BANK OF AFRICA KENYA LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

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BOARD OF DIRECTORS

Name		Nationality
Ambassador Dennis Awori*	Chairman, Non-Executive Director	Kenyan
Amine Bouabid	Non-Executive Director	Moroccan
Abdelkabir Bennani	Non-Executive Director	Moroccan
Susan Kasinga*	Non-Executive Director	Kenyan
Eunice Mbogo*	Non-Executive Director	Kenyan
Kathleen Cornelia Paulina Jobina Josina Goense	Non-Executive Director	Dutch
Ghali Lahlou (Appointed on 24 July 2018)	Non-Executive Director	Moroccan
Ronald Marambii	Managing Director	Kenyan

*Independent Non-Executive Directors

COMPANY SECRETARY

Anne Wanjiru Gitau
CPS (K)
Reg No. 2497
BOA House
School Lane, Westlands
P.O. BOX 69562
00400 Nairobi, Tom Mboya

REGISTERED OFFICE

BOA House
L. R. Nos 1870/III/313 and 1870/III/314
School Lane, Westlands
P.O. Box 69562
00400 Nairobi, Tom Mboya

INDEPENDENT AUDITOR

KPMG Kenya
8th Floor, ABC Towers
ABC Place, Waiyaki Way
P.O. Box 40612
00100 Nairobi, GPO

The Directors are pleased to submit their report together with the financial statements for the year ended 31 December 2018. The report discloses the state of affairs of the Company.

1. Principal activities

The Bank is engaged in the business of commercial banking and provision of related services and is licensed under the Banking Act and regulated by the Central Bank of Kenya.

2. Results

The results of the company for the year are set out on pages 15.

3. Dividend

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

4. Directors

The Directors who served during the year ended 31 December 2018 and up to the date of this report are as set out in page 1.

5. Business review

Please see pages 6 to 10 for a detailed analysis of the above.

6. Relevant audit information

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

- There is no relevant audit information of which the Company's auditor is unaware; and
- Each director has taken all the steps that they ought to have taken as a Director so as to be aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

7. Auditors

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

8. Approval of financial statements

The financial statements were approved and authorised for issue at a meeting of the Board of Directors held on 22 February 2019.

BY ORDER OF THE BOARD

ANNE GITAU CPS (K)
Reg. No.
2497

Anne Gitau
Company Secretary

Date: 22 February 2019

Corporate governance outlines the way companies are run and managed, the role of the Board of Directors and the framework of internal controls. The Board of Bank of Africa Kenya Limited is keen on ensuring the adoption of good corporate governance.

THE BOARD

As at 31 December 2018, the Board of Directors comprised of the Chairman, the Managing Director, and six Non-Executive Directors. All Directors are subject to periodic re-appointment in accordance with the Company's Articles of Association. On appointment, each Director receives information about the Bank and is advised of the legal, regulatory and other obligations of a Director.

The full Board meetings were held as shown in the table below. In the event that a Director cannot attend a Board Meeting, an acceptable apology with a valid reason is sent to the Chairman in advance of the meeting. Directors are given appropriate information that guides their control over strategic, financial, operational, compliance and governance matters. The Managing Director is in charge of the day-to-day operations while the Board oversees the performance of the executive management.

The following table shows the number of Board meetings held during the year and the attendance of individual Directors.

Board meeting membership and attendance in 2018				
	14 February 2018	**7 June 2018**	**21 September 2018**	**10 December 2018**
Ambassador Dennis Awori	√	√	√	√
Amine Bouabid	√	√	√	√
Abdelkabir Bennani	√	√	√	√
Susan Kasinga	√	√	√	√
Eunice Mbogo	√	√	√	√
Kathleen Cornelia Paulina Jobina Josina Goense	AP	√	√	√
Ronald Marambii	√	√	√	√
Ghali Lahlou (appointed a Director on 24 July 2018)	N/A	N/A	√	√

√ – Attended
AP – Absent with apology
N/A – Not Applicable, as the individual was not a Director of the Company at the time the meeting was held.

BOARD COMMITTEES

To increase efficiency and allow deeper focus on the management of key functions of the Bank, the Board has established the following four main Committees:-

The Board Audit Committee:

The main role of the Board Audit Committee is to provide independent oversight of the Bank's financial reporting and internal control systems to ensure that checks and balances within the Bank are in place. The Committee also reviews the performance and findings of the internal and external auditors, findings of the regulatory authorities, and recommends appropriate remedial action. The Committee has direct access to the Company's internal and external auditors. In the year 2018, the Members of this Committee were Ms. Susan Kasinga (Chairperson), Mr. Abdelkabir Bennani, Ms. Eunice Mbogo, Ms. Kathleen Cornelia Paulina Jobina Josina Goense and Mr. Ghali Lahlou (who was appointed a member of the Committee on 24 July 2018).

BOARD COMMITTEES (Continued)

The Board Credit Committee:

The overall responsibility of the Board Credit Committee is to approve and review the credit risk strategy and credit risk policies of the Bank. The Committee sets the acceptable risk appetite and tolerance that the Bank is willing to engage. In the year 2018, the Members of this Committee were Ms. Susan Kasinga (Chairperson), Mr. Abdelkabir Bennani, Ms. Kathleen Cornelia Paulina Jobina Josina Goense and Mr. Ghali Lahlou (who was appointed a member of the Committee on 24 July 2018).

The Board Risk Management Committee:

This Committee's main responsibility is to assist the Directors in discharging their responsibility of ensuring quality, integrity and reliability of the Bank's enterprise wide risk management and corporate accountability and associated risks in terms of management, assurance and reporting. The Committee also assists in fostering an effective risk management culture throughout the Bank as well as assisting the Board in fulfilling its oversight responsibility relating to compliance with legal and regulatory requirements and the Bank's policies. In the year 2018, the Members of this Committee were Ms. Eunice Mbogo (Chairperson), Mr. Abdelkabir Bennani, Ms. Susan Kasinga, Ms. Kathleen Cornelia Paulina Jobina Josina Goense and Mr. Ghali Lahlou (who was appointed a member of the Committee on 24 July 2018).

The Board Nomination, Compensation and Human Resources Committee:

The purpose of this Committee is to enable the Board to discharge its responsibilities in relation to the nomination of appropriate directors to the Board and its committees, the assessment of the performance of the Board, Directors (including the Executive Directors) and Senior Management, succession planning for Directors and Senior Management, remuneration, welfare, retention and human capital development policies and programs for the Directors and all staff of the Bank. In 2018, the Members of this Committee were Ms. Eunice Mbogo (Chairperson), Ms. Susan Kasinga, Mr. Abdelkabir Bennani, Ms. Kathleen Cornelia Paulina Jobina Josina Goense and Mr. Ghali Lahlou (who was appointed a member of the Committee on 24 July 2018).

At each quarterly Board Meeting, the Chairpersons of the various Board Committees report to the Board on the highlights of the Committees' deliberations and escalate to the Board all matters requiring its consideration and approval.

DIRECTORS' REMUNERATION

The remuneration of all Directors is subject to regular review to ensure that levels of remuneration and compensation are appropriate. Information on the aggregate amount of emoluments and fees paid to Directors is disclosed in Note 15 of the financial statements.

BOARD PERFORMANCE EVALUATION

Under the Prudential Guidelines issued by the Central Bank of Kenya, the Board is responsible for ensuring that an evaluation of its performance, that of its Committees and individual Directors is done. The results of such an evaluation are to be provided to the Central Bank of Kenya.

In a process led by the Board Chairman and supported by the Company Secretary, a comprehensive evaluation of the performance of the Board, the Board Committees and the Board Chairman for the year 2018 was conducted in the last quarter of 2018, with the aim of assessing capacity and effectiveness relative to the mandates, and identifying any challenges that could form a basis for action in the coming year.

BOARD PERFORMANCE EVALUATION (Continued)

The Directors, following the evaluation exercise, agreed that the Board continues to operate effectively, and there is a high level of meaningful interaction amongst the Directors, and also between the Board and Management. Areas requiring further attention and action by individual Directors were noted and shall be acted upon in the course of the year 2019. Key areas of focus by the Board as a whole in 2019 were agreed on, and include Branch performance, Bank Profitability, Fraud prevention, and Capital Adequacy.

The Board shall be monitoring keenly the performance of the Bank against each of these parameters.

GOING CONCERN

The Board ensures that the Bank has adequate resources to continue in business into the foreseeable future. For this reason, it continues to adopt the going concern basis when preparing the financial statements.

INTERNAL CONTROLS

The Board has the responsibility of ensuring that adequate systems of internal control that provide reasonable assurance of effective and efficient operations are in place.

The Board strives to achieve a strong control environment including the evaluation of non-financial risks guided by written policies and procedures to identify and manage risk.

The Bank's Internal Audit Department which is independent, reports to the Board Audit Committee and provides an independent confirmation that BOA Group business standards, policies and procedures are being complied with.

Business performance review

Statement of Profit or Loss

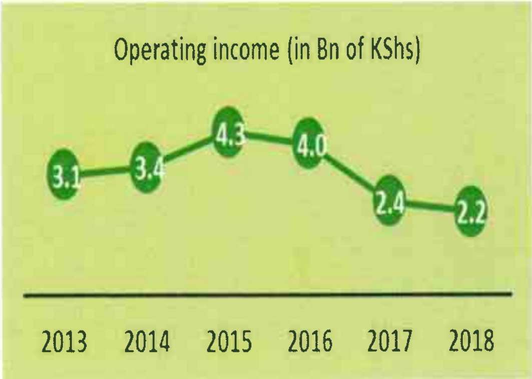
	31-Dec-14 KShs'000 Audited	31-Dec-15 KShs'000 Audited	31-Dec-16 KShs'000 Audited	31-Dec-17 KShs'000 Audited	31-Dec-18 KShs'000 Audited
Interest income	5,635,385	6,914,635	6,515,259	4,125,249	3,389,688
Interest expense	(3,157,464)	(3,764,295)	(3,492,703)	(2,870,214)	(2,206,815)
Net interest income	**2,477,921**	**3,150,340**	**3,022,556**	**1,255,035**	**1,182,873**
Non-interest income	888,365	1,121,769	946,258	1,194,388	1,002,731
Operating income	**3,366,286**	**4,272,109**	**3,968,814**	**2,449,423**	**2,185,604**
Expenses	(2,639,073)	(2,911,646)	(2,905,496)	(2,636,926)	(2,284,309)
Impairment losses on loans and advances	(561,825)	(2,777,945)	(1,216,268)	(6,756)	158,694
Operating expenses	**(3,200,898)**	**(5,689,591)**	**(4,121,764)**	**(2,643,682)**	**(2,284,309)**
Profit/ (loss) from operations	**165,388**	**(1,417,482)**	**(152,950)**	**(194,259)**	**59,989**
Share of profit of associates	47,218	3,558	136,453	229,444	149,572
Loss on loss of control	(8,940)	(20,264)	-	-	-
Profit/ (loss) before income tax	**203,666**	**(1,434,188)**	**(16,497)**	**35,185**	**209,561**
Income tax expense/credit	(59,555)	410,827	26,967	32,433	(36,488)
Profit for the year	**144,111**	**(1,023,361)**	**10,470**	**67,618**	**173,073**

Statement of Financial Position

	31-Dec-14 KShs'000 Audited	31-Dec-15 KShs'000 Audited	31-Dec-16 KShs'000 Audited	31-Dec-17 KShs'000 Audited	31-Dec-18 KShs'000 Audited
Assets					
Government securities and other securities	7,142,239	6,487,110	5,293,768	4,919,866	6,512,645
Loans and advances to customers	38,463,876	37,798,691	31,541,959	27,388,460	21,188,115
Other assets	15,676,604	22,601,323	16,636,280	19,478,963	19,522,706
Property and equipment	928,922	2,393,143	2,523,664	2,404,002	1,857,393
Total assets	**62,211,641**	**69,280,267**	**55,995,671**	**54,191,291**	**49,080,859**
Liabilities					
Customer deposits	41,670,812	47,487,589	34,463,707	31,572,432	30,122,457
Due to banks	8,028,520	5,679,098	2,911,521	7,898,519	6,918,773
Borrowed funds	4,150,013	6,794,425	9,108,249	5,662,402	4,683,357
Other liabilities	449,087	823,419	1,094,208	590,233	620,090
Total equity	7,913,209	8,495,736	8,417,986	8,467,705	6,736,182
Total liabilities and equity	**62,211,641**	**69,280,267**	**55,995,671**	**54,191,291**	**49,080,859**

Business performance review (continued)

(i) Operating income

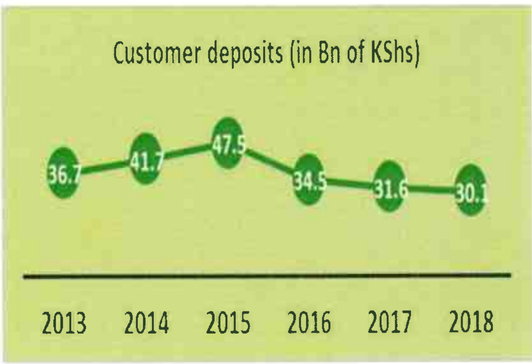


Operating income dropped by 10.8% in 2018 largely due to reduced credit portfolio. There were savings in interest expense during 2018, however the savings did not compensate sufficiently for the reduced interest income and thus the drop in operating income.

(ii) Operating expenses

Operating expenses dropped by 13.4% in 2018 largely attributed to increased efficiencies by the bank in its operations through innovations and increased use of ICT solutions. Further reduction was attributed to reduced marketing costs, the bank took a deliberate decision to slow down on advertising.

(iii) Customers deposits (in billion KShs)

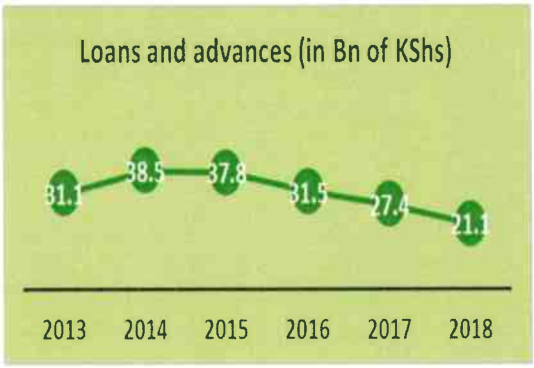


The bank's deposit Strategy during 2018 was to reduce cost of funds by changing the mix of deposits once it was clear that growing loans would be difficult.

The economy did not pick as quickly as expected in 2018 in the backdrop of prolonged elections and drought in 2017.

Deposits were maintained at an optimal level to track the growth in loans to the private sector which was subdued.

(iv) Loans and advances (in billion of KShs)



Drop from 2015 to 2018 was due to clean-up of the portfolio and the passing of the interest rate capping law. There was need to recalibrate the deposit structure and shrink the balance sheet for better management of the assets and liabilities.
In 2018, the loan book reduced due to Increased provisions after the implementation of IFRS 9. Further, increased liquidity in the market saw some clients prepay facilities. The bank also channelled some resources to fixed income securities as it strategises to reallocate more resources to private sector lending.

Business performance review (Continued)

Potential threats

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

Business performance review (Continued)

Potential threats (Continued)

Description	Example	Mitigation Measures
Operational risk		
This is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.	Inadequate/insufficient documentation of processes or procedures. Lack of inbuilt controls in procedures. Health and safety issues.	Robust operations risk management framework that ensures operational risks are identified, measure and corrective action taken.

Employee Relations

Capacity Building

In 2018 the bank embarked on recruitment of key positions that would assist in delivering on the banks' digitally aligned strategic plan. "Recruiting talented individuals is key in enabling us build a high performance organisation made up of highly engaged employees. We are committed to a conducive environment that that enables our employees grow in both career and personal life".

Internal talent management was a key focus in 2018 and will continue into the future.

Partnering with universities to onboard the right talent at entry level was a key focus area in 2018. We also held a career fair at United States International University- Africa (USIU) that provided a talent pool for 2018 entry and mid-career level recruitments.

Learning and Development

The performance, creativity and innovation of our people are critical components of sustainable business growth and we continue to offer them relevant training programmes. Several learning and development programmes have been put in place to ensure that staff continuously enhance their skills. In the current financial year, the bank has enrolled teams from business and credit to the globally reputed Omega Performance Credit course which will culminate in international accreditation. The bank is focusing on Performance Management and Change Training providing line managers with the skills to conduct crucial conversations with their teams, resulting in enhanced performance. Various external accredition both at local and international level for our employees helps ensure our staff are versed with the changing environment in the Banking sector.

Employee wellness

Employee wellness remains a critical component of a healthy and productive workforce. We continued to proactively support employees in managing their health and wellbeing with annual health checks and providing a comprehensive support programme for those dealing with illness. In another positive move, our medical scheme was revised to give employees the opportunity to enhance their cover for additional facilities at a discounted price and a toll free number to enable staff needing couselling services free access. This was aligned to the retention strategy of the bank for 2018

Awards and recognition

BOA Kenya (BOAK) has been participating in BOA Group campaigns where the Bank competes against other banks within the group. In 2018 we received an award for "Group Savings Campiagn"for the Enterprise team. The bank also participated in the Kenya Premier Chess League and brought the Best Corporate Winner's Trophy.

The Bank also seeks to recognise staff who have been exemplary in their service to both external and internal customers. This is done quarterly where staff who have performed well are recognised and rewarded.

Social and environmental management

The bank has a formalized Environmental and Social Management Policy that is reviewed regularly and is part of the overall risk management framework that guides operations/activities it finances to ensure they create sustainable long term value to the present and future generations without negative impacts to the environment.

Through constant engagement with the stakeholders, the bank has developed innovative products aimed at promoting financial inclusion, contribute to social-economic development hence alleviating poverty in line with sustainable development goals as well as creating long term relationships that are mutually beneficial to all stakeholders.

The bank continues to empower its staff with relevant knowledge and skills on sustainability by providing the requisite tools to enable them offer effective advisory services to clients and ensure resource optimization within the organization.

As a socially responsible citizen, during the period under review, the bank partnered with other stakeholders in promoting community health with several countrywide campaigns to create awareness on epilepsy and end stigma.

The Directors are responsible for the preparation and fair presentation of the financial statements of Bank of Africa Kenya Limited set out on pages 15 to 110 which comprise the statement of financial position at 31 December 2018, statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

Under the Kenyan Companies Act, 2015, the Directors are required to prepare financial statements for each financial period which give a true and fair view of the financial position of the Bank as at the end of the financial year and of the profit or loss of the Bank for that year. It also requires the Directors to ensure the Bank keeps proper accounting records which disclose with reasonable accuracy the financial position of the Bank.

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. The Directors are of the opinion that the financial statements give a true and fair view of the financial position of the Bank and of its profit or loss.

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

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

Approval of the financial statements

The financial statements, as indicated above, were approved and authorised for issue by the Board of Directors on 22 February 2019.

Chairman: Ambassador Dennis Awori

Managing Director: Ronald Marambii

Director: Susan Kasinga

Company Secretary: Anne Gitau

ANNE W. GITAU CPS (K) Reg. No. 2497

Date: 22 February 2019

KPMG

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REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF BANK OF AFRICA KENYA LIMITED

Report on the audit of the financial statements

Opinion

We have audited the financial statements of Bank of Africa Kenya Limited set out on pages 15 to 110, which comprise the statement of financial position as at 31 December 2018, statement of profit or loss and other comprehensive income, the statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Bank of Africa Kenya Limited as at 31 December 2018, and of the financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) and the manner required by the Kenyan Companies Act, 2015.

Basis for opinion

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

Other information

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

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

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

Directors' responsibilities for the financial statements

As stated on page 11, the Directors are responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs and in the manner required by the Kenyan Companies Act, 2015, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

KPMG

REPORT OF THE INDEPENDENT AUDITORS
TO THE MEMBERS OF BANK OF AFRICA KENYA LIMITED (CONTINUED)

Report on the audit of the financial statements (Continued)

Directors' responsibilities for the financial statements (Continued)

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

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

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 International Standards on Auditing (ISAs) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

KPMG

REPORT OF THE INDEPENDENT AUDITORS
TO THE MEMBERS OF BANK OF AFRICA KENYA LIMITED (CONTINUED)

Report on the audit of the financial statements (Continued)

Auditors' responsibilities for the audit of the financial statements (Continued)

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

Report on other legal and regulatory requirements

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

(i) In our opinion, the information given in the Directors' report for the year ended 31 December 2018 on page 2, is consistent with the financial statements; and

(ii) Our report is unqualified.

The Signing Partner responsible for the audit resulting in this independent auditors' report is FCPA Eric Aholi – P/1471.

KPMG Kenya

Certified Public Accountants
P.O Box 40612
00100 Nairobi

Date: 22 February 2019

Statement of profit or loss and other comprehensive income

	Notes	2018 KShs'000	2017 KShs'000
Interest income	5	3,389,688	4,125,249
Interest expense	6	(2,206,815)	(2,870,214)
Net interest income		**1,182,873**	**1,255,035**
Fee and commission income	7	624,262	710,344
Fee and commission expense	7	(4,327)	(5,772)
Net fee and commission income		**619,935**	**704,572**
Net foreign exchange income		436,126	510,022
Other operating loss	8	(50,569)	(20,206)
Total income		**2,188,365**	**2,449,423**
Impairment losses on other financial assets	4.1.3	(2,761)	-
Impairment gains/(losses) on loans and advances	17	158,694	(6,756)
Net operating income		**2,344,298**	**2,442,667**
Staff costs	9	(1,069,304)	(1,207,969)
Depreciation and amortisation	10	(199,067)	(246,310)
Other operating costs	11	(1,015,938)	(1,182,647)
Total operating expenses		**(2,284,309)**	**(2,636,926)**
Profit/(loss) from operations		**59,989**	**(194,259)**
Share of profit of associates	19	149,572	229,444
Profit before income tax		**209,561**	**35,185**
Income tax (expense)/ credit	12	(36,488)	32,433
Profit for the year		**173,073**	**67,618**
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Net changes in equity investments at FVOCI	18(a)	(284,960)	-
Deferred tax on equity investments at FVOCI	23	14,248	-
		(270,712)	**-**
Items that may subsequently be reclassified to profit or loss			
Net changes in fair value of available for sale investments	18(a)	-	(2,345)
Deferred tax on fair value of available for sale investments	23	-	117
Net losses on investments in financial instruments measured at FVOCI	19	(21,342)	-
Foreign currency translation differences for investments in foreign operations	19	(55,984)	(15,671)
		(77,326)	**(17,899)**
Other comprehensive income, net of tax		**(348,038)**	**(17,899)**
Total comprehensive income for the year		**(174,965)**	**49,719**

The notes on pages 20 to 110 are an integral part of these financial statements.

Statement of financial position

	Notes	2018 KShs'000	2017 KShs'000
ASSETS			
Cash and balances with Central Bank	13	9,927,343	5,152,891
Derivative assets held for risk management	14	83,155	-
Due from other banking institutions	15	2,872,506	6,597,236
Due from group banks	16(a)	1,012,283	2,959,913
Loans and advances to customers	17	21,188,115	27,388,460
Investment securities- FVOCI	18(a)	283,027	567,987
Investment securities- Amortised cost	18(b)	6,512,645	4,919,866
Investment in associate	19	1,311,749	1,318,576
Current income tax	12	438,004	98,594
Property and equipment	20	1,857,393	2,353,256
Non- current asset held for sale	21	29,746	107,843
Intangible assets	22	40,129	50,746
Deferred income tax	23	2,327,064	1,682,208
Other assets	24	1,197,700	993,715
TOTAL ASSETS		**49,080,859**	**54,191,291**
LIABILITIES			
Derivative liabilities held for risk management	14	-	34,095
Due to group banks	16 (b)	6,860,714	6,136,430
Due to other banking institutions	25	58,059	1,762,089
Customer deposits	26	30,122,457	31,572,432
Borrowings	27	4,683,357	5,662,402
Other liabilities	28	620,090	556,138
TOTAL LIABILITIES		**42,344,677**	**45,723,586**
SHAREHOLDERS' EQUITY			
Share capital	29	6,404,949	6,404,949
Share premium	29	1,980,356	1,980,356
Statutory credit risk reserve	30	486,296	2,152,182
Fair value reserve	31 (a)	(346,882)	(76,170)
Foreign currency translation reserve	31 (b)	(180,255)	(124,271)
Retained earnings		(1,608,282)	(1,869,341)
TOTAL SHAREHOLDERS' EQUITY		**6,736,182**	**8,467,705**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**49,080,859**	**54,191,291**

The financial statements on pages 15 to 110 were approved and authorised for issue by the Board of Directors on 22 February 2019 and signed on its behalf by:

Chairman: Ambassador Dennis Awori | **Managing Director: Ronald Marambii**

Director: Susan Kasinga | **Company Secretary: Anne Gitau**

ANNE W. GITAU CPS (K) Reg. No. 2497

The notes on pages 20 to 110 are an integral part of these financial statements

Statement of changes in equity

	Notes	Share capital KShs'000	Unissued capital KShs'000	Share premium KShs'000	Statutory credit risk reserve KShs'000	Fair value reserve KShs'000	Foreign currency translation reserve KShs'000	Retained earnings KShs'000	Total equity KShs'000
At 31 December 2017		**6,404,949**	**-**	**1,980,356**	**2,152,182**	**(76,170)**	**(124,271)**	**(1,869,341)**	**8,467,705**
Adjustment on initial application of IFRS 9	2.2.2	-	-	-	-	-	-	(2,223,654)	**(2,223,654)**
Tax impact on IFRS 9 adjustment	23	-	-	-	-	-	-	667,096	**667,096**
Statutory credit risk impact	30	-	-	-	(2,152,182)	-	-	2,152,182	**-**
Adjustment on initial application of IFRS 9 arising from investments in associates	19	-	-	-	-	-	-	(21,342)	**(21,342)**
Restated balance at 1 January 2018		**6,404,949**	**-**	**1,980,356**	**-**	**(76,170)**	**(124,271)**	**(1,295,059)**	**6,889,805**
Total comprehensive income									
Profit for the year		-	-	-	-	-	-	173,073	**173,073**
Transfer to statutory credit risk reserve	30	-	-	-	486,296	-	-	(486,296)	**-**
Net change in equity investments at FVOCI, net of deferred tax	18(a)	-	-	-	-	(270,712)	-	-	**(270,712)**
Foreign currency translation differences on investments in foreign operations	19	-	-	-	-	-	(55,984)	-	**(55,984)**
Total comprehensive income for the year		**-**	**-**	**-**	**486,296**	**(270,712)**	**(55,984)**	**(313,223)**	**(153,623)**
At 31 December 2018		**6,404,949**	**-**	**1,980,356**	**486,296**	**(346,882)**	**(180,255)**	**(1,608,282)**	**6,736,182**

The notes on pages 20 to 110 are an integral part of these financial statements.

Statement of changes in equity (Continued)

	Notes	Share capital KShs'000	Unissued capital KShs'000	Share premium KShs'000	Statutory credit risk reserve KShs'000	Fair value reserve KShs'000	Foreign currency translation reserve KShs'000	Retained earnings KShs'000	Total equity KShs'000
At 1 January 2017		**6,217,678**	**187,271**	**1,980,356**	**1,445,499**	**(73,942)**	**(108,600)**	**(1,230,276)**	**8,417,986**
Total comprehensive income		-	-	-	-	-	-	-	-
Profit for the year		-	-	-	-	-		67,618	**67,618**
Transfer to statutory credit risk reserve	30	-	-	-	706,683	-	-	(706,683)	-
Net change in fair value on AFS financial assets, net of deferred tax	18(a)	-	-	-	-	(2,228)	-	-	**(2,228)**
Foreign currency translation differences on investments in foreign operations	19	-	-	-	-	-	(15,671)	-	**(15,671)**
Total comprehensive income for the year		-	-	-	**706,683**	**(2,228)**	**(15,671)**	**(639,065)**	**49,719**
Transactions with owners, recorded directly in equity									
Issue of shares/(share allotment)	29	187,271	(187,271)	-	-	-	-	-	-
Total contributions by and distributions to owners		187,271	(187,271)	-	-	-	-	-	-
At 31 December 2017		**6,404,949**	-	**1,980,356**	**2,152,182**	**(76,170)**	**(124,271)**	**(1,869,341)**	**8,467,705**

The notes on pages 20 to 110 are an integral part of these financial statements.

Statement of cash flows

	Notes	2018 KShs'000	2017 KShs'000
Cash flows from operating activities			
Net profit before taxation		209,561	35,185
Adjustments for:			
Depreciation and amortisation	10	199,067	246,310
Profit on disposal of property and equipment	8	(2,931)	(53)
Share of profit of associate	19	(149,572)	(229,444)
Impairment of non-current assets	21	73,747	79,748
Write off of intangible assets	22	-	241
		329,872	**131,987**
Changes in:			
Derivative assets held for risk management	14	(83,155)	-
Loans and advances to customers	17	3,998,704	4,153,499
Cash reserve requirement	13	29,314	45,794
Other assets	24	(217,842)	107,128
Derivative liabilities held for risk management	14	(34,095)	69,979
Customer deposits	26	(1,449,975)	(2,891,275)
Due from other banking institutions		(1,057)	-
Amounts due from group companies	16(a)	1,846,073	(2,103,110)
Amounts due to group companies	16(b)	(1,810,383)	1,810,383
Increase in other liabilities	28	63,952	(331,974)
		2,341,536	**860,424**
Income tax paid	12	(339,410)	(739,797)
Net cash flows from operating activities		**2,331,998**	**252,614**
Cash flows from investing activities			
Acquisition of property and equipment	20	(56,359)	(297,279)
Acquisition of intangible assets	22	(9,294)	(12,879)
Proceeds from sale of property and equipment		393,240	81
Maturing of investment securities – bills and bonds	18(b)	(1,509,000)	618,241
Dividends received	19	79,073	61,390
Net cash flows (used in)/generated from investing activities		**(1,102,340)**	**369,554**
Cash flows from financing activities			
Net repayments from borrowings	27	(979,045)	(3,445,847)
Net cash flows used in financing activities		**(979,045)**	**(3,445,847)**
Net increase/(decrease) in cash and cash equivalents		**250,613**	**(2,823,679)**
Cash and cash equivalents at 1 January		4,947,209	7,770,888
Cash and cash equivalents at 31 December	**33**	**5,197,822**	**4,947,209**

The notes on pages 20 to 110 are an integral part of these financial statements.

1. General information

Bank of Africa Kenya Limited is incorporated in Kenya under the Kenyan Companies Act, 2015 as a limited liability company, and is domiciled in Kenya. The company is regulated by the Central Bank of Kenya. The Bank is controlled by BOA Group S.A. incorporated in Luxembourg with its ultimate parent being BMCE Bank incorporated in Morocco. The address of its registered office is:

BOA House
LR No: 1870/III/313 and 1870/III/314
School Lane
Westlands, Nairobi
P.O. Box 69562
00400- Nairobi, Tom Mboya

2. Significant accounting policies

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

2.1 Basis of preparation

(a) Statement of compliance

The financial statements set out on pages 15-110 have been prepared in accordance with International Financial Reporting Standards (IFRS) and the Kenyan Companies Act, 2015.

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

(b) Basis of measurement

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

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

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

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

2. Significant accounting policies (Continued)

2.1 Basis of preparation (continued)

(b) Basis of measurement (continued)

Level 2 – fair value measurements are derived from inputs other than quoted prices used in Level 1 that are observable for the assets or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 – fair value measurements are derived from valuation techniques that include inputs for assets or liabilities that are not based on observable market data (unobservable inputs).

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

(c) Use of estimates and judgements

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

(d) Borrowing costs

Borrowing costs, net of any temporary investment income on those borrowings, that are attributable to acquisition, construction or production of a qualifying asset are capitalised as part of the asset. The net borrowing cost capitalised is either the actual borrowing cost incurred on the amount borrowed specifically to finance the asset; or in the case of general borrowings, the borrowing cost is determined using the overall weighted average cost of the borrowings on all outstanding borrowings during the year less any specific borrowings directly attributable to the asset and applying this rate to the borrowing attributable to the asset. Capitalisation of borrowing costs ceases when all activities necessary to prepare the qualifying asset for its intended use or sale are complete.

(e) Changes in accounting policies and disclosures

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

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

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

2. Significant accounting policies (Continued)

2.1 Basis of preparation (continued)

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

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

The key changes to the Bank’s accounting policies resulting from its adoption of IFRS 9 are summarized below. The full impact of adopting the standard is set out in note 4.1.

2.1.1 Classification and measurement of financial instruments on the date of initial application of IFRS 9

The measurement category and the carrying amount of financial assets and liabilities in accordance with IAS 39 and IFRS 9 as at 1 January 2018 are compared as follows. The Bank initially recognizes loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognized on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

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

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

2. Significant accounting policies (Continued)

2.1.1 Classification and measurement of financial instruments on the date of initial application of IFRS 9 (Continued)

The following tables provide a reconciliation between line items in the statement of financial position and categories of financial instruments

IFRS 9 classification 31 December 2018	Note	Designated at FVOCI KShs'000	Amortised cost KShs'000	Mandatorily Designated at FVTPL KShs'000	Other financial assets and liabilities at amortised cost KShs'000	Total carrying amount KShs'000
Financial assets						
Cash and balances with Central Bank	13	-	-	-	9,927,343	9,927,343
Derivative assets held for risk management	14	-	-	83,155	-	83,155
Balances due from banking institutions	15	-	-	-	2,872,506	2,872,506
Balances from group banks	16(a)	-	-	-	1,012,283	1,012,283
Loans and advances to customers	17	-	-	-	21,188,115	21,188,115
Investment securities	18(a)	283,027	-	-	-	283,027
Investment securities	18(b)	-	-	-	6,512,645	6,512,645
Other financial assets	24	-	-	-	812,316	812,316
Total financial assets		**283,027**	**-**	**83,155**	**42,325,208**	**42,691,390**
Financial liabilities						
Balances due to group banks	16(b)	-	-	-	6,860,714	6,860,714
Balances due to other banks	25	-	-	-	58,059	58,059
Customer deposits	26	-	-	-	30,122,457	30,122,457
Borrowings	27	-	-	-	4,683,357	4,683,357
Other financial liabilities	28	-	-	-	525,658	525,658
Total financial liabilities		**-**	**-**	**-**	**42,250,245**	**42,250,245**

2. Significant accounting policies (Continued)

2.1.1 Classification and measurement of financial instruments on the date of initial application of IFRS 9 (Continued)

IAS 39 classification	Note	Held to maturity	Loans and receivables	Available for sale	Designated at FVTPL	Other financial assets and liabilities at amortised cost	Total carrying amount
31 December 2017		**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**	**KShs '000**
Financial assets							
Cash and balances with Central Bank	13	-	5,152,891	-	-	-	5,152,891
Balances due from banking institutions	15	-	6,597,236	-	-	-	6,597,236
Balances from group banks	16(a)	-	2,959,913	-	-	-	2,959,913
Loans and advances to customers	17	-	27,388,460	-	-	-	27,388,460
Investment securities	18(a)	-	-	567,987	-	-	567,987
Investment securities	18(b)	4,919,866	-	-	-	-	4,919,866
Other financial assets	24	-	588,670	-	-	-	588,670
Total financial assets		**4,919,866**	**42,687,170**	**567,987**		**-**	**48,175,023**
Financial liabilities							
Derivative liabilities held for risk management	14	-	-	-	34,095	-	34,095
Balances due to group banks	16(b)	-	-	-	-	6,136,430	6,136,430
Balances due to other banks	25	-	-	-	-	1,762,089	1,762,089
Customer deposits	26	-	-	-	-	31,572,432	31,572,432
Borrowings	27	-	-	-	-	5,662,402	5,662,402
Other financial liabilities	28	-	-	-	-	426,728	426,728
Total financial liabilities		**-**	**-**	**-**	**34,095**	**45,560,081**	**45,594,176**

2. Significant accounting policies (Continued)

2.1.1 Classification and measurement of financial instruments on the date of initial application of IFRS 9 (Continued)

	Note	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 KShs '000	New carrying amount under IFRS 9 KShs '000
31 December 2017					
Financial Assets					
Cash and balances with Central Bank	13	Loans and receivables	Amortised cost	5,152,891	5,152,891
Balances due from banking institutions	15	Loans and receivables	Amortised cost	6,597,236	6,595,001
Balances from group banks	16(a)	Loans and receivables	Amortised cost	2,959,913	2,958,856
Loans and advances to customers	17	Loans and receivables	Amortised cost	27,388,460	25,484,908
Investment Securities	18(a)	Available for Sale	FVOCI	567,987	567,987
Investment Securities	18(b)	Held to Maturity	Amortised cost	4,919,866	4,902,109
Other financial assets	24	Loans and receivables	Amortised cost	588,670	587,706
Total financial assets				**48,175,023**	**46,249,458**
Financial liabilities					
Derivative liabilities held for risk management	14	FVTPL	FVTPL	34,095	34,095
Balances due to group banks	16(b)	Other financial Liabilities	Amortised cost	6,136,430	6,136,430
Balances due to other banks	25	Other financial Liabilities	Amortised cost	1,762,089	1,762,089
Customer deposits	26	Other financial Liabilities	Amortised cost	31,572,432	31,572,432
Other financial liabilities	28	Other financial Liabilities	Amortised cost	426,728	426,728
Borrowings	27	Other financial Liabilities	Amortised cost	5,662,402	5,662,402
Total financial liabilities				**45,594,176**	**45,594,176**

2. Significant accounting policies (Continued)

2.1.2 Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The Bank performed a detailed analysis of its business models for managing financial assets and analysis of their cash flows characteristics.

	IAS 39 carrying amount 31 December 2017	Re-measurement	IFRS 9 carrying amount 1 January 2018
	KShs'000	KShs'000	KShs'000
Financial assets			
Amortised cost			
Cash and cash equivalents:			
Opening balance	5,152,891		
Re-measurement		-	
Closing balance			**5,152,891**
Balances due from banking institutions:			
Opening balance	6,597,236		
Re-measurement		(1,057)	
Closing balance			**6,596,179**
Balances from group banks:			
Opening balance	2,959,913		
Re-measurement		(2,235)	
Closing balance			**2,957,678**
Loans and advances to customers:			
Opening balance	27,388,460		
Re-measurement		(1,903,552)	
Closing balance			**25,484,908**
Investment securities (HTM):			
Opening balance	4,919,866		
To amortised cost		-	
Re-measurement		(17,757)	
Closing balance			**4,902,109**
Other financial assets			
Opening balance	588,670		
Re-measurement		(964)	
Closing balance			**587,706**
Outstanding commitments and contigent liabilities			
Opening balance	8,092,650		
Re-measurement		(298,089)	
Closing balance			**7,794,561**

2. Significant accounting policies (Continued)

2.1.2 Reconciliation of impairment allowance balance from IAS 39 to IFRS 9 (continued)

The following table reconciles:

- the closing impairment allowance for financial assets under IAS 39 and provisions for loan commitments and financial guarantee contracts under IAS 37 Provisions, Contingent Liabilities and Contingent Assets as at 31 December 2017; to
- the opening ECL allowance determined under IFRS 9 as at 1 January 2018.

	31 December 2017 (IAS 39/ IAS 37)	Re-measurement	1 January 2018 (IFRS 9)
	KShs'000	KShs'000	KShs'000
Cash and cash equivalents	-	-	-
Balances due from banking institutions	-	1,057	1,057
Balances from group banks	-	2,235	2,235
Loans and advances to customers	4,233,925	1,903,552	6,137,477
Investment securities (HTM)	-	17,757	17,757
Other financial assets	-	964	964
Outstanding commitments and contigent liabilities	-	298,089	298,089
	4,233,925	**2,223,654**	**6,457,579**

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

	Impact of adopting IFRS 9 at 1 January 2018
	KShs'000
Statutory credit risk reserve	
Closing balance under IAS 39 (31 December 2017)	2,152,182
Transfer to retained earnings for excess Central Bank provisions no longer required on initial application of IFRS 9	(2,152,182)
Opening balance under IFRS 9 (1 January 2018)	**-**
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	(1,869,341)
Transfer from statutory credit risk reserve on application of IFRS 9	2,152,182
Adjustment on initial application of IFRS 9	(2,223,654)
Related tax	667,096
Opening balance under IFRS 9 (1 January 2018)	**(1,273,717)**

2. Significant accounting policies (Continued)

2.2 Consolidation

(i) Associates

Associates are all entities over which the Bank has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The Bank's investment in associates includes goodwill identified on acquisition.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income is reclassified to profit or loss where appropriate.

The Bank's share of post-acquisition profit or loss is recognised in profit or loss, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Bank's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Bank does not recognise further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Bank determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Bank calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to 'share of profit/(loss) of associates in profit or loss.

Profits and losses resulting from upstream and downstream transactions between the Bank and its associate are recognised in the Bank's financial statements only to the extent of unrelated investor's interests in the associates. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Bank.

2.3 Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which entity operates ('the functional currency') which is in Kenya shillings. Except as otherwise indicated, financial information presented in Kenya shillings (Kshs) has been rounded to the nearest thousand.

(ii) Transactions and balances in foreign currency

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges. All other foreign exchange gains and losses (including those that relate to borrowings and cash and cash equivalents) are presented in profit or loss for the year within "other gains / losses".

2. Significant accounting policies (Continued)

2.3 Foreign currency translation (Continued)

(ii) Transactions and balances (continued)

Changes in the fair value of monetary securities denominated in foreign currency classified as Fair Value through Other Comprehensive Income (FVOCI) (AFS in 2017) are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in other comprehensive income.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as FVOCI (AFS in 2017), are included in other comprehensive income.

(iii) Interests in foreign operations

The results and financial position of all interests in foreign operations (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

— assets and liabilities are translated at the closing rate at the date of that balance sheet;

— income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and

— all resulting exchange differences are recognised in other comprehensive income and accumulated in a separate reserve in equity. On foreign operations disposal, such exchange differences are recognised in profit or loss (reclassified) when the gain or loss on disposal is recognised.

2.4 Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in deposits from banks or deposits from customers, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

2.5 Financial assets and liabilities

(i) Recognition and initial measurement

Policy applicable prior to 1 January 2018

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument. A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(i) Recognition and initial measurement (Continued)

Policy applicable prior to 1 January 2018

Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale financial assets. The directors determine the classification of its financial assets at initial recognition. The Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

— **Financial assets at fair value through profit or loss**

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise;
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis; or
- the financial assets consist of debt host and embedded derivatives that must be separated.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as 'Net gains/(losses) on financial instruments classified as held for trading'.

Interest income and expense and dividend income and expenses on financial assets held for trading are included in 'Net interest income' or 'Dividend income', respectively. Fair value changes relating to financial assets designated at fair value through profit or loss are recognised in 'Net gains on financial instruments designated at fair value through profit or loss'.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

Financial assets (Continued)

— **Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- those that the group intends to sell immediately or in the short term, which are classified as held for trading, and those that the Bank upon initial recognition designates as at fair value through profit or loss;
- those that the group upon initial recognition designates as available-for-sale; or
- those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method.

— **Held-to-maturity investments**

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the directors have the positive intention and ability to hold to maturity, other than:

- those that the group upon initial recognition designates as at fair value through profit or loss;
- those that the group designates as available-for-sale; and
- those that meet the definition of loans and receivables.

Held-to-maturity investments are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method.

— **Available-for-sale financial assets**

Available-for-sale financial assets are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Available-for-sale financial assets are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value with gains and losses being recognised in other comprehensive income and cumulated in a separate reserve in equity, fair value reserve, until the financial asset is derecognised. However, interest is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available-for-sale are recognised in profit or loss.

Financial liabilities

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

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(ii) Classification

Policy applicable from 1 January 2018

Financial assets

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or Fair Value Through Profit or Loss (FVTPL). A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

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

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

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

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

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

Business model assessment

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

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

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

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(ii) Classification (Continued)

Financial assets (Continued)

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

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

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

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

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

Non-recourse loans

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

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

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(ii) Classification (Continued)

Financial assets (Continued)

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

Contractually linked instruments

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

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

Reclassifications

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

Financial liabilities

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL.

(iii) Derecognition

Policy applicable from 1 January 2018

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(iii) Derecognition (continued)

Policy applicable from 1 January 2018

Financial assets

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to sale and repurchase transactions, because the Bank retains all or substantially all of the risks and rewards of ownership of such assets.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract if the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

Policy applicable prior to 1 January 2018

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

(iv) Modifications of financial assets and financial liabilities

Policy applicable from 1 January 2018

Financial assets

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(iv) Modifications of financial assets and financial liabilities (continued)

Policy applicable from 1 January 2018 (continued)

Financial assets (continued)

If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

If cashflows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place. This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method.

Financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(iv) Modifications of financial assets and financial liabilities (continued)

Policy applicable prior to 1 January 2018

Financial assets

If the terms of a financial asset were modified, then the Bank evaluated whether the cash flows of the modified asset were substantially different. If the cash flows were substantially different, then the contractual rights to cash flows from the original financial asset were deemed to have expired. In this case, the original financial asset was derecognised and a new financial asset was recognised at fair value.

If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using the premodification interest rate.

Financial liabilities

The Bank derecognised a financial liability when its terms were modified and the cash flows of the modified liability were substantially different. In this case, a new financial liability based on the modified terms was recognised at fair value. The difference between the carrying amount of the financial liability extinguished and consideration paid was recognised in profit or loss.

Consideration paid included non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability was not accounted for as derecognition, then any costs and fees incurred were recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

(v) Fair value measurement

Policy applicable from 1 January 2018

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in it absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When one is available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as 'active' if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument on initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value on initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique for which any unobservable inputs are judged to be insignificant in relation to the measurement, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value on initial recognition and the transaction price.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(v) Fair value measurement (continued)

Policy applicable from 1 January 2018 (continued)

Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for the particular risk exposure. Portfolio-level adjustments – e.g. bid-ask adjustment or credit risk adjustments that reflect the measurement on the basis of the net exposure – are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

Policy applicable prior to 1 January 2018

For financial instruments traded in active markets, the determination of fair values of financial instruments is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Nairobi Securities Exchange, Bloomberg and Reuters.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indicators that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, LIBOR yield curve, FX rates, volatilities and counterparty spreads) existing at the reporting dates.

The Bank uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market-observable.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(v) Fair value measurement (continued)

Policy applicable prior to 1 January 2018 (continued)

For more complex instruments, the Bank uses internally developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models such as present value techniques are used primarily to value derivatives transacted in the over-the-counter market, unlisted debt securities (including those with embedded derivatives) and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions. The impact on net profit of financial instrument valuations reflecting non-market observable inputs (level 3 valuations) is disclosed in Note 4.

(vi) Impairment

Policy applicable from 1 January 2018

The Bank recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- lease receivables;
- financial guarantee contracts issued; and
- loan commitments issued.

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition.

Loss allowances for lease receivables are always measured at an amount equal to lifetime ECL.

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank does not apply the low credit risk exemption to any other financial instruments.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1 financial instruments'.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(vi) Impairment (continued)

Policy applicable from 1 January 2018 (continued)

Measurement of ECL

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;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI, and finance lease receivables are credit-impaired (referred to as 'Stage 3 financial assets'). A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider
- otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(vi) Impairment (continued)

Policy applicable from 1 January 2018 (continued)

Credit-impaired financial assets (continued)

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered credit-impaired even when the regulatory definition of default is different.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through
- voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Presentation of allowance for ECL in the statement of financial position

- Loss allowances for ECL are presented in the statement of financial position as follows:
- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in the statement of profit or loss and OCI.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(vi) Impairment (continued)

Policy applicable from 1 January 2018 (continued)

Non-integral financial guarantee contracts

The Bank assesses whether a financial guarantee contract held is an integral element of a financial asset that is accounted for as a component of that instrument or is a contract that is accounted for separately. The factors that the Bank considers when making this assessment include whether:

- the guarantee is implicitly part of the contractual terms of the debt instrument;
- the guarantee is required by laws and regulations that govern the contract of the debt instrument;
- the guarantee is entered into at the same time as and in contemplation of the debt instrument; and
- the guarantee is given by the parent of the borrower or another company within the borrower's Bank.

If the Bank determines that the guarantee is an integral element of the financial asset, then any premium payable in connection with the initial recognition of the financial asset is treated as a transaction cost of acquiring it. The Bank considers the effect of the protection when measuring the fair value of the debt instrument and when measuring ECL.

If the Bank determines that the guarantee is not an integral element of the debt instrument, then it recognises an asset representing any prepayment of guarantee premium and a right to compensation for credit losses. A prepaid premium asset is recognised only if the guaranteed exposure neither is credit-impaired nor has undergone a significant increase in credit risk when the guarantee is acquired. These assets are recognised in 'other assets' (see Note 23). The Bank presents gains or losses on a compensation right in profit or loss in the line item 'impairment losses on financial instruments'.

Policy applicable prior to 1 January 2018

Objective evidence of impairment

At each reporting date, the Bank assessed whether there was objective evidence that financial assets not carried at FVTPL were impaired. A financial asset or a Bank of financial assets was 'impaired' when objective evidence demonstrated that a loss event had occurred after the initial recognition of the asset(s) and that the loss event had an impact on the future cash flows of the asset(s) that could be estimated reliably.

In addition, a loan that was overdue for 90 days or more was considered impaired. Objective evidence that financial assets were impaired included:

- significant financial difficulty of a borrower or issuer;
- default or delinquency by a borrower;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- indications that a borrower or issuer would enter bankruptcy;
- the disappearance of an active market for a security; or
- observable data relating to a Bank of assets, such as adverse changes in the payment status of borrowers or issuers in the Bank, or economic conditions that correlated with defaults in the Bank.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(vi) Impairment (continued)

Policy applicable prior to 1 January 2018 (continued)

A loan that was renegotiated due to a deterioration in the borrower's condition was usually considered to be impaired unless there was evidence that the risk of not receiving contractual cash flows had reduced significantly and there were no other indicators of impairment.

In addition, for an investment in an equity security, a significant or prolonged declinea in its fair value below its cost was objective evidence of impairment. In general, the Bank considered a decline of 20% to be 'significant' and a period of nine months to be 'prolonged'. However, in specific circumstances a smaller decline or a shorter period may have been appropriate.

The Bank considered evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and a collective level. All individually significant loans and advances and held-to-maturity investment securities were assessed for specific impairment. Those found not to be specifically impaired were then collectively assessed for any impairment that had been incurred but not yet identified (IBNR). Loans and advances and held-to-maturity investment securities that were not individually significant were collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar credit risk characteristics.

In making an assessment of whether an investment in sovereign debt was impaired, the Bank considered the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This included an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there was the capacity to fulfil the required criteria.

Individual or collective assessment

An individual measurement of impairment was based on management's best estimate of the present value of the cash flows that were expected to be received. In estimating these cash flows, management made judgements about a debtor's financial situation and the net realisable value of any underlying collateral. Each impaired asset was assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable were independently approved by the Credit Risk function.

The collective allowance for groups of homogeneous loans was established using statistical methods such as roll rate methodology or, for small portfolios with insufficient information, a formula approach based on historical loss rate experience. The roll rate methodology used statistical analysis of historical data on delinquency to estimate the amount of loss. Management applied judgement to ensure that the estimate of loss arrived at on the basis of historical information was appropriately adjusted to reflect the economic conditions and product mix at the reporting date. Roll rates and loss rates were regularly benchmarked against actual loss experience.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(vi) Impairment (continued)

Policy applicable prior to 1 January 2018 (continued)

Individual or collective assessment (continued)

The IBNR allowance covered credit losses inherent in portfolios of loans and advances, and held-to-maturity investment securities with similar credit risk characteristics when there was objective evidence to suggest that they contained impaired items but the individual impaired items could not yet be identified.

In assessing the need for collective loss allowance, management considered factors such as credit quality, portfolio size, concentrations and economic factors. To estimate the required allowance, assumptions were made to define how inherent losses were modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowance depended on the model assumptions and parameters used in determining the collective allowance.

Loans that were subject to a collective IBNR provision were not considered impaired.

Measurement of impairment

Impairment losses on assets measured at amortised cost were calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses on available-for-sale assets were calculated as the difference between the carrying amount and the fair value.

Reversal of impairment

- For assets measured at amortised cost: If an event occurring after the impairment was recognised caused the amount of impairment loss to decrease, then the decrease in impairment loss was reversed through profit or loss.
- For available-for-sale debt security: If, in a subsequent period, the fair value of an impaired debt security increased and the increase could be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss was reversed through profit or loss; otherwise, any increase in fair value was recognised through OCI.

Any subsequent recovery in the fair value of an impaired available-for-sale equity security was always recognised in OCI.

Presentation

Impairment losses were recognised in profit or loss and reflected in an allowance account against loans and receivables or held-to-maturity investment securities. Interest on the impaired assets continued to be recognised through the unwinding of the discount.

Impairment losses on available-for-sale investment securities were recognised by reclassifying the losses accumulated in the fair value reserve in equity to profit or loss. The cumulative loss that was reclassified from equity to profit or loss was the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment attributable to the application of the effective interest method were reflected as a component of interest income.

2. Significant accounting policies (Continued)

2.5 Financial assets and liabilities (Continued)

(vi) Impairment (continued)

Policy applicable prior to 1 January 2018 (continued)

Write-off

The Bank wrote off a loan or an investment debt security, either partially or in full, and any related allowance for impairment losses, when the Bank Credit determined that there was no realistic prospect of recovery.

(vii) Designation at fair value through profit or loss

Financial assets

At initial recognition, the Bank has designated certain financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, which would otherwise arise. Before 1 January 2018, the Bank also designated certain financial assets as at FVTPL because the assets were managed, evaluated and reported internally on a fair value basis.

Financial liabilities

The Bank has designated certain financial liabilities as at FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or the designation eliminates or
- significantly reduces an accounting mismatch that would otherwise arise.

Note 2.2.1 sets out the amount of each class of financial asset or financial liability that has been designated as at FVTPL. A description of the basis for each designation is set out in the note for the relevant asset or liability class.

2.6 Offsetting financial instruments

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

2.7 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

2.8 Property and equipment

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

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

2. Significant accounting policies (Continued)

2.8 Property and equipment (continued)

Depreciation of other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	1.5%
Fixtures, fittings and equipment	10.0%- 20.0%
Motor vehicles	33.3%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.
Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in 'other operating expenses' in profit or loss.

2.9 Intangible assets

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

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

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

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

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

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of 5 years.

2.11 Non-current asset held for sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets, or components of a disposal group, are re-measured in accordance with the Bank's accounting policies. Thereafter, generally the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. For non-financial assets, fair value takes into account the highest and best use either on a standalone basis or in combination with other assets or other assets and liabilities.

2. Significant accounting policies (Continued)

2.11 Non-current asset held for sale (continued)

Any impairment loss on a disposal group is first allocated to goodwill, and then to remaining assets and liabilities on pro rata basis, except that no loss is allocated to financial assets, deferred tax assets and employee benefit assets which continue to be measured in accordance with the Bank's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

2.12 Impairment of non-financial assets

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

2.13 Employee benefits

Pension obligations

The Bank operates a defined contribution retirement scheme, the assets of which are held in a separate trustee-administered fund. A defined contribution plan is a pension plan under which the Bank pays fixed contributions into a separate entity. For defined contribution plans, the Bank pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis.

The Bank has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Other entitlements

The estimated monetary liability for employees' accrued annual leave entitlement at the reporting date is recognised as an expense accrual.

2.14 Provisions for liabilities

Provisions for restructuring costs and legal claims are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2. Significant accounting policies (Continued)

2.15 Income tax

Current income tax

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

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

Deferred income tax

Deferred income tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

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

2.16 Dividend payable

Dividends on ordinary shares are charged to equity in the period in which they are declared. Proposed dividends are not recognised until they have been declared at an annual general meeting.

2.17 Acceptances and letters of credit

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

2.18 Share capital premium

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

2. Significant accounting policies (Continued)

2.19 Leases

Leases are divided into finance leases and operating leases.

(i) Operating lease

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

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

(ii) Finance lease

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

2.20 Interest income and expense

Policy applicable from 1 January 2018

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. For purchased or originated credit impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes fees and commissions related to lending received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

2. Significant accounting policies (Continued)

2.20 Interest income and expense (Continued)

Policy applicable from 1 January 2018 (Continued)

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance (or impairment allowance before 1 January 2018).

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

For information on when financial assets are credit-impaired, see Note 2.5(vi).

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes:

- interest on financial assets and financial liabilities measured at amortised cost;
- interest on debt instruments measured at FVOCI;
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period as the hedged cash flows affect interest income/expense; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

Interest expense presented in the statement of profit or loss and OCI includes:

- financial liabilities measured at amortised cost; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period as the hedged cash flows affect interest income/expense.

2. Significant accounting policies (Continued)

2.20 Interest income and expense (Continued)

Policy applicable from 1 January 2018 (Continued)

Presentation (continued)

Interest income and expense on all trading assets and liabilities are considered to be incidental to the Bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

Interest income and expense on other financial assets and financial liabilities at FVTPL are presented in net income from other financial instruments at FVTPL.

Policy applicable prior to 1 January 2018

Effective interest rate

Interest income and expense were recognised in profit or loss using the effective interest method. The effective interest rate was the rate that exactly discounted the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimated future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate included transaction costs and fees and points paid or received that were an integral part of the effective interest rate. Transaction costs included incremental costs that were directly attributable to the acquisition or issue of a financial asset or financial liability.

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes:

- interest on financial assets and financial liabilities measured at amortised cost;
- interest on debt instruments measured at FVOCI;
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period as the hedged cash flows affect interest income/expense; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

Interest expense presented in the statement of profit or loss and OCI includes:

- financial liabilities measured at amortised cost; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period as the hedged cash flows affect interest income/expense.

Interest income and expense on all trading assets and liabilities were considered to be incidental to the Bank's trading operations and were presented together with all other changes in the fair value of trading assets and liabilities in net trading income.
Interest income and expense on other financial assets and financial liabilities carried at FVTPL were presented in net income from other financial instruments at FVTPL.

2. Significant accounting policies (Continued)

2.21 Fee and commission income

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

2.22 Dividend income

Dividends are recognised in profit or loss when the Bank's right to receive payment is established.

2.23 Fiduciary activities

Assets held for clients in an agency or fiduciary capacity by the Bank are not assets of the Bank and are not included in the statement of financial position.

2.24 New standards, amendments and interpretations

(i) New standards, amendments and interpretations effective and adopted during the year

The Bank has adopted the following new standards and amendments during the year ended 31 December 2018, including consequential amendments to other standards with the date of initial application by the Bank being 1 January 2018. The nature and effects of the changes are as explained here in.

New standard or amendments	Effective for annual periods beginning on or after
— IFRS 15 Revenue from Contracts with Customers	1 January 2018
— IFRS 9 Financial Instruments (2014)	1 January 2018
— Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)	1 January 2018
— Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)	1 January 2018
— IFRIC 22 Foreign Currency Transactions and Advance Consideration	1 January 2018
— IAS 40 Transfers of Investment Property	1 January 2018
— Annual improvements cycle (2014-2016)	1 January 2018

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (Continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

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 the Bank will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures.

The Bank applied IFRS 15 on 1 January 2018 using the modified retrospective approach in which the cumulative effect of initially applying this Standard is recognised at the date of initial application as an adjustment to the opening balance of retained earnings as at 1 January 2018 without restating comparative periods.

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, identifying the performance obligation in the contract, determining the transaction price, allocating the transaction price to the performance obligation in the contract; and recognising revenue when (or as) the entity satisfies a performance obligation.

There was no material impact of application of IFRS 15 and no adjustment to retained earnings was required.

IFRS 9: Financial Instruments (2014)

On 24 July 2014 the IASB issued the final IFRS 9 Financial Instruments Standard, which replaces earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement.

The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As a result of the adoption of IFRS 9, the Bank has adopted consequential amendments to IFRS 7 Financial Instruments: Disclosures that are applied to disclosures about 2018, but have not been applied to the comparative information.

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below. The full impact of adopting the standard is set out in Notes 2.2.1 to 2.2.3 and 4.1.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL).

IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (Continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

Classification of financial assets and financial liabilities - continued

The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Bank classifies financial assets under IFRS 9, see Note 2.2.1.

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

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

For an explanation of how the Bank classifies financial liabilities under IFRS 9, see Note 2.2.1.

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see Notes 2.2.1 to 2.2.3 and note 4.1.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

Comparative periods generally have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9. The Bank used the exemption not to restate comparative periods.

The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

- The determination of the business model within which a financial asset is held.
- Determination of factors to consider in determining whether there has been a significant increase in credit risk.
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank has assumed that credit risk on the asset had not increased significantly since its initial recognition.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Notes 2.21 to 2.2.3 and Note 4.1.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (Continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)

The following clarifications and amendments are contained in the pronouncement:

— *Accounting for cash-settled share-based payment transactions that include a performance condition*

Up until this point, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

— *Classification of share-based payment transactions with net settlement features*

IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

— *Accounting for modifications of share-based payment transactions from cash-settled to equity-settled*

Up until this point, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognised in respect of the cash-settled share-based payment is derecognised and the equity-settled share-based payment is recognised at the modification date fair value to the extent services have been rendered up to the modification date.
- Any difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date would be recognised in profit and loss immediately.

The amendments were effective for annual periods beginning on or after 1 January 2018. Earlier application was permitted. The amendments were to be applied prospectively. However, retrospective application was allowed if possible without the use of hindsight. If an entity applies the amendments retrospectively, it must do so for all of the amendments described above.

The adoption of this standard did not have any impact on the Bank's financial statements.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (Continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

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

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

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

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

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

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

The adoption of this standard did not have any impact on the Bank's financial statements.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

This Interpretation applies to a foreign currency transaction (or part of it) when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognises the related asset, expense or income (or part of it).

This Interpretation stipulates that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

This Interpretation does not apply to income taxes, insurance contracts and circumstances when an entity measures the related asset, expense or income on initial recognition:

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (Continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consider - continued

(a) at fair value; or
(b) at the fair value of the consideration paid or received at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability arising from advance consideration (for example, the measurement of goodwill applying IFRS 3 Business Combinations).

The amendments apply retrospectively for annual periods beginning on or after 1 January 2018, with early application permitted.

The adoption of this standard did not have a material impact on the Bank's financial statements.

Transfers of Investment property (Amendments to IAS 40)

The IASB has amended the requirements in IAS 40 Investment property on when a Company should transfer a property asset to, or from, investment property.

The adoption of this standard did not have any impact on the amounts and disclosures of the Bank's financial statements.

Annual improvement cycle (2014 – 2016) – various standards

Standards	Amendments
IFRS 1 First-time Adoption of IFRS	Outdated exemptions for first-time adopters of IFRS are removed. The amendments apply prospectively for annual periods beginning on or after 1 January 2018.
IAS 28 Investments in Associates and Joint Ventures	A venture capital organisation, or other qualifying entity, may elect to measure its investments in an associate or joint venture at fair value through profit or loss. This election can be made on an investment-by-investment basis. A non-investment entity investor may elect to retain the fair value accounting applied by an investment entity associate or investment entity joint venture to its subsidiaries. This election can be made separately for each investment entity associate or joint venture. The amendments apply retrospectively for annual periods beginning on or after 1 January 2018; early application is permitted.

The adoption of these standards did not have a material impact on the amounts and disclosures of the Bank's financial statements.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (Continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2018, and have not been applied in preparing these financial statements.

The Bank does not plan to adopt these standards early. These are summarised below;

— IFRS 16 Leases	1 January 2019
— IFRIC 23 Uncertainty over income tax treatments	1 January 2019
— IFRS 9 Prepayment Features with Negative Compensation	1 January 2019
— IAS 28 Long-term Interests in Associates and Joint Ventures	1 January 2019
— Annual improvements cycle (2015-2017)	1 January 2019
— IAS 19 Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)	1 January 2019
— IFRS 3 Definition of a Business	1 January 2020
— Amendments to references to the Conceptual Framework in IFRS Standards	1 January 2020
— Amendments to IAS 1 and IAS 8 Definition of Material	1 January 2020
— IFRS 17 Insurance contracts	1 January 2022
— Sale or Contribution of Assets between an Investor and its Associate or Company (Amendments to IFRS 10 and IAS 28).	To be determined

All standards and interpretations will be adopted at their effective date (except for those standards and interpretations that are not applicable to the entity).

IFRS 16: Leases

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

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

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

The standard eliminates the classification of leases as either operating leases or finance leases for a lessee and introduces a single lessee accounting model. All leases are treated in a similar way to finance leases.

Applying that model significantly affects the accounting and presentation of leases and consequently, the lessee is required to recognise:

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 (Continued)

IFRS 16: Leases – continued

Assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A Company recognises the present value of the unavoidable lease payments and shows them either as lease assets (right-of-use assets) or together with property, plant and equipment. If lease payments are made over time, a Company also recognises a financial liability representing its obligation to make future lease payments.

a) depreciation of lease assets and interest on lease liabilities in profit or loss over the lease term; and

b) separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (typically presented within either operating or financing activities) in the statement of cash flows

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

The standard does not require a Company to recognise assets and liabilities for:

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

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

The Bank has assessed the potential impact on the amounts and disclosures of the Bank's financial statements and estimates its contractual leases will impact total assets and total liabilites by approximately 1%.

IFRIC 23 Clarification on accounting for Income tax exposures

IFRIC 23 clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities, whilst also aiming to enhance transparency.

IFRIC 23 explains how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 (Continued)

IFRIC 23 Clarification on accounting for Income tax exposures – continued

If an entity concludes that it is probable that the tax authority will accept an uncertain tax treatment that has been taken or is expected to be taken on a tax return, it should determine its accounting for income taxes consistently with that tax treatment. If an entity concludes that it is not probable that the treatment will be accepted, it should reflect the effect of the uncertainty in its income tax accounting in the period in which that determination is made. Uncertainty is reflected in the overall measurement of tax and separate provision is not allowed.

The entity is required to measure the impact of the uncertainty using the method that best predicts the resolution of the uncertainty (that is, the entity should use either the most likely amount method or the expected value method when measuring an uncertainty).

The entity will also need to provide disclosures, under existing disclosure requirements, about

(a) judgments made;
(b) assumptions and other estimates used; and
(c) potential impact of uncertainties not reflected.

The new Standard is effective for annual periods beginning on or after 1 January 2019.

The Bank is assessing the potential impact on its financial statements resulting from the application of IFRIC 23.

Prepayment Features with Negative Compensation (Amendments to IFRS 9)

The amendments clarify that financial assets containing prepayment features with negative compensation can now be measured at amortised cost or at fair value through other comprehensive income (FVOCI) if they meet the other relevant requirements of IFRS 9.

The amendments apply for annual periods beginning on or after 1 January 2019 with retrospective application, early adoption is permitted.

The adoption of these amendments will not have an impact on the financial statements of the Bank.

Long-term Interests in Associates and Joint Ventures (Amendment to IAS 28)

The amendments clarify that an entity applies IFRS 9 to long-term interests in an associate and joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.

The amendments apply for annual periods beginning on or after 1 January 2019. Early adoption is permitted.

The adoption of these standards will not have an impact on the financial statements of the Bank.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 (Continued)

Annual improvement cycle (2015 – 2017) – various standards

Standards	Amendments
IFRS 3 Business Combinations and IFRS 11 Joint Arrangements	Clarifies how a Company accounts for increasing its interest in a joint operation that meets the definition of a business: — If a party maintains (or obtains) joint control, then the previously held interest is not remeasured. — If a party obtains control, then the transaction is a business combination achieved in stages and the acquiring party remeasures the previously held interest at fair value.
IAS 12 *Income taxes*	Clarifies that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognised consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI or equity.
IAS 23 *Borrowing costs*	Clarifies that the general borrowings pool used to calculate eligible borrowing costs excludes only borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale – or any non-qualifying assets – are included in that general pool. As the costs of retrospective application might outweigh the benefits, the changes are applied prospectively to borrowing costs incurred on or after the date an entity adopts the amendments.

The amendments are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. The adoption of these amendments is not expected to affect the amounts and disclosures of the Bank's financial statements.

The Bank did not early adopt new or amended standards in the year ended 31 December 2018.

IAS 19 Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)

The amendments clarify that:
- on amendment, curtailment or settlement of a defined benefit plan, a Company now uses updated actuarial assumptions to determine its current service cost and net interest for the period; and
- the effect of the asset ceiling is disregarded when calculating the gain or loss on any settlement of the plan and is dealt with separately in other comprehensive income (OCI).

Consistent with the calculation of a gain or loss on a plan amendment, entities will now use updated actuarial assumptions to determine the current service cost and net interest for the period. Previously, entities would not have updated the calculation of these costs until the year-end.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 (Continued)

IAS 19 Plan Amendment, Curtailment or Settlement (Amendments to IAS 19) - continued

Further, if a defined benefit plan is settled, any asset ceiling would be disregarded when determining the plan assets as part of the calculation of gain or loss on settlement.

The amendments apply for plan amendments, curtailments or settlements that occur on or after 1 January 2019, or the date on which the amendments are first applied. Earlier application is permitted.

The adoption of this standard will not have an impact on the financial statements of the Bank.

IFRS 3 Definition of a Business

With a broad business definition, determining whether a transaction results in an asset or a business acquisition has long been a challenging but important area of judgement. These amendments to IFRS 3 Business Combinations seek to clarify this matter as below however complexities still remain.

- Optional concentration test
  The amendments include an election to use a concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets.
- Substantive process
  If an entity chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

  The definition of a business is now narrower and could result in fewer business combinations being recognised.

The amendment applies to businesses acquired in annual reporting periods beginning on or after 1 January 2020. Earlier application is permitted. The adoption of this standard will not have an impact on the financial statements of the Bank.

Amendments to References to the Conceptual Framework in IFRS Standards

This amendment sets out amendments to IFRS Standards (Standards), their accompanying documents and IFRS practice statements to reflect the issue of the International Accounting Standards Board (IASB) revised Conceptual Framework for Financial Reporting in 2018 (2018 Conceptual Framework).

Some Standards, their accompanying documents and IFRS practice statements contain references to, or quotations from, the IASC's Framework for the Preparation and Presentation of Financial Statements adopted by the IASB in 2001 (Framework) or the Conceptual Framework for Financial Reporting issued in 2010. Amendments to References to the Conceptual Framework in IFRS Standards updates some of those references and quotations so that they refer to the 2018 Conceptual Framework, and makes other amendments to clarify which version of the Conceptual Framework is referred to in particular documents.

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 (Continued)

Amendments to References to the Conceptual Framework in IFRS Standards - continued

These amendments are based on proposals in the Exposure Draft Updating References to the Conceptual Framework, published in 2015, and amend Standards, their accompanying documents and IFRS practice statements that will be effective for annual reporting periods beginning on or after 1 January 2020.

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

IAS 1 and IAS 8 Definition of Material

The amendment refines the definition of Material to make it easier to understand and aligning the definition across IFRS Standards and the Conceptual Framework.

The amendment includes the concept of 'obscuring' to the definition, alongside the existing references to 'omitting' and 'misstating'. Additionally, the amendments also adds the increased threshold of 'could influence' to 'could reasonably be expected to influence' as below.

"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."

However, the amendment has also removed the definition of material omissions or misstatements from IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The amendments are effective from 1 January 2020 but may be applied earlier.

The Bank is assessing the potential impact on its financial statements resulting from the application of the refined definition of materiality.

IFRS 17 Insurance Contracts

IFRS 17 Insurance Contracts sets out the requirements that an entity should apply in reporting information about insurance contracts it issues and reinsurance contracts it holds. An entity shall apply IFRS 17 Insurance Contracts to:

(a) insurance contracts, including reinsurance contracts, it issues;
(b) reinsurance contracts it holds; and
investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 requires an entity that issues insurance contracts to report them on the statement of financial position as the total of:

2. Significant accounting policies (Continued)

2.24 New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 (Continued)

IFRS 17 Insurance Contracts – continued

(a) the fulfilment cash flows—the current estimates of amounts that the entity expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and
(b) the contractual service margin—the expected profit for providing insurance coverage. The expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided.

IFRS 17 requires an entity to recognise profits as it delivers insurance services, rather than when it receives premiums, as well as to provide information about insurance contract profits that the Company expects to recognise in the future. IFRS 17 requires an entity to distinguish between groups of contracts expected to be profit making and groups of contracts expected to be loss making. Any expected losses arising from loss-making, or onerous, contracts are accounted for in profit or loss as soon as the Company determines that losses are expected. IFRS 17 requires the entity to update the fulfilment cash flows at each reporting date, using current estimates of the amount, timing and uncertainty of cash flows and of discount rates. The entity:

(a) accounts for changes to estimates of future cash flows from one reporting date to another either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it; and
(b) chooses where to present the effects of some changes in discount rates—either in profit or loss or in other comprehensive income.

IFRS 17 also requires disclosures to enable users of financial statements to understand the amounts recognised in the entity's statement of financial position and statement of profit or loss and other comprehensive income, and to assess the risks the Company faces from issuing insurance contracts.

IFRS 17 replaces IFRS 4 Insurance Contracts. IFRS 17 is effective for financial periods commencing on or after 1 January 2021. An entity shall apply the standard retrospectively unless impracticable. A Company can choose to apply IFRS 17 before that date, but only if it also applies IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers.

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

Sale or Contribution of Assets between an Investor and its Associate or Company (Amendments to IFRS 10 and IAS 28)

The amendments require the full gain to be recognised when assets transferred between an investor and its associate or Company meet the definition of a 'business' under IFRS 3 Business Combinations. Where the assets transferred do not meet the definition of a business, a partial gain to the extent of unrelated investors' interests in the associate or Company is recognised. The definition of a business is key to determining the extent of the gain to be recognised.

The effective date for these changes has now been postponed until the completion of a broader review.
The adoption of these changes will not affect the amounts and disclosures of the Bank's financial statements.

3. Critical accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. The directors also need to exercise judgment in applying the Bank's accounting policies.

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

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

3.1 Measurement of the expected credit loss allowance

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and debt instruments measured at FVOCI is an area that requires the use of complex models and significant assumptions about the future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses).
A number of significant judgements are also required in applying the accounting requirement for measuring ECL, such as:

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

3.2 Fair value of financial instruments

For those assets and liabilities measured at fair value, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When measuring the fair value of an asset or a liability, the Bank uses market observable data as far as possible. If the fair value of an asset or a liability is not directly observable, it is estimated by the Bank using valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs (e.g. by use of the market comparable approach that reflects recent transaction prices for similar items or discounted cash flow analysis). Inputs used are consistent with the characteristics of the asset / liability that market participants would take into account.
Fair values are categorised into three levels of fair value hierarchy based on the degree to which the inputs to the measurements are observable and the significance of the inputs to the fair value measurement in its entirety:

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

Level 2 – fair value measurements are derived from inputs other than quoted prices used in Level 1 that are observable for the assets or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

3. Critical accounting estimates and judgements in applying accounting policies (Continued)

3.3 Fair value of financial instruments (continued)

Level 3 – fair values measurements are derived from valuation techniques that include inputs for assets or liabilities that are not based on observable market data (unobservable inputs). Transfers between levels of the fair value hierarchy are recognised by the Bank at the end of the reporting period during which the change occurred.

3.3 Taxes

Determining the income tax liability involves judgment on the tax treatment of certain transactions. Deferred tax is recognised on temporary differences where it is probable that there will be taxable revenue against which these can be offset.

3.4 Depreciation of property and equipment

Critical estimates are made by the Directors in determining the useful lives of property and equipment.

4. Financial risk management

The Bank's business involves taking on risks in a targeted manner and managing them professionally. The effective management of risk within the stated risk appetite is fundamental to the banking activities of the Bank.

Risk management is at the core of the operating and management structures of the Bank and this involves managing and controlling of risks and in particular avoiding undue concentration of exposures, limiting potential losses from stress events and constraining profit or loss volatility. The core functions of the Bank's risk management are to identify all key risks for the Bank, measure these risks, manage the risk positions and determine capital allocations.

The overall responsibility for risk management within the Bank rests with the Board of Directors. Through the risk management structure, the Bank seeks to manage efficiently the core risks i.e credit, liquidity and market risks which arise directly through the Bank's commercial activities. Accountability for risk management resides at all levels within the Bank, from the Executive down through the organisation to each business manager and risk owner.

On a day- to -day basis, risks are managed through a number of management committees. Through this process the Bank monitors compliance with overall risk management policies. The Bank's risk management policies are approved by the Board and they identify, analyse the risks faced by the Bank as well as the appropriate risk limits and controls.

The Bank's Risk Management Committees are responsible for monitoring compliance with the Bank's risk management policies and procedures and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. Risk Management information is provided on a regular basis to the Board Risk Management and Compliance Committee.

The Board Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures and for reviewing the robustness of the risk management framework in relation to the risks faced by the Bank.

4.1 Credit risk

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

4. Financial risk management (Continued)
4.1 Credit risk (Continued)
4.1.1 Credit Quality Analysis

The following table sets out information about the credit quality of financial assets measured at amortised cost (2017 HTM). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively. Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in Note 4.1.3

			2018			2017
		Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	Total
Credit risk exposure	**Note**	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**
Balances due from banking institutions	14	2,872,542	-	-	2,872,542	6,597,236
Less: Impairment		(36)	-	-	(36)	-
Carrying amount		**2,872,506**	**-**	**-**	**2,872,506**	**6,597,236**
Due from group banks	15	1,013,777	-	-	1,013,777	2,959,913
Less: Impairment		(1,494)	-	-	(1,494)	-
Carrying amount		**1,012,283**	**-**	**-**	**1,012,283**	**2,959,913**
Investment securities - at amortised cost	17(b)	6,533,125	-	-	6,533,125	4,919,866
Less: Impairment		(20,480)	-	-	(20,480)	-
Carrying amount		**6,512,645**	**-**	**-**	**6,512,645**	**4,919,866**
Other Assets: Receivables	23	898,235	-	-	898,235	588,670
Less: Impairment		(2,764)	-	-	(2,764)	-
Carrying amount		**895,471**	**-**	**-**	**895,471**	**588,670**
Loans and advances to customers at amortised cost	16					
Normal		13,995,343	-	-	13,995,343	18,852,065
Watch		-	2,478,756	-	2,478,756	2,199,292
Substandard		-	-	1,134,892	1,134,892	1,401,721
Doubtful		-	-	7,962,539	7,962,539	8,643,951
Loss		-	-	411,543	411,543	525,356
Less: Impairment		(100,127)	(363,925)	(4,330,906)	(4,794,958)	(4,233,925)
Carrying amount		**13,895,216**	**2,114,831**	**5,178,068**	**21,188,115**	**27,388,460**

4. Financial risk management (Continued)
4.1 Credit risk (Continued)
4.1.1 Credit Quality Analysis (Continued)

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

		2018				2017
		Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	Total
Credit risk exposure	**Note**	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**	**KShs'000**
Loans and advances to customers at amortised cost-gross carrying amount	17					
Neither past due nor impaired		13,995,343	-	-	13,995,343	18,852,065
Past due but not impaired		-	2,478,756	-	2,478,756	2,199,292
Individually impaired		-	-	9,508,974	9,508,974	10,571,028
Gross		13,995,343	2,478,756	9,508,974	25,983,073	31,622,385
Less: Loss allowance		(100,127)	(363,925)	(4,330,906)	(4,794,958)	(4,233,925)
Carrying amount		**13,895,216**	**2,114,831**	**5,178,068**	**21,188,115**	**27,388,460**

		2018				2017
Credit Risk exposure	**Note**	**Stage 1 12-month ECL KShs'000**	**Stage 2 12-month ECL KShs'000**	**Stage 3 12-month ECL KShs'000**	**Total KShs'000**	**Total KShs'000**
Outstanding commitments and contingent liabilities	32					
Neither past due nor impaired		8,854,771	-	-	8,854,771	14,037,965
Loss allowance*		(41,879)	-	-	(41,879)	-
Carrying amount		**8,854,771**	**-**	**-**	**8,854,771**	**14,037,965**

*The loss allowance on outstanding commitments and financial guarantees is carried in other liabilities and therefore no impact on the carrying amount.

The following table sets out the credit quality of trading debt securities. The analysis has been based on Moody's ratings.

Investment securities at amortised cost (2017:HTM)	**Note**	**2018 Total KShs'000**	**2017 Total KShs'000**
Government bonds and treasury bills	18(b)		
Rated AAA		6,489,651	4,842,043
Loss allowance		(20,439)	-
		6,469,212	**4,842,043**
Corporate Bonds	18(b)		
Rated AAA		43,474	77,823
Loss allowance		(41)	-
Carrying amount		**43,433**	**77,823**
Total carrying amount		**6,512,645**	**4,919,866**

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.2 Collateral held and other credit enhancements

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

Type of credit exposure	Percentage of exposure that is subject to collateral requirements		
	2018	2017	Principal type of collateral held
Loans and advances to banks	100	100	Marketable Securities
Loans and advances to retail customers:			
Mortgage	80	80	Residential Property
Secured Term loans	75	75	Lease hold property
New Motor Vehicles	90	90	Personal Vehicle
Overdraft facilities	110	110	Lien on Cash deposit
LC's, guarantees & Acceptances	100	100	Lien on Cash deposit
Loans and advances to Corporate customers:			
Mortgage	80	80	Commercial Property
Secured Term loans	75	75	Lease hold property
New Motor Vehicles	90	90	Commercial Vehicles
Overdraft facilities	110	110	Lien on Cash deposit
LC's, guarantees & Acceptances	100	100	Lien on Cash deposit

4.1.3 Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk

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

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:
- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD at this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Bank uses three criteria for determining whether there has been a significant increase in credit risk:
- quantitative test based on movement in PD;
- qualitative indicators; and
- a backstop of 30 days past due.

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.3 Amounts arising from ECL (Continued)

Credit risk grades

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

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

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

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

4. Financial risk management (Continued)
4.1 Credit risk (Continued)
4.1.3 Amounts arising from ECL (Continued)
Credit risk grades (Continued)

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

The wholesale portfolio of the Bank is comprised of loans and advances to banks, public sector entities, sovereigns, corporates and other businesses.

Grading	12-month weighted-average PD	External rating
Grades A–K (Normal): Low–fair risk	1.34	AAA to B
Grades M–O (Watch): Higher risk	23.05	B to C
Grades R–S: Substandard, doubtful, loss	100.00	Default

The retail portfolios are comprised of mortgage lending and personal loans.

Grading	12-month weighted-average PD
Grades A–K (Normal): Low–fair risk	1.34
Grades M–O (Watch): Higher risk	23.05
Grades R–S: Substandard, doubtful, loss	100.00

Generating the term structure of PD

Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Bank collects performance and default information about its credit risk exposures analysed by jurisdiction or region and by type of product and borrower as well as by credit risk grading. For some portfolios, information purchased from external credit reference agencies is also used.

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

Determining whether credit risk has increased significantly

The Bank assesses whether credit risk has increased significantly since initial recognition at each reporting date. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the geographical region. What is considered significant differs for different types of lending, in particular between wholesale and retail.

As a general indicator, credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's quantitative modelling:

- the remaining lifetime PD is determined to have increased by more than 20% of the corresponding amount estimated on initial recognition; or,
- if the absolute change is annualised, lifetime PD since initial recognition is greater than 200 basis points.

In addition, irrespective of the relative increase since initial recognition, credit risk of an exposure is deemed not to have increased significantly if its remaining annualised lifetime PD at the reporting date is 20% basis points or less.

The credit risk may also be deemed to have increased significantly since initial recognition based on qualitative factors linked to the Bank's credit risk management processes that may not otherwise be fully reflected in its quantitative analysis on a timely basis. This will be the case for exposures that meet certain heightened risk criteria, such as placement on a watch list.

Such qualitative factors are based on its expert judgment and relevant historical experiences.

4. Financial risk management (Continued)
4.1 Credit risk (Continued)
4.1.3 Amounts arising from ECL (Continued)
Credit risk grades (Continued)

As a backstop, the Bank considers that a significant increase in credit risk occurs no later than when an asset is more than 90 days past due or, for certain types of exposure, more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

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

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

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes 30 days past due;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month PD (Stage 1) and lifetime PD (Stage 2 and 3).

Definition of default

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

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held);
- the borrower is more than 90 days past due on any material credit obligation to the Bank. Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding; or
- it is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to the borrower's inability to pay its credit obligations.

In assessing whether a borrower is in default, the Bank considers indicators that are:

- qualitative: e.g. breaches of covenant;
- quantitative: e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.The definition of default largely aligns with that applied by the Bank for regulatory capital purposes.

4. Financial risk management (Continued)
4.1 Credit risk (Continued)
4.1.3 Amounts arising from ECL (Continued)

Forward-looking information incorporated in the ECL models.

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

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

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

A total of 15 macro economic indicators were tested for correlation with the observed PD's and LGD's, and 5 were selected for the final modeling. The forecasts that were used in determining the macroeconomic adjustment for the selected macroeconomic variables, are provided below.

Year	Nominal GDP, % y-o-y	Money Supply M3 % y-o-y	Population % y-o-y	inflation (CPI) % y-o-y	Fiscal Revenue
2018	8.8%	8.9%	2.5%	6.6%	15.1%
2019	9.4%	9.0%	2.5%	6.5%	13.2%
2020	8.4%	9.0%	2.5%	6.5%	13.6%
2021	8.2%	9.0%	2.4%	6.5%	12.2%
2022	8.0%	9.0%	2.4%	6.5%	12.0%
2023	7.8%	9.0%	2.3%	6.5%	12.0%
2024	7.5%	9.0%	2.3%	6.5%	11.9%
2025	8.2%	9.0%	2.3%	6.5%	12.0%
2026	8.8%	9.0%	2.3%	6.5%	12.1%

Key:
CPI: Consumer Price Index
GDP: Gross Domestic Product
M3: Broad Money Supply
y-o-y: Year on Year

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.3 Amounts arising from ECL (Continued)

Modified Financial assets

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

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

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

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

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

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Bank Credit Committee regularly reviews reports on forbearance activities. For financial assets modified as part of the Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators. Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired. A customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired/in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to Stage 1.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

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

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LG models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. LGD estimates are recalibrated for different economic scenarios and, for real estate lending, to reflect possible changes in property prices.

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.3 Amounts arising from ECL (Continued)

Measurement of ECL (Continued)

They are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

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

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

However, for retail overdrafts that include both a loan and an undrawn commitment component, the Bank measures ECL over a period longer than the maximum contractual period if the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period.

These facilities do not have a fixed term or repayment structure and are managed on a collective basis. The Bank can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take, and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms.

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.3 Amounts arising from ECL (Continued)

Loss Allowance

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

			2018		
	Note	**Stage 1 KShs'000**	**Stage 2 KShs'000**	**Stage 3 KShs'000**	**Total KShs'000**
Loss allowance – Loans and advances to customers at amortised cost	17				
Balance as at 1 January		**121,667**	**736,159**	**5,279,651**	**6,137,477**
Changes in the loss allowance					
Transfer to Stage 1		365,366	(2,006)	(363,360)	-
Transfer to Stage 2		(3,992)	119,560	(115,568)	-
Transfer to Stage 3		-	(660,775)	660,775	-
Net remeasurement of loss allowance		-	-	(200,443)	(200,443)
New financial assets originated or purchased		9,073	304,322	3,323	316,718
Financial assets that have been derecognised		(29,068)	(4,087)	(120,944)	(154,099)
Write-offs		-	-	(1,538,284)	(1,538,284)
Foreign exchange and other movements		(404,799)	(129,248)	725,756	191,709
Loss allowance as at 31 December		**58,247**	**363,925**	**4,330,906**	**4,753,078**

			2018		
	Note	**Stage 1 KShs'000**	**Stage 2 KShs'000**	**Stage 3 KShs'000**	**Total KShs'000**
Outstanding commitments and contingent liabilities	32				
Balance as at 01 January 2018		**298,089**	**-**	**-**	**298,089**
Changes in the loss allowance					
Transfer to Stage 1		-	-	-	-
Transfer to Stage 2		-	-	-	-
Transfer to Stage 3		-	-	-	-
Net remeasurement of loss allowance		-	-	-	-
New financial assets originated or purchased		36,040	-	-	36,040
Financial assets that have been derecognised		(144,244)	-	-	(144,244)
Write-offs	-	-	-	-	-
Foreign exchange and other		(148,006)	-	-	(148,006)
Loss allowance as at 31 December		**41,879**	**-**	**-**	**41,879**

4. Financial risk management (Continued)
4.1 Credit risk (Continued)
4.1.3 Amounts arising from ECL (Continued)

Loss Allowance (Continued)

	2018 Stage 1 KShs'000	2017 Total KShs'000
Balances due from banking institutions:		
Balance at 1 January	1,057	-
Net remeasurement of loss allowance	-	-
Financial assets that have been derecognised	(1,057)	-
New financial assets originated or purchased	36	-
Foreign exchange and other movements	-	-
Balance at 31 December	**36**	**-**

	2018 Stage 1 KShs'000	2017 Total KShs'000
Balances from group banks:		
Balance at 1 January	2,235	-
Net remeasurement of loss allowance	-	-
Financial assets that have been derecognised	(2,235)	-
New financial assets originated or purchased	1,494	-
Foreign exchange and other movements	-	-
Balance at 31 December	**1,494**	**-**

	2018 Stage 1 KShs'000	2017 Total KShs'000
Investment securities:		
Balance at 1 January	17,757	-
Net remeasurement of loss allowance	-	-
Financial assets that have been derecognised	(17,757)	-
New financial assets originated or purchased	20,480	-
Foreign exchange and other movements	-	-
Balance at 31 December	**20,480**	**-**

	2018 Stage 1 KShs'000	2017 Total KShs'000
Other assets: receivable balances		
Balance at 1 January	964	-
Net remeasurement of loss allowance	-	-
Financial assets that have been derecognised	(964)	-
New financial assets originated or purchased	2,764	-
Foreign exchange and other movements	-	-
Balance at 31 December	**2,764**	**-**

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.3 Amounts arising from ECL (Continued)

Loss Allowance (Continued)

The following table provides a reconciliation between:

- amounts shown in the above tables reconciling opening and closing balances of loss allowance per class of financial instrument; and
- the 'impairment losses on financial instruments' line item in the statement of profit or loss and other comprehensive income.

	Loans and advances to customers	Outstanding commitments and contingent liabilities	Balances due from group banks	Balances due from banking institution	Investment securities	Other assets: receivable balances	Total
	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
Net remeasurement of loss allowance	(354,542)	(144,244)	-	-	-	-	(498,786)
New financial assets originated or purchased	316,718	36,040	(1,021)	(741)	2,723	1,800	355,519
Total	**(37,824)**	**(108,204)**	**(1,021)**	**(741)**	**2,723**	**1,800**	**(143,267)**
Recoveries of amounts previoulsy written off	(12,666)	-	-	-	-	-	(12,666)
Total	**(50,490)**	**(108,204)**	**(1,021)**	**(741)**	**2,723**	**1,800**	**(155,933)**

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.4 Concentration of risks of financial assets with credit exposure

All financial instruments' carrying amounts as per the statement of financial position represent the maximum exposure to credit risk without taking account of any collateral held or other credit enhancements.

Off balance sheet items carrying amounts represents the maximum exposure to credit risk without taking into account any collateral held or other credit enhancements as disclosed in note 32.

Carrying amounts	2018				2017
By economic sector	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	Total
	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
Loans and advances to customers					
Building and Construction	823,736	218,612	2,405,211	3,447,559	4,793,830
Manufacturing	2,105,718	32,965	2,528,233	4,666,916	4,997,761
Personal Services	3,112,516	627,484	859,419	4,599,419	6,023,674
Trade	2,301,428	874,585	2,458,724	5,634,737	6,629,716
Transport and Communication	2,339,288	674,478	549,595	3,563,361	3,502,696
Others	3,312,657	50,632	707,792	4,071,081	5,674,708
Total on balance sheet	**13,995,343**	**2,478,756**	**9,508,974**	**25,983,073**	**31,622,385**
Acceptances and letters of credit	1,002,246	-	-	1,002,246	406,142
Guarantees and performance bonds	7,081,072	-	-	7,081,072	9,541,433
Commitments to lend	771,453	-	-	771,453	4,090,390
Outstanding commitments and contingent liabilities	**8,854,771**	**-**	**-**	**8,854,771**	**14,037,965**
	22,850,114	**2,478,756**	**9,508,974**	**34,837,844**	**45,660,350**

Carrying amounts	Balances due from banks Stage 1	Investment securities Stage 1
	KShs'000	KShs'000
Banks (Both group and non-group)	3,884,789	-
Corporate	-	43,433
Goverment	-	6,469,212
Outstanding balances due from banks and investment securities	**3,884,789**	**6,512,645**

4. Financial risk management (Continued)

4.1 Credit risk (Continued)

4.1.5 Risk limit control and mitigation policies

The Bank manages, limits and controls concentrations of credit risk wherever they are identified in particular, to individual counterparties and banks, and to industries and countries.

The Bank 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 geographical and industry segments. Limits on the level of credit risk by product, industry sector and country are approved quarterly by the Board of Directors.

The exposure to any one borrower including banks and brokers is further restricted by sublimits covering on- and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Lending limits are reviewed in the light of changing market and economic conditions and periodic credit reviews and assessments of probability of default. Some other specific control and mitigation measures are outlined below:

(a) **Collateral**

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for funds advances, which is common practice. The Bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Mortgages over residential properties.
- Charges over business assets such as premises, inventory and accounts receivable.
- Charges over financial instruments such as debt securities and equities.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured. In addition, in order to minimise the credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances.

The Bank's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Bank since the previous period.

A portion of the Banks financial assets originated by the mortgage business has sufficiently low "loan to value" ratios, which results in a no loss allowance being recognised in accordance with the Banks expected credit loss model. The Bank closely monitors collateral held for financial assets considered to be credit impaired, as it becomes more likely that the Bank will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below.

LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in house price indices. For credit-impaired loans the value of collateral is based on the most recent appraisals.

4. Financial risk management (continued)

4.1 Credit risk (continued)

	2018				2017
	Gross Loans KShs'000	Impairment Allowance KShs'000	Carrying amount KShs'000	Fair value of collateral held KShs'000	Carrying amount KShs'000
Corporate	14,156,812	(3,294,616)	10,862,196	19,034,341	13,848,028
SME	6,774,294	(820,841)	5,953,453	16,423,951	7,261,482
Retail	5,051,967	(679,501)	4,372,466	7,376,430	6,278,950
Total credit impaired assets	**25,983,073**	**(4,794,958)**	**21,188,115**	**42,834,722**	**27,388,460**

The bank's policy is to dispose of any repossessed collateral on the open market at market value. As at the reporting date, the Bank had possession of the following collateral:

	2018 KShs'000	2017 KShs'000
Residential property	1,621,632	482,304
Motor vehicles	4,990	13,430
Total collateral repossessed	**1,626,622**	**495,734**

(b) Lending limits (for derivative and loan books)

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

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

(c) Financial covenants (for credit related commitments and loan books)

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

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

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

4. Financial risk management (Continued)

4.2 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows, such as debt maturities or margin calls for derivatives.

Such outflows would deplete available cash resources for client lending, trading activities and investments. In extreme circumstances, lack of liquidity could result in reductions in the statement of financial position and sales of assets, or potentially an inability to fulfil lending commitments. The risk that the Bank will be unable to do so is inherent in all banking operations and can be affected by a range of institution-specific and market-wide events including, but not limited to, credit events, merger and acquisition activity, systemic shocks and natural disasters.

The Bank's liquidity management process, as carried out within the Bank and monitored by the Assets and Liabilities Committee (ALCO) includes:

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

A key measure of liquidity risk is the ratio of net liquid assets to deposit liabilities. The Central Bank of Kenya requires banks to maintain a statutory minimum ratio of 20% of liquid assets to all its deposit liabilities. For this purpose, liquid assets comprise cash and balances with Central Bank of Kenya, net loans and advances with banks, treasury bonds and bills and net balances with banks abroad. Deposit liabilities comprise deposits from customers and other liabilities that have matured or maturing within 91 days.

The Bank also monitors on a regular basis the advances to deposits ratio. This is defined as the ratio of total loans and advances to customers relative to total customer deposits. A low advances to deposits ratio demonstrates that customer deposits exceed customer loans resulting from the emphasis placed on generating a high level of stable funding from customers.

Monitoring and reporting take the form of cash flow measurement and projections for the next day, week and month respectively, as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets .

4. Financial risk management (Continued)

4.2 Liquidity risk (Continued)

Non-derivative financial liabilities and assets held for managing liquidity risk

Balance at 31 December 2018	Months Up to 1 KShs'000	Months 1 to 3 KShs'000	Months 3 to 12 KShs'000	Years 1 to 5 KShs'000	Years >5 KShs'000	Total KShs'000
Customer deposits (Note 26)	23,172,947	4,322,146	2,755,362	28,586	-	30,279,041
Deposits and balances due to banking institutions (Note 25)	58,059	-	-	-	-	58,059
Interest payable on deposits and balances due to banking insttutions	-	-	-	-	-	-
Amounts due to group banks (Note 16 (b))	6,860,714	-	-	-	-	6,860,714
Interest payable on amounts due to group banks	46	-	-	-	-	46
Borrowings (Note 27)	-	3,207,385	-	1,475,972	-	4,683,357
Interest payable on borrowings	-	3,896	81,140	162,503	-	247,539
Other liabilities (Note 28)	525,658	-	-	-	-	525,658
Total financial liabilities (contractual maturity dates)	**30,617,424**	**7,533,427**	**2,836,502**	**1,667,061**	**-**	**42,654,414**
Assets held for managing liquidity (contractual maturity dates)	**18,111,621**	**1,041,813**	**5,721,477**	**14,177,732**	**3,657,949**	**42,710,592**

Balance at 31 December 2017	Months Up to 1 KShs'000	Months 1 to 3 KShs'000	Months 3 to 12 KShs'000	Years 1 to 5 KShs'000	Years >5 KShs'000	Total KShs'000
Customer deposits (Note 26)	22,227,525	6,431,234	2,906,790	7,245	-	**31,572,794**
Deposits and balances due to banking institutions (Note 25)	1,762,089	-	-	-	-	**1,762,089**
Interest payable on deposits and balances due to banking insttutions	1,341	-	-	-	-	**1,341**
Amounts due to group banks (Note 16 (b))	4,326,047	-	1,810,383	-	-	**6,136,430**
Interest payable on amounts due to group banks	-	-	9,549	-	-	**9,549**
Borrowings (Note 27)	-	98,336	295,008	5,269,058	-	**5,662,402**
Interest payable on borrowings	1,694	-	111,126	400,177	-	**512,997**
Other liabilities (Note 28)	426,728	-	-	-	-	**426,728**
Total financial liabilities (contractual maturity dates)	**28,745,424**	**6,529,570**	**5,132,856**	**5,676,480**	**-**	**46,084,330**
Assets held for managing liquidity (contractual maturity dates)	**18,910,571**	**2,678,229**	**5,242,216**	**16,498,251**	**4,682,814**	**48,012,081**

4. Financial risk management (Continued)

4.2 Liquidity risk (Continued)

Assets held for managing liquidity risk

The Bank holds a diversified portfolio of cash and high-quality highly-liquid securities to support payment obligations and contingent funding in a stressed market environment. The Bank's assets held for managing liquidity risk comprise:

- Cash and balances with Central Bank;
- Government bonds and other securities that are readily acceptable in repurchase agreement with Central Banks; and
- Secondary sources of liquidity in the form of highly liquid instruments in the Bank's trading portfolios.

4.3 Market risk

The Bank takes on exposure to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices. The Bank separates exposures to market risk into either trading or non-trading portfolios.

The market risks arising from trading and non-trading activities are concentrated with the Bank's Treasury and monitored by two teams separately. Regular reports are submitted to the Assets and Liabilities Committee (ALCO), Heads of each business unit and the Board of Directors.

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

Non-trading portfolios primarily arise from the interest rate management of the entity's Retail and Enterprise banking assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's held-to-maturity and available-for-sale financial assets.

Overall authority for market risk for both trading and non-trading portfolios is vested in Assets and Liabilities Committee (ALCO). The bank's Risk department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation.

Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The tables below summarises the Bank's exposure to foreign currency exchange rate risk as at 31 December 2018 and 2017. Included in the table are the Bank's financial instruments categorised by currency:

4. Financial risk management (Continued)

4.3 Market risk (continued)

Foreign exchange risk (Continued)

Balance at 31 December 2018	USD KShs'000	GBP KShs'000	EUR KShs'000	Others KShs'000	Total KShs'000
Assets					
Cash and Balances with Central Bank	5,300,977	40,278	790,284	1,444	6,132,983
Placements with banks	2,579,717	83,134	62,537	147,118	2,872,506
Amounts due from group companies	613,708	-	211,829	12,682	838,219
Loans and advances	8,315,648	9,680	1,213,676	1	9,539,005
Other assets	114,178	79,348	3,313	43,080	239,919
Total financial assets	**16,924,228**	**212,440**	**2,281,639**	**204,325**	**19,622,632**
Liabilities					
Customer deposits	6,681,556	53,781	1,200,790	109,295	8,045,422
Deposits and balances due to banking institutions	56,962	-	-	1,097	58,059
Amounts due to group banks	6,688,460	-	152,886	6,053	6,847,399
Borrowings	3,207,385	-	1,475,972	-	4,683,357
Other liabilities	39,988	4	-	477	40,469
Total financial liabilities	**16,674,351**	**53,785**	**2,829,648**	**116,922**	**19,674,706**
Net on-balance sheet position	249,877	158,655	(548,009)	87,403	(52,074)
Net off-balance sheet position	2,143,556	-	1,216,589	1,293,261	4,653,406
Net overall position	**2,393,433**	**158,655**	**668,580**	**1,380,664**	**4,601,332**

Balance at 31 December 2017	USD KShs'000	GBP KShs'000	EUR KShs'000	Others KShs'000	Total KShs'000
Assets					
Cash and Balances with Central Bank	507,900	43,113	98,954	779	650,746
Placements with banks	5,065,858	224,701	56,163	149,736	5,496,458
Amounts due from group companies	2,102,052	-	379,605	251,773	2,733,430
Loans and advances	9,907,938	12,675	1,327,317	1	11,247,931
Other assets	501,107	1	19,064	1,359	521,531
Total financial assets	**18,084,855**	**280,490**	**1,881,103**	**403,648**	**20,650,096**
Liabilities					
Customer deposits	4,905,262	71,170	634,988	874,414	6,485,834
Deposits and balances due to banking institutions	1,761,181	-	-	907	1,762,088
Amounts due to group banks	6,089,353	-	39,477	-	6,128,830
Borrowings	4,093,412	-	1,568,990	-	5,662,402
Other liabilities	17,749	10	1,301	525	19,585
Total financial liabilities	**16,866,957**	**71,180**	**2,244,756**	**875,846**	**20,058,739**
Net on-balance sheet position	1,217,898	209,310	(363,653)	(472,198)	591,357
Net off-balance sheet position	3,228,377	-	2,349,931	558,202	6,136,510
Net overall position	**4,446,275**	**209,310**	**1,986,278**	**86,004**	**6,727,867**

4. Financial risk management (Continued)

4.3 Market risk (continued)

Foreign exchange risk (Continued)

Foreign exchange risk sensitivity analysis

At 31 December 2018 if the shilling had strengthened or weakened by 5% against major trading currencies, with other variables held constant, the impact on after tax profit or loss / equity would have been as shown below. This analysis is performed on the same basis for 2017.

	2018 KShs'000	2017 KShs'000
+ 5% movement	1,823	7,653
- 5% movement	(1,823)	(7,653)

5% sensitivity rate represents management's assessment of the reasonable possible change in foreign exchange rates.

Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates.

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest rate repricing and value at risk that may be undertaken, which is monitored daily by Bank Treasury.

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

4. Financial risk management (Continued)

4.3 Market risk (continued)

Interest rate risk (Continued)

Balance at 31 December 2018	Effective interest rate	Month Up to 1 KShs'000	1 to 3 KShs'000	3 to 12 KShs'000	>12 KShs'000	Non-interest Bearing KShs'000	Total KShs'000
Cash and balances with Central Bank (Note 13)	-	-	-	-	-	9,927,343	9,927,343
Investment securities-Amortised cost (Note 18(b))	8.15%	149,273	196,602	2,891,793	3,274,977	-	6,512,645
Derivative assets held for risk management (Note 14)							
Placements with banks (Note 15)	3.02%	2,872,506	-	-	-	-	2,872,506
Amounts due from group companies (Note 16(a))	1.58%	235,114	297,343	479,826	-	-	1,012,283
Other assets (Note 24)	-	-	-	-	-	812,316	812,316
Investment securities-FVOCI (Note 17 (a))	-	-	-	-	-	283,027	283,027
Loans and advances (Note 16)	9.11%	3,729,685	547,868	16,910,562	-	-	21,188,115
Total financial assets		**6,986,578**	**1,041,813**	**20,282,181**	**3,274,977**	**11,022,686**	**42,608,235**
Customer deposits (Note 26)	5.06%	23,150,853	4,282,672	2,662,301	26,631	-	30,122,457
Deposits and balances due to banking institutions (Note 25)	3.44%	58,059	-	-	-	-	58,059
Amounts due to group banks (Note 16(b))	1.16%	6,860,714	-	-	-	-	6,860,714
Borrowings (Note 27)	5.07%	-	3,207,385	-	1,475,972	-	4,683,357
Other liabilities (Note 28)	-	-	-	-	-	525,658	525,658
Total financial liabilities		**30,069,626**	**7,490,057**	**2,662,301**	**1,502,603**	**525,658**	**42,250,245**
Interest sensitivity gap		**(23,083,048)**	**(6,448,244)**	**17,619,880**	**1,772,374**	**10,497,028**	**357,990**

4. Financial risk management (Continued)

4.3 Market risk (continued)

Interest rate risk - continued

Balance at 31 December 2017	Effective interest rate	Month Up to 1 KShs'000	1 to 3 KShs'000	3 to 12 KShs'000	>12 KShs'000	Non-interest Bearing KShs'000	Total KShs'000
Cash and balances with Central Bank (Note 13)	-	-	-	-	-	5,152,891	5,152,891
Investment securities-HTM (Note 17(b))	9.29%	-	244,339	1,297,420	3,378,107	-	4,919,866
Placements with banks (Note 14)	3.07%	6,597,236	-	-	-	-	6,597,236
Amounts due from group companies (Note 15(a))	4.02%	631,779	-	2,328,134	-	-	2,959,913
Other assets (Note 23)	-	-	-	-	-	588,670	588,670
Investment securities (Note 17 (a))	-	-	-	-	-	567,987	567,987
Loans and advances (Note 16)	9.89%	5,534,950	2,433,890	19,419,620	-	-	27,388,460
Total financial assets		**12,763,965**	**2,678,229**	**23,045,174**	**3,378,107**	**6,309,548**	**48,175,023**
Customer deposits (Note 25)	5.26%	22,227,525	6,431,234	2,906,790	6,883	-	31,572,432
Deposits and balances due to banking institutions (Note 24)	3.02%	1,762,089	-	-	-	-	1,762,089
Amounts due to group banks (Note 15(b))	2.20%	4,326,047	-	1,810,383	-	-	6,136,430
Borrowings (Note 26)	4.88%	-	98,336	295,008	5,269,058	-	5,662,402
Other liabilities (Note 27)	-	-	-	-	-	426,728	426,728
Total financial liabilities		**28,315,661**	**6,529,570**	**5,012,181**	**5,275,941**	**426,728**	**45,560,081**
Interest sensitivity gap		**(15,551,696)**	**(3,851,341)**	**18,032,993**	**(1,897,834)**	**5,882,820**	**2,614,942**

4. Financial risk management (Continued)

4.3 Market risk (continued)

Interest rate risk - continued

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain terms and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

Interest rate risk sensitivity analysis

At 31 December 2018 if interest rates were to increase or decrease by 2.5%, with other variables held constant, the impact on after tax profit or loss / equity would have been as shown below. This analysis is performed on the same basis for 2017.

	2018 KShs'000	2017 KShs'000
+ 2.5% movement	177,433	57,188
- 2.5% movement	(177,433)	(57,188)

4. Financial risk management (Continued)

4.4 Fair value of financial instruments

(a) Classification and fair values

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

	Note	Carrying value				Fair value hierarchy			
		FVOCI	FVTPL	Amortised cost	Total	Level 1	Level 2	Level 3	Total
		KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000	KShs'000
Balance at 31 December 2018									
Financial assets measured at fair value									
Derivative assets held for risk management	14	-	83,155	-	83,155	-	83,155	-	**83,155**
Investment securities - FVOCI	18 (a)	283,027	-	-	283,027	-	-	283,027	283,027
		283,027	**83,155**	**-**	**366,182**	**-**	**83,155**	**283,027**	**366,182**
Financial assets not measured at fair value									
Cash and balances with Central bank	13	-	-	9,927,343	**9,927,343**	-	9,927,343	-	**9,927,343**
Due from other banking institutions	15	-	-	2,872,506	**2,872,506**	-	2,872,506	-	**2,872,506**
Investments in government securities	18 (b)	-	-	6,512,645	**6,512,645**	-	6,462,402	-	**6,462,402**
Loans and advances to customers	17	-	-	21,188,115	**21,188,115**	-	21,188,115	-	**21,188,115**
Other Assets	24		-	812,316	**812,316**	-	812,316	-	**812,316**
Due from group banks	16 (a)	-	-	1,012,283	**1,012,283**	-	1,012,283	-	**1,012,283**
		-	**-**	**42,325,208**	**42,325,208**	**-**	**42,274,965**	**-**	**42,274,965**
Total financial assets		**283,027**	**83,155**	**42,325,208**	**42,691,390**	**-**	**42,358,120**	**283,027**	**42,641,147**
Financial liabilities not measured at fair value									
Customer deposits	26	-	-	30,122,457	**30,122,457**	-	30,122,457	-	**30,122,457**
Due to other banking institutions	25	-	-	58,059	**58,059**	-	58,059	-	**58,059**
Due to group banks	16 (b)	-	-	6,860,714	**6,860,714**	-	6,860,714	-	**6,860,714**
Borrowings	27	-	-	4,683,357	**4,683,357**	-	4,683,980	-	**4,683,980**
Other liabilities – Bills payable	28	-	-	525,658	**525,658**	-	525,658	-	**525,658**
Total financial liabilities		**-**	**-**	**42,250,245**	**42,250,245**	**-**	**42,250,868**	**-**	**42,250,868**

4. Financial risk management (Continued)

4.4 Fair value of financial instruments

(a) Classification and fair values (Continued)

		Carrying value					Fair value hierarchy			
	Note	Available for sale KShs'000	Held to maturity KShs'000	Loans and receivables KShs'000	Other financial liabilities KShs'000	Total KShs'000	Level 1 KShs'000	Level 2 KShs'000	Level 3 KShs'000	Total KShs'000
Balance at 31 December 2017										
Financial assets measured at fair value										
Investment securities available for sale	18 (a)	567,987	-	-	-	567,987	-	567,987	-	**567,987**
Financial assets not measured at fair value										
Cash and balances with Central bank	13	-	-	5,152,891	-	5,152,891	-	5,152,891	-	**5,152,891**
Due from other banking institutions	15	-	-	6,597,236	-	6,597,236	-	6,597,236	-	**6,597,236**
Investments in government securities	18 (b)	-	4,919,866	-	-	4,919,866	-	4,861,653	-	**4,861,653**
Loans and advances to customers	17	-	-	27,388,460	-	27,388,460	-	27,388,460	-	**27,388,460**
Other Assets	24		-	588,670	-	588,670	-	588,670	-	**588,670**
Due from group banks	16 (a)	-	-	2,959,913	-	2,959,913	-	2,959,913	-	**2,959,913**
		-	**4,919,866**	**42,687,170**	**-**	**47,607,036**	**-**	**47,548,823**	**-**	**47,548,823**
Total financial assets		**567,987**	**4,919,866**	**42,687,170**	**-**	**48,175,023**	**-**	**48,116,810**	**-**	**48,116,810**
Financial liabilities measured at fair value										
Derivative liabilities held for risk management	14	-	-	-	34,095	34,095		34,095	-	**34,095**
Financial liabilities not measured at fair value										
Customer deposits	26	-	-	-	31,572,432	31,572,432	-	31,572,432	-	**31,572,432**
Due to other banking institutions	25	-	-	-	1,762,089	1,762,089	-	1,762,089	-	**1,762,089**
Due to group banks	16 (b)	-	-	-	6,136,430	6,136,430	-	6,136,430	-	**6,136,430**
Borrowings	27	-	-	-	5,662,402	5,662,402	-	5,653,084	-	**5,653,084**
Other liabilities – Bills payable	28	-	-	-	426,728	426,728	-	426,728	-	**426,728**
Total financial liabilities		**-**	**-**	**-**	**45,594,176**	**45,594,176**	**-**	**45,584,858**	**-**	**45,584,858**

4. Financial risk management (Continued)

4.4 Fair value of financial instruments (Continued)

(b) Measurement of fair values

Financial instruments measured at fair value

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Nairobi Security Exchange) and exchanges traded derivatives like futures (for example, Nasdaq).

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible.

The following sets out the Bank's basis of establishing fair value of the financial instruments:

Cash and balances with Central Bank of Kenya

The fair value of cash and bank balances with the Central Bank of Kenya approximates their carrying amount.

Deposits and advances to banks

Deposits and advances to banks include inter-bank placements and items in the course of collection.
The carrying amount of floating rate placements and overnight deposits is a reasonable approximation of fair value.

The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining term to maturity. All loans and advances to banks are classified as level 2 under the fair value hierarchy table.

Loans and advances to customers

Loans and advances to customers are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates. Expected cash flows are discounted at current market rates to determine fair value for low interest loans. A substantial proportion of loans and advances reprice within 12 months and hence the carrying amount is a good proxy of the fair value.

4. Financial risk management (Continued)

4.4 Fair value of financial instruments (Continued)

(c) Measurement of fair values (Continued)

Unquoted equity securities

These comprise investment securities held at FVOCI. The fair value for these assets is estimated using market prices and earnings multiples of quoted securities of comparable companies.

Investments in government securities

Investments in government securities are measured at amortised cost using the effective interest method. The estimated fair value represents the discounted amount of future cash flows expected to be received.

Deposits from banks and customers

The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits without quoted market prices is based on discounting cash flows using the prevailing market.

A substantial proportion of deposits mature within 6 months and hence the carrying amount is a good proxy of the fair value.

4.5 Capital management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the balance sheets, are:

— to comply with the capital requirements set by the Central Bank of Kenya;
— to safeguard the Bank's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
— to maintain a strong capital base to support the development of its business.

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

The Central Bank of Kenya requires each bank to: (a) hold the minimum level of regulatory capital of KShs 1 Billion; (b) maintain a ratio of total regulatory capital to the risk-weighted assets plus risk-weighted off-balance sheet assets (the 'Basel ratio') at or above the required minimum of 10.5%; (c) maintain core capital of not less than 8% of total deposit liabilities; and (d) maintain total capital of not less than 14.5% of risk-weighted assets plus risk-weighted off-balance sheet items.

The bank's total regulatory capital is divided into two tiers:
— Tier 1 capital (core capital): share capital, share premium, plus retained earnings.
— Tier 2 capital (supplementary capital): 25% (subject to prior approval) of revaluation reserves, subordinated debt not exceeding 50% of Tier 1 capital and hybrid capital instruments. Qualifying Tier 2 capital is limited to 100% of Tier 1 capital.

The risk weighted assets are measured by means of a hierarchy of four risk weights classified according to the nature of – and reflecting an estimate of the credit risk associated with – each asset and counterparty. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

4. Financial risk management (Continued)

4.5 Capital management (Continued)

The table below summarises the composition of regulatory capital and the ratios of the Bank for the years ended 31 December 2018 and 2017. During those two years, the Bank complied with all of the externally imposed capital requirements to which it is subject to, except the ratio prescribed for investment in land and buildings.

Tier 1 capital (Core capital)	2018 KShs'000	2017 KShs'000
Share capital	6,404,949	6,404,949
Share premium	1,980,356	1,980,356
Retained earnings	(1,586,940)	(1,869,341)
Investment in associate	(1,570,179)	(1,570,179)
Deferred tax asset[1]	(1,804,245)	-
	3,423,941	**4,945,785**
Tier 2 capital		
Subordinated debt[2]	1,148,588	1,487,065
Statutory reserves	386,862	553,433
	1,535,450	**2,040,498**
Total regulatory capital	**4,959,437**	**6,986,283**
Risk weighted assets		
On balance sheet- Credit risk	23,018,097	32,465,289
Off balance sheet- Credit risk	2,730,985	5,970,607
Market and Operational risk	5,203,558	5,838,720
Total risk weighted assets	**30,952,640**	**44,274,616**
Deposit liabilities	36,977,156	35,898,519
Capital ratios		
Core Capital/total deposit liabilities (CBK minimum 8%) (2017: 8%)	9.3%	13.8%
Core Capital/Total risk weighted assets (CBK Minimum 10.5%) (2017: 10.5%)	11.1%	11.2%
Total Regulatory Capital/Total risk weighted assets (CBK minimum 14.5%) (2017: 14.5%)	16.0%	15.8%
Investment in Land and Buildings ratio		
Investment in land and buildings/Core capital (CBK maximum 20% (2017: 20%)	32.0%	29.8%
Investment in Financial Institutions ratio		
Investment in financial institutions/Core capital (CBK maximum 25% (2017: 25%)	31.4%	24.10%

[1] Effective 1 January 2018, Deferred tax assets (DTAs) are deductible from Tier 1 capital as per the 2013 Central Bank of Kenya Prudential Guidelines (CBK/PG/003). DTAs relating to temporary differences such as allowance for credit losses can only be recognized up to a limit of 10% of the institution's core capital.

[2] Subordinated debt has been amortised at 20% as at end of 2018 as per Central Bank of Kenya Prudential Guidelines (CBK/PG/003) that require the debt to be amortised by 20% per annum during the last five years to maturity.

The Bank is working to ensure compliance with the Investment in Land and Buildings and Investment in Financial Institutions ratios within 2019 financial year.

5. Interest income

	2018 KShs'000	2017 KShs'000
Loans and advances	2,713,067	3,359,127
Government and other securities	508,207	474,418
Balances with other banking institutions	130,068	269,096
Other	38,346	22,608
	3,389,688	**4,125,249**

Included in interest income on loans and advances is KShs 457 million in 2018 interest accrued on impaired loans and advances (282 million in 2017).

6. Interest expense

	2018 KShs'000	2017 KShs'000
Customer deposits	1,528,426	1,735,681
Deposits by banks	75,363	126,263
Long term liabilities	254,095	360,314
Swaps and forward contracts	348,931	647,956
	2,206,815	**2,870,214**

7. Net fee and commission income

	2018 KShs'000	2017 KShs'000
Credit related fees and commissions	277,909	389,257
Service related fees and commissions	346,353	321,087
Fee and commission income	624,262	710,344
Fees and commission paid	(4,327)	(5,772)
Net fee and commission income	**619,935**	**704,572**

8. Other operating loss

	2018 KShs'000	2017 KShs'000
Dividends received	12,043	16,577
Gain on sale of property and equipment	2,931	53
Rental income	1,118	-
Impairment of non current assets held for sale (Note 20)	(73,747)	(79,748)
Write off of intangible assets (Note 21)	-	(241)
Other	7,086	43,153
	(50,569)	**(20,206)**

9. Staff costs

	2018 KShs'000	2017 KShs'000
Salaries and wages	779,880	912,391
Retirement benefit costs		
– Defined contribution pension scheme	59,574	62,951
– National Social Security Fund	1,028	1,177
Staff medical costs	74,275	77,193
Staff training costs	20,704	14,994
Other staff costs	133,843	139,263
	1,069,304	**1,207,969**

The number of employees of the Bank as at 31 December 2018 was 423 (2017: 417). Other staff costs comprises of staff welfare costs, leave provisions, performance based incentives among others.

10. Depreciation and amortisation

	2018 KShs'000	2017 KShs'000
Depreciation of property and equipment (Note 19)	179,156	222,250
Amortisation of intangible assets (Note 21)	19,911	24,060
	199,067	**246,310**

11. Other operating costs

Directors' expenses	24,461	34,238
Auditors' remuneration	8,182	6,420
Marketing and advertisement costs	51,985	54,877
Property occupancy costs	314,042	379,794
Software subscriptions and licence fees	97,020	99,255
Computer hardware maintenance	6,424	13,666
Depositors' protection fund premiums	55,049	64,711
Communication costs	60,505	68,205
Operating lease rentals	11,978	17,940
Office administrative costs	180,647	200,174
Other costs*	205,645	243,367
	1,015,938	**1,182,647**

*Other costs mainly consist of BOA group recharges (see Note 16 (d)), professional fees, operational losses, transport costs, and stationery costs. Included in auditors' remuneration is KShs 1.7 million one off IFRS 9 audit review.

12. Taxation

	2018 KShs'000	2017 KShs'000
Current income tax:		
Current income tax	-	399,223
Deferred tax:		
Deferred tax movement (Note 23)	36,488	(431,656)
	36,488	**(32,433)**

The effective rax rate (ETR) for the year ended 31 December 2018 is 17.4% (2017: negative 92.2%). The increase in the ETR is mainly attributed to the impact of tax allowable loan provisions.

Current income tax (recoverable) /payable	2018 KShs'000	2017 KShs'000
Balance at 1 January	(98,594)	241,980
Charge for the year	-	399,223
Tax paid	(339,410)	(739,797)
Balance at 31 December	**(438,004)**	**(98,594)**

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

Profit before income tax	209,561	35,185
Tax calculated at the statutory income tax rate of 30% (2017: 30%)	62,868	10,556
Tax effect of:		
Income not subject to tax	(205,920)	(88,026)
Expenses not deductible for tax purposes	179,540	45,037
Income tax expense/ (credit)	**36,488**	**(32,433)**

13. Cash and balances with Central Bank

	2018 KShs'000	2017 KShs'000
Cash in hand	760,143	787,076
Balances with Central Bank:		
Cash reserve ratio	1,561,586	1,590,900
Other current accounts	7,605,614	2,774,915
	9,927,343	**5,152,891**

The cash reserve ratio with Central Bank of Kenya (CBK) is non-interest earning and is based on the value of deposits as adjusted for CBK requirements. At 31 December 2018, the cash reserve ratio requirement was 5.25% of eligible deposits (2017: 5.25%). The Bank is free to deviate from the 5.25% requirement on any given day, but not to fall below 3%, provided that the overall average for the month will be at least 5.25%.

14. Derivative assets and liabilities held for risk management

	2018 KShs'000	2017 KShs'000
Interest rate derivative contracts	5,628	41,444
Forward exchange contracts	77,527	(75,539)
	83,155	**(34,095)**

The types of derivatives used by the bank are set out below.The table analyses the notional principal amounts and the positive (assets) and negative (liabilities) fair values of the derivative financial instruments. Notional principal amounts are the amount of principal underlying the contract at the reporting date.

	2018		
	Notional principal amounts KShs'000	Assets KShs'000	Liabilities KShs'000
Interest rate derivative contracts	2,770.600	3,890,905	(3,885,277)
Forward exchange contracts	11,030,098	15,933,111	(15,855,584)
	13,800,698	**19,824,016**	**(19,740,861)**

	2017		
	Notional principal amounts KShs'000	Assets KShs'000	Liabilities KShs'000
Interest rate derivative contracts	1,812,712	2,063,455	(2,022,011)
Forward exchange contracts	3,289,211	5,180,052	(5,255,591)
	5,101,923	**7,243,507**	**(7,277,602)**

15. Due from other banking institutions

	2018 KShs'000	2017 KShs'000
Placements	18,335	1,100,719
Current account balances due from other banks	2,854,171	5,496,517
	2,872,506	**6,597,236**
Maturing within 90 days	**2,872,506**	**6,597,236**

16. Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operation decisions, or one party controls both. The Bank is controlled by BOA Group S.A. incorporated in Luxembourg with its ultimate parent being BMCE Bank incorporated in Morocco. There are other companies which are related to Bank of Africa Kenya Limited through common shareholdings or common directorships.

In the normal course of business, current accounts are operated and placement of foreign currency balances are made with the parent company and other group companies at interest rates in line with the market. The relevant balances are shown below:

(a) Amounts due from group banks

	2018 KShs'000	2017 KShs'000
Bank of Africa Uganda	133,042	386,288
Bank of Africa Tanzania	12,682	157,689
Bank of Africa France	130,484	340,192
Bank of Africa Mer Rouge	-	-
Bank of Africa Ghana	469,529	1,810,249
Bank of Africa Madagascar	174,994	226,082
BMCE International	5,617	25,349
BMCE Bank Banque Offshore	5,112	
Bank of Africa Togo	80,823	14,064
	1,012,283	**2,959,913**
Maturing within 90 days	532,457	631,779
Maturing after 90 days	479,826	2,328,134
	1,012,283	**2,959,913**
Placements	777,916	2,328,134
Current account balance	234,367	631,779
	1,012,283	**2,959,913**
Interest income earned on the above	38,656	117,876
Ledger fees earned on the above	2,495	1,014

16. Related party transactions (Continued)

(b) Amounts due to group banks

	2018 KShs'000	2017 KShs'000
Bank of Africa Madagascar	2,230,885	1,956,433
Bank of Africa Uganda	12,927	693
Bank of Africa Tanzania	52	47
Banque de Credit de Bujumbura	88,109	40,815
Bank of Africa Cote D'Ivoire	-	425
Bank of Africa RDC	713,935	594
Bank of Africa Ghana	3,221	1,813,757
Bank of Africa Togo	37,954	23,006
Bank of Africa Niger	76,650	-
Bank of Africa France	1,490	23
Bank of Africa Mer Rouge	3,695,491	2,300,637
	6,860,714	**6,136,430**
Maturing within 90 days	6,860,714	4,326,047
Maturing after 90 days	-	1,810,383
	6,860,714	**6,136,430**
Interest expense incurred on the above	49,491	99,135

(c) Investments in group companies

	2018 KShs'000	2017 KShs'000
Bank of Africa Tanzania (Note 17 (a))	273,789	533,709
Bank of Africa Uganda (Note 18)	1,311,749	1,318,576
Bank of Africa France (Note 17 (a))	7,050	32,090
	1,592,588	**1,884,375**

(d) Expenses incurred within the BOA group

	2018 KShs'000	2017 KShs'000
Technical assistance fees paid to African Financial Holdings (AFH)	140,522	120,510
Information technology fees paid to African Information Services and Software Associated (AISSA)	18,614	22,070
	159,136	**142,580**

(e) Loans to key management and directors

	2018 KShs'000	2017 KShs'000
Key management	49,415	45,176
Directors	20,065	12,025

Advances to customers as at 31 December 2018 includes loans to key management amounting to KShs 49 million (2017: KShs 45 million).
Total loans to directors amounted to KShs 11.5 million as at 31 December 2018 (2017: KShs 12 million).

	2018 KShs'000	2017 KShs'000
Interest income earned on loans to key management	3,242	3,575

(f) Key management compensation

	2018 KShs'000	2017 KShs'000
Salaries and other short-term employment benefits	115,388	96,225

16. Related party transactions (Continued)

(g) Directors' remuneration	2018 KShs'000	2017 KShs'000
Salaries to executive directors (included in key management compensation above)	30,003	28,535
Compensation to non-executive directors	16,716	17,803
	46,719	**46,338**

(h) Subordinated debt and borrowings

The disclosures on the subordinated debt from BoA Group S.A. and borrowings from BOA Mer Rouge and BMCE Bank are included in Note 26.

17. Loans and advances to customers

	2018 KShs'000	2017 KShs'000
	Amortised cost	HTM
Overdrafts	7,887,344	5,205,645
Personal loans	2,592,642	6,326,401
Mortgages	3,615,911	3,937,587
Commercial loans	9,534,707	15,581,912
Discounted bills	2,352,469	570,840
Gross loans and advances	**25,983,073**	**31,622,385**
Less: Impairment loss allowance		
Stage 1 ECL allowance	(100,127)	-
Stage 2 ECL allowance	(363,925)	-
Stage 3 ECL allowance	(4,330,906)	-
Individually assessed	-	(4,177,557)
Collectively assessed	-	(56,368)
Total impairment	(4,794,958)	(4,233,925)
Net loans and advances	**21,188,115**	**27,388,460**
Weighted average effective interest rate	9.11%	9.89%

Loss allowance at amortised cost	**Stage 1 12-month ECL KShs'000**	**Stage 2 Lifetime ECL KShs'000**	**Stage 3 Lifetime ECL KShs'000**	**Total KShs'000**
Balance as at 1 January	**419,756**	**736,159**	**5,279,651**	**6,435,566**
Changes in the loss allowance				
Transfer to Stage 1	365,366	(2,006)	(363,360)	-
Transfer to Stage 2	(3,992)	119,560	(115,568)	-
Transfer to Stage 3	-	(660,775)	660,775	-
Net remeasurement of loss allowance	-	-	(200,443)	**(200,443)**
New financial assets originated or purchased	45,113	304,322	3,323	**352,758**
Financial assets that have been derecognised	(173,312)	(4,087)	(120,944)	**(298,343)**
Write-offs	-	-	(1,538,284)	**(1,538,284)**
Foreign exchange and other movements	(552,804)	(129,248)	725,756	**43,704**
Loss allowance as at 31 December	**100,127**	**363,925**	**4,330,906**	**4,794,958**

17. Loans and advances to customers (Continued)

	Individually assessed KShs'000	Collectively assessed KShs'000	Total KShs'000
31 December 2017			
Balance at 1 January 2017	**4,698,830**	**67,957**	**4,766,787**
Provision recognised during the year	768,335	-	768,335
Recoveries on provisions no longer required	(736,630)	(11,589)	(748,219)
	31,705	**(11,589)**	**20,116**
Amounts written off during the year	(552,978)	-	**(552,978)**
Balance at 31 December 2017	**4,177,557**	**56,368**	**4,233,925**

Movements in provisions for impairment of loans and advances are as follows:

Charge to profit or loss:

	2018 KShs'000	2017 KShs'000
Net (decrease)/ increase in impairment loss allowance:		
Net remeasurement of loss allowance	(146,028)	-
- Individually assessed	-	31,705
- Collectively assessed	-	(11,589)
Recoveries of loans and advances previously written off	(12,666)	(13,360)
Net impairment charged to profit or loss	**(158,694)**	**6,756**

All impaired loans have been written down to their estimated recoverable amount. The aggregate carrying amount of impaired loans at 31 December 2018 was KShs 9,509 million (2017: KShs 10,571 million).

18. Investment securities

(a) Unquoted equity securities

	2018 KShs'000 FVOCI	2017 KShs'000 AFS
1 January	567,987	570,332
Loss on fair value of investment securities	(284,960)	(2,345)
31 December	**283,027**	**567,987**

2018: **FVOCI:**	BOA Tanzania KShs'000	BOA France KShs'000	Swift shares KShs'000	Total KShs'000
Balance at 1 January 2018	533,709	32,090	2,188	567,987
Fair value adjustments	(259,920)	(25,040)	-	(284,960)
Balance at 31 December 2018	**273,789**	**7,050**	**2,188**	**283,027**

18. Investment securities (Continued)

2017: AFS:	BOA Tanzania KShs'000	BOA France KShs'000	Swift shares KShs'000	Total KShs'000
Balance at 1 January 2017	535,325	32,819	2,188	570,332
Fair value adjustments	(1,616)	(729)	-	(2,345)
Balance at 31 December 2017	**533,709**	**32,090**	**2,188**	**567,987**

The Bank has used the market approach in determing the fair value of its equity investments as per IFRS 13 that defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

(b) Bills and bonds

	2018 KShs'000 Amortised cost	2017 KShs'000 Held to maturity
Corporate bonds	43,433	77,823
Treasury bills	2,856,398	829,694
Treasury bonds	3,612,814	4,012,349
	6,512,645	**4,919,866**
Maturing within 90 days of acquisition	345,875	244,339
Maturing after 90 days of acquisition	6,166,770	4,675,527
	6,512,645	**4,919,866**
Weighted average effective interest rate:		
Corporate bonds	12.00%	12.85%
Treasury bills	10.47%	10.46%
Treasury bonds	6.72%	7.35%

The unamortised premium on treasury bonds as at 31 December 2018 was KShs 254 million (2017: KShs 353 million).

19. Investment in associate companies

	2018 KShs'000	2017 KShs'000
At 1 January	1,318,576	1,166,193
Adjustment on initial application of IFRS 9	(21,342)	-
Restated balance at 1 January	1,297,234	
Prior year understated share of profits	-	19,038
Current year share of profit	149,572	210,406
Dividends received	(79,073)	(61,390)
Exchange difference	(55,984)	(15,671)
	1,311,749	**1,318,576**

19. Investment in associate companies (Continued)

Set out below is the Associate of the Bank, which in the opinion of the Directors, is material to the Bank. The Associate has share capital consisting solely of ordinary shares, which are held directly by the Bank. The country of incorporation or registration is also their principal place of business.

Name of entity	Place of business/ country of incorporation	% of ownership interest	Nature of the relationship	Measurement Method
Bank of Africa- Uganda	Uganda	2018:43.24% (2017: 43.24%)	Banking services	Equity

Summarised balance sheet	**2018 KShs'000**	**2017 KShs'000**
Assets		
Cash and balances with banks	2,877,475	3,159,748
Government securities – amortised cost (2018)/ HTM (2017)	4,831,352	4,634,954
Loans and advances to customers	9,413,230	9,201,209
Other assets	4,744,175	4,554,653
Total assets	**21,866,232**	**21,550,564**
Liabilities		
Customer deposits	15,624,528	15,435,609
Deposits from other banks	2,687,219	2,343,488
Other liabilities	520,837	722,031
Total liabilities	**18,832,584**	**18,501,128**
Net assets	**3,033,648**	**3,049,436**

Summarised income statement

Total operating income	2,121,335	2,355,911
Total operating expenses	(1,654,949)	(1,722,230)
Profit before income tax	**466,386**	**633,681**
Income tax charge	(120,475)	(147,081)
Profit for the year	**345,911**	**486,600**

Reconciliation of summarised financial information

	2018 KShs'000	**2017 KShs'000**
Opening net assets	3,049,436	2,697,026
Adjustment on initial application of IFRS 9	(49,356)	-
Restated net assets	3,000,080	2,697,026
Profit for the period	345,911	486,600
Exchange differences	(312,343)	(134,190)
Closing net assets	**3,033,648**	**3,049,436**
Interest in associate (43.24%; 2017: 43.24%)	1,311,749	1,318,576
Carrying value in associates	1,311,749	1,318,576
Difference	-	-

20. Property and equipment

2018:	Land and buildings KShs'000	Motor vehicles KShs'000	Fixtures, fittings and equipment KShs'000	Work in progress KShs'000	Total KShs'000
Cost:					
Balance at 1 January 2018	1,473,946	49,356	1,681,005	162,292	3,366,599
Additions	-	17,466	38,893	-	56,359
Disposals	(379,772)	(6,756)	(781)	-	(387,309)
Balance at 31 December 2018	**1,094,174**	**60,066**	**1,719,117**	**162,292**	**3,035,649**
Depreciation:					
Balance at 1 January 2018	22,109	40,512	950,722	-	1,013,343
Charge for the year	17,860	6,483	154,813	-	179,156
Disposals	(10,444)	(450)	(49)	-	(10,943)
Reversal 2017 depreciation on land	(3,300)	-	-	-	(3,300)
Balance at 31 December 2018	**26,225**	**46,545**	**1,105,486**	**-**	**1,178,256**
Net carrying amount at 31 December 2018	**1,067,949**	**13,521**	**613,631**	**162,292**	**1,857,393**
2017:					
Cost:					
Balance at 1 January 2017	1,473,946	42,601	1,886,690	14,881	3,418,118
Additions	-	6,755	140,894	149,630	297,279
Transfers from WIP	-	-	2,219	(2,219)	-
Disposals	-	-	(42)	-	(42)
Write offs	-	-	(29,022)	-	(29,022)
Transfer to non-current asset held for sale (Note 21)	-	-	(319,734)	-	(319,734)
Balance at 31 December 2017	**1,473,946**	**49,356**	**1,681,005**	**162,292**	**3,366,599**
Depreciation:					
Balance at 1 January 2017	-	35,394	921,228	-	956,622
Charge for the year	22,109	5,118	195,023	-	222,250
Disposals	-	-	(14)	-	(14)
Write offs	-	-	(29,022)	-	(29,022)
Transfer to non-current asset held for sale (Note 21)	-	-	(136,493)	-	(136,493)
Balance at 31 December 2017	**22,109**	**40,512**	**950,722**	**-**	**1,013,343**
Net carrying amount at 31 December 2017	**1,451,837**	**8,844**	**730,283**	**162,292**	**2,353,256**

During the financial year, the Bank disposed three floors of its Head Office to BOA Group in an effort to comply with the regulatory limit on Investments in Land and Buildings ratio.

21. Non-current asset held for sale

	2018 KShs'000	2017 KShs'000
Balance at 1 January	107,843	4,350
Transfer from property and equipment (NBV) (Note 20)	-	183,241
Impairment of fixed assets	(73,747)	(79,748)
Cash proceed from disposals	(4,350)	-
Balance at 31 December	**29,746**	**107,843**

The non-current asset held for sale relates to the Bank's fixtures, fittings and equipment planned to be disposed in 2019. As at 31 December 2018, the Bank was at an advanced stage of disposing of the assets no longer required following the relocation of 5 branches and closure of 7 branches in 2017.

22. Intangible assets

Software

Cost:	2018 KShs'000	2017 KShs'000
Balance at 1 January	309,215	303,472
Additions	9,294	12,879
Write offs	-	(7,136)
Balance at 31 December	**318,509**	**309,215**
Amortisation:		
Balance at 1 January	258,469	241,304
Charge for the year	19,911	24,060
Write offs	-	(6,895)
Balance at 31 December	**278,380**	**258,469**
Net carrying amount		
Balance at 31 December	**40,129**	**50,746**

23. Deferred income tax

The deferred income tax assets, deferred income tax charge/(credit) in the statement of profit or loss and deferred income tax charge/(credit) in other comprehensive income are attributable to the following items:

Deferred income tax asset	31.12.2017 KShs'000	Adustment on initial application of IFRS 9 KShs'000	Restated balance at 1 January 2018 KShs'000	Recognised in profit or loss KShs'000	Recognised in other comprehensive income KShs'000	31.12.2018 KShs'000
Impairment loss allowance	(1,757,956)	(667,096)	(2,425,052)	307,279	-	(2,117,773)
Provisions	(16,708)	-	(16,708)	(8,109)	-	(24,817)
Tax losses	-	-	-	(323,558)	-	(323,558)
Property and equipment	96,465	-	96,465	60,876	-	157,341
Equity investments at FVOCI	(4,009)	-	(4,009)	-	(14,248)	(18,257)
Net deferred income tax asset	**(1,682,208)**	**(667,096)**	**(2,349,304)**	**36,488**	**(14,248)**	**(2,327,064)**

Deferred income tax asset	1.1.2017 KShs'000	Recognised in profit or loss KShs'000	Recognised in other comprehensive income KShs'000	31.12.2017 KShs'000
Impairment loss allowance	(1,227,452)	(530,504)	-	(1,757,956)
Provisions	(50,792)	34,084		(16,708)
Property and equipment	31,702	64,763	-	96,465
Fair value on available for sale investments	(3,892)	-	(117)	(4,009)
Net deferred income tax asset	**(1,250,435)**	**(431,656)**	**(117)**	**(1,682,208)**

24. Other assets

	2018 KShs'000	2017 KShs'000
Financial assets		
Uncleared effects	138,245	164,770
Mobile banking and money transfer receivables	239,882	199,129
Security deposit refundable	79,531	80,028
Guarantee fees receivable	18,397	5,110
Other receivables	336,261	139,633
	812,316	**588,670**
Other assets		
Prepayments	385,384	405,045
	1,197,700	**993,715**

Other receivables include amounts due from group banks for reimbursements for costs incurred by the Bank on behalf of the group and commissions receivable for syndicated facilities.

25. Due to other banking institutions

Maturing within 90 days	58,059	1,762,089

Other banking institutions include both local and foreign non-group banks.

26. Customer deposits

	2018 KShs'000	2017 KShs'000
Current and demand deposits	13,872,844	16,793,614
Savings accounts	1,998,984	1,807,803
Fixed deposit accounts	14,140,338	12,782,248
Margin deposits	110,291	188,767
	30,122,457	**31,572,432**
Weighted average interest rate	5.06%	5.26%

27. Borrowings

	2018 KShs'000	2017 KShs'000
Borrowings from:		
FMO	-	983,360
BOA Mer Rouge	3,207,385	3,110,052
	3,207,385	**4,093,412**
Subordinated debt		
BOA Group S.A	1,475,972	1,568,990
	1,475,972	**1,568,990**
	4,683,357	**5,662,402**

	2018 KShs'000	2017 KShs'000
Balance at 1 January	5,662,402	9,108,249
Additions	-	3,101,751
Repayments	(969,297)	(6,711,473)
Net accrued Interest	124,566	(38,101)
Exchange differences	(134,314)	201,976
Balance at 31 December	**4,683,357**	**5,662,402**

27. Borrowings (Continued)

The fair values of borrowings are disclosed in Note 4. Fair values, are based on discounted cash flows using a discount rate based upon the borrowing rate that the Directors expect would be available to the Bank at the year end date.

Borrowings by Bank of Africa Kenya Limited are;

— An unsecured 7 year term loan of USD 25 million from FMO for the development of bank's lending business in foreign currency. The loan was obtained on 28 March 2013 and had a maturity date of 10 April 2020. Due to improved liquidity the loan was paid off in June 2018. It bore an interest rate referenced to the Libor which is paid quarterly in arrears.

— An unsecured 1 year and 30 days term loans of USD 30.0 million from BOA Mer Rouge for the development of the Bank's lending business in foreign currency. The loans were obtained in 2017 and are maturing in 2019. Interest is payable on maturity of the loan. The effective interest rate on the loans at 31 December 2018 was 5.07%. (2017: 4.59%).

The subordinated debt is made up of the below facility;

— A subordinated convertible loan as an unsecured 7 year loan of EUR 12.3 million issued by BOA Group S.A to enhance the Banks capital base. The loan was obtained on 31 December 2014 and has a maturity date of 31 December 2021.The debt has an initial five year principal repayment moratorium. It bears an interest rate referenced to the Euribor payable semi-annually in arrears. The effective interest rate on the subordinated debt as at 31 December 2018 was 5.57% (2017: 5.57%). The subordinated debt is treated as Tier 2 capital in line with Central Bank of Kenya Prudential Guidelines.

None of the borrowings were in default during the year.

28. Other liabilities

	2018 KShs'000	2017 KShs'000
Financial liabilities		
Outstanding bankers cheques	96,119	61,869
Accrued expenses	113,426	88,730
Insurance premiums payable	5,006	5,351
Provisions	69,963	117,984
Other payables	241,144	152,794
	525,658	**426,728**
Deferred income	94,432	129,410
	620,090	**556,138**

29. Share capital and share premium

	2018 KShs'000	2017 KShs'000
Authorised share capital:		
6,404,949 ordinary shares of KShs 1,000 each	6,404,949	6,404,949
Issued and fully paid up share capital: The movement in issued and fully paid up share capital and shares awaiting allotment during the year was as follows;		
Balance at 1 January	6,404,949	6,217,678
Shares allotted/ Issue of shares	-	187,271
Balance at 31 December 2018:	**6,404,949**	**6,404,949**
Unissued capital (Shares awaiting allotment):		
Balance at 1 January	-	187,271
Shares alloted	-	(187,271)
Balance at 31 December	-	-

Share premium

Balance at 31 December	**1,980,356**	**1,980,356**

Share premium arises from issue of shares at a price higher than the par value of the shares. These are being applied in business expansion of the Bank.

30. Statutory credit risk reserve

	2018 KShs'000	2017 KShs'000
Balance at 1 January	2,152,182	1,445,499
Impact on initial application of IFRS 9 on 1 January	(2,152,182)	-
Restated balance at 1 January	-	1,445,499
Transfer from retained earnings	486,296	706,683
Balance at 31 December	**486,296**	**2,152,182**

The statutory credit risk reserve represents an appropriation from retained earnings to comply with Central Bank of Kenya Prudential Guidelines. The balance in the reserve represents the excess of impairment provisions determined in accordance with Central Bank Guidelines over the impairment provisions recognized in accordance with the International Financial Reporting Standards.

31. Other reserves

(a) Fair value reserve
Policy applicable from 1 January 2018

The fair value reserve comprises the cumulative net change in the fair value of equity investment at FVOCI financial assets until the investments are derecognized or the asset is impaired at which point the cumulative changes are transferred to retained earnings.

Policy applicable prior to 1 January 2018

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale and investment in associate financial assets until the investments are derecognized or the asset is impaired which point the cumulative changes are recycled to the profit or loss.

(b) Foreign currency translation reserve

The foreign currency translation reserve represents translation differences on investments in foreign operations.

32. Off balance sheet financial instruments, contingent liabilities and commitments

In common with other banks, the Bank conducts business involving acceptances, letters of credit, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties. In addition, there are other off-balance sheet financial instruments including forward contracts for the purchase and sale of foreign currencies, the nominal amounts for which are not reflected in the statement of financial position.

Contingent liabilities

	2018 KShs'000	2017 KShs'000
Acceptances and letters of credit	1,002,246	406,142
Guarantees and performance bonds	7,081,072	9,541,433
	8,083,318	**9,947,575**

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

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

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

32. Off balance sheet financial instruments, contingent liabilities and commitments (Continued)

Commitments

	2018 KShs'000	2017 KShs'000
Unutilized credit lines and other facilities	771,453	4,090,390
Currency forwards	77,439	-
Foreign exchange spots	5,628	41,444
	854,520	**4,131,834**

Nature of commitments

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

Forward foreign exchange contracts are commitments to either purchase or sell a specified quantity of foreign currency at a specified future date at an agreed rate. The fair values of the respective currency forwards are carried under other assets or other liabilities as appropriate.

33. Analysis of cash and cash equivalents as shown in the cash flow statement

	2018 KShs'000	2017 KShs'000
Cash and balances with Central Bank (Note 13)	9,927,343	5,152,891
Less: cash reserve requirement (Note 13)	(1,561,586)	(1,590,900)
Investment and other securities (Note 18 (b))	345,875	244,339
Deposits due from other Banks (Note 15)	2,872,506	6,597,236
Due to banks and non-bank financial institutions (Note 25)	(58,059)	(1,762,089)
Amounts due to group banks (net) (Note 16)	(6,328,257)	(3,694,268)
At 31 December	**5,197,822**	**4,947,209**

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition including: cash and balances with Central Bank, treasury bills and other eligible bills, and amounts due from other banks. Cash and cash equivalents exclude the cash reserve requirement held with the Central Bank of Kenya.

34. Dividends

At the next Annual General Meeting, no dividend in respect of the year ended 31 December 2018 is to be proposed (2017: Nil). Payment of dividends is subject to withholding tax at a rate of 5% for resident and 10% for non-resident shareholders.

35. Fiduciary activities

The Bank holds asset security documents on behalf of customers with a value of KShs 2,298 million (2017: KShs 1,543 million). These securities are held by the Custody Services department of the Bank. The assets held comprise of deposits, government securities, debentures, title deeds, quoted and unquoted shares.

36. Subsequent events

The Bank is in the process of disposing off its shareholding in Bank of Africa Uganda and Tanzania to BMCE Bank.

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