Prime Bank

PUTTING YOU FIRST

ANNUAL REPORT

& FINANCIAL STATEMENTS

2018

OUR VISION

To be the financial service provider of first choice.

OUR MISSION

To provide quality and acceptable personalized financial services to our customers while observing compliance, growth and shareholder value..

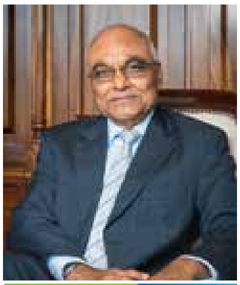
OUR CORE VALUES

- Integrity
- Quality
- Innovativeness
- Social Responsibility
- Teamwork

CONTENTS

CORPORATE INFORMATION
BOARD OF DIRECTORS

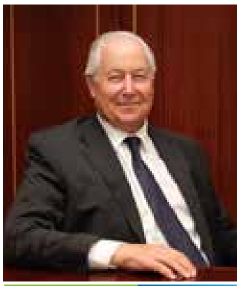
CHAIRMAN
Mr. R. C. Kantaria



Vice Chairman
Mr. S. K. Shah

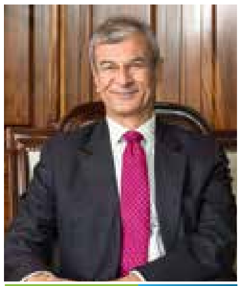
Director
Mr. T. M. Davidson

Director
Mr. J. N. Mungai



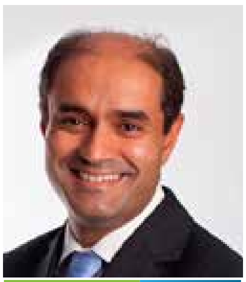
Director
Mr. D. G. M. Hutchison

Director
Mr. J. K. Kibet

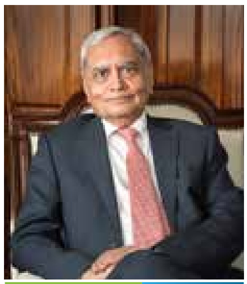


Director
Mr. Farid Mohamed

Director
Mr. Biniam Yohannes



Director
Mr. Skander Khalil



Company Secretary
Mr. Arun Shah

Executive Director
Mr. A. R. Kantaria

Managing Director
Mr. Bharat Jani

BANK INFORMATION

PRINCIPAL PLACE OF BUSINESS
L.R. 209/8571
Prime Bank Building
Riverside Drive
P.O. Box 43825 – 00100
Nairobi

REGISTERED OFFICE
L.R. 209/8890
Kenindia House
Loita Street
P.O. Box 43825 - 00100
Nairobi

LAWYERS
KIRUTI & COMPANY ADVOCATES
P. O Box 13160 - 00100
Nairobi

MACHARIA MWANGI & NJERU ADVOCATES
P.O. Box 10627 - 00100
Nairobi

A B PATEL & PATEL ADVOCATES
P. O. Box 80274 - 80100
Mombasa

MANDLA & SEHMI ADVOCATES
P. O. Box 48642 - 00100
Nairobi

MAHINDA & MAINA COMPANY ADVOCATES
P. O. Box 42508 - 00100
Nairobi

SECRETARY
A.H. SHAH
Company Secretary
P.O. Box 46559 - 00100
Nairobi

AUDITOR
DELOITTE AND TOUCHE
Certified Public Accountants (Kenya)
Deloitte Place
Waiyaki Way, Muthangari
P. O. Box 40092 - 00100
Nairobi

"In order to grow our business, Prime Bank embarked on a successful capital raising in 2018 by inviting subscription of equity capital from our customers and staff and private equity firms Afric Invest and Catalyst Principal Partners."

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2018

On behalf of the Board of Directors, I am pleased to present the Annual Report and Financial Statements of Prime Bank Group for the Year ended 31st December, 2018.

During the year under review, the group registered satisfactory performance against the backdrop of a challenging business environment thus signifying the resilience and the potential of the group.

OPERATING ENVIRONMENT
At the beginning of 2018, the global economy picked up well but lost momentum owing to the weakening of the financial markets.

The year was characterized by a slight decline in global growth to 3.0% from 3.1% recorded in 2017 as a result of the effects of trade conflicts between the US, China, and the Eurozone, as well as weak projections for emerging markets such as South Africa and Brazil.

According to African Development Bank, Africa's economic performance continued to improve during the period, however; growth upswing remained uneven with current and fiscal deficits and debt vulnerability affecting most countries.

Kenya's economy recorded an average growth of 6.0% compared to the 4.7% registered in the previous year, powered by several factors including improved weather conditions favoring agriculture, continued recovery of the tourism sector, and increased output in the manufacturing sector.

In 2018, inflation averaged 4.7% compared to 8% in the previous year. However, at the tail end of the year, it rose to 5.7%, mainly due to rising fuel prices occasioned by implementation of the 8.0% VAT on fuel.

The Kenyan Shilling remained resilient in 2018, appreciating by 1.3% against the USD to close at KShs 101.3.

REGULATORY ENVIRONMENT
The Kenyan banking sector remained stable in 2018, with commercial banks' average liquidity at 48 per cent and capital adequacy ratios at 18 percent largely aided by the improving economic conditions and a more conducive operating environment compared to last year, which was marred by uncertainties due to the general election.

GROUP PERFOMANCE
I am pleased to report that the Group exhibited resilience in its performance in 2018 despite the challenging operating environment. We continued to build a strong track record by delivering solid results. The group recorded a net profit of KShs 2.274 Billion in 2018 compared to KShs 2.245Billion registered in 2017.

GROUP CAPITAL RAISING INITIATIVE
In order to grow our business, Prime Bank embarked on a successful capital raising in 2018 by inviting subscription of equity capital from our customers and staff and private equity firms Afric Invest and Catalyst Principal Partners. This initiative will unfold opportunities for the Bank in the domestic and regional markets.

The new partnership with Afric Invest and Catalyst will further bolster our efforts in advancing our strategic plan

CHAIRMAN'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2018

which includes institutionalizing the governance and shareholding structures, local and regional expansion, optimization of services, offering of new products and further digitalizing operations while continuing to provide enhanced services to our customers.

CORPORATE GOVERNANCE AND BOARD CHANGES
In line with the Bank's high standards of corporate governance and regular review of our governance structures, the year 2018 saw the Bank make changes at the Board level with the appointment of Mr. Biniam Yohannes and Mr. Skander Khalil Oueslati. The two bring on board extensive experience in investment management, private equity, as well as investment banking and emerging markets.

CORPORATE SOCIAL INITIATIVES
Prime Bank has remained committed in maintaining the Bank's corporate value of caring for the society. Our long standing commitment to improve healthcare, education, support to the needy, and nurture talent through sports, continued to thrive in 2018.
During the period under review, in its flagship Corporate Social Responsibility (CSR) project – Freedom for Girls, the Bank donated KShs. 1.5 Million towards ensuring girls do not miss school during their monthly cycle. Since its inception, Prime Bank has so far donated KShs. 10.5 million hence ensuring 24,444 girls are guaranteed full year's supply of sanitary towels and undergarments.

The Jaipur Foot Project is one of the largest and oldest projects of Rotary District 9200. Since its inception in 1990 with the sole purpose of helping the physically challenged to get fitted with prostheses, over 30,000 patients have benefited from this project. Prime Bank supports the project yearly.

Prime Bank has partnered with Jalaram Temple, Nakuru who are setting up a medical centre. The medical centre will offer diagnostic laboratory services, radiology, CT scan, general practice clinics and pharmaceutical services at a subsidized rate, to low income households. Prime Bank donated KShs.3Million for construction of the facility.

The Rotary Club of Nairobi has been running the Kenya Rural Blindness Eradication Program that performs cataract operations to the less fortunate in the society for the past 30 years. In 2018, Prime Bank sponsored a charity golf tournament at the Vet Lab Sports Club with the aim of raising funds to support the Rotary Club of Nairobi. Over KShs.900,000 was raised through the charity tournament.

The Bank donated 10 tonnes of foodstuff - 2,000 packets of maize meal, 5 kg to help 4 members in a family - to reach 8,000 people who were affected by the drought in Turkana in May 2018.

Throughout the year, the Bank continued to support charitable institutions, non-governmental organizations, schools, and trusts, nurturing talent through promotion of sports, among other initiatives.

2019 AND BEYOND
The world economic growth this year remains uncertain due to the negative effects of tariff increases enacted in U.S and China and the sluggish growth momentum witnessed in the eurozone in the second half of 2018. Of major concern is also the adverse effects of climate change which continues to pose a serious challenge for the globe.

Back home, the economy is expected to robustly grow with inflation rate remaining within the target range of 2.5 to 7.5 per cent in the next 12 months. Favorable weather and low energy costs are some of the factors expected to keep inflation rate low.

We remain optimistic that the Kenyan shilling will remain stable against the US Dollar for the better part of the year. However, the likelihood of increase in oil prices, materialization of Brexit, and concerns of a global recession are some of the factors likely to cause the shilling to experience moderate pressure against the dollar during the second half of 2019.

The fluctuating regulatory environment in the banking sector remains an area of influence on our operations. However, I am confident that credit extended to private sector will increase in 2019 compared to 2018 supported by increasing economic activity and a stable macroeconomic environment.

The ruling by the courts on Section 33B (1) and (2) of the Banking (Amendment) Act 2016 that gave a 12-month window for Parliament to reconsider the provisions provides the industry with a good opportunity to re-engage with stakeholders, including the National Assembly, Central Bank and National Treasury.

At Prime Bank, 2018 marked the beginning of a new era as we welcomed new shareholders and partners on board. We are confident that our partnership will strengthen our brand and open doors for competitive trade finance lines.

CHAIRMAN'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2018

Going forward, we will remain true to our long-term commitment to sustainably grow returns on shareholders' investment.

In 2018, we continued to enhance our strategic influence in the industry and keeping our promise to our customers - *'Putting you first'*.

On behalf of the Board, I wholeheartedly thank our customers, partners and shareholders for their continued loyalty and support and the management team and staff for their admirable commitment during the period under review.

On behalf of my colleagues on the Board I extend my appreciation to our regulators, in particular Central Bank of Kenya, Capital Markets Authority and the Treasury for their invaluable guidance and support.

Finally, I take this opportunity to sincerely thank my colleagues on the Board for their wise counsel and support throughout the year.

With best Wishes,

R.C Kantaria
Chairman

"To remain competitive in the industry and ensure consistent growth across all our delivery channels, we continued to enhance our products and services offering to better serve our customers."

MANAGING DIRECTOR'S STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2018

Despite Political and Macroeconomic stability, the year was challenging for the economy and the banking sector in particular.

Inflation averaged 4.7% in 2018 well within the government target of 2.5% to 7.5% during the year. Interest rates declined by an average of 1% during the year mainly due to the reduction in CBR (Central Bank Rate). Contrary to expectations, the Kenya shillings exchange rate remained stable supported by strong growth in diaspora remittance, decline in International oil prices and higher Foreign Direct Investments. However, the private sector lending grew by a dismal 2.4% during the year. Coupled with increased regulatory compliance and Non Performing Loans in the industry, our business model was resilient and delivered satisfactory results.

It is against this backdrop that I am pleased to present the highlights of our financial performance and the outlook for 2019.

OPERATING ENVIRONMENT

2018 was characterized by low growth rates in domestic credit, revenue and balance sheet across the financial services sector.

In the wake of the capping of interest rates and compliance to the IFRS 9 standard, 2018 saw banks review their business models and credit policies to navigate through the relatively challenging operating environment.

The period under review also witnessed strategic consolidations with mergers and acquisitions recorded across the sector with the main aim of harnessing strength, capital, and network to harvest the benefit of economies of scales.

At Prime Bank, our business model has always emphasized the need for further expansion and during the 2018 financial year, we embarked on strengthening our capital base through bringing new investors on board.

Our first step was to issue a private placement which was successfully taken up by our longstanding customers and long serving staff which raised over KShs. 2Billion.

Our second step involved partnering with Afric Invest and Catalyst Principal Partners which saw the two private equity funds acquire a minority stake in the Bank. Through KShs. 5.1 billion capital injection, Afric Invest and Catalyst jointly acquired a 24.2 per cent stake in the Bank.

PERFORMANCE

Against a challenging business environment, our performance remained consistent with our strategic plan laying great emphasis on capital strength for growth plans ahead.

During the period under review, we maintained strong capital adequacy position, ending the year with core capital of KShs. 19.313Billion against Central Bank of Kenya's statutory requirements of KShs. 1Billion.

The Bank's balance sheet expanded by 29 % to KShs. 98.534 Billion from KShs. 76.438 Billion while non performing loans remaining low at 6.1 %.

MANAGING DIRECTOR'S STATEMENT (continued)
FOR THE YEAR ENDED 31 DECEMBER 2018

The group's net profit closed the year at Kshs. 2.274 Billion while the Bank's stood at KShs. 2.021Billion representing a 10 % increased from KShs. 1.842Billion recorded same period last year.

Shareholders funds shot up by 68% from 13.719Biilion recorded in 2017 to KShs. 23.038Billion during the period under review.

The Bank's total deposits grew by KShs 13Billion to KShs 71.422Billion while advances declined to KShs. 36.642Billion from KShs. 38.817Billion recorded during the 2017 financial year.

The Bank's liquidity ratio stood at 71.5% high above the CBK's statutory requirement of 20%.

OPERATIONAL HIGHLIGHTS

To remain competitive in the industry and ensure consistent growth across all our delivery channels, we continued to enhance our products and services offering to better serve our customers.

We expanded our local network through venturing into the Mount Kenya region with the opening of a branch in Meru County in the course of last year. We also broadened our virtual branches concept - the intelligent ATMs with new installations in strategic locations.

In line with our customers' needs, the Bank launched a unique and innovative service – "Bank on Wheels". This is a comprehensive and secure banking experience which will offer banking services for select customers at their convenience, through a specially designed truck. The Bank on Wheels works as a mini branch allowing customers deposit cash and cheques, make withdrawals, account enquiry and statements printing, on the vehicle.

The Bank in partnership with Visa International launched a prestigious product offering – the Prime Visa Platinum Credit Card to cater for the affluent segment of the Bank's customer base.

THE YEAR AHEAD

Going into 2019, the country's growth outlook is anticipated to remain stable and so are other macroeconomic indicators such as inflation, interest rates, currency exchange rates, and the political environment.

Low growth in revenue, balance sheet, and domestic credit uptake are likely to persist in the banking industry on the back of the interest rate cap law.

At Prime Bank we remain confident that the capital injection will further strengthen the capital base to bolster expansion of our local and regional network, delivery of new products and the optimization of our services.

We will continuously endeavor to further the digitalization of our operations as well as institutionalizing the governance and shareholding structures of our great business.

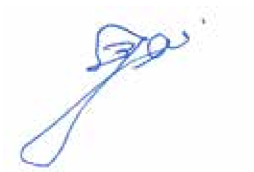
We look forward to the year with renewed hope of revenue growth and good returns to our shareholders' investment.

APPRECIATION

The progress we made in 2018 would not have been possible without the immense support, loyalty and cooperation of our customers throughout the year.

On behalf of the management and staff of Prime Bank, I extend appreciation to Board of Directors under the leadership of Dr. Rasik Kantaria for their continuous support, encouragement and guidance during the financial year under review.

The dedication, commitment and team work of our staff has always been impeccable and I thank them for keeping true to our mantra of putting our customers first.



Bharat Jani
Managing Director

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2018

The Directors have pleasure in submitting their report together with the consolidated audited financial statements for the year ended 31 December 2018.

Incorporation
The Bank 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 3.

Directorate
The directors who held office during the year and to the date of this report are set out on page 2. In accordance with Article 91 of the Articles of Association, A.R. Kantaria and T.M. Davidson retire by rotation and, being eligible, offer themselves for re- election.

Principal activities
The principal activities of the Bank are corporate and retail banking services while its subsidiary provides general insurance services with the exception of aviation insurance services.

Recommended dividend
The directors recommended and paid final dividend of KShs. 335 million for 2017 (interim dividend was KShs. 400 million). Current year interim dividend payable is KShs. 258.5 million.

Statement as to disclosure to the Bank'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 Bank '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 Bank 's auditor is aware of that information.

Terms of appointment of the auditor
Deloitte& Touche continues in office in accordance with the Company's Articles of Association and section 719 of the Kenya 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 6.1 million has been charged to profit or loss in the year.

Business review
Total assets of the Bank grew from KShs 76.4 billion in 2017 to KShs 98.5 billion in 2018; deposits grew from KShs 57.5 billion to KShs 71.4 billion in 2018, while profit after tax increased by 12.6% from KShs 1.8 billion to KShs 2.0 billion in 2018.

Management is aware of the liquidity risks that are inherent in the Banking sector and have maintained the Bank's liquidity ratio average at 59%, 39% over and above the 20% requirement under CBK regulations.

As regards the credit risk, a rigorous monitoring and close supervision of our credit portfolio throughout the year ensured that the non-performing loans were well under control at 4.4% way below the industry average.

The Bank acquired a majority stake in Tausi Assurance Company Limited last year. The Bank continues to cross sell products and services between banking and insurance clients which is expected to boost performance in future.

Staff training and hiring of new talent is at the heart of Prime Bank's long-term growth plans. European Investment Bank, which is the Bank's partner in financing of SME sector, is also providing training to the Bank's staff.

Future outlook
Real GDP grew by an estimated 5.9% in 2018, from 4.9% in 2017, supported by good weather, a stable political dispensation, improved business confidence, and stable macro-economic conditions. The Bank is optimistic of maintaining the growth momentum witnessed in 2018 to ensure profitability going forward. The Bank also expects to enhance its credit monitoring processes in all economic sectors in order to mitigate the impact of IFRS 9.

The bank will also explore different avenues of revenue generation, in a bid to increase non-funded income and further diversify revenue sources, given the continued effects of the interest rate cap, which has negatively impacted funded income. In a bid to minimize costs, the bank will embrace technology to reduce operational costs and thereby increase efficiency as well as implement cost monitoring and reduction strategies to eliminate waste.

Approval of financial statements
The financial statements were approved at a meeting of the Board of Directors held on 12 March 2019.

By order of the board

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Company Secretary
Nairobi

STATEMENT OF DIRECTORS' RESPONSIBILITIES
FOR THE YEAR ENDED 31 DECEMBER 2018

The Kenya 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 Bank 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 Bank keeps proper accounting records that: (a) show and explain the transactions of the Bank; (b) disclose, with reasonable accuracy, the financial position of the Bank; 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 Bank'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 Bank'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 12 March 2019 and signed on its behalf by:

……………………………………… Director	……………………………………… Director
……………………………………… Director	……………………………………… Secretary

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

INTRODUCTION

Prime Bank Limited recognises the need to conduct its business with integrity and in line with the generally accepted corporate practice. The Bank will strive to maintain the highest standards of corporate governance.

SHAREHOLDERS' RESPONSIBILITIES

The shareholders' role is to appoint the Board of Directors and independent auditors. The role of the shareholders is to ensure that the Board is accountable for effective and efficient governance.

BOARD OF DIRECTORS

The Board of Directors is responsible for the governance of the Bank and to ensure that the Bank complies with the law and the highest standards of corporate governance and business ethics. The Board is responsible for the long term growth and profitability of the Bank.

The Directors guide the management and maintain full and effective control over financial, strategic, operational and compliance issues of the Bank. The Board is chaired by a non-executive director and has six other non-executive directors, an executive director and the Managing Director. The Board meets regularly and holds special meetings as and when the situation demands.

ATTENDANCE OF DIRECTORS AT BOARD MEETINGS

Number of Board Meetings held in 2018 6

Name of Director	Number of meetings attended
Mr. R. C. Kantaria (Chairman)	5
Mr. S. K. Shah (Vice Chairman)	5
Mr. A. R. Kantaria (Executive)	5
Mr. Bharat Jani (Managing)	6
Mr. D. G. M. Hutchison	6
Mr. J. N. Mungai	6
Mr. T. M. Davidson	6
Mr. J.K. Kibet	4
Mr. F. Mohamed	6

BOARD PERFORMANCE EVALUATION

As per the Prudential Guidelines of the Central Bank of Kenya, the Board is responsible for ensuring that an evaluation of its performance as well as that of the individual directors and various committees is done. The results of such an evaluation are to be provided to the Central Bank of Kenya.

The Board conducted its evaluation and that of the members, the Chairman and the Board Committees. The aim was to assess their capacity and effectiveness relative to their mandates, and identify challenges that need to be addressed in the coming year. Each Board member was provided with the questionnaire before the Board meeting convened to discuss the evaluation. At the Board meeting, the ratings given by each member of the Board and its committees were discussed by all members under the direction of the Chairman of the Board. Overall ratings were agreed taking into account the individual ratings and comments. Overall, the Board concluded that it was operating in an effective manner.

The Board has appointed eight committees – Credit, Debt Management, Audit, Risk and Compliance, IT, Assets and Liability Management, Operations and Human Resource. These committees have been given terms of reference and they meet regularly. These committees make recommendations to the Board on matters which fall under their mandates. The committees are chaired by non-executive directors and four of them have an additional non-executive director as a member.

Mr. F. Mohamed, a non-executive director chairs the Credit Committee. Mr. J. N. Mungai, a non-executive director, Mr. A. R. Kantaria, Executive Director, Mr. Bharat Jani, Managing Director and Assistant General Manager (Credit) are the other members of the Committee. Fresh credit proposals are placed before the Credit Committee for sanction. The Committee also reviews the credit limits sanctioned, as per the credit policy approved by the Board.

DEBT MANAGEMENT COMMITTEE

This Committee is chaired by Mr. Jinaro Kibet who is a non - executive director. Mr. A. Kantaria, Executive Director, the Managing Director and the Assistant General Manager (Credit) are the other members of this Committee. The Committee monitors the progress made in the recovery of advances which have been classified as non-performing assets.

AUDIT COMMITTEE

The Audit Committee is headed by Mr. S. K. Shah who is a non-executive director. Mr. T. Davidson, non - executive director, Mr. J.K. Kibet, non-executive director and the Head of internal audit department are the other members of this Committee. The Committee reviews the audit reports presented to it by the internal and external auditors and based on these reports also reviews various operational areas of the Bank. The Committee also reviews the observations made by the Bank supervision department of the Central Bank of Kenya in its inspection reports.

STATEMENT OF CORPORATE GOVERNANCE ON THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

RISK AND COMPLIANCE COMMITTEE

The Risk and Compliance Committee is headed by Mr. S. K. Shah who is a non-executive director. Mr. T. Davidson, non-executive director, Head of risk department and Head of compliance are the other members of this Committee. The Committee reviews the risk and compliance reports presented to it by the respective departments. The Committee also reviews the observations given in the report and recommends remedial measures wherever necessary.

IT COMMITTEE

Mr. T. Davidson, a non-executive director chairs this Committee and Mr. David Hutchison another non - executive director is a member. The other members are Mr. A. Kantaria, Executive Director, the Managing Director and the General Manager. The responsibilities of the IT Committee are; approval of IT policy, identification of operational areas where automation is necessary, undertaking new automation projects, procurement of hardware and software and monitoring project implementation, providing directions to the IT and operations department on implementation issues and review of systems audit reports.

ASSETS AND LIABILITY MANAGEMENT COMMITTEE (ALCO)

This Committee is chaired by the Managing Director, the Executive Director, the General Manager, Chief Manager (Treasury), Assistant General Manager (Credit) and Chief Manager (Accounts) are the other members of the Committee. This Committee monitors the liquidity position of the Bank and the compliance with regard to statutory liquidity ratio, cash reserve ratio and foreign exchange exposure as per the prudential guidelines of the Central Bank of Kenya. The Committee decides on investments in various securities to maximise the returns. It also analyses the interest rate risk and fixes the interest rates in line with the market trends.

OPERATIONS COMMITTEE

The operations Committee is chaired by the General Manager and comprises the Risk Manager, Head of audit, Chief Manager (Accounts), Chief Manager (IT) and two Branch Managers. The Committee reviews various operational procedures of the Bank and decides on changes to be effected to improve operational efficiency, improve service delivery and minimise manual procedures.

HUMAN RESOURCES COMMITTEE

The HR Committee is headed by the Managing Director and has the Executive Director, General Manager and Senior Manager (HR) as the members. The Committee decides on recruitment of staff members, their placements, promotions, transfers and benefits to the employees. The Committee also monitors the training imparted to staff members.

EMPLOYEES

The Bank adheres to the Banking code of ethics which requires all employees to conduct business with high integrity. The staff members sign a declaration of fidelity and secrecy.

PUBLICATION OF ACCOUNTS

The Bank publishes its results every quarter in the newspapers as per the Prudential Guidelines of Central Bank of Kenya. Financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and the requirements of all relevant statutes, rules and regulations.

REPORT OF THE INDEPENDENT AUDITORS
TO THE MEMBERS OF PRIME BANK LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Our opinion

We have audited the accompanying financial statements of Prime Bank Limited (the "Bank") and the consolidated financial statements of the Bank and its subsidiary (together, the "Group"), set out on pages 11 to 106, each of which comprise a statement of financial position as at 31 December 2018 and statements 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 financial statements give a true and fair view of the financial position of the Group and of the Bank as at 31 December 2018 and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditors' responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA Code.

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

Other Matters

The financial statements of the Group and the Bank for the year ended 31 December 2017 were audited by another auditor, Ernest & Young LLP, who expressed an unmodified opinion on those statements on 20 March 2018.

Other Information

The Directors are responsible for the other information. The other information comprises the Report of the Directors and as required by the Kenyan Companies Act, 2015 and the Statement of Corporate Governance, which were obtained prior to the date of this report.

The other information does not include the Group and the Bank financial statements and our auditors' report thereon.

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

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

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 Group's and the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Bank and/or its subsidiary or to cease their operations, or have no realistic alternative but to do so.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with 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.

REPORT OF THE INDEPENDENT AUDITORS (continued)

TO THE MEMBERS OF PRIME BANK LIMITED

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

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

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

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

- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's and the Bank's ability to continue as going concerns. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause Bank and/or its subsidiary to cease to continue as going concerns.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated 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.

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

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

Report of the Directors

In our opinion, the information given in the report of the directors on pages 2 to 3 is consistent with the consolidated financial statements.

…………………………………………..

Certified Public Accountants (Kenya)
Nairobi, Kenya

27 March 2019

CPA Charles Munkonge Luo,
Practicing Certificate No. 2294
Signing Partner Responsible for the Independent Audit

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018

	Note	2018 KShs '000	2017 KShs '000 Restated
ASSETS			
Cash and balances with the Central Bank of Kenya	5	9,175,285	5,265,571
Placements and balances with other banks	6	11,587,459	3,090,911
Treasury bills and term notes	7	3,841,412	7,895,066
Investment in securities measured at amortised cost	8	16,506,914	12,803,105
Investment in securities at fair value through other comprehensive income	9	14,954,169	3,750,776
Investment in ordinary shares at fair value through other comprehensive income	10(a)	4,154,203	3,046,775
Investment in ordinary shares-at fair value through profit or loss	10(b)	116,883	141,222
Loans and advances	11	36,301,829	38,403,672
Other assets	12	880,771	858,235
Leasehold land	14	493,902	501,911
Property and equipment	15	1,375,226	1,374,058
Intangible assets	16	733,378	769,449
Tax recoverable	22	14,528	87,158
TOTAL ASSETS		100,135,959	77,987,909
LIABILITIES AND EQUITY			
LIABILITIES			
Balances due to banks and financial institutions	18	1,035,822	2,798,287
Medium term note	19	1,020,000	1,033,000
Deposits from customers	20	71,102,053	57,283,242
Other liabilities	21	2,104,196	1,827,185
Deferred tax liability	17	1,039,625	747,185
TOTAL LIABILITIES		76,301,696	63,688,899
EQUITY			
Share capital	23	6,649,390	5,000,000
Share premium	24	5,230,109	-
Reserves	25	11,667,715	9,042,221
Equity attributable to equity holders of the parent		23,547,214	14,042,221
Non-controlling interests		287,049	256,789
TOTAL EQUITY		23,834,263	14,299,010
TOTAL LIABILITIES AND EQUITY		100,135,959	77,987,909

These financial statements on pages 15 to 110 were approved by the Board of Directors on 12 March 2019 and signed on its behalf by: -

.... Director

.... Director

.... Director

.... Secretary

BANK STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018

	Note	2018 KShs '000	2017 KShs '000 Restated
ASSETS			
Cash and balances with the Central Bank of Kenya	5	9,172,657	5,257,076
Placements and balances with other banks	6	11,524,072	2,985,079
Treasury bills and term notes	7	3,841,412	7,895,066
Investment securities measured at amortised cost	8	15,643,082	11,909,836
Investment in bonds at fair value through other comprehensive income	9	14,654,392	3,651,715
Investment in ordinary shares at fair value through other comprehensive income	10	4,070,398	2,951,142
Loans and advances	11	36,168,128	38,255,467
Other assets	12	463,487	383,457
Investment in subsidiary	13	1,337,575	1,395,692
Leasehold land	14	402,669	409,411
Property and equipment	15	1,145,018	1,145,747
Intangible assets	16	89,279	124,731
Tax recoverable	22	22,286	73,780
TOTAL ASSETS		98,534,455	76,438,199
LIABILITIES AND EQUITY			
LIABILITIES			
Balances due to banks and financial institutions	18	1,035,822	2,790,922
Medium term note	19	1,020,000	1,033,000
Deposits from customers	20	71,449,704	57,554,722
Other liabilities	21	1,011,620	657,042
Deferred tax liability	17	978,336	683,309
TOTAL LIABILITIES		75,495,482	62,718,995
EQUITY			
Share capital	23	6,649,390	5,000,000
Share premium	24	5,230,109	-
Reserves	25	11,159,474	8,719,204
TOTAL EQUITY		23,038,973	13,719,204
TOTAL LIABILITIES AND EQUITY		98,534,455	76,438,199

These financial statements on pages 15 to 110 were approved by the Board of Directors on 12 March 2019 and signed on its behalf by: -

.... Director

.... Director

.... Director

.... Secretary

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 KShs '000	2017 KShs '000 Restated
Interest income	26	8,007,362	7,370,226
Interest expense	27	(4,245,145)	(3,741,459)
Net interest income		3,762,217	3,628,767
Fees and commission income	28	546,843	512,383
Foreign exchange gains		270,269	196,974
Dividend income		1,973	25,004
Other income	29	1,158,726	750,312
		5,740,028	5,113,440
Allowance for impairment of financial instruments	30	(188,110)	(340,588)
Other operating expenses	31	(3,132,861)	(2,384,746)
Profit before tax	32	2,419,057	2,388,106
Income tax expense	22	(145,005)	(142,963)
Profit for the year		2,274,052	2,245,143
Attributable to:			
Equity holders of the parent		2,225,327	2,236,384
Non-controlling interests		48,725	8,759
		2,274,052	2,245,143
Earnings per share (basic and diluted) (KShs):			
Attributed to:			
Equity Holder of Parent (Kshs)	33	335	447

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 KShs '000	2017 KShs '000 Restated
Profit for the year		2,274,052	2,245,143
Other comprehensive income			
Items that may be reclassified to profit or loss in subsequent periods:			
Fair value through other comprehensive income financial assets:			
Gain arising during the year		107,080	75,819
Deferred income tax on fair value gain		(32,124)	(22,745)
		74,956	53,074
Items that will not be reclassified to profit or loss in subsequent periods:			
Revaluation of land and buildings		-	4,866
Deferred income tax on revaluation surplus		-	(1,460)
Fair value gain on fair value through other comprehensive income - Equity investments	10(a)	1,112,394	1,989,966
Deferred income tax on equity investments		(333,718)	(596,990)
		778,676	1,396,382
Other comprehensive income for the year, net of tax		853,632	1,449,456
Total comprehensive income for the year, net of tax		3,127,684	3,694,599
Equity holders of the parent		3,080,554	3,683,735
Non controlling Interest		47,130	10,864

BANK STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 KShs '000	2017 KShs '000 Restated
Interest income	26	8,007,362	7,370,226
Interest expense	27	(4,245,145)	(3,741,459)
Net interest income		3,762,217	3,628,767
Fees and commission income	28	546,843	512,383
Foreign exchange gains		270,269	196,974
Dividend income		1,973	25,004
Other income	29	69,325	168,298
		4,650,627	4,531,426
Allowance for impairment of financial instruments	30	(188,110)	(340,588)
Other operating expenses	31	(2,374,042)	(2,320,374)
Profit before tax and share of profit of associate	32	2,088,475	1,870,464
Share of profit of associate		-	106,513
Profit before tax		2,088,475	1,976,977
Income tax expense	22	(67,150)	(134,968)
Profit for the year		2,021,325	1,842,009
Earnings per share (basic and diluted) (KShs)	33	304	368

BANK STATEMENT OF COMPREHENSIVE INCOME

	Note	2018 KShs '000	2017 KShs '000 Restated
Profit for the year		2,021,325	1,842,009
Other comprehensive income			
Items that may be reclassified to profit or loss in subsequent periods:			
Fair value through other comprehensive income financial assets:			
Gain arising during the year		103,527	96,954
Deferred income tax on fair value gain		(31,058)	(29,086)
		72,469	67,868
Items that will not be reclassified to profit or loss in subsequent periods:			
Fair value gain on fair value through other comprehensive income - Equity investments	10(a)	1,124,222	1,964,762
Deferred income tax on equity investments		(337,267)	(589,429)
		786,955	1,375,333
Other comprehensive income for the year, net of tax		859,424	1,443,201
Total comprehensive income for the year, net of tax		2,880,749	3,285,210

All of the profit for the year and total comprehensive income are attributable to equity holders of the Bank.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital KShs '000	Share Premium KShs '000	Retained earnings KShs '000	FVTOCI reserve KShs '000	Asset revaluation reserve KShs '000	Total KShs '000	Non-con-trolling interests KShs '000	Total Equity KShs '000
At 1 January 2017	-	-	-	-	-	-	-	-
On business combination	5,000,000	-	5,011,975	280,012	542,006	10,833,993	-	10,833,993
Dividends paid – 2017 (note 35)	-	-	(400,000)	-	-	(400,000)	-	(400,000)
NCI arising on business combination	-	-	-	-	-	-	364,648	364,648
Acquisition of NCI	-	-	(75,508)	-	-	(75,508)	(118,723)	(194,231)
Total comprehensive income:								
- profit for the year	-	-	2,236,384	-	-	2,236,384	8,759	2,245,143
- other comprehensive income - FVTOCI	-	-	-	2,064,640	-	2,064,640	1,146	2,065,786
- other comprehensive income-asset revaluation reserve	-	-	-	-	2,447	2,447	959	3,406
At 31 December 2017	5,000,000	-	6,772,851	2,344,652	544,453	14,661,956	256,789	14,918,745
At 1 January 2018 - As previously reported	5,000,000	-	6,772,851	2,344,652	544,453	14,661,956	256,789	14,918,745
Prior year adjustment** (Note 47)	-	-	-	(619,735)	-	(619,735)	-	(619,735)
At January 2018- As re-stated	5,000,000	-	6,772,851	1,724,917	544,453	14,042,221	256,789	14,299,010
Share issue @ KShs.1,000@ share	1,649,390	-	-	-	-	1,649,390	-	1,649,390
Share Premium @ KShs. 3,334 @ share	-	5,230,109	-	-	-	5,230,109	-	5,230,109
Dividends paid –2017 (note35)	-	-	(335,000)	-	-	(335,000)	-	(335,000)
Dividend Payable-2018	-	-	(258,500)	-	-	(258,500)	(13,882)	(272,382)
Adjustment for 2017 NCI	-	-	(400)	-	-	(400)	400	-
Total comprehensive income:								
– profit for the year	-	-	2,225,327	-	-	2,225,327	48,725	2,274,052
- other comprehensive income –FVTOCI	-	-	-	855,227	-	855,227	(1,595)	853,632
IFRS 9 day 1 adjustment (Bank)	-	-	153,021	-	-	153,021	-	153,021
IFRS 9 day 1 adjustment (subsidiary)	-	-	(14,181)	-	-	(14,181)	(3,388)	(17,569)
As at 31 December 2018	6,649,390	5,230,109	8,543,118	2,580,144	544,453	23,547,214	287,049	23,834,263

BANK STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital KShs '000	Share Premium KShs '000	Retained earnings KShs '000	FVTOCI reserve KShs '000	Revaluation Reserve (Fixed Assets) KShs '000	Total equity KShs '000
At 1 January 2017	5,000,000	-	5,011,975	280,012	542,006	10,833,993
Dividends paid – 2017 (note 35)	-	-	(400,000)	-	-	(400,000)
Total comprehensive income						
– profit for the year	-	-	1,842,009	-	-	1,842,009
- other comprehensive income	-	-	-	2,061,717	-	2,061,717
At 31 December 2017	5,000,000	-	6,453,984	2,341,729	542,006	14,337,719
At 1 January 2018 - As previously reported	5,000,000	-	6,453,984	2,341,729	542,006	14,337,719
Prior year adjustment** (Note 47)	-	-	-	(618,515)	-	(618,515)
Adjusted balance at beginning of period	5,000,000	-	6,453,984	1,723,214	542,006	13,719,204
Issue of shares	1,649,390	-	-	-	-	1,649,390
Share Premium	-	5,230,109	-	-	-	5,230,109
Dividends paid - 2017 (note 35)	-	-	(335,000)	-	-	(335,000)
Dividend Payable - 2018	-	-	(258,500)	-	-	(258,500)
Total comprehensive income:						
- profit for the year	-	-	2,021,325	-	-	2,021,325
- other comprehensive income	-	-	-	859,424	-	859,424
IFRS 9 day 1 adjustment	-	-	153,021	-	-	153,021
At 31 December 2018	6,649,390	5,230,109	8,034,830	2,582,638	542,006	23,038,973

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 KShs '000	2017 KShs '000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		2,419,057	2,388,106
Adjustments for:			
Loss/(gain) on disposal of property and equipment		4,606	(4,474)
Dividends received		(1,973)	(52,833)
Effect of foreign exchange gain on translation of foreign currency balances held		(270,269)	(196,974)
Fair value gain on previously held shares in associate		-	(372,018)
Fair value loss/(gain) on fair value through other comprehensive income shares	10(b)	24,239	(23,300)
Provision for staff leave		2,188	1,946
Allowances for impairment of financial instruments	30	188,110	340,588
Amortisation of leasehold land	14	9,109	9,069
Depreciation on property and equipment	15	156,134	134,869
Amortisation of intangible assets	16	67,473	80,594
Gain on sale of fair value of investments measured at FVTOCI		(3,276)	-
CASH FLOWS GENERATED FROM OPERATING ACTIVITIES BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		2,595,398	2,305,573
Increase in cash ratio reserve		(372,337)	(252,754)
Increase in securities maturing after 91 days		(383,055)	(1,857,495)
Decrease in loans and advances to customers		2,101,843	148,205
Increase in other assets		(22,536)	(378,307)
Increase in deposits from customers		13,818,811	7,960,649
Increase in other liabilities		277,011	1,243,413
Cash flows from operating activities		18,015,135	9,169,284
Income taxes paid	22	(145,340)	(160,706)
NET CASH FLOWS FROM OPERATING ACTIVITIES		17,869,795	9,008,578

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

AS AT 31 DECEMBER 2018

	Note	2018 KShs '000	2017 KShs '000
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of property and equipment		2,850	5,083
Dividend from subsidiary		58,116	-
Dividend income		1,973	52,833
Proceeds from redemption of Investment securities measured at amortised cost	8	1,486,993	1,677,068
Proceeds from redemption of treasury bills and term notes	7	9,485,000	12,779,350
Proceeds from sale of investments in bonds measured at FVTOCI	9	2,209,096	149,554
Proceeds from sale of quoted shares measured at FVTPL		100	-
Purchase of Investment securities measured at amortised cost	8	(5,194,168)	(6,792,102)
Purchase of treasury bills and term notes	7	(5,434,496)	(14,567,766)
Purchase of investments in bonds measured at FVTOCI	9	(13,322,158)	(103,620)
Purchase of property and equipment	15	(164,758)	(297,825)
Purchase of intangible assets	16	(31,402)	(47,906)
Acquisition of a subsidiary, net of cash acquired	13	-	(348,566)
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(10,902,854)	(7,493,897)
CASH FLOWS FROM FINANCING ACTIVITIES			
Issue of shares		1,649,390	-
Share premium		5,230,109	-
Acquisition of non-controlling interests		-	(194,231)
Dividends paid to equity holders of the parent	35	(335,000)	(400,000)
NET CASH FLOWS FROM/(USED IN) FINANCING ACTIVITIES		6,544,499	(594,231)
Net increase in cash and cash equivalents		13,511,440	920,450
Effect of foreign exchange gain on translation of foreign currency balances held		270,269	196,974
Cash and cash equivalents at 1 January		3,947,610	2,830,186
Cash and cash equivalents at 31 December	36	17,729,319	3,947,610

BANK STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018

	Notes	2018 KShs '000	2017 KShs '000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		2,088,475	1,976,977
Adjustments for:			
Loss/(gain) on disposal of property and equipment		4,606	(4,474)
Dividends received		(1,973)	(25,004)
Effect of foreign exchange gain on translation of foreign currency balances held		(270,269)	(196,974)
Provision for staff leave		2,188	1,946
Allowances for impairment of loans and advances	30	188,110	340,588
Share of profit of an associate	13	-	(106,513)
Amortisation of leasehold land	14	7,842	7,833
Depreciation on property and equipment	15	146,376	130,761
Amortisation of intangible assets	16	66,853	80,595
Gain on sale of fair value of investments measured at FVTOCI		(982)	-
CASH FLOWS FROM OPERATING ACTIVITIES BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		2,231,226	2,205,735
Increase in cash ratio reserve		(372,337)	(252,754)
Increase in securities maturing after 91 days		(295,913)	(155,789)
Decrease in loans and advances to customers		2,087,339	197,798
(Increase)/decrease in other assets		(80,030)	96,471
Increase in deposits from customers		13,894,982	8,232,128
Increase/(decrease) in other liabilities		354,578	(73,271)
Cash flows from operating activities		17,819,845	10,250,318
Income taxes paid	22	(88,517)	(149,318)
NET CASH FLOWS GENERATED FROM OPERATING ACTIVITIES		17,731,328	10,101,000

BANK STATEMENT OF CASH FLOWS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

	Notes	2018 KShs '000	2017 KShs '000
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of property and equipment		2,144	5,083
Dividend income		1,973	25,004
Proceeds from redemption of investment securities measured at amortised cost	8	1,434,024	1,669,831
Proceeds from redemption of treasury bills and term notes	7	9,485,000	12,779,350
Proceeds from sale of investments in bonds measured at FVTOCI	9	2,197,696	144,995
Purchase of shares from associate	13	-	(23,123)
Investments in subsidiary	13	-	(727,006)
Dividend from associate	13	58,116	27,829
Purchase of investment securities measured at amortised cost	8	(5,170,529)	(5,891,596)
Purchase of treasury bills and term notes	7	(5,434,496)	(14,567,766)
Purchase of investments in securities measured at FVTOCI	9	(13,113,568)	-
Purchase of property and equipment	15	(152,398)	(383,698)
Purchase of intangible assets	16	(31,402)	(45,683)
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(10,723,440)	(6,986,780)
CASH FLOWS FROM FINANCING ACTIVITIES			
Issue of shares		1,649,390	-
Share Premium		5,230,109	-
Purchase of shares in subsidiary		-	(194,231)
Dividends paid during the year	35	(335,000)	(400,000)
NET CASH FLOWS GENERATED FROM/(USED IN) FINANCING ACTIVITIES		6,544,499	(594,231)
Net increase in cash and cash equivalents		13,552,387	2,519,989
Effect of foreign exchange gain on translation of foreign currency balances held		270,269	196,974
Cash and cash equivalents at 1 January		3,840,648	1,123,686
Cash and cash equivalents at 31 December	36	17,663,304	3,840,648

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AS AT 31 DECEMBER 2018

1. GENERAL INFORMATION
Prime Bank Limited is a financial institution licensed under the Kenyan Banking Act, Cap 488 that provides corporate and retail banking services in various parts of the country. The Bank is incorporated and domiciled in Kenya under the Kenyan Companies Act, 2015. The consolidated financial statements comprise the Bank and its subsidiaries together referred to as “the Group”. The Group is primarily involved in corporate and retail banking and all classes of general insurance with the exception of aviation insurance services as defined by section 31 of the insurance Act (Cap 487).

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES
Adoption of new and revised International Financial Reporting Standards (IFRS)

i) New standards and amendments to published standards effective for the year ended 31 December 2018

Impact of initial application of IFRS 9 Financial Instruments

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

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

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also only been applied to the current period.

The adoption of IFRS 9 has resulted in changes in our accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on The Bank. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail in Note 3 (e).

Reclassifications

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

i) New standards and amendments to published standards effective for the year ended 31 December 2018 (continued)

Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

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

	Note	Classification under IAS 39	Classification under IFRS 9	Original carrying amount under IAS 39 KShs'000	New carrying amount under IFRS 9 KShs'000
FINANCIAL ASSETS					
Cash and balances with Central Bank of Kenya	5	Loans and receivables	Amortised cost	5,257,076	5,257,076
Placements and balances with other banks	6	Loans and receivables	Amortised cost	2,985,079	2,985,079
Investment securities measured at amortised cost	8	Held to maturity	Amortised cost	11,909,836	11,909,836
Treasury bills and term notes	7	Held to maturity	Amortised cost	7,895,066	7,895,066
Investments in bonds –fair value through other comprehensive income	9	Available for sale	FVTOCI	3,651,715	3,651,715
Investment in ordinary shares – fair value through other comprehensive income	10(a)	Available for sale	FVTOCI	2,951,142	2,951,142
Loans and advances	11	Loans and receivables	Amortised cost	38,255,467	38,527,382
Other assets	12	Loans and receivables	Amortised cost	383,457	383,457
TOTAL ASSETS				73,288,838	73,560,753
FINANCIAL LIABILITIES					
Balances due to banking institutions	18	Other financial liabilities	Amortised Cost	2,790,922	2,790,922
Deposits from customers	20	Other financial liabilities	Amortised Cost	57,554,722	57,554,722
Other liabilities and accrued expenses	21	Other financial liabilities	Amortised Cost	657,042	657,042
Medium term note	19	Other financial liabilities	Amortised Cost	1,033,000	1,033,000
TOTAL LIABILIITES				62,035,686	62,035,686

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

i) New standards and amendments to published standards effective for the year ended 31 December 2018 (continued)

Impairment allowance reconciliations (Day 1 Adjustment)

The table below reconciles the closing impairment allowances for financial assets in accordance with IAS 39 as at 31 December 2017, and the opening impairment allowances determined in accordance with IFRS 9 as at 1 January 2018

	IAS 39 as at 31 December 2017			Transition Adjusments	IFRS 9 as at 1 January 2018			
	Collectively Assessed KShs '000	Individually assessed KShs '000	Total KShs '000	KShs '000	Stage 1 KShs '000	Stage 2 KShs '000	Stage 3 KShs '000	Total KShs '000
Loans and advances to customers at amortised cost	37,485,837	2,140,699	39,626,536	-	35,886,140	1,599,697	1,784,349	39,270,186
Loan Commitments	-	-	-	-	4,138,708	-	-	4,138,708
Financial guarantee	-	-	-	-	6,848,594	-	-	6,848,594
TOTAL	37,485,837	2,140,699	39,626,536	-	46,873,442	1,599,697	1,784,349	50,257,488
Corporate bonds and Term Notes	451,069	110,849	561,918	-	451,069	-	110,849	561,918
TOTAL	37,936,906	2,251,548	40,188,454	-	47,324,511	1,599,697	1,895,198	50,819,406
Allowances								
Loans and advances to customers at amortised cost	425,712	589,006	1,014,718	-	99,185	116,703	526,916	742,804
Loan Commitments	-	-	-	-	21,167	-	-	21,167
Financial guarantee	-	-	-	-	38,137	-	-	38,137
Corporate bonds and Term Notes	3,326	-	3,326	-	5,273	-	57,642	62,915
GRAND TOTAL	429,038	589,006	1,018,044	-	163,762	116,703	584,558	865,023
IFRS9 transition adjustment	-	-	1,018,044	(153,021)	-	-	-	865,023

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

i) New standards and amendments to published standards effective for the year ended 31 December 2018 (continued)

Impairment allowance reconciliations (Day 1 Adjustment) (Continued)

An analysis of the Bank's credit risk exposure during the transition period per class of financial asset, internal rating and "stage" without taking into account the effects of any collateral or other credit enhancements is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

Loans and advances to customers at amortised cost	Stage 1 12-month ECL KShs '000	Stage 2 Lifetime ECL KShs '000	Stage 3 Lifetime ECL KShs '000	POCI KShs '000	1-Jan 2018 Total KShs '000	31-Dec 2017 Total KShs '000
Grades 1: Low to fair risk	35,886,140	-	-	-	35,886,140	35,886,140
Grades 2: Watch		1,599,696	-	-	1,599,696	1,599,696
Grades 3: Substandard	-	-	349,192	-	349,192	387,164
Grade 4: Doubtful	-	-	1,230,596	-	1,230,596	1,330,726
Grade 5: Impaired	-	-	204,562	-	204,562	422,810
Total gross carrying amount	35,886,140	1,599,696	1,784,350	-	39,270,186	39,626,536
Loss allowance	99,185	116,703	526,916	-	742,804	1,371,069
Carrying amount	35,786,955	1,482,993	1,257,434		38,527,382	38,255,467
Loan commitments						
Grades 1: Low to fair risk	4,138,708	-	-	-	4,138,708	4,138,708
Grades 2: Watch	-	-	-	-	-	-
Grades 3: Substandard	-	-	-	-	-	-
Grade 4: Doubtful	-	-	-	-	-	-
Grade 5: Impaired	-	-	-	-	-	-
Total gross carrying amount	4,138,708	-	-	-	4,138,708	4,138,708
Loss allowance	21,167	-	-	-	21,167	-
Carrying amount	4,117,541	-	-	-	4,117,541	4,138,708

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

i) New standards and amendments to published standards effective for the year ended 31 December 2018 (continued)

Impairment allowance reconciliations (Day 1 Adjustment) (Continued)

Loans and advances to customers at amortised cost	Stage 1 12-month ECL KShs '000	Stage 2 Lifetime ECL KShs '000	Stage 3 Lifetime ECL KShs '000	POCI KShs '000	1-Jan 2018 Total KShs '000	31-Dec 2017 Total KShs '000
Grades 1: Low to fair risk	6,848,594	-	-	-	6,848,594	6,848,594
Grades 2: Watch	-	-	-	-	-	-
Grades 3: Substandard	-	-	-	-	-	-
Grade 4: Doubtful	-	-	-	-	-	-
Grade 5: Impaired	-	-	-	-	-	-
Total gross carrying amount	6,848,594	-	-	-	6,848,594	6,848,594
Loss allowance	38,137	-	-	-	38,137	-
Carrying amount	6,810,457	-	-	-	6,810,457	6,848,594

Reclassification from retired categories with no change in measurement

The following debt instruments have been reclassified to new categories under IFRS 9, as their previous categories under IAS 39 were `retired`, with no changes to their measurement basis:

i) Those previously classified as held to maturity and now classified as measured at amortised cost.
ii) Those previously classified as loans and receivables and now classified as measured at amortised cost.

a. Cash and cash equivalents
b. Short term deposits
c. Loans and advances
d. Investment in bonds

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

The amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions clarify the following aspects:

- In estimating the fair value of a cash-settled share-based payment, the accounting for the effects of vesting and non-vesting conditions should follow the same approach as for equity-settled share-based payments.
- Where tax law or regulation requires an entity to withhold a specified number of equity instruments equal to the monetary value of the employee's tax obligation to meet the employee's tax liability which is then remitted to the tax authority (typically in cash), i.e. the share-based payment arrangement has a 'net settlement feature', such an arrangement should be classified as equity-settled in its entirety, provided that the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)
Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)
i) New standards and amendments to published standards effective for the year ended 31 December 2018 (continued)

Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions (continued)	■ A modification of a share-based payment that changes the transaction from cash-settled to equity-settled should be accounted for as follows: i) the original liability is derecognised; ii) the equity-settled share-based payment is recognised at the modification date fair value of the equity instrument granted to the extent that services have been rendered up to the modification date; and iii) any difference between the carrying amount of the liability at the modification date and the amount recognised in equity should be recognised in profit or loss immediately. The amendments to the standard has had no impact on the Group and the Bank's financial statements.
Amendments to IFRS 15 Revenue from Contracts with Customers	Amends IFRS 15 Revenue from Contracts with Customers to clarify three aspects of the standard (identifying performance obligations, principal versus agent considerations, and licensing) and to provide some transition relief for modified contracts and completed contracts. The amendments to the standard has had no impact on the Group and the Bank's financial statements.
IFRS 15 Revenue from Contracts with Customers	IFRS 15 provides a single, principles based five-step model to be applied to all contracts with customers. The five steps in the model are as follows: • Identify the contract with the customer • Identify the performance obligations in the contract • Determine the transaction price • Allocate the transaction price to the performance obligations in the contracts • Recognise revenue when (or as) the entity satisfies a performance obligation The application of these amendments has had no impact on the Group and the Banks's financial statements.
Amendments to IAS 40 Transfers of Investment Property	The amendments to IAS 40 Transfers of Investments Property clarify the following aspects: ■ Transfer to, or from, investment property necessitates an assessment of whether a property meets, or has ceased to meet, the definition of investment property, supported by observable evidence that a change in use has occurred. The amendments to IAS 40 Transfers of Investments Property clarify the following aspects: ■ An entity assesses a deferred tax asset in combination with other deferred tax assets. Where tax law restricts the utilisation of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

i) New standards and amendments to published standards effective for the year ended 31 December 2018 (continued)

	The amendments to the standard has had no impact on the Group and the Bank's financial statements.
Annual Improvements to IFRS Standards 2014-2016 Cycle	The annual improvements to IFRSs 2014-2016 cycle include a number of amendments to various IFRSs, which are summarised below: The amendments to IAS 28 Investments in Associates and Joint Ventures clarify that the option for a venture capital organisation and other similar entities to measure investments in associates and joint ventures at FVTPL is available separately for each associate or joint venture, and that election should be made at initial recognition. In respect of the option for an entity that is not an investment entity (IE) to retain the fair value measurement applied by its associates and joint ventures that are IEs when applying the equity method, the amendments make a similar clarification that this choice is available for each IE associate or IE joint venture. The amendments to the standard has had no impact on the Group and the Bank's financial statements.

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

New standards and Amendments to standards	Effective for annual periods beginning on or after
IFRS 16 Leases	1-Jan-19
IFRS 17 Insurance Contracts	1-Jan-22
IFRIC 23 Uncertainty over Income Tax Treatments	1-Jan-19
IFRIC 22 Foreign Currency Transactions and Advance Consideration	1-Jan-19
Annual Improvements to IFRS Standards 2015-2017 Cycle	1-Jan-19
Amendments to IAS 19	1-Jan-19
Amendments to IFRS 9	1-Jan-19

IFRS 16 Leases

IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. The entity's operating leases expenses are only rental for office space and parking slots.

These will be assessed against requirements of IFRS 16 on 1 January 2019, as the Directors do not anticipate the rental expense to have a significant impact on amounts reported.

The Directors of the Group and the Bank are assessing the impact of the application of IFRS 16 in the future. It is not practical to provide a reasonable estimate of this effect until a detailed review has been completed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

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

IFRIC 22 Foreign Currency Transactions and Advance Consideration

The interpretation addresses foreign currency transactions or parts of transactions. The Interpretations Committee came to the following conclusion:

The date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability.

If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.

The Directors of the Group and the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank financial statements.

IFRIC 23 Uncertainty over Income Tax Treatments

The interpretation addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:

- Whether tax treatments should be considered collectively;
- Assumptions for taxation authorities' examinations;
- The determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- The effect of changes in facts and circumstances.

The Directors of the Group and the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group and the Bank financial statements.

IFRS 17 Insurance Contracts

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

(a) insurance contracts, including reinsurance contracts, it issues;

(b) reinsurance contracts it holds; and

(c) investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts

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

(a) the fulfilment cash flows—the current estimates of amounts that the entity expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and

(b) the contractual service margin—the expected profit for providing insurance coverage. The expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided.

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

(c) accounts for changes to estimates of future cash flows from one reporting date to another either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it; and

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

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

IFRS 17 Insurance Contracts (continued)

(d) chooses where to present the effects of some changes in discount rates—either in profit or loss or in other comprehensive income.

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

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

The Group and the Bank is expecting potential impact on the financial statements arising from these changes as it has as a fully-fledged subsidiary, Tausi Assurance Company Limited.

Prepayment Features with Negative Compensation (Amendments to IFRS 9)

Amends the existing requirements in IFRS 9 regarding termination rights in order to allow measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments.

The Directors of the Group and the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group and the Bank financial statements.

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

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

The Directors of the Group and the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank financial statements.

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

If a plan amendment, curtailment or settlement occurs, it is now mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement.

In addition, amendments have been included to clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling.

The Directors of the Group and the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group and the Bank financial statements.

Annual Improvements to IFRS Standards 2015-2017 Cycle

The Annual Improvements to IFRS Standards 2015-2018 cycle makes amendments to the following standards:

- IAS 12 Income Taxes - The amendments clarify that an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions that generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits.

- IAS 23 Borrowing Costs - The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

- IFRS 11 Joint Arrangements - The amendments to IFRS 11 clarify that when a party that participates in, but does not have joint control of, a joint operation that is a business obtains joint control of such a joint operation, the entity does not remeasure its PHI in the

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

Adoption of new and revised International Financial Reporting Standards (IFRS) (contined)

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

IFRS 17 Insurance Contracts (continued)

joint operation. All the amendments are effective for annual periods beginning on or after 1 January 2019 and generally require prospective application. Earlier application is permitted.

iii) Early adoption of standards

The Group and the Bank did not early adopt new or amended standards in 2018.

3. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation

The consolidated financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS), which comprise standards and interpretations, as issued by the International Accounting Standard Board (IASB) and the requirements of the Kenyan Companies Act, 2015. The financial statements are presented in the functional currency, Kenya Shillings, rounded to the nearest thousand (KShs '000),except where otherwise indicated and have been prepared on a historical basis except for fair value through other comprehensive income investments, investments at fair value through profit or loss and land and buildings which have been measured at fair value.

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

(b) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at 31 December 2018. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Specifically, the Group controls an investee if, and only if, the Group has:

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

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

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

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

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

A change in the ownership interest of a subsidiary, without a loss of control, is accounted

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Basis of consolidation (contined)

for as an equity transaction. If the Group loses control over a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value.

(c) Business combinations and goodwill

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

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

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 Financial Instruments: Recognition and Measurement, is measured at fair value with the changes in fair value recognised in the statement of profit or loss in accordance with IAS 39.Other contingent consideration that is not within the scope of IAS 39 is measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

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

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

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

(d) Fair value measurement

The Bank measures financial instruments and land and buildings at fair value at each reporting date. 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 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. Fair value related disclosures for financial instruments that are measured at fair value are made in note 42.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Fair value measurement (contined)

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.

(e) Financial assets and liabilities

Measurement methods

Amortised cost and effective interest rate

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

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

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

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

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

Initial recognition and measurement

Financial assets and financial liabilities are recognized when the entity becomes a party to the contractual provisions of the instrument. Purchases and sales of financial assets are recognized on trade date, the date on which The Bank commits to purchase or sell the asset.

At initial recognition, The Bank measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)
(e) Financial assets and liabilities (contined)
Initial recognition and measurement (continued)

in profit or loss. Immediately after initial recognition, an expected credit loss allowance (ECL) is recognized for financial assets measured at amortised cost and investments in debt instruments measured at FVTOCI, as described in expected credit loss measurement note, which results in an accounting loss being recognized in profit or loss when an asset is newly originated.

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

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

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

Financial assets

(i) Classification and subsequent measurement

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

- Fair value through other comprehensive income (FVTOCI)
- Fair value through profit or loss (FVPL) or
- Amortised cost.

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

Debt instruments

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

Classification and measurement of debt instruments depend on:

- The Bank's business model for managing the asset; and
- The cash flow characteristics of the asset.

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

- Amortised cost: Financial assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest, and that are not designated at FVPL, are measured at amortised cost. A gain or loss on a debt investment that is subsequently measured at amortised cost and is not part of a hedging relationship is recognized in profit or loss when the asset is derecognized or impaired. Interest income from these financial assets is included in finance income using the effective interest rate method.
- Fair value through other comprehensive income (FVTOCI): Financial assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at fair value through other comprehensive income (FVTOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses which are recognized in profit and loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss and recognized in other gains/(losses). Interest income from these financial assets is included in finance income using the effective interest rate method.
- Fair value through profit or loss: Financial assets that do not meet the criteria for amortised cost or FVTOCI are measured at fair value through profit or loss. A business model in which an entity manages financial assets with the objective of realizing cash flows through solely the sale of the assets, would result in an FVTPL business model.
- A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and presented net in the profit or loss statement

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)
(e) Financial assets and liabilities (contined)
Financial assets (continued)

(i) Classification and subsequent measurement (continued)

within other gains/(losses) in the period in which it arises. Interest income from these financial assets is included in the finance income.

Business model: The business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable, then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Bank in determining the business model for assets include past experience on how the cash flows of these assets were collected, how the performance of the assets is evaluated and reported to key management personnel, the risks that affect the performance of the business model (and the financial assets within) and in particular, the way that those risks are managed; and how assets managers are compensated.

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

The Bank reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent.

Equity instruments

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

The Bank subsequently measures all equity investments at fair value. Where the Bank's management has elected to present fair value gains and losses on equity investments in other comprehensive income, there is no subsequent reclassification of fair value gains and losses to profit or loss. Dividends from such investments continue to be recognized in profit or loss as other income when the Bank's right to receive payments is established.

Changes in the fair value of financial assets at fair value through profit or loss are recognized in other gain/(losses) in the statement of profit or loss as applicable. Impairment losses (and reversal of impairment losses) on equity investments measured at FVTOCI are not reported separately from other changes in fair value.

When the Bank derecognizes investments in equity instruments measured at FVTOCI, it shall disclose:

- The reason for disposing the investments,
- The fair value of investments at the date of derecognition; and
- The cumulative gain or loss on disposal.

(ii) Impairment of financial assets

The Bank assesses on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and FVTOCI and with the exposure arising from project finance loan and corporate loans. The Bank recognizes a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

a) An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

b) The time value of money; and

c) Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Financial assets and liabilities (contined)

Financial assets (continued)

(iii) Modification of loans

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

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

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

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

Financial liabilities

(i) Derecognition

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

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

Please refer to Credit Management for a detailed credit risk management and approach within note 45.

(ii) Classification and subsequent measurement

Financial liabilities are classified as subsequently measured at amortised cost, except for;

- Financial liabilities at fair value through profit or loss; this classification is applied to derivatives, financial liabilities held for trading and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)
(e) Financial assets and liabilities (contined)
Financial liabilities (continued)

(ii) Classification and subsequent measurement (continued)

in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss.

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition or when the continuing involvement approach applies.

- Financial guarantee contracts and loan commitments.

(f) Offsetting
Financial assets and financial liabilities are offset, and the net amount reported in the statement of financial position only when there is currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense will not be offset in profit or loss unless required by an accounting standard or interpretation and is specifically disclosed in the accounting policies of the Group and the Bank.

A financial liability is derecognised when the obligation under the liability is discharged or 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, and the difference in the respective carrying amounts is recognised in profit or loss.

(g) 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 recognition criteria must also be met before revenue is recognised:

(i) Interest income and expense

For all financial instruments measured at amortised cost and interest bearing financial instruments classified as at fair value through other comprehensive income financial investments, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments through the expected life of the financial instrument or a shorter period where appropriate, to the net carrying amount of the financial asset or liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest rate used to discount the future cash flows for the purpose of measuring the impairment loss.

(ii) Fees and commission income

The Bank earns fees and commission income from a diverse range of services it provides to its customers. Fees earned for the provision of services over a period of time are accrued over that period.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

(iii) Dividend income

Dividend income is recognised when the Bank's right to receive payment is established.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Property and equipment

Property and equipment, except for land and buildings, are stated at cost less accumulated depreciation and impairment in value.

Land and buildings are measured at fair value at the dates of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses on buildings. Valuations are performed every three years to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

A revaluation surplus is recorded in other comprehensive income and credited to the asset revaluation reserve in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in profit or loss, the increase is recognised in profit and loss. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation reserve.

An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation is calculated on the straight-line basis at annual rates estimated to write off carrying amounts of the assets over their expected useful lives.

The annual depreciation rates in use are: -	
Furniture and fittings	12.50%
Office equipment	12.50%
Motor vehicles	25.00%
Computer equipment	25% - 33.33%
Leasehold improvements	12.50%

Buildings are depreciated over their shorter of the estimated useful lives and the lease term.

Freehold land is not depreciated as it is deemed to have an indefinite life.

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

The assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted prospectively if appropriate, at each financial year-end.

(i) Foreign currency translation

Transactions in foreign currencies during the year are converted into Kenya shillings at rates ruling at the transaction dates. Monetary assets and liabilities at the reporting date which are expressed in foreign currencies are translated into Kenya shillings at rates ruling at that date. The resulting differences from conversion and translation are dealt with in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(j) Defined contribution plans

The Bank contributes to a statutory defined contribution provident scheme, the National Social Security Fund (NSSF). Contributions are determined by local statute and are currently limited to KShs 200 per employee per month. The Bank also operates a defined contribution provident fund scheme for all its employees. The assets of the scheme are held in a separate trustee administered fund that is funded by both the Bank and employees.

The Bank's contributions in respect of retirement benefit costs are charged to profit or loss in the year to which they relate.

(i) Employee benefits

(ii) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Defined contribution plans (contined)

expensed as the related service is provided. The liability for employees' accrued annual leave entitlement at the reporting date is recognised as an expense accrual.

(k) Taxation

1. Current tax

Current income tax is provided for on the basis of the results for the year as shown in the financial statements, adjusted in accordance with tax legislation. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

2. Deferred tax

Deferred taxation is provided using the liability method, for all temporary differences arising 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:

- Where the deferred tax 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,
- In respect of temporary differences associated with investments in subsidiaries and associates, 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 tax assets are recognised for all deductible temporary differences, carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilized except;

- 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,
- In respect of deductible temporary differences associated with investments in subsidiaries and associates, 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 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 is 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 in 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 reporting date.

Current tax and deferred tax relating to items recognised directly in other comprehensive income or equity are also recognised in other comprehensive income or equity and not in profit or loss.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Taxation (contined)

3 Value added tax

Expenses and assets are recognised net of Value added tax, except:

- When the value added tax incurred on a purchase of assets or services is not recoverable from the taxation authority, 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
- When receivables and payables are stated with the amount of value added tax included.

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

(l) Guarantees, acceptances and letters of credit

Letters of credit, acceptances, guarantees and performance bonds are generally written by the bank to support performance by a customer to third parties. The bank will only be required to meet these obligations in the event of the customer's default. These obligations are accounted for as off financial position transactions and disclosed as contingent liabilities.

(m) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date and requires an assessment whether fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset, even if that right is not explicitly specified in an arrangement.

Leases of leasehold land are classified as operating leases. Operating leases are leases which do not transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased items. The costs incurred to acquire the lease are included in the financial statements as long term prepayments and rentals payable are accounted for on a straight-line basis over the lease term and included in other operating expenses in the statement of profit or loss.

(n) Intangible assets

The Bank's intangible assets include the value of computer software (swift software, finacle software and other associated costs) and Visa license fees. 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 loss.

The useful lives of intangible assets are assessed to be finite. Intangible assets are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset are reviewed at least each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in an asset are accounted for by changing the amortisation period and method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets is recognised in profit or loss in the expense category consistent with the function of the asset.

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over the estimated useful lives as follows:

- Computer software 5 years
- Visa license 5 years

(o) Dividends

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

(p) Impairment of non - financial assets

The Bank assesses at each reporting date, or more frequently if events or changes in circumstances indicate that an asset may be impaired, whether there is an indication that a non-financial asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank makes an estimate of the asset's recoverable amount. 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. 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 available. If no such transactions can be identified, an appropriate valuation model is used. Where the

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Impairment of non - financial assets (contined)

carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount.

Impairment losses are recognised in the profit or loss in expense categories consistent with the function of the impaired asset, except for properties previously revalued with the revaluation surplus taken to OCI. For such properties, the impairment is recognised in OCI up to the amount of any previous revaluation.

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 recoverable amount is estimated. A previously recognised impairment loss is reversed if, and only if, there has been a change in the estimates 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, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of profit or loss unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

(q) Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in profit or loss net of any reimbursement.

4. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Bank's financial statements requires management to make judgments, 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 amount of assets or liabilities affected in future periods.

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.

(i) Measurement of the expected credit loss

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

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

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

The impairment loss on loans and advances is disclosed in note 11 and discussed further in note 44 (a).

(ii) Business models and SPPI (Solely Payment of Principal and Interest)

Determining the appropriate business models and assessing the SPPI requirements for financial assets may require significant accounting judgement and have a significant impact on the financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

4. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

(iii) Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets, they are 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 where observable market data are 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 42.

5. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Cash in hand	638,844	621,726	636,216	613,231
Balances with Central Bank of Kenya:				
-Restricted balances (Cash Reserve Ratio)	2,017,001	1,644,664	2,017,001	1,644,664
-Unrestricted balances	6,113,088	2,501,021	6,113,088	2,501,021
Cheques and items for clearing	406,352	498,160	406,352	498,160
	9,175,285	5,265,571	9,172,657	5,257,076

The Cash Reserve Ratio is non-interest earning and is based on the value of deposits as adjusted for the Central Bank of Kenya requirements. At 31 December 2018, the Cash Reserve Ratio requirement was 5.25% (2017 – 5.25%) of all qualifying deposits.

These funds are available for use by the Bank in its day-to-day operations in a limited way provided that on any given day this balance does not fall below the 3.00% requirement and provided that the overall average in the month is at least 5.25%.

Cheques and items for clearing represent values of outward clearing instruments, which are awaiting clearance.

6. PLACEMENTS AND BALANCES WITH OTHER BANKS

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Lending to other banks and financial institutions	2,074,030	984,181	2,010,643	878,349
Lending and balances with banks outside Kenya	9,513,429	2,106,730	9,513,429	2,106,730
	11,587,459	3,090,911	11,524,072	2,985,079

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

7. TREASURY BILLS AND TERM NOTES

	Group and Bank	
	2018 KShs '000	2017 KShs '000
At 1 January	7,895,066	6,106,650
Purchase of investment securities	5,434,496	14,567,766
IFRS 9 provision	(3,150)	-
Retirement of investment securities	(9,485,000)	(12,779,350)
At 31 December	3,841,412	7,895,066
Treasury bills:		
Maturing within 91 days of the date of acquisition	299,505	-
Maturing after 91 days to 182 days of the date of acquisition	1,530,375	3,597,631
Maturing after 182 days of the date of acquisition	1,669,395	3,923,059
IFRS 9 provision	(3,150)	-
Term notes:		
Maturing within 91 days of the date of acquisition	19,398	34,079
Maturing after 91 days to 182 days of the date of acquisition	-	64,465
Maturing after 182 days of the date of acquisition	325,889	275,832
	3,841,412	7,895,066

Treasury bills are debt securities issued by the Government of Kenya and are classified as loans and receivables. The weighted average effective interest rate on the treasury bills as at 31 December 2018 was 10.35% (2017: 10.66%).

Term notes are debt instruments issued by private and public entities for varied terms and maturity dates.

8. INVESTMENT IN SECUIRITY MEASURED AT AMORTISED COST

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
At 1 January	12,803,105	7,688,071	11,909,836	7,688,071
Purchase of investment securities	5,194,168	6,792,102	5,170,529	5,891,596
Retirement of investment securities	(1,486,993)	(1,677,068)	(1,434,024)	(1,669,831)
IFRS 9 provision	(3,366)	-	(3,259)	-
At 31 December	16,506,914	12,803,105	15,643,082	11,909,836
Treasury and corporate bonds are maturing after 182 days of the date of acquisition	16,506,914	12,803,105	15,643,082	11,909,836

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

9. INVESTMENT IN BONDS- MEASURED AT FVTOCI

The bonds and bills are debt securities and include treasury bills and bonds issued by the Government of Kenya, offshore bonds and corporate bond issued by Kengen Limited and are classified as securities measured at fair value through other comprehensive income (FVTOCI). The fair value of the bonds is determined by reference to published price quotations in an active market.

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
As at 1 January	3,750,776	3,698,408	3,651,715	3,698,408
Purchase of investment securities	13,322,158	103,620	13,113,568	-
Sales (maturity) of investment securities	(2,209,096)	(149,554)	(2,197,696)	(144,995)
Foreign exchange (loss)/gain	(975)	1,348	(975)	1,348
IFRS 9 Provision	(9,868)	-	(9,841)	-
Gain on fair valuation	101,174	96,954	97,621	96,954
As at 31 December	14,954,169	3,750,776	14,654,392	3,651,715
The maturity profile is as follows:				
Within one year	9,996,497	4,442	9,996,497	4,442
After one year but within two years	63,355	251,820	63,355	227,379
After two but within five years	2,125,530	2,007,224	2,102,726	2,007,224
After five years	2,778,655	1,487,290	2,501,655	1,412,670
IFRS 9 Provision	(9,868)	-	(9,841)	-
	14,954,169	3,750,776	14,654,392	3,651,715

10. INVESTMENT IN ORDINARY SHARES

a) At fair value through other comprehensive income (FVTOCI)

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Investment in listed shares (note 10 (a)(i)	3,891,293	2,778,899	3,807,488	2,683,266
Investment in privately held shares (note 10 (a)(ii)	262,910	267,876	262,910	267,876
Total investment in ordinary	4,154,203	3,046,775	4,070,398	2,951,142
i) Investment in listed shares:				
Investment as at 1 January	2,778,899	788,933	2,683,266	718,504
Gain in fair value	1,112,394	1,989,966	1,124,222	1,964,762
As at 31 December	3,891,293	2,778,899	3,807,488	2,683,266

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

10. INVESTMENT IN ORDINARY SHARES (continued)

The fair value of the listed shares is determined by reference to published price quotations in an active market. FVTOCI investments in ordinary shares have no fixed maturity date or coupon rate. The fair value movement relating to First Merchant Bank, Malawi amounts to a gain of KShs 1.18 billion (2017: gain of KShs 1.91 million).The fair value movement relating to locally held shares amounts to a loss of KShs 53.2 million (2017: gain of KShs 55.9 million).

	GROUP	BANK
	2018 KShs '000	2017 KShs '000
ii) Investment in privately held shares:		
Capital Bank Limited, Botswana	96,067	125,183
Capital Bank Mozambique	141,525	115,438
Cooperative Bank Plc, United Kingdom	25,318	27,255
As at 31 December	262,910	267,876
The movement in these shares is summarised below:		
As at 1 January	267,876	263,057
Foreign exchange (loss)/gain	(4,966)	4,819
As at 31 December	262,910	267,876

Investment in privately held shares comprises investments in shares of Capital Bank Limited, Botswana and Capital Bank Limited, Mozambique, which are unquoted companies. These shares are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions. The directors have taken a conservative approach and equated the fair value of unquoted shares at cost. There were no material impairment noted on the unquoted shares.

All other securities measured at FVTOCI are carried at fair value, with unrealized gains/losses recognized as other comprehensive income until the investment is derecognized or impaired.

10. INVESTMENT IN ORDINARY SHARES (continued)

b) At fair value through profit and loss (GROUP)

	2018 KShs '000	2017 KShs '000
At start of the year	141,222	117,946
Disposals	(100)	(24)
Fair value (loss)/gain	(24,239)	23,300
At end of the year	116,883	141,222

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

11. LOANS AND ADVANCES

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Loans and advances to customers (gross)	37,119,400	39,774,741	36,985,699	39,626,536
Less – Allowances on impairment of loans and advances	(817,571)	(1,371,069)	(817,571)	(1,371,069)
Loans and advances to customers net of ECL allowances	36,301,829	38,403,672	36,168,128	38,255,467

Please note that the 2017 allowances on impairment of loans and advances included KShs 1,018,044,000 provision for loan and impairment and KShs 356,351,000 suspended interest.

a) Lending concentration

Economic sector risk concentrations within the customer loan portfolio were as follows:

	2018 %	2017 %
Agriculture	0	0
Building & Construction	3	3
Energy &Water	0	0
Financial Services	0	0
Manufacturing	22	23
Mining & Quarrying	0	0
Personal/Household	6	5
Real Estate	12	17
Tourism, Restaurant & Hotels	2	2
Trade	51	45
Transport & Communication	4	5
Total	100%	100%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

11. LOANS AND ADVANCES (continued)

a) Lending concentration (continued)

Maturity analysis - GROUP

2018	Within 30 days KShs '000	31-60 days KShs '000	61-90 days KShs '000	More than 90 days KShs '000	Total KShs '000
Agriculture	1,458	-	23,726	109,419	134,603
Building & construction	177,918	39,111	-	921,770	1,138,799
Energy &water	-	481	-	121,969	122,450
Financial services				140,318	140,318
Manufacturing	1,366,120	151,778	425,398	6,217,320	8,160,616
Mining & quarrying	167	-	-	11,409	11,576
Personal/household	284,127	102,895	51,305	1,836,131	2,274,458
Real Estate	525,546	118,239	62,336	3,747,005	4,453,126
Tourism, restaurant & hotels	98,784	1,469	60,115	614,651	775,019
Trade	2,076,323	1,566,823	374,262	14,301,151	18,318,559
Transport & communication	332,180	67,174	2,062	1,188,460	1,589,876
Other	-	-	-	-	-
Total	4,862,623	2,047,970	999,204	29,209,603	37,119,400

Maturity analysis - BANK

2018	Within 30 days KShs '000	31-60 days KShs '000	61-90 days KShs '000	More than 90 days KShs '000	Total KShs '000
Agriculture	1,458	-	23,726	109,419	134,603
Building & construction	177,918	39,111	-	921,770	1,138,799
Energy &water	-	481	-	121,969	122,450
Financial services				140,318	140,318
Manufacturing	1,366,120	151,778	425,398	6,217,320	8,160,616
Mining & quarrying	167	-	-	11,409	11,576
Personal/household	284,127	102,895	51,305	1,702,430	2,140,757
Real Estate	525,546	118,239	62,336	3,747,005	4,453,126
Tourism, restaurant & hotels	98,784	1,469	60,115	614,651	775,019
Trade	2,076,323	1,566,823	374,262	14,301,151	18,318,559
Transport & communication other	332,180	67,174	2,062	1,188,460	1,589,876
Other	-	-	-	-	-
Total	4,862,623	2,047,970	999,204	29,075,902	36,985,699

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

11. LOANS AND ADVANCES (continued)

a) Lending concentration (continued)

Maturity analysis - GROUP

2017	Within 30 days KShs '000	31-60 days KShs '000	61-90 days KShs '000	More than 90 days KShs '000	Total KShs '000
Agriculture	879	-	-	186,266	187,145
Building & construction	144,302	-	54,021	961,717	1,160,040
Energy &water	943	-	-	131,241	132,184
Financial services	-	-	-	155,094	155,094
Manufacturing	1,322,716	230,360	169,555	7,353,800	9,076,431
Mining & quarrying	-	-	-	6,636	6,636
Personal/household	81,404	1,715	1,498	1,871,345	1,955,962
Real Estate	1,067,699	1,237	231,801	4,156,151	5,456,888
Tourism, restaurant & hotels	137,760	18,556	6,185	567,238	729,739
Trade	2,966,188	1,088,069	388,455	14,538,896	18,981,608
Transport & communication	314,651	-	773	1,469,385	1,784,809
Other	-	-	-	148,205	148,205
Total	6,036,542	1,339,937	852,288	31,545,974	39,774,741

Maturity analysis - BANK

2017	Within 30 days KShs '000	31-60 days KShs '000	61-90 days KShs '000	More than 90 days KShs '000	Total KShs '000
Agriculture	879	-	-	186,266	187,145
Building & construction	144,302	-	54,021	961,717	1,160,040
Energy &water	943	-	-	131,241	132,184
Financial services	-	-	-	155,094	155,094
Manufacturing	1,322,716	230,360	169,555	7,353,800	9,076,431
Mining & quarrying	-	-	-	6,636	6,636
Personal/household	81,404	1,715	1,498	1,871,345	1,955,962
Real Estate	1,067,699	1,237	231,801	4,156,151	5,456,888
Tourism, restaurant & hotels	137,760	18,556	6,185	567,238	729,739
Trade	2,966,188	1,088,069	388,455	14,538,896	18,981,608
Transport & communication other	314,651	-	773	1,469,385	1,784,809
Other	-	-	-	-	-
Total	6,036,542	1,339,937	852,288	31,397,769	39,626,536

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

12. OTHER ASSETS

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Prepayments and deposits	187,453	154,253	187,453	154,253
Accrued income	61,583	49,777	61,583	49,777
Others*	631,735	654,205	214,451	179,427
	880,771	858,235	463,487	383,457

** Comprises amounts paid in advance for various projects being undertaken by the Bank, salary advances, deposits paid for properties to be acquired and withholding tax on interest on fixed deposits paid in advance. It also includes receivables arising out of insurance and reinsurance arrangements and reinsurer's share of contract liabilities.*

13. INVESTMENT IN SUBSIDIARY

The breakdown of the investment in subsidiary as at 31 December 2018 is as follows:

	2018 KShs '000	2017 KShs '000
As at 1 January	1,395,692	372,648
Purchase of additional shares in associate	-	963,185
Dividends received	(58,117)	(27,829)
Share of profit	-	104,273
Share of Comprehensive loss	-	(16,585)
As at 31 December	1,337,575	1,395,692

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

14. LEASEHOLD LAND

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
COST				
At 1 January	509,744	329,000	417,244	329,000
Acquisition of subsidiary	-	80,000	-	-
Revaluation	-	12,500	-	-
Additions	1,100	88,244	1,100	88,244
At 31 December	510,844	509,744	418,344	417,244
AMORTISATION				
At 1 January	7,833	-	7,833	-
On business combination	-	1,069	-	-
Charge for the year	9,109	9,069	7,842	7,833
Eliminated on revaluation	-	(2,305)	-	-
At 31 December	16,942	7,833	15,675	7,833
NET CARRYING AMOUNT				
At 31 December	493,902	501,911	402,669	409,411

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

15. PROPERTY AND EQUIPMENT - GROUP

a) Year ended 31 December 2018

	Freehold land KShs '000	Buildings KShs '000	Leasehold improvements KShs '000	Furniture and fittings KShs '000	Office equipment KShs '000	Motor vehicles KShs '000	Computer equipment KShs '000	Total KShs '000
COST								
At 1 January 2018	49,000	999,116	352,002	176,980	176,775	95,893	413,794	2,263,560
Additions	-	-	49,452	11,562	26,997	27,133	49,614	164,758
Disposals	-	-	(9,468)	(31,067)	(44,570)	(5,884)	-	(90,989)
At 31 December 2018	49,000	999,116	391,986	157,475	159,202	117,142	463,408	2,337,329
DEPRECIATION								
At 1 January 2018	-	22,418	214,636	138,017	118,484	71,636	324,311	889,502
Charge for the year	-	22,738	36,155	9,458	16,469	18,370	52,944	156,134
Disposals	-	-	(6,935)	(29,560)	(42,820)	(4,218)	-	(83,533)
At 31 December 2018	-	45,156	243,856	117,915	92,133	85,788	377,255	962,103
NET CARRYING AMOUNT								
At 31 December 2018	49,000	953,960	148,130	39,560	67,069	31,354	86,153	1,375,226

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

15. PROPERTY AND EQUIPMENT - GROUP (continued)

a) Year ended 31 December 2017

	Freehold land KShs '000	Buildings KShs '000	Leasehold improvements KShs '000	Furniture and fittings KShs '000	Office equipment KShs '000	Motor vehicles KShs '000	Computer equipment KShs '000	Total KShs '000
COST								
At 1 January 2017	49,000	636,472	284,918	133,505	153,739	90,356	293,436	1,641,426
Additions	-	92,992	64,629	10,988	23,158	19,000	87,058	297,825
Acquisition of subsidiary	-	269,652	2,455	32,748	-	962	33,300	339,117
Disposals	-	-	-	(261)	(122)	(14,425)	-	(14,808)
At 31 December 2017	49,000	999,116	352,002	176,980	176,775	95,893	413,794	2,263,560
DEPRECIATION								
At 1 January 2017	-	-	180,085	107,564	103,102	71,450	250,575	712,776
Acquisition of subsidiary	-	3,900	2,455	21,486	-	-	28,214	56,055
Charge for the year		18,518	32,096	9,130	15,492	14,111	45,522	134,869
Disposals	-	-	-	(163)	(110)	(13,925)	-	(14,198)
At 31 December 2017	-	22,418	214,636	138,017	118,484	71,636	324,311	889,502
NET CARRYING AMOUNT								
At 31 December 2017	49,000	976,698	137,366	38,963	58,291	24,257	89,483	1,374,058

PRIME BANK MILESTONES FOR THE YEAR 2018

BANK ON WHEELS

In 2018, the Bank launched a unique and innovative service "Bank on Wheels". This is a comprehensive and secure banking experience which offers banking services for select customers at their convenience, through a specially designed truck. Working as a mini branch, Bank on Wheels allows customers:

- Deposit cash,
- Deposit cheques,
- Account enquiry and statements printing, on the vehicle.

CAPITAL RAISING

Private Placement: In the course of the year, Prime Bank issued a private placement which was successfully taken up by longstanding customers and long serving staff. The successful take-up raised over KShs. 2Billion.

New Partnerships: Our second step involved partnering with Afric Invest and Catalyst Principal Partners which saw the two private equity funds acquire a minority stake in the Bank. Through KShs. 5.1 billion capital injection, Afric Invest and Catalyst jointly acquired a 24.2 per cent stake in the Bank.

PRIME BANK MILESTONES FOR THE YEAR 2018 (continued)

SHAREHOLDING STRUCTURE

Shareholders Name	% of Shares Held
Corporate Shareholders	
Afric Azure SPV	24.20%
Prime Capital Holding Ltd	14.36%
Jamson Ltd	8.02%
Crason Ltd	8.02%
Prime Trustees Ltd	8.02%
Capta Nominees Ltd	8.02%
Casa Ltd	6.91%
Jamar Ltd	6.91%
Individual Shareholders	
Foreign (7)	1.85%
Local (28)	5.67%
Total	**100%**

LOCAL NETWORK

The Bank expanded its local network through venturing into the Mount Kenya region with the opening of a branch in Meru County as well as broadening its our virtual branches concept - the intelligent ATMs with new installations in strategic locations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

15. PROPERTY AND EQUIPMENT - BANK

a) Year ended 31 December 2018

	Freehold land KShs '000	Buildings KShs '000	Leasehold improvements KShs '000	Furniture and fittings KShs '000	Office equipment KShs '000	Motor vehicles KShs '000	Computer equipment KShs '000	Total KShs '000
COST OR VALUATION								
At 1 January 2018	49,000	784,215	349,547	121,136	176,775	92,156	350,101	1,922,930
Additions	-	-	49,452	5,681	26,997	24,361	45,907	152,398
Disposals	-	-	(9,468)	(31,067)	(44,570)	(3,654)	-	(88,759)
At 31 December 2018	49,000	784,215	389,531	95,750	159,202	112,863	396,008	1,986,569
DEPRECIATION								
At 1 January 2018	-	18,518	212,181	93,436	118,484	68,861	265,704	777,184
Charge for the year		18,518	36,155	7,315	16,469	17,613	50,306	146,376
Disposals	-	-	(6,935)	(29,560)	(42,820)	(2,694)	-	(82,009)
At 31 December 2018	-	37,036	241,401	71,191	92,133	83,780	316,010	841,551
NET CARRYING AMOUNT								
At 31 December 2018	49,000	747,179	148,130	24,559	67,069	29,083	79,998	1,145,018

The Bank's freehold land and buildings were revalued as at 31 December 2017 by Knight Frank, registered valuers, on the open market value basis. The carrying amount of the freehold land and buildings was adjusted to the revalued amount and the resultant surplus, net of deferred tax, was recognised in other comprehensive income and credited to the asset revaluation reserve in equity. If freehold land and buildings were measured using the cost model, their net carrying amounts as at 31 December 2018 would have been KShs 15,645,000 and KShs 284,139,019 respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

15. PROPERTY AND EQUIPMENT - BANK (continued)
a) Year ended 31 December 2017

	Freehold land KShs '000	Buildings KShs '000	Leasehold improvements KShs '000	Furniture and fittings KShs '000	Office equipment KShs '000	Motor vehicles KShs '000	Computer equipment KShs '000	Total KShs '000
COST OR VALUATION								
At 1 January 2017	49,000	691,223	284,918	111,308	153,739	87,581	264,516	1,642,285
Additions	-	92,992	64,629	10,089	23,158	19,000	85,585	295,453
Disposals	-	-	-	(261)	(122)	(14,425)	-	(14,808)
At 31 December 2017	49,000	784,215	349,547	121,136	176,775	92,156	350,101	1,922,930
DEPRECIATION								
At 1 January 2017	-	-	180,085	86,077	103,102	68,995	222,362	660,621
Charge for the year	-	18,518	32,096	7,522	15,492	13,791	43,342	130,761
Disposals	-	-	-	(163)	(110)	(13,925)	-	(14,198)
At 31 December 2017	-	18,518	212,181	93,436	118,484	68,861	265,704	777,184
NET CARRYING AMOUNT								
At 31 December 2017	49,000	765,697	137,366	27,700	58,291	23,295	84,397	1,145,747

The Bank's freehold land and buildings were revalued as at 31 December 2017 by Knight Frank, registered valuers, on the open market value basis. The carrying amount of the freehold land and buildings was adjusted to the revalued amount and the resultant surplus, net of deferred tax, was recognised in other comprehensive income and credited to the asset revaluation reserve in equity. If freehold land and buildings were measured using the cost model, their net carrying amounts as at 31 December 2018 would have been KShs 15,645,000 and KShs 284,139,019 respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

16. INTANGIBLE ASSETS

GROUP	Computer software and Visa license fees KShs'000'	Good will KShs'000'	Total KShs'000'
Year ended 31 December 2018			
COST			
At 1 January	533,289	642,752	1,176,041
Additions	31,402	-	31,402
At 31 December	564,691	642,752	1,207,443
AMORTISATION			
At 1 January	406,592	-	406,592
Charge for the year	67,473	-	67,473
At 31 December	474,065	-	474,065
NET CARRYING AMOUNT			
At 31 December	90,626	642,752	733,378
Year ended 31 December 2017			
COST			
At 1 January	462,840	-	462,840
Additions	45,682	-	45,682
Acquisition of subsidiary	1,967	642,752	644,719
At 31 December	510,489	642,752	1,153,241
AMORTISATION			
At 1 January	303,198	-	303,198
Charge for the year	80,594	-	80,594
At 31 December	383,792	-	383,792
NET CARRYING AMOUNT			
At 31 December	126,697	642,752	769,449

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. The Group performed its annual impairment test on December 2018. The Group considers the relationship between its probable market capitalisation and its book value, among other factors, when reviewing for indicators of impairment. As at 31 December 2018, the market capitalisation of the Group was above the book value of its equity, indicating that no potential impairment of goodwill. In addition, the Banking industry in the country remains stable.

The Group has not identified separate cash generating units (CGUs) and as such goodwill has not been allocated.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

16. INTANGIBLE ASSETS (continued)

BANK	2018 KShs '000	2017 KShs '000
COST		
At 1 January	508,523	462,840
Additions	31,401	45,683
At 31 December	539,924	508,523
AMORTISATION		
At 1 January	383,792	303,198
Charge for the year	66,853	80,594
At 31 December	450,645	383,792
NET CARRYING AMOUNT		
At 31 December	89,279	124,731

Intangible assets comprise computer software and Visa license fees. Computer software is what the entity paid to acquire the Bank's core banking system and other peripheral systems. Visa license fees is paid for the use of the Visa payment system. Most of these assets will be amortised in the next four years. The Bank has not pledged its intangible assets as security for liabilities and therefore the Bank has no restriction over title of its assets as at 31 December 2017 and 31 December 2018.

17. DEFERRED TAX

Movement of the deferred tax (liability) asset during the year is as follows:

GROUP	At 1 January KShs '000	Recognised in statement of profit or loss KShs '000	Recognised in other comprehensive income KShs '000	At 31 December KShs '000
2018				
Arising from:				
Property and equipment	(267,284)	18,049	-	(249,235)
Provision for staff leave	4,589	657	-	5,246
Provision for loans and advances	135,245	54,696	-	189,941
FVTOCI	(619,735)	-	(365,842)	(985,577)
	(747,185)	73,402	(365,842)	(1,039,625)
2017				
Arising from:				
Property and equipment	(271,928)	6,104	(1,460)	(267,284)
Provision for staff leave	4,005	584	-	4,589
Provision for loans and advances	143,211	(7,966)	-	135,245
FVTOCI	-	-	(619,735)	(619,735)
	(124,712)	(1,278)	(621,195)	(747,185)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

17. DEFERRED TAX (continued)

Movement of the deferred tax (liability) asset during the year is as follows:

BANK	At 1 January KShs '000	Recognised in statement of profit or loss KShs '000	Recognised in other comprehensive income KShs '000	At 31 December KShs '000
2018				
Arising from:				
Property and equipment	(195,743)	18,074	-	(177,669)
Provision for staff leave	4,589	657	-	5,246
Provision for loans and advances	126,360	54,567	-	180,927
FVTOCI	(618,515)	-	(368,325)	(986,840)
	(683,309)	73,298	(368,325)	(978,336)
2017				
Arising from:				
Property and equipment	(212,194)	16,451	-	(195,743)
Provision for staff leave	4,005	584	-	4,589
Provision for loans and advances	134,159	(7,799)	-	126,360
FVTOCI	-	-	(618,515)	(618,515)
	(74,030)	9,236	(618,515)	(683,309)

The deferred tax liability is mainly due to accelerated capital allowances and the tax effect of the revaluation surplus on leasehold land and buildings valued in the year as detailed in notes 14 and 15.

18. BALANCES DUE TO BANKS AND FINANCIAL INSTITUTIONS

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Due to other banks	-	1,350,265	-	1,342,900
Due to financial institutions	1,035,822	1,448,022	1,035,822	1,448,022
	1,035,822	2,798,287	1,035,822	2,790,922

19. MEDIUM TERM NOTE

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Medium term note	1,020,000	1,033,000	1,020,000	1,033,000

The Bank issued a medium term note on 1 February 2017 at a fixed rate of 7 % per annum. The note will be redeemed in full on 26 July 2021.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

20. DEPOSITS FROM CUSTOMERS

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Current deposits	17,473,061	13,808,848	17,512,238	13,822,880
Savings deposits	635,137	552,715	635,137	552,715
Call deposits	229,108	352,852	229,108	352,852
Fixed deposits	52,764,747	42,568,827	53,073,221	42,826,275
	71,102,053	57,283,242	71,449,704	57,554,722

Included in deposits from customers, were deposits of KShs 431 million (2017: KShs 334 million) held as collateral for irrevocable commitments. The weighted average effective interest rate on interest bearing customer deposits as at 31 December 2018 was 6.6 % (2017: 6.7%).

21. OTHER LIABILITIES

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Pay orders issued	63,221	95,186	63,221	95,186
Dividend payable	258,500	-	258,500	-
Bills payable	227,193	203,084	227,193	203,084
Sundry creditors and accruals	1,342,192	1,528,915	249,616	358,772
IFRS 9 provisions on financial guarantees and loan commitments	213,090	-	213,090	-
	2,104,196	1,827,185	1,011,620	657,042

Pay orders issued, bills payable and sundry creditors and accruals are payable on demand and are non-interest bearing.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

22. INCOME TAX

GROUP	2018 KShs '000	2017 KShs '000
STATEMENT OF FINANCIAL POSITION		
Balance brought forward	(87,158)	(67,264)
Charge for the year	218,407	141,685
Withholding tax recovered	(437)	(873)
Paid during the year	(145,340)	(160,706)
Income tax recoverable	(14,528)	(87,158)
BANK		
STATEMENT OF FINANCIAL POSITION		
Balance brought forward	(73,780)	(67,793)
Charge for the year	140,448	144,204
Withholding tax recovered	(437)	(873)
Paid during the year	(88,517)	(149,318)
Income tax recoverable	(22,286)	(73,780)

	GROUP		BANK	
STATEMENT OF PROFIT OR LOSS	2018	2017	2018	2017
Current income tax at 30% on the taxable profit for the year	218,407	141,685	140,448	144,204
Deferred tax (credit)/charge (note 17)	(73,402)	1,278	(73,298)	(9,236)
Income tax expense	145,005	142,963	67,150	134,968
Reconciliation of tax expense to tax based on accounting profit:				
Accounting profit before tax	2,419,057	2,388,106	2,088,475	1,976,977
Tax applicable rate of 30%	725,717	716,432	626,543	593,093
Tax effect of share of profit of associate	-	-	-	(31,954)
Other expenses not deductible for tax purposes	88,749	24,853	74,782	24,653
Other income not subject to tax	(669,461)	(598,322)	(634,175)	(450,824)
Tax charge for the year	145,005	142,963	67,150	134,968

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

23. SHARE CAPITAL

	2018 Ordinary shares of KShs 1,000 each	2017 Ordinary shares of KShs 1,000 each
Authorised:		
Ordinary shares of KShs 1,000 each	8,000,000	5,000,000
3 million shares of KShs 1,000 each	-	3,000,000
	8,000,000	8,000,000
Issued and fully paid:		
At 1 January and 31 December	5,000,000	5,000,000
500,000 shares of KShs 1,000 each	500,000	-
1,149,390 shares of KShs 1,000 each	1,149,390	-
	6,649,390	5,000,000

During the year, the Bank issued 1,649,390 additional shares @ KShs 1,000 each.

24. SHARE PREMIUM

	2018 Ordinary shares of KShs 1,000 each	2017 Ordinary shares of KShs 1,000 each
Share premium 500,000 shares of KShs 3,334 each	1,667,000	-
Share premium 1,149,390 shares of KShs 3,100 each	3,563,109	-
	5,230,109	-

25. RESERVES

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Retained earnings	8,543,118	6,772,851	8,034,830	6,453,984
FVTOCI reserve	2,580,144	1,724,917	2,582,638	1,723,214
Asset revaluation reserve	544,453	544,453	542,006	542,006
	11,667,715	9,042,221	11,159,474	8,719,204

The fair value through other comprehensive income reserve comprises changes in fair value of fair value through other comprehensive income investments.

The asset revaluation reserve is not distributable and is used to record increases in the fair value of land and buildings and decreases to the extent that such decrease relates an increase in the fair value of the same assets previously recognized in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

26. INTEREST INCOME (GROUP AND BANK)

	2018 KShs '000	2017 KShs '000
Loans and advances to customers	4,494,303	4,794,699
Placements and bank balances	217,872	140,910
Reverse repurchase agreements	3,594	25,674
Treasury bills and term notes	1,156,230	751,262
Government securities-held-to-maturity	1,690,225	1,218,372
Available -for-sale investments	445,138	439,309
	8,007,362	7,370,226

27. INTEREST EXPENSE (GROUP AND BANK)

	2018 KShs '000	2017 KShs '000
Due to customers	4,090,268	3,527,362
Due to banks and other financial institutions	154,877	214,097
	4,245,145	3,741,459

28. FEES AND COMMISSION INCOME (GROUP AND BANK)

	2018 KShs '000	2017 KShs '000
Commission income	304,660	303,394
Fees income	242,183	208,989
	546,843	512,383

29. OTHER INCOME

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Insurance business income	1,089,401	209,996	-	-
Miscellaneous income	68,125	71,766	68,125	71,766
Recoveries of loans and advances previously written off	1,200	96,532	1,200	96,532
Fair value on previous equity interest in subsidiary	-	372,018	-	-
	1,158,726	750,312	69,325	168,298

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

30. ALLOWANCES FOR IMPAIRMENT OF FINANCIAL INSTRUMENTS

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Allowance on loans and advances to customers	74,767	359,800	74,767	330,800
Allowance on Loan Commitments	138	(29,000)	138	-
Allowance on Financial Guarantees	(7,186)	-	(7,186)	-
Allowance on term notes and bonds	97,919	-	97,919	-
Allowance on government securities	16,250	-	16,250	-
Write-off during the year	6,222	9,788	6,222	9,788
	188,110	340,588	188,110	340,588

31. OTHER OPERATING EXPENSES

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Staff costs (note 34)	1,266,694	1,124,299	1,107,850	1,106,960
Depreciation on property and equipment	156,134	134,869	146,376	130,761
Amortisation of intangible assets	67,473	80,594	66,853	80,594
Amortisation of leasehold land	9,109	9,069	7,842	7,833
Auditors' remuneration	8,456	4,199	6,148	3,899
Directors' emoluments	140,136	120,564	134,245	119,727
Deposit protection fund levy	81,778	75,697	81,778	75,697
Rent and rates	134,901	129,954	134,901	129,953
Other general administration expenses	1,268,180	705,501	688,049	664,950
	3,132,861	2,384,746	2,374,042	2,320,374

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

32. PROFIT BEFORE TAX

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Profit before tax is stated after charging/(crediting): -				
Depreciation on property and equipment	156,134	134,869	146,376	130,761
Amortisation of intangible assets	67,473	80,594	66,853	80,594
Amortisation of leasehold land	9,109	9,069	7,842	7,833
Directors' emoluments	140,136	120,564	134,245	119,727
Auditors' remuneration	8,456	4,199	6,148	3,899
And after crediting: -				
Foreign exchange gains	270,269	196,974	270,269	196,974
Dividend income	1,973	25,004	1,973	25,004
(Gain)/loss on sale of property and equipment	(4,606)	4,474	(4,606)	4,474

33. EARNINGS PER SHARE

a) Basic earnings per share is calculated on the profit for the year and on the weighted average number of shares outstanding during year.

b) Diluted earnings per share is calculated on the profit for the year and on the weighted average number of shares outstanding during the year plus the weighted average number of shares that would be issued on conversion of all the dilutive potential shares into shares. There are no such dilutive shares.

The following reflects the profit for the year and share data used in calculating the basic and diluted earnings per share:

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Profit for the year attributable to equity holders of the parent (KShs '000)	2,225,327	2,236,384	2,021,325	1,842,009
Weighted average number of shares (Thousands)	6,649	5,000	6,649	5,000
Basic and diluted earnings per share (KShs)	335	447	304	368

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

34. STAFF COSTS

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Salaries and wages	1,097,946	958,034	956,479	943,248
Contributions to pension scheme	63,019	53,731	56,162	52,961
Other staff costs	105,729	112,534	95,209	110,751
	1,266,694	1,124,299	1,107,850	1,106,960

35. DIVIDENDS PAID (GROUP AND BANK)

	2018 KShs '000	2017 KShs '000
Dividend declared and paid on ordinary shares	335,000	400,000
Dividend per ordinary share	67	80

Dividend per share is calculated based on the amount of the dividends and on the number of shares in issue at the reporting date.

36. CASH AND CASH EQUIVALENTS

For the purpose of the statement of cash flows, cash and cash equivalents comprise the following:

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Cash in hand (note 5)	638,844	621,726	636,216	613,231
Balances with Central Bank of Kenya-unrestricted (note 5)	6,113,088	2,501,021	6,113,088	2,501,021
Cheques and items for clearing (note 5)	406,352	498,160	406,352	498,160
Placements and balances with other banks	11,587,459	3,090,911	11,524,072	2,985,079
Government securities and term notes maturing within 91 days (note 7)	19,398	34,079	19,398	34,079
Due to banks and financial institutions (note 18)	(1,035,822)	(2,798,287)	(1,035,822)	(2,790,922)
	17,729,319	3,947,610	17,663,304	3,840,648

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

37. CONTINGENT LIABILITIES

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
Letters of credit	1,105,497	1,875,490	1,105,497	1,875,490
Local guarantees	3,789,471	3,628,250	3,789,471	3,628,250
Bills for collection	3,561,642	3,138,106	3,561,642	3,138,106
Foreign currency bills for collection	271,429	173,966	271,429	173,966
Custodial treasury bonds	3,228,784	3,036,699	3,228,784	3,036,699
Spot sales/purchase	744,247	841,186	744,247	841,186
Swap sales/purchases	7,591,402	5,268,024	7,591,402	5,268,024
Forward contracts	1,019,063	1,983,011	1,019,063	10,983,011
	21,311,535	19,944,732	21,311,535	19,944,732

The contingent liabilities represent transactions entered into in the normal course of business and are represented by counter indemnities or cash securities from customers for the same amount. Letters of credit, guarantee and acceptance commit the Bank to make payments on behalf of the customers in the event of a specific act, generally relating to the import and export of goods.

38. CAPITAL COMMITMENTS

	2018 KShs '000	2017 KShs '000
Capital commitments contracted for	462,000	270,000

Capital commitments relate to expected capital expenditure to be incurred in leasehold improvements, furniture and fittings and other assets.

39. OPERATING LEASE COMMITMENTS

As a lessee, the Bank leases a number of branch and office premises under operating leases. The leases typically run for a year up to ten years, with an option to renew the lease after that date. Lease payments are increased accordingly to reflect market lease rentals.

The total future minimum lease payments due to third parties under non-cancellable operating leases are as follows:

	2018 KShs '000	2017 KShs '000
Within 1 year	66,601	78,704
After 1 year but not more than 5 years	160,365	139,291
More than 5 years	4,283	2,199
	231,249	220,194

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

40. RELATED PARTY TRANSACTIONS

The Bank enters into transactions, arrangements and agreements involving directors, senior management and their related concerns in the ordinary course of business at commercial interest and commission rates.

	2018 KShs '000	2017 KShs '000
a) Due from:		
i) Loans and advances to employees	330,040	288,194
ii) Loans and advances to directors and their associates	1,622,068	1,651,510
	1,952,108	1,939,704
Allowance during the year:		
At 1 January	3,029	18,116
Allowance during the year	541	1,896
At 31 December	3,570	20,012

The loans to related parties are given in the ordinary course of business. The average term of the loans to related parties is 3 years. The loans are secured by titles to property and directors' guarantees.

	2018 KShs '000	2017 KShs '000
b) Due to:		
i) Deposits from employees	451,412	321,047
ii) Deposits from directors and their associates	2,915,176	886,445
	3,366,588	1,207,492
c) Key management personnel compensation		
Salaries	455,368	332,921
Post-employment benefits	22,558	19,899
	477,926	352,820

	GROUP		BANK	
	2018 KShs'000	2017 KShs'000	2018 KShs '000	2017 KShs'000
d) Directors' emoluments				
As management	84,154	70,580	84,154	70,167
As executives	57,280	49,984	57,280	49,560
	141,434	120,564	141,434	119,727

e) Transactions with related parties

Included in interest income is KShs 215,647,050 (2017: KShs 208,084,729) being interest on loans and advances to related parties.
Included in interest expense is KShs 30,617,153 (2017: KShs 95,156,720) being interest on deposits from related parties.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

41. 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.

As at 31 December 2018 GROUP	**Within 12 months KShs '000**	**After 12 months KShs '000**	**Total KShs '000**
ASSETS			
Cash and balances with the Central Bank of Kenya	9,175,285	-	9,175,285
Placements and balances with other banks	11,205,959	381,500	11,587,459
Treasury bills and term notes	3,680,562	160,850	3,841,412
Investment securities measured at amortised cost	1,125,882	15,381,032	16,506,914
Investment in bonds-fair value through other comprehensive income	9,986,655	4,967,514	14,954,169
Investment in ordinary shares fair value through other comprehensive income	-	4,154,203	4,154,203
Loans and advances to customers	19,122,623	17,179,208	36,301,831
Other assets	801,225	79,546	880,771
Intangible assets	-	733,376	733,376
Tax recoverable	14,528	-	14,528
Leasehold land	-	493,902	493,902
Property and equipment	-	1,375,226	1,375,226
Quoted shares at fair value through profit and loss	-	116,883	116,883
TOTAL ASSETS	55,112,719	45,023,240	100,135,959
LIABILITIES			
Balances due to banks and financial institutions	6,800	1,029,022	1,035,822
Medium term note	-	1,020,000	1,020,000
Deposits from customers	71,102,053	-	71,102,053
Other liabilities	2,104,196	-	2,104,196
Deferred tax liability	-	1,039,625	1,039,625
TOTAL LIABILITIES	73,213,049	3,088,647	76,301,696
NET ASSETS	(18,100,330)	41,934,593	23,834,263

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

41. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

As at 31 December 2017 GROUP	Within 12 months KShs '000	After 12 months KShs '000	Total KShs '000
ASSETS			
Cash and balances with the Central Bank of Kenya	5,265,571	-	5,265,571
Placements and balances with other banks	2,755,186	335,725	3,090,911
Treasury bills and term notes	7,619,233	275,833	7,895,066
Investment securities measured at amortised cost	796,924	11,991,734	12,788,658
Investment in bonds- at FVTOCI	-	3,750,776	3,750,776
Investment in ordinary shares at FVTOCI	-	3,046,775	3,046,775
Loans and advances to customers	16,828,496	21,575,176	38,403,672
Other assets	512,175	346,060	858,235
Intangible assets	-	769,449	769,449
Tax recoverable	87,158	-	87,158
Leasehold land	-	501,911	501,911
Property and equipment	-	1,374,058	1,374,058
Commercial paper	-	14,447	14,447
Quoted shares at fair value through profit and loss	-	141,222	141,222
TOTAL ASSETS	33,864,743	44,123,166	77,987,909
LIABILITIES			
Balances due to banks and financial institutions	2,798,287	-	2,798,287
Medium term note	-	1,033,000	1,033,000
Deposits from customers	57,283,242	-	57,283,242
Other liabilities	1,069,687	757,498	1,827,185
Deferred tax liability	-	747,185	747,185
TOTAL LIABILITIES	61,151,216	2,537,683	63,688,899
NET ASSETS	(27,286,473)	41,585,483	14,299,010

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

41. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

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

As at 31 December 2018 BANK	Within 12 months KShs '000	After 12 months KShs '000	Total KShs '000
ASSETS			
Cash and balances with the Central Bank of Kenya	9,172,657	-	9,172,657
Placements and balances with other banks	11,142,572	381,500	11,524,072
Treasury bills and term notes	3,680,562	160,850	3,841,412
Investment in securities measured at amortised cost	1,118,870	14,524,212	15,643,082
Investment in bonds- measured at FVTOCI	9,986,655	4,667,737	14,654,392
Investment in ordinary shares measured at FVTOCI	-	4,070,398	4,070,398
Loans and advances to customers	19,122,623	17,045,505	36,168,128
Other assets	383,941	79,546	463,487
Investment in Subsidiary	-	1,337,575	1,337,575
Intangible assets	-	89,279	89,279
Tax recoverable	22,286	-	22,286
Leasehold land	-	402,669	402,669
Property and equipment	-	1,145,018	1,145,018
TOTAL ASSETS	54,630,166	43,904,289	98,534,455
LIABILITIES			
Balances due to banks and financial institutions	6,800	1,029,022	1,035,822
Medium term note	-	1,020,000	1,020,000
Deposits from customers	71,449,704	-	71,449,704
Other liabilities	1,011,620	-	1,011,620
Deferred tax liability	-	978,336	978,336
TOTAL LIABILITIES	72,468,124	3,027,358	75,495,482
NET ASSETS	(17,837,958)	40,876,931	23,038,973

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

41. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

As at 31 December 2017 BANK	Within 12 months KShs '000	After 12 months KShs '000	Total KShs '000
ASSETS			
Cash and balances with the Central Bank of Kenya	5,257,076	-	5,257,076
Placements and balances with other banks	2,649,354	335,725	2,985,079
Treasury bills and term notes	7,619,233	275,833	7,895,066
Investment in securities measured at amortised cost	759,445	11,150,391	11,909,836
Investment in bonds- measured at FVTOCI	-	3,651,715	3,651,715
Investment in ordinary shares measured at FVTOCI	-	2,951,142	2,951,142
Loans and advances to customers	16,739,816	21,515,651	38,255,467
Other assets	344,538	38,919	383,457
Investment in associate	-	1,395,692	1,395,692
Intangible assets	-	124,730	124,730
Tax recoverable	73,780	-	73,780
Leasehold land	-	409,411	409,411
Property and equipment	-	1,145,748	1,145,748
TOTAL ASSETS	33,443,242	42,994,957	76,438,199
LIABILITIES			
Balances due to banks and financial institutions	2,790,922	-	2,790,922
Medium term note	-	1,033,000	1,033,000
Deposits from customers	57,554,722	-	57,554,722
Other liabilities	657,042	-	657,042
Deferred tax liability	-	683,309	683,309
TOTAL LIABILITIES	61,002,686	1,716,309	62,718,995
NET ASSETS	(27,559,444)	41,278,648	13,719,204

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

42. FAIR VALUE MEASUREMENT

a) Comparison of the carrying amounts and fair values of the financial instruments

	GROUP				BANK				
	2018		2017		2018		2017		
	Carrying amount KShs '000	Fair value KShs '000	Carrying amount KShs '000	Fair value KShs '000	Carrying amount KShs '000	Fair value KShs '000	Carrying amount KShs '000	Fair value KShs '000	Unrecognised gain/(loss) KShs '000
Cash and balances with Central Bank of Kenya	9,175,285	9,175,285	5,265,571	5,265,571	9,172,657	9,172,657	5,257,076	5,257,076	-
Placements and balances with other banks	11,587,459	11,587,459	3,090,911	3,090,911	11,524,072	11,524,072	2,985,079	2,985,079	-
Investment in security measured at amortised cost	16,506,914	16,506,914	12,788,658	12,788,658	15,643,082	15,643,082	11,909,836	11,909,836	-
Treasury bills	3,496,131	3,496,131	7,520,690	7,520,690	3,496,131	3,496,131	7,520,690	7,520,690	-
Term notes	345,281	345,281	374,376	374,376	345,281	345,281	374,376	374,376	-
Bills & Bonds-at FVTOCI	14,954,169	14,954,169	3,750,776	3,750,776	14,654,392	14,654,392	3,651,715	3,651,715	-
Ordinary shares- at FVTOCI	4,154,203	4,154,203	3,046,775	3,046,775	4,070,398	4,070,398	2,951,142	2,951,142	-
Investment in ordinary shares-at fair value through profit or loss	116,883	116,883	141,222	141,222	-	-	-	-	-
Loans and advances to customers	36,301,831	36,301,831	38,403,672	38,403,672	36,168,128	36,168,128	38,255,467	38,255,467	-
Due to banks and other financial institutions	1,035,822	1,035,822	2,798,287	2,798,287	1,035,822	1,035,822	2,790,922	2,790,922	-
Medium term note	1,020,000	1,020,000	1,033,000	1,033,000	1,020,000	1,020,000	1,033,000	1,033,000	-
Deposits from customers	71,102,053	71,102,053	57,283,242	57,283,242	71,449,704	71,449,704	57,554,722	57,554,722	-

b) Determination of fair value and fair value hierarchy

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

Level 1:

Included in level 1 category are financial assets that are measured in whole or in part by reference to unadjusted, quoted prices in an active market for identical assets and liabilities. Quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The assets are traded in an active market and quoted prices are available

Level 2:

Included in level 2 category are financial assets measured using inputs other than quoted prices included within level 1 that are observable for the asset, either directly (i.e. as prices) or indirectly (i.e. derived from prices). For example, instruments measured using a valuation technique such as discounted cash flows, based on assumptions that are supported by prices from observable current market transactions are categorized as level 2.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
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42. FAIR VALUE MEASUREMENT (continued)

Level 3:

Financial assets measured using inputs that are not based on observable market data are categorised as level 3. Non market observable inputs means that fair values are determined in whole or in part using a valuation technique (model) based on assumptions that are neither supported by prices from observable current market transactions in the same instrument nor are they based on available market data. Valuation techniques are used to the extent that observable inputs are not available, thereby allowing for situations for which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of the Bank. Therefore, unobservable inputs reflect the Bank's own assumptions about the assumptions that market participants would use in pricing the asset (including assumptions about risk). These inputs are developed based on the best information available, which might include the Bank's own data. However, significant portion of the unquoted shares have been valued at cost and variation in inputs would not have significant fair value change.

GROUP 2018	Note	Level 1 KShs '000	Level 2 KShs '000	Level 3 KShs '000	Total KShs '000
Financial investments at FVTOCI:					
Investment in bonds at FVTOCI	9	5,103,349	9,850,820	-	14,954,169
Investments in ordinary shares at FVTOCI	10 (a)	3,891,293	262,910	-	4,154,203
Investments in ordinary shares at fair value through profit or loss	10 (b)	116,883	-	-	116,883
Investments securities at amortised cost	8	16,506,914	-	-	16,506,914
Property and equipment		-	-	1,002,960	1,002,960
(Freehold land and buildings)	15				
Leasehold land	14	-	-	493,902	493,902
		25,618,439	10,113,730	1,496,862	37,229,031

GROUP 2017	Note	Level 1 KShs '000	Level 2 KShs '000	Level 3 KShs '000	Total KShs '000
Financial investments at FVTOCI:					
Investment in bonds at FVTOCI	9	3,750,776	-	-	3,750,776
Investments in ordinary shares at FVTOCI	10 (a)	2,778,899	267,876	-	3,046,775
Investments in ordinary shares at fair value through profit or loss	10 (b)	141,222	-	-	141,222
Investments securities at amortised cost	8	12,803,105	-	-	12,803,105
Property and equipment		-	-	1,025,698	1,025,698
(Freehold land and buildings)	15				
Leasehold land	14	-	-	501,911	501,911
		19,474,002	267,876	1,527,609	21,269,487

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

42. FAIR VALUE MEASUREMENT (continued)

b) Determination of fair value and fair value hierarchy

BANK 2018	Note	Level 1 KShs '000	Level 2 KShs '000	Level 3 KShs '000	Total KShs '000
Financial investments at FVTOCI:					
Investment in bonds & bills at FVTOCI	9	4,803,572	9,850,820	-	14,654,392
Investments in ordinary shares	10 (a)	4,070,398	-	-	4,070,398
Investment securities measured at amortised cost	8	15,643,082	-	-	15,643,082
Property and equipment		-	-	796,179	796,179
(Freehold land and buildings)	15				
Leasehold land	14	-	-	402,669	402,669
		24,517,052	9,850,820	1,198,848	35,566,720

BANK 2017	Note	Level 1 KShs '000	Level 2 KShs '000	Level 3 KShs '000	Total KShs '000
Financial investments at FVTOCI:					
Investment in bonds measured at FVTOCI	9	3,651,715	-	-	3,651,715
Investments in ordinary shares	10 (a)	2,683,266	-	-	2,683,266
Investment securities measured at amortised cost	8	11,909,836	-	-	11,909,836
Property and equipment					
(Freehold land and buildings)	15	-	-	814,697	814,697
Leasehold land	14	-	-	409,411	409,411
		18,244,817	-	1,224,108	19,468,925

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

	Valuation technique	**Significant unobservable inputs**	**Range (Weighted Average)**
Free hold land, leasehold land and buildings	Open market valuation	Estimated rental value per s.q.m. per month	KShs 180 –ground floor space KShs 120 –upper floor space
		Rent growth p.a.	8%
		Discount rate	8%

There were no transfers between levels 1, 2 and 3 in the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

43. FAIR VALUE MEASUREMENT (continued)

b) Determination of fair value and fair value hierarchy (contined)
Reconciliation of fair value measurement of the land and buildings

	2018 KShs'000	2017 KShs '000
Leasehold land		
As at 1 January	417,244	329,000
Additions	1,100	88,244
Accumulated depreciation	(15,675)	(7,833)
As at 31 December	402,669	409,411
Freehold land		
As at 1 January	49,000	49,000
Total gains and losses recognised in other comprehensive income	-	-
As at 31 December	49,000	49,000
Buildings		
As at 1 January	784,215	691,223
Additions	-	92,992
	784,215	784,215
Accumulated depreciation	(39,036)	(18,518)
As at 31 December	745,179	765,697

Significant increases (decreases) in estimated rental value per square metre in isolation would result in a significantly higher (lower) fair value on a linear basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
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44. CAPITAL MANAGEMENT
Regulatory capital

The Central Bank of Kenya sets and monitors capital requirements for the Banking industry as a whole. It has set among other measures, the rules and ratios to monitor adequacy of a bank's capital.

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

The Bank's regulatory capital is analysed in two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

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

Various limits are applied to elements of the capital base; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There are also restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital.

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

The Bank has complied with capital requirements.

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

	2018		2017	
	Actual KShs '000	Required KShs '000	Actual KShs '000	Required KShs '000
Tier 1 Capital	19,313,389	1,000,000	11,175,783	1,000,000
Tier 2 Capital				
Term subordinated debt	408,000	-	619,800	-
Statutory Loan Loss Reserve	353,022	-	-	-
Total regulatory capital	20,074,411	1,000,000	11,795,583	1,000,000
Risk weighted assets	53,837,765	-	52,554,722	-
Capital Ratios				
Total regulatory capital expressed as a percentage of total risk-weighted assets	37%	14.50%	23%	14.50%
Total tier 1 capital expressed as a percentage of risk weighted assets	36%	10.50%	21%	10.50%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT

Risk management framework

The Bank's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risks. The Bank's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Bank's financial performance.

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 various committees, which are responsible for developing and monitoring the Bank's risk management policies in their specified areas. All committees report regularly to the Board on their activities.

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.

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.

The Bank considers all elements of credit risk exposure such as counterparty default risk, geographical risk and sector risk for risk management purposes.

Management of credit risk

The Board has delegated the responsibility for the management of credit risk to the Credit Committee chaired by a Non-Executive Director. The Credit Department, headed by the Assistant General Manager, oversees the operation under the guidance of top management responsible for overseeing of the Bank's credit risk including:

1. Formulating credit policies, covering collateral requirements, credit assessment, risk grading, documentary and legal procedures, and compliance with regulatory and statutory requirements.

2. Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to various officers at different levels. Larger facilities require approval by Credit Committee or the Board as appropriate.

3. Reviewing and assessing credit risk. Credit Department assesses all credit exposures prior to facilities being committed to customers concerned. Renewals and reviews of facilities are subject to the same review process.

4. Limiting concentrations of exposure. The Board approved delegated authority restricts exposure for any sector.

5. 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/Board in respect of large borrowers.

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

7. Developing and maintaining the Group's risk grading to categorise exposures according to the degree of risk of default. Risk grades are subject to regular reviews.

8. Developing and maintaining the Group's processes for measuring ECL including monitoring of credit risk, incorporation of forward-looking information and the method used to measure ECL.

9. Ensuring that the Bank has policies and procedures in place to appropriately maintain and validate models used to assess and measure ECL.

Regular audits of Credit Department processes are undertaken by Internal Audit Department.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Impairment

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

Loans and advances to customers;

Debt investment securities;

Loan commitments issued; and

Financial guarantee contracts issued.

No impairment loss is recognised on equity investments.

With the exception of Purchased or Originated credit -impaired (POCI) financial assets (which are considered separately below), ECLs are required to be measured through a loss allowance at an amount equal to:

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

A loss allowance for full lifetime ECL is required for a financial instrument if the credit risk on that financial instrument has increased significantly since initial recognition. For all other financial instruments, ECLs are measured at an amount equal to the 12-month ECL. More details on the determination of a significant increase in credit risk are provided below.

ECLs are a probability-weighted estimate of the present value of credit losses. These are measured as the present value of the difference between the cash flows due to the Bank under the contract and the cash flows that the Bank expects to receive arising from the weighting of multiple future economic scenarios, discounted at the asset's EIR.

For undrawn loan commitments, the ECL is the difference between the present value of the difference between the contractual cash flows that are due to the Bank if the holder of the commitment draws down the loan and the cash flows that the Bank expects to receive if the loan is drawn down; and

for financial guarantee contracts, the ECL is the difference between the expected payments to reimburse the holder of the guaranteed debt instrument less any amounts that the Bank expects to receive from the holder, the debtor or any other party.

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

Credit-impaired financial assets

A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Credit-impaired financial assets are referred to as Stage 3 assets. Evidence of credit-impairment includes observable data about the following events:

a) significant financial difficulty of the borrower or issuer;

b) a breach of contract such as a default or past due event;

c) the lender of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession that the lender would not otherwise consider;

d) the disappearance of an active market for a security because of financial difficulties; or

e) the purchase of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired. The Bank assesses whether debt instruments that are financial assets measured at amortised cost or Fair Value through Other Comprehensive Income are credit-impaired at each reporting date. A loan is considered credit-impaired when a concession is granted to the borrower due to a deterioration in the borrower's financial condition, unless

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Credit-impaired financial assets (continued)

there is evidence that as a result of granting the concession the risk of not receiving the contractual cash flows has reduced significantly and there are no other indicators of impairment. For financial assets where concessions are contemplated but not granted the asset is deemed credit impaired when there is observable evidence of credit-impairment including meeting the definition of default. The definition of default (see below) includes unlikeliness to pay indicators and a back- stop if amounts are overdue for 90 days or more.

Purchased or originated credit-impaired (POCI) financial assets

POCI financial assets are treated differently because the asset is credit-impaired at initial recognition. For these assets, the Bank recognises all changes in lifetime ECL since initial recognition as a loss allowance with any changes recognised in profit or loss. A favourable change for such assets creates an impairment gain.

Definition of default

Critical to the determination of ECL is the definition of default. The definition of default is used in measuring the amount of ECL and in the determination of whether the loss allowance is based on 12-month or lifetime ECL, as default is a component of the probability of default (PD) which affects both the measurement of ECLs and the identification of a significant increase in credit risk .

The Bank considers the following as constituting an event of default:

a) the borrower is past due more than 90 days on any material credit obligation to the Bank; or

b) the borrower is unlikely to pay its credit obligations to the Bank in full.

This definition of default is used by the Bank for accounting purposes as well as for internal credit risk management purposes and is broadly aligned to the regulatory definition of default. The definition of default is appropriately tailored to reflect different characteristics of different types of assets. Overdrafts are considered as being past due once the customer has breached an advised limit or has been advised of a limit smaller than the current amount outstanding.

When assessing if the borrower is unlikely to pay its credit obligation, the Bank takes into account both qualitative and quantitative indicators. As noted in the definition of credit impaired financial assets above, default is evidence that an asset is credit impaired. Therefore credit impaired assets will include defaulted assets, but will also include other non-defaulted given the definition of credit impaired is broader than the definition of default.

Significant increase in credit risk

The Group monitors all financial assets, issued loan commitments and financial guarantee contracts that are subject to the impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant increase in credit risk the Bank will measure the loss allowance based on lifetime rather than 12-month ECL. The Bank's accounting policy is not to use the practical expedient that financial assets with 'low' credit risk at the reporting date are deemed not to have had a significant increase in credit risk. As a result the Bank monitors all financial assets, issued loan commitments and financial guarantee contracts that are subject to impairment for significant increase in credit risk.

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Bank compares the risk of a default occurring on the financial instrument at the reporting date based on the remaining maturity of the instrument with the risk of a default occurring that was anticipated for the remaining maturity at the current reporting date when the financial instrument was first recognised. In making this assessment, the Bank considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort, based on the Group's historical experience and expert credit assessment including forward-looking information.

Multiple economic scenarios form the basis of determining the probability of default at initial recognition and at subsequent reporting dates. Different economic scenarios will lead to a different probability of default. It is the weighting of these different scenarios that forms the basis of a weighted average probability of default that is used to determine whether credit risk has significantly increased.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Purchased or originated credit-impaired (POCI) financial assets (continued)

Forward-looking information includes the future prospects of the industries in which the Bank's counterparties operate, obtained from economic expert reports, financial analysts, governmental bodies and other similar organisations, as well as consideration of various internal and external sources of actual and forecast economic information. Also additional forecasts of local economic indicators, particularly for regions with a concentration to certain industries, as well as internally generated information of customer payment behaviour.

The Bank allocates its counterparties to a relevant internal credit risk grade depending on their credit quality. The quantitative information is a primary indicator of significant increase in credit risk and is based on the change in lifetime

- PD by comparing:
- the remaining lifetime PD at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated based on facts and circumstances at the time of initial recognition of the exposure.

The PDs used are forward-looking and the Bank uses the same methodologies and data used to measure the loss allowance for ECL .

The qualitative factors that indicate significant increase in credit risk are reflected in PD models on a timely basis. However the Bank still considers separately some qualitative factors to assess if credit risk has increased significantly. For corporate lending there is particular focus on assets that are included on a 'watch list' given an exposure is on a watch list once there is a concern that the creditworthiness of the specific counterparty has deteriorated. For retail lending the Group considers the expectation of forbearance, credit scores and events such as unemployment, bankruptcy, divorce or death.

Given that a significant increase in credit risk since initial recognition is a relative measure, a given change, in absolute terms, in the PD will be more significant for a financial instrument with a lower initial PD than compared to a financial instrument with a higher PD.

As a back-stop when an asset becomes 30 days past due, the Group considers that a significant increase in credit risk has occurred and the asset is in stage 2 of the impairment model, i.e. the loss allowance is measured as the lifetime ECL. In addition loans that are individually assessed and are included on a watch list are in stage 2 of the impairment model. As noted if there is evidence of credit-impairment the assets are at stage 3 of the impairment model.

Modification and derecognition of financial assets

A modification of a financial asset occurs when the contractual terms governing the cash flows of a financial asset are renegotiated or otherwise modified between initial recognition and maturity of the financial asset. A modification affects the amount and/or timing of the contractual cash flows either immediately or at a future date. In addition, the introduction or adjustment of existing covenants of an existing loan would constitute a modification even if these new or adjusted covenants do not yet affect the cash flows immediately but may affect the cash flows depending on whether the covenant is or is not met (e.g. a change to the increase in the interest rate that arises when covenants are breached).

The Bank renegotiates loans to customers in financial difficulty to maximise collection and minimise the risk of default. A loan forbearance is granted in cases where although the borrower made all reasonable efforts to pay under the original contractual terms, there is a high risk of default or default has already happened and the borrower is expected to be able to meet the revised terms. The revised terms in most of the cases include an extension of the maturity of the loan, changes to the timing of the cash flows of the loan (principal and interest repayment), reduction in the amount of cash flows due (principal and interest forgiveness) and amendments to covenants.

When a financial asset is modified the Bank assesses whether this modification results in derecognition. In accordance with the Bank's definition a modification results in derecognition when it gives rise to substantially different terms. To determine if the modified terms are substantially different from the original contractual terms the Group considers the following:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Modification and derecognition of financial assets (continued)

Qualitative factors, such as contractual cash flows after modification are no longer SPPI, change in currency or when rights to cash flows between the original counterparties expire because a new debtor replaces the original debtor (unless both debtors are under common control), the extent of change in interest rates, and maturity. If these do not clearly indicate a substantial modification, then;

A quantitative assessment is performed to compare the present value of the remaining contractual cash flows under the original terms with the contractual cash flows under the revised terms, both amounts discounted at the original effective interest.

If the difference in present value is greater than 10% the Group deems the arrangement is substantially different leading to derecognition. When performing a quantitative assessment of a modification or renegotiation of a credit-impaired financial asset or a purchased or originated credit-impaired financial asset that was subject to a write-off, the group considers the expected (rather than the contractual) cash flows before modification or renegotiation and compares those with the contractual cash flows after modification or renegotiation.

In the case where the financial asset is derecognised the loss allowance for ECL is remeasured at the date of derecognition to determine the net carrying amount of the asset at that date. The difference between this revised carrying amount and the fair value of the new financial asset with the new terms will lead to a gain or loss on derecognition. The new financial asset will have a loss allowance measured based on 12-month ECL except in the rare occasions where the new loan is considered to be originated- credit impaired. This applies only in the case where the fair value of the new loan is recognised at a significant discount to its revised par amount because there remains a high risk of default which has not been reduced by the modification. The Bank monitors credit risk of modified financial assets by evaluating qualitative and quantitative information, such as if the borrower is in past due status under the new terms.

When the contractual terms of a financial asset are modified and the modification does not result in derecognition, the Bank determines if the financial asset's credit risk has increased significantly since initial recognition by comparing:

a) the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms; with

b) the remaining lifetime PD at the reporting date based on the modified terms.

For financial assets modified as part of the Bank's forbearance policy, where modification did not result in derecognition, the estimate of PD reflects the Group's ability to collect the modified cash flows taking into account the Group's previous experience of similar forbearance action, as well as various behavioural indicators, including the borrower's payment performance against the modified contractual terms. If the credit risk remains significantly higher than what was expected at initial recognition the loss allowance will continue to be measured at an amount equal to lifetime ECL. If a forborne loan is credit impaired due to the existence of evidence of credit impairment (see above), the Group performs an ongoing assessment to ascertain if the problems of the exposure are cured, to determine if the loan is no longer credit-impaired. The loss allowance on forborne loans will generally only be measured based on 12-month ECL when there is evidence of the borrower's improved repayment behaviour following modification leading to a reversal of the previous significant increase in credit risk.

Where a modification does not lead to derecognition the Bank calculates the modification loss by comparing the gross carrying amount before and after the modification (excluding the ECL allowance). Modification losses for financial assets are included in the profit or loss account in 'Losses on modification of financial assets'. Then the Group measures ECL for the modified asset, where the expected cash flows arising from the modified financial asset are included in calculating the expected cash shortfalls from the original asset.

The Group derecognises a financial asset only when the contractual rights to the asset's cash flows expire (including expiry arising from a modification with substantially different terms), or when the financial asset and substantially all

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Modification and derecognition of financial assets (continued)

the risks and rewards of ownership of the asset are transferred to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain/loss that had been recognised in OCI and accumulated in equity is recognised in profit or loss, with the exception of equity investment designated as measured at FVTOCI, where the cumulative gain/loss previously recognised in OCI is not subsequently reclassified to profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Group retains an option to repurchase part of a transferred asset), the Group allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain/loss allocated to it that had been recognised in OCI is recognised in profit or loss. A cumulative gain/loss that had been recognised in OCI is allocated between the part that continues to be recognised and the part that is no longer recognised on the basis of the relative fair values of those parts. This does not apply for equity investments designated as measured at FVTOCI, as the cumulative gain/loss previously recognised in OCI is not subsequently reclassified to profit or loss.

Write-off

Loans and debt securities are written off when the Bank has no reasonable expectations of recovering the financial asset (either in its entirety or a portion of it). This is the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. A write-off constitutes a derecognition event. The Group may apply enforcement activities to financial assets written off. Recoveries resulting from the Bank's enforcement activities will result in impairment gains, which will be presented in 'net impairment loss on financial assets' in the statement of profit or loss.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- for financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- for loan commitments and financial guarantee contracts: as a provision; and
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision.

Critical judgements and key sources of estimation uncertainty

In the application of the Bank's policies, the directors are required to make judgements, estimates and assumptions about the carrying amounts of loans and Advances that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised in the period in which the estimate is revised if the revision affects only

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Critical judgements and key sources of estimation uncertainty (continued)

that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgements in applying the Bank's Lending policies

The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the directors have made in the process of applying the Bank's lending policies and that have the most significant effect on the amounts recognised in financial statements:

Significant increase of credit risk: ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased the Group takes into account qualitative and quantitative reasonable and supportable forward-looking information. Refer to note 1 and note 3 for more details.

Establishing groups of assets with similar credit risk characteristics: When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics.

The Group monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is appropriate re-segmentation of the assets. This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of that group of assets. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa, but it can also occur within portfolios that continue to be measured on the same basis of 12-month or lifetime ECLs but the amount of ECL changes because the credit risk of the portfolios differ.

Models and assumptions used: The Bank uses various models and assumptions in measuring fair value of financial assets as well as in estimating ECL. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk.

Determination of life of revolving credit facilities: The Bank measures ECL considering the risk of default over the maximum contractual period. However, for financial instruments such as credit cards, revolving credit facilities and overdraft facilities that include both a loan and an undrawn commitment component, the Group's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Group's exposure to credit losses to the contractual notice period. For such financial instruments the Group measures ECL over the period that it is exposed to credit risk and ECL would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

Key sources of estimation uncertainty

The following are key estimations that the directors have used in the process of applying the Bank's accounting policies and that have the most significant effect on the amounts recognised in financial statements:

Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and determining the forward-looking information relevant to each scenario: When measuring ECL the Bank uses reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

Probability of default: PD constitutes a key input in measuring ECL. PD is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, assumptions and expectations of future conditions.

Loss Given Default: LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from collateral and integral credit enhancements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Internal credit risk ratings

In order to minimise credit risk, the Group has tasked its credit management committee to develop and maintain the Group's credit risk grading to categorise exposures according to their degree of risk of default. The Group's credit risk grading framework comprises five categories. The credit rating information is based on a range of data that is determined to be predictive of the risk of default and applying experienced credit judgement. The nature of the exposure and type of borrower are taken into account in the analysis. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default.

The credit risk grades are designed and calibrated to reflect the risk of default as credit risk deteriorates. As the credit risk increases the difference in risk of default between grades changes. Each exposure is allocated to a credit risk grade at initial recognition, based on the available information about the counterparty. All exposures are monitored and the credit risk grade is updated to reflect current information. The monitoring procedures followed are both general and tailored to the type of exposure. The following data are typically used to monitor the Bank's exposures:

Payment record, including payment ratios and ageing analysis;

- Extent of utilisation of granted limit;
- Forbearances (both requested and granted);
- Changes in business, financial and economic conditions;
- Credit rating information supplied by external rating agencies;
- For retail exposures: internally generated data of customer behaviour, affordability metrics etc.; and
- For corporate exposures: information obtained by periodic review of customer files including audited financial statements review, changes in the financial sector the customer operates etc.

The Bank uses credit risk grades as a primary input into the determination of the term structure of the PD for exposures. The Bank collects performance and default information about its credit risk exposures analysed by jurisdiction or region and by type of product and borrower as well as by credit risk grading. The information used is both internal and external depending on the portfolio assessed. The table below provides a mapping of the Group's internal credit risk grades to external ratings.

Group Rating	Description
1	Low to fair risk
2	Watch list
3	Substandard
4	Doubtful
5	Impaired

The Bank analyses all data collected using statistical models and estimates the remaining lifetime PD of exposures and how these are expected to change over time. The factors taken into account in this process include macro-economic data such as Public debt to GDP, Saving Interest rates, lending Interest rates and House pricing index. The Bank generates a 'base case' scenario of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The Bank then uses these forecasts, which are probability-weighted, to adjust its estimates of PDs.

The Bank uses different criteria to determine whether credit risk has increased significantly per portfolio of assets. The criteria used are both quantitative changes in PDs as well as qualitative. Loan commitments are assessed along with the category of loan the Bank is committed to provide, i.e. commitments to provide mortgages are assessed using similar criteria to mortgage loans, while commitments to provide a corporate loan are assessed using similar criteria to corporate loans.

Irrespective of the outcome of the above assessment, the Bank presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due unless the Bank has reasonable and supportable information that demonstrates otherwise.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Internal credit risk ratings (continued)

The Bank has monitoring procedures in place to make sure that the criteria used to identify significant increases in credit are effective, meaning that significant increase in credit risk is identified before the exposure is defaulted or when the asset becomes 30 days past due. The Bank performs periodic back-testing of its ratings to consider whether the drivers of credit risk that led to default were accurately reflected in the rating in a timely manner.

The Bank has controls and procedures in place to identify when the credit risk of an asset improves and the definition of significant increase in credit risk is no longer met. When this is the case the asset may move back to stage 1 from stage 2, subject to payments being up to date and the ability of the borrower to make future payments on time.

Incorporation of forward-looking information

The Bank uses forward-looking information that is available without undue cost or effort in its assessment of significant increase of credit risk as well as in its measurement of ECL. The Bank employs experts who use external and internal information to generate a 'base case' scenario of future forecast of relevant economic variables along with a representative range of other possible forecast scenarios. The external information used includes economic data and forecasts published by governmental bodies and monetary authorities. The Bank uses multiple scenarios to model the non-linear impact of assumptions about macroeconomic factors on ECL. The Bank applies probabilities to the forecast scenarios identified. The base case scenario is the single most-likely.

Key drivers of credit risk and credit losses for each portfolio of financial instruments and, using a statistical analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. The Bank has not made changes in the estimation techniques or significant assumptions made during the reporting period. In addition to the base case scenario the Bank uses Upside and Adverse scenarios, with associated probability weightings. The probability weighting is such that the base scenario has the highest weighting, since it is the most likely outcome and the weighting of the Upside and adverse scenarios depend on the probability of the scenario.

The table below summarises the principal macroeconomic indicators included in the economic scenarios used at 31 December 2018 that has a material impact in ECLs.

	2019		
	Base	**Upside**	**Adverse**
	Weighting		
Macro-Economic Variable	**90%**	**5%**	**5%**
Savings Rate	4%	6.35%	1.65%
Lending Rates	12.74%	15.93%	9.56%
Housing Price Index	0.39%	1.19%	-0.41%
Public Debt to GDP	60.90%	67.67%	54.15%

Measurement of ECL

The key inputs used for measuring ECL are:

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

These figures are generally derived from internally developed statistical models and other historical data and they are adjusted to reflect probability-weighted forward-looking information.

PD is an estimate of the likelihood of default over a given time horizon. It is estimated as at a point in time. The calculation is based on statistical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on market data , as well as internal data comprising both quantitative and qualitative factors. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates. The estimation is based on current conditions, adjusted to take into account estimates of future conditions that will impact PD.

LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from any collateral. The LGD

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Incorporation of forward-looking information (continued)

models for secured assets consider forecasts of future collateral valuation taking into account sale discounts, time to realisation of collateral, cross- collateralisation and seniority of claim, cost of realisation of collateral and cure rates (i.e. exit from non-performing status). LGD models for unsecured assets consider time of recovery, recovery rates and seniority of claims. The calculation is on a discounted cash flow basis, where the cash flows are discounted by the original EIR of the loan.

EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities. The Bank's modelling approach for EAD reflects expected changes in the balance outstanding over the lifetime of the loan exposure that are permitted by the current contractual terms, such as amortisation profiles, early repayment or overpayment, changes in utilisation of undrawn commitments and credit mitigation actions taken before default. The Bank uses EAD models that reflect the characteristics of the portfolios.

The Bank measures ECL considering the risk of default over the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if contact extension or renewal is common business practice. However, for financial instruments such as credit cards, revolving credit facilities and overdraft facilities that include both a loan and an undrawn commitment component, the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period. For such financial instruments the Bank measures ECL over the period that it is exposed to credit risk and ECL would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. These financial instruments do not have a fixed term or repayment structure and have a short contractual cancellation period. However, the Bank does not enforce in the normal day-to-day management the contractual right to cancel these financial instruments. This is because these financial instruments are managed on a collective basis and are cancelled only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take to mitigate ECL, e.g. reduction in limits or cancellation of the loan commitment.

The ECL calculation for accounting purposes is different to the ECL calculation for regulatory purposes, although many inputs used are similar. The Bank has ensured that the appropriate methodology is used when calculating ECL for both accounting and regulatory purposes.

The measurement of ECL is based on probability weighted average credit loss. As a result, the measurement of the loss allowance should be the same regardless of whether it is measured on an individual basis or a collective basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Incorporation of forward-looking information (continued)

Loans and advances to customers at amortised cost	31-Dec-18 KShs '000	1-Jan-18 KShs '000
Concentration by sector		
Agriculture	134,603	187,145
Building & Construction	1,138,799	1,160,041
Energy &Water	122,450	132,184
Financial Services	140,318	155,094
Manufacturing	8,160,616	9,076,432
Mining & Quarrying	11,577	6,636
Personal/Household	2,140,757	1,955,962
Real Estate	4,453,126	5,456,888
Tourism, Restaurant & Hotels	775,019	729,739
Trade	18,318,558	18,981,607
Transport & Communication	1,589,876	1,784,808
TOTAL	36,985,699	39,626,536

Loan commitments	31-Dec-18 KShs '000	1-Jan-18 KShs '000
Concentration by sector		
Agriculture	12,199	10,958
Building & Construction	178,233	72,334
Energy &Water	14,849	19,866
Financial Services	2,594	591
Manufacturing	1,048,344	707,121
Mining & Quarrying	-	2,858
Personal/Household	610,408	491,100
Real Estate	183,876	295,799
Tourism, Restaurant & Hotels	21,085	16,090
Trade	2,167,658	2,405,475
Transport & Communication	56,210	116,516
TOTAL	4,295,456	4,138,708

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Incorporation of forward-looking information (continued)

Financial guarantee contracts	31-Dec-18 KShs '000	1-Jan-18 KShs '000
Concentration by sector		
Agriculture	18,003	16,969
Building & Construction	605,803	647,722
Energy &Water	19,400	26,900
Financial Services	17,903	60,984
Manufacturing	1,169,886	1,863,539
Mining & Quarrying	6,018	-
Personal/Household	31,469	56,248
Real Estate	116,876	129,951
Tourism, Restaurant & Hotels	8,688	10,260
Trade	4,751,410	3,971,513
Transport & Communication	85,608	64,508
TOTAL	6,831,064	6,848,594

An analysis of the Bank's credit risk exposure per class of financial asset, internal rating and "stage" without taking into account the effects of any collateral or other credit enhancements is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

Impairment allowance reconciliations

	31-Dec-18					1-Jan-18
Loans and advances to customers at amortised cost	Stage 1 12-month ECL KShs '000	Stage 2 Lifetime ECL KShs '000	Stage 3 Lifetime ECL KShs '000	POCI KShs '000	Total KShs '000	Total KShs '000
Grades 1: Low to fair risk	32,102,885	-	-	-	32,102,885	35,886,140
Grades 2: Watch	-	2,799,481	-	-	2,799,481	1,599,696
Grades 3: Substandard	-	-	180,391	-	180,391	349,192
Grade 4: Doubtful	-	-	1,696,821	-	1,696,821	1,230,596
Grade 5: Impaired	-	-	206,121	-	206,121	204,562
Total gross carrying amount	32,102,885	2,799,481	2,083,333	-	36,985,699	39,270,186
Loss allowance	112,255	147,679	557,637	-	817,571	742,804
Carrying amount	31,990,630	2,651,802	1,525,696	-	36,168,128	38,527,382

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Impairment allowance reconciliations (continued)

Loan commitments	Stage 1 12-month ECL KShs '000	Stage 2 Lifetime ECL KShs '000	Stage 3 Lifetime ECL KShs '000	POCI KShs '000	31-Dec-18 Total KShs '000	1-Jan-18 Total KShs '000
Grades 1: Low to fair risk	4,295,456	-	-	-	4,295,456	4,138,708
Grades 2: Watch	-	-	-	-	-	-
Grades 3: Substandard	-	-	-	-	-	-
Grade 4: Doubtful	-	-	-	-	-	-
Grade 5: Impaired	-	-	-	-	-	-
Total gross carrying amount	4,295,456	-	-	-	4,295,456	4,138,708
Loss allowance	21,305	-	-	-	21,305	21,167
Carrying amount	4,274,151	-	-	-	4,274,151	4,117,541

Financial guarantee contracts	Stage 1 12-month ECL KShs '000	Stage 2 Lifetime ECL KShs '000	Stage 3 Lifetime ECL KShs '000	POCI KShs '000	31-Dec-18 Total KShs '000	1-Jan-18 Total KShs '000
Grades 1: Low to fair risk	6,831,063	-	-	-	6,831,063	6,848,594
Grades 2: Watch	-	-	-	-	-	-
Grades 3: Substandard	-	-	-	-	-	-
Grade 4: Doubtful	-	-	-	-	-	-
Grade 5: Impaired	-	-	-	-	-	-
Total gross carrying amount	6,831,063	-	-	-	6,831,063	6,848,594
Loss allowance	30,951	-	-	-	30,951	38,137
Carrying amount	6,800,112	-	-	-	6,800,112	6,810,457

This table summarises the loss allowance as of the year-end by class of exposure/asset.

Loss allowance by classes	31-Dec-18	1-Jan-18
Loans and advances to customers at amortised cost	817,571	742,804
Loan commitments	21,305	21,167
Financial guarantee contracts	30,951	38,137
Total	869,827	802,108

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Impairment allowance reconciliations (continued)

The tables below analyse the movement of the loss allowance during the year per class of assets.

Loss allowance – Loans and advances to Customers at amortised cost	**Stage 1 12-month ECL KShs '000**	**Stage 2 Lifetime ECL KShs '000**	**Stage 3 Lifetime ECL KShs '000**	**POCI KShs '000**	**Total KShs '000**
Loss allowance as at 31 December 2017	377,842	47,991	566,715	-	992,548
Restatement of the prior year	(278,657)	68,712	(39,799)	-	(249,744)
Loss allowance as at 1 January 2018	99,185	116,703	526,916	-	742,804
Changes in the loss allowance					
– Transfer to stage 1	92,049	(92,004)	(45)	-	-
– Transfer to stage 2	(5,836)	5,836	-	-	-
– Transfer to stage 3	(667)	(2,681)	3,348	-	-
– Increases due to change in credit risk	29,282	99,740	87,893	-	216,915
– Decreases due to change in credit risk	(111,026)	(3,030)	(69,165)	-	(183,221)
– Write-offs	-	(9)	(321)	-	(330)
– Changes due to modifications that did not result derecognition	5,427	-	-	-	5,427
New financial assets originated or purchased	26,553	27,238	13,088	-	66,879
Financial assets that have been Settled	(22,711)	(4,115)	(4,077)	-	(30,903)
Loss allowance as at 31 December 2018	112,256	147,678	557,637	-	817,571

Loss allowance – Loan Commitments	**Stage 1 12-month ECL KShs '000**	**Stage 2 Lifetime ECL KShs '000**	**Stage 3 Lifetime ECL KShs '000**	**POCI KShs '000**	**Total KShs '000**
Loss allowance as at 31 December 2018	-	-	-	-	-
Restatement of the prior year	21,167				
Loss allowance as at 1 January 2018	21,167	-	-	-	21,167
Changes in the loss allowance					
– Transfer to stage 1	-	-	-	-	-
– Transfer to stage 2	-	-	-	-	-
– Transfer to stage 3	-	-	-	-	-
– Increases due to change in credit risk	2,502	-	-	-	2,502
– Decreases due to change in credit risk	(6,340)	-	-	-	(6,340)
– Write-offs	-	-	-	-	-
New financial assets originated or purchased	11,500	-	-	-	11,500
Financial assets that have been Settled derecognised	(7,524)	-	-	-	(7,524)
Loss allowance as at 31 December 2018	21,305	-	-	-	21,305

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

a) Credit risk **(continued)**

Impairment allowance reconciliations (continued)

Loss allowance – Financial guarantee contracts	Stage 1 12-month ECL KShs '000	Stage 2 Lifetime ECL KShs '000	Stage 3 Lifetime ECL KShs '000	POCI KShs '000	Total KShs '000
Loss allowance as at 31 December 2017	-	-	-	-	-
Restatement of the prior year	38,137	-	-	-	38,137
Loss allowance as at 1 January 2018	38,137	-	-	-	38,137
Changes in the loss allowance					
– Transfer to stage 1	-	-	-	-	-
– Transfer to stage 2	-	-	-	-	-
– Transfer to stage 3	-	-	-	-	-
– Increases due to change in credit risk	3,967	-	-	-	3,967
– Decreases due to change in credit risk	(1,186)	-	-	-	(1,186)
– Write-offs	-	-	-	-	-
New financial assets originated or purchased	21,202	-	-	-	21,202
Financial assets that have been settled derecognised	(31,169)	-	-	-	(31,169)
Loss allowance as at 31 December 2018	30,951	-	-	-	30,951

As discussed above in the significant increase in credit risk section, under the Bank's monitoring procedures a significant increase in credit risk is identified before the exposure has defaulted, and at the latest when the exposure becomes 30 days past due. This is the case mainly for loans and advances to customers and more specifically for retail lending exposures because for corporate lending and other exposures there is more borrower specific information available which is used to identify significant increase in credit risk. The table below provides an analysis of the gross carrying amount of loans and advances to customers by past due status.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)
Risk management framework (continued)

	31-Dec-18		1-Jan-18	
	Gross Carrying Amount KShs '000	Loss Allowance KShs '000	Gross Carrying Amount KShs '000	Loss Allowance KShs '000
Loans and Advances to Customers				
0-29 days	32,102,885	112,255	35,886,140	99,184
30-59 days	2,799,481	147,679	1,599,697	116,703
60-89 days	180,391	35,318	387,163	37,006
90-180days	1,696,821	315,751	1,330,847	285,200
More than 181 days	206,121	206,568	422,689	204,711
	36,985,699	817,571	39,626,536	742,804
Loan Commitments				
0-29 days	4,295,456	21,305	4,138,708	21,167
30-59 days	-	-	-	-
60-89 days	-	-	-	-
90-180days	-	-	-	-
More than 181 days	-	-	-	-
	4,295,456	21,305	4,138,708	21,167
Financial guarantee contracts				
0-29 days	6,831,063	30,951	6,848,594	38,137
30-59 days	-	-	-	-
60-89 days	-	-	-	-
90-180days	-	-	-	-
More than 181 days	-	-	-	-
	6,831,063	30,951	6,848,594	38,137

b) Liquidity risk

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

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.

Details of the reported bank ratio of net liquid assets to deposits from customers at the reporting date and during the year were as follows:

	2018	2017
At 31 December	71.50%	49%
Average for the year	59.40%	49%
Maximum for the year	71.50%	51%
Minimum for the year	49.70%	42%
Central Bank of Kenya required minimum	20%	20%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

b) Liquidity risk (continued)

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 Institution's reputation.

Treasury department maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to financial institutions and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the institution as a whole. All liquidity policies and procedures are subject to review and approval by an Assets and Liabilities Committee.

The Bank manages the liquidity structure of assets, liabilities and commitments so that cash flows are appropriately matched to ensure that all funding obligations are met when due. Banking operations are such that mismatch of assets and liabilities according to their maturity profiles cannot be avoided. However, management ensures that the mismatch is controlled in line with allowable risk levels. The table below analyses maturity profiles of the undiscounted cash flows of the financial assets and liabilities of the Bank based on the remaining period using 31 December 2018 as a base period to the contractual maturity date. Deposits from customers shown as maturing within 90 days relate to current, savings, call and fixed account balances. Although classified in this band, previous experience has shown these to be stable and of a long term nature.

As at 31 December 2018 GROUP	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months – 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
FINANCIAL ASSETS						
Cash and balances with Central Bank of Kenya	9,175,285	-	-	-	-	9,175,285
Placements and balances with other banks	9,385,959	500,000	1,320,000	-	381,500	11,587,459
Treasury bills and term notes	299,505	1,549,773	1,831,284	-	160,850	3,841,412
Investment securities measured at amortised cost	51,000	-	1,074,882	5,460,943	9,920,089	16,506,914
Bonds- at fair value through other comprehensive income	746,917	2,064,445	7,185,134	958,929	3,998,744	14,954,169
Loans and advances to customers	4,351,213	3,023,481	11,747,929	8,114,451	9,064,757	36,301,831
Other assets	-	-	61,583	-	-	61,583
Total assets	24,009,879	7,137,699	23,220,812	14,534,323	23,525,940	92,428,653
FINANCIAL LIABILITIES						
Due to banks and financial institutions	-	-	6,800	1,029,022	-	1,035,822
Medium term note	-	-	-	1,020,000	-	1,020,000
Deposits from customers	30,495,589	14,015,994	26,590,470	-	-	71,102,053
Other liabilities	258,500	1,409,912	-	-	-	1,668,412
Total liabilities	30,754,089	15,425,906	26,597,270	2,049,022	-	74,826,287
Net liquidity gap	(6,744,210)	(8,288,207)	(3,376,458)	12,485,301	23,525,940	17,602,366

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

b) Liquidity risk (continued)

Management of liquidity risk (continued)

As at 31 December 2017 GROUP	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months – 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Cash and balances with Central Bank of Kenya	5,265,571	-	-	-	-	5,265,571
Placements and balances with other banks	3,090,911	-	-	-	-	3,090,911
Treasury bills and term notes	1,143,774	2,317,599	4,268,710	475,897	-	8,205,980
Investment securities measured at amortised cost	160,475	268,940	367,509	4,637,766	9,198,234	14,632,924
Bonds- at fair value through other comprehensive income	-	-	-	326,675	4,607,406	4,934,081
Other assets	-	-	49,777	-	-	49,777
Total assets	9,660,731	2,586,539	4,685,996	5,440,338	13,805,640	36,179,244
FINANCIAL LIABILITIES						
Due to banks and financial institutions	523,865	2,274,422	-	-	-	2,798,287
Medium term note	-	-	-	1,045,000	-	1,045,000
Deposits from customers	16,252,509	21,001,856	20,002,128	32,650	-	57,289,143
Other liabilities	-	1,544,181	-	-	-	1,544,181
Total liabilities	16,776,374	24,820,459	20,002,128	1,077,650	-	62,676,611
Net liquidity gap	(7,115,643)	(22,233,920)	(15,316,132)	4,362,688	13,805,640	(26,497,367)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

b) Liquidity risk (continued)

Management of liquidity risk (continued)

As at 31 December 2018 BANK	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months – 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Cash and balances with Central Bank of Kenya	9,172,657	-	-	-	-	9,172,657
Placements and balances with other banks	9,322,572	500,000	1,320,000	-	381,500	11,524,072
Treasury bills and term notes	299,505	1,549,773	1,831,284	-	160,850	3,841,412
Investment securities measured at amortised cost	51,000	-	1,067,870	5,301,694	9,222,518	15,643,082
Bill & Bonds- at fair value through other comprehensive income	746,917	2,064,445	7,185,134	946,064	3,711,832	14,654,392
Loans and advances to customers	4,351,213	3,023,481	11,747,929	7,980,748	9,064,757	36,168,128
Other assets	-	61,583		-	-	61,583
Total assets	23,943,864	7,199,282	23,152,217	14,228,506	22,541,457	91,065,326
FINANCIAL LIABILITIES						
Due to banks and financial institutions	-	-	6,800	1,029,022	-	1,035,822
Medium term note	-	-	-	1,020,000	-	1,020,000
Deposits from customers	18,810,557	25,740,203	26,898,944		-	71,449,704
Other liabilities	258,500	290,413	-	-	-	548,913
Total liabilities	19,069,057	26,030,616	26,905,744	2,049,022	-	74,054,439
Net liquidity gap	4,874,807	(18,831,334)	(3,753,527)	12,179,484	22,541,457	17,010,887

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

b) Liquidity risk (continued)

Management of liquidity risk (continued)

As at 31 December 2017 Bank	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months – 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Cash and balances with Central Bank of Kenya	5,257,076	-	-	-	-	5,257,076
Placements and balances with other banks	2,985,079	-	-	-	-	2,985,079
Treasury bills and term notes	1,143,774	2,317,599	4,268,710	475,897	-	8,205,980
Investment securities measured at amortised cost	160,475	255,541	343,429	4,534,007	9,198,234	14,491,686
Bonds- at fair value through other comprehensive income	-	-	-	302,234	4,532,786	4,835,020
Other assets	-	-	49,777	-	-	49,777
Total assets	9,546,404	2,573,140	4,661,916	5,312,138	13,731,020	35,824,618
FINANCIAL LIABILITIES						
Due to banks and financial institutions	516,500	2,274,422	-	-	-	2,790,922
Medium term note	-	-	-	1,045,000	-	1,045,000
Deposits from customers	16,523,988	21,001,856	20,002,128	32,650	-	57,560,622
Other liabilities	-	374,039	-	-	-	374,039
Total liabilities	17,040,488	23,650,317	20,002,128	1,077,650	-	61,770,583
Net liquidity gap	(7,494,084)	(21,077,177)	(15,340,212)	4,234,488	13,731,020	(25,945,965)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) 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 GROUP	Armotised cost KShs'000	Armotised cost KShs'000	Fair value through other comprehensive income financial assets KShs'000	At fair value through profit or loss KShs'000	Financial liabilities measured at amortised cost KShs'000	Carrying amount KShs'000
Assets						
Cash and balances with Central Bank of Kenya	-	9,175,285	-	-	-	9,175,285
Placements and balances with other banks	-	11,587,459	-	-	-	11,587,459
Treasury bills and term notes	3,496,125	345,287	-	-	-	3,841,412
Investment securities measured at amortised cost	16,506,914		-	-	-	16,506,914
Investment in bonds- fair value through other comprehensive income	-	-	14,954,169	-	-	14,954,169
Investment in ordinary shares- fair value through other comprehensive income	-	-	4,154,203	-	-	4,154,203
Investment in ordinary shares- at fair value through profit or loss	-	-	-	116,883	-	116,883
Loans and advances to customers	-	36,301,829	-	-	-	36,301,829
Other assets	-	61,583	-	-	-	61,583
Total assets	20,003,039	57,471,443	19,108,372	116,883		96,699,737
Liabilities	-	-	-	-		
Balances due to banks and financial institutions	-	-	-	-	1,035,822	1,035,822
Medium term note	-	-	-	-	1,020,000	1,020,000
Deposits from customers	-	-	-	-	71,102,053	71,102,053
Other liabilities	-	-	-	-	1,668,412	1,668,412
Total liabilities	-	-	-	-	74,826,287	74,826,287

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Classification of financial instruments (continued)

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 2017 GROUP	Armotised cost KShs'000	Armotised cost KShs'000	Fair value through other comprehensive income financial assets KShs'000	At fair value through profit or loss KShs'000	Financial liabilities measured at amortised cost KShs'000	Carrying amount KShs'000
Assets						
Cash and balances with Central Bank of Kenya	-	5,265,571	-	-	-	5,265,571
Placements and balances with other banks	-	3,090,911	-	-	-	3,090,911
Treasury bills and term notes	7,520,690	374,376	-	-	-	7,895,066
Investment securities measured at amortised cost	12,803,105	-	-	-	-	12,803,105
Investment in bonds- fair value through other comprehensive income	-	-	3,750,776	-	-	3,750,776
Investment in ordinary shares- fair value through other comprehensive income	-	-	3,046,775	-	-	3,046,775
Investment in ordinary shares- at fair value through profit or loss	-	-	-	141,222	-	141,222
Loans and advances to customers	-	38,403,672	-	-	-	38,403,672
Other assets	-	49,777	-	-	-	49,777
Total assets	20,323,795	47,184,307	6,797,551	141,222	-	74,446,875
Liabilities						
Balances due to banks and financial institutions	-	-	-	-	2,798,287	2,798,287
Medium term note	-	-	-	-	1,033,000	1,033,000
Deposits from customers	-	-	-	-	57,283,242	57,283,242
Other liabilities	-	-	-	-	1,544,181	1,544,181
Total liabilities	-	-	-	-	62,658,710	62,658,710

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Classification of financial instruments (continued)

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 BANK	Armotised cost KShs'000	Armotised cost KShs'000	Fair value through other comprehensive income financial assets KShs'000	Financial liabilities measured at amortised cost KShs'000	Carrying amount KShs'000
Assets					
Cash and balances with Central Bank of Kenya	-	9,172,657	-	-	9,172,657
Placements and balances with other banks	-	11,524,072	-	-	11,524,072
Treasury bills and term notes	3,496,125	345,287	-	-	3,841,412
Investment securities measured at amortised cost	15,671,157	-	-	-	15,671,157
Investment in bonds-fair value through other comprehensive income	-	-	14,664,233	-	14,644,233
Investment in ordinary shares fair value through other comprehensive income	-	-	4,070,398	-	4,070,398
Loans and advances to customers	-	36,168,128	-	-	36,168,128
Other assets	-	64,150	-	-	64,150
Total assets	19,167,282	57,274,294	18,734,631	-	95,156,207
Liabilities					
Balances due to banks and financial institutions	-	-	-	1,035,822	1,035,822
Medium term note	-	-	-	1,020,000	1,020,000
Deposits from customers	-	-	-	71,449,704	71,449,704
Other liabilities	-	-	-	548,913	548,913
Total liabilities	-	-	-	74,054,439	74,054,439

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

c) Classification of financial instruments (continued)

At 31 December 2017: BANK	Armotised cost KShs'000	Armotised cost KShs'000	Fair value through other comprehensive income financial assets KShs'000	Financial liabilities measured at amortised cost KShs'000	Carrying amount KShs'000
Assets					
Cash and balances with Central Bank of Kenya	-	5,257,076	-	-	5,257,076
Placements and balances with other banks	-	2,985,079	-	-	2,985,079
Treasury bills and term notes	7,520,690	374,376	-	-	7,895,066
Investment securities measured at amortised cost	11,909,836	-	-	-	11,909,836
Investment in bonds-fair value through other comprehensive income	-	-	3,651,715	-	3,651,715
Investment in ordinary shares fair value through other comprehensive income	-	-	2,951,142	-	2,951,142
Loans and advances to customers	-	38,255,467	-	-	38,255,467
Other assets	-	49,777	-	-	49,777
Total assets	19,430,526	46,921,775	6,602,857	-	72,955,158
Liabilities					
Balances due to banks and financial institutions	-	-	-	2,790,922	2,790,922
Medium term note	-	-	-	1,033,000	1,033,000
Deposits from customers	-	-	-	57,554,722	57,554,722
Other liabilities	-	-	-	374,039	374,039
Total liabilities	-	-	-	61,752,683	61,752,683

d) Market risk

Market risk is the risk that fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices.

The objective of market risk management is to manage and control market risk exposure within acceptable levels, while optimising on return on the risk.

Equity price risk

Equity price risk is the risk that the fair value of equities fluctuates as a result of changes in the value of equity indices and individual stocks. A 10% increase in the value of the Bank's at fair value through other comprehensive income equities as at 31 December 2018 would have increased equity by KShs 72million (2017: KShs 69 million). An equivalent decrease would have resulted in an equivalent but opposite impact and would cause a potential impairment which would reduce profit before tax.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) Market risk (continued)

Interest risk exposure

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of changes in the prevailing levels of market rates but may also decrease or create losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest repricing that may be undertaken. Consequently, the interest sensitivity effect on profit or loss would not be significant given the repricing frequency.

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

As at 31 December 2018 GROUP	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months to 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
ASSETS						
Placements and balances with other banks	7,329,777	500,000	1,320,000	394,887	-	9,544,664
Treasury bills and term notes	229,505	1,549,773	1,834,434	-	164,000	3,777,712
Investment securities measured at amortised cost	51,000	-	1,075,095	5,460,943	9,919,876	16,506,914
Bonds- fair value through other comprehensive income	746,917	2,064,445	7,185,134	958,929	3,998,744	14,954,169
Loans and advances to customers	4,351,213	3,023,481	11,747,929	8,114,451	9,064,757	36,301,831
Total assets	12,708,412	7,137,699	23,162,592	14,929,210	23,147,377	81,085,290
LIABILITIES						
Due to banks & financial institutions	-	-	6,800	1,029,022	-	1,035,822
Medium term note	-	-	-	1,020,000	-	1,020,000
Deposits from customers	11,724,209	14,015,994	26,898,344	-		52,638,547
Total liabilities	11,724,209	14,015,994	26,905,144	2,049,022		54,694,369
Total interest sensitivity gap	984,203	(6,878,295)	(3,742,552)	12,880,188	23,147,377	26,390,921
As at 31 December 2017						
Total assets	4,970,816	8,016,184	14,367,362	13,818,879	24,098,553	65,271,794
Total liabilities	2,953,497	23,276,278	20,028,878	1,033,000	-	47,291,653
Total interest sensitivity gap	2,017,319	(15,260,094)	(5,661,516)	12,785,879	24,098,553	17,980,141

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) Market risk (continued)

Interest risk exposure (continued)

BANK As at 31 December 2018	Up to 1 Month KShs '000	1 to 3 Months KShs '000	3 Months to 1 year KShs '000	1 to 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
ASSETS						
Placements and balances with other banks	7,329,777	500,000	1,320,000	331,500	-	9,481,277
Treasury bills and term notes	229,505	1,549,773	1,834,434	-	164,000	3,777,712
Investment securities measured at amortised cost	160,475	255,541	343,429	4,534,007	10,349,630	15,643,082
Bills & Bonds- fair value through other comprehensive income	746,917	2,064,445	7,185,134	946,064	3,711,832	14,654,392
Loans and advances to customers	4,351,213	3,023,481	11,747,929	7,980,748	9,064,757	36,168,128
Total assets	12,817,887	7,393,240	22,430,926	13,792,319	23,290,219	79,724,591
LIABILITIES						
Due to banks & financial institutions	-	-	6,800	1,029,022	-	1,035,822
Medium term note	-	-	-	1,020,000	-	1,020,000
Deposits from customers	11,724,209	14,015,994	26,898,344	-	-	52,638,547
Total liabilities	11,724,209	14,015,994	26,905,144	2,049,022		54,694,369
Total interest sensitivity gap	1,093,678	(6,622,754)	(4,474,218)	11,743,297	23,290,219	25,030,222
As at 31 December 2018						
Total assets	8,536,674	4,369,759	46,494,112	5,811,571	13,070,557	78,282,673
Total liabilities	11,724,209	14,015,994	26,584,512	313,832	600	52,639,147
Total interest sensitivity gap	(3,187,535)	(9,646,235)	19,909,600	5,497,739	13,069,957	25,643,526

The sensitivity computations assume that loan and advances and deposits maintain a constant rate of return from one year to the next. The effect on profit due to reasonable possible changes in interest rates, with all other variables held constant, is as follows:

	2018 KShs '000	2017 KShs '000
Effect on profit before tax of a +1% change in interest rates	(124,422)	(90,675)
Effect on profit before tax of a -1% change in interest rates	124,422	90,675

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) Market risk (continued)

Foreign currency exchange risk

The Bank records transactions in foreign currencies at the rates in effect at the date of the transaction. The Bank retranslates monetary assets and liabilities denominated in foreign currencies at the rates of exchange in effect at the reporting date. The Bank holds foreign currency denominated balances for cash and bank balances and placements, loans and advances and customer deposits. All the gains or losses arising from the changes in the currency exchange rates are accounted for in profit or loss.

The Bank's functional currency, the Shilling, has generally, over the recent past shown a weakening tendency against the US dollar and strengthening against the Euro, the two major currencies in which the Bank has significant foreign transactions.

The US dollar

At 31 December 2018, if the US dollar had strengthened by 1% against the Shilling, with all other variables held constant, the sensitised effect on profit or loss would have been a decrease in profit before tax of KShs 26,046,000 (2017: KShs 21,017,000) mainly as a result of the Dollar denominated net monetary liabilities. The reverse would also occur if the Kenya Shilling weakened with all other variables held constant.

The Euro

At 31 December 2018, if the Euro had strengthened against the Shilling by 6%, with all other variables held constant, the sensitised effect on profit or loss would have been an increase in profit before tax of KShs 22,127 (2017: KShs 54,633) mainly as a result of the Euro denominated net monetary assets. The reverse would also occur if the Kenya Shilling weakened with all other variables held constant.

In computing the percentage change in exchange rates, management has taken into consideration the direction of the published rates movement in the functional currency against the major foreign transactional currencies over the last two years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)
AS AT 31 DECEMBER 2018

45. FINANCIAL RISK MANAGEMENT (continued)

Risk management framework (continued)

d) Market risk (continued)

Foreign currency exchange risk (continued)

The table below summarises foreign currency exposure to the group and bank:

As at 31 December 2018 *In KShs'000*	**USD**	**GBP**	**Euro**	**ZAR**	**JPY**	**Others**	**Total**
Assets							
Cash and cash equivalents (Group and Bank)	7,107,099	1,285,052	1,512,972	(2,296)	5,587	18,313	9,926,727
Investment in ordinary shares fair value through other comprehensive income	237,592	-	-	-	-	3,733,158	3,970,750
Offshore bonds	323,936	-	-	-	-	-	323,936
Loans and advances	7,992,910	64,554	2,989,280	-	-	-	11,046,744
Total assets	15,661,537	1,349,606	4,502,252	(2,296)	5,587	3,751,471	25,268,157
Liabilities							
Balances due to banks and financial institutions	972,961	-	76,737	-	-		1,049,698
Deposits	12,083,944	3,813,322	1,841,959	11,671	348	6,671	17,757,915
Total liabilities	13,056,905	3,813,322	1,918,696	11,671	348	6,671	18,807,613
Net exposure as at 31 December	2,604,632	(2,463,716)	2,583,556	(13,967)	5,239	3,744,800	6,460,544

As at 31 December 2017 *In KShs'000*	**USD**	**GBP**	**Euro**	**ZAR**	**JPY**	**Others**	**Total**
Assets							
Cash and cash equivalents (Group and Bank)	1,693,355	98,929	87,871	38,020	10,133	(3,358)	1,922,842
Investment in ordinary shares fair value through other comprehensive income	240,620	27,255	-	-	-	2,555,673	2,823,548
Offshore bonds	136,152	-	-	-	-	-	136,152
Loans and advances	9,782,174	151,010	1,625,435	-	-	-	11,558,619
Total assets	11,852,301	277,194	1,713,306	38,020	10,133	2,552,315	16,443,269
Liabilities							
Balances due to banks and financial institutions	2,742,840	-	101,602	-	-	-	2,844,442
Deposits	7,007,727	1,491,515	627,581	35,125	5,617	2,811	9,170,376
Total liabilities	9,750,567	1,491,515	729,183	35,125	5,617	2,811	12,014,818
Net exposure as at 31 December	2,101,734	(1,214,321)	984,123	2,895	4,516	2,549,504	4,428,451

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

46. OPERATIONAL RISK

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

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall bank standards for the management of operational risk in the following areas:

- Requirements for appropriate segregation of duties, including the independent authorisation of transactions
- Requirement for the reconciliation and monitoring of transactions
- Compliance with regulatory and other legal requirements
- Documentation of controls and procedures
- Requirements for the yearly assessment of operational risk faced, and the requirements of controls and procedures to address the risk identified
- Requirements for the reporting of operational losses and proposed remedial action
- Development of contingency plans
- Training and professional development
- Ethical and business standards
- Risk mitigation, including insurance where this is effective

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

AS AT 31 DECEMBER 2018

47. PRIOR YEAR ADJUSTMENTS

The prior year adjustment relates to deferred tax on surplus on equity investments and other investments portfolio measured at fair value through other comprehensive income. Deferred tax on revaluation surplus was erroneously not recognised on the statement of other comprehensive income. The total amounts erroneously not recognised in the statement of other compresive income are Sh 619,735 for the Group and Sh 618,515 for the Bank.

The effect this adjustment is summarised below:

Restatement of audited statement of financial position as at 1 January 2018	**As at 1 January (as previously reported) Sh'000**	**Adjustment Sh'000**	**As at 1 January (as restated) Sh'000**
Liabilities - Group			
Deferred tax liability	127,450	619,735	747,185
Liabilities - Bank			
Deferred tax liability	64,794	618,515	683,309

Restatement of audited statement of financial position as at 1 January 2017	**As at 1 January (as previously reported) Sh'000**	**Adjustment Sh'000**	**As at 1 January (as restated) Sh'000**
Group			
Gain on revaluation surplus	2,065,785	(619,735)	1,446,050
Bank			
Gain on revaluation surplus	2,061,716	(618,515)	1,443,201

47. PRIOR YEAR ADJUSTMENTS

The Directors have evaluated whether the retrospective restatement may result into material effect on the information on the statement of the Group and Bank financial position of the preceding period. The Directors have concluded retrospective restatement on the Group and the Bank financial position of the preceding period not to be material.

48. EVENTS AFTER THE REPORTING PERIOD

The Board of Directors approved the financial statements on 12 March 2019 and authorised that the financial statements be issued. On this date, the Directors were not aware of any matter or circumstances arising since the end of the financial year, not otherwise dealt with in the financial statements, which would significantly affect the financial position of the group and bank and results of its operations as laid out in these financial statements.

CORPORATE SOCIAL RESPONSIBILITY
FOR THE YEAR 2018

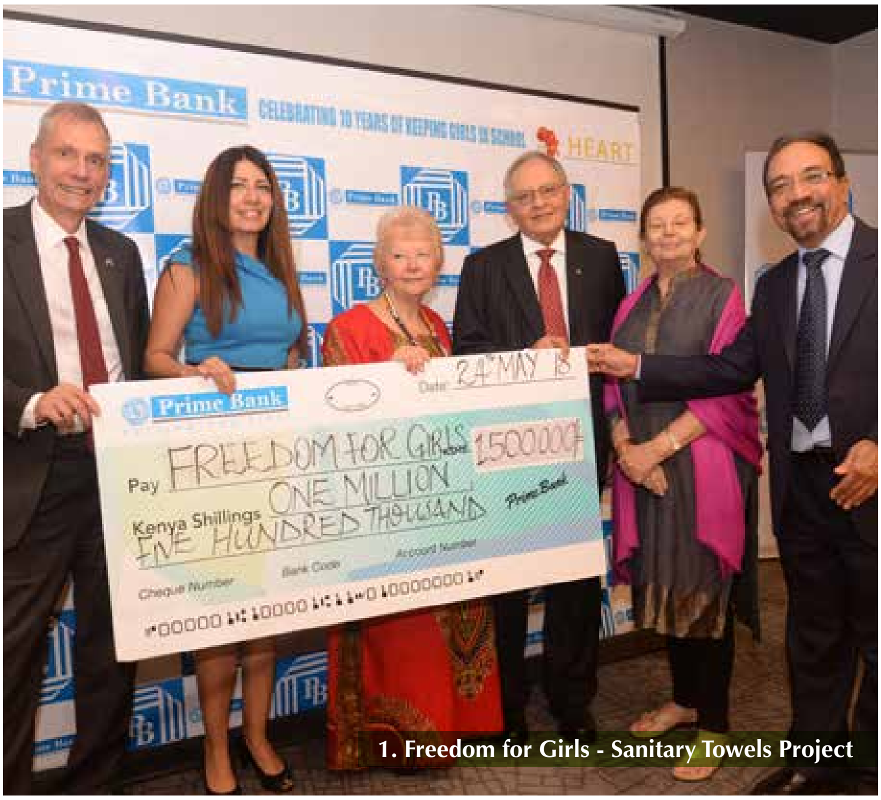
1. Freedom for Girls - Sanitary Towels Project

1. Freedom for Girls - Sanitary Towels Project

Prime Bank sponsored 3,333 orphaned and vulnerable girls with a full year's supply of sanitary towels, undergarments and health education to mark the 10th Anniversary of the Freedom for Girls Sanitary Towel Project.

In its flagship Corporate Social Responsibility (CSR) project – Freedom for Girls, the Bank donated KShs. 1.5 Million towards ensuring girls do not miss school during their monthly cycle.

Since its inception, Prime Bank has so far donated KShs. 10.5 million hence ensuring 24,444 girls are guaranteed full year's supply of sanitary towels and undergarments.



1. Freedom for Girls - Sanitary Towels Project

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CORPORATE SOCIAL RESPONSIBILITY (continued)
FOR THE YEAR 2018

2. Bank Shares Christmas with Nyumbani Children's Home

2. Bank Shares Christmas with Nyumbani Children's Home

3. Junior Golf Foundation Annual Gala

2. Bank Shares Christmas with Nyumbani Children's Home

As it has always been its tradition during the festive season, Prime Bank staff paid a visit to Nyumbani Children's Home in Nairobi, interacted and shared special moments with the children through various activities including singing and dancing and sharing a meal in a true reflection of the Bank's spirit of caring for the communities in which it operates in. The Bank also donated foodstuffs to the home.

3. Junior Golf Foundation Annual Gala

The 2018 Junior Golf Foundation Annual Gala was held in December at the Sigona Golf Club.

During the event, Prime Bank took the opportunity to present a cheque of KShs. 1Million as proceeds of the partnership with Junior Golf Foundations (JGF) and Kenya Golf Union (KGU) through the Prime Visa Golf Card for the year 2018.

Prime Bank partnered with KGU, JGF, and Visa to launch the first ever golf card in Kenya – the Prime Visa Golf Card.

CORPORATE SOCIAL RESPONSIBILITY (continued)
FOR THE YEAR 2018


3. Junior Golf Foundation Annual Gala

This unique concept of a core-branded Visa golf card is geared towards developing talent and making golf courses accessible to the youth. This golf credit card has a twin effect in that it is specifically designed to enable golfers enjoy a wide range of benefits on and off the course at the same time making funds available for JGF.

4. Jaipur Foot Project Donation

4. Jaipur Foot Project Donation

The Jaipur Project is one of the largest and oldest project of Rotary District 9200 with the Jaipur Foot Trust. Since its inception in 1990 with the sole purpose of helping the physically challenged to get fitted with prostheses, over 30,000 patients have benefited from this project. Through Dr. Rasik Kantaria who is also the Chairman of the Jaipur Foot Trust, Prime Bank has continued to support the project over the years.

5. Jalaram Medical Centre – Nakuru

5. Jalaram Medical Centre – Nakuru

The Jalaram Temple in Nakuru is set to launch a medical centre to cater for low income households. The medical centre will offer diagnostic laboratory services, radiology, CT scan, general practice clinics and pharmaceutical services at a subsidized rate.

6. Charity Golf Day Sponsorship at Vet Lab

7. Famine Relief

8. Annual Diani Beach Masters Golf Championship

To support this project, Prime Bank donated KShs.3Million for construction of the facility.

6. Charity Golf Day Sponsorship at Vet Lab

Prime Bank in partnership with the sponsored a charity golf tournament at the Vet Lab Sports Club on 24th February with the aim of raising funds to enable the Rotary Club of Nairobi conduct free cataract operation to elderly patients. Through this project, over 18,000 free cataract operations have been undertaken in Kisumu, Kisii, Nyamira, Siaya, Migori, Uasin Gishu, and Nandi Counties since its inception.

The Rotary Club of Nairobi has been running the Kenya Rural Blindness Eradication Program that performs cataract operations to the less fortunate in the society for the past 30 years.

Over KShs.900, 000 was raised through the charity tourney.

7. Famine Relief

Prime Bank donated 10 tonnes of foodstuff - 2,000 packets of maize meal, 5 kg each expected to help 4 members in a family - to reach 8,000 people who were affected by the drought in Turkana in May 2018.

8. Annual Diani Beach Masters Golf Championship

The 2018 Prime Bank Diani Beach Masters took place at Leisure Lodge Beach & Golf Resort from October 18 to 21. The tournament is one of Kenya's most celebrated and prestigious golf championships that brings together golfers from around the East African region.

During this edition, the Bank donated KShs.1 Million towards the success of the event.


Integrity, heart and teamwork are the only ingredients needed to consistently see positive growth personally and professionally.

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