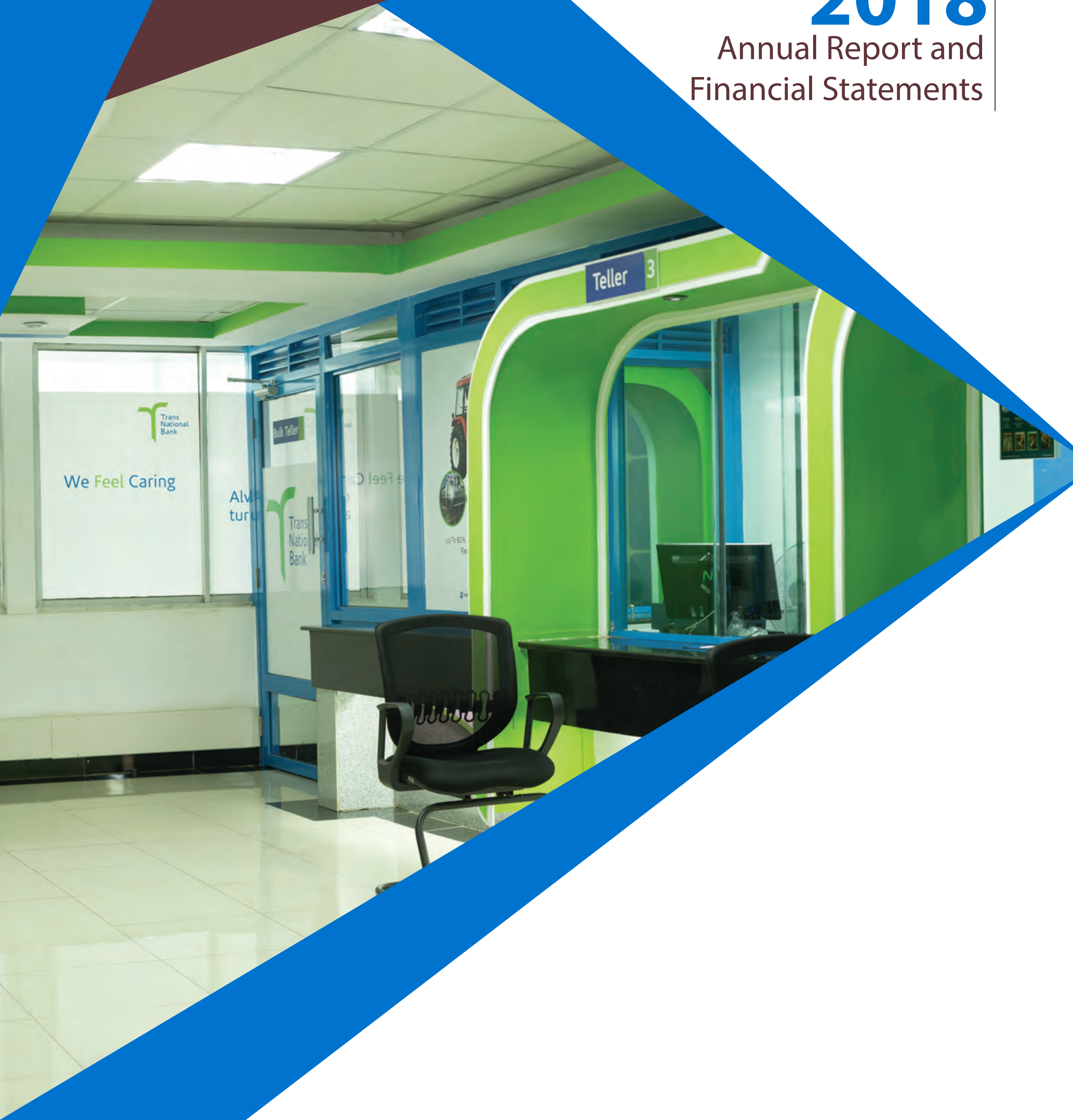
2018
Annual Report and Financial Statements



Trans National Bank

Our Vision

An enterprising people

Our Mission

Always seeking to turn opportunities into successes

Our Values

Think: Community

We have a stake in the development of the communities we work with. Community starts with our colleagues, to our customers, to the wider society. We put the good of the community first in everything we do.

Behave: Collaboration

We believe in finding ways to ensure mutually rewarding collaboration with our customers. We go beyond providing what customers need, to anticipating what they imagine and working together with them to ensure success.

Feel: Caring

We work with a human face, a human character and we do this in a truly caring manner, ensuring that we seek to serve the customer's interests with a human touch.

Our Personality

Tenacious

Tenacity allows us to be unrelenting and single minded as we strive to reap rewards from the ventures we get into with our clients

Youthful

Youthfulness is the spirit that drives us to tread where others fear to, to remain fresh, flexible and always adventurous

Warm

Warmth makes us approachable, easy to work with and great partners for those seeking to realize their wildest dreams

Our Growth

	No of Employees	No of Customers	Branches
2012	108	36,000	16
2018	241	97,000	28

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DIRECTORS	Prof. Henry Kiplangat Mr. Peter Kemei Mr. John Kenduiwo Mr. Andre DeSimone* Prof. Daniel Rotich Mr. Sammy Lang'at * American	**Chairman** Retired on 3rd December, 2018
CHIEF EXECUTIVE OFFICER	Mr. Sammy Lang'at	
AUDIT COMMITTEE	Mr. Peter Kemei Mr. John Kenduiwo Prof. Daniel Rotich	**Chairman**
CREDIT COMMITTEE	Prof. Daniel Rotich Mr. Andre DeSimone Mr. John Kenduiwo Mr. Sammy Lang'at Mr. Wilson Ruto	**Chairman**
STRATEGY AND FINANCE COMMITTEE	Mr. Andre DeSimone Mr. John Kenduiwo Mr. Peter Kemei Mr. Sammy Lang'at Mr. Laban Molonko	**Chairman**
RISK AND COMPLIANCE COMMITTEE	Mr. Peter Kemei Mr. Andre DeSimone Prof. Daniel Rotich Ms. Jacqueline Onsando Mr. Sammy Langa't	**Chairman**
HUMAN RESOURCES, NOMINATION AND RENUMENERATION COMMITTEE (HRNRC)	Mr. John Kenduiwo Mr. Sammy Lang'at Ms. Jacqueline Onsando Prof. Henry Kiplangat Prof. Daniel Rotich Ms. Emmy Kiptugen	**Chairman**
ASSETS AND LIABILITY MANAGEMENT COMMITTEE (ALCO)	Mr. Sammy Lang'at Mr. Justus Kittony Mr. Laban Molonko Mr. Wilson Ruto Ms. Faith Mutwiri Mr. Joseph Seii	**Chairman**

SECRETARY

Irene Jebet Kipkorir
Certified Public Secretary (Kenya)
P.O. Box 75840 - 00200
Nairobi

Jacqueline Onsando*
Certified Public Secretary (Kenya)
P.O. Box 72133 - 00200
Nairobi

*Retired on 31st August 2018

REGISTERED OFFICE

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P O Box 75840 - 00200,
Nairobi.

AUDITORS

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Kenya-Re Towers, Upper-hill
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P.O. Box 44286 – 00100,
Nairobi

ADVOCATES

Cheptumo & Company Advocates
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Ochieng Onyango Kibet & Ohaga Advocates
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Mukite Musangi & Co Advocates
P.O. Box 149 - 20100
Nairobi

Chairman's Statement

I am pleased, on behalf of the Board of Directors to present Transnational Bank PLC Annual Report and financial statements for the year ended 31st December, 2018.

2018 OPERATING ENVIRONMENT

Kenya's economy grew by 5.7% in 2018 compared to 4.9% recorded in 2017. This growth was supported by improved weather conditions which led to increased agricultural production, growth in Micro Small and Medium Enterprises (MSMEs), public investment in infrastructure, increased growth in digital economy and a strong performance in the tourism sector.

Overall inflation dropped to 4.7% from 8.0% in December 2017 which was within annual government target range of 2.5% and 7.5%. The decline in inflation is on account of lower food prices following favourable weather conditions and limited demand-driven inflationary pressures. Food inflation went down from 4.9% in 2017 to 2.6% in December 2018.

The foreign exchange market remained stable supported by strong growth in diaspora remittances and tourism receipts supported by decline in international oil prices.

DEVELOPMENT IN THE BANKING SECTOR

Kenya's banking sector aggregate total assets increased by 9.2 percent from Kshs. 4.03 trillion in December 2017 to Kshs. 4.40 trillion in December 2018. Gross loans and advances were at Kshs. 2.57 trillion up from Kshs. 2.45 trillion registered in 2017 (4.9 percent growth) while non performing portfolio rose from Kshs. 259.2 billion to Kshs. 308.8 billion (19.13 percent growth). Deposit grew by 12.88 percent from Kshs. 2.95 trillion to Kshs. 3.33 trillion.

Profit before tax for the sector for the period ended 31st December, 2018 was Kshs. 152.3 billion, compared with prior year profit of Kshs 135.5 billion.

BANK'S PERFORMANCE

The Bank's total balance sheet was at Kshs. 10.24 billion, same as 2018. This was on account of lower growth in customer deposits and customer loans and advances. Customer deposits rose by 1.5% from Kshs. 7.91 billion to Kshs. 8.02 billion while loans and advances grew by 0.5% to Kshs. 6.63 billion from Kshs. 6.60 billion recorded in 2017.

Non-performing Loans went up from Kshs. 1.17 billion to Kshs. 1.85 billion in 2018 associated with lower performance in the real estate sector. The Bank's pre-tax profit was at a loss of Kshs. 98.5 million compared to profit of Kshs. 53.7 million in 2017.

Reflecting on this performance, the Board of Directors do not recommend payment of a final dividend for the year. In 2018, the Bank paid out Kshs. 30 million as interim dividends.

FUTURE OUTLOOK

Kenya's economic growth is projected to grow by 5.7% in 2019 compared to 5.8% in 2018. The decline is associated with prolonged drought experienced in most parts of the country which is expected to affect the agricultural sector. It is however expected that it will rebound to 5.9% in 2020 boosted by the ongoing investments in the government's development agenda and improved business sentiment.

As a Board, we are committed to our oversight role. We will continue to work closely with management and staff of the Bank to serve our customers' needs aimed at growing shareholders value. The various Board and Management Committees will remain active with specific responsibilities that ensure they effectively carry out their monitoring roles to ensure regulatory compliance as well as the Bank's profitability.

APPRECIATION

Finally, I take this opportunity to extend my sincere appreciation to our esteemed customers and partners for their continued support and the confidence they have demonstrated to us over the years. I also wish to thank my fellow Board Members, Management and Staff of the Bank for their efforts in working for the continued success of the Bank.

Thank you

Prof. Henry Kiplangat
Chairman Board of Directors

Transnational Bank PLC (the "Bank") is fully committed to the principles of transparency, integrity and accountability. The Directors of the Bank are ultimately accountable to all stakeholders for ensuring that the Bank's business is conducted in accordance with high standards of corporate governance. Of particular importance to the Bank is the observance of shareholders' interest, efficient practices and open corporate communication systems.

1. BOARD OF DIRECTORS

The names of the directors who held office at the date of this report are set out on page 1.

The Board is responsible for formulating the Bank's policies and strategies and ensuring that business objectives, aimed at promoting and protecting shareholder value, are achieved. The Board also retains the overall responsibility for effective control of the Bank and implements corporate governance policies of the Bank.

The Board comprises five non-executive directors and one executive director. The directors have diverse skills and are drawn from various sectors of the economy. The Chairmen of the Board and the Board committees, respectively, are non-executive directors.

A timetable of calendar dates for Board meetings to be held in the following year is fixed in advance by the Board. The notice of Board meetings is given in advance in accordance with the Bank's Articles of Association and is distributed together with the agenda and board papers to all the directors beforehand. The Board meets regularly and at least seven times annually. In accordance with the Bank's practice, one Board meeting is normally scheduled to coincide with the occasion of the Annual General Meeting.

The Bank's Secretary is always available to the Board of Directors.

(a) Directors' Emoluments and Loans

The aggregate amount of emoluments paid to directors for services rendered during the financial year is disclosed in Note 32(e) to the financial statements for the year ended 31 December 2018. The Bank advances loans to companies related through shareholding, common directorship and companies controlled by directors or their families as disclosed in Notes 32 (d).

(b) Related Party Transactions

There have been no related party transactions, pecuniary transactions or relationships between the Bank and its directors or management, except those disclosed in Note 32 to the financial statements for the year ended 31 December 2018.

2. BOARD COMMITTEES

The Board has in place six main committees, namely the Risk and Compliance, Credit, Audit, Nomination and Remuneration, Asset and Liability Committee and Strategy and Finance. These committees assist the Board in ensuring that proper policies, strategies, internal controls, and organizational structures are in place to achieve the Bank's objectives and obligations to its stakeholders.

All the committees have detailed terms of reference and hold meetings as necessary. The Board may delegate some of its powers to any committee and may appoint any other committee, including ad hoc task forces, as and when it is deemed necessary.

(a) Risk and Compliance Committee

The committee is chaired by a non-executive director and meets quarterly. It is responsible for overseeing the implementation of the Bank's risk management framework and policies to ensure that all current and potential significant risks are identified and effectively managed. The committee considers both internal and external sources of information regarding risk to keep abreast with new developments and their potential impact on the Bank's business. The committee receives periodic reports from the risk and compliance function relating to the Bank's strategic risk, credit risk, market risk (interest rate risk, price risk and foreign exchange risk), operational risk, regulatory risk, reputational risk and liquidity risk.

(b) Credit Committee

The committee is chaired by a non-executive director and meets at least once per quarter to review the overall lending policy. It also meets at least once in a month to consider and approve loan applications beyond the credit management approval limits, to review and consider all issues that may materially impact on the present and future quality of the institution's credit management and ensuring that the credit policy and risk lending limits of the Bank are reviewed where appropriate. Periodically, it reviews the credit policy of the Bank.

(c) Nomination and Remuneration Committee

The committee is responsible for providing policy guidelines on Human Resources (HR) practices of recruitment, training, remuneration and compensation, disciplinary actions and manpower quality across the Bank, review system of performance management, job grading, skills gaps, principles of rationalising etc. The committee is responsible for study of productivity levels across the Bank and addressing anomaly in staff productivity. The committee assists the Board in providing efficient, productive and quality organisation structures for the Bank. The committee is responsible for approval of candidates for appointment to the Board. The committee also reviews and approves recommendations from the Bank's management for appointment of the Bank's senior managers.

(d) Audit Committee

The Audit Committee is chaired by a non-executive director. All the other members are non-executive directors, in addition to the Internal Audit Manager. The Committee meets on a quarterly basis and is responsible for ensuring that the systems, procedures and policies of the Bank are properly established, monitored and reported on. The Committee receives reports from both external and internal auditors, and also monitors implementation of audit recommendations, on behalf of the Board. The Audit committee is also responsible for monitoring and providing effective supervision of the management's financial reporting process to ensure accurate and timely financial reporting. Additionally, the Committee is responsible for ensuring entrenchment of good corporate governance practices in the Bank.

(e) Strategy and Finance Committee

The committee comprises three directors, the Chief Executive Officer and the Head of Finance. The Strategy and Finance Committee's roles and responsibilities include an analysis of the Bank's strategy and, more specifically, oversight of the implementation of the strategy approved by the Board and review of progress on a regular basis, design of action plans per business unit to ensure that objectives are met while factoring in organisational, human, technical and financial aspects, analysis of any investment/capital expenditure programme prior to its submission to the Board. The Committee meets on a quarterly basis.

(f) Asset and Liability Committee (ALCO)

The Investment/Asset and Liability Committee of the Bank is responsible for recommending to the Board of Directors investment policies and procedures/guidelines and to supervise investment activity, while striving to maximize portfolio performance and to keep the management of the portfolio within the bounds of good banking and satisfy the liquidity and legal requirements of the bank. The committee comprises the Chief Executive Officer, General Manager Business Support, General Manager Credit, General Manager Business, Head of Risk and Compliance, and Head of Treasury. ALCO meets monthly if not on a more frequent basis.

3. RISK MANAGEMENT AND INTERNAL CONTROL

Management, in consultation with the Board Committees, is responsible for the Bank's day-to-day overall risk management to minimize potential adverse effects on its financial performance while the Board is responsible for the Bank's system of internal control and for reviewing its effectiveness. The Bank has an on-going process of identifying, evaluating and managing significant risks inherent in its business, through the Risk Management department. This process is also reviewed by the Internal Auditor. The Bank has in place a chain of controls which include, but are not limited to, an annual strategic planning and budgeting process, a regular review of strategic initiatives, a well-defined organizational structure, which is kept under regular review by the Board, clearly laid down authority levels, and a review of quarterly financial and operating information by Management and the Board.

4. BUSINESS ETHICS

The Bank conducts its business in compliance with high ethical standards of business practice. In this respect, transactions with its clients, intermediaries, insiders, employees and other stakeholders are conducted at arm's length, with integrity and transparency. The business is conducted with high levels of transparency and accountability.

5. RESPONSIBILITY FOR STAFF WELFARE AND TRAINING

As part of its policy, the Bank recognizes the need for diversity, equal opportunities, gender sensitivity and provision of a safe and conducive work environment for all its staff. The Bank assists its staff to undertake continuous professional and development training programmes to fulfil their potential. This process is appropriately managed to align staff development with the Bank's strategic and business goals and objectives, and is reinforced with appropriate remuneration and incentive systems.

6. SHAREHOLDERS

The list of shareholders and their individual holdings as at 31 December 2018 was as follows:

	No. of Shares	%
Archers and Wilcock Limited	47,492,155	23.75
Sovereign Trust Limited	46,056,845	23.03
Duggan Limited	31,069,078	15.53
Pyramid Trustee Limited	30,237,545	15.12
November Nominees Limited	14,552,857	7.28
Simbi Investors	8,217,059	4.11
Losupuk Limited	5,579,844	2.79
Kenyerere Limited	4,291,381	2.15
Lohan Investments Limited	2,899,916	1.45
Others	9,603,320	4.8
TOTAL	**200,000,000**	**100.00**

7. BOARD PERFORMANCE EVALUATION

The Chairman conducts evaluations of the performance of the Board, individual directors and Board Committee's annually. In addition, the Board and its Committees undertake an annual evaluation of their performance and report their findings and any resulting recommendations to the Board. The Board also undertakes an evaluation of the performance of the Chairman. The Board discusses the results of its evaluations and uses the process to constructively improve the effectiveness of the Board. The results of this evaluation are submitted to Central Bank of Kenya as required under the Prudential Guidelines for institutions licensed under the Banking Act.

8. BOARD AND COMMITTEE MEETINGS ATTENDANCE

(a) Board Meetings

During the year under review, the Board held seven meetings excluding the working committee meetings. The Board members attendance for 2018 was as follows;

Name	Number of attendance	Percentage attendance
Prof. Henry Kiplangat	7	100
Mr. Peter Kemei	6	86
Mr. John Kenduiwo	7	100
Prof. Daniel Rotich	7	100
Mr. Andre DeSimone	4	57
Ms. Jacqueline Onsando	3	43
Mr. Sammy Lang'at	7	100

(b) Committee Meetings

(i) Audit Committee Meetings

Name	Number of attendance	Percentage attendance
Mr. Peter Kemei	5	100
Mr. John Kenduiwo	5	100
Prof. Daniel Rotich	5	100
Mr. Christopher Lochuria	5	100

(ii) Risk and Compliance Committee Meetings

Name	Number of attendance	Percentage attendance
Mr. Andre DeSimone	2	67
Mr. Peter Kemei	3	100
Prof. Daniel Rotich	3	100
Ms. Jacqueline Onsando	2	67
Mr. Sammy Lang'at	3	100
Ms. Carol Odongo	3	100

(iii) Credit Committee Meetings

Name	Number of attendance	Percentage attendance
Prof. Daniel Rotich	6	100
Mr. Andre DeSimone	4	67
Mr. Sammy Lang'at	6	100
Mr. Wilson Ruto	6	100

(iv) Strategy and Finance Committee Meetings

Name	Number of attendance	Percentage attendance
Mr. Andre DeSimone	3	75
Mr. Peter Kemei	4	100
Mr. John Kenduiwo	4	100
Mr. Sammy Lang'at	4	100
Mr. Laban Molonko	4	100

(v) Nomination and Remuneration Committee Meetings

Name	Number of attendance	Percentage attendance
Prof. Henry Kiplangat	4	80
Mr. John Kenduiwo	5	100
Prof. Daniel Rotich	5	100
Ms. Jacqueline Onsando	4	80
Mr. Sammy Lang'at	5	100
Ms. Emmy Kiptugen	5	100

(vi) Assets and Liability committee meetings

Name	Number of attendance	Percentage attendance
Mr. Sammy Lang'at	7	60
Mr. Laban Molonko	9	75
Mr. Justus Kittony	9	75
Mr. Wilson Ruto	11	95
Ms. Carol Odongo	8	70
Mr. Joseph Seii	7	60
Ms. Faith Mutwiri	12	100

9. DIRECTORS' EXTERNAL ACTIVITIES AND CONFLICTS OF INTEREST

Directors have a statutory duty to avoid situations in which they have or may have interests that conflict with those of the Bank.

Business transactions with the directors or their related parties are disclosed in Note 32.

10. COMPLIANCE

The Bank operates within the requirements of the Banking Act, among other Acts, and adopts certain universally accepted principles in the areas of human rights and labour standards in its commitment to best practice. Additionally, the Bank prepares its financial statements in accordance with International Financial Reporting Standards (IFRS) and the requirements of the Kenyan Companies Act, 2015.

....	....
Director	Director

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

Incorporation

The company is domiciled in Kenya where it is incorporated as a private company limited by shares under the Kenyan Companies Act, 2015. The address of the registered office is set out on page 1.

Directorate

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

Principal activities

The principal activities of the Bank are the provision of banking, financial and related services.

Recommended dividend

The directors do not recommend the payment of a dividend (2017: KShs 30 million).

Business review

The banking environment 2018 remained challenging, with impact of interest capping being registered for the second year running. The Bank adopted and implemented IFRS 9 on impairment of assets. Whilst the Bank has adopted the new Standard, the bank has continued to enhance its credit standards and customer requirements.

The bank's products and service offerings has enabled businesses thrive, trade to grow and protect customers' wealth for the future. This is in line with the Bank's vision where the bank see enterprising people as it continuously seek to turn opportunities into successes.

The bank continues to embrace digital banking in line with ever changing customers' needs and market demands. The bank revamped it's digital offering to provide value added services to its esteemed customers. Through revamped online banking, the bank's customers can now access their account from anywhere in the world through the internet once they sign up. The bank's mobile application now enables customers with smart phones to conduct all the banking wherever they are.

Over the period, the bank experienced significant growth in Agribusiness. Provision of tailor made products and services in line with Agribusiness value chain financing culminated in the bank being awarded the best bank in Agriculture and livestock financing in Kenya, 1st runners up (Think Business 2018).

The Bank shall continue to recognize its social responsibility. The bank's aim is to achieve sustainable growth and create added value for its customers, employees, investors and local communities surrounding its location. We believe in finding ways to ensure mutually rewarding collaboration with our customers.

Management is committed to developing its human capital. The staff will play a major role in delivering real value which will be achieved through training on branch operations, service delivery, risk management and products. There is a continuing need to bolster the middle management so that their skill is set ready to be deployed in branches as well as people who can be promoted and moved up to senior management as part of succession planning.

As for senior management, the Bank will continue to provide senior level strategic leadership training programs, which will help in team building as well as succession planning.

In line with banking business, the Bank is faced with a number of risks and challenges. Accordingly, the Bank has identified and taken full responsibility of these risks and uncertainties as detailed on Note 3, Risk Management Objectives and Policies of the Financial Report

Statement as to disclosure to the company's auditor

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

a) there is, so far as the person is aware, no relevant audit information of which the company's auditor is unaware; and,

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

Terms of appointment of the auditor

Ernst & Young LLP continues in office in accordance with the company's Articles of Association and Section 719 of the Companies Act, 2015. The directors monitor the effectiveness, objectivity and independence of the auditor. The directors also approve the annual audit engagement contract which sets out the terms of the auditor's appointment and the related fees. The agreed auditor's remuneration of KShs 6 million has been charged to profit or loss in the year.

By order of the Board

....
Director/Company Secretary

Nairobi 28th March, 2019

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the company as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the company keeps proper accounting records that: (a) show and explain the transactions of the company; (b) disclose, with reasonable accuracy, the financial position of the company; and (c) enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Companies Act, 2015.

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

(i) designing, implementing and maintaining such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;

(ii) selecting suitable accounting policies and applying them consistently; and

(iii) making accounting estimates and judgements that are reasonable in the circumstances.

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

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

Approved by the board of directors on 13th March, 2019 and signed on its behalf by:

....	....
Director	Cheif Executive Officer

....

Director

Opinion

We have audited the accompanying financial statements of Transnational Bank PLC set out on pages 13 to 85 which comprise the statement of financial position as at 31 December 2018, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Transnational Bank PLC 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 the requirements of the Kenyan Companies Act, 2015.

Basis for Opinion

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

Other Information

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

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

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

Responsibilities of the Directors for the Financial Statements

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

The directors are responsible for overseeing the Company’s financial reporting processes.

Auditor’s Responsibilities for the Audit of the Financial Statements

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

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

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

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

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

In our opinion, the information given in the report of the directors on page 8 and 9 is consistent with the financial statements.

The engagement partner responsible for the audit resulting in this independent auditor's report is CPA
Herbert Wasike Practicing Certificate No. 1485.

Nairobi, Kenya

29th March 2019

Statement of Profit or Loss and other Comprehensive Income for the year Ended 31 December 2018

	Notes	2018 KShs'000	2017 KShs'000
Interest income	5	1,011,239	1,122,276
Interest expense	6	(443,102)	(435,393)
NET INTEREST INCOME		568,137	686,883
Fees and commission income	7	241,198	231,634
Other income	8	23,945	53,529
OPERATING INCOME		833,280	972,046
Other operating expenses	9	(868,352)	(837,814)
Credit loss expense on financial assets	11	(63,391)	(80,248)
OPERATING EXPENSES		(931,743)	(918,062)
(LOSS)/PROFIT BEFORE TAXATION		(98,463)	53,984
TAXATION CREDIT/ (CHARGE)	12(a)	26,622	(17,551)
(LOSS)/PROFIT FOR THE YEAR		(71,841)	36,433
OTHER COMPREHENSIVE INCOME, NET OF TAX		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		(71,841)	36,433
EARNINGS PER SHARE			
Basic and diluted earnings per share (KShs)	13	(0.36)	0.18

	Notes	2018 KShs'000	2017 KShs'000
ASSETS			
Cash and balances with Central Bank of Kenya	14	1,108,907	944,256
Deposits and balances due from banking institutions	15	211,348	480,749
Derivatives	16	1,110	215
Loans and advances to customers	17	6,625,522	6,604,120
Government securities at amortised cost	18	1,614,217	-
Government securities-held to maturity	18	-	1,630,439
Tax recoverable	12(c)	28,985	6,131
Other assets	19	287,927	236,100
Property and equipment	20	133,857	178,257
Intangible assets	21	53,043	38,370
Deferred tax asset	22	170,608	122,731
TOTAL ASSETS		10,235,524	10,241,368
LIABILITIES			
Due to banking institutions	23	63,990	51,625
Customer deposits	24	8,018,770	7,898,496
Other liabilities	25	224,178	212,895
TOTAL LIABILITIES		8,306,938	8,163,016
EQUITY			
Share capital	26	1,000,000	1,000,000
Share premium	27	42,236	42,236
Retained earnings		732,593	914,342
Statutory reserve	28	153,757	121,774
TOTAL EQUITY		**1,928,586**	**2,078,352**
TOTAL EQUITY AND LIABILITIES		10,235,524	10,241,368

The financial statements were approved and authorised for issue by the board of directors on 28th March, 2019 and were signed on its behalf by:

Prof. Henry Kiplangat

Director

Sammy Lang'at

Chief Executive Officer

Mr. John Kenduiwo

Director

Irene Jebet Kipkorir

Company Secretary

Statement of Changes in Equity
for the year Ended 31 December 2018

	Note	Share Capital Sh'000	Share premium Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Total Sh'000
At 1 January 2017		1,000,000	42,236	934,832	104,851	2,081,919
Transfer to statutory reserve	28	-	-	(16,923)	16,923	-
2016 dividends declared	30	-	-	(40,000)	-	(40,000)
Total comprehensive income for the year		-	-	36,433	-	36,433
At 31 December 2017		1,000,000	42,236	914,342	121,774	2,078,352
Balance at 1 January 2018		1,000,000	42,236	914,342	121,774	2,078,352
Impact of adopting IFRS 9 **	2(c)	-	-	(47,925)	-	(47,925)
Restated opening balance under IFRS 9		1,000,000	42,236	866,417	121,774	2,030,427
Transfer to statutory reserve	28	-	-	(31,983)	31,983	-
2017 dividends declared	30	-	-	(30,000)	-	(30,000)
Total comprehensive income for the year		-	-	(71,841)	-	(71,841)
At 31 December 2018		1,000,000	42,236	732,593	153,757	1,928,586

* Statutory reserve relates to extra provisions made in regard to non-performing loans in compliance with the Central Bank of Kenya Prudential Guidelines and is not distributable.

** The Bank applied IFRS 9 prospectively, with an initial application date of 1 January 2018. The bank has not restated the comparative information, which continues to be reported under IAS 39. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings and are disclosed in Note 2(c).

	Notes	2018 Sh'000	2017 Sh'000
Cash flows from operating activities			
Cash flows (used in)/ generated from operating activities	29(a)	(12,902)	125,540
Tax paid	12(c)	(23,570)	(18,591)
Net cash (used in) / generated from operating activities		(36,472)	106,949
INVESTING ACTIVITIES			
Purchase of equipment	20	(12,816)	(67,201)
Purchase of intangible assets	21	(51,242)	(12,768)
Maturity of government securities		216,602	208,332
Purchase of government securities		(210,254)	-
Proceeds from disposal of equipment		-	310
Net cash (used in) / generated from investing activities		(57,710)	128,673
FINANCING ACTIVITIES			
Dividends paid	30(a)	(30,000)	(40,000)
Net cash used in financing activities		(30,000)	(40,000)
Net movement in cash and cash equivalents		(124,182)	195,622
Cash and cash equivalents at the beginning of the year		959,462	763,840
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**29(b)**	**835,280**	**959,462**

1. GENERAL INFORMATION

Transnational Bank PLC (the "Bank") provides commercial banking services. The bank is incorporated in Kenya under the Kenyan Companies Act, 2015, licensed under the Kenyan Banking Act, (chapter 488) and is domiciled in Kenya.

2. ACCOUNTING POLICIES

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

(a) Basis of preparation

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

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

(b) Changes in accounting policies and disclosures

New and amended standards and interpretations

The Bank applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2018. The Bank has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The following new standards and amendments became effective as of 1 January 2018:
- IFRS 9 Financial Instruments
- IFRS 15 Revenue from Contracts with Customers
- Clarifications to IFRS 15 Revenue from Contracts with Customers
- IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration
- Amendments to IAS 40 Transfers of Investment Property
- Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions
- Amendments to IFRS 4 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts
- Amendments to IAS 28 Investments in Associates and Joint Ventures – Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice
- Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards – Deletion of short-term exemptions for first-time adopters.

However, in these financial statements, the Bank has applied IFRS 9, IFRS 15 and IFRS 7R, effective for annual periods beginning on or after 1 January 2018, for the first time. The other standards, amendments and interpretations had no material impact on the financial statements. The nature and impact of new standard or amendments is described below:

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

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

Changes to classification and measurement

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics .The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:

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

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

The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 2 (c).

Changes to the impairment calculation

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

The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 2(c).

IFRS 7R

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the Bank has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in Note 2(c).

Reconciliations from opening to closing ECL allowances are presented in Notes 15,17,18 and 31(f). IFRS 7R also requires additional and more detailed disclosures for hedge accounting even for entities opting to continue to apply the hedge accounting requirements of IAS 39.

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are listed below. The bank intends to adopt these standards, if applicable, when they become effective:

Effective for annual periods beginning on or after 1 January 2019

- IFRS 16 Leases
- IFRIC Interpretation 23 Uncertainty over Income Tax Treatments
- Prepayment Features with Negative Compensation – Amendments to IFRS 9
- Long-term Interests in Associates and Joint Ventures – Amendments to IAS 28
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement
- AIP IFRS 3 Business Combinations – Previously held Interests in a joint operation
- AIP IFRS 11 Joint Arrangements – Previously held Interests in a joint operation
- AIP IAS 12 Income Taxes – Income tax consequences of payments on financial instruments classified as equity
- AIP IAS 23 Borrowing Costs – Borrowing costs eligible for capitalization

Effective for annual periods beginning on or after 1 January 2020

- Conceptual Framework for Financial Reporting to replace its 2010 conceptual framework. For the IASB, the revised conceptual framework has been in effect since its publication date. Early application is permitted.
- Definition of Material – Amendments to IAS 1 and IAS 8
- Definition of a Business – Amendments to IFRS 3

Effective for annual periods beginning on or after 1 January 2021

- IFRS 17 Insurance Contracts
- Amendments to IFRS 10 and IAS 28 - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture - Effective date postponed indefinitely

The nature and the effect of the standards issued but not yet effective, which the Bank reasonably expects to be applicable at a future date, are described below.

IFRS 16, 'Leases'

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Bank plans to adopt IFRS 16 using modified retrospective approach on 01 January 2019. The Bank will elect the practical expedient on determining the discount rate at portfolio approach.

During 2018, the Bank has performed an impact assessment of IFRS 16. In summary, the impact of IFRS 16 adoption is expected to be, as follows:

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

	KShs'000'	KShs'000'
Assets		
Right to use ("ROU") asset	-	112,995
Liabilities		
Current Lease Liabilities	78,880	
Long term Lease Liabilities	62,308	(141,188)
Net impact on equity		(28,193)

On adoption of IFRS 16 on 1 January 2019, the Bank's retained earnings will reduce. This is due to the change in the accounting for expenses of leases that were classified as operating leases under IAS 17.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Bank.

(c) (i) Impact of adopting IFRS 9

The following pages set out the impact of adopting IFRS 9 on the statement of financial position (retained earnings) including the effect of replacing IAS 39's incurred credit loss calculations with IFRS 9's ECLs. A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as of 1 January 2018 is, as follows:

	IAS 39 measurement category	Classification under IFRS 9 Reference	As at December 31 2017 Carrying amount under IAS 39 KShs'000'	Remeasurement KShs'000'	As at January 1, 2018 Carrying amount under IFRS 9 KShs'000'
Financial Assets					
Cash and bank balances with CBK	Loans and Receivables Debt Instruments at Amortized cost		944,256	-	944,256
Derivatives		At fair value through profit or loss	215	-	215
Deposit and balances due from other banks	Loans and Receivables	Debt Instruments at Amortized cost	480,749	(474)	480,275
Government securities	Held-to-maturity	Debt Instruments at Amortized cost	1,630,439	-	1,630,439
Other assets	Loans and Receivables	Debt Instruments at Amortized cost	97,266	-	97,266
Loans and advances	Loans and Receivables	Debt Instruments at Amortized cost	6,604,120	(48,379)	6,555,741
			9,757,045	(48,853)	9,708,192
Financial liabilities					
Deposits and balances due to local banking institutions	Amortized cost	Amortized cost	51,625	-	51,625
Customer deposits	Amortized cost	Amortized cost	7,898,496	-	7,898,496
Other liabilities	Amortized cost	Amortized cost	126,943	-	126,943
Allowance for credit losses on off-statement of financial position exposures		Amortized cost	-	(19,611)	(19,611)
			8,077,064	(19,611)	8,057,453
				(68,464)	
Deferred tax in relation to the above (Note 22)				20,539	
Total change in equity due to adopting IFRS 9				(47,925)	

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

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as at 31 December 2017 to the opening impairment allowance under IFRS 9 as at 1 January 2018

	Impairment allowance under IAS 39 as at 31 December 2017 KShs '000'	Remeasurement KShs'000'	Impairment allowance under IFRS 9 as at 1 January 2018
Loans and advances	595,107	48,379	643,485
Deposits with financial institutions	-	474	474
Deposit and balances due from other banks	-	19,611	19,611
	595,107	**68,464**	**663,570**

Off-balance sheet credit risks include credit risks such as undrawn lending commitments, letters of credit and letters of guarantee.

(d) Significant accounting estimates and assumptions

The preparation of the Bank's financial statements requires management to make judgements, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets or liabilities affected in future periods.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Bank based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances beyond the control of the Bank. Such changes are reflected in the assumptions when they occur.

Going concern

The Bank's management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be measured based on quoted prices in active markets, their fair value is determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer–dated derivatives and discount rates, prepayment rates and default rate assumptions for asset-backed securities. The valuation of financial instruments is described in more detail in Note 3 (ii) (d).

Impairment losses on financial assets-IFRS 9 (applicable from 1 January 2018)

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk.

The expected credit loss model requires the recognition of credit losses based on up to 12 months of expected losses for performing loans and the recognition of lifetime losses on performing loans that have experienced a significant increase in credit risk since origination.

The determination of a significant increase in credit risk takes into account many different factors and varies by product and risk segment. The main factors considered in making this determination are relative changes in probability of default since origination, and certain other criteria, such as 30-day past due and watchlist status. The assessment of a significant increase in credit risk requires experienced credit judgment. In determining whether there has been a significant increase in credit risk and in calculating the amount of expected credit losses, we must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown.

These judgments include changes in circumstances that may cause future assessments of credit risk to be materially different from current assessments, which could require an increase or decrease in the allowance for credit losses.

The calculation of expected credit losses includes the explicit incorporation of forecasts of future economic conditions. We have developed models incorporating specific macroeconomic variables that are relevant to each portfolio. Key economic variables for our retail portfolios include primary operating markets where considered significant. Forecasts are developed internally by considering external data and our view of future economic conditions. We exercise experienced credit judgment to incorporate multiple economic forecasts which are probability-weighted in the determination of the final expected credit loss. The allowance is sensitive to changes in both economic forecasts and the probability weight assigned to each forecast scenario. The nature and carrying amounts of the deposits and balances due from banking institutions, loans and advances to customer, government securities and other assets are disclosed in Notes 15, 17, 18 and 19 respectively.

Impairment losses on financial assets-IAS 39 (applicable before 1 January 2018)

The Bank reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in profit or loss. In particular, management's judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance (See Note 3 (a)).

Loans and advances that have been assessed individually (and found not to be impaired) are assessed together with all individually insignificant loans and advances in groups of assets with similar risk characteristics. This is to determine whether provision should be made due to incurred loss events for which there is objective evidence, but the effects of which are not yet evident. The collective assessment takes account of data from the loan portfolio (such as levels of arrears, credit utilisation, loan-to-collateral ratios, etc.), and judgements on the effect of concentrations of risks and economic data (including levels of unemployment, real estate price indices and country risk). The nature and carrying amounts of the deposits and balances due from banking institutions, loans and advances to customers,government securities and other assets are disclosed in Notes 15, 17, 18 and 19 respectively.

The Bank reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in profit or loss. In particular, management's judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance (See Note 3 (a)).

Loans and advances that have been assessed individually (and found not to be impaired) are assessed together with all individually insignificant loans and advances in groups of assets with similar risk characteristics. This is to determine whether provision should be made due to incurred loss events for which there is objective evidence, but the effects of which are not yet evident. The collective assessment takes account of data from the loan portfolio (such as levels of arrears, credit utilisation, loan-to-collateral ratios, etc.), and judgements on the effect of concentrations of risks and economic data (including levels of unemployment, real estate price indices and country risk). The nature and carrying amounts of the deposits and balances due from banking institutions, loans and advances to customers,government securities and other assets are disclosed in Notes 15, 17, 18 and 19 respectively.

Deferred tax assets
Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that future taxable profits will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax-planning strategies (see Notes 12 and 22).

Provisions and contingent liabilities
The Bank operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result, it is involved in various litigation, arbitration and regulatory investigations and proceedings arising in the ordinary course of the Bank's business. When the Bank can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the Bank records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed.

However, when the Bank is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the Bank does not include detailed, case-specific disclosures in its financial statements. Given the subjectivity and uncertainty of determining the probability and amount of losses, the Bank takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgement is required to conclude on these estimates.

For further details on provisions and contingent liabilities, see Notes 2(l) and 31.

(e) Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the bank and the revenue can be reliably measured. The following specific criteria must be met before revenue is recognised:

i) Interest and similar income and expenses
Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost and financial instruments designated at FVPL. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

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

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

The Bank calculates interest income by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets.

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

Interest income and expense are recognised in profit or loss on the accrual basis. Interest income and expense presented in the statement of profit or loss and other comprehensive income include interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis.

ii) Fee and commission income

Fee and commission income including account servicing fees, investment management fees, placement fees and syndication fees, are recognised as the related services are performed.

Fees relating to loan origination, including commitment, restructuring and renegotiation fees, are considered an integral part of the yield earned on the loan and are accounted for using the effective interest rate method. Fees received for commitments that are not expected to result in a loan are included in Non-interest income over the commitment period.

Fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

iii) Other trading income

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

(f) Financial Instruments

IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018.

(i) Date of recognition

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

(ii) Initial measurement of financial instruments

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

Day 1 profit or loss

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

Measurement categories of financial assets and liabilities

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

- Amortised cost,
- FVPL

The Bank classifies and measures its derivative and trading portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

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

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

(iii) Financial assets and liabilities

(a) Financial assets measured at amortized cost

Before 1 January 2018, Due from banks (deposits and balances due from banking institutions and central bank), Loans and advances to customers and other assets, included non–derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

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

From 1 January 2018, the Bank only measures Due from banks, Loans and advances to customers and other financial investments at amortised cost if both of the following conditions are met:

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

The details of these conditions are outlined below.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective. The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

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

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

The SPPI test

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

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

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

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

(b) Derivatives recorded at fair value through profit or loss

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e., the 'underlying').
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

The Bank enters into derivative transactions with various counterparties. These include futures, cross-currency swaps and forward foreign exchange. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative.

(c) Financial instruments designated at FVTPL (fair value option)

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

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis

Or

- The liabilities (and assets until 1 January 2018 under IAS 39) are part of a group of financial liabilities (or financial assets, or both under IAS 39), which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy

Or

The liabilities (and assets until 1 January 2018 under IAS 39) containing one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited

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

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

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.
The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the statement of financial position. The Bank occasionally issues loan commitments at below market interest rates drawdown. Such commitments are subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

(e) (i) Held-to-maturity financial investments (Policy applicable before 1 January 2018)
Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the bank has the positive intention and ability to hold to maturity. After initial measurement held-to-maturity investments are measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the investments are derecognised or impaired, as well as through the amortisation process. The bank's held-to maturity investments are treasury bonds.

(ii) Reclassification of financial assets and liabilities

From 1 January 2018, the Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank acquires, disposes of, or terminates a business line. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets or liabilities in 2017.

(iii) Derecognition of financial assets and liabilities
Derecognition due to substantial modification of terms and conditions
The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:
- Change in currency of the loan
- Introduction of an equity feature
- Change in counterparty
- If the modification is such that the instrument would no longer meet the SPPI criterion

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

Derecognition other than for substantial modification

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

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

- The Bank has transferred its contractual rights to receive cash flows from the financial asset

Or

- It retains the rights to the cash flows, but has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement.

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

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

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

A transfer only qualifies for derecognition if either:

- The Bank has transferred substantially all the risks and rewards of the asset

Or

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

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

When the Bank has neither transferred nor retained substantially all the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Bank's continuing involvement, in which case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration the Bank could be required to pay.

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

Financial liabilities

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

(vi) Impairment of financial assets (under IFRS 9- Policy applicable after 1 January 2018)

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach.

Under IFRS 9, ECL allowances are recognized on all financial assets that are debt instruments classified either as amortized cost or FVOCI and for all loan commitments and financial guarantees that are not measured at FVTPL. The application of an ECL model represents a significant change from the incurred loss model under IAS 39. ECL allowances represent credit losses that reflect an unbiased and probability-weighted amount which is determined by evaluating a range of possible outcomes, the time value of money and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. Forward-looking information is explicitly incorporated into the estimation of ECL allowances, which involves significant judgment In contrast, the incurred loss model under IAS 39 incorporated a single best estimate, the time value of money and information about past events and current conditions.

ECL allowances for loans and acceptances are included in allowance for credit losses on the Statement of Financial Position. ECL allowances for FVOCI debt securities are included as a component of the carrying value of the securities, which are measured at fair value. ECL allowances for other financial assets are included in the carrying value of the instrument. ECL allowances for guarantees and loan commitments are included in other liabilities.

ECL allowances are measured at amounts equal to either: (i) 12-month ECL; or (ii) lifetime ECL for those financial instruments which have experienced a significant increase in credit risk since initial recognition or when there is objective evidence of impairment. In contrast, under the incurred loss model lifetime credit losses were recognized when there was objective evidence of impairment and allowances for incurred but not identified credit losses were also recognized.

(vi) Impairment of financial assets (under IFRS 9- Policy applicable after 1 January 2018)
The calculation of ECL allowances is based on the expected value of three probability-weighted scenarios to measure the expected cash shortfalls,
discounted at the effective interest rate. A cash shortfall is the difference between the contractual cash flows that are due and the cash flows that we expect to receive. The key inputs in the measurement of ECL allowances are as follows:

- The probability of default (PD) is an estimate of the likelihood of default over a given time horizon;
- The LGD is an estimate of the loss arising in the case where a default occurs at a given time; and
- The exposure at default (EAD) is an estimate of the exposure at a future default date.

Lifetime ECL is the expected credit losses that result from all possible default events over the expected life of a financial instrument. 12-month ECL is the portion of lifetime expected credit losses that represent the expected credit losses that result from default events on the financial instrument that are possible within the 12 months after the reporting date.
Due to the inclusion of relative credit deterioration criteria and consideration of forward-looking information, lifetime credit losses are generally recognized earlier under IFRS 9.

Stage migration and significant increase in credit risk
As a result of the requirements above, financial instruments subject to ECL allowances are categorized into three stages.

For performing financial instruments:
Stage 1 is comprised of all performing financial instruments which have not experienced a significant increase in credit risk since initial recognition.
We recognize 12 months of ECL for stage 1 financial instruments. In assessing whether credit risk has increased significantly, we compare the risk of a default occurring on the financial instrument as at the reporting date, with the risk of a default occurring on the financial instrument as at the date of its initial recognition.

Stage 2 is comprised of all performing financial instruments which have experienced a significant increase in credit risk since initial recognition. We recognize lifetime ECL for stage 2 financial instruments. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, then we revert to recognizing 12 months of ECL as the financial instrument has migrated back to stage 1.

We determine whether a financial instrument has experienced a significant increase in credit risk since its initial recognition on an individual financial instrument basis. Changes in the required ECL allowance, including the impact of financial instruments migrating between stage 1 and stage 2, are recorded in Provision for credit losses in the Statement of Profit or loss and other comprehensive income.

Stage 3 financial instruments are those that we have classified as impaired. We recognize lifetime ECL for all stage 3 financial instruments. We classify a financial instrument as impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial instrument have occurred after its initial recognition. Evidence of impairment includes indications that the borrower is experiencing significant financial difficulties, or a default or delinquency has occurred. Under IFRS 9, all financial instruments on which repayment of principal or payment of interest is contractually 90 days in arrears are automatically considered impaired, except for credit card loans which are classified as impaired and are fully written off when payments are contractually 180 days in arrears or at the earlier of the notice of bankruptcy, settlement proposal, or enlistment of credit counselling services.

A financial instrument is no longer considered impaired when all past due amounts, including interest, have been recovered, and it is determined that the principal and interest are fully collectable in accordance with the original contractual terms or revised market terms of the financial instrument with all criteria for the impaired classification having been remedied.
Financial instruments are written off, either partially or in full, against the related allowance for credit losses when we judge that there is no realistic prospect of future recovery in respect of those amounts. When financial instruments are secured, this is generally after all collateral has been realized, or in certain circumstances, when the net realizable value of any collateral and other available information suggests that there is no reasonable expectation of further recovery. In subsequent periods, any recoveries of amounts previously written off are credited to the provision for credit losses.

(vii) Impairment of financial assets (IAS 39)- Policy applicable before 1 January 2018
The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default or delinquency in interest or principal payments and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortised cost

Financial assets carried at amortised cost include amounts due from banks, loans and advances to customers as well as held-to-maturity investments.

For loans and advances, impairment losses are computed based on:

(a) Central Bank of Kenya Prudential Guidelines

The bank reviews its loans and advances at each reporting date to assess whether an allowance for impairment should be recognised in the profit or loss. In particular, judgement by the directors is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on the assumptions about a number of factors and actual results may differ, resulting in future changes in the allowance.

In addition to specific allowances against individual significant loans and advances, the bank makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration such factors as any deterioration in industry, technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

A collective allowance for impairment is made at the rate of 1% of loans and advances classified under normal and 3% for watch categories as per the Central Bank Kenya Prudential Guidelines. Advances are written off/down when the directors are of the opinion that their recoverability will not materialise.

(b) International Accounting Standard (IAS) 39

Financial assets accounted for at amortised cost are assessed for objective evidence of impairment and required allowances are estimated in accordance with IAS 39. Impairment exists if the carrying amount of a loan or a portfolio of loans exceeds the present value of the cash flows actually expected in future periods discounted at the financial asset's original effective interest rate. These cash flows include scheduled interest payments, principal repayments, or other payments due (for example from guarantees), including liquidation of collateral where available.

The total allowance for recognised financial assets consists of two components: specific counterparty impairment losses and collectively assessed impairment losses. The specific counterparty component applies to claims evaluated individually for impairment and is based upon directors' best estimate of the present value of the cash flows which are expected to be received. In estimating these cash flows, directors make judgments about counterparty's financial situation and the net realizable value of any underlying collateral or guarantees in the bank's favour.

(viii) Collateral valuation

To mitigate its credit risks on financial assets, the Bank seeks to use collateral, where possible. The collateral comes in various forms, such as cash, securities, letters of credit/guarantees, receivables, other non-financial assets and credit enhancements such as netting agreements. The Bank's accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same is it was under IAS 39. Collateral, unless repossessed, is not recorded on the Bank's statement of financial position.

However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a quarterly basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Bank uses active market data for valuing both financial and non financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral are valued based on data provided by third parties and other independent sources.

(ix) Collateral repossessed

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

In its normal course of business, the Bank does not physically repossess properties or other assets in its retail portfolio, but engages external agents to recover funds, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers/obligors. As a result of this practice, the residential properties under legal repossession processes are not recorded on the statement of Financial Position. The bank did not have repossessed assets in the current year (2017: nil).

(x) Write-offs

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

(xi) Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

(xii) Offsetting

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

(g) Property and equipment

Property and equipment is stated at cost excluding the costs of day–to–day servicing, less accumulated depreciation and accumulated impairment losses.

Depreciation

Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of the property and equipment over their expected useful lives as follows:

Motor vehicles	25%
Computer hardware and software	30%
Equipment, furniture, fixtures and fittings	12.5%

Leasehold improvements are written off over their estimated useful life or the lease period, whichever is shorter.

The residual values, useful lives and methods of depreciation of property and equipment are reviewed at each financial year-end and adjusted prospectively, if appropriate.
An item of property and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in other income in profit or loss in the year the asset is derecognised.

(h) Intangible assets

The Bank's intangible assets include the value of computer software licences.

An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Bank.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year-end.

Changes in the expected useful life, or the expected pattern of consumption of future economic benefits embodied in the asset, are accounted for by changing the amortisation period or methodology, as appropriate, which are then treated as changes in accounting estimates. Currently, software costs are amortised over three years. An intangible asset initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal.

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

(i) Operating leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date. The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset (or assets).

Bank as a lessee

Leases, where substantially all the risk and rewards of ownership are retained by the lessor, are classified as operating leases. The total payments due under operating leases are charged to profit or loss 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.

(j) Related party transactions

The bank discloses the nature, volume and amounts outstanding at the end of each financial year from transactions with related parties, which include transactions with the directors, executive officers and related companies.

(k) Fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
The bank's fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

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

The principal or the most advantageous market must be accessible by the bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

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

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

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

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

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

(l) Provisions

A provision is recognised if, as a result of a past event, the bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(m) Foreign currency translation

(i) Functional and presentation currency
The financial statements of the Bank are measured using the currency of the primary economic environment in which it operates (the "functional currency"). The financial statements are presented in Kenya Shillings, which is the Bank's functional and presentation currency. The financial information presented in Kenya Shillings has been rounded to the nearest thousand (KShs'000), except where otherwise indicated.

(ii) Transactions and balances
Transactions in foreign currencies are initially recorded by the Bank in the functional currency at the spot rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency at the spot rate of exchange at the reporting date. All differences arising from settlement and translation of monetary items are recognised in profit or loss.

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

(n) Employee benefits

The bank operates a defined contribution retirement scheme for its employees. The assets of the scheme are held in a separate trustee administered fund which is funded by contributions from both the bank and employees. The bank's contributions to the scheme are charged to profit or loss in the year to which they relate. The bank also contributes to a statutory defined contribution pension scheme, the National Social Security Fund (NSSF). Contributions are determined by local statute and are currently limited to KShs 200 per employee per month.

Short-term benefits consist of salaries, bonuses and any non-monetary benefits such as medical aid contributions and free services.

Employee entitlements to annual leave are recognised when they accrue to employees. The monetary liability for employees' accrued annual leave entitlement at the end of reporting period is recognised as an expense accrual.

(o) Taxes

Current tax

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

Deferred income tax

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

(i) where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
(ii) in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

(i) where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
(iii) in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

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

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Value Added Tax

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

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

(p) Cash and cash equivalents

Cash and cash equivalents comprise balances with maturities of less than 91 days from the date of acquisition and include cash and balances with Central Bank of Kenya (excluding restricted balances - cash reserve ratio), items in the course of collection, government securities and deposits and balances due from banking institutions. For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of deposits and balances due to banks. Cash and cash equivalents are measured at amortised cost.

(q) Dividends

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

(r) Impairment of non-financial assets

The carrying amounts of the bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less costs of disposal and its value in use.
Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.
In determining fair value less costs of disposal, recent market transactions are taken into account. If no such transactions can be identified, an appropriate valuation model is used.
Impairment losses are recognised in profit or loss in those expense categories consistent with the function of the impaired asset.

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

3. RISK MANAGEMENT OBJECTIVES AND POLICIES

Risk management framework
The Board of Directors (the "Board") has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Asset and Liability Committee (ALCO) and the Credit and Risk and Compliance committees, which are responsible for developing and monitoring the Bank's risk management policies in their specified areas. All board committees have both executive and non-executive members and report regularly to the Board of Directors on their activities. The Board has set up an independent compliance function reporting to the Board.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, 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 Bank, 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 Audit committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The 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.

The Bank's overall financial risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on financial performance.

(i) Non-Financial Risk Management disclosures:

(a) Strategic risk

Strategic risk is the potential for loss arising from ineffective business strategies, improper implementation of strategies, sudden unexpected changes in the Bank's environment, or from lack of adequate responsiveness to changes in the business environment.

The Bank faces several strategic risks from its environment which include:

- Macro-economic changes.
- Competition from the financial industry and organisations providing similar services.
- Technological changes.
- Key legislative and regulatory changes.
- Major political events.
- Human capital or social/demographic trends and changes.

Who manages strategic risk
The Board of Directors is responsible for the overall direction and implementation of the Bank's strategy for purposes of enhancing shareholders' value. However, it has delegated the implementation aspects to the Chief Executive Officer (CEO) and the Senior Management team who execute strategy.

Additionally, the Board of Directors, with support from CEO and Senior Management, develops and implements a new strategic cycle every 3 years to cater for the next plan period for the bank.

Managing strategic risk
The CEO, supported by Senior Management executes the approved strategic objectives on a day to day basis and actively monitors business performance against these objectives through periodic reviews. The business carries out business performance reviews periodically but at a minimum on a monthly basis against pre-determined milestones and key performance indicators. The reviews are reported to the Bank's Strategy Committee for information and advice, or action where significant deviations occur. These reports include identifying the key risks faced by the Bank and how they are being managed.

The Bank's CEO co-ordinates an annual strategic planning process for Senior Management intended to align individual business strategies to overall enterprise level strategies as approved by the Board of Directors. They include a comprehensive review and evaluation of the business strategies, competitive positioning, financial performance, initiatives of strategic executions and key business risks.

Each head of department is responsible for directing strategies in their respective departments and ensure such strategies are aligned to the overall strategy of the Bank. They are also responsible for monitoring, managing and reporting on the effectiveness of their departmental strategic objectives, and the progress they have made towards achieving these. They oversee the direction and trends of significant current and emerging risks related to their departments and that mitigating actions are taken where appropriate.

The Bank's financial and non-financial performance, including its key risks, is reported to the Board of Directors on a quarterly basis for review and action, where necessary.

(b)Operational risk

Operational risk is the potential for loss arising from inadequate or failed processes, systems, people or external events. Operational risk is embedded in all business activities including the practices for managing other risks e.g. credit, market and liquidity risks and arises in the normal course of business. The impact of these risks can result in significant financial loss, reputational harm or regulatory censure and penalties.

The Bank categorizes its operational risk into the following seven loss event categories.

- Internal frauds-Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or Bank policy, excluding diversity and discrimination events, which involves at least one internal party.

- External risks-Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party.

- Employment Practices and workplace safety-Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity and discrimination events.

- Clients, products and business practices- Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from improper business or market practices, from product flaws, or from disputes over performance of advisory activities.

- Damage to physical assets -Losses arising from loss or damage to physical assets from natural disaster or external events such as terrorism or vandalism.

- Business disruptions and system failures- Losses arising from disruption of business or system failures (i.e. hardware, software, network, telecommunication).

- Execution, delivery and process management- Losses from failed transaction processing or process management.

Who manages operational risk

The Board of Directors and the CEO have direct responsibility for the management and control of operational risk throughout the Bank. Management and the Risk and Compliance Committee of the Board coordinate, facilitate, and oversee the effectiveness and integrity of the Bank's operational risk management framework while Internal Audit and the Bank's external auditors provide independent assurance and challenge across all business functions in respect of the integrity and effectiveness of this framework.

The staff and management working within or managing an operational branch are responsible for the day-to-day management and control of operational risk within their businesses.

The Bank's structure is designed with operational risk in mind. As an example, the Bank maintains specialised functions that manage business continuity, human resources, compliance, administration and procurement, security services and organisational change management.

Senior Management in turn reports to the Risk and Compliance Committee on all the key risks detailing corrective action initiatives to address the risks.

How the Bank manages operational risk

The Bank's operational risk management framework is designed to ensure key risk exposures are proactively managed within acceptable levels. It incorporates best practice and meets regulatory guidelines through:

(i) Governance and Policy: Management reporting and organisational structures emphasise accountability, ownership and effective oversight of each business unit's operational risk exposures. Furthermore, the Board Risk and Compliance Committee and Senior Management's expectations are guided by the Bank's policies.

(ii) Risk and Control Self-Assessment: Through quarterly comprehensive assessments of the Bank's key operational risk exposures and internal control environments, Senior Management is able to evaluate its effectiveness and implement appropriate additional corrective actions where needed, to offset or reduce unacceptable risks.

(iii) Operational Risk Event Monitoring: The Bank's policies require that internal and industry-wide operational risk events are identified, tracked, and reported to the right levels to ensure they are analysed appropriately and corrective action taken in a timely manner.

(iv) Risk Reporting: Significant operational risk issues together with measures to address them are tracked, assessed and reported to Senior Management and the Board of Directors to ensure accountability is maintained over current and emerging risks.

(v) Insurance: A comprehensive portfolio of insurance and other risk mitigating arrangements are maintained with the type and level of insurance coverage continually assessed to ensure both risk tolerance and statutory requirements are met. This includes identifying opportunities for transferring our risks to third parties where appropriate.

(vi) Technology and Information: The key risks here revolve around our reliance on technology and information and their impact on operational availability, integrity and security of our information data and systems / infrastructure. Our risk framework and programs use best practice and include robust threat and vulnerability assessments, as well as security and change management practices.

(vii) Business Continuity Management: Business Continuity Management supports the ability of Senior Management to continue to operate their businesses, and provide customer access to products and services in times of disruptions. This program includes formal crisis management protocols and continuity strategies. All key functions of the Bank are regularly tested to confirm their contingency plan designs are able to respond to a broad range of potentially disruptive scenarios.

(viii) Project Management: We have a disciplined project management program to ensure projects are implemented successfully in a planned and systematic manner and are monitored by Senior Management.

(ix) Financial Crime: Safeguarding customers, employees, assets, information, and preventing plus detecting fraud as well as other forms of financial crime.

(c) Compliance (policy/legal/regulatory) risk:

Compliance risk refers to the potential of loss arising from non-compliance with laws, rules, regulations, obligatory practices/standards, contractual agreements, or other legal requirements including the effectiveness of preventing and handling litigation. It is not actively or deliberately pursued in the expectation of a return but occurs in the normal course of our business operations.

The Bank strives for high standards of compliance with policy, legal and regulatory requirements in all business dealings and transactions. As a result of high financial business regulation, the Bank is exposed to regulatory and legal risks in virtually all our activities including those from the regulator (Central Bank of Kenya). Failure to comply with regulation not only poses a risk of censure and litigation but may lead to serious reputational risks. Financial penalties and costs related to litigation may also substantially erode the Bank's earnings.

Who manages regulatory and legal risk

Business unit heads have the responsibility and accountability of managing regulatory and legal risks relating to their units on a day to day basis with assistance/advice and oversight from Legal and Risk & Compliance Departments. The Compliance Department identifies and monitors the key risks and is responsible for ensuring that the day to day business controls comply with applicable legislation and are in line with best practice. Internal and external legal counsel work closely with business units to identify areas of existing and potential regulatory/legal risks and actively manage them to reduce the Bank's exposures.

Senior Management and the Board Risk and Compliance Committee receive the Risk and Compliance Department's opinions/reports on the strength of the Bank's Compliance Risk Framework to enable them to determine whether it is under control and where not, tracks significant corrective actions to finality. Additionally, significant exposures under "for or against" litigation are reviewed periodically.

How the Bank manages regulatory and legal risks

The Board of Directors and Senior Management through the Bank's Code of Conduct sets the "tone at the top" for a culture of integrity beginning with concern for what is right (including compliance to policy and the law) in all our business considerations, decisions and actions. All employees are required to attest to this Code when they join the Bank and thereafter periodically, indicating that they have understood it and that they have complied with its provisions.

Departmental Heads manage day-to-day regulatory and legal risk primarily by implementing appropriate policies, procedures and controls already in place. The Legal and Risk and Compliance departments assist them by:

(i) Communicating and advising on regulatory and legal requirements, and emerging compliance obligations to each business unit as required.

(ii) Implementing or assisting with reviews of policies, procedures and training. They do this by independently monitoring and testing for adherence to certain regulatory and legal requirements, as well as the effectiveness of associated key internal controls.

(iii) Tracking, escalating and reporting significant issues and findings to Senior Management and the Board of Directors.

(iv) Liaising with regulators, as appropriate, regarding new or revised legislation, regulatory guidelines or regulatory examinations.

The Bank has developed robust policies, programs and systems designed to manage the Know Your Customer (KYC) and Anti-Money Laundering (AML) risks as envisaged in the Proceeds of Crime & Anti-Money Laundering Act and Regulation. The Bank has upgraded account opening requirements and customer transaction screening procedures to meet the stringent requirements stipulated therein. Reporting of suspicious and other transactions is done as required by the law and policy standards. Appropriate periodic due diligence is carried out on correspondent banking counterparties, and KYC/AML obligations to them are met continuously. All staff are trained when they join the Bank and periodically certified as such in line with the law.

(d)Reputational risk

Reputational risk is the potential that negative stakeholder impressions or perceptions, whether true or not, regarding the Bank's business practices, actions or inactions, will or may cause a decline in its value, brand, liquidity or customer base. It is a resultant effect of all other risks highlighted in this report and therefore cannot be managed in isolation. Therefore, when all the other risks are managed well, this risk is substantially minimised. The Bank's reputation is an invaluable business asset essential for optimising shareholder value, hence it is constantly under threat. Our services and activities, including new ones, ensure the Bank's good reputation is always maintained or enhanced.

Who manages reputational risk
Ultimate responsibility for this risk rests with the Board of Directors and Senior Management who examine the Bank's reputational risk as part of their regular mandate. Their purpose is to ensure that all products, services, and activities meet the Bank's reputational risk objectives in line with the Board of Director's approved appetite. Nonetheless, every employee and representative of the Bank has a responsibility to contribute positively to our reputation. Senior Management and the Board of Directors receive periodic reports on the assessment of the Bank's reputational risk exposures that arise from its business (including sales and service) activities so as to form a view on associated risks and implement corrective actions.

How the Bank manages reputational risk
Every employee and representative of the Bank has a responsibility to contribute in a positive way towards our reputation. This is through ensuring ethical practices are always adhered to, interactions with all stakeholders are positive, and the Bank complies with applicable policies, legislation, and regulations. Reputational risk is most effectively managed when every individual works continuously to protect and enhance the Bank's reputation.

(ii) Financial Risk Management disclosures:

The Bank has exposure to credit risk, liquidity risk and market risks from its use of financial instruments.

(a) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure.

(i) Management of credit risk

The Board of Directors has delegated responsibility for the management of credit risk to the credit committee. A separate credit department, reporting to the credit committee, is responsible for oversight of the Bank's credit risk, including:

- 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.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to business unit Managers. Larger facilities require approval by head office credit committee or the Board of Directors, as appropriate.
- Reviewing and assessing credit risk. Credit risk function 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.
- Limiting concentrations of loans and advances to counterparties, geographies and business sectors and by issuer, credit rating band, market liquidity and country (for investment securities).
- Developing and maintaining the Bank's risk gradings 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 credit risk management department.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries,

country risk and product types. Regular reports are provided to credit committee on the credit quality of local portfolios and appropriate corrective action is taken.

- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

The Bank monitors concentration of risk by economic sector in line with the Bank's set limits per the sector. An analysis of concentrations within the loans and advances to customers, and off balance sheet items is as follows:

(a) Loans and advances to customers – net

	2018 KShs'000	%	2017 KShs'000	%
Agriculture	1,740,342	27	1,566,188	24
Manufacturing	81,675	1	153,169	2
Wholesale and retail	204,005	3	371,876	6
Transport and communication	324,010	5	371,876	6
Real estate	654,759	10	671,977	10
Social community and personal services	204,005	3	202,707	3
Business services	68,403	1	101,587	1
Other	3,348,323	50	3,164,740	48
	6,625,522	100	6,604,120	100

(b) Items not reported in statement of financial position (letters of credit and guarantees)

	2018 KShs'000	%	2017 KShs'000	%
Agriculture	70,432	14	139,085	10
Manufacturing	12,385	2	30,961	2
Wholesale and retail	40,588	8	25,094	2
Transport and communication	68,450	13	292,762	21
Real estate	16,765	3	51,700	4
Social community and personal services	22,238	4	27,328	2
Business services	168,143	32	470,002	32
Other	125,406	24	380,079	27
	524,407	100	1,417,011	100

(ii) Maximum exposure to credit risk before collateral held

	2018 KShs'000	%	2017 KShs'000	%
Credit exposures:				
Items reported in the statement of financial position:				
Balances held with Central Bank of Kenya	745,976	8	524,657	5
Deposits and balances due from banking institutions	211,348	2	480,749	4
Loans and advances to customers – net	6,625,522	67	6,604,120	60
Government securities held to maturity	1,614,217	16	1,630,439	15
	9,197,063	93	9,239,965	84

Items not reported in the statement of financial position:				
Letters of credit	8,433	-	223,741	2
Letters of guarantees and performance bonds	287,905	3	550,281	5
Loans committed but not disbursed at year end	228,069	3	642,989	6
Foreign exchange forward contracts	141,278	1	325,650	3
	665,685	7%	1,742,661	16
	9,862,748	100%	10,982,626	100

(iii) Classification of loans and advances

	2018 KShs'000	2017 KShs'000
Individually impaired		
Grade 5: Impaired (loss)	1,028,104	1,015,960
Grade 3 & 4: Impaired (substandard and doubtful)	758,278	579,287
Gross amount	1,786,382	1,595,247
Allowance for impairment	(676,703)	(503,620)
Carrying amount	1,109,679	1,091,627
Past due but not impaired		
Watch (30-90 days)	2,780,288	1,962,540
Allowance for impairment	(33,042)	(91,487)
Carrying amount	2,747,246	1,871,053
Neither past due nor impaired		
Grade 1: Normal	2,779,474	3,641,440
Allowance for impairment	(10,877)	-
Carrying amount	2,768,597	3,641,440
Total carrying amount	6,625,522	6,604,120

Impaired loans and advances

Impaired loans and securities are loans and advances for which the Bank determines that it is probable that it will be unable to collect a part/whole of principal and interest due according to the contractual terms of the loan/securities agreement(s). These loans are graded 3, 4 and 5 in the Bank's internal credit risk grading system.

Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security/collateral available and or the stage of collection of amounts owed to the Bank. These exposures are categorised as watch accounts in line with Central Bank of Kenya prudential guidelines and a general provision at 3% is made and appropriated under statutory reserves.

Loans and advances that are neither past due nor impaired.

The Bank classifies loans and advances under this category for those exposures that are upto date and in line with contractual agreements. Such loans would have demonstrated financial conditions, risk factors and capacity to repay that are acceptable. These exposures will normally be maintained largely within approved product programs and with no signs of impairment or distress. These exposures are categorised as normal accounts in line with Central Bank of Kenya (CBK) prudential guidelines and a general provision at 1% is made and appropriated under statutory reserves.

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring. From a risk management point of view, once an asset is modified, the Bank's credit department continues to monitor the exposure until it is completely and ultimately derecognised.

The table below includes Stage 2 and 3 assets that were modified and, therefore, treated as forborne during the period, with the related modification loss suffered by the Bank

	2018 KShs
Amortised costs of financial assets modified during the period	352,333
Net modification loss	(2,394)

The table below shows the gross carrying amount of previously modified financial assets for which loss allowance has changed to 12mECL measurement during the period:

	Post modification		**Pre-modification**	
	Gross carrying amount KShs'000'	Corresponding ECL KShs'000'	Gross carrying amount KShs'000'	Corresponding ECL KShs'000'
Facilities that have cured since modification and are now measured using 12mECLs (Stage 1)	21,382	259	43,668	378
Facilities that reverted to (Stage 2/3) LTECLs having once cured	229,448	2,779	64,995	3,879

(iv) Allowances for impairment

The Bank sets aside from its income an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to each defaulting borrower, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

(v) Write-off policy

The Bank writes off a loan/security balance (and any related allowances for impairment losses) when the credit committee determines that the loans/securities are uncollectible. This determination 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. For smaller balance standardised loans, charge off decisions generally are based on a product specific past due status.

(vi) Collateral held on loans and advances

The Bank holds collateral against loans and advances to customers, non-insiders as well as insiders 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 usually is not held against investment securities, and no such collateral was held at 31 December 2018.

An estimate of the fair values of collateral and other security enhancements held against all financial assets are shown below. The bank has the obligation to return the securities to the customers upon settlement of the obligation. There are no other significant terms and conditions associated with the use of the collateral.

(vi) Collateral held on loans and advances
Fair value of collateral and credit enhancements held

2018

	Maximum exposure to credit risk KShs'000'	Cash KShs'000'	Securities KShs'000'	Property KShs'000'	Other* KShs'000'	Total collateral KShs'000'	Net exposure KShs'000'	Associated ECLs KShs'000'
Cash and balances with central banks	1,108,907	11,198	-	-	-	11,198	1,097,709	-
Due from banks	211,348	-	-	-	-	-	211,348	119
Loans and advances to customers	6,625,522	373,035	234,060	7,225,780	-	7,832,875	(1,207,353)	720,622
Government securities at amortised cost	1,614,217	-	-	-	-	-	1,614,217	-
Financial assets at fair value through profit or loss	1,110	-	-	-	-	-	1,110	-
Other assets	212,860	-	-	-	-	-	212,860	-
Financial guarantees	287,905	287,905	-	-	-	287,905	-	-
Letters of credit for customers	8,433	8,433	-	-	-	8,433	-	-
Other commitments	228,069	17,133	210,936	-	-	228,069	-	1,868
	10,298,371	697,704	444,996	7,225,780	-	8,368,480	1,929,891	722,609

2017

	Maximum exposure to credit risk KShs'000'	Cash KShs'000'	Securities KShs'000'	Property KShs'000'	Other* KShs'000'	Total collateral KShs'000'	Net exposure KShs'000'
Cash and balances with central banks	944,256	11,357	-	-	-	11,357	932,899
Due from banks	480,749	-	-	-	-	-	480,749
Loans and advances to customers	6,604,120	373,035	210,654	8,846,804	-	9,430,493	(2,826,373)
Government securities at amortised cost	1,630,439	-	-	-	-	-	1,630,439
Other assets	97,266	-	-	-	-	-	97,266
Financial assets at fair value through profit or loss	215	-	-	-	-	-	215
Financial guarantees	550,281	550,281	-	-	-	550,281	-
Letters of credit for customers	223,741	223,741	-	-	-	223,741	-
Other commitments	642,989	23,030	142,670	-	-	165,700	477,289
	11,174,056	1,181,444	353,324	8,846,804	-	10,381,572	792,484

vii) Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a counterparty to honour its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transactions, the Bank mitigates this risk by conducting settlements through a Settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval/limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from the Bank's board of directors.

(b)Liquidity risk

The Bank is exposed to the risk that it will encounter difficulty in raising funds to meet commitments associated with customer requirements. Liquidity risk is addressed through the following measures:

(i) Management of liquidity risk

The Bank's approach to managing liquidity is 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 Bank's reputation. The Asset and Liability Committee (ALCO), a management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when due and that no difficulties in meeting financial liabilities as they fall due are encountered.

The Bank's Treasury department 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.

(ii) Source of funding

The Bank has an aggressive strategy aimed at increasing the customer base and maintains a diversified and stable base comprising retail and corporate customers. The Bank also borrows from the interbank market through transactions with other Banks and from the wholesale market through transactions with pension funds and insurance companies for short term liquidity requirements.

(iii) Exposure to liquidity risk

The key measure used by the Bank 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.

(iii) Exposure to liquidity risk

Details of the reported Bank's ratios of net liquid assets to customer deposits at the reporting date and during the reporting period were as follows:

	2018	**2017**
At 31 December	35%	24%
Average for the period	31%	31%
Maximum for the period	35%	38%
Minimum for the period	29%	24%
Statutory Minimum requirement	20%	20%

Liquidity risk based on undiscounted cash flows

The table below represents the cash flows payable by the Bank under non-derivative financial instruments by remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows, since the Bank manages the inherent liquidity risk based on expected undiscounted cash inflows.

At 31 December 2018	Upto 3 months KShs'000	3-6 months KShs'000	6-12 months KShs'000	'1-3 years KShs'000	3-5 years KShs'000	Over 5 years KShs'000	Total KShs'000
FINANCIAL LIABILITIES							
Customer deposits	7,161,259	461,521	416,502	-	-	-	8,039,282
Liabilities not recognised in statement of financial position	524,407	-	-	-	-	-	524,407
Other liabilities	91,561	-	-	-	-	-	91,561
Due to banking institutions	63,990	-	-	-	-	-	63,990
Total undiscounted liabilities	**7,841,217**	**461,521**	**416,502**	**-**	**-**	**-**	**8,719,240**
FINANCIAL ASSETS							
Cash balances	362,931	-	-	-	-	-	362,931
Bank balances with the Central Bank of Kenya	745,976	-	-	-	-	-	745,976
Less: restricted balance	(420,985)	-	-	-	-	-	(420,985)
Deposits and balances due from banking institutions	211,348	-	-	-	-	-	211,348
Loans and advances to customers	995,147	347,022	1,074,227	2,825,278	2,572,675	-	7,814,349
Other assets	212,860	-	-	-	-	-	212,860
Government securities	-	-	212,851	339,367	450,804	926,437	1,929,459
Total undiscounted Assets	2,107,277	347,022	1,287,078	3,164,645	3,023,479	926,437	10,855,938
Net liquidity gap as at 31 December 2018	**(5,733,940)**	**(114,499)**	**870,576**	**3,164,645**	**3,023,479**	**926,437**	**2,136,698**
At 31 December 2017							
FINANCIAL LIABILITIES							
Customer deposits	6,007,484	1,595,698	295,314	-	-	-	7,898,496
Liabilities not recognised in statement of financial position	1,417,011	-	-	-	-	-	1,417,011
Other liabilities	126,043	-	-	-	-	-	126,043
Due to banking institutions	51,625	-	-	-	-	-	51,625
Total undiscounted liabilities	7,602,163	1,595,698	295,314	-	-	-	9,493,175
FINANCIAL ASSETS							
Cash balances	419,599	-	-	-	-	-	419,599
Bank balances with the Central Bank of Kenya	524,657	-	-	-	-	-	524,657
Less: restricted balance	(413,918)	-	-	-	-	-	(413,918)
Deposits and balances due from banking institutions	480,749	-	-	-	-	-	480,749
Loans and advances to customers	1,395,690	808,141	1,209,087	2,638,596	826,535	391,611	7,269,660
Other assets	97,266	-	-	-	-	-	97,266
Government securities	-	-	-	591,409	161,873	1,328,500	2,081,782
Total undiscounted Assets	2,504,043	808,141	1,209,087	3,230,005	988,408	1,720,111	10,459,795
Net liquidity gap as at 31 December 2017	**(5,098,120)**	**(787,557)**	**913,773**	**3,230,005**	**988,408**	**1,720,111**	**966,620**

(c) Market risks

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing). 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 Asset and Liability Committee. The senior management is responsible for the development of detailed risk management policies (subject to review and approval by the Board) and for the day-to-day review of their implementation.

Exposure to interest rate risk – non-trading portfolios
The Bank is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on financial position and cash flows. The assets and liability committee closely monitors the interest rates trends to minimize the potential adverse impact of interest rate changes. The table overleaf summarizes the exposure of interest rate risk at the reporting date. The Bank maintains an appropriate mix of fixed and floating rates deposit base. Interest rates on advances to customers and other risk assets are either pegged to the Bank's base lending rate or Treasury bill rate. The base rate is adjusted from time to time to reflect the cost of deposits.

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

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

The Bank is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows.

Interest rate risks
The Assets and Liability Committee closely monitors the interest rate trends to minimize the potential adverse impact of interest rate changes. The table below summarises the exposure to interest rate risk at the reporting date whereby financial assets and liabilities at carrying amounts are categorized by the earlier of contractual re-pricing and maturity dates.

At 31 December 2018

FINANCIAL ASSETS	Upto 3 months KShs'000	3-6 months KShs'000	6-12 months KShs'000	1-3 Years years KShs'000	Over 3 Years KShs'000	Total KShs'000
Deposits and balances due from banking institutions	211,348	-	-	-	-	211,348
Loans and advances to customers	995,147	336,099	1,011,037	2,500,246	1,782,993	6,625,522
Government securities	-	-	207,694	313,469	1,093,054	1,614,217
Total financial assets	1,206,495	336,099	1,218,731	2,813,715	2,876,047	8,451,087
FINANCIAL LIABILITIES						
Customer deposits	4,045,223	454,119	359,708	-	-	4,859,049
Due to banking institutions	63,990	-	-	-	-	63,990
Total financial liabilities	4,109,213	454,119	359,708	-	-	4,923,039
Interest sensitivity gap	(2,902,718)	(118,020)	859,023	2,813,715	2,876,047	3,528,048
At 31 December 2017						
FINANCIAL ASSETS						
Loans and advances to customers	1,395,690	782,703	1,137,964	2,335,041	952,722	6,604,120
Government securities	-	-	-	742,540	887,899	1,630,439
TOTAL FINANCIAL ASSETS	1,395,690	782,703	1,137,964	3,077,581	1,840,621	8,234,559
FINANCIAL LIABILITIES						
Customer deposits	3,474,981	1,595,698	295,314	-	-	5,365,993
Due to banking institutions	51,625	-	-	-	-	51,625
TOTAL FINANCIAL LIABILITIES	3,526,606	1,595,698	295,314	-	-	5,417,618
INTEREST SENSITIVITY GAP	(2,130,916)	(812,995)	842,650	3,077,581	1,840,621	2,816,941

Interest rate risk stress test - Increase/decrease of 1% in Net Interest Margin

Interest rate risk sensitivity analysis is based on the following assumptions

- Changes in the market interest rates affect the interest income or expenses on financial instruments with variable interest rates
- Changes in market interest rates only affect interest income or expenses in relation to financial instruments with fixed rates if these are recognised at fair value.
- The interest rate changes will have significant effect on interest sensitive assets and liabilities and hence simulation modelling is applied to net interest margins.
- Interest rates of all maturities move by the same amount and, therefore, do not reflect the potential impact on net income of some rates changing while others remain unchanged.
- The projections make other assumptions including that all positions are held to maturity.

With all other variables held constant, the effect of 1% increase or decrease in interest rates on financial assets and liabilities on the (loss)/ profit before tax and equity would be as follows:

		2018			2017	
ASSETS	**Carrying Amount KShs'000**	**1% increase KShs'000**	**1% decrease KShs'000**	**Carrying Amount KShs'000**	**1% increase KShs'000**	**1% decrease KShs'000**
Deposits and balances due from banks	211,348	2,113	(2,113)	480,749	4,807	(4,807)
Government securities	1,614,217	16,142	(16,142)	1,630,439	16,304	(16,304)
Loans and advances to customers	6,625,522	66,255	(66,255)	6,604,120	66,041	(66,041)
		84,511	(84,511)		87,153	(87,153)
LIABILITIES & EQUITY						
Deposits and balances due to banks	63,990	(640)	640	51,625	(516)	516
Customers' deposits	4,859,049	(48,590)	48,590	5,365,993	(53,660)	53,660
		(49,230)	49,230		(54,176)	54,176
Effect on profit before tax		35,280	(35,280)		32,977	(32,977)
As percentage of (loss)/profit before tax (%)		(36%)	36%		61%	(61%)
Effect on equity		24,696	(24,696)		23,084	(23,084)
As percentage of equity (%)		1%	(1%)		1%	(1%)

Overall non-trading interest rate risk positions are managed by treasury, which uses investment securities, advances to banks, deposits from banks and derivative instruments to manage the overall position arising from the Bank's non-trading activities.

Currency risk

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

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

At 31 December 2018	**USD KShs'000**	**GBP KShs'000**	**EURO KShs'000**	**Others KShs'000**	**Total KShs'000**
FINANCIAL ASSETS					
Cash balances	14,875	398	4,265	2,593	22,131
Bank balances with Central Bank of Kenya	118,242	766	4,769	18,731	142,508
Deposits and balances due from banking institutions	105,829	13,296	44,139	4,202	167,466
Derivatives	1,138	(28)	-	-	1,110
Loans and advances	107,599	-	50,124	-	157,723
Total financial assets	347,683	14,432	103,297	25,526	490,938
FINANCIAL LIABILITIES					
Deposits and balances due to banking institutions	63,990	-	-	-	63,990
Customer deposits	140,145	1,195	15,566	13	190,924
Total financial liabilities	204,135	1,195	15,566	3	254,914
Net items reported in statement of financial position	143,548	13,237	87,731	25,513	236,024
At 31 December 2017					
Total financial assets	458,593	47,706	141,644	5,763	653,706
Total financial liabilities	136,705	34,869	19,337	13	190,924
Net items reported in statement of financial position	321,888	12,837	122,307	5,750	462,782

Foreign currency risk stress test-appreciation/depreciation of Kenya shilling by 5%

The foreign exchange risks sensitivity analysis is based on the following assumptions:

- Foreign exchange exposures represent net currency positions of all currencies other than the Kenya shilling
- The currency risk sensitivity analysis is based on the assumption that all net currency positions are highly effective.
- The base currency in which bank's business is transacted is Kenya shilling.

The table below summarises the estimated impact of a 5% decline/appreciation of the Kenya Shilling.

	2018 Carrying amount KShs'000	5% appreciation	5% depreciation	2017 Carrying amount 5% depreciation	5% appreciation	5% depreciation
Foreign Currency Assets:						
USD 347,683	(17,384)	17,384	458,593	(22,929)	22,929	
GBP 14,432	(721)	721	47,706	(2,385)	2,385	
EURO	103,297	(5,164)	5,164	141,644	(7,082)	7,082
Others	25,526	(1,276)	1,276	5,763	(288)	288
	(24,545)	24,545		(32,684)	32,684	
Foreign Currency Liabilities:						
USD 204,135	10,206	(10,206)	136,705	6,835	(6,835)	
GBP 1,195	59	(59)	34,869	1,743	(1,743)	
EURO	15,566	778	(778)	19,337	966	(966)
Others	13	-	-	13	-	-
		11,043	(11,043)		9,544	(9,544)
Effect on profit before tax		(13,502)	13,502		(23,140)	23,140
As percentage(%) of (loss)/profit before tax		13.71%	(13.71%)		(42.86%)	42.86%
Effect on equity		(9,451)	9,451		(16,198)	16,198
As percentage(%) of equity		(0.49%)	0.49%		(0.88%)	0.88%
Adjusted core capital		1,919,135	1,938,037		2,090,456	2,122,852
Risk weighted assets (RWA)		10,226,073	10,244,975		10,133,908	10,166,304
Adjusted core capital to RWA		18.77%	18.77%		20.63%	20.88%

Exposure to other market risks – non-trading portfolios

Credit spread risk (not relating to changes in the obligor/issuer's credit standing) on debt securities held by treasury and equity price risk is subject to regular monitoring by ALCO but is not currently significant in relation to the overall results and financial position of the Bank.

(d) Fair value of financial assets and liabilities

(i) Fair value hierarchy

The bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique

- Level 1 – Quoted prices in active markets for identical assets or liabilities. This level includes equity securities and debt instruments listed on the Nairobi Securities exchange.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly as prices or indirectly as derived from prices.
- Level 3 – inputs for the assets or liabilities that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components

The following describes the methodologies and assumptions used to determine fair values of the bank's financial instrument

Type of Financial Instrument	Valuation technique	Significant Observable Input
Level 1		
Government securities-debt instruments at amortised cost / Held to maturity-Treasury bonds	Fair value at closing rate	Quoted prices in active market

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy, except for financial instruments whose carrying amounts are a reasonable approximation of fair value.

As at 31 December 2018	**Level 1 KShs'000**	**Level 2 KShs'000**	**Level 3 KShs'000**	**Total KShs'000**
Financial assets fair value disclosures				
Treasury bonds	1,443,412	-	-	1,443,412

At 31 December 2017	**Level 1 KShs'000**	**Level 2 KShs'000**	**Level 3 KShs'000**	**Total KShs'000**
Financial assets fair value disclosures				
Treasury bonds	1,375,012	-	-	1,375,012

There were no transfers between levels 1, 2 and 3 in the period (2017: Nil).

There were no financial assets or financial liabilities measured at fair value on level 3 fair value measurement (2017: none).

(e) Classification of financial instruments

The table below sets out the Bank's classification of each class of financial assets and liabilities. The amounts in the table are the carrying amounts of the financial instruments at the reporting date

At 31 December 2018:	**Amortized cost KShs'000**	**Mandatorily measured at FVTPL KShs'000**	**Fair Value KShs'000**
Financial assets			
Cash and balances with Central Bank of Kenya	1,108,907	-	1,108,907
Deposits and balances due from banking institutions	211,348	-	211,348
Derivative instruments	-	1,110	1,110
Government Securities	1,614,217	-	1,443,412
Loans and advances to customers	6,625,522	-	6,625,522
Other assets	212,860	-	212,860
Total assets	**9,772,854**	**1,110**	**9,773,964**
Financial liabilities			
Balances due to banks and financial institutions	63,990	-	63,990
Deposits from customers	8,018,770	-	8,018,770
Other liabilities	91,561	-	91,561
Total liabilities	**8,174,321**	-	**8,174,321**

At 31 December 2017:	Held to maturity KShs'000	Loans and receivables KShs'000	IAS 39 Fair value through profit or loss KShs'000	Other liabilities at amortized cost KShs'000	Carrying amount KShs'000	Fair Value KShs'000'
Assets						
Cash and balances with Central Bank of Kenya	-	944,256	-	-	944,256	944,256
Deposits and balances du from banking institutions	-	480,749	-	-	480,749	480,749
Financial derivatives	-	-	215	-	215	215
Held to maturity investments	1,630,439	-		-	1,630,439	1,375,012
Loans and advances to customers	-	6,604,120		-	6,604,120	6,604,120
Other assets	-	97,266	-	-	97,266	97,266
Total assets	1,630,439	8,126,391	215	-	9,757,045	9,501,618
Liabilities						
Balances due to banks and financial institutions	-	-	-	51,625	51,625	51,625
Deposits from customers	-	-		7,898,496	7,898,496	7,898,496
Other liabilities	-	-	-	126,043	126,043	126,043
Total liabilities	-	-	-	8,076,164	8,076,164	8,076,164

4. CAPITAL MANAGEMENT

Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the Bank 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 calculates requirements for operations risk and market risk for internal monitoring purposes.

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 and translation reserve after deductions for intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

- 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.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 percent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of banks and certain other regulatory items.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

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

In implementing current capital requirements, the Central Bank of Kenya requires each Bank to maintain;

- A minimum level of regulatory capital of KShs 1 billion as at 31 December 2018.
- A ratio of core capital to the risk–weighted assets plus risk-weighted off-balance sheet assets at or above the required minimum of 10.5%.
- Core capital of not less than 10.5% of total deposit liabilities.
- Total capital of not less than 14.5% of risk-weighted assets plus risk-weighted off-balance sheet items.

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

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

	2018 KShs'000	2017 KShs'000
Tier 1 capital		
Total share capital	1,000,000	1,000,000
Share premium	42,236	42,236
Retained earnings	732,593	914,342
Total	1,774,829	1,956,578
Tier 2 capital		
Statutory reserve	153,757	121,774
Total regulatory capital	1,928,586	2,078,352
Risk-weighted assets		
Retail bank, corporate bank and central treasury	9,136,177	10,242,049
Total risk weighted assets	9,136,177	10,242,049
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets	19%	19%
Total tier 1 capital expressed as a percentage of total risk-weighted assets	21%	20%

5. INTEREST INCOME

	2018 KShs'000	2017 KShs'000
Loans and advances	851,608	938,182
Government securities – financial assets measured at amortised cost/held to maturity investments	153,679	162,619
Deposits and balances due from banking institutions	5,952	21,475
	1,011,239	1,122,276

6. INTEREST EXPENSE

	2018 KShs'000	2017 KShs'000
Interest on customer deposits	434,035	425,501
Interest on deposits due to banking institutions	9,067	9,892
	443,102	435,393

7. FEES AND COMMISSION INCOME

	2018 KShs'000	2017 KShs'000
Commissions	215,875	202,880
Ledger related fees	25,323	28,754
	241,198	231,634

8. OTHER INCOME

	2018 KShs'000	2017 KShs'000
Gain on sale of treasury bonds	6,348	19,363
(Loss)/gain on disposal of equipment	(90)	310
Miscellaneous income	512	3,534
Foreign exchange gains*	17,175	30,322
	23,945	53,529

* Foreign exchange gains arose from foreign currency transactions and translation of foreign currency monetary assets and liabilities.

9. OTHER OPERATING EXPENSES

	2018 KShs'000	2017 KShs'000
Staff costs (note 10)	388,284	406,420
Directors' emoluments – fees	6,400	7,117
Other emoluments	9,488	9,502
Other expenses	87,821	55,751
Rent and parking	82,307	80,735
Depreciation (note 20)	57,142	59,390
Security services	48,516	49,686
Amortisation of intangible assets (note 21)	36,569	40,563
Telephone, data and postage	32,922	36,568
Computer maintenance	28,998	25,921
Provision for legal fees	19,813	2,833
Insurance	19,226	19,000
Other provisions	16,073	6,460
Contribution to Central Depository and Settlement Protection	12,559	11,102
Stationery and supplies	9,649	11,337
Advertising and marketing	6,585	8,429
Auditors' remuneration	6,000	7,000
	868,352	837,814

	2018 KShs'000	2017 KShs'000
10. STAFF COSTS		
Salaries and wages	320,468	328,807
Pension costs - defined contribution plan	22,185	21,283
Provision for leave pay	15,605	24,113
Gratuity and union salary increment provisions	5,159	4,153
Medical expenses	15,224	14,484
Refreshments and entertainment	7,356	8,003
Other staff costs*	1,692	4,951
National Social Security Fund contributions	595	626
	388,284	406,420

*Other staff costs include cost incurred staff training, utilities and uniform

11. CREDIT LOSS EXPENSE ON FINANCIAL ASSETS

The table below shows the ECL charges on financial instruments for the year recorded in profit or loss:

	Note	Stage 1 KShs '000'	Stage 2 KShs '000'	Stage 3 KShs '000'	Total KShs '000'
Due from banks	15	(354)	-	-	(354)
Loans and advances to customers	17	-	-	81,488	81,488
Off balance sheet items	31(f)	(17,743)	-	-	(17,743)
Total Impairment loss		(18,097)	-	81,488	63,391

	In accordance with IAS 39 2017 KShs '000'
Individual allowance	67,127
Collective allowance	13,121
	80,248

	2018 KShs'000	2017 KShs'000
12. TAXATION		
(a) Tax (credit) / charge		
Current taxation based on the taxable profit for the year at 30%		
Current tax charge	716	43,208
Adjustment in respect of current year income tax of previous year	-	2,600
Deferred taxation credit (note 22)	(27,338)	(28,257)
Tax (credit) / charge	(26,622)	17,551

	2018 KShs'000	2017 KShs'000
(b) Reconciliation of tax charge to the expected taxation based on accounting profit		
(Loss)/profit before taxation	(98,463)	53,984
Tax at the applicable rate of 30%	(29,538)	16,195
Adjustment in respect of current income tax of prior years	-	2,600
Tax effect of expenses not deductible for tax purposes	2,916	3,533
Income not subject to tax	-	(4,777)
Tax (credit)/charge for the year	(26,662)	17,551
(c) Tax (recoverable) / payable		
At the beginning of the year	(6,131)	(33,348)
Charge for the year	716	43,208
Adjustment in respect of current income tax of prior years	-	2,600
Payments during the year	(23,570)	(18,591)
At end of the year	(28,985)	(6,131)

13. EARNINGS PER SHARE

	2018 KShs'000	2017 KShs'000
(Loss)/profit attributable to owners of the Bank – KShs	(71,841)	36,433
Ordinary Shares at 1 January and 31 December (note 26)	200,000,000	200,000,000
Basic earnings per share – KShs	(0.36)	0.18

The basic earnings per share is the same as the diluted earnings per share as there were no dilutive potential ordinary shares as at 31 December 2018 and 31 December 2017, respectively.

14. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2018 KShs'000	2017 KShs'000
Cash on hand	362,931	419,599
Balances with Central Bank of Kenya:		
Cash ratio requirement	420,985	413,918
Cash with Central Bank of Kenya	324,991	110,739
	745,976	524,657
	1,108,907	944,256

The cash ratio requirement balance is non-interest earning and is based on the value of customer deposits as adjusted by the Central Bank of Kenya requirements. As at 31 December 2018, the cash ratio requirement was 5.25% (2017 – 5.25%) of the average outstanding customer deposits over a cash reserve cycle period of one month. These funds are not available to finance the Bank's day-to-day operations.

15. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	2018 KShs'000	2017 KShs'000
Placements with other banks	211,467	480,749
Less: Allowance for impairment losses (b)	(119)	-
	211,348	480,749

The weighted average effective interest rate on deposits with banking institutions as at 31 December 2018 was 6.59% (2017 – 6.51%) and nil for current account balances.

(a) Impairment allowance for due from banks

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

	2018				2017
	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'	Total KShs'000'
Internal rating grade					
Performing					
High grade	167,328	-	-	167,328	480,749
Standard grade	44,139	-	-	44,139	-
Non- performing					-
Individually impaired	-	-	-	-	-
Total	211,467	-	-	211,467	480,749

(b) An analysis of changes in the gross carrying amount and the corresponding ECL allowances is as follows:

	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'
Gross carrying amount as at 1 January 2018	480,749	-	-	480,749
Assets derecognised or repaid (excluding write offs)	(269,282)	-	-	(269,282)
At 31 December 2018	211,467	-	-	211,467

	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'
ECL allowance as at 1 January 2018	474	-	-	474
Assets derecognised or repaid	(355)	-	-	(355)
	119	-	-	119

16. DERIVATIVES

At 31 December 2018

Maturing within 3 months	Contract exchange rate 2018 KShs'000'	Foreign currency 2018 KShs'000'	Contract value 2018 KShs'000'	Fair value asset 2018 KShs'000'
Sell USD	102.60	250	25,650	200
	102.65	450	46,193	383
	102.90	300	30,870	330
	102.70	250	25,675	225
Sell GBP	128.90	100	12,890	(28)
			141,278	1,110

At 31 December 2017

Maturing within 3 months	Contract exchange rate 2017 KShs'000'	Foreign currency 2017 KShs'000'	Contract value 2017 KShs'000'	Fair value asset 2017 KShs'000'
Sell USD	103.20	250	25,800	(13)
	103.50	1,400	144,900	350
	103.05	500	51,525	(100)
	103.60	500	51,800	175
Sell EUR	122.40	200	51,625	(197)
			325,650	215

The Bank enters into forward foreign exchange contracts to cover specific exposure generated from payments and receipts of foreign currency. The fair value is the difference between the contract value and the foreign currency at the closing rate of KShs 101.8 to US Dollar (2017: KShs 103.25), KShs 129.2 to GBP (2017: KShs 123.38) and KShs 113.37 to EURO (2017:KShs 113.38).

17. LOANS AND ADVANCES TO CUSTOMERS

	2018 KShs'000	2017 KShs'000
Loans and advances to customers	7,020,626	6,903,312
Staff loans (note 32(d)	325,518	295,915
	7,346,144	7,199,227
Less: Allowance for ECL/impairment losses (a)	(720,622)	(595,107)
	6,625,522	6,604,120

(a)An analysis of changes in the gross carrying amount and the corresponding ECL allowances

	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'
Gross carrying amount as at 1 January 2018	3,641,440	1,962,540	1,595,247	7,199,227
New exposures	726,364	1,502,825	284,408	2,513,597
Assets derecognised or repaid (excluding write offs)	(1,206,465)	(420,823)	(735,040)	(2,362,329)
Transfers to Stage 1	(381,865)	-	381,865	-
Transfers to Stage 2	-	(264,254)	264,254	-
Transfers to Stage 3	-	-	-	-
Amounts written off	-	-	(4,351)	(4,351)
	2,779,474	2,780,288	1,786,382	7,346,144

Impairment allowance for loans and advances to customers in accordance with IFRS 9

	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'
ECLs allowance as at 1 January 2018	69,621	70,243	503,621	643,485
New exposures	-	-	81,488	81,488
Transfers to Stage 3	(58,744)	(37,201)	95,945	-
Amounts written off	-	-	(4,351)	(4,351)
At 31 December 2018	10,877	33,042	676,703	720,622

Transfers represent stage movements of prior year ECL allowances to the current year stage classification.
Impairment allowance for loans and advances to customers in accordance with IAS 39

	2017 KShs'000
At 1 January	531,959
Provisions in the year	80,248
Written off in the year	(17,100)
At December	595,107
Make up:	
Individually impaired	503,620
Past due but not impaired	91,487
At December	595,107

(b) Credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system

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

	2018				2017
	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'	Total KShs'000'
Internal rating grade					
Performing					
High grade	2,267,360	-	-	2,267,360	3,641,440
Standard grade	50,126	-	-	50,126	-
Sub-standard grade	461,988	-	-	461,988	-
Past due but not impaired	-	2,780,288	-	2,780,288	1,962,540
Non- performing					
Individually impaired	-	-	1,786,382	1,786,382	1,595,247
Total	2,779,474	2,780,288	1,786,382	7,346,144	7,199,227

According to the Bank's internal rating grade, individually impaired are loans and advances for which the Bank determines that it is probable that it will be unable to collect a part/whole of principal and interest due according to the contractual terms of the loan/securities agreement(s). These loans are graded in accordance with the regulator's prudential guidelines and are termed as non-performing loan

Past due but not impaired loans are loans and securities where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security/ collateral available and or the stage of collection of amounts owed to the Bank. These loans are graded 2 in the Bank's internal credit risk grading system.

Loans and advances are neither past due nor impaired are graded as performing. The Bank classifies loans and advances under this category for those exposures that are up to date and in line with contractual agreements. Neither past due nor impaired high grade loans and advances for performing grade are backed by collateral in the form of cash, properties motor vehicles and whereas standard grade are backed by household collateral and debentures. Sub standard grade unsecured performing loans

(c) Non performing loans and advances to customers

Included in net loans and advances of KShs 6.6 billion (2017 - KShs 6.6 billion) are loans and advances amounting to KShs 0.93 billion (2017 - KShs 1.1 billion), net of specific provisions, which have been classified as non-performing.

(d)Maturity of gross loans and advances

	2018 KShs'000	2017 KShs'000
Maturing:		
Up to one month	524,824	1,129,445
1-3 months	727,715	549,386
3-6 months	350,676	891,602
6-12 months	1,081,267	1,225,083
1-3 years	2,690,695	2,373,931
3-5 years	1,970,967	622,224
Over 5 years	-	407,556
Loans and advances to customers (gross)	7,346,144	7,199,227

18. GOVERNMENT SECURITIES

	2018 KShs'000	2017 KShs'000
Treasury bonds -at amortised cost	1,614,217	-
Treasury bonds -held-to-maturity	-	1,630,439

Treasury bonds are debt securities issued by the Republic of Kenya

An analysis of changes in the gross carrying amount is as follows:

	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'
Gross carrying amount as at 1 January 2018	1,630,439	-	-	1,630,439
New assets purchased	210,254	-	-	210,254
Assets derecognised or matured	(226,476)	-	-	(226,476)
Amounts written off	-	-	-	-
	1,614,217	-	-	1,614,217

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

	2018				2017
	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'	Total KShs'000'
Internal rating grade					
Performing					
High grade	1,614,217	-	-	1,614,217	1,630,439
Standard grade	-	-	-	-	-
Non- performing					-
Individually impaired	-	-	-	-	-
Total	1,614,217	-	-	1,614,217	1,630,439

The weighted average effective interest rate on government securities as at 31 December 2018 was 9.88% (2017 – 9.85%). As at 31 December 2017, the bank had held to maturity carried at amortized cost with a carrying amount of KShs 1.630 billion and a fair value of 1.8 billion. Held to maturity securities measured at amortized cost are required to be assessed for impairment on a periodic basis. Impairment exists when, in management's opinion, there is no longer reasonable assurance that the full amount of principal and interest can be collected. As at 31 December 2017, we determined that these held to maturity securities, which were reclassified as financial assets at amortised cost in 2018, were not impaired. These were also not impaired as at 31 December 2018 During 2018, government securities KShs 226,476 (under buy and sale back arrangement) were sold.

	2018 KShs'000	2017 KShs'000
Maturity analysis of government securities		
The maturity profile of Government securities is as follows:		
maturing within 90 days	-	-
maturing between 90 days to 1 year	207,694	-
maturing between 1 - 2 years	313,469	524,454
maturing after 2 years but within 5 years	387,769	127,449
maturing after 5 years	705,285	978,536
	1,614,217	1,630,439

19. OTHER ASSETS

	2018 KShs'000	2017 KShs'000
Clearing and transit items	212,860	97,266
Sundry debtors	62,070	97,134
Deposits and prepayments	9,675	12,548
Interest receivable	3,013	29,152
Other assets	309	-
	287,927	236,100

Other assets are settled no more than 12 months after the reporting date. All the balances are non-interest bearing.

20. PROPERTY AND EQUIPMENT

COST	Leasehold improvements KShs'000	Furniture, fittings and equipment, computer hardware KShs'000	Motor vehicles KShs'000	Total KShs'000
At 1 January 2018	236,606	365,603	11,886	614,095
Additions	4,100	8,716	-	12,816
Disposals	-	(205)	-	(205)
At 31 December 2018	240,706	374,114	11,886	626,706
DEPRECIATION				
At 1 January 2018	164,286	260,209	11,343	435,838
Charge for the year	24,987	31,687	468	57,142
Disposals	-	(131)	-	(131)
At 31 December 2018	189,273	291,765	11,811	492,849
NET CARRYING AMOUNT				
At 31 December 2018	51,433	82,349	75	133,857
At 31 December 2017				
At 1 January 2017	205,958	331,826	12,536	550,320
Additions	30,648	36,553	-	67,201
Disposals	-	-	(650)	(650)
Transfers	-	(2,776)	-	(2,776)
At 31 December 2017	236,606	365,603	11,886	614,095
DEPRECIATION				
At 1 January 2017	140,636	226,620	10,780	378,036
Charge for the year	23,650	34,527	1,213	59,390
Disposals	-	-	(650)	(650)
Transfers	-	(938)	-	(938)
At 31 December 2017	164,286	260,209	11,343	435,838
NET CARRYING AMOUNT				
At 31 December 2017	72,320	105,394	543	178,257

Transfer relates to damaged ATM that had been erroneously capitalised. However, the amount is receivable from the insurance company and the amount is included under other assets.
The bank has not pledged any property and equipment as security for liabilities.

21. INTANGIBLE ASSETS

	2018 KShs'000	2017 KShs'000
Computer Software		
COST		
At 1 January	218,066	205,298
Additions	51,242	12,768
At 31 December	269,308	218,066
AMORTISATION		
At 1 January	179,696	139,133
Charge for the year	36,569	40,563
At 31 December	216,265	179,696
NET CARRYING AMOUNT		
At 31 December	53,043	38,370

22. DEFERRED TAX ASSET

Deferred tax is calculated on all temporary differences under the liability method using a principal tax rate of 30%. The makeup of the deferred tax liabilities at the end of the year and the movements on the on the deferred tax account during the year are presented below:

	2018 KShs'000'	Through Profit or Loss KShs'000'	Through Retained Earnigs Note 2(c) (i) KShs'000'	2017 KShs'000'
Accelerated wear and tear over depreciation	21,631	5,240	-	16,391
Provision for credit losses	132,412	19,020	20,539	92,853
Other provisions	4,822	(4,631)	-	9,453
Leave pay	2,096	158	-	1,938
Gratuity and union salary increment	2,794	1,548	-	1,246
Legal fees	6,853	6,003	-	850
Deferred tax asset	170,608	27,338	20,539	122,731

	Through 2017 KShs'000'	Through Profit or Loss KShs'000'	Retained Earnigs Note 2(c) (i) KShs'000'	2016 KShs'000'
Provision for credit losses		92,853	24,075	68,778
Accelerated wear and tear over depreciation		16,391	(13,167)	29,558
Other provisions		9,453	19,057	(9,604)
Leave pay		1,938	(720)	2,658
Gratuity and union salary increment		1,246	646	600
Legal fees		850	(1,634)	2,484
Deferred tax asset		122,731	28,257	94,474

23. DEPOSITS AND BALANCES DUE TO OTHER BANKS

	2018 KShs'000	2017 KShs'000
Demand accounts	63,990	51,625

The average effective interest rate on deposits and balances due to banking institutions at 31 December 2018 was 4.5% (2017: 4.5%).

24. CUSTOMER DEPOSITS

	2018 KShs'000	2017 KShs'000
Current and demand accounts	3,072,708	2,992,210
Savings accounts	820,012	952,583
Fixed and call deposit accounts	4,126,050	3,953,703
	8,018,770	7,898,496
MATURITY ANALYSIS OF CUSTOMER DEPOSITS		
Repayable:		
Within one month	3,892,720	3,604,490
Within 1 - 3 months	3,225,210	2,402,994
Within 3 - 6 months	541,132	1,595,698
Within 6-12 months	359,708	295,314
	8,018,770	7,898,496

The weighted average effective interest rate on interest bearing customer deposits at 31 December 2018 was 5.2% (2017 – 5.2%).
The related party transactions and balances are disclosed under note 32.

25. OTHER LIABILITIES

	2018 KShs'000	2017 KShs'000
Bankers cheques outstanding	85,278	73,521
Deposits for letters of credit and letters of guarantee	6,283	52,522
Allowances for credit losses — off-balance-sheet commitments(i)	1,870	-
Provision for leave pay	6,994	24,113
Legal fees provision	22,845	2,826
Other liabilities and accruals (ii)	100,908	59,913
	224,178	212,895

(i) Upon IFRS 9 adoption on 1 January 2018, allowances for credit losses on off-balance-sheet commitments are now reported in the Other liabilities item of the Statement of Financial Position

(ii) Other liabilities and accruals relate to bills payable, sundry creditors and accruals. They are payable on demand and the balances are non-interest bearing.

26. SHARE CAPITAL

	2018 KShs'000	2017 KShs'000
Authorised :-		
230,000,000 (2017 - 230,000,000) ordinary shares of KShs 5 each	1,150,000	1,150,000
Issued and fully paid:-		
200,000,000 (2017 - 200,000,000) ordinary shares of KShs 5 each	1,000,000	1,000,000

27. SHARE PREMIUM

	2018	2017
At 1 January	42,236	42,236

The premium arose in 2010 when the Bank issued 6,142,908 new shares. The shares, with a par value of KShs 5, were issued at KShs 11.876 each.

28. STATUTORY RESERVE

	2018 KShs'000	2017 KShs'000
At 1 January	121,774	104,851
Transfer from retained earnings	31,983	16,923
At 31 December	153,757	121,774

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 of loan provisions as computed in accordance with the Central Bank of Kenya prudential guidelines over the impairment of loans and receivables computed in accordance with IFRS 9. The statutory reserve is not distributable.

29. NOTES TO THE STATEMENT OF CASH FLOWS

	Notes	2018 KShs'000	2017 KShs'000
(a) Reconciliation of profit before taxation to cash used in operating activities			
(Loss)/Profit before taxation		(98,463)	53,984
Depreciation	20	57,142	59,390
Amortisation of intangible assets	21	36,569	40,563
Other provisions		56,650	37,559
Loss/(gain) on disposal of equipment	8	90	(310)
Movement in provisions for credit losses	11	63,391	80,248
Unrealised exchange differences		(411)	(18,596)
Cash flows from operating activities before changes in operating assets and liabilities		114,968	252,838
Changes in operating assets and liabilities			
Loans and advances to customers		(190,712)	(224,089)
Other assets		(54,392)	181,838
Customer deposits		154,655	(101,506)
Other liabilities		(45,383)	12,182
Financial liability – derivatives		895	157
Cash ratio requirement	14	7,067	4,120
Cash (used in)/ generated from operating activities		(12,902)	125,540

(b) Analysis of cash and cash equivalents

	Notes	2018 KShs'000	2017 KShs'000
Cash and balances with the central banks	14	1,108,907	944,256
Cash reserve requirement	14	(420,985)	(413,918)
Deposits and balances due from banking institutions	15	211,348	480,749
Deposits and balances due to banking institutions	24	(63,990)	(51,625)
		835,280	959,462

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

30. DIVIDENDS AND DIVIDENDS PER SHARE

(a) Dividends payable
Dividends payable relate to dividends declared in the current and previous year by the Bank but not collected by the shareholders or their representatives. The dividends payable have been included in other liabilities.

	2018 KShs'000	2017 KShs'000
At 1 January	-	-
Dividends declared	30,000	40,000
Dividends paid	(30,000)	(40,000)
At 31 December	-	-

(b) Proposed dividend
Proposed dividends are not accounted for until they have been ratified at the Annual General Meeting.
The directors do not recommend the payment of dividend (2017 - KShs 30 million). At the forthcoming annual general meeting, no dividend in respect of 2018 (2017: KShs 0.2 cents) is to be proposed.

31. CONTINGENT LIABILITIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS

(a) Contingent liabilities
The bank conducts business involving acceptances, guarantees, performance bonds and letters of credit. The majority of these facilities are offset by corresponding obligations of third parties.

	2018 KShs'000	2017 KShs'000
Letters of credit	8,433	223,741
Guarantees and performance bonds	287,905	550,281
Loans committed but not disbursed at year end	228,069	642,989
	524,407	1,417,011

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

Letters of guarantee and performance bonds are issued by the Bank, on behalf of customers, to guarantee performance by customers to third parties. The Bank will only be required to meet these obligations in the event of default by the customers. Generally, the term of these letters of guarantee is less than two years. Loans committed but not disbursed are agreements to lend to customers in future subject to certain conditions. Such commitments are normally made for a fixed period.

(b) Foreign exchange forward contracts

	2018 KShs'000	2017 KShs'000
Foreign exchange forward contracts	141,278	325,650

Foreign exchange forward contracts are agreements to buy or sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate.

(c) Commitments

Commitments contracted for at the reporting date but not recognised in the financial statements were as follows:

	2018 KShs'000	2017 KShs'000
(i) Capital: Authorised and contracted for	158	14,200
(ii) Capital: Authorised and not contracted for	26,000	83,400

(d) Litigations against the bank

Litigation against the bank relates to civil suits lodged against the Bank by customers and employees in the normal course of business. It is not possible to estimate the Bank's possible loss in relation to these matters, nor the effect that they might have upon operating results in any particular financial period. The Directors, however, do not anticipate that any liability will accrue from the pending suits.

(e) Operating lease arrangements

The Bank as a lessee

The bank has entered into commercial property leases on a number of branches and office premises under operating leases. These non-cancellable leases have remaining terms of between one and five years. All leases include a clause that enables upward revision of the rental charges on an agreed basis according to prevailing market conditions. During the year ended 31 December 2018, KShs 78.9 million (2017: KShs 76.3 million) was recognised as an expense in profit or loss in respect of operating leases. Future minimum rentals payable under non-cancellable operating leases as at 31st December are shown below.

	2018 KShs'000	2017 KShs'000
Within one year	61,112	78,982
Between 2 and 5 years	284,387	346,401
	345,499	425,383

(f) Impairment losses on guarantees and other commitments

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

	2018				2017
	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'	Total KShs'000'
Internal rating grade					
Performing					
High grade	399,858	-	-	399,858	1,299,229
Standard grade	-	121,053	-	121,053	117,782
Sub-standard grade	-	-	3,496	3,496	-
Total	399,858	121,053	3,496	524,407	1,417,011

An analysis of changes in the gross carrying amount and the corresponding ECL allowances

	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'
Gross carrying amount as at 1 January 2018	1,299,229	117,782	-	1,417,011
Assets derecognised or repaid (excluding write offs)	399,857	121,053	3,497	524,407
Assets derecognised or repaid	(1,331,321)	(85,690)	-	(1,417,011)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
	367,765	153,145	3,497	524,407

Impairment losses on guarantees and other commitments

	Stage 1 Individual KShs'000'	Stage 2 Individual KShs'000'	Stage 3 KShs'000'	Total KShs'000'
ECL allowance as at 1 January 2018	8,282	11,329	-	19,611
Reversal of credit losses	(7,965)	(9,778)	-	(17,743)
Transfers to Stage 3	-	(73)	73	-
At 31 December 2018	317	1,478	73	1,868

32. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

The Bank holds deposits from directors, companies associated with directors and employees. Advances to customers include advances and loans to directors, companies associated with directors and employees.

Contingent liabilities include guarantees and letters of credit for companies associated with the directors.

(a) The Bank leases office and parking space from Autosilo (Queensway) Ltd, a company with common directorship. Payments during the year amounted to KShs 28,263,350 (2017 - KShs 26,063,948).

(b) Directors Loans to directors:	**2018** **KShs'000'**	**2017** **KShs'000'**
At start of year	19,253	22,222
Advanced during the year	13,360	5,500
Repaid during the year	(17,805)	(8,469)
At end of year	14,808	19,253
Interest income earned from directors' loans	2,617	2,965
(c) Deposits by directors:		
At start of year	18,295	10,160
Net movement during the year	(10,897)	8,135
At end of year	7,398	18,295
Interest paid on directors' deposits	776	987
(d) Other disclosures		
Advances to other related parties		
Advances to companies related through control by a common shareholder or their families	529,352	518,671
Advances to companies controlled by directors or their families	40,395	71,887
Advances to employees (Note 17)	325,518	295,915
Contingent liabilities including letters of credit and guarantees issued for companies related through shareholding, common directorship and companies controlled by directors or their families	45,829	132,223
Interest income earned from related companies and employees	65,614	69,641
Deposits with other related parties		
Deposits by companies related through control by a common shareholder or their families	1,424,812	1,538,771
Deposits by companies controlled by directors or their families	24,738	25,327
Deposits by employees	19,678	17,016
Interest expense incurred on deposits by related companies and employees	86,017	89,572

	2018 KShs'000'	2017 KShs'000'
Key management compensation		
Salaries and other short-term employment benefits	49,609	49,662
Post employment benefits	9,316	2,736
	58,925	52,398
Director's remuneration		
-fees for services as a director	6,400	7,117
-other emoluments*	9,488	9,502
	15,888	16,619

*Relates to directors travel expenses, accommodations and annual general meeting package

33. ASSET PLEDGED AS SECURITY

As at 31 December 2018, assets pledged as security comprised balances with the Central Bank of Kenya under lien for Domestic Foreign Currency clearing amounting to USD 110,000 (2017: USD 110,000).

34. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled.

At 31 December 2018

	Within 12 months KShs '000	After 12 months KShs'000	2018 KShs'000
ASSETS			
Cash and balances with Central Bank of Kenya	1,108,907	-	1,108,907
Deposits and balances due from banking institutions	211,348	-	211,348
Financial derivatives	1,110	-	1,110
Loans and advances to customers	2,342,283	4,283,239	6,625,522
Government securities	207,694	1,406,523	1,614,217
Tax recoverable	28,985	-	28,985
Other assets	287,927	-	287,927
Property and equipment	-	133,857	133,857
Intangible assets	-	53,043	53,043
Deferred tax asset	-	170,608	170,608
TOTAL ASSETS	4,188,254	6,047,270	10,235,524
LIABILITIES			
Due to banking institutions	63,990	-	63,990
Customer deposits	8,018,770	-	8,018,770
Other liabilities	224,178	-	224,178
TOTAL LIABILITIES	8,306,938	-	8,306,938
NET ASSETS	(4,118,684)	6,047,270	1,928,586

At 31 December 2017

	Within 12 months KShs '000	After 12 months KShs'000	2017 KShs'000
ASSETS			
Cash and balances with Central Bank of Kenya	944,256	-	944,256
Deposits and balances due from banking institutions	480,749	-	480,749
Financial derivatives	215	-	215
Loans and advances to customers	3,597,147	3,006,973	6,604,120
Government securities	-	1,630,439	1,630,439
Tax recoverable	6,131	-	6,131
Other assets	236,100	-	236,100
Property and equipment	-	178,257	178,257
Intangible assets	-	38,370	38,370
Deferred tax asset	-	122,731	122,731
TOTAL ASSETS	5,264,598	4,976,770	10,241,368
LIABILITIES			
Due to banking institutions	51,625	-	51,625
Customer deposits	7,898,496	-	7,898,496
Other liabilities	212,895	-	212,895
TOTAL LIABILITIES	8,163,016	-	8,163,016
NET ASSETS	(2,898,418)	4,976,770	2,078,352

35. INCIDENTAL BUSINESS ACTIVITIES

The Bank is in partnership with Liaison Group (I.B) Limited to offer Bancassurance services to both the Bank's internal and external customers. As per the agreement, the commissions on underwritten business are to be shared on a ratio 50:50 between the Bank and Liaison Group (I.B) Limited. The commission shared are net of expenses and are included in fees and commission income on the statement of profit or loss and other comprehensive income.

	2018 KShs'000	2017 KShs'000
Commissions – net of expenses	1,370	1,681

36. EVENTS AFTER THE REPORTING PERIOD

No significant events have come to the attention of the Directors after the reporting date that require adjustment to, or disclosure in, these financial statements.

37. COUNTRY OF INCORPORATION

The Bank is incorporated under the Kenyan Companies Act, 2015 and domiciled in Kenya.

38. CURRENCY

The financial statements are presented in thousands of Kenya shillings (KShs'000), which is the Bank's functional and presentation currency.

Our Branch Footprint

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Email – westlandsbranch@tnbl.co.ke

Sheikh Karume Branch
Pramukh Plaza, Sheikh Karume Road
P.O Box 60377 – 00100, Nairobi
Tel. 254-020-2216060, 2216061
Email – sheikhkarume@tnbl.co.ke

Baringo County
Kabarnet Branch
Matetai Building, Philemon Road
P.O Box 385-30400, Kabarnet
Tel. 254-053-22028/29
Email – kabarnetbranch@tnbl.co.ke

Marigat Branch
Tel. 0776 180218
Email – marigatbranch@tnbl.co.ke

Eldama Ravine Branch
Tel. 254 704870207
P.o. Box 1010 – 20103, Eldama Ravine
Email. Eldamaravinebranch@tnbl.co.ke

Bomet County
Bomet Branch
Sigor House, Kipchamba Street
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Tel. 254-020-2362119/20
Email – bometbranch@tnbl.co.ke

Elgeyo Marakwet County
Iten Branch
Mosop Plaza, Iten-Kessup Road
P.O. Box 540-30700, Iten,
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Kapcherop Branch
Plot No. 33 Kapcherop
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Tel. +254797759599/ +254797 759603
Email. kapcheropbranch@tnbl.co.ke

Kericho County
Kericho Branch
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Machakos County
EPZ Athi River Branch
Export Processing Zone, Athi River
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Mombasa International Airport Branch
Moi International Airport, Arrivals Unit
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Tel. 254-041- 3432877

Nandi County
Nandi Hills Branch
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Lessos Branch
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Nakuru Branch
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Kabarak University Branch
Kabarak University, Kabarak
P.O. Box 148 – 20100, Kabarak
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Kiptagich Branch
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Olenguruone Branch
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Narok Branch
Mara House, Mara Road
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Trans Nzoia County
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Uasin Gishu County
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Burnt Forest Branch
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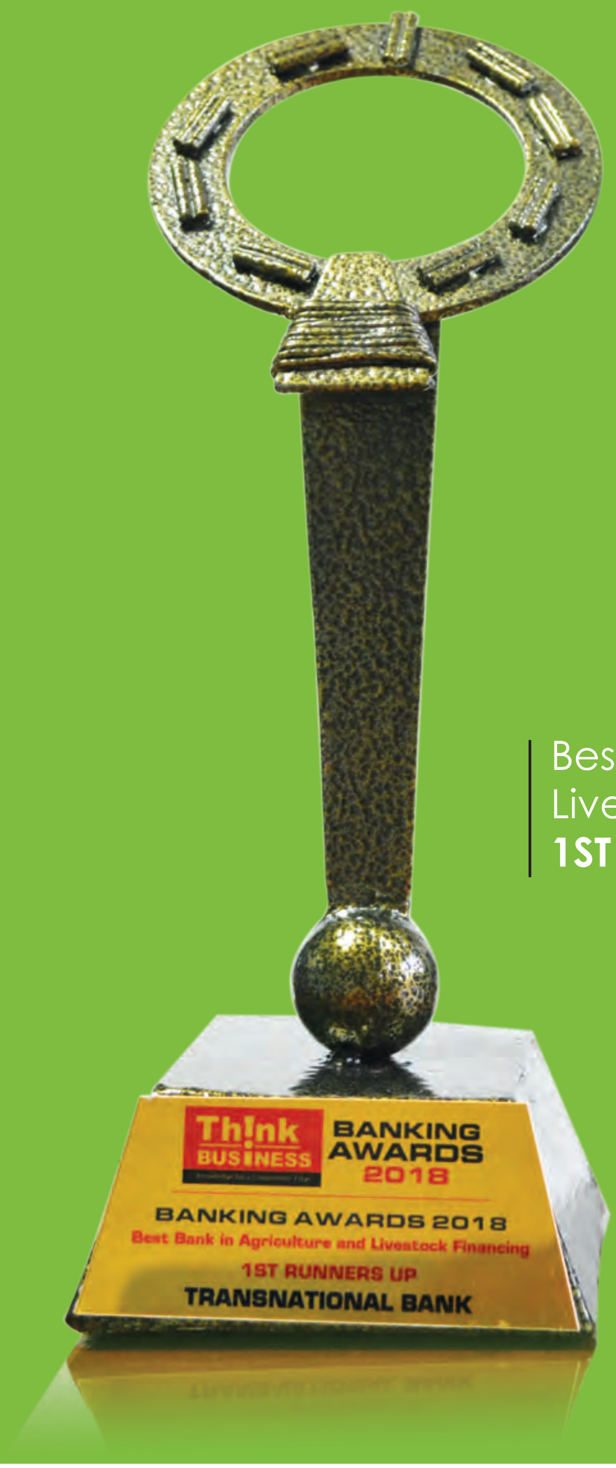
West Pokot County
Kapenguria Branch
Paves building
Tel. 0772 973 116, 0772 973 100
P.o. Box 295 – 30600\, Kapenguria
Email. kapenguriabranch@tnbl.co.ke



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