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Company Information

Registered office

Finance House, Loita Street
P. O. Box 30483, 00100
Telephone: (254) 020 340401/2/3
Telefax: (254) 020 250399, Telex: 22662
Email: dbk@devbank.com
Telegrams: DEVBANK.KE
Nairobi, Kenya

Subsidiary
Small Enterprises Finance Company Limited (SEFCO)
P. O. Box 34045 - 00100
Telephone: (254) 020 340401/2/3
Telex: 22662
Nairobi, Kenya

Shareholders
Industrial & Commercial Development Corporation (ICDC)
P. O. Box 45519 - 00100
Nairobi, Kenya

TransCentury Limited
PO Box 42588 - 00100
Nairobi, Kenya

Directors
The directors who served during the year and to the date of this report are:

Prof. H.K. Mengech – Chairman
Ndungu Gathinji (Appointed 2 May 2018)
Prof. J.H. Kimura
Victor Kidiwa
Industrial & Commercial Development Corporation (ICDC)
Cabinet Secretary to the Treasury of Kenya

Secretary
C. A. Otieno (Mrs)
Finance House
Loita Street
P. O. Box 30483 - 00100
Nairobi, GPO

Senior officers

V. J. O. Kidiwa	Chief Executive
J. K. Kiniti	Chief Finance Officer

Auditors

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

On behalf of: The Auditor-General
Kenya National Audit Office
Anniversary Towers
University Way
P. O. Box 30084 - 00100
Nairobi GPO

Correspondent Banks

Standard Chartered Bank
One Madison Avenue
New York, 10010 - 3603
USA

Nedbank
P. O. Box 1144
Johannesburg 2000, GTG
South Africa

Standard Chartered Bank
1 Basinghall Avenue
London EC2V 5DD
Tel +44 (020) 7885 8888

Standard Chartered Bank
90 Matatma Gandi Road
Mumbai India 400 001
Tel. + 91 22 226 70162

BHF Bank
Bockenheimer
Landstrasse 10
D – 60323
Frankfurt Am Main
Germany

Bank of Communications China
188 Yin Cheng Zhong Road
Shangai 200120 - China
Tel: + 86 21 58408478

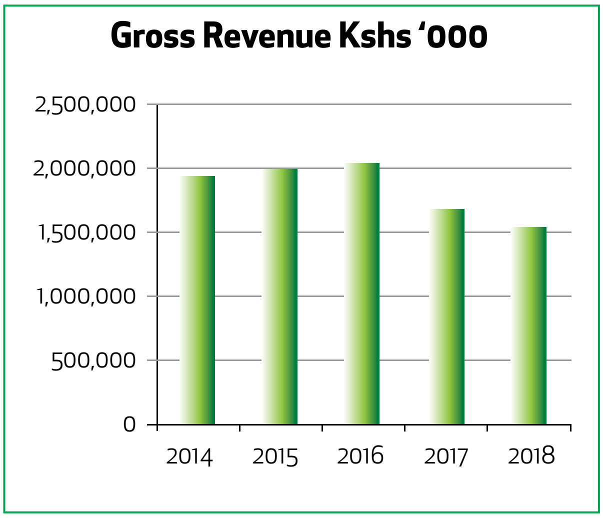
Five year financial summary

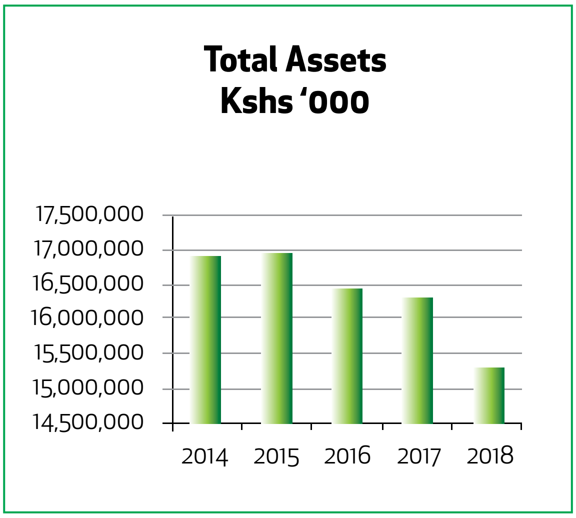
Five-year Group financial summary

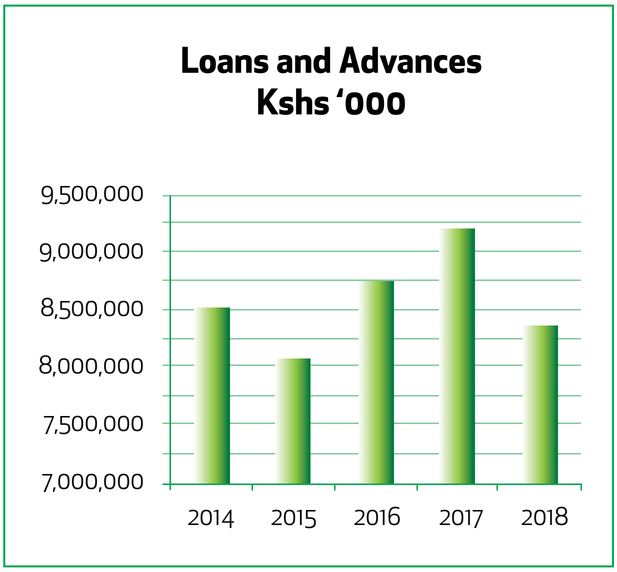
	2018 Shs'000	2017 Shs'000	2016 Shs'000	2015 Shs'000	2014 Shs'000
Gross revenue	1,551,617	1,684,587	2,031,005	1,990,760	1,941,074
Profit before tax	170,767	59,426	97,755	180,468	319,326
Profit after tax	115,813	27,658	61,715	121,620	220,592
Gross loans and advances	9,862,729	10,312,685	9,823,634	8,868,029	9,225,833
Less impairment losses on loans and advances	(1,476,042)	(1,112,906)	(1,090,422)	(824,091)	(698,201)
Loans and advances to customers (net of impairment)	8,386,697	9,199,779	8,733,212	8,043,938	8,527,632
Total deposits	6,799,074	7,643,952	7,760,936	11,690,687	11,292,787
Borrowings	5,037,465	5,435,938	5,472,728	2,132,846	2,618,047
Shareholders' equity	2,886,270	2,943,323	2,915,665	2,853,950	2,772,330
Total assets	15,312,605	16,309,056	16,411,435	16,942,552	16,944,142
KEY RATIOS					
Basic Earnings Per Share (EPS)	2.22	0.53	1.18	2.33	4.23
Return on Assets (ROA)	0.76%	0.17%	0.38%	0.72%	1.30%
Return on Equity (ROE)	4.01%	0.94%	2.12%	4.26%	7.96%
Capital Adequacy Ratio	19.90%	20.10%	21.60%	23.90%	25.7%

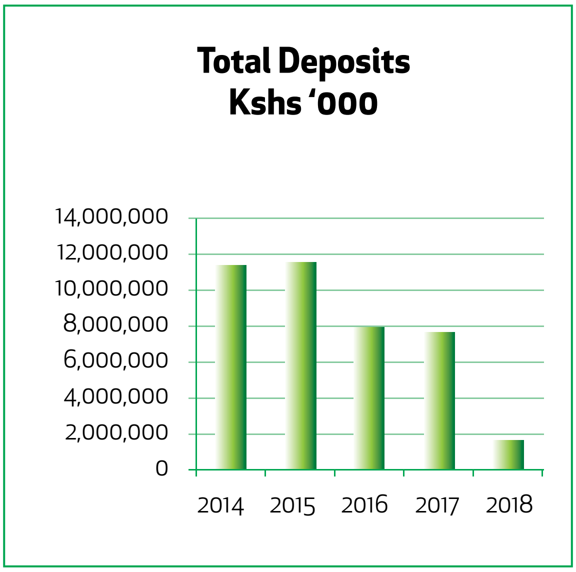
Five year financial summary

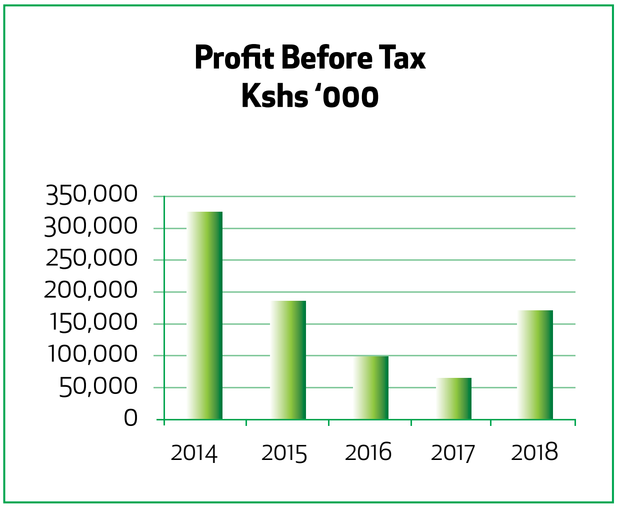
Key Performance Indicators









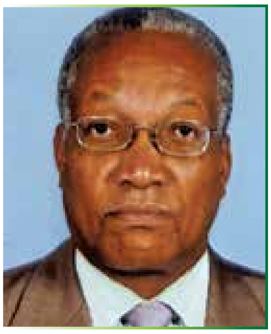


Board of Directors

Prof. H. K. Mengech
Chairman

Henry Rotich
Cabinet Secretary, Treasury

Kungu Gatabaki
Director
Resigned in March 2017



Prof. J.H. Kimura
Director

Mbatha Mbithi
ICDC

Keneth Wanderi
ICDC

Management

Victor J.O. Kidiwa
Chief Executive

Johnson K. Kiniti
Chief Finance Officer

Olga Sechero
Acting Manager Credit

Jacob Mananda
Projects Relationship Manager

Mrs. Celestine Otieno
Company Secretary

Walter Ogada
IT Manager

Benjamin Kakule
Branch Operations Manager

Dayana Kamunde
Business Development Manager

Fredrick O. Ouma
Head Internal Audit

Mary Mwambire
Branch Manager, Ngong Road

Peter Pertet
Risk & Compliance Manager

Chairman's Statement

Prof. H.K. Mengech

Introduction

I am pleased to present to you the audited Financial Statements for the Bank and its wholly owned subsidiary for the year ended December 2018.

The banking sector remained robust throughout the year despite having to contend with the effects of interest rate capping. There was sustained clamour to have this policy changed, but this did not happen. Instead, Parliament scrapped the law on minimum interest payable on savings.

During the year, banks were required to fully implement the new accounting standards, IFRS 9 and 15 which have completely redefined the way assets held by banks are assessed and reported. I am glad to report that Development Bank has fully implemented these standards.

Economic Overview

The Kenyan economy recorded growth rate of 4.9% in 2017, compared to 5.8% and 5.6% achieved in 2016 and 2015 respectively. The growth is the slowest annual expansion in 5 years. This was due to drought, sluggish credit growth and prolonged election period. Growth in the year was on the backdrop of stable political climate, favourable agricultural climate and improved manufacturing.

Credit growth remained depressed due to the impact of interest rate capping. Lending rates have been on a decline driven by downward revision of the Central Bank Rate (CBR) by the Monetary Policy Committee (MPC). CBR currently stands at 9.0% from 10.0% at the beginning of 2018. This has, however not spurred growth in credit due to the feeling by banks that the uniform price offered does not adequately compensate for risk across various products on offer. Most banks have instead chosen to invest with the government through Treasury Bonds and Bills in place of private credit.

Developments in the Banking Sector

The Banking sector remained stable throughout the year with no significant changes. There were no major changes in its landscape closing at 43 commercial banks, 13 microfinance banks, 9 representative offices of foreign banks, 72 foreign exchange bureaus, 19 money remittance providers and 3 credit reference bureaus.

During the year, Chase Bank which had been placed under management was sold to SBM Mauritius Bank while efforts are in place to solve Imperial Bank case.

In terms of Policy, the Monetary Policy Committee (MPC) led by the Central Bank of Kenya (CBK) reviewed the CBR downwards twice in the year from 10.0% in January to 9.5% in March and 9.0% in July. This had the effect of reducing borrowing rate from 14.0% to 13.0% at the close of the year.

Towards the end of the year, Banks implemented the change in the law on interest rate payable to savings account holders. The minimum rate fixed at 70% of the CBR rate was scrapped.

In 2018, as per the requirement of the International Financial Reporting Standards (IFRS), the sector implemented two significant standards: IFRS 9 and IFRS 15. Whereas IFRS 9 deal with the classification, measurement and reporting of financial assets by entities, IFRS 15 deals more specifically with revenue recognition.

The DBK's Performance

The Bank performed better than previous year. Profit before tax for the period tripled to KShs 170.8 million from the previous year's outcome of KShs 59.4 million. The increase in profit was driven mainly by accelerated recovery on non-performing loans. Recovery from such loans provided not only profits but also the much needed cash flow to fund the Bank's operations.

The total Assets of the Bank continued to decline to close at KShs 15.3 billion compared to 2017's level of 16.3 billion. This was due to reduced lending while aggressively collecting on non-performing loans. Consequently the loan book dropped from the previous level of KShs 9.2 billion at close of 2017 to KShs 8.4 billion as at the end of 2018. The attendant loan portfolio is distributed as below.

SECTOR	Portfolio 2018	Portfolio 2017
Agriculture	7.1%	7.8%
Manufacturing	16.92%	13.1%
Building & Construction	3.06%	3.1%
Trade	28.63%	27.1%
Tourism, Restaurants & Hotels	3.39%	3.7%
Transport & Communication	3.01%	3.4%
Real Estate	33.81%	37.0%
Financial Services	0.45%	0.4%
Personal Households	3.32%	3.6%
Mining & Quarrying	-	0.9%
TOTAL	**100.0%**	**100.0%**

Funding the loan book remained a challenge with customer deposits reducing by 8.0% to close at KShs 5.7 billion. To supplement the decline in deposits, the Board and shareholders agreed to sell Finance House which was non-core to the business of the Bank.

Appreciation

I take this opportunity to express my sincere gratitude to all our esteemed clients for their continued support and confidence that they have expressed in us during these challenging times.

I also wish to thank my fellow directors, management and staff of the bank for their able stewardship of the bank without which it would have been difficult to achieve the results we have.

PROF. H. N. K. MENGECH
CHAIRMAN
Date: 11 March 2019

Corporate Governance

The Shareholders being the ultimate owners of the Bank appoint a Board of Directors to conduct the business of the bank on their behalf. The Board executes its responsibilities through Management and Board Committees that it creates from time to time. The responsibilities for daily operations are delegated to a management team appointed by the Board. A clear segregation of responsibilities between the Board and management is always maintained. The Board makes all policy decisions while management implements the decisions of the Board.

Board of Directors

The current Board is made up of six directors inclusive of a non-executive chairman.

Board and Management Committees

Tabulated below are Board and Management Committees, their composition and membership and functions.

	Composition & Membership	Chairman	Members	Main Functions
Executive Committee	Senior Management	CEO	V. Kidiwa J. Kiniti J. Mananda P. Pertet D. Kamunde B. Kakule W. Ogada O. Sechero M. Mwambire K. Gonah C. A. Otieno (Mrs)	Strategy decision making in accordance with powers conferred upon by the Board
Board Audit Committee	Three Non-Executive Directors, and Senior Management	Non-Executive Director	Prof. J. Kimura K. Wanderi V. Kidiwa F. Ouma C. A. Otieno (Mrs) J. Kiniti	Strengthening the control environment, financial reporting and audit function
Assets and Liabilities Committee	Senior Management	CEO	V. Kidiwa J. Kiniti J. Mananda C. A. Otieno (Mrs) D. Kamunde	Management of assets and investments
Board Credit Committee	Executive Directors, and Senior Management	Non-Executive Director	Prof. J. Kimura K.Wanderi V. Kidiwa J. Mananda C. A. Otieno (Mrs)	Appraisal and approval of credit applications
Debt Collection Committee	Senior Management	CEO	V. Kidiwa J. Kiniti O. Sechero J. Mananda C. A. Otieno (Mrs)	Monitoring and reviewing non-performing portfolio
Automation Committee	Four Non-Executive Directors and Senior Management	Non-Executive Director	Prof. J. Kimura V. Kidiwa J. Kiniti C. A. Otieno (Mrs)	Develops the long-term automation plan for the board's approval
Human Resources	Three Non-Executive Directors and Senior Management	Non-Executive Director	Prof. H. K. Mengech M.Mbithi V. Kidiwa C. A. Otieno (Mrs)	Management & development of human resources

	Composition & Membership	Chairman	Members	Main Functions
Strategy Committee	Four Non-Executive Directors and Senior Management	Non-Executive Director	Prof. J. Kimura K. Wanderi J. Kiarii V. Kidiwa J. Kiniti J. Mananda C. A. Otieno (Mrs)	Overall Bank Strategy Policy Formulation and implementation
Board Risk & Compliance	Three Non-Executive Directors and Senior Management	Non-Executive Director	Prof. J. Kimura J. Kiarii V. Kidiwa P. Pertet C. A. Otieno (Mrs)	To ensure quality integrity and reliability of the institution's risk management

Board attendance

Prudential regulations require that every Board member attend a minimum of 75% of all Board meetings. Below is an extract from the attendance register for the Board meetings held in 2018:

Names	6th Mar	2nd May	14th May	25th July	4th Oct Special	11th Oct Special	2nd Nov	5th Dec Special	19th Dec	% Attendance
Prof.H.K. Mengech	X	X	X	X	X	X	X	X	X	100
Prof.J.H. Kimura	X	X	X	X	-	X	X	X	X	89
Kennedy Wanderi*	X	X	X	N/A	N/A	N/A	N/A	N/A	N/A	100
Mbatha Mbithi	X	-	-	X	X	X	X	X	-	67
Joseph Kiarii	-	X	X	X	-	-	X	X	X	67
Ndungu Gathinji**	N/A	X	X	X	X	X	X	X	X	100
William Haggai***	N/A	N/A	N/A	X	X	X	X	X	X	100

* Mr Kennedy Wanderi left the Board in 14 May 2018
**Mr Ndungu Gathinji joined the Board in 2 May 2018
*** Mr William Haggai joined the Board on 25 July 2018 replacing Mr Kennedy Wanderi

Directors Evaluation Report

It is a requirement that the performance of every Director and the Chairman of the Board be evaluated once every year. Evaluation of directors' performance is underway and is expected to be complete before 31 March 2019.

Directors' Report

The directors submit their report together with the audited financial statements for the year ended 31 December 2018.

BUSINESS REVIEW

The Group is engaged in the business of development and commercial banking. It is licensed under the Kenyan Banking Act.

During the year 2018, the Group recorded a profit of KShs 170.8 million which is 187.4% higher than the previous year's profit of KShs 59.4 million. The increase was attributable to increased recoveries from non-performing loans leading to write-backs into profit.

Total assets reduced to KShs 15.3 billion (2017 – KShs 16.3 billion). Loan portfolio declined by 4.3% to KShs 9.9 billion. The quality of the portfolio as measured by the non-performing ratio to the gross loan book deteriorated from 22.6% (2017) to 28.2% (2018). Total deposits decreased by 11.1% to KShs 6.8 billion (2017: KShs 7.6 billion).

DIVIDEND

The net profit for the year of KShs 115,813,000 (2017: KShs 27,658,000) has been added to retained earnings. The directors do not recommend a dividend payment for the year ended 31 December 2018 (2017: Nil).

DIRECTORS

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

DISCLOSURES TO AUDITORS

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

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

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

TERMS OF APPOINTMENT OF AUDITORS

The Auditor- General is responsible for the statutory audit of the company's financial statements in accordance with Article 229 of the Constitution of Kenya. Section 23(1) of the Public Audit Act 2015, empowers the Auditor – General to nominate other auditors to carry out an audit on their behalf. KPMG Kenya who were appointed by the Auditor – General, have carried out the audit for the year ended 31 December 2018.

APPROVAL

The financial statements were approved and authorised for issue by the board of directors on 11 March 2019.

BY ORDER OF THE BOARD

Company Secretary
Date: 11 March 201

Statement of Director's responsibilities

The Directors are responsible for the preparation and presentation of the consolidated and separate financial statements of Development Bank of Kenya Limited (the "Group" and "Company") set out on pages 14 to 97 which comprise the consolidated and company statements of financial position as at 31 December 2018, consolidated and company statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies and other explanatory information, 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 and the profit or loss of the group and the company.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and 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 year which give a true and fair view of the financial position of the group and the company as at the end of the financial year and of the profit or loss of the group and the company for that year. It also requires the Directors to ensure the company keeps proper accounting records which disclose with reasonable accuracy the financial position of the group and the company.

The Directors 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 company and its subsidiary ability to continue as a going concern and have no reason to believe the group and company will not be a going concern for at least the next twelve months from the date of this statement.

Approval of the consolidated and separate financial statements
The consolidated and separate financial statements, as indicated above, were approved and authorised for issue by the Board of Directors on 11 March 2019.

Prof. H. K. Mengech
Chairman

Date: 11 March 2019

Prof. J. Kimura
Director

Date: 11 March 2019

Report of the Auditor General

For the year ended 31 December 2018

REPORT ON GROUP FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of Development Bank of Kenya Limited set out on pages 14 to 97 which comprise the consolidated and separate statements of financial position as at 31 December 2018, and the consolidated and separate statements of comprehensive financial performance, consolidated and separate statement of changes in net assets and consolidated and separate statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, have been audited on my behalf by KPMG Kenya, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results of their audit and on the basis of their report, I'm satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit have been obtained.

In my opinion, the consolidated and separate financial statements present fairly, in all material respects, the financial position of Development Bank of Kenya Limited as at 31 December 2018, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with Kenya Companies Act, 2015.

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Development Bank of Kenya Limited in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable for performing audits of financial statements in Kenya. I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my opinion.

Emphasis of Matter

Material Uncertainty Related to Going Concern

As reported in the previous year, I draw attention to Note 2(a) to the financial statements which describe the Director's application of going concern assumption in preparing the financial statements. During the year the group reported an increase in profitability of KShs 137.5M up from KShs 27.6M in the year 2017. The group reported a net current liability position of KShs 6.9B, determined after comparing the current assets and current liabilities. The Bank experienced decreases in customer savings to stand at KShs 5.7B from KShs 6.2B in the year 2017. Central Bank of Kenya has advanced the bank KShs 4.4B to meet its obligations guaranteed on the banks investments in government securities maturing after one year of an equivalent amount. Since the group is having challenges in meeting its short and long term obligations as and when they fall due, both short term and long term measures to ensure that the group continues to operate as a going concern have been put in place by management and include borrowing from CBK to meet short term cash needs of the group and disposal of Finance House.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, are of most significance in the audit of financial statements. There were no Key Audit Matters to report in the year under review.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the effects of the matters described in the Basis for a Qualified Opinion section of my report, I confirm that, nothing else has come to my attention to cause me to believe that public resources have not been applied lawfully and in an effective way.

Basis for conclusion

The audit was conducted in accordance with ISSAI 4000. The standard requires that I comply with ethical requirements and plan and perform the audit to obtain assurance about whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that govern them. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

Report of the Auditor General (Contd)

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

Conclusion

As required by Section 7(1)(a) of the Public Audit Act, 2015, based on the audit procedures performed, I confirm that, nothing else has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

Basis for conclusion

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards require that I plan and perform the audit to obtain assurance about whether effective processes and systems of internal control, risk management and governance were operating effectively, in all material respects. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

Responsibilities of Management and Those Charged with Governance

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal controls as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is 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 management either intends to cease operations of the Bank, or have no realistic alternative but to do so.

Management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 of the Public Audit Act, 2015.

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

Auditor-General's Responsibilities for the Audit

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement and weakness when its 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 conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances and for the purpose of giving an assurance 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 management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit 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.

- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Bank to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

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

i. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit;
ii. In my opinion, adequate accounting records have been kept by the Bank, so far as appears from the examination of those records; and,
iii. The Bank's financial statements are in agreement with the accounting records and returns.

FCPA Edward R. O. Ouko. CBS
AUDITOR GENERAL

Nairobi

Date: 2 April 2019

Consolidated statement of comprehensive income

	Note	2018 KShs'000	2017 KShs'000
Effective interest income	5	1,438,240	1,576,725
Effective interest expense	6	(1,013,935)	(1,070,754)
Net interest income		424,305	505,971
Net fees and commission income	7	22,162	27,308
Other income	8	91,215	80,554
Operating income		537,682	613,833
Impairment losses on loans and advances	20	(12,110)	(169,590)
Operating expenses	9	(354,805)	(384,817)
Profit before income tax	11	170,767	59,426
Income tax expense	12	(54,954)	(31,768)
Profit for the year		115,813	27,658
Other comprehensive income ***Items that are or may be reclassified to Profit or***			
Net change in fair value of available for sale financial assets	13	22,913	-
Deferred tax on fair value of available-for -sale financial assets	13	(1,146)	-
Other comprehensive income net of tax		**21,767**	**-**
Total comprehensive income		**137,580**	**27,658**
Earnings per share (KShs per share)	15	2.22	0.53
Dividends per share (KShs per share)	14	-	-

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Company statement of comprehensive income

	Note	2018 KShs'000	2017 KShs'000
Effective interest income	5	1,436,005	1,574,490
Effective interest expense	6	(1,014,495)	(1,071,312)
Net interest income		421,510	503,178
Net fees and commission income	7	22,162	27,308
Other income	8	91,215	80,554
Operating income		534,887	611,040
Impairment losses on loans and advances	20	(11,961)	(169,367)
Operating expenses	9	(354,114)	(384,041)
Profit before income tax	11	168,812	57,632
Income tax expense	12	(54,367)	(31,230)
Profit for the year		114,445	26,402
Items that are or may be reclassified to Profit or loss:			
Net change in fair value of available for sale financial assets	13	22,913	-
Deferred tax on fair value of available-for -sale financial assets	13	(1,146)	-
Total other comprehensive income for the year		21,767	-
Total comprehensive income		136,212	26,402
Earnings per share (KShs per share)	15	2.20	0.51
Dividends per share (KShs per share)	14	-	-

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Consolidated statement of financial position

	Note	2018 KShs'000	2017 KShs'000
ASSETS			
Cash and balances with Central Bank of Kenya	17	119,097	351,112
Financial assets at fair value through profit and loss	18	95,865	91,449
Financial assets at amortised cost	18	4,533,997	4,733,933
Deposits and balances due from banking institutions	19	946,077	835,952
Loans and advances to customers	20	8,386,697	9,199,779
Other assets	24	79,430	52,703
Financial assets at fair value through other comprehensive income	21	825,413	805,499
Current income tax	23	347	-
Deferred income tax	25	116,082	16,376
Non-current assets held for sale	28	87,405	-
Prepaid operating lease rentals	26	-	3,812
Property and equipment	27	122,195	218,441
TOTAL ASSETS		15,312,605	16,309,056
LIABILITIES			
Deposits from banks	29	1,069,595	1,416,138
Deposits from customers	30	5,729,479	6,227,814
Borrowings	31	5,037,465	5,435,938
Current income tax	23	-	13,698
Other liabilities	32	589,796	272,145
		12,426,335	13,365,733
EQUITY			
Share capital	33	1,042,500	1,042,500
Retained earnings		750,431	588,030
Statutory reserves	39 (a)	349,913	591,134
Other reserves	39 (b)	743,426	721,659
		2,886,270	2,943,323
TOTAL LIABILITIES AND EQUITY		15,312,605	16,309,056

The financial statements set out on pages 14 to 97 were approved by the Board of Directors on 11 March 2019 and were signed on its behalf by:

Prof. H Mengech
Director

Prof. J. Kimura
Director

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Company statement of financial position

	Note	2018 KShs'000	2017 KShs'000
ASSETS			
Cash and balances with Central Bank of Kenya	17	119,097	351,112
Financial assets at fair value through profit and loss	18	95,865	91,449
Financial assets at amortised cost	18	4,512,923	4,712,844
Deposits and balances due from banking institutions	19	946,077	835,952
Loans and advances to customers	20	8,386,697	9,199,779
Other assets	24	79,430	52,703
Financial assets at fair value through other comprehensive income	21	825,413	805,499
Investment in subsidiary	22	32,048	32,048
Deferred income tax	25	115,961	16,285
Non-current assets held for sale	28	87,405	-
Prepaid operating lease rentals	26	-	3,812
Property and equipment	27	122,195	218,441
TOTAL ASSETS		15,323,111	16,319,924
LIABILITIES			
Deposits and balances due to banking institutions	29	1,069,595	1,416,138
Customers deposits	30	5,752,500	6,249,316
Borrowings	31	5,037,465	5,435,938
Tax payable	23	3,022	17,374
Other liabilities	32	589,205	271,413
		12,451,787	13,390,179
EQUITY			
Share capital	33	1,042,500	1,042,500
Retained earnings		735,485	574,452
Statutory reserves	39 (a)	349,913	591,134
Other reserves	39 (b)	743,426	721,659
		2,871,324	2,929,745
TOTAL LIABILITIES AND EQUITY		15,323,111	16,319,924

The financial statements set out on pages 14 to 97 were approved by the Board of Directors on 11 March 2019 and were signed on its behalf by:

Prof. H Mengech
Director

Prof. J. Kimura
Director

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Consolidated statement of changes in equity

	Share capital KShs'000	Statutory reserves KShs'000	Other reserves KShs'000	Retained earnings KShs'000	Proposed dividends KShs'000	Total KShs'000
At 1 January 2017	1,042,500	437,072	721,659	714,434	-	2,915,665
Comprehensive income for the year						
Profit for the year	-	-	-	27,658	-	27,658
Transfer to statutory reserves	-	154,062	-	(154,062)	-	-
Total comprehensive income for the year	-	154,062	-	(126,404)	-	27,658
At 31 December 2017	1,042,500	591,134	721,659	588,030	-	2,943,323
Adjustment on initial application of IFRS 9 (Note 16)	-	-	-	(301,370)	-	(301,370)
Related tax	-	-	-	106,737	-	106,737
IFRS 9 Re - Measurements	-	(301,370)	-	301,370	-	-
At 1 January 2018	1,042,500	289,764	721,659	694,767	-	2,748,690
Comprehensive income for the year						
Profit for the year	-			115,813		115,813
Transfer to statutory reserves	-	60,149	-	(60,149)	-	-
Other comprehensive income net of tax						
Revaluation reserves	-	-	21,767	-	-	21,767
Total comprehensive income for the year	-	60,149	21,767	55,664		137,580
At 31 December 2018	**1,042,500**	**349,913**	**743,426**	**750,431**	**-**	**2,886,270**

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Bank statement of changes in equity

	Share capital KShs'000	Statutory reserves KShs'000	Other reserves KShs'000	Retained earnings KShs'000	Proposed dividends KShs'000	Total KShs'000
At 1 January 2017	1,042,500	437,072	721,659	702,112	-	2,903,343
Comprehensive income for the year						
Profit for the year	-	-	-	26,402	-	26,402
Transfer to statutory reserves	-	154,062	-	(154,062)	-	-
Total comprehensive income for the year	-	154,062	-	(127,660)	-	26,402
At 31 December 2017	1,042,500	591,134	721,659	574,452	-	2,929,745
Adjustment on initial application of IFRS 9 (Note 16)	-	-	-	(301,370)	-	(301,370)
Related tax	-	-	-	106,737	-	106,737
IFRS Re-measurement	-	(301,370)	-	301,370	-	-
At 1 January 2018	1,042,500	289,764	721,659	681,189	-	2,735,112
Comprehensive income for the year						
Profit for the year	-	-	-	114,445	-	114,445
Transfer to statutory reserves	-	60,149	-	(60,149)	-	-
Other comprehensive income net of tax						
Revaluation reserves	-	-	21,767	-	-	21,767
Total comprehensive income for the year	-	60,149	21,767	54,296	-	136,212
At 31 December 2018	**1,042,500**	**349,913**	**743,426**	**735,485**	**-**	**2,871,324**

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Consolidated statement of cash flows

	Note	2018 KShs'000	2017 KShs'000
Operating activities			
Profit before taxation		170,767	59,426
Depreciation	27	17,115	18,673
Provision on impairment on Equity Investment	21	3,000	-
Amortisation of prepaid operating lease rentals	26	61	61
Profit on disposal of property and equipment		(49)	(95)
Interest charged on borrowings		22,314	19,101
Tax paid	23	(63,114)	(11,964)
Cash flows from operating activities before changes in operating assets and liabilities		150,094	85,202
Changes in operating assets and liabilities			
Loans to customers*		511,712	(466,567)
Deposits held for regulatory purposes		192,435	(22,633)
Investments in treasury bonds		195,520	302,737
Other assets		(26,727)	16,149
Customer's deposits		(498,335)	459,361
Other liabilities		317,650	10,039
Net cash generated from operations		842,349	384,288
Cash flows from investing activities			
Purchase of property and equipment	27	(4,566)	(8,000)
Proceeds from sale of property and equipment		92	166
Net cash used in investing activities		(4,474)	(7,834)
Cash flows from financing activities			
Interest paid on borrowings		(22,314)	(19,101)
Loans receipts		-	398,832
Loans repayments		(398,473)	(435,622)
Net cash used in financing activities		(420,787)	(55,891)
Net increase in cash and cash equivalents		417,088	320,563
Cash and cash equivalents balances as at start of year		(515,631)	(836,194)
Cash and cash equivalents at end of year	34	(98,543)	(515,631)

* The 2018 movement is net of IFRS 9 adjustment recorded directly in retained earnings.

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Bank statement of cash flows

	Note	2018 KShs'000	2017 KShs'000
Operating activities			
Profit before taxation		168,812	57,632
Depreciation	27	17,115	18,673
Provision on impairment on equity investment	21	3,000	-
Amortisation of prepaid operating lease rentals	26	61	61
Profit on disposal of property and equipment		(49)	(95)
Interest charged on borrowings		22,314	19,101
Tax paid	23	(62,805)	(11,657)
Cash flows from operating activities before changes in operating assets and liabilities		148,448	83,715
Changes in operating assets and liabilities			
Loans to customers*		511,712	(466,567)
Deposits held for regulatory purposes		192,435	(22,633)
Investments in treasury bonds		195,505	302,722
Other assets		(26,727)	16,149
Customer's deposits		(496,816)	460,802
Other liabilities		317,792	10,100
Net cash generated from operations		842,349	384,288
Cash flows from investing activities			
Purchase of property and equipment	27	(4,566)	(8,000)
Proceeds from sale of property and equipment		92	166
Net cash used in investing activities		(4,474)	(7,834)
Cash flows from financing activities			
Interest paid on loan capital		(22,314)	(19,101)
Dividend paid		-	-
Loans received		-	398,832
Loans repaid		(398,473)	(435,622)
Net cash used in financing activities		(420,787)	(55,891)
Net increase in cash and cash equivalents		417,088	320,563
Cash and cash equivalents as at start of year		(515,631)	(836,194)
Cash and cash equivalents at end of year	34	(98,543)	(515,631)

* The 2018 movement is net of IFRS 9 adjustment recorded directly in retained earnings.

The notes set out on pages 22 to 97 form an integral part of these financial statements.

Notes to the financial statements

1. General information

Development Bank of Kenya Limited (the "Group", "Bank" or the "Company") is incorporated as a limited company in Kenya under the Kenyan Companies Act, and is domiciled in Kenya. The address of its registered office is as follows:

Finance House
Loita Street
P. O. Box 30483, 00100
Nairobi

The annual financial statements have been prepared in accordance with International Financial Reporting Standards and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (IFRIC) and the requirements of the Kenyan Companies Act, 2015, as amended.

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

The consolidated and separate financial statements are prepared in millions of Kenya Shillings (Shs 'million), the presentation currency of the group.

2. Summary of significant accounting policies

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

(a) Going concern

The Group has this year reported better performance from a profitability perspective, with a profit before tax of KShs 170 million, up from KShs 59 million in 2017. The Group however remains in a net current liability position of KShs 6.9 billion (2017: KShs 6.9 billion) as demonstrated by the maturity analysis for balances maturing up to 12 months as presented under Note 4 (b). The Group's ratio of loans and advances to customer deposits as at 31 December 2018 was 146% (2017: 148%).

With the implementation of the Banking (Amendment) Bill 2015 in September 2016, the net interest margins across the banking industry have been significantly impacted and it is expected that profitability will reduce going forward. This has impacted the Group results in the year and the impact will be felt into the foreseeable future. The Banking industry is also facing challenges with the increase in the level of non-performing loans and this too has impacted the Group as seen in the increase in the level of impairment provisions. The adoption of the new accounting standard IFRS 9 Financial Instruments has further compounded the impact for the year and is expected to do so going forward.

The Group has further been significantly affected by the increase in the cost of funding attributed to the sustained reduction in liquidity in the market and especially in the mid and lower tier Banks. This is evident from the decrease in customer deposits. The Group is therefore currently reliant on CBK funding to be able to meet its current obligations. As at 31 December 2018, the borrowings from CBK comprised of short term borrowings payable within one month amounting to KShs 4.4 billion at an average interest rate of 10% p.a as disclosed in Note 31. These are renewable on an ongoing basis and are secured on the Group's portfolio of government securities of an equal amount.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(a) Going concern (continued)

The above factors are indicative of a decline in the Group's overall performance and the fact that the Group is having challenges with liquidity and may not be able to meet its obligations as and when they fall due. Management has put in place short term and long term measures to ensure that the Group continues to operate as a going concern. The borrowings from CBK are available to meet short term needs of the Group and are part of management's funding plans.

Long term measures currently being pursued by the Group include:

- Disposal of Finance House. The Bank closed a sale of the building to Industrial and Commercial Development Corporation (ICDC) in the beginning of 2019. The sale will generate Kshs 1.2 billion;
- Sale of share of the Bank at Kenya Hotel Property with a value of Kshs 825 million.
- Shareholder loans from Treasury via ICDC. The Bank made a request for funding from Treasury of Kshs 5.5 billion. As at the close of 2018, Treasury had approved Kshs 800 million long term lending to the Bank.
- Ongoing mobilization of deposits to increase the Bank's funding and focus to increase the Group lending and effectively increase the net interest margin and profitability going forward.
- Accelerated program of collecting on non-performing loans; and
- Raising additional capital by issuing additional shares. This is expected to raise Kshs 3.0 billion.

Based on the above measures and factors, the directors believe that it is appropriate for the financial statements to be prepared on a going concern basis.

(b) Basis of preparation

Changes in accounting policies and disclosures

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

During the current year, the bank has adopted all of the new and revised standards and interpretations issues by the IASB and IFRIC that are relevant to its operations and effective for the annual periods beginning on 1 January 2018. The impact of the adoption of these new and revised standards and interpretations has been documented below:

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

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) Basis of preparation (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 Company will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures.

The Company 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.

There was no material impact of application of IFRS 15.

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

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below. The full impact of adopting the standard is set out in Note 16.

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).

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (continued)

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

Classification of financial assets and financial liabilities - continued

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

The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Bank classifies financial assets under IFRS 9, see Note 14

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 16.

Impairment of financial assets

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

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see Note 4(a).

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 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 Company used the exemption not to restate comparative periods.

For short-term leases (less than 12 months), and leases for which the underlying asset is of low value (such as laptops and office furniture).

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (continued)

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

Transition - continued

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 Company 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 Note 16.

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:

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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) - continued

- 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 a material impact on the Group and Company financial statements.

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.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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) - continued

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 a material impact on the Group and Company 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:

(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 Group and Company financial statements.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (continued)

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

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 a material impact on the amounts and disclosures of the Group and Company 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 Group and Company financial statements.

(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 Group does not plan to adopt these standards early. These are summarised below;

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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	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.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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)

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

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 Group is still assessing the potential impact on the amounts and disclosures of the Group and Company financial statements.

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.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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

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.

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 Group 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 a significant impact on the Group and Company financial statements.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (continued)

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

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 Group and Company.

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 Group and Company financial statements.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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)

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.

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 Group and Company.

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 Company.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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

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.

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 Group and Company 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 Group is assessing the potential impact on its financial statements resulting from the application of the refined definition of materiality.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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

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:

(a) the fulfillment 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.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

b) Basis of preparation (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

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 Group and Company 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 Group and Company financial statements.

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

(c) Consolidation principles

The consolidated financial statements include the financial statements of Development Bank of Kenya Limited (DBK) and its wholly owned subsidiary company, Small Enterprises Finance Company Limited (SEFCO), which is controlled by the bank. Control exists when the bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All inter-company balances and transactions have been eliminated on consolidation.

(d) Foreign currency translation

(i) Functional and Presentation Currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which entity operates ('the Functional Currency'). The consolidated financial statements presented in Kenya shillings, which is the Group's presentation currency. All financial information presented in these consolidated financial statements has been rounded off to the nearest thousand Kenya shillings.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(d) Foreign currency translation (continued)

(ii) Transactions and balances

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

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale 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.

(e) Revenue recognition

Income is recognised on an accrual basis.

(i) Effective interest income

Effective interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for Purchased or originated credit impaired ('POCI') financial assets and Financial assets that are not "POCI' but have subsequently become credit impaired.

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

Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the expected credit loss provision).

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance). The calculation does not consider expected credit losses and includes transaction costs, and fees that are integral to the effective interest rate, such as origination fees.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset. For 'POCI' financial assets if any — assets that are credit-impaired at initial recognition — the Group calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(e) Revenue recognition (continued)

(ii) Fees and commission income

Fees and commission income that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment are recognised as the related services are performed.

(iii) Dividend income

Dividend income is recognised once the right to receive the dividends has been established.

(f) Financial assets

(i) Measurement methods

Amortised cost and effective interest rate

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

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

Initial recognition and measurement

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

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

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

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(f) Financial assets (continued)

(i) Measurement methods - continued

Initial recognition and measurement - continued

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

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

(ii) Classification and subsequent measurement

From 1 January 2018, the Group has applied IFRS 9 and classifies its financial assets in the following measurement categories:

a) Fair value through profit or loss (FVPL);
b) Fair value through other comprehensive income (FVOCI); or
c) Amortised cost.

The classification requirements for debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds.

Classification and subsequent measurement of debt instruments depend on:

a) The Group's business model for managing the asset; and
b) the cash flow characteristics of the asset.

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

Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described under the expected credit loss measurement section. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method. Financial assets classified in this category include treasury bills and treasury bonds purchased from the secondary market; loans and advances to banks and customers with fixed or determinate payment that are not quoted in active market.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(f) Financial assets (continued)

(ii) Classification and subsequent measurement - continued

Debt instruments - continued

Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in Net Investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

Fair value through profit or loss: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented in the profit or loss statement within Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method. Financial instruments reclassified in this category are those that the Group holds principally for the purpose of short-term profit taking. These comprise mainly certain Treasury bonds.

Business model: the business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Group in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the ` SPPI test'). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement.

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

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(f) Financial assets (continued)

(ii) Classification and subsequent measurement - continued

Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets.

The Group has designated at FVOCI investments in a small portfolio of equity securities. The Group chose this presentation alternative because the investments were made for strategic purposes rather than with a view to profit on a subsequent sale, and there are no plans to dispose of these investments in the short or medium term. There was no dividend recognised during the period nor transfers of the cumulative gain within equity.

(iii) Impairment

The Group assesses on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and with the exposure arising from loan commitments and non-financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date.

The measurement of ECL reflects:

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

(iv) Modification of loans

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

a) If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
b) Whether any substantial new terms are introduced that substantially affects the risk profile of the loan.
c) Significant extension of the loan term when the borrower is not in financial difficulty.
d) Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(f) Financial assets (continued)

(iv) Modification of loans - continued

If the terms are substantially different, the Group derecognises the original financial asset and recognises a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

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

(v) Derecognition other than on a modification

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

(g) Leases

(i) The Bank is the lessee

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 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.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(g) Leases (continued)

(i) The Bank is the lessee - continued

Finance lease

Lease of assets where the Bank has substantially all the risks and rewards of ownership are classified as finance leases. These are capitalised at 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.

(ii) The Bank is the lessor

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

(h) Property and equipment

All property and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment.

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

Depreciation is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

- Buildings on leasehold land	over the lease period
- Furniture and equipment	8 years
- Computers	3 years
- Motor vehicles	4 years
- Leasehold improvements	6 years

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(h) Property and equipment (continued)

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'Other (losses)/gains – net' in the income statement.

(i) Non-current assets held for sale

Non-current assets (or disposal group's comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. This condition is regarded as met only when the sale is highly probable and the non-current asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and an active programme to locate a buyer and complete the plan must have been initiated. The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification. Immediately before classification as held for sale, the assets (or components of a disposal group) are re-measured in accordance with the Group's accounting policies. Thereafter the assets (or disposal group) are measured at the lower of their carrying amount or fair value, less cost to sell. Any impairment loss on a disposal group is first allocated to reduce goodwill and then to remaining assets and liabilities on a pro rata basis, except that no loss is allocated to financial assets, deferred tax assets, investment properties, insurance assets and employee benefit assets, which continue to be measured in accordance with the Group'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 until finally sold.

Property, equipment and intangible assets, once classified as held for sale, are not depreciated or amortised.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of their previous carrying amount and fair value less costs to sell.

(j) Income tax

(i) Current income tax

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

The current income tax charge is calculated on the basis of 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.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(j) Employee benefits (continued)

(ii) Deferred income tax

Deferred income tax is recognised, using the liability method, 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 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.

(k) Employee benefits

(i) Post-employment benefits

The majority of the Group's employees are eligible for retirement benefits under a defined contribution plan.

Obligations for contributions to the defined contribution plan are recognised as an expense in profit or loss as incurred. Any difference between the charge to profit or loss income and the contributions payable is recorded in the statement of financial position under other assets or liabilities.

(ii) Leave

All employees are entitled to such leave as is determined by the Bank from time to time. All annual leave must be taken in the year it is earned subject to a maximum of 15 days carried forward. The bank does not compensate staff leave days carried forward in excess of 15 days unless sanctioned and supported by the head of department.

Leave days not taken within policy are accrued for at the individual staff salary scale.

(l) Cash and cash equivalents

For the purpose of presentation of the cash flows in the financial statements the cash and cash equivalents include cash and balances with Central Bank of Kenya net of cash ratio reserve, net balances from banking institutions, uncleared effects and investment in government securities with a maturity of three months or less from the date of acquisition.

Notes (Cont'd)

2. Summary of significant accounting policies (continued)

(m) Dividends

Dividends are recognised as a liability in the period in which they are declared. Proposed dividends are disclosed as a separate component of equity.

(n) Provisions

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

(o) Non-financial guarantee contracts, letters of credit, performance bonds and loan commitments

Letters of credit, acceptances, guarantees and performance bonds, which are credit-related instruments, are generally given by the Group to support performance by a customer to third parties. Non-financial guarantees are those issued by the Group to a client to guarantee full and due performance of a contractor according to plans and specifications in a contract. If the contractor fails to perform under the contract, the Group will compensate the customer for losses incurred as a result and will then recoup the amount paid from the contractor.

Loan commitments provided by the Group are measured as the amount of the loss allowance. The Group has not provided any commitment that can be settled net in cash or by delivering or issuing another financial instrument. For loan commitments, the loss allowance is recognised as a provision.

3. Critical accounting estimates and judgements

In preparing these consolidated financial statements, management has made judgements and estimates that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are continuously reviewed on an ongoing basis are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances. Revisions to estimates are recognised prospectively.

This note provides an overview of the areas that involve a higher degree of judgement or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year.

(a) Measurement of the expected credit allowance

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

Notes (Cont'd)

3. Critical accounting estimates and judgements (continued)

(a) Measurement of the expected credit allowance (continued)

Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 4 (i), which also sets out key sensitivities of the ECL to changes in these elements.

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

a) Determining criteria for significant increase in credit risk;
b) Choosing appropriate models and assumptions for the measurement of ECL;
c) Establishing the number and relative weightings of forward-looking scenarios for each type of product and the associated ECL; and
d) Establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Group in the above areas is set out in note 4(i).

(b) Income taxes

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

(c) Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

All financial instruments are initially recognised at fair value, which is normally the transaction price. In certain circumstances, the initial fair value may be based on a valuation technique which may lead to the recognition of profits or losses at the time of initial recognition. However, these profits or losses can only be recognised when the valuation technique used is based solely on observable market inputs.

Subsequent to initial recognition, some of the Group's financial instruments are carried at fair value, with changes in fair value either reported within the statement of comprehensive income or within other comprehensive income until the instrument is sold or becomes impaired. Details of the type and classification of the Group's financial instruments are set out in note 4 and the accounting policy set out in note 2 to the accounts.

The fair values of quoted financial instruments in active markets are based on current prices. If the market for a financial instrument is not active, and for unlisted securities, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Notes (Cont'd)

3. Critical accounting estimates and judgements (continued)

(c) Fair value of financial instruments (continued)

Where representative prices are unreliable because of illiquid markets, the determination of fair value may require estimation of certain parameters, which are calibrated against industry standards and observable market data, or the use of valuation models that are based on observable market data.

The fair value for the majority of the Group's financial instruments is based on observable market prices or derived from observable market parameters.

Equity investments that do not have an observable market prices are fair valued by applying various valuation techniques, such as earnings multiples, net assets multiples, discounted cash flows, and industry valuation benchmarks. These techniques are generally applied prior to any initial public offering after which an observable market price becomes available. Disposal of such investments are generally by market trades or private sales.

4. Financial risk management

Introduction and overview

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

i. Credit risk;
ii. Liquidity risk; and
iii. Market risks, comprising of interest rate risk, currency risk and price risk

Group's risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has established the Asset and Liability (ALCO), Credit and Risk and Debt collection committees, which are responsible for developing and monitoring the Group's risk management policies in their specified areas. All Board committees have both executive and non-executive members and report regularly to the main Board on their activities.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Group Audit Committee is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk

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

The Group is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its trading activities ('trading exposures') including non-equity trading portfolio assets. For risk management reporting purposes, the Group considers and consolidates all elements of credit risk exposure. Further, credit risk arising on trading securities is managed independently, but reported as a component of market risk exposure.

Management of credit risk

Credit risk is the single largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. The Board of Directors has delegated responsibility for the management of credit risk to its Board Credit Committee. The Board Credit Committee is responsible for oversight of the Group's credit risk, including:

a) Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements;
b) Establishing the authorisation structure for the approval and renewal of credit facilities;
c) Reviewing and assessing credit risk. Group credit assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process;
d) Limiting concentrations of exposure to counterparties and industries for loans and advances;
e) Developing and maintaining the Group's risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of five grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate. Risk grades are subject to regular reviews by Group Risk;
f) Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to Group Credit on the credit quality of local portfolios and appropriate corrective action is taken; and
g) Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of credit risk. Each business unit is required to implement Group credit policies and procedures, with credit approval authorities delegated from the Group Credit Committee.

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Credit risk measurement

Loans and advances (including loan commitments and guarantees)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9.

Credit risk grading

The Group uses credit risk grading that reflect its assessment of the probability of default and specific characteristics of individual counterparties. Various qualitative and quantitative factors such as the facility arrears status, facility restrucutures as well as specific industry risk assessment are considered. In addition, the credit grading enable expert judgement from the credit risk team to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

Expected credit loss measurement

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

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

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Significant increase in credit risk (SICR)

The Group considers a financial instrument to have experienced a significant increase in credit risk based on its assessment of both quantitative factors and qualitative factors or when the backstop criteria have been met.

Quantitative criteria: This considers the facilities arrears status and considers whether expected contractual payments are 30 days past due.

Qualitative criteria: This considers whether the facility has been restructured due to cash flow difficulties experienced by the customer as well as an assessment of perceived risk of the industry in which the facility falls in. Further the group assesses the perceived risk of the obligor in assessment of financial instrument to have experienced a significant increase in credit risk.

The assessment of SICR incorporates forward-looking information. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent Credit Risk team. A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

The Group has not used the low credit risk exemption for any financial instruments in the year ended 31 December 2018.

Definition of default and credit-impaired assets:

The Group defines a financial instrument as in default when the borrower is more than 90 days past due on its contractual payments The definition has been used consistently across all ECL inputs i.e. PD, EAD and LGD. The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Group's expected loss calculations.

Measuring ECL — Explanation of inputs, assumptions and estimation techniques:

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

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD).

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Significant increase in credit risk (SICR) - continued

Measuring ECL — Explanation of inputs, assumptions and estimation techniques: - continued

- Loss Given Default (LGD) represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type of claim and availability of collateral or other credit support. LGD is calculated on a 12-month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

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

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

The 12-month and lifetime EADs are determined based on the expected payment profile. The 12-month and lifetime LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type. The Group has based on the entity's historical experience, determined the time to realization. Forced sale values of the land and non-land collateral are also used in the determination of the LGD. In some cases, the group determines the forced sale value assumption taking into account factors such as the most recent revaluation reports on the collateral, the perceived risk of the client whose assets are secured by a negative pledges, any other claims on collateral in instances where the Bank's claim ranks pari passu to that of other lenders and the exposure of all of a client's facilities where a single client has multiple facilities secured by the same collateral.

Forward-looking economic information is also included in determining the 12-month and lifetime PD, EAD and LGD. The assumptions underlying the ECL calculation such as how the maturity profile of the PDs and how collateral values change etc are monitored and on an ongoing basis. There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

The group reviews all inputs, assumptions and estimation techniques applied in measuring the ECL to assess any changes and appropriateness on an annual basis. Consideration is made to changes in the business, changes in the economy, changes in the factors affecting the PD, LGD, EAD and other inputs. Such changes are expected to be very infrequent. There have been no significant changes in estimation techniques or significant assumptions made during the reporting period. Unless significant changes are identified, the Group expects to update the PDs, LGD and any other significant assumptions after every 3 years.

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Significant increase in credit risk (SICR) - continued

Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. Using macro-economic overlays. Overlays were estimated and applied for three different scenarios, base case scenario, downside scenario and optimistic scenario.

These macroeconomic overlays and the probability of each economic scenario occurring were set using management judgement based on the assessment of the Group's portfolio performance. The number of scenarios and their attributes are reassessed at each reporting date. At 1 January 2018 and 31 December 2018, for all portfolios the Group concluded that three scenarios appropriately captured non-linearities.

The assessment of SICR is performed using the Lifetime PD under each of the base, and the other scenarios, multiplied by the associated scenario weighting, along with qualitative and backstop indicators. Following this assessment, the Group measures ECL as either a probability weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes and has established that the chosen scenarios are appropriately representative of the range of possible scenarios.
Grouping of instruments for losses measured on a collective basis.

For expected credit loss provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogeneous. In performing this grouping, there must be sufficient information for the group to be statistically credible. The appropriateness of groupings is monitored and reviewed on a periodic basis by the Credit Risk team.

Maximum exposure to credit risk - Financial instruments subject to impairment.

The following table contains an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

The following table contains an analysis of the credit risk exposure (credit quality analysis) of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

Group		31-Dec-18			31-Dec-17
	Stage 1 KShs'000	Stage 2 KShs'000	Stage 3 KShs'000	Total KShs'000	Total KShs'000
Cash and balances with Central Bank of Kenya	119,097	-	-	119,097	351,112
Financial assets at fair value through profit and loss	95,865	-	-	95,865	91,449
Financial assets at fair value through other comprehensive income	4,533,997	-	-	4,533,997	4,733,933
Deposits and balances due from banking institutions	946,077	-	-	946,077	835,952
Loans and advances to customers	3,009,135	3,921,645	2,931,959	9,862,739	10,312,685
Undrawn loan commitments	100,480	-	-	100,480	512,420
Other financial assets	60,132	-	-	60,132	35,699
Letters of credit and guarantees	576,017	-	-	576,017	611,640
Gross carrying amount	**9,440,800**	**3,921,645**	**2,931,959**	**16,294,404**	**17,484,890**
Loss allowance	(46,459)	(406,814)	(1,022,769)	(1,476,042)	(1,112,906)
Net carrying amount	**9,394,341**	**3,514,831**	**1,909,190**	**14,818,362**	**16,371,984**

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Bank	31-Dec-18 Stage 1 KShs'000	Stage 2 KShs'000	Stage 3 KShs'000	31-Dec-17 Total KShs'000	Total KShs'000
Cash and balances with central Bank of Kenya	119,097	-	-	119,097	351,112
Financial assets at fair value through profit and loss	95,865	-	-	95,865	91,449
Financial assets at fair value through other comprehensive income	4,512,923	-	-	4,512,923	4,712,844
Deposits and balances due from banking institutions	946,077	-	-	946,077	835,952
Loans and advances to customers	3,009,135	3,921,645	2,876,085	9,806,865	10,256,960
Undrawn loan commitments	100,480	-	-	100,480	512,420
Other financial assets	60,132	-	-	60,132	52,703
Letters of credit and guarantees	576,017	-	-	576,017	611,640
Gross carrying amount	**9,419,726**	**3,921,645**	**2,876,085**	**16,217,456**	**17,425,080**
Loss allowance	(46,459)	(406,814)	(966,895)	(1,420,168)	(1,057,181)
Net carrying amount	**9,373,267**	**3,514,831**	**1,909,190**	**14,797,288**	**16,367,899**

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

The movement in the allowance for impairment for debt securities at amortised cost during the year was as follows (see Note 20 for the movement for the year ended 31 December 2017):

Group	Stage 1 12 month ECL KShs'000	Stage 2 Lifetime ECL KShs'000	31-Dec-18 Stage 3 Lifetime ECL KShs'000	Total KShs'000
Loans and advances at amortised cost				
Balances at 1 January	42,068	72,274	998,564	1,112,906
IFRS 9 transition adjustment	100,650	265,024	(64,304)	301,370
Adjusted balance at 1 January	**142,718**	**337,298**	**934,260**	**1,414,276**
Transfer to Stage 1 (12 month ECL)	3,678	(3,678)	-	-
Transfer to Stage 2 (lifetime ECL not credit impaired)	(55,595)	57,428	(1,833)	-
Transfer to Stage 3 (lifetime ECL credit impaired)	(3,945)	(53,848)	57,793	-
Net remeasurement of loss allowances	(45,005)	74,541	158,740	188,276
New financial assets originated or purchased	4,847	-	1,426	6,273
Financial assets derecognised	(239)	(4,927)	(7,115)	(12,281)
Write offs	-	-	-	-
Recoveries from write offs	-	-	(120,502)	(120,502)
Balance at 31 December	**46,459**	**406,814**	**1,022,769**	**1,476,042**

Bank				
Loans and advances at amortised cost				
Balances at 1 January	42,068	72,274	942,839	1,057,181
IFRS 9 transition adjustment	100,650	265,024	(64,304)	301,370
Adjusted balance at 1 January	**142,718**	**337,298**	**878,535**	**1,358,551**
Transfer to Stage 1 (12 month ECL)	3,678	(3,678)	-	-
Transfer to Stage 2 (lifetime ECL not credit impaired)	(55,595)	57,428	(1,833)	-
Transfer to Stage 3 (lifetime ECL credit impaired)	(3,945)	(53,848)	57,793	-
Net remeasurement of loss allowances	(45,005)	74,541	158,591	188,127
New financial assets originated or purchased	4,847	-	1,426	6,273
Financial assets derecognised	(239)	(4,927)	(7,115)	(12,281)
Write offs	-	-	-	-
Recoveries from write offs	-	-	(120,502)	(120,502)
Balance at 31 December	**46,459**	**406,814**	**966,895**	**1,420,168**

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Collateral and other credit enhancements

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation. The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically.

The Group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured. Collateral is usually not held against investment securities, and no such collateral was held at 31 December 2018 or 2017.

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period. The Group closely monitors collateral held for financial assets, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

The Group closely monitors collateral held for financial assets, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses.

Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

Loans and advances to customers		2018		
Group	**Gross exposure KShs'000**	**Impairment allowance KShs'000**	**Carrying amount KShs'000**	**FV of collateral held KShs'000**
Carrying amount	**9,862,739**	**(1,476,042)**	**8,386,697**	**22,592,027**
Bank	**Gross exposure KShs'000**	**Impairment allowance KShs'000**	**Carrying amount KShs'000**	**FV of collateral held KShs'000**
Carrying amount	**9,806,865**	**(1,420,168)**	**8,386,697**	**22,592,027**

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Collateral and other credit enhancements - continued

Loans and advances to customers Group	Gross exposure KShs'000	2017 Impairment allowance KShs'000	Carrying amount KShs'000	FV of collateral held KShs'000
Carrying amount	**10,312,685**	**(1,112,906)**	**9,199,779**	**19,960,415**

Bank	Gross exposure KShs'000	Impairment allowance KShs'000	Carrying amount KShs'000	FV of collateral held KShs'000
Carrying amount	**10,256,960**	**(1,057,181)**	**9,199,779**	**19,960,415**

Loss allowance

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

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

Write-off policy

The Group writes off a loan balance (and any related allowances for impairment losses) when Group Credit determines that the loans are uncollectible. This is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The Group still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Collateral and other credit enhancements - continued

Modification of financial assets

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery. Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider.

Such restructuring activities include extended payment term arrangements. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans. The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset. The Group monitors the subsequent performance of modified assets. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more. This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more.

Concentration by Sector

The Group monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown below:

The Group monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown below:

Concentration by Sector	**2018 KShs'000**	**2017 KShs'000**
Agriculture	734,408	813,341
Manufacturing	1,633,802	1,439,711
Building and construction	302,795	321,350
Trade	2,835,489	2,825,176
Tourism, restaurants, and hotels	335,711	380,232
Transport and communication	298,148	346,859
Real estate	3,348,751	3,782,601
Financial services	45,058	45,987
Personal households	328,577	357,428
	9,862,739	**10,312,685**

Notes (Cont'd)

4. Financial risk management (continued)

(a) Credit risk (continued)

Exposure to credit risk

	Group KShs'000	2018 Bank KShs'000	Group KShs'000	2017 Bank KShs'000
Balances with Central Bank of Kenya	119,097	119,097	351,112	351,112
Deposits and balances due from banking institutions	946,077	946,077	835,952	835,952
Loans and advances to customers	8,386,697	8,386,697	9,199,779	9,199,779
Financial assets at fair value through profit and loss	95,865	95,865	91,449	91,449
Financial assets at amortised cost	4,533,997	4,512,923	4,733,933	4,712,844
Other assets	79,430	79,430	52,703	52,703
Financial assets at fair value				
Through profit or loss	825,413	825,413	805,499	805,499
	14,986,576	**14,965,502**	**16,070,427**	**16,049,338**

(b) Liquidity risk

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

Management of liquidity risk

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

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

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

Notes (Cont'd)

4. Financial risk management (continued)

(b) Liquidity risk (continued)

Exposure to liquidity risk

The key measure used by the Group for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. Details of the reported Group ratio of net liquid assets to deposits from customers at the reporting date and during the reporting period were as follows:

	2018	2017
Average for the period	-4.2%	1.2%
Maximum for the period	3.1%	12.2%
Minimum for the period	-8.3%	-9.6%

Notes (Cont'd)

4. Financial risk management (continued)

(b) Liquidity risk (continued)

The table below analyses the Company's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows:

Group	0 to 1 month KShs'000	1 to 3 months KShs'000	3 to 12 months KShs'000	1 to 5 years KShs'000	Over 5 years KShs'000	Total KShs'000
At 31 December 2018						
Liabilities						
Due to banking institutions	514,773	462,990	91,832	-	-	1,069,595
Customer deposits	2,023,578	2,808,852	867,049	30,000	-	5,729,479
Borrowings	4,443,641	75,627	70,905	426,129	21,163	5,037,465
Other liabilities	43,311	322,791	45,582	45,582	132,530	589,796
Total liabilities	**7,025,303**	**3,670,260**	**1,075,368**	**501,711**	**153,693**	**12,426,335**
At 31 December 2017						
Liabilities						
Due to banking institutions	340,720	1,075,418	-	-	-	1,416,138
Customer deposits	2,805,222	3,051,466	368,480	2,646	-	6,227,814
Borrowings	4,642,286	101,223	96,229	575,037	21,163	5,435,938
Other liabilities	37,229	15,742	36,484	36,484	146,207	272,146
Total liabilities	**7,825,457**	**4,243,849**	**501,193**	**614,167**	**167,370**	**13,352,036**

Notes (Cont'd)

4. Financial risk management (continued)

(b) Liquidity risk (continued)

The table below analyses the Company's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows:

Group	0 to 1 month KShs'000	1 to 3 months KShs'000	3 to 12 months KShs'000	1 to 5 years KShs'000	Over 5 years KShs'000	Total KShs'000
At 31 December 2018						
Assets						
Cash and balances with Central Bank of Kenya	119,097	-	-	-	-	119,097
Financial assets at fair value through P &L	-	-	-	-	95,865	95,865
Financial assets at amortised cost	-	-	-	1,331,944	3,202,053	4,533,997
Due from other banks	378,511	470,907	51,601	45,058	-	946,077
Loans and advances to customers	1,572,797	691,089	1,518,198	1,298,796	3,305,817	8,386,697
Financial assets at fair value through OCI	-	-	-	-	825,413	825,413
Other assets	19,810	9,905	19,810	6,251	23,654	79,430
Total assets	**2,090,215**	**1,171,901**	**1,589,609**	**2,682,049**	**7,452,802**	**14,986,576**
At 31 December 2017						
Assets						
Cash and balances with Central Bank of Kenya	351,112	-	-	-	-	351,112
Investment in government securities	-	-	205,470	933,177	3,665,646	4,804,293
Due from other banks	358,772	366,664	66,084	44,432	-	835,952
Loans and advances to customers	1,756,932	890,976	1,612,445	1,953,713	2,985,713	9,199,779
Equity investments	-	-	-	-	837,548	837,548
Other assets	14,568	6,355	12,710	12,710	6,360	52,703
Total assets	**2,481,384**	**1,263,995**	**1,896,709**	**2,944,032**	**7,495,267**	**16,081,387**

Notes (Cont'd)

4. Financial risk management (continued)

(c) Market risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

Overall authority for market risk is vested in ALCO. The Group separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios mainly are held by the Treasury Department, and include positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

The Group is primarily exposed to interest rate risk and foreign exchange risk.

(a) Interest rate risk

This is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the Group's interest rate gap position reflecting assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates is shown on the next page.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a regular basis include a 100, 50, and 25 basis point (bp) parallel fall or rise in all yield curves. An analysis of the Group's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

	2018 KShs '000	2017 KShs '000
100 Basis points upward parallel shift	(5,525)	(5,820)
50 Basis points upward parallel shift	(2,816)	(2,972)
25 Basis points upward parallel shift	(1,422)	(1,501
100 Basis points downward parallel shift	1,450	1,534
50 Basis points downward parallel shift	2,931	3,102
25 Basis points downward parallel shift	5,981	6,340

Notes (Cont'd)

4. Financial risk management (continued)

(c) Market risk (continued)

(a) Interest rate risk (continued)

The table below summarises the exposure to interest rate risks. Included in the table below are the Bank's assets and liabilities for 2018 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Group	Effective interest rates	0 to 3 month KShs'000	3 to 12 months KShs'000	1 to 5 months KShs'000	Over 5 years KShs'000	Non interest bearing KShs'000	Total KShs'000
Assets							
Cash and balances with Central Bank of Kenya	-	-	-	-	-	119,097	119,097
Financial assets at fair value through P&L	11.25	-	-	-	95,865	-	95,865
Financial assets at amortised cost	11.45	-	-	1,331,944	3,202,053	-	4,533,997
Due from banking institutions	6.44	849,418	51,601	45,058	-	-	946,077
Loans and advances to customers	12.06	2,902,867	879218	1,298,795	3,305,817	-	8,386,697
Other assets	-	-	-	-	-	79,430	79,430
Total assets		**3,752,285**	**930,819**	**2,675,797**	**6,603,735**	**198,529**	**14,161,163**
Liabilities							
Due to banking institutions	7.93	1,069,595	-	-	-	-	1,069,595
Customers' deposits	8.77	5,368,014	331,465	30,000	-	-	5,729,479
Borrowings	8.32	4,519,268	70,905	426,129	21,163	-	5,037,465
Other liabilities		-	-	-	-	589,796	589,796
Total liabilities		**10,956,877**	**402,370**	**456,129**	**21,163**	**589,796**	**12,426,335**

Notes (Cont'd)

4. Financial risk management (continued)

(c) Market risk (continued)

(a) Interest rate risk (continued)

The table below summarises the exposure to interest rate risks. Included in the table below are the Bank's assets and liabilities for 2017 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Group	Effective interest rates	0 to 3 month KShs'000	3 to 12 months KShs'000	1 to 5 months KShs'000	Over 5 years KShs'000	Non interest bearing KShs'000	Total KShs'000
Assets							
Cash and balances with Central Bank of Kenya	-	-	-	-	-	351,112	351,112
Investments in government securities	11.51	-	205,470	933,177	3,686,735	-	4,825,382
Due from banking institutions	8.17	700,289	-	44,432	-	91,231	835,952
Loans and advances to customers	12.63	2,647,908	1,612,445	1,953,713	2,985,713	-	9,199,779
Other assets		-	-	-	-	52,703	52,703
Total assets		**3,348,197**	**1,817,915**	**2,931,322**	**6,672,448**	**495,046**	**15,264,928**
Liabilities							
Due to banking institutions	1.90	1,416,138	-	-	-	-	1,416,138
Customers' deposits	8.20	4,637,646	1,361,426	226,242	-	-	6,225,314
Borrowings	8.51	4,743,509	96,229	575,037	21,163	-	5,435,938
Other liabilities		-	-	-	-	272,146	272,146
Total liabilities		**10,797,293**	**1,457,655**	**801,279**	**21,163**	**272,146**	**13,349,536**

Notes (Cont'd)

4. Financial risk management (continued)

(c) Market risk (continued)

(a) Interest rate risk (continued)

The table below summarises the exposure to interest rate risks. Included in the table below are the Bank's assets and liabilities for 2018 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Group	Effective interest rates	0 to 3 month KShs'000	3 to 12 months KShs'000	1 to 5 months KShs'000	Over 5 years KShs'000	Non interest bearing KShs'000	Total KShs'000
Assets							
Cash and balances with Central Bank of Kenya		-	-	-	-	119,097	119,097
Financial assets at fair value through P&L	11.25	-	-	-	95,865	-	95,865
Financial assets at amortised cost	11.45	-	-	1,331,944	3,180,979	-	4,512,923
Due from banking institutions	6.44	849,418	51,601	45,058	-	-	946,077
Loans and advances to customers	12.06	2,902,867	879,218	1,298,795	3,305,817	-	8,386,697
Other assets		-	-	-	-	79,432	79,432
Total assets		**3,752,285**	**930,819**	**2,675,797**	**6,582,661**	**198,529**	**14,140,091**
Liabilities							
Due to banking institutions	7.93	1,069,595	-	-	-	-	1,069,595
Customers' deposits	8.77	5,391,035	331,465	30,000	-	-	5,752,500
Borrowings	8.32	4,519,268	70,905	426,129	21,163	-	5,037,465
Other liabilities		-	-	-	-	589,205	589,205
Total liabilities		**10,979,898**	**402,370**	**456,129**	**21,163**	**589,205**	**12,448,765**

Notes (Cont'd)

4. Financial risk management (continued)

(c) Market risk (continued)

(a) Interest rate risk (continued)

The table below summarises the exposure to interest rate risks. Included in the table below are the Bank's assets and liabilities for 2017 at carrying amounts categorised by the earlier of contractual repricing or maturity dates.

Group	Effective interest rates	0 to 3 month KShs'000	3 to 12 months KShs'000	1 to 5 months KShs'000	Over 5 years KShs'000	Non interest bearing KShs'000	Total KShs'000
Assets							
Cash and balances with Central Bank of Kenya	-	-	-	-	-	351,112	351,112
Investments in government securities	11.51	-	205,470	933,177	3,665,646	-	4,804,293
Due from banking institutions	8.17	700,289	-	44,432	-	91,231	835,952
Loans and advances to customers	12.63	2,647,908	1,612,445	1,953,713	2,985,713	-	9,199,779
Other assets		-	-	-	-	52,703	52,703
Total assets		**3,348,197**	**1,817,915**	**2,931,322**	**6,651,359**	**495,046**	**15,243,839**
Liabilities							
Due to banking institutions	1.90	1,416,138	-	-	-	-	1,416,138
Customers' deposits	8.20	4,659,148	1,361,426	226,242	-	-	6,246,816
Borrowings	8.51	4,743,509	96,229	575,037	21,163	-	5,435,938
Other liabilities		-	-	-	-	271,413	271,413
Total liabilities		**10,818,795**	**1,457,655**	**801,279**	**21,163**	**271,413**	**13,370,305**

Notes (Cont'd)

4. Financial risk management (continued)

(c) Market risk (continued)

(b) Currency risk

The Group is exposed to currency risk through transactions in foreign currencies. The Group's transactional exposures give rise to foreign currency gains and losses that are recognised in profit or loss. In respect of monetary assets and liabilities in foreign currencies, the Group ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate.

The table below analyses the currencies to which the Group and the Bank are exposed at 31 December 2018:

At 31 December 2018	USD KShs'000	GBP KShs'000	Euro KShs'000	Other KShs'000	Total KShs'000
Assets					
Cash and balances with Central Bank of Kenya	21,755	820	121	103	22,799
Deposits and balances due from banking institutions	23,376	200	23,235	405	47,216
Loans and advances to customers	791,528	-	565,655	-	1,357,183
Total foreign currency assets	**836,659**	**1,020**	**589,011**	**508**	**1,427,198**
Liabilities					
Borrowings	572,661	-	-	-	572,661
Deposits and balances due to banking institutions	-	-	835,877	-	835,877
Total foreign currency liabilities	572,661	-	835,877	-	1,408,538
Foreign currency exposure at 31 December 2018	**263,998**	**1,020**	**(246,866)**	**508**	**18,660**

Notes (Cont'd)

4. Financial risk management (continued)

(c) Market risk (continued)

(b) Currency risk

The Group is exposed to currency risk through transactions in foreign currencies. The Group's transactional exposures give rise to foreign currency gains and losses that are recognised in profit or loss. In respect of monetary assets and liabilities in foreign currencies, the Group ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate.

The table below analyses the currencies to which the Group and the Bank are exposed at 31 December 2017:

At 31 December 2017	USD KShs'000	GBP KShs'000	Euro KShs'000	Other KShs'000	Total KShs'000
Assets					
Cash and balances with Central Bank of Kenya	35,618	2,184	1,200	-	39,002
Deposits and balances due from banking institutions	56,182	1,121	26,257	216	83,776
Loans and advances to customers	765,940	-	707,163	-	1,473,103
Total foreign currency assets	**857,740**	**3,305**	**734,620**	**216**	**1,595,881**
Liabilities					
Borrowings	772,489	-	-	-	772,489
Deposits and balances due to banking institutions	-	-	712,414	-	712,414
Total foreign currency liabilities	772,489	-	712,414	-	1,484,903
Foreign currency exposure at 31 December 2017	**85,251**	**3,305**	**22,206**	**216**	**110,978**

Notes (Cont'd)

4. Financial risk management (continued)

(d) Capital management

The Central Bank of Kenya sets and monitors capital requirements for the Group as a whole.

In implementing current capital requirements the Central Bank of Kenya requires the bank to maintain a prescribed ratio of total capital to total risk-weighted assets.

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

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings, translation reserve and minority interests after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

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

The Group has complied with all externally imposed capital requirements throughout the period. There have been no material changes in the Group's management of capital during the period.

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

Core capital (Tier 1)	**2018 KShs'000**	**2017 KShs'000**
Paid up share capital	1,042,500	1,042,500
Retained earnings	735,485	574,452
Other reserves	281	281
Core capital	**1,778,266**	**1,617,233**
Minimum statutory capital	1,000,000	1,000,000
Excess capital	**778,266**	**617,233**
Supplementary capital (Tier 2)	297,492	281,099
Total capital	**2,075,758**	**1,898,332**
Total risk weighted assets	**8,936,476**	**8,060,325**

Notes (Cont'd)

4. Financial risk management (continued)

(d) Capital management (continued)

Capital adequacy ratios	2018	2017
Percentage of Core Capital to Risk Weighted Asset ratio	19.9%	20.10%
Minimum requirement	10.5%	10.5%
Percentage of Total Capital to Risk Weighted Asset ratio	23.2%	23.60%
Minimum requirement	14.50%	14.50%
Percentage of Core Capital to Deposits ratio	29.7%	23.30%
Minimum requirement	8%	8%

(e) Fair value measurement

Fair value hierarchy

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

- Level 1 – fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – fair value measurements are derived from inputs other than quoted prices included 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 values measurements are derived from valuation techniques that include inputs for assets or liabilities that are not based on observable market data (unobservable inputs).

As at 31 December 2018	Level 1 KShs'000	Level 2 KShs'000	Level 3 KShs'000	Total KShs'000
Assets				
Fair value through profit or loss	-	95,865	-	95,865
Fair value through other comprehensive income	-	-	825,413	825,413
Total assets	**-**	**95,865**	**825,413**	**921,278**

As at 31 December 2017	Level 1 KShs'000	Level 2 KShs'000	Level 3 KShs'000	Total KShs'000
Assets				
Held for trading government securities	-	91,449	-	91,449
Available for sale equity investments	-	-	805,499	805,499
Total assets	**-**	**91,449**	**805,499**	**896,948**

Notes (Cont'd)

4. Financial risk management (continued)

(e) Fair value measurement (continued)

Financial instruments in level 2

The fair value of these financial assets is determined by using valuation techniques which maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. Specifically, the directors have used the discounted cash flow technique using quoted yields for the same or similar products.

5. Effective interest income

Group	2018 KShs'000	2017 KShs'000
Loans and advances to customers	419,169	517,849
Overdrafts	423,637	460,392
Financial assets at fair value through profit and loss	11,928	11,250
Financial assets at amortised cost	528,528	541,639
Deposits and balances due from banking institutions	54,978	45,595
	1,438,240	**1,576,725**
Bank		
Loans and advances to customers	419,169	517,849
Overdrafts	423,637	460,392
Financial assets at fair value through profit and loss	11,928	11,250
Financial assets at amortised cost	526,293	539,404
Deposits and balances due from banking institutions	54,978	45,595
	1,436,005	**1,574,490**

Included within interest income on investment securities for the year ended 31 December 2018 is KShs 514,778,000(2017 - KShs 541,639,000) relating to debt securities held at amortised cost (held-to-maturity for 2017).

6. Effective interest expense

Group	2018 KShs'000	2017 KShs'000
Customer deposits	538,678	562,796
Deposits and balances due to banking institutions	4,812	15,604
Borrowings	470,445	492,354
	1,013,935	**1,070,754**

Notes (Cont'd)

6. Effective interest expense (continued)

Bank	2018 KShs'000	2017 KShs'000
Customer deposits	539,238	563,354
Deposits and balances due to banking institutions	4,812	15,604
Borrowings	470,445	492,354
	1,014,495	**1,071,312**

7. Net fees and commissions income

Group and Bank	2018 KShs'000	2017 KShs'000
Commissions on loans and advances	11,102	12,579
Other fees	11,060	14,729
	22,162	**27,308**

8. Other income

Group and Bank	2018 KShs'000	2017 KShs'000
Gains arising from dealing in foreign currencies	18,289	26,491
Rental income	51,437	52,203
Other income	21,489	1,860
	91,215	**80,554**

9. Operating expenses

Group	2018 KShs'000	2017 KShs'000
Salaries and employee benefits (Note 10)	208,939	202,218
Occupancy expenses	36,647	48,615
Deposit Protection Fund	10,800	14,597
Depreciation	17,115	18,673
Amortisation of prepaid operating lease rentals	61	61
Directors' emoluments	8,298	10,019
Professional and legal services	21,913	9,651
Telecommunication	3,835	3,262
Other expenses	47,197	77,721
	354,805	**384,817**

Bank	2018 KShs'000	2017 KShs'000
Salaries and employee benefits (Note 10)	208,939	202,218
Occupancy expenses	36,647	48,615
Deposit Protection Fund	10,800	14,597
Depreciation	17,115	18,673
Amortisation of prepaid operating lease rentals	61	61
Directors' emoluments	8,198	9,919
Professional and legal services	21,913	9,651
Telecommunication	3,835	3,262
Other expenses	46,605	77,045
	354,114	**384,041**

Notes (Cont'd)

10. Salaries and employee benefits

Group and Bank	2018 KShs'000	2017 KShs'000
Salaries	163,317	158,739
Contributions to defined contribution plans	18,797	18,629
National Social Security Fund	886	893
Other staff costs	25,939	23,957
	208,939	202,218

11. Profit before taxation

Profit before taxation is arrived at after charging:

	2018 KShs'000	2017 KShs'000
Group		
Depreciation expense (Note 27)	17,115	18,673
Amortisation of prepaid operating lease rentals (Note 26)	61	61
Director's emoluments:		
– Fees as non-executive	1,300	1,500
– Other*	6,998	8,619
Auditors' remuneration	2,784	2,662

10. Bank

	2018 KShs'000	2017 KShs'000
Depreciation expense (Note 27)	17,115	18,673
Amortisation of prepaid operating lease rentals (Note 26)	61	61
Director's emoluments:		
– Fees as non-executive	1,200	1,400
– Other*	6,998	8,619
Auditors' remuneration	2,400	2,662

*Directors emoluments 'other' include sitting allowances, chairman's honorarium and director's travel expenses.

12. Income tax expense

Group	2018 Group KShs'000	2018 Company KShs'000	2017 Group KShs'000	2017 Company KShs'000
Current income tax	49,069	48,452	40,770	40,202
Deferred income tax (Note 25)	5,885	5,915	(9,002)	(8,972)
	54,954	**54,367**	**31,768**	**31,230**

Notes (Cont'd)

12. Income tax expense (continued)

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

Group	2018 KShs'000	2017 KShs'000
Accounting profit before tax	170,767	59,426
Computed tax using the applicable corporation tax rate of 30% (2017: 30%)	51,230	17,828
Tax impact of expenses not deductible for tax purposes	3,724	13,940
Income tax expense	**54,954**	**31,768**
Bank		
Accounting profit before tax	168,812	57,632
Computed tax using the applicable corporation tax rate of 30% (2017: 30%)	50,643	17,290
Tax impact of expenses not deductible for tax purposes	3,724	13,940
Income tax expense	**54,367**	**31,230**

13. Equity investment designated as FVOCI

Group and Bank		
Revaluation surplus on equity investment	22,913	-
Related income tax	(1,146)	-
	21,767	**-**

14. Dividend per share

The Bank did not pay an interim dividend in the year (2017: Nil). The company does not propose payment of a final dividend (2017: Nil).

15. Earnings per share

The calculation of basic earnings per share is based on:

Group	2018	2017
Net profit for the year attributable to shareholders (KShs '000)	115,813	27,658
Number of ordinary shares ('000)	52,125	52,125
Earnings per share (KShs)	2.22	0.53
Bank		
Net profit for the year attributable to shareholders (KShs '000)	114,445	26,402
Number of ordinary shares ('000)	52,125	52,125
Earnings per share (KShs)	2.20	0.51

There were no potentially dilutive shares outstanding at 31 December 2018 and 2017.

Notes (Cont'd)

16. Classification and measurement of financial instruments

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

Group	IAS 39		IFRS 9	
	Classification and measurement category	Carrying amount KShs '000	Classification and measurement category	Carrying amount KShs '000
Financial assets				
Cash and balances with Central Bank of Kenya	Loans and receivables	351,112	Amortised cost	351,112
Investment in government securities	Held to maturity	4,733,933	Amortised cost	4,733,933
	Fair value through profit or loss	91,449	Fair value through profit or loss	91,449
Deposits and balances due from banking institutions	Loans and receivables	835,952	Amortised cost	835,952
Loans and advances to customers	Loans and receivables	9,199,779	Amortised cost	8,898,409
Other assets	Loans and receivables	35,699	Amortised cost	35,699
Equity investments	Available for sale	805,499	Fair value through other comprehensive income (FVOCI)	805,499
Financial liabilities				
Deposits from banks	Other liabilities	1,416,138	Amortised cost	1,416,138
Deposits from customers	Other liabilities	6,227,814	Amortised cost	6,227,814
Borrowings	Other liabilities	5,435,938	Amortised cost	5,435,938

Notes (Cont'd)

16. Classification and measurement of financial instruments (Continued)

Bank	IAS 39		IFRS 9	
	Classification and measurement category	Carrying amount KShs '000	Classification and measurement category	Carrying amount KShs '000
Financial assets				
Cash and balances with Central Bank of Kenya	Loans and receivables	351,112	Amortised cost	351,112
Investment in government securities	Held to maturity	4,712,844	Amortised cost	4,712,844
	Fair value through profit or loss	91,449	Fair value through profit or loss (FVPL)	91,449
Deposits and balances due from banking institutions	Loans and receivables	835,952	Amortised cost	835,952
Loans and advances to customers	Loans and receivables	9,199,779	Amortised cost	8,898,409
Other assets	Loans and receivables	52,703	Amortised cost	52,703
Equity investments	Available for sale	805,499	Fair value through other comprehensive income (FVOCI)	805,499
Financial liabilities				
Deposits from banks	Other liabilities	1,416,138	Amortised cost	1,416,138
Deposits from customers	Other liabilities	6,249,316	Amortised cost	6,249,316
Borrowings	Other liabilities	5,435,938	Amortised cost	5,435,938

Notes (Cont'd)

16. Classification and measurement of financial instruments (Continued)

- Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

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

The following table reconciles the carrying amounts of financial assets, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

Group	IAS 39 carrying amount 31-Dec-17 Opening balance under IAS 39 KShs '000	Reclassifications KShs '000	Remeasurements KShs '000	IFRS 9 carrying amount 01-Jan-18 Closing balance under IFRS 9 KShs '000
Cash and balances with Central Bank of Kenya	351,112	-	-	351,112
Investment in government securities	4,825,382	-	-	4,825,382
Deposits and balances due from banking institutions	835,952	-	-	835,952
Loans and advances to customers	9,199,779	-	(301,370)	8,898,409
Other assets	52,703	-	-	52,703
Equity investments	805,499	-	-	805,499
Total	**16,070,427**	**-**	**(301,370)**	**15,769,057**

Notes (Cont'd)

16. Classification and measurement of financial instruments (Continued)

Bank	IAS 39 carrying amount 31-Dec-17 Opening balance under IAS 39 KShs '000	Reclassifications KShs '000	Remeasurements KShs '000	IFRS 9 carrying amount 01-Jan-18 Closing balance under IFRS 9 KShs '000
Cash and balances with Central Bank of Kenya	351,112	-	-	351,112
Investment in government securities	4,804,293	-	-	4,804,293
Deposits and balances due from banking institutions	835,952	-	-	835,952
Loans and advances to customers	9,199,779	-	(301,370)	8,898,409
Other assets	52,703	-	-	52,703
Equity investments	805,499	-	-	805,499
Total	**16,049,338**	**-**	**(301,370)**	**15,747,968**

The total re-measurement loss of KShs 301,370 million was recognised in opening reserves at 1 January 2018.

Notes (Cont'd)

16. Classification and measurement of financial instruments (Continued)

Group Measurement category	IAS 39 Loan loss allowance under IAS 39 KShs '000	Reclassifications KShs '000	Remeasurements KShs '000	IFRS 9 Loan loss allowance under IFRS 9 KShs '000
Cash and balances with Central Bank of Kenya	-	-	-	-
Investment in government securities	-	-	-	-
Deposits and balances due from banking institutions	-	-	-	-
Loans and advances to customers	1,112,906	-	290,857	1,403,763
Other assets	-	-	-	-
Letters of credit and guarantees	-	-	10,513	10,513
	1,112,906	**-**	**301,370**	**1,414,276**
Bank				
Cash and balances with Central Bank of Kenya	-	-	-	-
Investment in government securities	-	-	-	-
Deposits and balances due from banking institutions	-	-	-	-
Loans and advances to customers	1,057,181	-	290,857	1,348,038
Other assets	-	-	-	-
Letters of credit and guarantees	-	-	10,513	10,513
	1,057,181	**-**	**301,370**	**1,358,551**

Notes (Cont'd)

17. Cash and balances with Central Bank of Kenya

Group and Bank	2018 KShs'000	2017 KShs'000
Cash on hand	24,975	64,555
Balances with Central Bank of Kenya:		
– Local currency cash reserve ratio	94,122	286,557
	119,097	**351,112**

The cash reserve ratio is non-interest earning and is based on the value of deposits as adjusted for Central Bank of Kenya requirements. At 31 December 2018, the cash reserve requirement was 5.25% (2017:5.25%) of all customer deposits. These funds are available to finance the bank's day-to-day operations in a limited way provided that on any given day the balance does fall below the 3% minimum daily requirements and provided that the overall average in the month is at least 5.25%.

18. Financial assets (Investment in government securities)

	2018 KShs'000	2017 KShs'000
Group		
Financial assets at amortised cost (Held to maturity -2017)		
Treasury bonds:		
Maturing within one year	-	205,470
Maturing after one year	4,533,997	4,528,463
Total held to maturity	**4,533,997**	**4,733,933**
Financial assets at fair value through profit and Loss (Held for trading - 2017		
Treasury bonds:		
Maturing after one year	95,865	91,449
	4,629,862	**4,825,382**
Bank		
Financial Assets at amortised cost 2017 (Held to maturity -2017)		
Treasury bonds:		
Maturing within one year	-	205,470
Maturing after one year	4,512,923	4,507,374
Total held to maturity	**4,512,923**	**4,712,844**
Financial assets at fair value through profit and Loss (Held for trading - 2017)		
Treasury bonds:		
Maturing after one year	95,865	91,449
	4,608,788	**4,804,293**

The weighted average effective interest rate on government securities at 31 December 2018 was 11.35% (2017: 11.51%).

Notes (Cont'd)

19. Deposits and balances due from banking institutions

	2018 KShs'000	2017 KShs'000
Group and Bank		
Due within 90 days	849,418	725,436
Due between 3 months and 1 year	51,601	66,084
Due between 1 year and 5 year	45,058	44,432
	946,077	**835,952**

The weighted average effective interest rate on placements with other banks at 31 December 2018 was 5.81% (2017: 8.71%).

20. Loans and advances

	2017 Group KShs'000	Bank KShs'000
Overdrafts	4,973,608	4,973,608
Loans	5,040,937	4,985,212
Staff loans	298,140	298,140
	10,312,685	**10,256,960**
Less: Impairment allowances	(1,112,906)	(1,057,181)
	9,199,779	**9,199,779**
Maturing within 1 year	4,215,921	4,215,921
Between 1 and 3 years	854,116	854,116
Over 3 years	4,129,742	4,129,742
	9,199,779	**9,199,779**
	2018	
Overdrafts	4,847,279	4,847,279
Loans	4,733,720	4,677,846
Staff loans	281,740	281,740
	9,862,739	**9,806,865**
Less: ECL allowance	(1,476,042)	(1,420,168)
	8,386,697	**8,386,697**
Maturing within 1 year	3,742,280	3,742,280
Between 1 and 3 years	730,090	730,090
	8,386,697	**8,386,697**

Notes (Cont'd)

20. Loans and advances to customers (continued)

The weighted average effective interest rate on loans and advances to customers at 31 December 2018 was 12.06% (2017: 12.63%).

Impairment losses on loans and advances charged to profit or loss	2018 KShs'000	2017 KShs'000
Group		
Provisions during the year	132,290	276,176
Recovered during the year	(120,502)	(106,761)
Direct write offs	322	175
	12,110	**169,590**
Bank		
Provisions during the year	132,141	275,953
Recovered during the year	(120,502)	(106,761)
Direct write offs	322	175
	11,961	**169,367**

Impairment losses movement (2017)	Identified impairment KShs'000	Unidentified impairment KShs'000	Total KShs'000
Group			
2017			
At 1 January 2017	997,091	93,331	1,090,422
Amounts written off during the year	(146,931)	-	(146,931)
Reversals on recovery during the year	(106,761)	-	(106,761)
Made during the year	255,165	21,011	276,176
At 31 December 2017	**998,564**	**114,342**	**1,112,906**
Bank			
2017			
At 1 January 2017	941,588	93,331	1,034,919
Amounts written off during the year	(146,931)	-	(146,931)
Reversals on recovery during the year	(106,761)	-	(106,761)
Made during the year	254,943	21,011	275,954
At 31 December 2017	**942,839**	**114,342**	**1,057,181**

See Note 4(a) for movement in impairment losses for the year ended 31 December 2018.

Loans and advances include an amount of KShs 1,903,935,000 (2017: KShs 1,298,611,000) net of impairment losses which have been classified as impaired loans and advances.

Estimated value of underlying collaterals amount to KShs 2,772,464,000 (2017: KShs 1,011,204,000). The directors are of the opinion that recovery of the principal amounts thereof is not doubtful.

Notes (Cont'd)

21. Financial assets at fair value through other comprehensive income.

	2018 KShs'000	2017 KShs'000
Group and Bank		
Unquoted shares measured at fair value through other comprehensive income (2017 - AFS) – refer to note 13.		
Kenya Hotel Properties Limited		
2,258,017 ordinary shares of KShs 20 each	825,413	802,499
	825,413	**802,499**
Unquoted shares that are impaired		
Chemilil Sugar Company Limited		
150,000 ordinary shares of KShs 20 each	3,000	3,000
Pan African Paper Mills Limited		
104,000 ordinary shares at KShs 20	2,080	2,080
Kenya United Steel Company Limited		
180,000 ordinary shares of KShs 5 each	900	900
East African Sugar Industries Limited		
100,000 ordinary shares of KShs 20 each	2,000	2,000
	7,980	**7,980**
Impairment allowance	(7,980)	(4,980)
Net carrying amount of unquoted shares (impaired)	**-**	**3,000**
Net carrying amount of equity investments	**825,413**	**805,499**

22. Investment in subsidiary

Bank	2018 KShs'000	2017 KShs'000
Shares at cost:		
Small Enterprises Finance Company Limited (SEFCO)	**32,048**	**32,048**

SEFCO is a wholly owned subsidiary of the bank. The subsidiary company is incorporated in Kenya.

23. Tax recoverable/(payable)

	2018 Group KShs'000	2018 Bank KShs'000	2017 Group KShs'000	2017 Bank KShs'000
As at 1 January	(13,698)	(17,374)	15,108	11,172
Tax expense (Note 12)	(49,069)	(48,452)	(40,770)	(40,202)
Paid	63,114	62,804	11,964	11,656
	347	**(3,022)**	**(13,698)**	**(17,374)**

Notes (Cont'd)

24. Other assets

	2018 Group KShs'000	2018 Bank KShs'000	2017 Group KShs'000	2017 Bank KShs'000
Rent receivable	32,598	32,598	21,691	21,691
Uncleared effects	7,139	7,139	7,362	7,362
Prepayments	19,298	19,298	17,004	17,004
Other receivables	20,395	20,395	6,646	6,646
	79,430	**79,430**	**52,703**	**52,703**

25. Deferred income tax

Deferred income tax is calculated in full on all temporary differences under the liability method using a principal tax rate of 30% (2015: 30%). The movement on the deferred tax account is as follows:

	Group KShs'000	Bank KShs'000
2017		
At start of the year	7,374	7,313
Credited to profit or loss	9,002	8,972
	16,376	**16,285**
2018		
At start of the year	16,376	16,285
IFRS day one adjustment	106,737	106,737
Adjusted 1 January 2018	**123,113**	**123,022**
Charged to profit or loss	(5,885)	(5,915)
Charged to other comprehensive income	(1,146)	(1,146)
	116,082	**115,961**

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

Notes (Cont'd)

25. Deferred income tax (continued)

Group	At 1 January* KShs'000	(Charge)/ credit to profit or loss KShs'000	At 31 December KShs'000
2017			
Deferred income tax liabilities			
Fair value gain on equity investments	(37,967)	-	(37,967)
Deferred income tax assets			
Property and equipment	14,647	1,585	16,232
Portfolio impairment provisions on loans and advances	27,999	6,304	34,303
Other provisions	2,695	1,113	3,808
	45,341	9,002	54,343
	7,374	**9,002**	**16,376**
2018			
Deferred income tax liabilities			
Fair value gain on equity investments	(37,967)	(1,146)	(39,113)
Deferred income tax assets			
Property and equipment	16,419	1,528	17,947
Portfolio impairment provisions on loans and advances	140,853	(7,641)	133,212
Other provisions	3,808	228	4,036
	161,080	(5,885)	155,195
	123,113	**(7,031)**	**116,082**
Bank			
2017			
Deferred income tax liabilities			
Fair value gain on equity investments	(37,967)	-	(37,967)
Deferred income tax assets			
Property and equipment	14,647	1,585	16,232
Portfolio impairment provisions on loans and advances	27,999	6,304	34,303
Other provisions	2,634	1,083	3,717
	45,280	8,972	54,252
	7,313	**8,972**	**16,285**

Notes (Cont'd)

25. Deferred income tax (continued)

Bank 2018	At 1 January* KShs'000	(Charge)/ credit to profit or loss KShs'000	At 31 December KShs'000
Deferred income tax liabilities			
Fair value gain on equity investments	(37,967)	(1,146)	(39,113)
Deferred income tax assets			
Property and equipment	16,419	1,528	17,947
Portfolio impairment provisions on loans and advances	140,853	(7,641)	133,212
Other provisions	3,717	198	3,915
	160,989	(5,915)	155,074
	123,022	**(7,061)**	**115,961**

*The balance at 1 January 2018 includes the effects of initially applying IFRS 9.

26. Prepaid operating lease rentals

Group and Bank	2018 KShs'000	2017 KShs'000
Cost		
At 1 January	6,000	6,000
Transfer to non-current assets (Note 28)	(6,000)	-
	-	**6,000**
Amortisation		
At 1 January	2,188	2,127
Amortisation for the year	61	61
Transfer to non-current assets (Note 28)	(2,249)	-
At 31 December	-	2,188
Net carrying amount at 31 December	**-**	**3,812**

Notes (Cont'd)

27. Property and equipment

Group and Bank

2017	Building KShs'000	Leasehold improvements KShs'000	Furniture and equipment KShs'000	Computers KShs'000	Motor vehicles KShs'000	Capital work in progress KShs'000	Total KShs'000
Cost							
At 1 January 2017	123,425	63,038	101,143	38,383	38,034	108,601	472,624
Additions	-	2,108	334	4,908	-	650	8,000
Transfer from WIP	-	-	-	1,596	-	(1,596)	-
Disposals	-	-	-	(169)	-	-	(169)
At 31 December 2017	**123,425**	**65,146**	**101,477**	**44,718**	**38,034**	**107,655**	**480,455**
Depreciation							
At 1 January 2017	(37,059)	(47,146)	(93,354)	(34,364)	(31,516)	-	(243,439)
Charge for the year	(1,356)	(7,052)	(3,337)	(3,706)	(3,222)	-	(18,673)
Disposals	-	-	-	98	-	-	98
At 31 December 2017	(38,415)	(54,198)	(96,691)	(37,972)	(34,738)	-	262,014
Net book amount at 31 December	**85,010**	**10,948**	**4,786**	**6,746**	**3,296**	**107,655**	**218,441**

Notes (Cont'd)

27. Property and equipment (continued)

Group and Bank 2018	Building KShs'000	Leasehold improvements KShs'000	Furniture and equipment KShs'000	Computers KShs'000	Motor vehicles KShs'000	Capital work in progress KShs'000	Total KShs'000
Cost							
At 1 January 2018	123,425	65,146	101,477	44,718	38,034	107,655	480,455
Additions	-	-	1,571	2,995	-	-	4,566
Transfer to Non- current Assets	(123,425)	(4,532)	(68,501)	-	-	-	(196,458)
Disposals	-	-	-	(102)	-	-	(102)
At 31 December 2018	-	60,614	34,547	47,611	38,034	107,655	288,461
Depreciation							
At 1 January 2018	(38,415)	(54,198)	(96,691)	(37,972)	(34,738)	-	(262,014)
Charge for the year	(1,356)	(7,067)	(2,517)	(3,596)	(2,579)	-	(17,115)
Transfer to Non- current Assets	39,771	4,532	68,501	-	-	-	112,804
Disposals	-	-	-	59	-	-	59
At 31 December 2018	-	(56,733)	(30,707)	(41,509)	(37,317)	-	(166,266)
Net book amount at 31 December	**-**	**3,881**	**3,840**	**6,102**	**717**	**107,655**	**122,195**

28. Non-current assets held for sale

In November 2018, management committed to a plan to sell Finance House, a building wholly owned by the Bank. Accordingly, the asset (made up of the building, leasehold improvements, furniture and fitting amounting to KShs 83,654,000 as per note 27 and the land on which it seats on as per note 26 on prepaid operating lease rentals amounting to KShs 3,751,000) with a net book value of KShs 87,405,000 is presented as a non-current asset held for sale. The Bank closed a sale of the building at Kshs 1.2 billion to ICDC in the beginning of 2019. The bulk of the sales proceeds have been received by the Bank and the sale is expected to be completed by 31 March 2019.

Notes (Cont'd)

29. Deposits and balances due to other banks

Group and Bank

	2018 KShs'000	2017 KShs'000
Payable within 90 days	1,069,595	1,416,138
Payable between 3 months and one year	-	-
	1,069,595	**1,416,138**

The weighted average effective interest rate on deposits from other banks at 31 December 2018 was 7.93% (2017: 2.19%).

30. Deposits from customers

	2018 Group KShs'000	2018 Bank KShs'000	2017 Group KShs'000	2017 Bank KShs'000
From government and parastatals	1,322,148	1,322,148	865,661	865,661
From private sector and individuals	4,407,331	4,430,352	5,362,153	5,383,655
	5,729,479	**5,752,500**	**6,227,814**	**6,249,316**

Included in the Company customers deposits is KShs 23,021,000 (2017: KShs 21,502,000) due to the subsidiary company. Interest paid on these deposits during the year amounted to KShs 560,000 (2017: KShs 558,000).

The weighted average effective interest rate on customer deposits at 31 December 2018 was 8.77% (2017: 8.72%).

31. Borrowings

Group and Bank

	2018 KShs'000	2017 KShs'000
European Investment Bank	21,163	21,163
Central Bank of Kenya	4,443,641	4,642,286
China Development Bank	572,661	772,489
	5,037,465	**5,435,938**
Maturities		
Less than one year	4,590,173	4,839,738
Between one and five years	426,129	575,037
Over 5 years	21,163	21,163
	5,037,465	**5,435,938**

Notes (Cont'd)

31. Borrowings (continued)

The weighted average effective interest rate on loan capital at 31 December 2018 was 8.32% (2017: 8.92%).

Loan terms

- The loan from China Development Bank was disbursed in 2008 and 2009 and is to be repaid over a period of 15 years. The loan matures in 2022. The loan is payable half yearly and interest is charged at 6 months LIBOR plus margin of 0.8%.
- Borrowings from the Central Bank of Kenya comprise of short term borrowings of up to 1 month at an average interest rate of 10% p.a.

32. Other liabilities

	2018 Group KShs'000	Bank KShs'000	2017 Group KShs'000	Bank KShs'000
Bills payable	15,441	15,441	11,329	11,329
Rent deposit	18,804	18,804	18,150	18,150
Deutsche Investitions-und Entwcklungsges-ellschaftmbH (DEG) retained funds	130,543	130,543	127,965	127,965
Payable to Government of Kenya	65,281	65,281	65,281	65,281
Finance House Sale Deposit	300,000	300,000	-	-
Provisions and accruals	27,904	27,313	34,290	34,290
Other liabilities	31,823	31,823	15,130	14,398
	589,796	**589,205**	**272,145**	**271,413**

33. Share capital

	2018 KShs'000	2017 KShs'000
Authorised, issued and fully paid		
17,375,000 ordinary shares of KShs 20 each	347,500	347,500
34,750,000 ordinary shares of KShs 20 each	695,000	695,000
	1,042,500	**1,042,500**

Total number of shares in issue 52,125,000(2017: 52,125,000).

All ordinary shares rank equally with regard to the company's residual assets. The holders of ordinary shares are entitled to receive dividend as declared from time to time and are entitled to one vote per share at the general meeting of the company.

Notes (Cont'd)

34. Cash and cash equivalents

Group and Bank

	2018 KShs'000	2017 KShs'000
Cash in hand (Note 17)	24,975	64,555
Deposits and balances due from banks (Note 19)	946,077	835,952
Deposits and balances due to banks (Note 29)	(1,069,595)	(1,416,138)
	(98,543)	**(515,631)**

35. Contingencies

At any time the Group has outstanding commitments to extend credit. These commitments take the form of approved loans and overdraft facilities. At 31 December 2018, interest rates on loans and overdrafts ranged from 3.00% to 13.00% (2017:3.00% to 14.00%). The contractual amounts of commitments are set out below:

(a) Commitments to extend credit with respect to:

	2018 KShs'000	2017 KShs'000
Undrawn loans	82,768	426,690
Undrawn overdraft facilities	5,470	122,178
Unutilised guarantees and letters of credit	12,242	85,730
	100,480	**634,598**

At 31 December 2018, interest rate on facilities subject to commitments ranged from 3.00% - 13.00% (2017: 3.00% to 14.00%).

(b) Commitments with respect to outstanding off-balance items

	2018 KShs'000	2017 KShs'000
Guarantees	564,417	531,368
Acceptances	-	48,038
Letters of credit	11,600	32,142
Undelivered spots	92	92
	576,109	**611,640**

Notes (Cont'd)

35. Contingencies (Continued)

(c) Nature of contingent liabilities

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

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

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

(d) Litigations against Small Enterprises Finance Company Limited (SEFCO)

Litigations against the subsidiary company, SEFCO, arising from normal cause of business have been lodged by some customers. The likely outcome of these cases cannot be objectively determined as at the date of signing of these financial statements. However, the Directors do not anticipate that any liability will arise from these suits.

36. Operating leases

The Company leases out part of its building under operating leases. The operating lease rentals receivable are as follows:

	2018* KShs'000	2017 KShs'000
Less than one year	-	35,395
Between one and five years	-	120,607
Over five years	-	18,506
	-	**174,508**

*Finance house, the main source of rental income was in the process of being sold. All lease agreements to be transferred to the buyer of the property at the start of 2019.

37. Related party transactions

(a) Loans and advances to employees

	2018 KShs'000	2017 KShs'000
At 1 January	98,140	282,461
Advances in the year	62,447	114,279
Repayments in the year	(78,847)	(98,600)
At 31 December	**281,740**	**298,140**

Interest earned on staff loans during the year amounted to KShs 17,669,749 (2017: KShs 18,235,851).

Notes (Cont'd)

38. Related party transactions

(b) Loans and advances to directors and their associates

The Group has entered into transactions with its directors and their associates as follows:

	2018 KShs'000	2017 KShs'000
Gross amount at 1 January	654,212	783,661
Interest charged	6,363	38,061
Loans disbursed	46,675	19,971
Write offs	-	(63,203)
Cash received	-	(124,278)
Net amount at 31 December	**707,250**	**654,212**

(c) Related party deposits

Included in deposits is KShs 23,021,000(2017: KShs 21,502,000) due to a subsidiary company. Interest paid on these deposits during the year amounted to KShs 560,000 (2017: KShs 558,000).

(d) Key management compensation

Compensation to senior management for the year ended 31 December 2018 amounted to KShs 66,277,812 (2017: KShs 65,024,769).

(e) Directors remuneration

	2018 KShs'000	2017 KShs'000
Fees for services as a director	1,200	1,400
Other emoluments	7,098	8,619
	8,298	**10,019**

39. Financial assets that may be repledged or resold by counterparties

As at 31 December 2018, Government securities amounting to KShs million 4,456.0 (2017: KShs 4,714.9 million) were pledged as security against the facility from the Central Bank of Kenya. These transactions are conducted under terms that are usual and customary to standard lending, and securities borrowing and lending activities.

Notes (Cont'd)

40. Reserves

(a) Statutory reserves

The statutory reserve represents an appropriation from retained earnings to comply with Central Bank of Kenya's prudential guidelines on impairment of loans and advances. It represents the excess loan provisions as computed in accordance with Central Bank of Kenya's prudential guidelines over the impairment arrived at in accordance with International Financial Reporting Standards.

(b) Other reserves

Other reserves comprise of:

(i) KShs 280,000 of interest reserve established under a lending agreement between the bank and Industrial & Commercial Development Corporation (ICDC). Under the agreement, part of the interest payable on the loan capital balance was retained as interest reserve and is available for furtherance of the bank's business. The interest reserve is not available for distribution.

(ii) KShs 744,292,292 revaluation reserves on the equity investment in Kenya Hotel properties net of related tax.

NOTES