 |
| Net carrying amount | 431,389 | 160,594 |

At acquisition of CBLIR the bank harmonised its core banking system and wrote off certain legacy systems that were no longer in use. The net carrying amount of the written off software was KShs. 122,640,000

## 23. INVESTMENT PROPERTY

| | Group | | Bank | |
|---|---|---|---|---|
| | 2018 Total | 2017 Total | 2018 Total | 2017 Total |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| At start of year | 440,043 | 440,043 | 313,148 | 313,148 |
| Additions | - | - | - | |
| Reclassification to property and equipment | (313,148) | - | (313,148) | - |
| At end of the year | 126,895 | 440,043 | - | 313,148 |
| Impairment loss** | (126,895) | - | - | - |
| | - | 440,043 | - | 313,148 |

* Reclassification to property and equipment
During year the Bank transferred the Mombasa investment property of KShs 313,148,000 to property and equipment, as there is a change in use, evidenced by increase of owner-occupation of the building. As at 31 December 2018, the portion rented out is not significant.

** Impairment loss
Management carried out an impairment test on the investment property, LR 209/8873/2 and recorded an impairment loss of KShs 126,895,000 (2017- nil) as the carrying value of property exceeded its recoverable amount by KShs 126,895,000. In impairing the property, management considered the fact that the property is under legal dispute as disclosed in Note 33(a).

As at 31 December 2017, the fair value of investment property was determined by reference to the market prices of similar properties of the type and in the area in which the property is situated. The valuation was done on 31 December 2017 by Redfearn Valuers Limited, an independent professional valuer with recent experience in the location and category of the investment property being valued.

Investment properties include

| | Investment type | L.R. No. | Ownership | Amount KShs' 000 | Reclassified to property and equipment | Impaired | Total |
|---|---|---|---|---|---|---|---|
| Mombasa – along Nyerere Avenue | Building | Mombasa Block XXI/606 | Bank | 313,148 | (313,148) | - | - |
| Waiyaki Way land | Land | LR 209/8873/2 | Richardson Properties Limited | 126,895 | - | (126,895) | - |
| | | | | 440,043 | (313,148) | (126,895) | - |

Leasehold land and building LR No. Mombasa/Block XXI/606 and LR 209/8873/2 have been pledged as security to Central Bank of Kenya for amounts borrowed under the liquidity support framework as disclosed in note 28.

The rental income for the year was KShs 7,857,000 for the Group (2017: 5,614,000) and KShs nil (2017: 5,614,000) for the Bank. This has been included under other income.

The direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the year was KShs 1,778,000 for the Group (2017: 4,379,000) and KShs nil (2017: 4,379,000) for the Bank.

There were no direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period

**NOTES (continued)**

## 24. DEFERRED TAX ASSET

Deferred tax is calculated on all temporary differences under the liability method using a principal tax rate of 30% (2017: 30%). The deferred tax asset and deferred tax charge/(credit) in profit or loss are attributable to the following:

| **Group 2018:** | 1 January 2018 | Prior year provisions (under) / over | Bargain purchase gain | Recognised in profit or loss | Recognised in other comprehensive income | 31 December 2018 |
|---|---|---|---|---|---|---|
| | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 |
| Arising from: | | *(Note 14)* | *(Note 14)* | *(Note 14)* | | |
| Fair value losses | (7,243) | - | - | - | - | (7,243) |
| Leave pay provision | (2,904) | - | - | (4,532) | - | (7,436) |
| Other general provisions | (435,682) | - | - | (167,577) | - | (603,287) |
| Unrealised exchange loss | (556) | 6,850 | - | 24,322 | - | 30,616 |
| Deferred tax on bargain purchase | - | - | 1,036,649 | - | - | 1,036,649 |
| Tax losses carried forward | (260,364) | - | - | (185,431) | - | (445,795) |
| Excess capital allowance over depreciation | 30,700 | - | - | (33,783) | - | (3,083) |
| Net deferred tax | (676,049) | 6,850 | 1,036,649 | (367,001) | - | 421 |

| **Group 2017:** | 1 January 2017 | Prior year provisions (under) / over | Bargain purchase gain | Recognised in profit or loss | Recognised in other comprehensive income | 31 December 2017 |
|---|---|---|---|---|---|---|
| | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 | KShs '000 |
| Arising from: | | *(Note 14)* | *(Note 14)* | *(Note 14)* | | |
| Fair value losses | (7,243) | - | - | - | - | (7,243) |
| Leave pay provision | (2,676) | - | - | (228) | - | (2,904) |
| Other general provisions | (437,887) | (2,344) | - | 4,549 | - | (435,682) |
| Unrealised exchange loss | (556) | - | - | - | - | (556) |
| Tax losses carried forward | (231,421) | - | - | (28,943) | - | (260,364) |
| Excess capital allowance over depreciation | 33,271 | - | - | (2,571) | - | 30,700 |
| Net deferred tax | (646,512) | (2,344) | - | (27,193) | - | (676,049) |

**NOTES (continued)**

**24. DEFERRED TAX ASSET (continued)**

| **Bank 2018:** | 1 January 2018 KShs '000 | Prior year provisions (under) / over KShs '000 | Bargain purchase gain KShs '000 | Recognised in profit or loss KShs '000 | Recognised in other comprehensive income KShs '000 | 31 December 2018 KShs '000 |
|---|---|---|---|---|---|---|
| Arising from: | | *(Note 14)* | *(Note 14)* | *(Note 14)* | | |
| Fair value losses | (7,243) | - | - | - | - | (7,243) |
| Leave pay provision | (2,904) | - | - | (4,532) | - | (7,436) |
| Other general provisions | (435,682) | - | - | (167,577) | - | (603,259) |
| Unrealised exchange loss | (556) | 6,850 | - | 24,322 | - | 30,616 |
| Deferred tax on bargain purchase | - | - | 1,036,649 | - | - | 1,036,649 |
| Tax losses carried forward | (259,336) | - | - | (185,431) | - | (444,767) |
| Excess capital allowance over depreciation | 30,622 | - | - | (33,783) | - | (3,161) |
| Net deferred tax | (675,099) | 6,850 | 1,036,649 | (367,001) | - | 1,399 |

| **Bank 2017:** | 1 January 2017 KShs '000 | Prior year provisions (under) / over KShs '000 | Bargain purchase gain KShs '000 | Recognised in profit or loss KShs '000 | Recognised in other comprehensive income KShs '000 | 31 December 2017 KShs '000 |
|---|---|---|---|---|---|---|
| Arising from: | | *(Note 14)* | *(Note 14)* | *(Note 14)* | | |
| Fair value losses | (7,243) | - | - | (0) | - | (7,243) |
| Leave pay provision | (2,676) | - | - | (228) | - | (2,904) |
| Other general provisions | (437,887) | (2,344) | - | 4,549 | - | (435,682) |
| Unrealised exchange loss | (556) | - | - | - | - | (556) |
| Tax losses carried forward | (230,393) | - | - | (28,943) | - | (259,336) |
| Excess capital allowance over depreciation | 33,193 | - | - | (2,571) | - | 30,622 |
| Net deferred tax | (645,562) | (2,344) | - | (27,193) | - | (675,099) |

**NOTES (continued)**

## 25. OTHER ASSETS

Other assets and other receivables that have fixed or determinable payments and that are not quoted in an active market are measured at amortised cost less any impairment loss.

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Deposits and prepayments | 320,323 | 38,196 | 320,323 | 38,196 |
| Other receivables | 437,599 | 12,514 | 436,428 | 10,957 |
| | 757,922 | 50,710 | 756,751 | 49,153 |

## 26. DEPOSITS FROM BANKS

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Current and demand accounts | - | 413,329 | - | 413,097 |

## 27. CUSTOMER'S DEPOSITS

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Current and demand accounts | 6,993,466 | 886,981 | 7,008,935 | 900,895 |
| Savings accounts | 3,625,995 | 257,844 | 3,625,995 | 257,844 |
| Call deposits | 197,733 | 64,052 | 197,733 | 64,052 |
| Term deposits | 33,424,246 | 4,316,043 | 33,424,246 | 4,316,043 |
| Foreign currency deposits | 6,787,011 | 890,206 | 6,787,011 | 890,206 |
| | 51,028,451 | 6,415,126 | 51,043,920 | 6,429,040 |

| Analysis of the Bank's customer deposits by maturity: | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
|---|---|---|---|---|
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Payable within 90 days | 21,614,570 | 5,992,675 | 21,630,039 | 6,006,589 |
| Payable after 90 days and within 1 year | 11,364,998 | 422,451 | 11,364,998 | 422,451 |
| Payable after 1 year | 18,048,883 | - | 18,048,883 | - |
| | 51,028,451 | 6,415,126 | 51,043,920 | 6,429,040 |

**Concentration**

The economic sector concentrations within the customer deposits portfolio for the Bank were as follows:

| | 2018 | 2018 | 2017 | 2017 |
|---|---|---|---|---|
| | KShs' 000 | % | KShs' 000 | % |
| Wholesale, retail and hotel | 54,973 | 0% | 1,446,367 | 23% |
| Transport and communication | 1,041,099 | 2% | 385,698 | 6% |
| Agriculture | 1,178,710 | 2% | 32,145 | 0% |
| Hire purchases and insurance | 916,415 | 2% | 64,282 | 1% |
| Business services | 1,932,577 | 4% | 1,478,508 | 23% |
| Building, construction and real estate | 1,555,267 | 3% | 642,829 | 10% |
| Social community and personal Services | 17,586,584 | 34% | 2,249,904 | 35% |
| Manufacturing | 919,231 | 2% | - | 0% |
| Financial services | 8,918,976 | 18% | - | 0% |
| Petroleum and natural Gas | 18,293 | 0% | - | 0% |
| Electricity and water | 65,600 | 0% | - | 0% |
| Trade | 4,237,489 | 8% | - | 0% |
| Health services | 58,099 | 0% | - | 0% |
| Mining and quarrying | 37,974 | 0% | - | 0% |
| Public sector | 456,008 | 1% | - | 0% |
| Others* | 12,066,625 | 24% | 129,307 | 2% |
| | 51,043,920 | 100% | 6,429,040 | 100% |

**NOTES (continued)**

## 28. AMOUNTS DUE TO CENTRAL BANK OF KENYA

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Liquidity Support Framework | 9,104,981 | 2,892,626 | 9,104,981 | 2,892,626 |
| Other balances due to Central Bank of Kenya | - | - | - | - |
| | 9,104,981 | 2,892,626 | 9,104,981 | 2,892,626 |

**Movement in amounts due to Central Bank of Kenya**

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| | KShs' 000 | KShs' 000 |
| At January | 2,892,626 | 2,918,996 |
| Acquired from CBLIR | 9,683,999 | - |
| Fair value gain on valuation of the acquired liquidity support from CBLIR | (3,670,998) | - |
| Fair value of liquidity support at acquisition date | 6,013,001 | - |
| Amortisation of fair value gain classsified under interest expense (note 8) | 215,501 | - |
| Accrued interest | 27,266 | - |
| Repaid during the year | (43,413) | (285,387) |
| Received during the year | - | 259,017 |
| At December | 9,104,981 | 2,892,626 |

KShs 2.892 billion relates to an amount borrowed from Central Bank of Kenya under a liquidity support framework granted prior to 2017. The amount is partly secured by two properties belonging to the Group i.e. LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way, Nairobi, as disclosed in note 23.

The Bank assumed KShs 9,683,999,000 as part of the liabilities from the acquisition of CBLIR. At the acquisition date, the fair value of the liability was determined based on the new agreed terms and the change in fair value was factored into the determination of bargain purchase gain. Management assumed an interest rate of 10% and the liquidity support repayment term of 5 years.

Subsequently, the liquidity support is measured at amortised cost and the amortisation of the fair value gain is recorded as interest expense under note 8.

The amount is secured by government securities with a face value of KShs 6.879 billion.

## 29. OTHER LIABILITIES

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Outstanding bankers drafts and cheques | 42,288 | 3,702 | 42,288 | 3,702 |
| Sundry creditors | 2,560,411 | 203,745 | 2,560,411 | 200,812 |
| Leave pay provision | 24,786 | 10,675 | 24,786 | 10,675 |
| | 2,627,485 | 218,122 | 2,627,485 | 215,189 |

Other liabilities are expected to be settled within 12 months from the reporting date. Sundry creditors include direct and indirect taxes payable as at year end, accrued expenses and general provisions held.

## 30. Due to group companies

| | Group | | Bank | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Due to related entities | 36,390 | - | 6,335 | 188,032 |

**NOTES (continued)**

## 31. OPERATING LEASE COMMITMENTS

The Group leases 52 bank premises under operating leases. During the year, KShs 291,456,000 each (2017: KShs 59,787,000) was charged to profit or loss in respect of operating leases by the Group and Bank respectively. All the commitments below relate to future rent payable for the 52 bank premises based on the existing contracts and projected renewals. The lease agreements are between SBM Bank (Kenya) Limited and landlords and have no provisions relating to contingent rent payable. The terms of renewal vary from one lease to another and may include a written notice to the lessors before the expiration of the leases and the lessors will grant to the lessee new leases of the said premises/properties for a further term as may be mutually agreed by the parties.

The escalation rates vary from property to property and are factored into the operating lease commitment values presented below.

Future minimum lease payments under these operating leases are as follows:

**(a) Group as a lessee**

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| | KShs' 000 | KShs' 000 |
| Less than one year | 28,393 | 40,398 |
| One to five years | 395,826 | 221,992 |
| Over five years | 280,060 | - |
| | 704,279 | 262,390 |

**(a) Group as a lessor**

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| | KShs' 000 | KShs' 000 |
| Maturing within one year | 5,278 | 5,124 |
| Maturing over one to five years | 21,110 | 20,495 |
| | 26,388 | 25,619 |

All the commitments relate to future rent receivable for the rented building based on the existing contracts and projected renewals. The lease agreements are between Rover Investment Limited and tenants and have no provisions relating to contingent rent receivable. The terms of renewal vary from one lease to another and may include a written notice to the Group, as lessor, before the expiration of the leases, and the Group will grant to the lessee new leases of the said premises/properties for a further term as may be mutually agreed by the parties.

**NOTES (continued)**

## 32. SHARE CAPITAL

### (a) Share capital

| | Group and Bank Number of ordinary shares (thousands) | | Group and Bank Issued and paid up capital | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 KShs' 000 | 2017 KShs' 000 |
| At start of year | 51,703,007 | 153,007 | 2,045,570 | 1,530,070 |
| Transfer from share capital pending allotment | 1,412 | - | 14,116 | - |
| Additional capital injection | 10,581 | 51,550,000 | 105,814 | 515,500 |
| At end of year | 51,715,000 | 51,703,007 | 2,165,500 | 2,045,570 |

The authorised share capital is divided into 165,000,000 ordinary shares of KShs 10 each amounting to a value of KShs 1,650,000,000, and 51,550,000,000 class B shares of KShs. 0.01 amounting to KShs 515,500,000.

During the year, the Bank transferred KShs 14,116,133 to share capital from share capital pending allotment. These were made up of 1,411,613 number of shares at a par value of KShs 10. Additionally, 10,581,387 new shares were issued at a premium of KShs 427.80 per share.

### (b) Share capital pending allotment

| | Group and Bank 2018 KShs' 000 | Group and Bank 2017 KShs' 000 |
|---|---|---|
| At start of the year | 618,000 | - |
| Increase during the year | - | 618,000 |
| Transfer to share capital | (14,116) | - |
| Transfer to share premium | (603,884) | - |
| At end of the year | - | 618,000 |

Allotment of shares was completed during the year with a total number of 1,411,613 shares allotted at a par value of KShs 10 per share and premium of KShs 427.80 per share. This movement is shown in the statement of changes in equity

### (c) Share premium

| | Group and Bank 2018 KShs' 000 | Group and Bank 2017 KShs' 000 |
|---|---|---|
| At start of the year | 1,572,222 | 25,722 |
| Transfer from share capital pending allotment | 603,884 | - |
| Share premium arising from capital injection | 4,525,839 | 1,546,500 |
| At end of the year | 6,701,945 | 1,572,222 |

1,411,613 shares were allotted at a par value of KShs 10 and premium of KShs 427.80 per share thus total premium of KShs 603,884,000.

Additionally, 10,581,387 ordinary shares were issued in the year at a premium of KShs 427.80 per share.

### (d) Preference share capital

| | Group and Bank Number of preference shares (thousands) | | Group and Bank Issued and fully paid | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 KShs' 000 | 2017 KShs' 000 |
| Issued and fully paid | 10,000 | 10,000 | 100,000 | 100,000 |

The authorised preference shares are divided into 10,000,000 preference shares of KShs 10 each amounting to a value of KShs 100,000,000.

The non-cumulative preference shares confer the same voting rights as ordinary shares of the Bank. A non-cumulative annual preference dividend of 13% is payable by the Bank. These preference shares rank in priority to any dividend payable on the ordinary shares of the Bank.

In winding up the Bank, the non-cumulative preference shares will be paid off in priority to ordinary shares but rank behind creditors of the Bank.

### (e) Revaluation reserve

The revaluation reserve relates to the revaluation of leasehold land and buildings. These reserves are not distributable.
During the year, leasehold land and buildings were revalued resulting to a fair valuation loss. This loss led to the utilization of the revaluation surplus carried forward from prior periods.

**NOTES (continued)**

**32. SHARE CAPITAL (continued)**

**(f) Fair value reserve of financial assets at fair value through comprehensive income**

This represents the cumulative gains and losses arising from revaluation of financial assets at fair value through other comprehensive income (government securities measured at FVOCI) from cost to fair value based on the market values of the assets at the end of the reporting period. This is not distributable.

The disaggregation of changes of OCI by fair value reserve of financial assets at fair value through other comprehensive income in equity is shown below.

| | Group and Bank | |
|---|---|---|
| | 2018 | 2017 |
| | KShs' 000 | KShs' 000 |
| At start of the year | - | - |
| Reclassified to statement of profit and loss | - | - |
| Fair value loss on debt instruments at FVOCI [Note 18(c)] | 14,703 | - |
| | 14,703 | - |

**(g) Statutory credit risk reserve**

Where impairment losses required by legislation or regulations exceed those computed under International Financial Reporting Standards (IFRSs), the excess is recognised as a statutory reserve and accounted for as an appropriation of retained profits and the reverse for reductions. These reserves are not distributable. For the year ended 31 December 2018, statutory credit risk reserve was nil (2017: 6,256,000).

**33. OFF STATEMENT OF FINANCIAL POSITION FINANCIAL INSTRUMENTS, CONTINGENT LIABILITIES AND COMMITMENTS**

**(a) Legal proceedings - Bank**

There were a number of legal proceedings outstanding against the Bank as at 31 December 2018. No provision has been made as professional advice indicates that it is unlikely that any significant loss will arise.

Land dispute over LR 209/8873/2

The property LR 209/8873/2, disclosed in note 23, is an investment property currently under legal dispute before the National Land Commission and the Environmental and Land court. In the dispute, the plaintiff, Muguga Greens Apartments Management Limited, alleged that the property had been illegally allocated to Emtol Properties. Emtol Properties were the previous owners before they sold it to the Bank.

**(b) Contractual off-statement of financial position of financial liabilities**

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

| | Group and Bank | |
|---|---|---|
| | 2018 | 2017 |
| Contingencies related to: | KShs' 000 | KShs' 000 |
| Acceptances and letters of credit | 708,621 | 173,194 |
| Letters of guarantee | 1,833,184 | 297,656 |
| Forwards, swaps and options | 1,388,918 | - |
| Funds held on behalf of customers for purchase of securities | - | 19,196 |
| At end of the year | 3,930,723 | 490,046 |

**(c) Nature of contingent liabilities**

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

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

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

Forward contracts are arrangements to buy or sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate.
The fair values of the respective currency forwards are carried on the face of the statement of financial position.

**(d) Commitments**

There were no undrawn formal stand-by facilities, credit lines and other commitments to lend

**34. ASSETS PLEDGED AS SECURITY - BANK**

As at 31 December 2018, Government securities with a face value of KShs 6.879 billion were held under lien in favour of The Central Bank of Kenya Limited (2017: KShs. 9 million). In addition, the property previously classified as investment property has been pledged as collateral to Central Bank of Kenya. These are disclosed in note 28.

**35. DIVIDENDS**

There were no dividends paid in the current year (2017: nil)

**NOTES (continued)**

## 36. NOTES TO THE STATEMENT OF CASH FLOWS

### (a) Cash flows from operating activities

| For the year ended 31 December | Note | GROUP 2018 KShs' 000 | GROUP 2017 KShs' 000 | BANK 2018 KShs' 000 | BANK 2017 KShs' 000 |
|---|---|---|---|---|---|
| Profit / (Loss) before tax | | 964,054 | (358,060) | 955,731 | (360,627) |
| *Adjustments for:* | | | | | |
| Write back general provisions | 12(c) | (465,160) | - | (470,165) | - |
| Leave accrual | 11 | 25,936 | 1,841 | 25,936 | 1,841 |
| Movement in accrued interest and ECL impairment loss on investment securities | | (253) | | (253) | |
| Impairment of investment in subsidiaries | 20 | - | - | 336,394 | - |
| Loss on revaluation of property and equipment | 21 | 174,778 | - | 179,783 | - |
| Impairment of property and equipment | 21 | 44,112 | - | 47,221 | - |
| Impairment of intangible assets | 22 | 122,640 | - | 122,640 | - |
| Impairment of investment property | 23 | 126,895 | - | - | - |
| Accrued interest and amortisation of fair value gain on valuation of amounts due to Central Bank of Kenya | 28 | 242,767 | - | 242,767 | - |
| Depreciation on property and equipment | 21 | 124,230 | 38,062 | 124,230 | 38,024 |
| Amortisation on intangible assets | 22 | 144,242 | 39,186 | 144,242 | 39,186 |
| Net (increase)/decrease in impairment loss on financial instruments | 13(c) | 1,542,263 | (10,816) | 1,542,263 | (10,816) |
| ECL impairment loss on government securities | 13(c) | 69,618 | - | 69,618 | - |
| Bargain purchase gain | 10(c) | (2,790,776) | - | (2,790,776) | - |
| Amortisation of discounts/premiums and accrued interest on government securities | 18 | (810,575) | 32,551 | (810,575) | 32,551 |
| Profit on sale of property and equipment | 10(a) | - | (4,552) | - | (4,552) |
| Dividend from investment securities | 10(b) | (174) | (86) | (174) | (86) |
| Profit/(Loss) before changes in operating assets and liabilities | | (485,403) | (261,874) | (281,118) | (264,479) |
| *(Increase)/decrease in operating assets:* | | | | | |
| Movement in loans and advances to customers | | (1,787,430) | 487,196 | (1,786,083) | 482,485 |
| Investment in securities | | 164,150 | (24) | 164,150 | - |
| Investment in government securities | | (30,916,679) | (87,315) | (30,916,679) | (87,315) |
| Cash and balances with Central Bank of Kenya (Cash Reserve Ratio) | | (2,227,740) | (53,717) | (2,227,740) | (53,717) |
| Other assets | | 31,537,743 | 7,574 | 31,537,357 | 7,616 |
| Net (decrease)/increase in operating assets and liabilities | | (3,229,956) | 353,714 | (3,228,995) | 349,069 |
| *(decrease)/increase in operating liabilities:* | | | | | |
| Customer deposits | | (12,508,779) | 2,178,875 | (12,507,224) | 2,177,562 |
| Due to group companies | | 36,390 | - | (181,697) | - |
| Other liabilities | | 1,016,205 | (833,994) | 1,024,171 | (825,199) |
| | | (11,456,184) | 1,344,881 | (11,664,750) | 1,352,363 |
| Cash flows used in operations | | (15,171,543) | 1,436,721 | (15,174,863) | 1,436,953 |
| Tax paid | 13(c) | (3,088) | - | - | - |
| Net cash flows generated (utilised)/from operating activities | | (15,174,631) | 1,436,721 | (15,174,863) | 1,436,953 |

### (b) Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following:

**GROUP**

| | 2018 KShs' 000 | 2017 KShs' 000 | Changes during the year |
|---|---|---|---|
| Cash and cash equivalents [Note 16(a)] | 8,137,819 | 1,804,815 | 6,333,004 |
| Placements with other banking institutions [Note 16(b)] | 3,024,424 | 813,382 | 2,211,042 |
| Less: Restricted balances (Cash Reserve Ratio) | (2,535,662) | (307,922) | (2,227,740) |
| Less: Deposits due to other banking institutions (Note 26) | - | (413,329) | 413,329 |
| | 8,626,581 | 1,896,946 | 6,729,635 |

**BANK**

| | 2018 KShs' 000 | 2017 KShs' 000 | Changes during the year |
|---|---|---|---|
| Cash and cash equivalents [Note 16(a)] | 8,137,819 | 1,804,815 | 6,333,004 |
| Placements with other banking institutions [Note 16(b)] | 3,024,424 | 813,382 | 2,211,042 |
| Less: Restricted balances (cash reserve ratio) | (2,535,662) | (307,922) | (2,227,740) |
| Less: Deposits due to other banking institutions (Note 26) | - | (413,097) | 413,097 |
| | 8,626,581 | 1,897,178 | 6,729,403 |

**NOTES (continued)**

## 37. RELATED PARTY TRANSACTIONS AND BALANCES

The parent company is SBM Africa Holdings Limited, and ultimate holding company is SBM Holdings Limited, both incorporated in Mauritius. There are other companies related to SBM Bank (Kenya) Limited through common shareholding.

On 17 May 2017, SBM Holdings Limited (incorporated in Mauritius) through its subsidiary, SBM Africa Holdings Limited acquired more than 94% ordinary shareholding in Fidelity Commercial Bank Limited, making it, its subsidiary, and subsequently changing its name to SBM (Bank) Kenya Limited.

On 18 August 2018, through a business combination, SBM Bank (Kenya) Limited acquired certain assets and assumed certain liabilities of Chase Bank (Kenya) Limited (in receivership)

Included in loans and advances and customer deposits are amounts advanced to/received from certain directors and companies in which directors are involved either as shareholders or directors (related companies)

Included in the letters of guarantee in Note 33(b) are guarantees to Finsure Insurance Brokers Limited, a subsidiary of the Bank amounting to KShs 3,000,000. There have been no other guarantees provided or received for any related party receivables or payables.

The following are transactions and balances with related parties:

### (a) Bank balances and placement with other banking institutions

| | Group and Bank | |
|---|---|---|
| | 2018 | 2017 |
| | KShs' 000 | KShs' 000 |
| *Current account balances* | | |
| SBM Bank (Mauritius) Limited | 1,421 | - |
| *Placements with related banking institutions* | | |
| SBM Bank Mauritius (fellow subsidiary company) | 944,285 | - |
| | 945,706 | - |

### (b) Capital injection

| | Group and Bank | |
|---|---|---|
| | 2018 | 2017 |
| | KShs' 000 | KShs' 000 |
| Capital injection from SBM Africa Holdings | | |
| - share capital [Note 32(a)] | 105,814 | 515,500 |
| - share premium [Note 32(c)] | 4,525,839 | 1,546,500 |
| - shareholders' contributions pending allotment [Note 32(b)] | - | 618,000 |
| | 4,631,653 | 2,680,000 |

### (c) Deposits from other banking institutions

| | Group and Bank | |
|---|---|---|
| | 2018 | 2017 |
| | KShs' 000 | KShs' 000 |
| SBM Bank Mauritius (fellow subsidiary company) | - | 413,329 |

### (d) Other balances due to group companies (note 30)

| | Group | | Bank | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| SBM Holdings Limited | 6,335 | - | 6,335 | - |
| Richardson Properties Limited | 7,630 | - | - | - |
| Kentbury Investments Limited | 14,836 | - | - | - |
| Rover Investments Limited | 1,905 | - | - | 188,032 |
| Finsure Insurance Brokers Limited | 5,684 | - | - | - |
| | 36,390 | - | 6,335 | 188,032 |

**NOTES (continued)**

**37. RELATED PARTY TRANSACTIONS AND BALANCES (continued)**

| | Directors | | Related companies | | Senior management employees | | Other employees | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Outstanding loans and advances | | | | | | | | |
| At start of year | 16,961 | - | 4,119 | 5,239 | 62,324 | 33,690 | 336 | 1,201 |
| Net movement during the year | (16,961) | 16,961 | (816) | (1,120) | 76,217 | 28,634 | 1,017,475 | (865) |
| At end of the year | - | 16,961 | 3,303 | 4,119 | 138,541 | 62,324 | 1,017,811 | 336 |
| Guarantees | - | - | 3,000 | - | - | - | - | - |
| Interest income | - | 360 | - | 594 | 4,933 | 3,246 | 33,504 | 108 |

The loans and advances to related parties are performing.
Interest income earned from related parties in 2018 was KShs 38,437,000 (2017 – KShs 4,308,000). The effective interest rate was 5% (2017: 10.04%) with loan tenors stretching to a maximum of 20 years.
No provisions have been recognised in respect of the loans and advances to directors, related parties or staff as they are performing well.

| | Directors | | Related companies | | Senior management employees | | Other employees | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Deposits | | | | | | | | |
| At start of year | 32,513 | 15,360 | 6 | 1,004 | (4,119) | (65,826) | 3,693 | 1,524 |
| Deposits received during year | 222,716 | 19,741 | - | - | 219,669 | 128,943 | 1,529,829 | 56,352 |
| Interest charged | 48 | 392 | - | 6 | - | 654 | 375 | 35 |
| Withdrawals during year | (211,236) | (2,980) | (6) | (1,004) | (197,110) | (67,890) | (1,425,880) | (54,218) |
| At end of the year | 44,041 | 32,513 | - | 6 | 18,440 | (4,119) | 108,017 | 3,693 |

The weighted average interest rate for deposits was 6.5% (2017: 8.7%).

**Directors' benefits and other remuneration**

| | Group and Bank | |
|---|---|---|
| | 2018 | 2017 |
| | KShs' 000 | KShs' 000 |
| Salaries | 29,136 | 13,900 |
| Fees [note 12(a)] | 8,387 | 19,028 |
| Other remunerations | - | 549 |
| | 37,523 | 33,477 |

**Key personnel compensation**

| | Group and Bank | |
|---|---|---|
| | 2,018 | 2,017 |
| | Total | Total |
| | KShs' 000 | KShs' 000 |
| Salaries and other employment benefits | 67,347 | 111,040 |
| Post employment benefits | 4,378 | 6,050 |
| Other long term benefits | - | - |
| Termination benefits | - | 2,336 |
| | 71,725 | 119,426 |

**NOTES (continued)**

## 38. CAPITAL MANAGEMENT

### Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the Banking industry as a whole. The statutory minimum core capital is KShs 1 billion. In implementing current capital requirements The Central Bank of Kenya requires the Bank to maintain a 14.5% prescribed ratio of total capital to total risk-weighted assets. The Bank has met this requirement

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

**(a)** Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, after deductions for intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

**(b)** Tier 2 capital, which includes 25% of asset revaluation reserves which have received prior Central Bank of Kenya approval, subordinated debt and other capital instruments approved by Central Bank of Kenya.

Various limits are applied to elements of the capital base; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 Capital.

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

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

| | Statement of financial position nominal amount | | Risk weighted amount | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | KShs' 000 | KShs' 000 | KShs' 000 | KShs' 000 |
| Cash and cash equivalents | 8,137,819 | 1,804,815 | - | - |
| Placements with other banking institutions | 3,024,424 | 813,382 | 661,600 | 321,477 |
| Loans and advances to non-bank customers | 12,209,536 | 4,404,664 | 9,916,933 | 3,946,580 |
| Financial assets at fair value through profit and loss | 926,112 | - | 926,112 | - |
| Government securities | 43,339,371 | 2,882,958 | - | - |
| Investment securities | 301,626 | 3,491 | 301,626 | 3,491 |
| Tax recoverable | 60,108 | 60,108 | 60,108 | 60,110 |
| Other assets | 756,751 | 49,153 | 457,235 | 55,480 |
| Investment in subsidiaries | - | 336,394 | - | 336,144 |
| Property and equipment | 1,460,603 | 241,339 | 1,460,603 | 236,110 |
| Intangible assets | 431,389 | 160,594 | 431,389 | 160,755 |
| Investment property | - | 313,148 | - | 435,500 |
| Deferred tax assets | - | 675,099 | - | 645,563 |
| Total assets | 70,647,739 | 11,745,145 | 14,215,606 | 6,201,210 |
| Off statement of financial position: | | | | |
| Credit related commitments and other off balance sheet items | 2,541,805 | 490,046 | 1,847,140 | 490,046 |
| Total balance sheet and off balance sheet risk weighted assets | | | 16,062,746 | 6,691,256 |
| Market risk qualifying assets | | | (2,113) | (220,925) |
| Adjusted credit risk weighted assets | | | 16,060,633 | 6,470,331 |
| Total market risk weighted assets | | | 11,379,597 | 222,781 |
| Total risk weighted assets for operational risk | | | 1,224,337 | 140,986 |
| Total | | | 28,664,567 | 6,834,098 |

**NOTES (continued)**

## 38. CAPITAL MANAGEMENT (continued)

**Capital adequacy requirement calculation**

| | 2018 Total KShs' 000 | 2017 Total KShs' 000 |
|---|---|---|
| Tier 1 - core capital | | |
| Share capital | 2,165,500 | 2,663,570 |
| Share premium | 6,701,945 | 1,572,222 |
| Preference share capital | 100,000 | 100,000 |
| Accumulated losses | (2,015,235) | (2,794,961) |
| | 6,952,210 | 1,540,831 |
| Tier 2 capital - supplementary capital | | |
| Statutory credit risk reserve | - | 6,256 |
| Revaluation reserve (25%) | - | 15,019 |
| | - | 21,275 |
| Total regulatory capital | 6,952,210 | 1,562,106 |

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

| | Actual ratios | | Minimum requirement | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Core capital to risk weighted assets ratio | 24.25% | 16.10% | 10.50% | 10.50% |
| Core capital to deposits ratio | 13.62% | 15.90% | 10.50% | 10.50% |
| Total capital to risk weighted assets ratio | 24.25% | 16.40% | 14.50% | 14.50% |

*Capital allocation*

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

The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Group Risk and Group Credit, and is subject to review by the Group Credit Committee or ALCO as appropriate. Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Group to particular operations or activities, it is not the sole basis used for decision-making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Group's longer term strategic objectives. The Group's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

## 39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The tables below show an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. Trading assets and liabilities have been classified to mature and/or be repaid within 12 months, regardless of the actual contractual maturities of the products. With regard to loans and advances to customers, the Group uses the same basis of expected repayment behaviour that was used for estimating the EIR. Issued debt reflect the contractual coupon amortisations.

**GROUP**

| **At 31 December 2018** | **Within 12 months KShs'000** | **After 12 months KShs'000** | **Total KShs'000** |
|---|---|---|---|
| ASSETS | | | |
| Cash and cash equivalents | 8,137,819 | - | 8,137,819 |
| Placements with other banking institutions | 3,024,424 | - | 3,024,424 |
| Loans and advances to non-bank customers | 2,912,623 | 9,293,610 | 12,206,233 |
| Financial assets at fair value through profit and loss | 926,112 | - | 926,112 |
| Government securities | 27,152,372 | 16,186,999 | 43,339,371 |
| Investment securities | - | 301,677 | 301,677 |
| Tax recoverable | 62,783 | - | 62,783 |
| Other assets | 757,922 | - | 757,922 |
| Property and equipment | - | 1,466,332 | 1,466,332 |
| Intangible assets | - | 431,389 | 431,389 |
| | 42,974,055 | 27,680,007 | 70,654,062 |
| LIABILITIES | | | |
| Deposits from banks | - | - | - |
| Customers' deposits | 32,979,568 | 18,048,883 | 51,028,451 |
| Other liabilities | 2,627,064 | 421 | 2,627,485 |
| Due to group companies | 36,390 | - | 36,390 |
| Amounts due to Central Bank of Kenya | 9,104,981 | - | 9,104,981 |
| Financial liabilities at fair value through profit and loss | 926,112 | - | 926,112 |
| **TOTAL LIABILITIES** | 45,674,115 | 18,049,304 | 63,723,419 |
| NET | (2,700,060) | 9,630,703 | 6,930,643 |

**39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)**

**BANK**

| At 31 December 2018 | Within 12 months KShs'000 | After 12 months KShs'000 | Total KShs'000 |
|---|---|---|---|
| ASSETS | | | |
| Cash and cash equivalents | 8,137,819 | - | 8,137,819 |
| Placements with other banking institutions | 3,024,424 | - | 3,024,424 |
| Loans and advances to non-bank customers | 2,848,495 | 9,361,041 | 12,209,536 |
| Financial assets at fair value through profit and loss | 926,112 | - | 926,112 |
| Government securities | 27,152,372 | 16,186,999 | 43,339,371 |
| Investment securities | - | 301,626 | 301,626 |
| Tax recoverable | 60,108 | - | 60,108 |
| Other assets | 756,751 | - | 756,751 |
| Investment in subsidiaries | - | - | - |
| Property and equipment | - | 1,460,603 | 1,460,603 |
| Intangible assets | - | 431,389 | 431,389 |
| | 42,906,081 | 27,741,658 | 70,647,739 |
| LIABILITIES | | | |
| Customers' deposits | 32,995,037 | 18,048,883 | 51,043,920 |
| Other liabilities | 2,627,485 | 1,399 | 2,628,884 |
| Due to group companies | 6,335 | - | 6,335 |
| Amounts due to Central Bank of Kenya | - | 9,104,981 | 9,104,981 |
| Financial liabilities at fair value through profit and loss | 926,112 | - | 926,112 |
| **TOTAL LIABILITIES** | 36,554,969 | 27,155,263 | 63,710,232 |
| NET | 6,351,112 | 586,395 | 6,937,507 |

## 39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

**GROUP**

| At 31 December 2017 | Within 12 months KShs'000 | After 12 months KShs'000 | Total KShs'000 |
|---|---|---|---|
| ASSETS | | | |
| Cash and cash equivalents | 1,804,815 | - | 1,804,815 |
| Placements with other banking institutions | 813,382 | - | 813,382 |
| Loans and advances to non-bank customers | 2,556,802 | 1,843,151 | 4,399,953 |
| Government securities | 192,223 | 2,690,735 | 2,882,958 |
| Investment securities | - | 3,573 | 3,573 |
| Tax recoverable | 59,695 | | 59,695 |
| Other assets | 50,710 | 676,049 | 726,759 |
| Property and equipment | - | 241,541 | 241,541 |
| Intangible assets | - | 160,594 | 160,594 |
| Investment property | - | 440,043 | 440,043 |
| | 5,477,627 | 6,055,686 | 11,533,313 |
| LIABILITIES | | | |
| Deposits from banks | 413,329 | - | 413,329 |
| Customers' deposits | 6,375,539 | 39,587 | 6,415,126 |
| Other borrowed funds | - | - | - |
| Other liabilities | 218,122 | - | 218,122 |
| Amounts due to Central Bank of Kenya | - | 2,892,626 | 2,892,626 |
| **TOTAL LIABILITIES** | 7,006,990 | 2,932,213 | 9,939,203 |
| NET | (1,529,363) | 3,123,473 | 1,594,110 |

## 39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

**BANK**

| At 31 December 2017 | Within 12 months KShs'000 | After 12 months KShs'000 | Total KShs'000 |
|---|---|---|---|
| ASSETS | | | |
| Cash and cash equivalents | 1,804,815 | - | 1,804,815 |
| Placements with other banking institutions | 813,382 | - | 813,382 |
| Derivative financial instruments | - | - | - |
| Loans and advances to non-bank customers | 2,561,513 | 1,843,151 | 4,404,664 |
| Financial assets at fair value through profit and loss | - | - | - |
| Government securities | 192,223 | 2,690,735 | 2,882,958 |
| Investment securities | - | 3,491 | 3,491 |
| Tax recoverable | 60,108 | 0 | 60,108 |
| Other assets | 38,196 | 686,056 | 724,252 |
| Investment in subsidiaries | - | 336,394 | 336,394 |
| Property and equipment | - | 241,339 | 241,339 |
| Intangible assets | - | 160,594 | 160,594 |
| Investment property | - | 313,148 | 313,148 |
| | 5,470,237 | 6,274,908 | 11,745,145 |
| LIABILITIES | | | |
| Deposits from other banking institutions | 413,097 | - | 413,097 |
| Customers' deposits | 6,389,453 | 39,587 | 6,429,040 |
| Other liabilities | 215,189 | - | 215,189 |
| Due to group companies | 188,032 | - | 188,032 |
| Amounts due to Central Bank of Kenya | - | 2,892,626 | 2,892,626 |
| **TOTAL LIABILITIES** | 7,205,771 | 2,932,213 | 10,137,984 |
| NET | (1,735,534) | 3,342,695 | 1,607,161 |